United States International Trade Commission

U.S.-Central America-Dominican Republic Free Trade Agreement:

Potential Economywide and Selected Sectoral Effects

Investigation No. TA-2104-13
USITC Publication 3717
August 2004

U.S. International Trade Commission

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PREFACE

On March 11, 2004, the United States International Trade Commission (Commission), instituted Investigation No. TA-2104-13, U.S-Central America-Dominican Republic Free Trade Agreement: Potential Economywide and Selected Sectoral Effects. The investigation, conducted pursuant to section 2104(f) of the Trade Act of 2002 (the Trade Act), was in response to a request from the United States Trade Representative (see appendix A).

The purpose of this investigation is to assess the likely impact of the U.S.-Central America-Dominican Republic Free Trade Agreement on the U.S. economy as a whole and on specific industry sectors and the interests of U.S. consumers. As provided for in section 2104(f)(2) of the Trade Act, the Commission must submit to the President and the Congress (not later than 90 calendar days after the President enters into the agreement) a report assessing the likely impact of the agreement on the United States economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the agreement, and the interests of the United States consumers.

Section 2104(f)(3) of the Trade Act requires that the Commission, in preparing the assessment, review available economic assessments regarding the agreement, including literature regarding any substantially equivalent proposed agreement, and provide in its assessment a description of the analyses used and conclusions drawn in such literature and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the agreement.

The Commission solicited public comment for this investigation by publishing a notice in the *Federal Register* of March 23, 2004 (see appendix B), and held a public hearing for this investigation on April 27, 2004. Interested party views are summarized in chapter 9 of this report.

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List of Frequently Used Abbreviations and Acromyms

ACTPN	Advisory Committee on Trade Policy and Negotiations
ATC	Agreement on Textiles and Clothing
CBERA	Caribbean Basin Economic Recovery Act
CBTPA	Caribbean Basin Trade Partnership Act
CGE	computable general equilibrium
DEIF	date of entry into force
CA/DR	Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) and the Dominican Republic
EU	European Union
FAO	Food and Agriculture Organization
FAS	Foreign Agricultural Service
FDI	foreign direct investment
FSU	former Soviet Union
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GNP	gross national product
GSP	Generalized System of Preferences
GTAP	Global Trade Analysis Project
HTS	Harmonized Tariff Schedule of the United States
IFAC	Industry Functional Advisory Committee
IMF	International Monetary Fund
ITA	Information Technology Agreement
IPR	intellectual property rights
MFN	most-favored-nation
MT	metric tons
ISAC	Industry Sectoral Advisory Committee
NAFTA	North American Free Trade Agreement
NTR	normal trade relations
OECD	Organization for Economic Cooperation and Development
ROO	rules of origin
SPS	sanitary and phytosanitary
STRV	short tons, raw value
TBT	technical barriers to trade
TEPAC	Trade and Environment Policy Advisory Committee
TPL	tariff preference level
TRIPs	Trade-Related Aspects of Intellectual Property Rights
TRQ	tariff rate quota
UN	United Nations

List of Frequently Used Abbreviations and Acromyms—*Continued*

US&FCS	U.S. and Foreign Commercial Service
USDA	U.S. Department of Agriculture
USDOC	U.S. Department of Commerce
USITC	United States International Trade Commission
USTR	United States Trade Representative
WCT	WIPO Copyright Treaty
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

EXECUTIVE SUMMARY
U.S.-Central America-Dominican Republic Free Trade Agreement

On January 28, 2004, the U.S. International Trade Commission (Commission or USITC) received a letter from the Office of the United States Trade Representative (USTR) requesting that the Commission prepare a report in accordance with section 2104(f) of the Trade Act of 2002, to assess the likely impact on the U.S. economy as a whole and on specific industry sectors and the interests of U.S. consumers of the United States-Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua)-Dominican Republic Free Trade Agreement (U.S.-CA/DR FTA).[1, 2] Section 2104(f) also requires that the Commission, in preparing its report, review available economic assessments regarding the agreement, including literature regarding any substantially equivalent proposed agreement, and provide a description of analyses used and conclusions drawn in such literature, and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the agreement.

Scope and Approach of the Study

The economic benefits to the U.S. economy as a whole of the U.S.-CA/DR FTA consist of quantifiable and nonquantifiable effects. The quantifiable benefits of the FTA are related to the immediate reciprocal tariff elimination, including the immediate elimination of duties on more than one-half of the value of current U.S. agricultural exports to CA/DR (with most remaining tariffs to be phased out over 15 years and TRQ products over 20 years), and more than 80 percent of U.S. exports of consumer and industrial goods to the CA/DR region (with remaining tariffs to be phased out over 10 years). In addition, U.S. agricultural producers also will benefit from new tariff rate quotas (TRQs) that provide enhanced access to the CA/DR market.[3] In most cases, this

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[1] The U.S.-CA/DR FTA is a regional trade agreement among all seven signatories. The U.S. FTA with the five Central American countries was signed by the parties on May 28, 2004. Although the U.S. FTA with the Dominican Republic was negotiated separately from the U.S. FTA with the Central American countries, the Dominican Republic is to assume the same set of obligations and commitments as the Central American countries. The FTA with the Dominican Republic was signed by the parties on August 5, 2004, integrating the Dominican Republic into the FTA with the Central American countries. USTR, "Dominican Republic Joins Five Central American Countries in Historic FTA with U.S.," press release 04-66, August 5, 2004, and USTR, "USTR Resources: U.S.-Central American Free Trade Agreement and Dominican Republic Free Trade Agreement," found at *http://www.ustr.gov/new/fta/cafta.htm*, retrieved August 6, 2004.

[2] A brief chronology of the US-CA/DR FTA is provided in Chapter 1.

[3] The relaxation of TRQs is expected to allow U.S. exports of grains to increase from $600 million to $725 million by the full implementation of the FTA (see chapter 3).

trade liberalization will create preferences for U.S. exports over (or put U.S. exports on equal footing with) those of third-country suppliers to the CA/DR market.[4]

The FTA also establishes specific obligations in important areas that are more difficult to quantify but nevertheless are likely to benefit the U.S. economy—including rules of origin; trade in services; investment; trade facilitation (including customs administration, technical barriers to trade, sanitary and phytosanitary regulations, electronic commerce, and transparency); and the regulatory environment (including trade remedies, government procurement, the protection and enforcement of intellectual property rights, labor, and the environment).

The Commission's analysis is based on an assessment of all 22 chapters of the U.S.-CA/DR FTA, including its annexes and associated side letters.[5] To assess the likely effects of the FTA on the U.S. economy as a whole and specific economic sectors, the Commission employs an approach that combines quantitative and qualitative analyses. In this report, the Commission quantifies the likely impact of the FTA to the extent that the necessary data are available. Thus, the quantitative assessment is limited to provisions related to increased market access by the liberalization of tariffs and TRQs on originating goods (goods that meet the FTA's rules of origin).[6] Remaining components of the FTA, for which the likely effects could not be quantified, are analyzed using qualitative analysis. Combining the quantitative and qualitative analyses provides a comprehensive assessment of the likely impact of the U.S.-CA/DR FTA on the U.S. economy.

U.S. Trade with Central America and the Dominican Republic

In 2003, U.S. domestic merchandise exports to the CA/DR region were valued at $14.4 billion, while U.S. imports for consumption from CA/DR were $16.7 billion. The United States recorded a $2.3 billion merchandise trade deficit with CA/DR in 2003, approximately the same as in 2002. Combined, the CA/DR region ranked as the 12th largest market for U.S. exports and the 15th largest U.S. supplier of imports in 2003.

In both 2002 and 2003, approximately 80 percent of U.S. imports from CA/DR entered duty free either at general duty rates or under various U.S. programs,

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[4] See chapter 1, page 1-8 for the free trade agreements Central American countries and the Dominican Republic have signed with Latin America and Caribbean countries.

[5] There are a total of 26 substantive side letters on a variety of topics including various service sectors, the relationship between this FTA and other trade preference programs and the tariff treatment of specific goods such as finished confectionery products. Each Central American country and the Dominican Republic has at least one side letter. There are also two understandings that apply to all six countries. One provides that the obligations of Chapter 15 (IPR) will not impair public health programs for the treatment and prevention of AIDS/HIV or other epidemic diseases or national health emergencies. The second understanding states that the agreement does not impose any obligations on immigration.

[6] The Commission did not explicitly quantify the impact of rules of origin, but the quantitative analysis is consistent with the existence of rules of origin. This is discussed in more detail in chapter 4 of the report.

including the U.S. Generalized System of Preferences (GSP),[7] Caribbean Basin Economic Recovery Act (CBERA), and Caribbean Basin Trade Partnership Act (CBTPA).[8] The remaining 20 percent, comprising U.S. dutiable imports from CA/DR, was valued at approximately $3.3 billion in both 2002 and 2003.

The leading U.S. exports to CA/DR in 2003 included petroleum oils and light oils, digital integrated circuits, dyed knitted or crocheted cotton fabrics, corn, cotton t-shirts, men's or boys' cotton trousers, and wheat. Leading U.S. dutiable imports from CA/DR in 2003 included cotton sweaters, pullovers, and sweatshirts; men's or boys' cotton trousers; women's or girls' cotton trousers; women's or girls' cotton blouses and shirts; and cotton t-shirts. For 2003, leading duty-free imports from CA/DR included items entering the United States under the CBTPA program such as cotton t-shirts and tank tops, men's and boys' cotton trousers, and cotton sweaters and sweatshirts as well as items not claiming any special tariff program such as medical and surgical instruments, bananas and plantains, electronic integrated circuits, and coffee.

Highlights of the U.S. Free Trade Agreement With Central America and the Dominican Republic

Under the market access commitments of the U.S.-CA/DR FTA, many originating U.S. exports would be eligible for immediate duty-free entry into CA/DR; 21 duty staging categories would apply to originating exports, eliminating duties over periods of up to 20 years. TRQs under the FTA would apply to some agricultural commodities, with new TRQs providing improved market access for such U.S. exports as corn, rice, beef, pork, and poultry. Eligible CA/DR exports to the United States are covered by 12 different duty staging categories, and a wide range of originating goods would receive immediate duty-free entry. Most other duties would be phased out over periods of up to 15 years. TRQs would apply to U.S. imports of beef, dairy products, sugar, peanuts and peanut butter, tobacco, ethyl alcohol (i.e. ethanol), and cotton, and some of these provisions would continue indefinitely with over-quota shipments dutiable at normal trade relations (NTR) rates. Rules of origin based mainly on specific changes in tariff classification, applicable to third-country inputs, or on regional value content would determine eligibility for FTA treatment.

Many of the substantive commitments in the U.S.-CA/DR FTA reflect obligations of the parties under World Trade Organization (WTO) agreements on the same subject matter, and the language in this FTA often parallels provisions in recent FTAs with Singapore, Chile, Australia, and Morocco. As with other U.S. trade agreements, safeguard measures would be available if, because of the FTA, significantly increased imports would constitute a substantial cause of serious injury, or the threat thereof, to like or directly competitive domestic products. A Free Trade Commission and other entities would be established under the FTA to administer its provisions, coordinate cooperation among the parties, and handle any disputes that may be brought under the FTA provisions.

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[7] Nicaragua is not designated for benefits under the U.S. GSP program.

[8] GSP and CBERA afford duty-free entry to qualifying imports from designated countries. CBTPA provides duty-free entry to some products previously ineligible for CBERA, most notably certain apparel articles.

Methodology

To provide a comprehensive assessment of the effects of the U.S.-CA/DR FTA on the U.S. economy and specific sectors, the Commission employs an approach that combines quantitative and qualitative analyses. The quantitative analysis focuses on the liberalization of tariffs and TRQs (corresponding to the market access provisions of chapters 3-4 of the FTA). The qualitative analysis focuses on the non-quantifiable effects associated with provisions of the FTA related to trade in goods (including the rules of origin) and services, investment, trade facilitation, and the regulatory environment (corresponding to chapters 5-20 of the FTA).[9] These effects are not readily quantifiable owing to the lack of necessary data and the intangible nature of some of these effects. Information to assess the liberalization of the nontariff barriers in these areas was obtained from written submissions in response to the Commission's Federal Register notice for this investigation;[10] the Commission's public hearing held in connection with this investigation on April 27, 2004, in Washington, D.C.;[11] government, industry, and academic sources; and international organizations, including the International Monetary Fund (IMF), the United Nations (UN), the World Bank, and the WTO.

For the liberalization of tariffs and TRQs, this study employs a multicountry model with economywide coverage of merchandise and service sectors (a global computable general equilibrium (CGE) model). The analysis is static and assumes the U.S.-CA/DR FTA is fully implemented with its full effects felt on January 1, 2005. That is, it assumes that the FTA provisions will not be phased in over time, or its effects gradually realized over time. The modeled results can be considered to be long-run effects, after all adjustments have worked their way through the economy, of a fully implemented FTA in a U.S. economy otherwise identical to the baseline 2005 economy.[12] This simulation liberalizes trade completely in all goods subject to liberalization under the FTA for all of the parties.[13] As noted above, most U.S. imports from CA/DR already enter free of duty under various U.S. programs. It is expected that those sectors that face relatively higher trade restrictions will show larger effects from the implementation of the FTA.

Principal Findings

The Commission's comprehensive assessment of the U.S.-CA/DR FTA addresses four substantive areas: market access, trade facilitation, investment, and the regulatory environment. A summary of the impact assessments is presented below for each of these four areas.

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[9] Chapters 1, 19, 21, and 22 of the FTA address administrative and legal matters.

[10] A copy of the *Federal Register* notice for this investigation is in appendix B.

[11] A list of hearing participants is in appendix C.

[12] Models are highly simplified descriptions of an economy, dependent on parameter estimates and subject to potential biases due to product and regional aggregations. See appendix D for additional information on the model used in this report.

[13] The effects of the FTA on the U.S. economy are estimated for the CA/DR region as a whole, and not for each country in the CA/DR region.

Market Access

Market access refers to the degree of openness or accessibility that one country's goods and services experience in another market. The entire array of trade policy measures that a country employs to administer, measure, and support its trade regime affect the ability of foreign-produced products or services to enter another country under nondiscriminatory conditions.

Market access provisions provide the principal guarantee of national treatment under the U.S.-CA/DR FTA for originating goods in bilateral trade. Reflecting the broader principles of the WTO, the specific obligations in these provisions commit the parties to progressively eliminate duties on originating CA/DR goods and to implement a wide array of customs procedures that would enhance this trade to ensure consistent customs treatment by the parties. Many of these measures already apply to U.S. imports, under various provisions, but the FTA would make the treatment of these imports permanent. The U.S.-CA/DR FTA also provides that no new duties or charges may be imposed, that the parties cannot apply import and export restrictions other than in limited cases, that administrative fees relating to trade would be limited to the cost of services rendered, and that merchandise processing fees must be eliminated.

Figure ES-1 presents an overview of the potential effects, both qualitative and quantitative, of the U.S.-CA/DR FTA in the market access area.

The largest percentage increases in trade are found in those sectors undergoing the greatest degree of tariff liberalization. According to the Commission's quantitative analysis, the U.S. sectors showing the greatest value increase in exports to the CA/DR market are textiles and apparel; petroleum, coal, other fossil fuels; machinery and equipment; other manufactures; motor vehicles; and grains. The greatest increases in the value of imports are estimated to occur in textiles and apparel and leather products, and in raw cane sugar.

Overall, some sectors of the U.S. economy are likely to experience increased import competition from the CA/DR region, while other sectors are likely to experience increased export opportunities to the CA/DR market. However, given the small economy and market size of the CA/DR region relative to the United States, any such increases would be from a small initial level and, thus, are likely to have a minimal impact on production, employment, or prices in corresponding U.S. sectors.

Sectoral Effects

A more detailed qualitative analysis also was conducted for some sectors at a more disaggregated level. The sectors were selected based upon a number of criteria, including the extent of liberalization under the FTA, the importance of the sector in terms of bilateral trade, and the opinions of industry representatives.[14] Selected for

[14] The criteria are described in more detail in chapter 3 of the report.

Figure ES-1
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Market Access Provisions—Qualitative Assessment

Subject negotiated and FTA chapter

Market Access Provisions

Consumer and industrial goods, ch. 3
- Tariff elimination on a wide range of goods.
- Dominican Republic to join the WTO Information Technology Agreement.

Agricultural goods, ch. 3
- Tariff elimination on a wide range of agricultural products.
- Improved market access under TRQs for U.S. exports of certain products (including beef, pork, poultry, rice, and dairy products).

Rules of origin (non-textile/apparel product categories), ch. 4
- Rules designed to be easy to administer.
- Rules resemble provisions of NAFTA and U.S. FTAs with Singapore and Chile.

Textiles, apparel, and footwear, ch. 3
- Immediate duty-free trade for many imports that meet the rules of origin, but TRQs apply.
- Temporary provision for qualifying apparel and textile articles to have 3rd country content.
- Cumulation provisions allow certain apparel to contain woven fabrics from Canada and Mexico to up to a cap.
- Benefits retroactive to Jan. 1, 2004.

Likely economic impact on U.S. economy

Staged phase-in of FTA

Sugar and sugar-containing products— A negligible increase in U.S. exports of sugar and sugar-containing products. The United States generally is not competitive with CA/DR producers. A small increase likely in U.S. imports of sugar and sugar-containing products equal to the additional amount allowed under the TRQ. Although the FTA increases the quota, the prohibitive over-quota tariff rates remain in place.

U.S. sweetener industry (farmers, processors, suppliers) states that increased sugar imports from CA/DR would have an adverse effect on U.S. production and domestic jobs. On the other hand, U.S. sweetener users state that increased sugar imports from the CA/DR region would benefit the U.S. confectionary and other sugar-using industries, increase U.S. employment in those industries, and benefit U.S. consumers.

Grains (corn and rice)— Negligible short-term impact on U.S. exports because the FTA provides little immediate additional market access for U.S. corn and rice exports. TRQs for corn and rice gradually expand over a period of 15-20 years; after that period, quotas are to be eliminated, and U.S. exports of corn and rice are likely to increase substantially. No impact likely on U.S. imports of grains because the CA/DR region generally does not export grains.

Textiles, apparel, and footwear—Small to moderate increase in U.S. exports of textiles, apparel, and footwear. Moderate increase in U.S. imports of textiles, apparel, and footwear from CA/DR, but the net increase in total U.S. imports of these goods is likely to be small because most of the expected increase in shipments from CA/DR is likely to displace imports from other U.S. suppliers.
U.S. apparel and footwear producers, retailers, and importers state that imports from CA/DR will increase, benefitting U.S. consumers. U.S. textile producers state that domestic production and employment are likely to be adversely affected.

Figure ES-1—*Continued*
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Market Access Provisions—Qualitative Assessment

Subject negotiated and FTA chapter	Likely impact on U.S. economy
Market Access Provisions	***Staged phase-in of FTA***
Cross-border trade in services, ch. 11 • National treatment. • Market access: guarantees U.S. access in all service sectors, without specific exemptions. • Enhances regulatory transparency in the CA/DR region. • Improves upon CA/DR commitments under the WTO General Agreement on Trade in Services (GATS) by guaranteeing market access and national treatment in areas where CA/DR governments previously had no obligations.	*Services*—No significant increases in either U.S. exports or imports of services because of the relatively small size of the CA/DR market. Other important benefits from the FTA are likely in terms of improved CA/DR market access, national treatment, and greater regulatory transparency. *Telecommunications*—Costa Rica commits to open segments of its telecommunication sector for the first time; Guatemala, Honduras, and Nicaragua commit to ensure cost-based interconnection; and Honduras and Nicaragua make first-time commitments on licensing, the establishment of independent regulators, allocation of scarce resources, and the prevention of anticompetitive behavior. *Distribution*—Costa Rica, Dominican Republic, El Salvador, Guatemala, and Honduras commit to loosen restrictions on dealer protection regimes, which posed significant barriers for U.S. firms by locking them into exclusive or inefficient distributor arrangements. *Insurance*—Costa Rica commits for the first time to liberalize its insurance market; U.S. insurance providers also will benefit from FTA provisions allowing the establishment of foreign insurance providers through branches or subsidiaries and new rules permitting the cross-border provision of marine, aviation, and transportation insurance. *Banking and securities*—The FTA contains new specific binding commitments by CA/DR related to asset management services; in addition, El Salvador, Guatemala, Honduras, and Nicaragua commit to allow branch banking.

Source: Text of the U.S.-Dominican Republic-Central America FTA, found at *http://www.ustr.gov/new/fta/cafta.htm*. Impact estimates obtained from USITC estimates and calculations and compiled from multiple sources cited elsewhere in this report, including written submissions in response to the *Federal Register* notice for this investigation the Commission's public hearing in connection with the investigation, USITC saff interviews with industry officials, and reports filled by the various U.S. governnment trade policy advisory committees.

Figure ES-1—*Continued*
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Market Access Provisions—Quantitative Assessment

Subject negotiated and FTA chapter

Likely impact on U.S. economy

Market Access Provisions

Complete implementation, full phase-in of tariffliberalization

Consumer and industrial goods, ch. 3
- Tariff elimination on a wide range of goods.

Agricultural goods, ch. 3
- Tariff elimination on a wide range of agricultural products.
- Improved market access under TRQs for U.S. exports of certain products (including beef, pork, poultry, rice, and dairy products).

Textiles and apparel, ch. 3
- Immediate duty-free trade for many imports that meet the rules of origin, but TRQs apply.
- Temporary provision for qualifying apparel and textile articles to have 3rd country content.
- Cumulation provisions allow certain apparel to contain woven fabrics from Canada and Mexico up to a cap.
- Benefits retroactive to Jan. 1, 2004.

Model-based results

Economywide results

Welfare—Effects of tariff removal under the U.S.- CA/DR FTA on U.S. economic welfare and GDP are likely to be minimal (less than 0.01 percent of U.S. GDP). Actual simulation results: between $135.0 million and $248.0 million.

Exports— After full phase-in of tariff elimination, U.S. world exports are likely to be higher by $1.9 billion or 0.16 percent. For U.S. exports to CA/DR, the largest increases are expected to be in: textiles, apparel, and leather products; petroleum, coal, etc.; machinery and equipment; other manufactures; motor vehicles; and grains. Key U.S. exports gain immediate duty-free access.

Imports—After full phase-in of tariff elimination, U.S. world imports are likely to be 0.07 percent higher or an increase of $1.2 billion. For U.S. imports from CA/DR, the largest increases are expected to be in textiles, apparel, and leather products and in manufactured sugar. In most cases, the increases in trade with CA/DR come at the expense of trade with other partners.

Production—Little or no change in U.S. production in distinct industry sectors. The largest proportional increase is in grains, output of which increases by 0.25 percent; the largest decrease in production is for manufactured sugar and sugar crops, output of both decrease by 1.09 percent.

Employment—Little or no change likely in U.S. employment in distinct industry sectors.

Consumers—Little or no impact on U.S. consumers (household prices).

Sectoral results

Exports—After full phase-in of tariff elimination, U.S. exports to CA/DR of textiles and apparel would likely increase by $802.8 million; petroleum, coal, etc., $406.1 million; machinery and equipment, $400.6 million; other manufactures, $234.6 million; motor vehicles, $180.4 million; and grains, $157.3 million. U.S. exports to CA/DR as a whole would increase by $2.7 billion (14.8 percent).

Imports—After full phase-in of tariff elimination, U.S. imports from CA/DR of textiles and apparel would increase by $3.1 billion, and manufactured sugar imports increase by $113.2 million, but imports of other commodities and services would decline by $404 million. U.S. imports from CA/DR as a whole would increase by $2.8 billion (12.4 percent).

Source: Text of the U.S.-Central America-Dominican Republic FTA, found at *http://www.ustr.gov/new/fta/cafta.htm*. Impact estimates obtained from USITC estimates and calculations and compiled from multiple sources cited elsewhere in this report, including written submissions in response to the *Federal Register* notice for this investigation, the Commission's public hearing in connection with the investigation, USITC staff interviews with industry officials, and reports filed by the various U.S. government trade policy advisory committees.

analysis were U.S. imports and, to a lesser extent, exports of textiles, apparel, and footwear; U.S. imports of sugar and sugar-containing products; and U.S. exports of grains (corn and rice).[15] Key findings from the analysis of these sectors are presented below.

Textiles, apparel, and footwear

The U.S.-CA/DR FTA would provide for the immediate elimination of duties on textiles and apparel that meet the rules of origin specified in the FTA ("originating goods"), retroactive to January 1, 2004.[16] The FTA rules of origin for apparel generally apply only to the component that determines the tariff classification of the garment—that is, the component that provides the garment its "essential character."[17] The FTA rules of origin require that the "essential character component" for imports of most textile and apparel articles from the CA/DR region be made from inputs produced in that region or in the United States, generally from the yarn stage forward. However, the FTA contains significant exceptions to the yarn-forward rule for CA/DR producers. These exceptions include a fiber forward rule that applies to a limited number of articles (mainly yarns and knit fabrics), which must be made in an FTA party from the fiber stage forward, and duty-free treatment for imports of apparel made in the FTA countries from nonoriginating materials—that is, yarns and fabrics produced in countries other than the United States and CA/DR. Additional exceptions include tariff preference levels (TPLs)[18] for Nicaragua and Costa Rica, a fabric forward rule of origin for wool apparel, a single transformation origin rule for certain articles, a cumulation provision that will permit the use of woven fabrics from Mexico and Canada up to a cap, and an expanded list of yarns and fabrics deemed to be in short supply in the United States and CA/DR.

The FTA would provide for the immediate elimination of duties on all qualifying footwear except for rubber footwear still made in the United States, duties on which will be phased out in equal annual increments over 10 years. The FTA origin rule for most footwear is based on "substantial transformation," which permits the use of nonoriginating materials, particularly uppers, the most labor-intensive of the footwear components. Under the FTA, the production of footwear in the CA/DR region, particularly in the Dominican Republic, is likely to involve the assembly of components made in third countries, especially China.

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[15] In light of the differences in aggregation and in analytic framework, the sectors analyzed qualitatively are not directly comparable to the sectors analyzed quantitatively. This is discussed in more detail in chapter 4 of the report.

[16] Rules of origin under the FTA are summarized in chapter 2 of the report. Provisions with respect to textiles, apparel, and footwear are described in greater detail in chapter 3.

[17] In contrast to the CBTPA that requires that all fabric components be made of U.S. or CBTPA formed fabrics from U.S. formed yarns, the U.S-CA/DR FTA requires only that the component that imparts the tariff classification of the good be made from U.S. or U.S-CA/DR FTA formed fabrics. The U.S-CA/DR FTA allows components that account for a minor share of the value of the goods to be sourced from third country suppliers, thereby enhancing sourcing flexibility.

[18] A TPL allows nonoriginating goods to receive the same duty preference as qualifying goods up to a specified level. Nonoriginating goods can continue to be imported in excess of this level, however, normal duty rates will be applied.

The FTA is likely to result in a moderate increase in the quantity of U.S. imports of textiles and apparel from the CA/DR region, largely because the FTA provides for significant and permanent enhancements of the Caribbean Basin Trade Partnership Act (CBTPA) as it relates to these goods. However, the FTA is likely to result in a small increase in total U.S. imports of these goods because most of the expected increase in CA/DR shipments is likely to displace imports from other countries that do not benefit from geographic proximity to the United States or preferential access to the U.S. market. The FTA is likely to enhance the competitiveness of U.S. firms sourcing apparel from the CA/DR region. However, it could displace some production and employment in the U.S. textile and apparel sector, to the extent that the FTA encourages U.S. apparel firms to move additional operations to the CA/DR region, and encourages CA/DR apparel manufacturers to use third-country yarns and fabrics instead of U.S. materials. For footwear, because the U.S. market is supplied almost entirely by imports, most product substitution that could occur as a result of the FTA is likely to take place between footwear articles made in the CA/DR region and those produced in Asia.

The FTA is likely to result in a small increase in U.S. exports of textiles, apparel, and footwear to CA/DR, with a negligible impact on U.S. production and employment. U.S. exports of textiles and apparel to CA/DR, which accounted for 25 percent (or $3.6 billion) of total U.S. exports to these countries in 2003, consist almost entirely of yarns, fabrics, and garment parts (i.e of t-shirts, trousers, and other garments) for use in the production of apparel for export to the United States. As such, these apparel production inputs are already duty free under other U.S. provisions, such as the CBTPA and the 9802.00.80 production sharing provision. The FTA is likely to have a negligible effect on U.S. exports of finished apparel and footwear because of the low per capita income in the CA/DR region relative to that of the United States. Furthermore, an increase in U.S. exports of textiles, apparel, and footwear as a result of the FTA may be mitigated to the extent that the FTA rules of origin allow the use of nonoriginating inputs.

Sugar and sugar-containing products[19]

The FTA would provide an immediate additional preferential duty-free TRQ of 109,000 metric tons (mt) for U.S. imports of CA/DR sugar and sugar-containing products (SCPs).[20] This quantity is to increase in equal annual increments over a 15-year period to 153,140 mt. After this staging period, the FTA TRQ is to increase by 2,000 mt annually in perpetuity. There would be discrete FTA TRQs for each country in the CA/DR region. The additional TRQ access is limited to the lesser of the specified amount or the net trade surplus position of each individual country for certain sugar

[19] The sugar and sugar-containing products sector described here does not correspond to the manufactured sugar sector in the quantitative analysis because of differences in sectoral aggregation. The manufactured sugar sector used in the quantitative analysis includes raw (milled) cane sugar, refined cane and beet sugars, sugar syrups, and molasses, but it does not include sugar-containing products.

[20] In fiscal year 2003, TRQs for raw cane sugar totaled 311,700 metric tons.

items. The FTA also includes a mechanism by which CA/DR sugar exporters may be compensated in lieu of being provided duty-free treatment under the FTA TRQ. The FTA excludes the CA/DR region from additional, price-based U.S. safeguard measures that apply to imports of certain sugar and SCPs from certain other suppliers.

The FTA is likely to result in a small increase in U.S. sugar and SCP imports from the CA/DR region. Lower prices resulting from increased imports under the FTA likely would have an adverse impact on production and employment for U.S. sugar producers, and a beneficial impact for U.S. producers of certain SCPs. The final FTA TRQ quantity of 153,140 mt represents less than 10 percent of U.S. imports of sugar and SCPs, and about 1 percent of U.S. consumption in fiscal year 2003. The FTA TRQ is likely to be filled in its entirety, as the quantity is relatively small, and the U.S. market price is significantly higher than prices in other markets for CA/DR exports. The impact of the FTA on U.S. sugar and SCP exports is likely to be negligible, as U.S. sugar exports typically are not competitive in the world market.

Grains (corn and rice)

Under the U.S.-CA/DR FTA, restrictive TRQs on U.S. corn[21] and rice[22] exports are to be removed over a period of 15-20 years. The FTA is likely to provide little immediate additional market access for U.S. corn and rice exports. In the longer term, by the end of the 15-20 year phase-out of the corn and rice TRQs, annual incremental U.S. exports of corn and rice to CA/DR are likely to increase substantially, albeit from a small base, with a negligible impact on total U.S. production and employment.

The CA/DR region is a high-cost producer of corn and rice, is highly dependent on imports for grain supplies, and generally does not export grains. Thus, the U.S.-CA/DR FTA is likely to have no measurable effect on U.S. imports of grains.

Services

The FTA improves upon commitments scheduled by CA/DR under the WTO General Agreement on Trade in Services by, in many instances, guaranteeing market access and national treatment in areas where the countries previously had no commitments. In addition to according substantial market access across the entire CA/DR services regime, the FTA also provides improved regulatory transparency and establishes a secure and predictable framework for U.S. investors operating in CA/DR.

The FTA provides other important benefits, particularly for U.S. providers of telecommunications, distribution, insurance, and banking and securities services to the CA/DR market. Costa Rica commits to open segments of its telecommunication sector for the first time; Guatemala, Honduras, and Nicaragua commit to ensure cost-based interconnection; and Honduras and Nicaragua make first-time commitments on

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[21] El Salvador, Guatemala, Honduras, and Nicaragua impose TRQs on U.S. corn.
[22] All countries in the CA/DR region impose TRQs on U.S. rice.

licensing, the establishment of independent regulators, allocation of scarce resources, and the prevention of anticompetitive behavior. Costa Rica, the Dominican Republic, El Salvador, Guatemala, and Honduras commit to loosen restrictions on dealer protection regimes, which pose significant barriers for U.S. firms by locking them into exclusive or inefficient distributor arrangements. Costa Rica agreed for the first time to liberalize its insurance market; U.S. insurance providers are likely to benefit from FTA provisions allowing the establishment of foreign insurance providers through branches or subsidiaries and new rules permitting the cross-border provision of marine, aviation, and transportation insurance. The FTA contains new specific binding commitments by CA/DR related to asset management services; in addition, El Salvador, Guatemala, Honduras, and Nicaragua commit to allow branch banking.

Economywide Effects of Tariff Liberalization

The most relevant and comprehensive measure of the impact that the quantifiable components (tariff liberalization) of the U.S.-CA/DR FTA is likely to have on the U.S. economy as a whole is the change in welfare. It summarizes the benefits to consumers of tariff liberalization, as well as the effects on households in their roles as providers of labor, owners of capital, and taxpayers. According to the Commission's simulation, after tariff liberalization has been fully implemented and all economic adjustments have occurred under the FTA, overall U.S. welfare is likely to increase in the range of $135.31 million to $248.17 million. That is, as long as the FTA is in effect, overall U.S. welfare would be between $135.31 million to $248.17 million higher than in the absence of the FTA. U.S. exports to CA/DR are likely to increase by $2.7 billion or 15percent, and U.S. imports from CA/DR are likely to increase by $2.8 billion or by 12percent after full implementation of the tariff liberalization provisions of the FTA. Total U.S. exports to the world are likely to increase by approximately $1.9 billion or by 0.16percent, and total U.S. imports from the world are likely to increase by about $1.2 billion or by 0.07percent, with minimal impact on U.S. employment and output.

Trade Facilitation

The U.S.-CA/DR FTA contains a number of provisions that may facilitate the movement of goods and the provision of services among the parties. The FTA offers specific improvements with respect to customs administration, sanitary and phytosanitary regulations, technical barriers to trade, electronic commerce, and transparency. Measures with respect to trade facilitation can directly affect the cost of doing business. This is particularly true with the gradual decline in the significance of NTR duties as a result of successful multilateral rounds of tariff and trade negotiations, and the increased reliance on technology to aid in the international movement of goods and services. Figure ES-2 presents the likely effects of the U.S.-CA/DR FTA in the area of trade facilitation.

The Commission's analysis suggests that the FTA's provisions with respect to trade facilitation are likely to benefit U.S. producers, exporters, service providers, and

Figure ES-2
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Trade Facilitation Provisions—Qualitative Assessment

Subject negotiated and FTA chapter

Customs administration, ch. 5
- Improved transparency, efficiency, and predictability of CA/DR laws.
- A greement to share information to combat illegal transhipments of goods and to facilitate express shipments.
- Provision for the rapid release of goods—within 48 hours to the extent possible.
- Importers granted judicial review and appeal.

Sanitary/phytosanitary (SPS) measures, ch. 6
- CA/DR agree to apply science-based disciplines of the WTO SPS Agreement.
- CA/DR to move to recognizing the U.S. export eligibility for processing plants inspected under the U.S. food safety inspection system.

Technical barriers to trade (TBT), ch. 7
- CA/DR reaffirm their WTO TBT commitments and to make their standards systems more transparent and more open.
- Agreement builds on the WTO TBT Agreement by allowing for greater transparency in the rule making process.

Transparency, ch. 18
- Each government must publish its laws and regulations governing trade and investment.
- Each government must publish proposed regulations in advance and provide an opportunity for public comment on them.

Electronic commerce, ch. 14
- Nondiscriminatory treatment of digital products.
- Agreement not to impose customs duties on digital products based on value of media, not content.
- Agreement on method of valuation for physically delivered digital products.

Likely economic impact on U.S. economy

Benefits to U.S. exporters, but overall relatively small impact on the U.S. economy is expected because of the relatively small CA/DR market size and low income levels in CA/DR.

U.S. industry generally pleased with the FTA's provisions. U.S.-based air courier and express delivery firms likely to benefit from improved customs procedures as a result of the FTA.

Benefits to U.S. suppliers of digital products, but overall relatively small impact on the U.S. economy is expected because of the relatively small market size and low income levels in CA/DR.

Source: Text of the U.S.-Dominican Republic-Central America FTA, found at *http://www.ustr.gov/new/fta/cafta.htm*. Impact estimates compiled from multiple sources cited elsewhere in this report, including written submissions in response to the *Federal Register* notice for this investigation, the Commission's public hearing in connection with the investigation, USITC staff interviews with industry officials, and reports filed by the various U.S. government trade policy advisory committees.

investors. However, the overall impact of the FTA on the U.S. economy with respect to trade facilitation is likely to be very small because of the small size of the CA/DR economy and the CA/DR market relative to the United States.

Investment

The FTA establishes a secure, predictable legal framework for U.S. investors operating in the CA/DR region—addressing many longstanding U.S. concerns and providing assurances to U.S.

investors. Currently, the only operational U.S. Bilateral Investment Treaty in the region is with Honduras. Figure ES-3 presents the likely effects of the investment provisions of the FTA on the U.S. economy.

The effects of investment provisions of the FTA are likely to benefit U.S. investors, service providers, and exporters. Here again, the overall impact of the FTA on the U.S. economy with respect to investment is likely to be very small because of the small size of the CA/DR economy and the CA/DR market relative to the United States.

Regulatory Environment

The U.S.-CA/DR FTA contains a number of provisions that may improve the regulatory environment for bilateral trade and investment. The FTA provides measures for trade remedies and dispute settlement procedures, includes government procurement disciplines, and provides for improved protection and enforcement for intellectual property rights (IPR) which exceed the protection afforded in the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPs). U.S. industry representatives generally found that the FTA meets U.S. negotiating objectives with respect to labor and environmental issues, and provides commitments that the parties to enforce, and not weaken, their labor and environmental laws. U.S. labor representatives expressed concern about the FTA, especially with the FTA's provisions on enforcement and with the pact's impact on employment in sensitive U.S. sectors. Some labor groups criticized the FTA's provisions requiring the parties to effectively enforce their labor laws rather than requiring that the parties to meet international standards, noting that the CA/DR's labor laws are not up to international standards. Labor groups also argued that the rules of origin and safeguard provisions of the FTA fail to protect workers in sensitive U.S. sectors, such as textiles and apparel, from possible surges in imports. U.S. environmental representatives generally support the FTA, but expressed concerns about the environmental impact of over-quota tariff reductions that could result in overproduction and lead to stress on delicate or endangered U.S. ecosystems. Figure ES-4 presents likely effects of the U.S.-CA/DR FTA with respect to the regulatory environment.

U.S. firms are likely to benefit from the application of these provisions by CA/DR, primarily as a result of improvements in regulatory transparency. The FTA's provisions

Figure ES-3
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Investment Provisions—Qualitative Assessment

Subject negotiated and FTA chapter	Likely economic impact on U.S. economy
Investment, ch. 10 and annexes I to III • Minimum standard of treatment afforded to covered investments: national treatment; most-favored-nation treatment; nondiscriminatory treatment; fair and equitable treatment with customary international law standard of treatment of aliens. • Secure, predictable legal framework. • FTA includes an investor-state dispute settlement process. • Only Honduras has an operative Bilateral Investment Treaty (BIT) with the United States. The FTA establishes new investment commitments for the other parties, as well as commitments beyond those of the BIT with Honduras.	Increased U.S. investment opportunities, but overall relatively small impact on the U.S. economy is expected because of the relatively small CA/DR regional market size and low income levels in the CA/DR region.

Source: Text of the U.S.-Dominican Republic-Central America FTA, found at *http://www.ustr.gov/new/fta/cafta.htm*. Impact estimates compiled from multiple sources cited elsewhere in this report, including written submissions in response to the *Federal Register* notice for this investigation, the Commission's public hearing in connection with the investigation, USITC staff interviews with industry officials, and reports filed by the various U.S. government trade policy advisory committees.

Figure ES-4
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Provisions With Respect to the Regulatory Environment—Qualitative Assessment

Subject negotiated and FTA chapter	Likely economic impact on U.S. economy
Trade remedies, ch. 8 and Dispute settlement, ch. 20 • Provides framework for procedures covering the application of safeguards. • Encourages the early identification and settlement of disputes through consultation. • Seeks to establish fair, transparent, timely, and effective procedures to settle disputes under the FTA.	FTA makes no changes to U.S. antidumping and countervailing duty laws. Negotiated provisions help increase the effectiveness of trade remedies, as well as minimize the possibility of misuse of trade remedy measures. Benefits U.S. exporters and investors by ensuring the transparency and predictability of government-to-government dispute settlement. Benefits business decisionmaking and competitiveness conditions by focusing on fine-based penalties that are less likely to disrupt trade flows between the parties than a dispute-settlement mechanism that results in trade restrictive measures. Benefits are likely to have a small impact on the U.S. economy because of the relatively small size of the CA/DR market.
Government procurement, ch. 9 • FTA reflects many of the principles and commitments of the WTO Government Procurement Agreement (CA/DR are not signatories or observers to the WTO Government Procurement Agreement). • Nondiscriminatory treatment for covered government purchases. • Transparent disciplines on procurement procedures. • Criminalizes bribery in government procurement.	Benefits to U.S. exporters and service providers, but overall relatively small impact on the U.S. economy is expected because of the relatively small size of the CA/DR market.
Intellectual Property Rights, ch. 15 • New, higher IPR standards, including certain WTO TRIPs-plus provisions for IPR protection. • Parties agree to ratify or accede to an extensive list of international agreements and provide national treatment to nationals of the other parties. • Strengthened copyright, patent, trademark, and data protection measures. • Provisions that address Internet and other digital piracy issues. • The FTA is considered more extensive than the WTO TRIPS agreement in that it provides longer terms of protection, stronger enforcement measures, and specific coverage of electronic and digital media.	Potential increase in revenues for U.S. industries dependent on copyrights, patents, trade secrets, trademarks, and for industries that could benefit from stronger Internet and digital piracy provisions, as well as enhanced enforcement. Overall relatively small impact on the U.S. economy because of the relatively small size of the CA/DR market.

Figure ES-4—*Continued*
U.S.-Central America-Dominican Republic (CA/DR) FTA: Impact of Provisions With Respect to the Regulatory Environment—Qualitative Assessment

Subject negotiated and FTA chapter	Likely economic impact on U.S. economy
Labor, ch. 16 • Parties commit to effectively enforce their domestic labor laws, with enforcement provisions that go beyond those of the U.S. FTAs with Chile and Singapore. • Agreement includes cooperative mechanism for labor issues.	Overall, provisions are expected to ensure that existing labor laws are enforced. U.S. labor representatives concerned that deficiencies will continue and that the FTA may have an adverse impact on sensitive U.S. sectors, such as textiles and apparel.
Environment, ch. 17 • Parties agree to effectively enforce their domestic environmental laws. • Commitment not to weaken or reduce environmental laws to attract investment or trade. • The FTA includes a cooperative mechanism in environmental areas.	According to USTR's interim environmental review for the U.S.-CA/DR FTA, no likely adverse environmental effects on the U.S. economy under the FTA are expected because of the relatively small CA/DR market size, the relatively low levels of U.S. bilateral trade with the region, and the relatively small impact the FTA is expected to have on U.S. production of goods and services as a result of the FTA.

Source: Text of the U.S.-Dominican Republic-Central America FTA, found at *http://www.ustr.gov/new/fta/cafta.htm*. Impact estimates compiled from multiple sources cited elsewhere in this report, including written submissions in response to the *Federal Register* notice for this investigation, the Commission's public hearing in connection with the investigation, USITC staff interviews with industry officials, and reports filed by the various U.S. government trade policy advisory committees.

with respect to IPR are likely to increase revenues for U.S. industries dependent on copyrights, trademarks, patents, and trade secrets. However, these effects are likely to be very small because of the small size of the CA/DR economy relative to the United States.

Literature Review and Comparison with Commission Findings

Studies of the economic impact of FTAs generally entail investigating static effects (such as trade creation and trade diversion), as well as terms of trade (the price of exports relative to the price of imports). In addition, related scale effects (the extent that FTAs integrate and, hence, enlarge markets) as well as nonquantifiable effects also are taken into account. The effects of an FTA that are attributable either to the liberalization of trade in services, investment, and IPR provisions usually remain unmeasured. As the review of literature shows, the nonquantifiable effects of an FTA could be more significant than the effects of removing tariffs.

A small number of studies have directly assessed the impact on the United States of a hypothetical U.S.-CA/DR FTA.[23] A study by Brown, Kiyota, and Stern (BKS) employed computable general equilibrium analysis of a U.S. FTA with a "Central America and the Caribbean" regional aggregate that directly assesses the impact of such an FTA on the United States.[24] Like the USITC estimate, BKS found a positive but very small welfare benefit (0.00 to 0.04 percent change of U.S. GNP) for the United States based on the removal of all tariffs and selected nontariff barriers in the hypothetical FTA. A scenario with a very large services barrier tariff equivalent produced a much larger result (0.13 percent change of U.S. GNP). To more directly compare the outcome of the BKS model to that of the Commission, the USITC model was used to obtain welfare estimates using the BKS tariff assumptions. The objective of applying the alternative trade barriers to the USITC model was to determine the extent to which the BKS results depend on the assumptions made about barriers, as opposed to other differences between the models. For the most part, differences do not depend on assumptions related to trade barriers, but on the assumptions related to substitution elasticities, investment effects, and scale economies.

Interested Parties

Interested party views of the U.S.-CA/DR FTA expressed in direct testimony to the Commission in this investigation, as well as written submissions, covered a wide range

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[23] The Commission's analysis in this report is based on the final text of the negotiated U.S.-CA/DR FTA, and reflects actual commitments on tariff concessions made by the parties. The available literature reviewed generally predates the public release of the actual FTA, and is based on a hypothetical FTA through various assumptions about tariff concessions and countries included in the agreement.

[24] Drusilla K. Brown, Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," February 8, 2004, found at *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved March 2004, p. 5.

of opinions. The majority of the interested parties stated their support for the FTA and/or for specific provisions of the FTA. Submissions from representatives of the Commonwealth of Puerto Rico stated that the FTA is likely to benefit Puerto Rican trade with the Dominican Republic. A submission from the Honduran ambassador to the United States notes that the FTA is likely to benefit the economies of all parties. Other interested parties indicated that commitments in the FTA provide for enhanced market access and trade, promote a stable business environment for service providers, and offer a high degree of IPR protection.

U.S. producers, importers and retailers for apparel, as well as distributors and retailers of footwear and travel goods (luggage, leather goods, handbags, and computer cases) generally support the FTA and its provisions for the use of certain nonoriginating inputs. U.S. textile producers oppose the FTA, and stated that expanded duty-free entry and provisions allowing for the use of nonoriginating inputs are likely to have adverse economic effects on U.S. production and employment in the textile sector. U.S. sweetener users support the FTA, and stated that it is likely to benefit U.S. consumers through lower prices and lead to increased U.S. employment in confectionery and sugar-using industries. U.S. sugar producers oppose the FTA, and stated that quota expansion is likely to harm U.S. sugar producers and not benefit U.S. consumers. U.S. processed food exporters support the tariff elimination under the FTA, and stated that U.S. food exports are likely to increase. Representatives of the U.S. express delivery services industry support the FTA and its recognition of express delivery services as a unique service sector. Representatives of U.S. copyright-based and pharmaceutical industries support the FTA and its measures to strengthen IPR protection; a consumer-based interest group does not oppose the FTA, but expressed concerns about provisions that go beyond TRIPs with respect to drug patents. A U.S. citrus producers' association wrote that it does not oppose the FTA, but expressed the concern that country of origin provisions of the FTA must be adequately enforced to avoid transshipments of orange juice from Brazil. U.S. producers of dehydrated onions and garlic oppose the FTA and stated that U.S. production would be adversely affected by duty-free imports on a permanent basis from the CA/DR region.

For some of the specific U.S. industry views above, table ES-1 provides a summary of the industry's negotiating objectives and assessments of the U.S.-CA/DR FTA.

Table ES-1
U.S.-Central America-Dominican Republic FTA: Summary of U.S. industry views[1]

Industry	FTA objectives	FTA benefits and impact
Copyright-based industries	• full implementation of TRIPs obligations and enforcement	• TRIPs-plus provisions and enforcement commitments likely to lead to increased revenues for U.S. industries dependent on copyrights, trademarks, and patents
Express delivery services	• recognize express delivery as a uniqueservice sector • provisions to limit unfair regulation and taxation and to facilitate customs clearance	• recognizes express delivery as a unique service sector, guaranteeing market access and national treatment for U.S.-based firms in the region • commitments to limit unfair regulation and taxation and to facilitate customs clearance, improve regulatory certainty and educe cost for U.S.-based firms
Footwear distributors and retailers	• duty-free treatment for footwear • provision to allow use of nonoriginating inputs	• immediate duty elimination to benefit U.S. consumers • regional production likely to become more globally competitive
Processed food exporters	• no products excluded from FTA	• all key exports to receive duty-free access • likely increase in U.S. food and beverage exports
Pharmaceutical industry	• stable, predictable framework for IPR protection • same level of IPR protection for FTA partners as in United States.	• tariff reductions and provisions to strengthen IPR protection and enforcement likely to lead to an increase in U.S. exports
Sugar		
• Sugar producers	• prevent oversupply of sugar to U.S. market • prefer that market access for sugar be negotiated in the WTO rather than in FTAs	• increase in U.S. sugar TRQs likely to lead to a decline In U.S. employment and income in the sugar sector
• Sweetener users	• increase market access for imported sugar	• likely to result in an increase in U.S. employment in the confectionary and other sugar-using industries

Table ES-1—Continued
U.S.-Central America-Dominican Republic FTA: Summary of U.S. industry views[1]

Industry	FTA objectives	FTA benefits and impact
Textiles and apparel		
• Producers	• limit exceptions to rules of origin that allow use of nonoriginating inputs	• exceptions to rules of origin that allow use of nonoriginating imports likely to lead to a decline in U.S. employment and income in the textile sector; however, reduction in paperwork/documentation is likely to increase oportunities for appaarel producers and importers.
• Importers and retailers	• eliminate duties on all textiles and apparel • allow flexibility on use of nonorignating inputs	• regional production likely to become more globally competitive
Travel goods		
	• duty-free treatment for all travel goods • simple and flexible substantial transformation rule of origin	• simple, flexible rules of origin and customs procedures • likely increase in U.S. exports of textile and leather travel goods inputs

[1] Based on U.S. industry views provided in response to the Commission's *Federal Register* notice, testimony at the Commission's hearing for this investigation held on April 27, 2004, and Government Trade Policy Advisory Committees. A summary of all interested party views received in connection with this investigation is provided in chapter 9.

CHAPTER 1
Introduction

Purpose of the Report

This report assesses the likely impact on the U.S. economy as a whole and on specific industry sectors and the interests of U.S. consumers of the U.S-Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) - Dominican Republic Free Trade Agreement (U.S.-CA/DR FTA).[1] The U.S. International Trade Commission (USITC or "Commission") initiated work on this fact-finding investigation on the US-CA/DR FTA pursuant to section 2104(f) of the Trade Act of 2002 following receipt of a request letter from the United States Trade Representative (USTR) on January 28, 2004.[2]

Section 2104(f)(2) of the Trade Act provides that the Commission must submit to the President and the Congress (not later than 90 calendar days after the President enters into the FTA) a report assessing the likely impact of an agreement (here, the U.S.-CA/DR FTA) on the U.S. economy as a whole and on specific industry sectors, including the impact the FTA will have on the gross domestic product (GDP), exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the FTA, and the interests of U.S. consumers.

Section 2104(f)(3) provides that the Commission, in preparing its assessment, must review available economic assessments regarding the FTA, including literature regarding any substantially equivalent proposed agreement, and provide in its assessment a description of the analyses used and conclusions drawn in such literature and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the FTA.

Scope of the Report

This report assesses the likely impact of the U.S.-CA/DR FTA on the U.S. economy as a whole and on specific sectors and the interests of U.S. consumers. It also includes a summary of the FTA, and a review of relevant economic literature on the FTA.

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[1] The U.S.-CA/DR FTA is a regional trade agreement among all seven signatories. The U.S. FTA with the five Central American countries was signed on May 28, 2004. The Dominican Republic was integrated into the FTA upon its August 5, 2004 signature of the Agreement. A chronology of the history of the FTA is in the section "Chronology of the FTA" below. USTR. "Dominican Republic Joins Five Central American Countries in Historic FTA with U.S.," press release 04-66, August 5, 2004

[2] A copy of the request letter from USTR is in appendix A. A copy of the Commission's *Federal Register* notice of institution for this investigation is in appendix B.

The Commission's analysis examines all 22 chapters of the final text of the U.S.-CA/DR FTA, including its annexes and associated side letters and understandings.[3] A quantitative assessment is conducted for chapters 2 through 4 of the FTA (i.e., liberalization of tariffs and selected nontariff barriers) that increase market access for products of the United States and the CA/DR region. This computational analysis is supplemented with a qualitative analysis of the potential impact of increased market access for certain product sectors (textiles, apparel, footwear, and luggage; sugar and sugar-containing products; and grains) and service sectors (telecommunications, distribution services, insurance, and banking and securities) (FTA chapters 11 through 13). A qualitative assessment also is conducted for negotiated objectives that facilitate trade (FTA chapters 5, 6, 7, 14, and 18); enhance investment opportunities (FTA chapters 10 and 12); and improve the regulatory environment (FTA chapters 8, 9, 15 through 17, and 20).

Approach of the Report

To assess the effects of the FTA on the U.S. economy as a whole and specific economic sectors, the Commission employs an approach that combines quantitative and qualitative analyses. In this report, the Commission quantifies the impact of the FTA to the extent that the necessary data are available. Thus, the quantitative assessment is limited to the liberalization of tariffs and TRQs, the portion of tariff-rate quotas (TRQs) collected as duties, and an adjustment for the increase in the quota levels for the TRQ on sugar. Remaining components of the FTA are analyzed using qualitative analysis. Combining the quantitative and qualitative analyses provides a comprehensive assessment of the impact of the FTA on the U.S. economy.

A qualitative analysis is conducted to assess the impact of the market access provisions of the U.S.-CA/DR FTA for U.S. product and service sectors that were selected based upon a comprehensive examination and consideration of the following: trade liberalization schedules of the FTA to assess the relative liberalization of sectoral trade with respect to tariffs and nontariff measures; U.S. bilateral trade flows with the CA/DR region; assessments of the apparent sensitivity of specific industries, commodities, and service sectors; and determinations made based on the expertise of Commission industry analysts. This qualitative assessment takes into account the FTA staging process as tariff and nontariff barriers are phased out over time.

Other nonquantifiable effects of the FTA are associated with provisions with respect to trade in services, investment, trade facilitation (including customs administration, transparency, and technical barriers to trade), and the regulatory environment (including intellectual property rights, government procurement, trade remedies, labor, and the environment). These effects are harder to quantify because of the lack of necessary data and their intangible nature.

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[3] The preamble and chapters 1, 19, 21, and 22 of the FTA address primarily administrative and legal matters and are not analyzed in this report.

For the quantitative assessment of the economywide effects of the U.S.-CA/DR FTA, the Commission employs a multicountry model with economywide coverage (a global computable general equilibrium model). This USITC model is based on the Global Trade Analysis Project (GTAP) database, which is described more fully in appendix D. Unlike the qualitative analysis, which is done at a disaggregated sectoral level, the USITC model estimates the likely trade and economic impact of the tariff and TRQ reductions or elimination for 23 aggregated sectors.[4] The commodity aggregation adopted here identifies sectors that have relatively high domestic-world price gaps due to tariffs and TRQs and relatively large trade flows. The economies covered in the analysis included the United States and CA/DR region,[5] as well as 11 regional aggregates representing the rest of the world. While providing insights on the FTA's potential effects on aggregate industry sectors, a primary purpose of the modeling is to provide an estimate of some of the benefits of the agreement to the U.S. economy as a whole.

The GTAP database, which represents the global economy in 2001, was adjusted to reflect expected economic growth in the United States and its CA/DR FTA partners as well as the expected economic growth in the rest of the world to 2005, the year the proposed FTA is scheduled to enter into force. The adjusted database reflects the scheduled removal of textile and apparel quotas under the Agreement on Textiles and Clothing in January 2005, as well as other international agreements.[6] The changes attributed to the FTA are from this adjusted data base, and not from 2004 trade patterns. The analysis is static and assumes the FTA is fully implemented and its effects felt on January 1, 2005. In the model, the FTA's provisions are not phased in over time, nor are its effects assumed to be gradually realized over time. The modeled results can be considered to be the long-run effects, after all adjustments have worked their way through the U.S. economy, of the fully implemented FTA in a U.S. economy otherwise identical to the baseline 2005 economy.[7] A series of simulations were conducted to determine the sensitivity of impacts to the critical parameters that determine the response to changes in trade prices. The analysis and discussion of FTA impacts are based on the ranges obtained from the sensitivity analysis.

The literature review for this investigation includes a description of analyses of the economic effects of FTAs substantially similar to the proposed U.S.-CA/DR FTA. The economic literature reviewed was drawn from relevant academic, public sector, and private sector institutions.

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[4] The relationship between the disaggregated sectors analyzed in chapter 3 of this report and the aggregated sectors used in the model is shown in table 4-1, in chapter 4.

[5] The effects of the FTA on the U.S. economy are estimated for the CA/DR region as a whole, and not for each country in the CA/DR region.

[6] In addition to reflecting the recently enacted U.S. FTAs with Chile and Singapore, the adjusted database also reflects Uruguay Round tariff reductions insofar as they are reflected in trade data projected to 2005.

[7] Models are highly simplified descriptions of an economy; they depend on parameter estimates and are subject to potential biases due to product and regional aggregations. The USITC model is discussed in more detail in appendix D of this report.

Data and other information for the study were obtained from written submissions in response to the Commission's *Federal Register* notice for this investigation,[8] the Commission's public hearing held in connection with this investigation on April 27, 2004, in Washington, D.C.,[9] interviews with government and industry contacts, official reports of the Government Trade advisory committees, industry reports, and the GTAP database. Other data sources include the U.S. Department of Agriculture, the U.S. Department of Commerce, the U.S. Department of State, the International Monetary Fund (IMF), the United Nations, and the World Trade Organization (WTO).

Organization of the Report

Chapter 2 of this report presents an overview of the U.S.-CA/DR FTA. Chapter 3 presents the results of a qualitative analysis of the likely impact of the FTA on selected sectors. Chapter 4 reports quantitative estimates of the likely trade and economywide effects for the United States of increased market access due to the removal of tariff and selected nontariff barriers (for which tariff equivalents were available) in the United States and in the CA/DR region. The assessment of the FTA includes a number of measures of U.S. economic activity, including exports, imports, production, and employment. Chapter 5 discusses the potential impact of trade facilitation provisions of the FTA on the United States. Chapter 6 discusses the investment provisions of the FTA, and provides a qualitative assessment of the potential impact on the United States. Chapter 7 provides a summary of the provisions of the FTA with respect to the regulatory environment—including intellectual property provisions and provisions with respect to trade remedies (safeguards and dispute settlement), labor, and the environment—and provides qualitative assessments of the potential impacts on the United States. Chapter 8 presents the literature review as well as the comparison between the Commission's findings and the findings from studies reviewed. The report concludes with Chapter 9, summarizing the positions and views of interested parties who responded to the Commission's *Federal Register* notice inviting public submissions on the impact of the U.S.-CA/DR FTA.

Chronology of the FTA

On October 3, 2002, President Bush authorized and directed USTR to notify Congress of the President's intention to initiate FTA negotiations with the Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua). In his letters to Congress, U.S. Trade Representative Robert Zoellick set out the U.S. negotiating objectives for the FTA with respect to trade in goods; customs matters, rules

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[8] The Commission's *Federal Register* notice of institution for this investigation is in appendix B.
[9] The list of hearing participants is presented in appendix C.

of origin, and enforcement cooperation; sanitary and phytosanitary measures; technical barriers to trade; intellectual property rights; trade in services; investment; electronic commerce; government procurement; transparency; anticorruption; and regulatory reforms; trade remedies; environment; labor; and dispute settlement.[10] Those objectives are discussed in more detail in respective chapters of this report.

Negotiations for the U.S. FTA with the Central American countries were launched on January 8, 2003. On August 4, 2003, the President notified Congress of his intention to enter into negotiations for an FTA with the Dominican Republic and to seek to integrate the Dominican Republic into the FTA with the Central American countries.

On December 17, 2003, USTR announced that the United States had successfully concluded negotiations for an FTA with El Salvador, Guatemala, Honduras, and Nicaragua. At that time, USTR also announced that consultations with Costa Rica would continue before finalizing that country's participation in the FTA and that negotiations were to be launched with the Dominican Republic with the goal of integrating that country into the FTA with the Central American countries. On January 25, 2004, USTR announced that the United States and Costa Rica had successfully concluded FTA negotiations and that Costa Rica would become a party to the FTA. The draft text of the FTA with the five Central American countries was made public on January 28, 2004. On March 15, 2004, USTR announced that negotiations for an FTA with the Dominican Republic had been successfully concluded and that the Dominican Republic would be added to the FTA with the Central American countries. The draft text of the FTA with the Dominican Republic was made public on April 9, 2004. Although the U.S. FTA with the Dominican Republic was negotiated separately from the U.S. FTA with the Central American countries, the Dominican Republic is to assume the same set of obligations and commitments as the Central American countries.[11]

On February 20, 2004, President Bush notified Congress of the intent to enter into an FTA with the Central American countries, starting the countdown for when it could be signed; Congressional notification for the FTA with the Dominican Republic was made on March 25, 2004. The U.S. FTA with the five Central American countries was signed by the parties on May 28, 2004.[12] The FTA with the Dominican Republic was signed by the parties on August 5, 2004, integrating the Dominican Republic into the FTA with the Central American countries.[13]

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[10] Amb. Robert B. Zoellick, USTR letters to Congressional leaders initiating action on trade agreements, October 1, 2002, found at *http://www.ustr.gov/releases/2002/10/2002-10-01-centralamerica-house.pdf*, retrieved July 9, 2004.

[11] As with the Central American countries, the United States negotiated individual market access schedules with the Dominican Republic for goods, agriculture, services, investment, and government procurement. USTR, "Adding Dominican Republic to CAFTA: Combining to Create America's Second Largest Export Market in Latin America," press release, March 15, 2004, found at *http://www.ustr.gov/new/fta/Dr/2004-03-15-factsheet.pdf*, retrieved June 29, 2004.

[12] USTR, "United States and Central America sign Historic Free Trade Agreement," press release, found at *http://www.itc-central.usitc.gov/intranet/text/internet.htm.*, May 28, 2004, retrieved August 20, 2004.

[13] USTR, "Dominican Republic Joins Five Central American Countries in Historic FTA with U.S.," press release 04-66, August 5, 2004, retrieved August 20, 2004.

Central America and the Dominican Republic: Economic and Trade Profiles

Figure 1-1 provides an economic profile for CA/DR region, presenting data on the recent macroeconomic indicators, important products in the region's world trade, the region's leading trade partners, and the major products in bilateral trade between the region and the United States. The overview highlights key features of the CA/DR regional economy relevant to the Commission's assessment of the impact of the FTA.

Figure 1-1

Economic and Trade Profiles

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Dominican Republic

Economic Indicators, 2003

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic	CA/DR region	United States
Population (mn, 2002)	3.9	6.4	12.0	6.8	5.3	8.6	43.0	290.3
GDP (US$ bn, PPP)	37.7	28.0	50.0	18.0	13.3	54.0	201.0	10,625.7
GDP per capita (US$, PPP)	9,034	4,210	3,838	2,561	2,427	6,168.0	4,706 (average)	36,520
Real GDP growth (%)	5.6	2.0	2.1	3.2	2.3	-0.4	2.5 (average)	3.1
Goods exports (US$ bn)	6.1	3.2	2.8	1.4	0.7	5.4	19.6	713.8
Goods imports (US$ bn)	7.2	5.4	5.7	3.1	1.8	7.9	31.1	1,263

Note.—Purchasing Power Parities (PPPs) are currency conversion rates that both convert to a common currency and equalise the purchasing power of different currencies. In other words, they eliminate the differences in price levels between countries in the process of conversion.

Sources: Economist Intelligence Unit, *EIU Viewswire*, various months; International Monetary Fund, *World Economic Database*, Apr. 2004, found at *http://www.imf.org/external/pubs/ft/weo/2004/01/data/*, retrieved July 16, 2004; and World Bank, *World Development Indicators Database*, found at *http://www.worldbank.org/data/countrydata/countrydata.html*, retrieved July 16, 2004.

International Trade Agreements

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Dominican Republic, are all members of the WTO. They also all participate in the following regional trade agreements with other Latin American and Caribbean countries.

- Central American Common Market (CACM). Members: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. A common external tariff ranging from 5 to 15 percent applies to most imports from nonmembers. Progress toward implementing a regional FTA has been uneven as tariffs have been reduced at different speeds.
- Costa Rica-Caribbean Community FTA (signed 2004) Caribbean Community (CARICOM). Members are: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Lucia, Saint Kitts and Nevis, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago.
- Costa Rica-Canada FTA (effective 2002)
- Central America-Chile (signed 1999)
  - Costa Rica-Chile (effective 2002)
  - El Salvador-Chile (effective 2002)
  - others pending implementation
- Central America-Panama FTA (signed 2002)
- Central America-Dominican Republic FTA (signed 1998)
  - Costa Rica-Dominican Republic (effective 2002)
  - El Salvador-Dominican Republic (effective 2001)
  - Guatemala-Dominican Republic (effective 2001)
  - Honduras-Dominican Republic (effective 2001)
- El Salvador, Guatemala, Honduras FTA with Mexico (effective 2001)
- Nicaragua-Mexico FTA (effective 1998)
- Dominican Republic-CARICOM FTA (signed 1998)

Sources: Inter-American Development Bank, *Instrumentos básicos de integración económica en América Latina y el Caribe, March 2004*, found at *http://www.iadb.org/intal/ingles/i-default.htm*, retrieved July 15, 2004; IADB, *Central American Report, 2000*, found at *http://www.intal.org/intal/ingles/publicaciones/inf_subreg/central_american_report_1.pdf*, retrieved June 15, 2004; and Organization of American States, Trade Unit, *List of Negotiations*, found at *http://www.sice.oas.org/TPD/TPD_e.asp*, retrieved July 14, 2004.

Preferential Trade Arrangements

Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua all receive unilateral (i.e., nonreciprocal) trade preferences from the United States and the European Union (EU).

Figure 1-1-Continued

Economic and Trade Profiles

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Dominican Republic

- All six countries are beneficiaries under the U.S. Caribbean Basin Economic Recovery Act (CBERA) and the Caribbean Basin Trade Partnership Act (CBTPA). All but Nicaragua are designated under the U.S. Generalized System of Preferences (GSP). GSP affords duty-free entry to qualifying imports from designated developing countries. CBERA , which covers more tariff categories and has more liberal qualifying rules than GSP, provides duty-free and reduced-duty treatment to qualifying imports from designated Caribbean Basin countries. CBTPA provides duty-free treatment to some products previously ineligible for CBERA, most notably certain apparel, as well as equivalent treatment given to Mexico under the North American Free Trade Agreement for other products previously ineligible for duty-free treatment, including certain footwear; canned tuna; handbags, luggage, flat goods, work gloves, and leather wearing apparel; petroleum; and certain watches and watch parts. CBERA benefits are permanent, whereas GSP is scheduled to expire in 2006, and CBTPA is scheduled to expire in 2008. The U.S.-Dominican Republic-Central America FTA (U.S.-CA/DR FTA) would enhance these preferences and make them permanent, and afford reciprocal duty-free treatment to U.S. goods in the CA/DR region.
- The EU provides duty-free access to EU markets for all industrial products as well as duty-free access for some agricultural products from all six countries under the EU GSP program, currently scheduled to expire in 2006.
- Dominican Republic is included as one of the African, Caribbean, and Pacific (ACP) countries that traditionally have had nonreciprocal preferential access to the EU market for eligible goods under the EU's Lomé Convention. Effective in 2003, the Lomé Convention was replaced by EU Partnership Agreements with individual ACP countries. Trade preferences are to be based on the EU GSP program.

Sources: EU, *The EU's Relations with Central America*, found at *http://europa.eu.int/comm/external_relations/ca/*, retrieved July 14, 2004; and USITC, *The Impact of the Caribbean Basin Economic Recovery Act, Sixteenth Report 2001-2002*, Inv. No. 332-227, publication 3636, September 2003.

Trade with the United States

- Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua combined ranked as the 12th largest market for U.S. exports in 2003, and the 15th largest U.S. supplier in 2003.
- In 2002 and 2003, about 80 percent of U.S. imports from the CA/DR region entered free of duty.

U.S. merchandise trade with the CA/DR region, 2000–03

(US$ million)

	2000	2001	2002	2003
U.S. exports	13,202	13,025	13,532	14,372
U.S. imports	16,150	15,304	16,013	16,862
Trade balance	-2,948	-2,279	-2,481	-2,490
Total imports	16,150	15,304	16,013	16,862
Dutiable[1]	5,477	3,504	3,273	3,340
Duty free	10,673	11,800	12,740	13,522
NTR	8,596	4,830	4,634	4,924
CBERA	1,744	1,940	2,252	2,193
CBTPA	149	4,959	5,936	6,167
GSP	182	162	82	236
Duty-free imports as a percentage of total imports (percent)	66.1	77.1	79.6	80.2

[1] Includes reduced-duty imports under CBERA and CBTPA.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Figure 1-1-Continued

Economic and Trade Profiles

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Dominican Republic

U.S. merchandise trade with the CA/DR region, by country, U.S. exports, imports, dutiable imports, and balance, 2000–03

	2000	2001	2002	2003	2000–03 change
	US$ million				Percent
Costa Rica					
U.S. exports	2,368	2,411	2,891	3,134	32.3
U.S. imports	3,555	2,912	3,146	3,354	-5.7
of which dutiable[1]	429	232	251	224	-47.8
Balance	-1,187	-501	-255	-220	
El Salvador					
U.S. exports	1,741	1,690	1,608	1,763	1.3
U.S. imports	1,925	1,882	1,976	2,018	4.8
of which dutiable[1]	866	554	519	562	-35.1
Balance	-184	-192	-368	-255	
Guatemala					
U.S. exports	1,835	1,801	1,976	2,175	18.5
U.S. imports	2,603	2,589	2,785	2,954	13.5
of which dutiable[1]	1,450	1,241	1,254	1,168	-19.4
Balance	-768	-788	-809	-779	
Honduras					
U.S. exports	2,545	2,405	2,524	2,793	9.7
U.S. imports	3,091	3,131	3,262	3,312	7.1
of which dutiable[1]	1,117	625	559	569	-49.1
Balance	-546	-726	-738	-519	
Nicaragua					
U.S. exports	361	428	423	482	33.5
U.S. imports	597	603	677	769	28.8
of which dutiable[1]	294	284	309	365	24.1
Balance	-236	-175	-254	-287	
Dominican Republic					
U.S. exports	4,352	4,290	4,109	4,024	-7.5
U.S. imports	4,378	4,187	4,167	4,455	1.8
of which, dutiable[1]	1,320	567	382	453	-65.7
Balance	-26	103	-58	-431	

[1] Includes reduced-duty imports under CBERA and CBTPA.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Figure 1-1-Continued

Economic and Trade Profiles

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Dominican Republic

Leading U.S. exports to the CA/DR region, 2003, US$ million

HTS No.	Description	
854221	Electronic monolithic digital integrated circuits	850
271019	Petroleum oils & oils (not light) from bituminous minerals or preps nesoi 70%+ by wt. from petroleum oils or bitum. min.	690
600622	Dyed knitted or crocheted fabrics of cotton, nesoi	313
100590	Corn (maize), other than seed corn	295
610910	T-shirts, singlets, tank tops and similar garments of cotton, knitted or crocheted	262
620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts of cotton, not knitted or crocheted	261
271011	Light oils and preps. from petroleum oils and oils from bitum. minerals or preps 70%+ by wt. from petroleum oils or bitum. min.	224
100190	Wheat (other than durum wheat) and meslin	190
230400	Soybean oilcake and other solid residues	169
600621	Unbleached or bleached knitted or crocheted fabrics of cotton, nesoi	164
852520	Transmission apparatus incorp. reception apparatus for radiotelephonoy, radiotelegraphy, radiobroadcasting ,or television	156
847330	Parts and accessories for automatic data processing machines	156
480411	Kraftliner, uncoated, unbleached, in rolls or sheets	147
391690	Monofilament with a cross-sectional dimension over 1 mm, rods, sticks and profile shapes of plastics, nesoi,	144
610711	Men's or boys' underpants and briefs of cotton, knitted or crocheted	138

Source: Compiled from official statistics of the U.S. Department of Commerce.

Figure 1-1-Continued

Economic and Trade Profiles

Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Dominican Republic

Leading U.S. imports from the CA/DR region, by dutiable value, 2003, US$ million

HTS No.	Description	
611020	Sweaters, pullovers, sweatshirts, vests and similar articles of cotton, knitted or crocheted	764
620342	Men's or boys' trousers, bib and brace overalls, breeches and shorts of cotton, knitted or crocheted	231
620462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton, not knitted or crocheted	218
610610	Women's or girls' blouses and shirts of cotton, knitted or crocheted	154
610910	T-shirts, singlets, tank tops and similar garments of cotton, knitted or crocheted	147
610462	Women's or girls' trousers, bib and brace overalls, breeches and shorts of cotton, knitted or crocheted	121
610510	Men's/ boys' shirts of cotton, knitted or crocheted	117
854430	Insulated ignition wiring sets and other wiring sets for vehicles, aircraft and ships.	92
620711	Men's or boys' underpants and briefs of cotton, not knitted or crocheted	74
620463	Women's or girls' trousers, bib and brace overalls, breeches and shorts of synthetic fibers, not knitted or crocheted	72
611120	Babies' garments and clothing accessories of cotton, knitted or crocheted	60
620520	Men's or boys' shirts of cotton, not knitted or crocheted	53
611030	Sweaters, pullovers, sweatshirts, vests and similar articles of manmade fibers, knitted or crocheted	50

Source: Compiled from official statistics of the U.S. Department of Commerce.

CHAPTER 2
Overview of the FTA

Background on Free Trade Agreements

Like other FTAs to which the United States is a party,[1] the proposed agreement with Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic would create a preferential regime with a specific, negotiated range of goods and services measures of mutual benefit or interest to the parties, and with commitments covering other trade-related matters. Under this FTA, duties on categories of originating goods[2] would be phased out over periods of up to 20 years. It also would provide a set of commitments on matters that were not previously subject to the WTO regime or that are covered by agreements to which one or more of the other partners is not a party. The FTA would not cover every aspect of bilateral trade or give preferences for all goods under any tariff category, but would accord benefits to originating goods; its ROOs grant special tariff treatment to particular goods upon importer claim, and sensitive agricultural products are subject to TRQs. Among the FTA's objectives, the preamble states that the pact is meant to strengthen cooperation, help expand trade within a structure of rules, and simplify regional trade.

Brief Summary of Treaty Provisions

The proposed FTA[3] is largely modeled upon recent FTAs negotiated and implemented by the United States. The FTA contains separate commitments of each party set forth in schedules and annexes on market access, rules of origin, services, and procurement, as well as general disciplines that apply to all partners. Some provisions of the FTA draw upon multilateral instruments of the WTO or other treaties, or state that the same

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[1] The United States has implemented FTAs with Israel, Canada and Mexico (the FTA with Canada was later incorporated into NAFTA), Jordan, Singapore, and Chile to date. If the other parties complete domestic preparations, the Congressionally approved FTAs with Australia and Morocco could be implemented on January 1, 2005.

[2] Goods are evaluated to identify the particular country to which they are attributable in the ordinary customs sense, to determine if normal trade relations (NTR) or column 2 duty rates should be imposed, in the U.S. case. Additional rules, more clearly described as "rules of preference," determine if a good that would otherwise be dutiable at NTR duty rates can be accorded a special duty rate upon importer compliance with Customs requirements. In our FTAs, a good that meets all requirements is referred to as an originating good of the FTA partner in question, and the importer must claim the preference and establish eligibility to Customs' satisfaction.

[3] References in this section to chapters and articles are made to the cited provisions in the final agreement texts as posted on the USTR web site at *www.ustr.gov* as of Aug. 5, 2004.

obligations apply under the FTA. For example, the FTA contains preferential agricultural TRQs,[4] as does the WTO, and some provisions on intellectual property protections adopt by reference, or draw upon, commitments in other agreements. These obligations exist separately even if the corresponding WTO agreement provision were eliminated. Some FTA commitments deal with specific aspects of trade relations between or among the partner countries, and side letters provide for ongoing cooperation or cover other specific matters. The following discussion is a brief summary of the text of the FTA chapters; it is not intended to interpret them or to identify the negotiators' intent.

Summary of Tariff Commitments

The FTA's national schedules of concessions[5] would eliminate duties on a wide and varied range of the partner countries' originating goods immediately, while phasing out duties on other originating goods over differing time periods and providing permanent preferential TRQs on certain sensitive agricultural goods. Many originating goods of partner countries under the FTA's ROOs would be guaranteed existing duty-free access or receive immediate duty-free entry into the United States, corresponding to the duty-free status currently available under most tariff rate lines under the Caribbean Basin Economic Recovery Act (CBERA) or the Generalized System of Preferences (GSP). The textile and apparel sector is covered by separate rules; important apparel categories (mainly those goods of cotton or of man-made fibers that do not comply with the FTA's rules of origin) would receive reduced duty rates, up to stated tariff preference levels, with such rates identical to those under the Caribbean Basin Trade Partnership Act (CBTPA).[6]

Chapter-by-Chapter Review[7]

Chapters 1 and 2—Establishment and Definitions

The text states that the parties agree to set up an FTA that is consistent with the General Agreement on Tariffs and Trade (GATT) 1994, reaffirm that existing bilateral rights

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[4] In a TRQ, two tariff provisions are minimally required, with one according a lower duty rate to imports up to a specified trigger quantity, and a second one according higher duty rates to all other shipments. An importer may choose to enter a shipment under either line, until the trigger quantity is filled, and this choice might be made where unit values of the good in question vary by country, quality, time of entry, etc. After the Uruguay Round, as of Jan. 1, 1995, TRQs replaced prior absolute quotas imposed under section 22 of the Agricultural Adjustment Act (7 U.S.C. 624) or other measures. The over-TRQ duty rate is intended to be economically prohibitive, thus restricting imports to the in-quota or trigger quantity.

[5] The United States included a single schedule covering all goods plus a TRQ annex, while the other partners each have set forth their concessions on agricultural products in a separate schedule from those on all other goods and also have added a TRQ annex. Each country's schedule has general notes to provide interpretive guidance.

[6] Title II, Trade and Development Act of 2000 (Public Law 106-200, 114 Stat. 251, 275; 19 U.S.C. 2701 note). Additional quantities would be dutiable at NTR duty rates unless otherwise provided in the Harmonized Tariff Schedule of the United States (HTS).

[7] References to chapters and articles in this section are to the corresponding provisions of the final text of the FTA, as posted on the USTR web site as of Aug. 5, 2004.

and obligations continue to apply, and restate that nothing in the FTA is to be read as altering any legal obligation under another international pact. Among the general definitions in the FTA, the term "territory" is defined for each party to state where the FTA will apply; for the United States, the definition is unchanged from recent FTAs,[8] and a related definition outlines U.S. "regional level of government." For each of the other partners, the definition covers the "land, maritime, and air space under its sovereignty and the exclusive economic zone and the continental shelf within which it exercises sovereign rights and jurisdiction in accordance with international law and its domestic law" without any mention of free trade zones or other areas.

Chapter 3—National Treatment and Market Access

The commitments on national treatment[9] and market access are similar in form to the corresponding provisions of the GATT 1994[10] but apply only among the member countries. Under the chapter, the parties agree to eliminate their customs duties on originating goods under the attached schedules, to refrain from: increasing any duty rate, imposing a new rate, and imposing or expanding performance requirements to obtain an FTA benefit. Further, they can agree to accelerate the elimination of any duty. The 5 Central American countries are allowed to provide "more favorable tariff treatment to a good as provided for under the legal instruments of Central American integration"; the scope of this provision is not known, but such goods must meet the ROOs of the other instruments. Duty level ceilings are provided in the event that a concession must be withdrawn; a party could impose a duty authorized by the WTO Dispute Settlement Body or return to a higher FTA scheduled rate after a unilateral duty reduction. Export taxes would continue to be allowed concerning Costa Rican bananas, coffee, and meat.[11] The parties could not adopt or expand duty waivers related to performance requirements, although such waivers that are maintained in accordance with the WTO Agreement on Subsidies and Countervailing Measures[12] could continue through 2009.

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[8] U.S. territory would include the 50 states, Puerto Rico, the District of Columbia, U.S. ocean waters and subsoil thereto under its legal or economic control, and foreign trade zones. As in the case of our other FTAs, the U.S. insular possessions would not be included.

[9] The U.S. commitment does not apply to exports of logs; to existing provisions of the Merchant Marine Act of 1920 and other specified statutes; to the continuation, renewal or amendment of listed non-conforming provisions; to U.S. actions authorized by the WTO Dispute Settlement Body; and to U.S. actions authorized by the WTO Agreement on Textiles and Clothing. Other portions of annex 3.2 set forth exempt measures of the other parties.

[10] Costa Rica and El Salvador have included the provisions of the WTO Information Technology Agreement in their schedules of concessions but the other partner countries have not done so. None of the other partners is a party to the plurilateral WTO Agreement on Trade in Civil Aircraft.

[11] The U.S. Constitution prohibits the imposition of export taxes.

[12] Article 27.4 of that agreement required that developing countries phase out export subsidies over 8 years, but allowed them to extend certain approved subsidies for 2 additional years. See *Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statement of Administrative Action, and Required Supporting Statements*, Message from the President of the United States, House Doc. 103-316, vol. 1, 103d Congress, 2d Session (Sept. 27, 1994), p. 1561.

Other provisions in the chapter are similar to those of other FTAs and deal with temporary importations, speedy release of goods, and other customs procedures. Article XI of GATT 1994 would control whether a specific measure would be allowed under the FTA. Legitimate prohibitions or restrictions on trade with nonparties are to be allowed and are recognized under this article. Import licensing must comply with the WTO agreement on that subject, and the partners would be barred from restricting or banning imports from another party on the grounds of alleged violations of local law. Still other provisions would ban consular transactions[13] and the U.S. merchandise processing fee (the so-called "Customs user fee") and require other fees and charges that are not duties or their equivalent to be directly related to administrative services being rendered. All fees and charges on trade in goods are required to be published on the Internet. The parties would be required to recognize Bourbon Whiskey and Tennessee Whiskey as distinctive U.S. products; they could request that the FTA Committee on Trade in Goods offer amendments to the Agreement to recognize a good as a distinctive product.

Originating agricultural products are covered by scheduled duty staging categories, with a small number subject to TRQs having different staging for within- and over-TRQ shipments. Under section F of the chapter, compliance with relevant GATT 1994 provisions is required and key matters are regulated. Food aid and other non-commercial shipments of an agricultural good could not be counted against FTA TRQ trigger levels, which must be allocated in "commercially viable shipping quantities and, to the maximum extent possible, in the amounts that importers request." No new export subsidies could be given with respect to trade with any party, and consultations about any such subsidy in effect must be held if another party so requests. A key portion of this section covers FTA agricultural safeguards, the ceiling for which is limited to the lower of a party's prevailing applied most-favored-nation (MFN) duty rate[14] or the applied MFN duty rate on the day before the FTA's date of entry into force. Such safeguards could apply during a calendar year and only to originating goods that enter in quantities exceeding scheduled TRQ trigger levels. A party could apply only one safeguard at a time, either under this article, under chapter 8 of the FTA, or under the GATT 1994 and the WTO Safeguards Agreement. Safeguards cannot apply after the tariff elimination period for an originating agricultural good (when the good is free of duty). This section also would allow the United States to invoke a "sugar compensation mechanism" and pay another party's exporters rather than allow them to ship some or all of their available quantity of duty-free sugar. Under other provisions, consultations on poultry trade must be held in year 9 of the FTA's operation, and an Agriculture Review Commission must be established in year 14 to review the FTA's operation. A Committee on Agricultural Trade representing all parties and providing a forum for supervising agricultural trade would be set up within 90 days of the date of entry into force (DEIF) of the FTA.

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[13] The required paperwork and fees in dealing with both customs and consular officials can impose costs and cause delays in shipment.

[14] For the United States, the MFN rate is the HTS general or normal trade relations duty rate.

Section G deals with trade in textiles and apparel, regulating tariff elimination, providing for duty-free access for handmade or handloomed goods, and requiring the United States to end quantitative restrictions on imports from Costa Rica, Dominican Republic, El Salvador, and Guatemala only, as of the DEIF. Upon importer request, a party would refund "any excess customs duties" collected on most originating sector goods entered between January 1, 2004, and the DEIF, unless the party had filed at least 90 days before the DEIF a notice to other parties that it will not give such refunds on its sector imports; such a notice would bar refunds on that party's sector exports unless it provides an equivalent benefit to its sector imports. FTA textile safeguard measures would be allowed during the duty staging period only, where the FTA duty reductions or eliminations cause harm as defined and investigated under the article; the provision would allow a duty increase not to exceed the MFN applied rate at the time or the MFN applied rate on the day before the DEIF. Only one safeguard measure of any type could apply to any sector good at a given time. The text also preserves the parties' rights under relevant WTO agreements and sets compensation levels when such safeguards are imposed. Cooperation relating to trade in these goods would be required, and origin verification rules are provided. Rules for fabrics, yarns, and fibers that are not available in commercial quantities within the region could be adjusted so goods containing such materials could obtain FTA benefits. A de minimis non-originating content level, computed for the component that determines a good's tariff classification, would provide that a good would not be disqualified when certain fibers or yarns (whose weight cannot exceed 10 percent of the total weight of that component) in such component do not undergo the applicable tariff change set forth in the FTA. Other provisions cover the treatment of apparel sets and of nylon filament yarn (so that the latter is covered by language of the recent amendments to the Andean Trade Preference Act, cited in the FTA, that prevents such yarn from disqualifying otherwise complying goods). With respect to nonoriginating goods of chapters 61-63, the United States could apply its MFN duty only to the value of the assembled good minus the value of U.S. materials, where the good is sewn or otherwise assembled inone or more FTA parties from U.S. thread, from U.S. formed-and-cut fabric, or from components knit-to-shape in the United States—terms that are defined in footnotes to the text.

Section H establishes institutional provisions relating to trade in goods, including the creation of a Committee on Trade in Goods, and defines numerous terms used in chapter 3. Annexes to the chapter list excluded measures or goods for each country and set forth agreed FTA safeguard treatment. Other annexes list goods deemed to be in "short supply" and set forth tariff preference levels (TPLs)[15] for particular sector products.

For scheduled concessions on trade in goods, base duty rates are the January 10, 2003 rates (the effective date of numerous U.S. tariff changes), and rates are to be

[15] A TPL grants tariff preferences to negotiated quantities of nonoriginating goods of specified types. Shipments in excess of such quantity limits are dutiable at general rates.

rounded down to the nearest tenth of 1 percent or to the nearest tenth of a cent. Procedures for the timing of the entry into force of the FTA are provided. Under the U.S. general notes and TRQ provisions, during the transition or staging period, TRQ goods would be eligible for in-quota rates only if they are "qualifying goods"—meaning that the good satisfies FTA rules of origin but U.S. operations or contributions are considered as coming from a nonparty. During the tariff elimination period, the United States could apply its nonpreferential or NTR rules of origin to decide when a country-specific TRQ applies to a qualifying good. The United States would apply separate TRQs to beef, sugar, peanuts, peanut butter, various dairy products, cotton, tobacco, and ethyl alcohol (ethanol), with allocations for the other partners. These TRQ trigger quantities would gradually increase over time; quantity limits for most categories eventually would disappear, but limits would continue indefinitely for other products. The 5 Central American parties have scheduled proposed TRQs applicable to originating goods of the United States, as modifications of the preexisting Central American Tariff System or Sistema Arancelario Centroamericano. These annexes generally cover specified meat, dairy, and grain products (white or yellow corn and brown or milled rice). The Dominican Republic has also included proposed TRQs on originating agricultural imports and would likewise make its TRQ in-quota provisions available only to qualifying goods, defined as those complying with FTA chapter 4 requirements except that any contribution by a Central American party is treated as nonoriginating, while U.S. contribution would presumably be treated as originating. Dominican Republic TRQs would apply to certain beef and beef trimmings, pork cuts and trimmings, bacon, chicken leg quarters, mechanically de-boned chicken meat, turkey meat, various dairy products, brown and milled rice, beans, glucose, and pig fat.

Eight duty staging categories, with cuts in equal stages in the specified years, would be utilized by all of the parties, each of which attached a proposed schedule of concessions: (A) immediate duty-free entry; (B) 5 stages; (C) 10 stages; (D) 15 stages; (E) delayed onset staging, with 9 stages starting in year 7; (F) delayed onset staging, with 10 stages starting in year 10; (G) continuation of existing duty-free treatment; and (H) continuation of a party's existing MFN duty. Four staging categories set forth in the general notes to the U.S. schedule would apply to the other parties: (I) from the 2005 base rate under the CBTPA,[16] reductions in specified stages over 10 years; (J) elimination in accord with the U.S. WTO Schedule XX commitments; (K) elimination of duty and bond on listed provisions of chapter 98 at the start of year 1; and (L) for HTS subheading 9802.00.60, imposition of same rate of duty as applies to the good itself under FTA staging. In addition, the other partners included in their draft schedules of concessions staging from among 13 additional duty staging categories: (M) a phased 10-year schedule with greater cuts in later years; (N) 12 stages; (O) delayed onset, phased staging starting in year 7 and continuing through year 15; (P) delayed onset,

[16] See HTS general note 17, subchapter XX to HTS chapter 98, and title II to the Trade and Development Act of 2000 (Public Law 106-200 of May 18, 2000; 114 Stat. 251), implemented by Presidential Proclamation No. 7351 of Oct. 2, 2000 (65 F.R. 59329).

with varying staging in years 11 through 18; (Q) varying 15-year staging; (R) delayed staging with reductions from years 7 through 15; (S) delayed onset, with staging in years 6 through 15; (T) delayed onset, with staging in years 5 through 15; (U) delayed onset, with staging in years 10 through 17; (V) base rates continue until year 11, then phased reductions through year 20; (W) 4 stages; (X) 4 stages beginning in year 2 after the DEIF; and (Y) 15-percent annual cuts from the DEIF through year 5, and then 5-percent annual cuts until duty-free status is reached as of year 10. A duty-related side letter reflects the Dominican Republic's concern that articles co-produced in the Dominican Republic and Haiti for export to the United States would no longer be eligible for CBTPA benefits, under current U.S. law, when the Dominican Republic enters into the FTA, and contains a U.S. expression of intent to work toward amendment of that act to allow continued benefits for goods co-produced in CBTPA and FTA countries.

Chapter 4—Rules of Origin

The FTA's tariff benefits would apply to "originating goods" unless otherwise provided. Such goods fall into two categories—namely, those comprising inputs *only* from the parties, and those complying with rules of origin based largely on stated changes in tariff classification from foreign inputs to finished goods or containing allowable de minimis foreign content. Eligibility for some goods containing third-party inputs are covered by value content or other specified requirements. Goods containing de minimis foreign content that does not undergo the requisite tariff shifts (limited in the aggregate for all such materials to 10 percent of the adjusted value[17] of the good, with the component-based formula applicable to textile and apparel products) could also qualify as originating, though their value would still be counted as "nonoriginating" when a regional value content test applies. A limited number of products—all in the agricultural sector and primarily sensitive commodities covered by U.S. TRQs—could not use the de minimis rule to become originating goods. In general, the principles used parallel the rules in NAFTA and in FTAs with Singapore and Chile.

The legal discipline provided in the chapter is similar to that in recent FTAs. An originating material of one party that is used in another party to make a good would be considered to originate in the latter party; a good involving production in multiple parties or by multiple firms within the region would be considered to originate, if it meets the specific tests of this chapter. Rules and formulas for computing regional value content are provided, with two types of computations—the build-down method and the build-up method—designed to take into account all nonoriginating content. As is true under existing U.S. FTAs and preference programs, direct shipment is required, and a good that undergoes subsequent production or other operations outside the parties (not counting minor preservation or loading operations) will not be considered originating. Rules for goods classified as sets pursuant to Harmonized System (HS) general interpretive rule 3 are provided and are quite technical in nature.

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[17] The FTA's regional value content provisions provide that certain adjustments be made by the importer, so that the figure ultimately used differs from ordinary declared customs value.

Other provisions of the chapter deal with consultations among the parties and the verification and documentation of origin needed under the FTA. Benefits are to be given unless the parties learn the particular goods do not qualify and make a "factual or legal determination that the claim is invalid," and importers who make errors are not to be punished if they act in good faith or correct the entry documents and pay necessary duties in one year or a longer period set by a party. Written or electronic certifications of origin could be required and are valid for 4 years from the date of issuance; records must be kept for 5 years after entry to establish the origin of goods. The parties are to publish agreed "common guidelines for the interpretation, application, and administration" of the rules, preferably before the DEIF.

Modifications of FTA rules are provided to ensure their uniform, effective, and consistent application and to keep them current. This consensus-based procedure also is undertaken under NAFTA and results in occasional changes in rules of origin or other tariff provisions (sometimes as a result of HS classification or nomenclature changes). Any party could take issues relating to the interpretation or application of rules or of the chapter to the Free Trade Commission, as provided in chapter 19. Last, article 4.22 provides definitions relating to the chapter.

Annex 4.1 contains the proposed product-specific rules at an HS heading or subheading level. The rule listed next to each heading or subheading applies to goods of such provision, so that goods classified therein can be evaluated; where alternative rules are listed for a heading or subheading, a good need only comply with one of them. The annex contains the "tariff shift" and subsidiary rules, which apply only to non-originating materials,[18] for the entire HS nomenclature structure.

These rules are complex, and it is difficult to obtain information on current input sourcing patterns and types of local processing for every good. Some "products of" a party in the ordinary customs sense, goods now receiving CBERA or GSP treatment, or goods shipped from one party to the other may not qualify for FTA benefits. However, it is not possible to take FTA rules of origin fully into account in this report, to state whether they are "tighter" than those of other FTAs, or provide a "bottom line" assessment of the percentage of goods now in trade that would qualify under these rules or the type and volume of trade that might comply with them in future as sourcing patterns change. In assessing the impact of the FTA, it was assumed that importers would claim FTA benefits for all current trade among the parties (based upon rules of origin that are now applied) and that all such goods would qualify.

Chapter 5—Customs Administration

This chapter on customs procedures and their implementation generally tracks other FTAs and existing U.S. law and regulations. Cooperation among customs authorities

[18] Thus, if the applicable rule excludes the tariff provisions applicable to the fabric used to make a garment, that fabric must have been made in the region for the garment to qualify. Reference must always be made to the tariff nomenclature when the product-specific rules are interpreted.

would be a cornerstone to administering the FTA. Other provisions deal with review and appeal, penalties, advance rulings, and similar subjects. The FTA countries would implement various provisions in this chapter from 1 to 3 years after the DEIF. The parties indicate that the Committee on Trade Capacity Building should focus its initial priorities on this chapter, so that future trade growth can be handled by each customs administration.

Chapter 6—Sanitary and Phytosanitary Measures

This chapter covers the protection of human, animal, and plant health conditions in the parties' territories, insofar as they directly or indirectly affect trade among them, and the enhancement of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures. It establishes a Committee on Sanitary and Phytosanitary Matters to coordinate administration of the chapter. The substantive commitments in this area were already made in the WTO pact, so that cooperation and continued attention are required herein.

Chapter 7—Technical Barriers to Trade

This chapter is directed toward encouraging the full implementation of the WTO agreement on the same subject and embodies the same principles and obligations. It rests on enhanced cooperation and consultations and a phasing out of certain current barriers in the area of conformity assessments. Recognition of each party's technical regulations and transparency in administration are two other key provisions of the chapter. A Committee on Technical Barriers to Trade also would be established to deal with the covered subject matter and to monitor the parties' adherence, along with an organized effort to exchange related information.

Chapter 8—Trade Remedies

This chapter would provide for FTA safeguards on originating goods, complementing the provisions in chapter 3 concerning FTA agricultural safeguards. During the transition period only, a party could impose an FTA safeguard measure on an originating good by suspending duty staging or increasing the duty rate (to a level not exceeding the lesser of the MFN level the party then applies or the party's MFN applied rate on the day before the DEIF) when, as a result of the reduction or elimination of a duty under the FTA, imports of such good are in such increased quantities as to be a substantial cause of serious injury or threat thereof to a domestic industry producing a like or directly competitive good. A party could exclude another party's originating goods from the scope of an FTA safeguard if that other party had given duty-free entry to the safeguard-imposing country's goods for the 3 years prior to the DEIF of the FTA. Notification of the other party and of the WTO is required, and parties must cooperate in investigating such situations. A safeguard could be imposed for up to 4 years, including any extension, and only one safeguard can ever be imposed on a particular originating good. The rate of duty to be applied at the end of a safeguard and the

re-calculation of duty staging also are regulated. The parties must progressively liberalize such measures and then, at the end point, return the rate of duty to the level that would have applied without the safeguard. Administration of the safeguard proceedings, notification and consultation, confidentiality and compensation are covered; an annex would impose on the other parties the procedures and requirements that the United States already employs under existing law (notice, public hearing, causation and injury, and so on). Each party would retain all rights and obligations of the WTO Agreement on Safeguards but would gain no additional ones under the FTA; if a WTO safeguard is in place, no FTA safeguard on the covered good could be imposed at the same time.

Section B of the chapter covers antidumping and countervailing duties. The United States would agree to continue to treat each other party as a "beneficiary country" under domestic law; the cited statutory provision exempted CBERA beneficiary countries from the cumulation provisions otherwise required in such investigations.

Chapter 9—Government Procurement

The chapter sets forth many of the principles and commitments that are contained in the WTO Agreement on Government Procurement[19] and provides the rules and procedures for covered contractual purchases by government entities. This chapter sets out definitions, requirements for publication of notice of intended procurement, time limits of no less than 40 days between publication and the submission of tenders, documentation, technical specifications, tendering procedures, information on awarded contracts, and a mechanism for the review of supplier challenges. The FTA would not cover non-contractual agreements or any form of public or governmental assistance not specifically covered under the schedules of this chapter. The annex to the chapter indicates that the commitments extend to central or federal government entities. It lists covered entities, specific conditions for coverage or exclusion from coverage for particular purchases, and transition mechanisms to assist the six partner countries as they implement the obligations. The annex also sets forth U.S. obligations and indicates that small and minority business set-asides and the procurement of transportation services incidental to a contract are not covered by the chapter.

Chapter 10—Investment

The chapter provides rules on measures of any party relating to investors from the other parties, including the types of investments to which it would apply. Each party would be required to give national and MFN treatment to investors of other parties and covered investments. Treatment of affected entities must be in accordance with customary international law, including fair and equitable treatment and full protection and security. Expropriation would be allowed only for a public purpose, and it must be non-discriminatory and occur upon payment of prompt, adequate compensation in

[19] None of the six other parties is currently a signatory or observer to the plurilateral Agreement on Government Procurement.

accordance with due process of law. Each party must permit all transfers relating to a covered investment to be made freely and without delay. The parties could not impose or enforce performance requirements of several types; nor could a party require that the senior management of an enterprise be of a particular nationality. However, a party may require that a majority of the board of directors be of a particular nationality. In the event of an investment dispute, the claimant and respondent are initially to try to resolve the dispute by consultation and negotiation, which may include the use of nonbinding third-party procedures. Investment disputes may be submitted to arbitration. The chapter also discusses the FTA's mechanism for investor-state dispute resolution..

Chapter 11—Cross-Border Trade in Services

This chapter deals with cross-border trade in services and investment within the FTA region. Significantly, the measures covered by the FTA include those by national and sub-national governments and also by nongovernment service suppliers of a party, but not measures dealing with financial services, air services in most cases, government procurement, subsidies, and grants. No obligation of employment is created by the FTA, and the provisions would not apply to "services supplied in the exercise of governmental authority" (noncommercial and noncompetitive services). National and MFN treatment on covered services would be guaranteed, with other provisions similar to those of the WTO General Agreement on Trade in Services (GATS) and the NAFTA; regulation of services must proceed under the FTA framework. Specific commitments are made concerning express delivery services, and an annex covers professional services and standards relating thereto.

Among the rules in this chapter are prohibitions on any limit on the number of service suppliers, value, operations or output, and on local presence, given the exceptions set forth in related annex schedules. The provisions on mutual recognition are permissive rather than mandatory but would apply without discrimination once implemented. Transfers and payments of funds resulting from cross-border supply of covered services must be able to move freely and quickly. A party could deny benefits of the FTA in specific instances, but regulations must be developed and applied in a transparent manner. Last, regular meetings must be held on the obligations of this chapter and matters of mutual interest. There are reservations and specific commitments in country schedules.

Chapter 12—Financial Services

Pursuant to this chapter, each party must accord national treatment and MFN treatment to investors of the other parties and will provide market access for financial institutions without limitations on the number of financial institutions, value of transactions, number of service operations or number of persons employed. A party must permit cross-border trade in financial services and allow other parties' financial institutions to provide new financial services that it would permit its own institutions to provide without additional legislative action. No party would be required to furnish or

allow access to information related to individual customers or confidential information the disclosure of which would impede law enforcement, be contrary to the public interest, or prejudice legitimate commercial concerns. A party could not require financial institutions of another party to hire individuals of a particular nationality or require more than a minority of the board of directors to be nationals or residents of the party. Provisions are made for nonconforming measures and exceptions. The parties agree that transparent regulations and policies are important and must publish in advance any regulations of general application and maintain or establish mechanisms to respond to inquiries from interested persons. Consultations and dispute resolution are discussed and cross-referenced to the article covering dispute settlement procedures. An annex related to the article on cross-border trade discusses banking and other financial services and insurance and insurance-related services. Annexes lay out the specific commitments undertaken by each party; a schedule of limitations and conditions, a list of nonconforming measures, and national reservations are attached.

Chapter 13—Telecommunications

Under this chapter, each party would be required to ensure that enterprises of the other parties have access to and use of any public telecommunications transport network and service offered in its territory or across its borders. Such enterprises must be permitted to provide services to individual or multiple end-users, connect leased or owned circuits with public communication networks, purchase or lease equipment, use public communication transport networks, and have access to network elements on an unbundled basis. Each party's telecommunications regulatory body would be directed to determine which network elements to make available in accordance with national law. Also, each party would need to ensure that major suppliers in its territory provide interconnection for suppliers of the other parties under nondiscriminatory terms, at any technically feasible point, in a timely fashion and of no less favorable quality than that provided by such major supplier for its own services and provide for number portability. These provisions cover submarine cable systems and landing stations where provided under national law and regulation. The member countries would be required to make licensing criteria, procedures, terms and conditions, and normal time frames publically available. Each is directed to ensure that its national telecommunications regulatory body is independent of service providers and that the regulatory body maintains appropriate procedures and authority to enforce domestic measures relating to the obligations set out in this chapter and provide for dispute resolution. There are annexes on Costa Rica's additional commitments on telecommunication services; rural telephone suppliers; and interconnection at cost-oriented rates for parties that do not have existing commitments under the GATS.

Chapter 14—Electronic Commerce

Under this text, a party could not apply customs duties or other duties, fees or charges on or in connection with the importation or exportation of digital products by electronic transmission. Internal taxes charged on domestic and imported products are allowed

if imposed in accordance with the FTA. The customs value of imported carrier media must be determined by the cost of the medium alone without regard to the value of the digital products stored on the carrier medium. A party likewise could not accord less favorable treatment to some digital products that it accords to other like digital products on the basis of the nationality of the author, performer, producer, developer, or distributor of the products or the grounds that the digital products were created, stored, transmitted, or published outside its territory. Transparency and cooperation are to be the guiding principles. To date, this subject has not been covered in explicit terms in WTO agreements.

Chapter 15—Intellectual Property Rights

Under this detailed chapter, the parties agree to ratify or accede to and to give effect to a list of international agreements.[20] As a key obligation, national treatment must be granted by each partner country to nationals of the others, and the FTA would apply to existing subject matter but does not apply to prior acts. All laws, regulations, procedures, and final judicial decisions concerning the protection or enforcement of intellectual property rights (IPR) must be in writing and be published or made publicly available. The separate discussion on IPR in this report discussed the notable provisions of this FTA and the differences between this FTA and the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement, including longer terms of copyright protection under the FTA,[21] specific coverage of electronic and digital media, and increased enforcement measures.[22] The stronger enforcement provisions of the FTA include civil and criminal liability for the knowing circumvention of effective technological measures to protect works, trafficking in devices intended to circumvent such measures, removing or altering rights management information, and trafficking in works from which such information has been removed. Encrypted program-carrying satellite signals would be protected by civil and criminal sanctions.

The FTA also grants authors the right to authorize or prohibit the communication to the public of their work, directly or indirectly by wire or wireless means. Judicial authorities

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[20] The listed pacts are the Patent Cooperation Treaty, as revised and amended (1970); the Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite (1974); the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (1980); the International Convention for the Protection of New Varieties of Plants (1991); the Trademark Law Treaty (1994); the World Intellectual Property Organization (WIPO) Copyright Treaty (1996); and the WIPO Performances and Phonograms Treaty (1996). Each party must also use its best efforts to ratify or accede to the Patent Law Treaty (2000); the Protocol relating to the Madrid Agreement Concerning the International Registration of Marks (1989) and the Hague Agreement Concerning the International Registration of Industrial Designs (1999).

[21] The term of protection of a work would be either the life of the author plus 70 years after the author's death or not less than 70 years from the end of the calendar year of the first authorized publication of the work, if the term is not based on the life of a natural person.

[22] An applicant to a customs authority would need to provide adequate evidence to show prima facie infringement and may be required to provide security. The competent authorities may initiate border measures ex officio and take action against goods passing in transit, and goods determined to be pirated or bearing counterfeit marks must be destroyed. The simple removal of a counterfeit trademark would not be sufficient to permit release of goods into commerce. The parties agree not to allow the export of goods bearing counterfeit marks or pirated goods.

could order an infringer to identify third parties involved in the production or distribution of infringing goods or services and impose appropriate penalties. Under the chapter, each party would be obliged to provide appropriate criminal procedures and penalties at least to cases of willful trademark counterfeiting or copyright or related rights piracy on a commercial scale. Parties must provide legal incentives for service providers to cooperate with rights holders and limitations on liability. Cooperation and consultations are provided for to carry out the FTA provisions. The Dominican Republic agrees, in an annex, to address the issue of television broadcasting piracy and report periodically on its progress.

Chapter 16—Labor

The parties reaffirm their obligations as members of the International Labor Organization, commit to ensure that their domestic laws are consistent with international standards, and agree to enforce these laws and try to improve those standards. The obligation of a party under the FTA relates to the effective enforcement of those standards, and it proscribes "a sustained or recurring course of action or inaction" affecting trade between the parties. Each country must ensure that "persons with a legally recognized interest" under local law have access to "tribunals" of all types for enforcement, with the proceedings handled on a "fair, equitable, and transparent" basis. The parties would be required to assist in the conduct of these proceedings and promote awareness of labor laws. A Labor Affairs Council would be set up to maintain contacts within the member governments and to ensure that the chapter is implemented. Attention is paid to obtaining improvements regarding labor, by means of a Labor Cooperation and Capacity Building Mechanism; its duties are laid out in an annex. Intergovernmental consultations on a regular basis on labor issues are provided for, with the Council handling matters not resolved by mutual agreement. Provision is made for setting up a roster of dispute settlement panelists.

Chapter 17—Environment

In this chapter, each party agrees to ensure that its environmental protection laws provide for high levels of protection and would strive to improve those laws, provide appropriate and effective remedies and sanctions for violations of such laws, and provide opportunities for public participation. The parties agree that trade and investment should not be encouraged by weakening or reducing environmental measures. To that end, the parties agree to pursue cooperative environmental activities and provide for environmental consultations; they also agree to encourage voluntary mechanisms and incentives as methods of attaining compliance. An Environmental Affairs Council of cabinet-level representatives or their designees would consider ways to promote environmental activities and measures, and the public would be able to become involved and to file submissions alleging ineffective enforcement (but U.S. persons alleging a lack of U.S. compliance must file under provisions of the North American Agreement on Environmental Cooperation). Environmental cooperation and collaborative consultations upon request by any party would be required. An annex to this chapter discusses environmental cooperation.

Chapter 18—Transparency

Transparency regarding the parties' actions under the FTA is the main commitment of this chapter, which provides structural rules to govern the application of the FTA. In general, these "public access and information" requirements are similar to those in other FTAs. Interested persons would have a right to know about actual or future measures in the member countries and to comment on them. In most other cases, nongovernmental entities given rights to obtain access or relief under the text would be those directly affected by actions, rulings, measures, or proceedings under the FTA. Such entities are to have access to administrative tribunals and to review and appeal therefrom. Such rights generally already exist under U.S. law.

Section B of the chapter is entitled "Anti-corruption" and begins by stating that the parties "affirm their resolve to eliminate bribery and corruption in international trade and investment" by legal and other means, including criminal prosecution. Specific commitments on public officials of each party also are set forth, along with provisions to protect informers and to work in other international fora to aid and support anti-corruption provisions. Moreover, the parties agree that, once laws to implement these obligations are in place, they will be enforced according to the principles in the FTA.

Chapter 19—Administration of the Agreement

The chapter sets up a Free Trade Commission of cabinet-level representatives of the member countries to supervise the implementation of the FTA and consider all types of matters raised under it; it is charged with seeking "to resolve disputes that may arise regarding the interpretation or application of this Agreement." USTR is designated as the head of the U.S. delegation to the committee, while each FTA country designates an appropriate official or designee to represent that country. The chapter includes provisions on the administration of dispute settlement proceedings that require designation by each member of an office to assist the Free Trade Commission and it sets up a Committee on Trade Capacity Building to help encourage trade and reform. The new Free Trade Commission could address or modify the schedules of tariff concessions, rules of origin, Common Guidelines on administration, and article 9.1 on government procurement. A free trade coordinator would be appointed by each country to assist the work of the Free Trade Commission. It is believed that the Dominican Republic would be included in these activities and commitments; no specific provision on that point has yet been issued.

Chapter 20—Dispute Settlement

Under this chapter, although the parties commit to consult and cooperate on FTA matters, one party could invoke dispute settlement if it believes another has an FTA-inconsistent measure or has failed to carry out an FTA obligation, or that a benefit it reasonably expected has not been given. Parties could refer issues to the Free Trade Commission for resolution or arbitration; matters could also be referred to the WTO or other fora available to both parties. Once a panel constituted under the chapter has

supplied its final report, the report would be made public and the parties would be obliged to agree on the resolution of the dispute in question in a manner "which normally shall conform with the determinations and recommendations, if any, of the panel." Absent agreement to resolve the issues, compensation could be negotiated. If non-implementation of the agreed outcome is evident, the complainant could advise the other party that it intends to suspend benefits of equivalent effect. Certain matters—such as labor laws and environmental laws—are treated separately. In such situations "an annual monetary assessment" set in U.S. dollars (not to exceed $15 million annually, adjusted for inflation, paid into a fund relating to the pertinent area at issue) could be imposed on the violating party. These assessments would be expended, as directed by the Free Trade Commission, for appropriate labor or environmental initiatives. The chapter also contains provisions directing compliance reviews and 5-year reviews under the FTA. Matters under the FTA could be referred to the Free Trade Commission from judicial or administrative proceedings of a party. Also, "no Party may provide for a right of action under its domestic law against any other Party on the ground that a measure of another Party is inconsistent with this Agreement." Thus, mechanisms available under the FTA at the governmental level would serve as the means of obtaining redress, instead of private actions at law. The chapter also states that parties will encourage the use of alternate dispute resolution for the settlement of international commercial disputes between private parties in the free trade area and authorizes the commission to establish an advisory panel on private commercial disputes. Actions relating to excepted matters could not be taken.

Chapter 21—Exceptions

General provisions on balance of payments, general exceptions, essential security, taxation, disclosure of information, and corruption are set forth in this chapter, along with specific commitments on expropriation and investment.

Chapter 22—Final Provisions

This chapter contains the mechanisms for acceding to the FTA and putting it into force and an article on the legal significance of annexes. Article 22.3 provides that the parties must consult on any changes made in provisions of the WTO Agreement incorporated in this text to determine if the same principle will apply herein. Reservations would be allowed only upon written consent of the other parties. If the parties agree, any country or group of countries may accede to the FTA. Under article 22.5, the FTA would enter into force on January 1, 2005, after the exchange of written notifications by the United States and at least one other signatory that all respective legal requirements have been fulfilled, unless otherwise agreed. English and Spanish texts are to be equally authentic. Any withdrawal would take effect 6 months after written notice.

CHAPTER 3
Sectoral Impact of Market Access Provisions of the FTA

This chapter provides a qualitative assessment of the potential impact of the market access provisions of the U.S.-CA/DR FTA with respect to bilateral merchandise and service trade. For manufactured goods and agricultural products (chapters 2-4 of the FTA), this includes analysis of the impact of tariff reductions and eliminations, quota liberalization, and rules of origin provisions, on selected sectors of the U.S. economy. Product sectors selected for analysis (selection criteria are described below) are textiles, apparel, and footwear; sugar and sugar-containing products; and grains. For services (chapters 11, 12, and 13 of the FTA), the analysis focuses on the impact of improved market access conditions and greater regulatory transparency for telecommunication, distribution, insurance, and banking/securities services.

Benefits from Trade Liberalization under the FTA

The FTA between the United States and the CA/DR partners will provide increased market access for U.S. manufacturers by immediately eliminating tariffs on more than 80 percent of U.S. manufactured goods exported to the region, with the remaining tariffs phased out over 10 years. U.S. farmers will benefit from increased export opportunities through new TRQs and the immediate elimination of tariffs on a wide range of agricultural products, with tariffs on TRQ products to be phased out over periods of up to 20 years and on other farm products over 15 years. The FTA also is likely to increase the competitiveness of U.S. exports to the CA/DR region relative to other foreign suppliers to the region. In 2003, 80 percent of U.S. imports from CA/DR entered the United States duty free under several U.S. provisions.[1] The FTA will consolidate these benefits and make them permanent.

With respect to trade in services, many of the benefits of the FTA are indirect. Such benefits include improved regulatory transparency of both the regulations themselves as well as of the rule-making process. Moreover, the United States will gain access to the entire CA/DR market for services, subject to very few exceptions. The FTA generally improves upon the commitments made by CA/DR under the WTO's General Agreement on Trade in Services, in many instances guaranteeing market access and national treatment in areas where the countries previously had no commitments. One far-reaching benefit of the FTA is that agreed trade disciplines are automatically extended to services that have yet to be created or brought to market.

[1] U.S. trade trends with the CA/DR region and current U.S. preferences for imports from CA/DR are shown in figure 1-1.

Sector Selection Criteria

Sectors were selected for analysis in this chapter on the basis of a number of criteria, including the importance of the sector in terms of bilateral trade; the likelihood of increased export opportunities for U.S. producers relative to other foreign suppliers; the extent and speed of trade liberalization under the FTA and its potential for increasing U.S. trade; the opinions of industry representatives; and the apparent sensitivity of certain U.S. industries to trade liberalization. The Commission's assessments in this chapter are based on industry knowledge and expertise of USITC industry analysts, industry sources, reports by U.S. industry and functional trade advisory committees on the FTA,[2] and written submissions received in response to the Commission's *Federal Register* notice of institution for this investigation.[3]

Impact on Selected Goods

Textiles, Apparel, and Footwear[4]

Overview

U.S. industry

The United States is the world's largest importer of textiles and apparel, accounting for 24 percent of world imports.[5] Imports supply about two-thirds of the U.S. market for apparel. Imports of apparel made up 80 percent of U.S. textile and apparel imports by value in 2003.[6] Retailers are increasingly sourcing apparel directly from developing countries, as are many U.S. apparel firms that have reduced or eliminated domestic production altogether so as to focus on product design and marketing. Competition in the U.S. market will intensify following removal of U.S. quotas in January 2005,[7] likely

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[2] The advisory committees and their role are described in more detail in chapter 5 of this report.

[3] A copy of the *Federal Register* notice is in appendix B.

[4] Includes textiles (except raw wool and cotton), apparel, and footwear classified in HTS chapters 50-65.

[5] From official statistics of the United Nations, compiled by the U.S. Department of Agriculture, Foreign Agricultural Service.

[6] Compiled from official statistics of the U.S. Department of Commerce (USDOC).

[7] Textile and apparel trade among WTO member countries is governed by the Agreement on Textiles and Clothing (ATC), which came into force with the WTO agreements in 1995. The ATC obligates the United States, the European Union, and Canada to phase out their import quotas on textiles and apparel from WTO countries over 10 years ending on January 1, 2005. The United States applies quotas, mostly established under the 1974 Multifiber Arrangement, on articles from 44 countries, either under the ATC (38 WTO countries) or under bilateral agreements with non-WTO countries (Belarus, Cambodia, Laos, Russia, Ukraine, and Vietnam). Two of the six FTA countries (Honduras and Nicaragua) are not subject to quotas.

increasing downward pressure on prices throughout the textile and apparel supply chain.[8] Faced with difficult market conditions and the prospect of increased import competition, the U.S. textile and apparel sector has undergone extensive restructuring, posting a 14-percent decline in shipments, to $128 billion, and a 36-percent decline in employment, to 752,800 workers, during 1999-2003.[9]

The United States accounted for 30 percent of world footwear imports in 2002. Imports supply almost all the U.S. footwear market (98 percent by quantity in 2002) and come mostly from China. U.S. footwear imports rose by 18 percent during 1999-2003 to 1.9 billion pairs (valued at $15 billion); those from China grew by 26 percent to 1.5 billion pairs ($10 billion), or 81 percent of the total.[10] The U.S. footwear industry continued to decline in size during 1999-2003, posting declines of about 50 percent in production, to an estimated 55 million pairs, and 43 percent in employment, to 19,900 workers.[11] In general, the domestic industry competes on the basis of factors such as product quality and differentiation (e.g., in shoes in special sizes), brand names, exclusive channels of distribution, and support services. Some U.S. producers also import footwear articles from low-cost countries.

Industry in Central America and the Dominican Republic

Apparel is the largest category of U.S. imports from the CA/DR region, accounting for 55 percent (or $9.2 billion) of total U.S. merchandise imports from the FTA countries in 2003. The six countries are small suppliers of textiles ($75 million) and finished footwear ($72 million) to the United States, owing to their small manufacturing base for such goods.[12]

U.S. imports of certain textiles, apparel, and footwear from the CA/DR region are eligible for preferential treatment under the United States-Caribbean Basin Trade Partnership Act (CBTPA), implemented in October 2000. In brief, CBTPA grants duty-free treatment to (1) apparel and luggage made of U.S. yarns and fabrics, (2) knit apparel made of materials formed in CBTPA countries from U.S. yarns, subject to

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[8] The producer price index ([PPI], not seasonally adjusted) for textile products and apparel (series WPU03) declined by 1 percent during 1999-2003, compared with an increase of 12 percent in the PPI for nondurable manufactured goods (series WPUDUR0222), based on data of the U.S. Bureau of Labor Statistics (BLS).

[9] Data on U.S. industry shipments (from the U.S. Census Bureau) and employment (BLS) are for textiles (North American Industry Classification System [NAICS] 313), textile products (314), and apparel (315).

[10] Import data which are compiled from official statistics of USDOC, are for "finished" footwear except zoris (e.g., shower clogs) and disposable footwear. Imports of zoris, disposable footwear, and footwear parts totaled an additional $377 million in 2003.

[11] Production data for 2003 were estimated by the Commission, based on U.S. Census Bureau data for 1999-2002. Employment data for 1999-2003 are BLS data (series CEU3231620001).

[12] Import data which are compiled from official statistics of USDOC, are for textiles (NAICS 313), textile products (314), apparel (315), and footwear (3162). The FTA countries also supplied $77 million in footwear parts, which are reported in "basket" NAICS provisions.

limitations,[13] and (3) apparel made of yarns or fabrics deemed to be in "short supply" either under the North American Free Trade Agreement (NAFTA) or as subsequently determined by the President.[14] The CBTPA grants NAFTA-equivalent treatment to footwear that is ineligible for duty-free treatment under the Caribbean Basin Economic Recovery Act (CBERA)—that is, imports of footwear from CA/DR meeting NAFTA rules of origin are eligible to enter the United States on the same NAFTA terms as goods from Mexico.[15]

The CA/DR region relies heavily on the United States both as a market for their apparel exports, where they benefit from trade preferences, few restrictive quotas, proximity, and as a source for yarn and fabrics used in apparel export production, because U.S. trade preferences generally require the use of U.S. materials. U.S. apparel firms conduct production-sharing trade in the CA/DR region in an effort to reduce their overall cost structure and improve their competitiveness in the U.S. market vis-à-vis low-cost Asian suppliers.[16] The proximity of the CA/DR region to suppliers and markets in the United States enables U.S. firms to maintain greater management control over production, adjust orders in response to changes in market demand, and obtain quicker turnaround than those firms sourcing from Asia.[17] The pattern of U.S. apparel production-sharing trade with CA/DR has changed as a result of the CBTPA, whereby U.S. firms no longer need to cut fabrics into garment parts in the United States to qualify for trade preferences on the finished garments assembled in the region, as was the case under heading 9802.00.80 of the Harmonized Tariff Schedule of the

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[13] For the 1-year period ending on September 30, 2004, CBTPA grants duty-free entry to outerwear T-shirts up to a cap of 10 million dozen and other knit apparel up to a cap of 850 million square meter equivalents (SMEs).

[14] CBTPA authorized duty-free treatment for apparel made in eligible countries from yarn or fabric that is not produced in the United States or a beneficiary country, as stated in Annex 401 of NAFTA, or if it has been determined that such fabric or yarn cannot be supplied by the domestic industry in commercial quantities in a timely manner and the President has proclaimed such treatment. Imports of apparel made in CBTPA countries from a yarn or fabric deemed to be in short supply are eligible to enter free of duty, regardless of the source of the yarn or fabric.

[15] NAFTA rules of origin for most footwear require that the uppers and parts thereof be made in a beneficiary country and assembled there into footwear, as well as a local value content of not less than 55 percent. An industry source noted that CBTPA has had "only limited benefit" for footwear because of the restrictive rules of origin and long duty phaseout under NAFTA. James C. Jacobsen, Vice Chairman, Kellwood Co., on behalf of the American Apparel & Footwear Association (AAFA), written submission to the Commission, April 27, 2004. The United States first permitted duty-free entry of finished footwear assembled in FTA countries in section 222 of the Caribbean Basin Economic Recovery Expansion Act, provided the footwear was assembled entirely from U.S. components.

[16] The textile and apparel sector in the five Central American countries employs roughly 400,000 workers and operates mostly in free trade zones to benefit from tax benefits and infrastructure support. The IBERC Group (division of Sandler, Travis & Rosenberg, P.A., Washington, DC), "Assessment of Long-Term Competitiveness of the Central American Textile and Apparel Industries and Need for Free Trade Agreement," December 2003, p. 1.

[17] Shipping times from the CA/DR region range from 2 to 7 days depending on the country and the U.S. port of entry, compared with 12 to 14 days from China, and as many as 55 days from Indonesia. USITC, *Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market* (Inv. No. 332-448), publication 3671, January 2004, vol. I, pp. 3-30, and vol. II, I-9.

United States (HTS).[18] As such, U.S. firms now ship mostly uncut fabrics to CA/DR for cutting and sewing.

U.S. apparel imports from the CA/DR region consist mostly of high-volume, low-unit-valued garments, such as basic knit shirts, pants, underwear, and nightwear. Such garments have relatively low labor content and predictable consumer demand. Their production involves large and standardized runs, simple sewing tasks, and few styling changes, which together help offset the higher cost of labor in the region vis-a-vis Asia.[19] In general, CA/DR producers have lower labor productivity than most major Asian exporting countries and, to qualify for CBTPA preferences, must use U.S. fabric, which costs more than Asian fabric.[20]

Potential Impact on U.S. Trade Flows

U.S. imports

The U.S.-CA/DR FTA is likely to result in a moderate increase in U.S. imports of textiles, apparel, and footwear from the CA/DR region, largely because, as discussed further in this section, the FTA provides for significant and permanent enhancements of the CBTPA as it relates to these goods.[21] However, the FTA is likely to result in a small increase in total U.S. imports of these goods because most of the expected increase in shipments from CA/DR producers is likely to displace imports from other countries, especially those that do not benefit from proximity or preferential access to the U.S. market.[22] The extent to which this trade shift occurs in apparel articles is likely to

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[18] Under HTS heading 9802.00.80 (before 1989, item 807.00 of the former Tariff Schedules of the United States), U.S. importers receive a partial duty exemption for goods assembled abroad in whole or in part of U.S. components. In brief, duty is assessed only on the value added abroad (mainly the cost of sewing the apparel). The fabric for making the garment parts can be of either U.S. or foreign origin as long as it is cut in the United States. The former "807A" program guaranteed access for apparel made in Caribbean Basin countries from U.S.-formed and -cut fabric.

[19] The average hourly labor cost (including social benefits) in apparel manufacturing for 2003 was $1.87 in the Dominican Republic, $1.65 in Guatemala, $1.29 in Honduras, and $0.90 in Nicaragua, compared with $0.60 and $0.90 in China and India, respectively, and less than $0.30 in Bangladesh and Vietnam. See Mary O' Rourke, "The World After Quotas," presentation at workshop sponsored by the U.S. Department of State, Bureau of Intelligence and Research, and U.S. Central Intelligence Agency, Office of Transnational Affairs, May 21, 2004.

[20] USITC, *Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market* (Inv. No. 332-448), publication 3671, January 2004, vol. II, app. I, p. I-9.

[21] Representatives of the U.S. apparel industry have noted that considerable paperwork requirements associated with the CBTPA have, in their view, been "very onerous and are a disincentive to use the program." They have estimated that the "paperwork burden adds as much as four percent to the cost of a transaction." They have noted, however, that the FTA "addresses these concerns and more, and it does so in a way that will continue to promote U.S. imports so U.S. supplier companies to our industry can enjoy many of the benefits of the program." Apparel industry representatives have stated that although "it's too early to tell," they expect paperwork and documentation requirements to be "substantially less" under the FTA.

[22] U.S. imports of articles from the Dominican Republic currently eligible for CBTPA benefits, including garments co-produced in neighboring Haiti, will no longer be eligible for these benefits when the FTA enters into force. A side letter to the FTA with the Dominican Republic states that the USTR "intends to work with the Congress to amend CBTPA to allow articles currently eligible for CBTPA benefits that are co-produced in the FTA countries and CBTPA countries to continue to be eligible for such benefits after the FTA enters into force."

depend on the ability of CA/DR producers to adjust to an increase in competition in the U.S. market from Asian suppliers following quota elimination in 2005. The FTA is likely to spur new trade and investment linkages and further development of the textile and apparel supply chain between the United States and the CA/DR region. The FTA is likely to enhance the competitiveness of U.S. firms sourcing apparel from CA/DR producers, but could displace some production and employment in the U.S. textile and apparel sector to the extent that the FTA encourages U.S. apparel firms to move additional operations into the CA/DR region, and apparel manufacturers in the CA/DR region to use third-country yarns and fabrics instead of U.S. materials. For footwear, because the U.S. market is supplied almost entirely by imports, most product substitution that could occur as a result of the FTA will likely take place between footwear articles made in the CA/DR region and those produced in Asia. In general, most U.S.-made shoes are not easily substitutable for imports because they are niche items that compete primarily on nonprice factors.

U.S. textile and apparel imports from the CA/DR region rose by 16 percent during 1999-2003 to 3.8 billion square meter equivalents (SMEs), valued at $9.2 billion, almost all of which consisted of apparel.[23] Notwithstanding CBTPA preferences, the share of U.S. apparel imports accounted for by CA/DR fell to 19.5 percent by quantity in 2003 from 22.1 percent in 1999, reflecting significant growth in U.S. apparel imports from Asian countries.[24] Moreover, CA/DR producers' share of U.S. apparel imports is smaller in terms of value (15 percent in 2003), reflecting a product mix made up largely of high-volume, low-unit-valued goods. Imports from the FTA countries are subject to a trade-weighted average ad valorem tariff of 5.2 percent for textiles and apparel and 0.2 percent for footwear, reflecting the fact that about three-fourths of the textiles and apparel and almost all the footwear from CA/DR entered duty free or at reduced duty rates in 2003.

The FTA provides for the immediate elimination of duties on textiles and apparel that meet the rules of origin specified in the FTA (originating goods), retroactive to January 1, 2004.[25] The FTA rules of origin for apparel generally apply only to the component that determines the tariff classification of the garment—that is, the component that provides the garment its "essential character."[26] The FTA rules of origin require that

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[23] Import data are for goods subject to the U.S. textile trade program, as published in the *Major Shippers Report of the USDOC*, the data are available at *http://otexa.ita.doc.gov*.

[24] According to one industry representative, CBTPA benefits "have fallen far short of expectations" because of incomplete rule making, restrictive rules of origin, difficult short supply procedures, and burdensome paperwork requirements. James C. Jacobsen, Vice Chairman, Kellwood Co., on behalf of AAFA, written submission to the Commission, April 4, 2004.

[25] Trade sources note that the 2004 retroactive starting date would help "keep orders anchored in this hemisphere this year, especially for the busy $back to school' and $holiday 2004' seasons," and that immediate duty elimination would "provide a substantial incentive for placing business in a particular country" because apparel is subject to high tariffs. James C. Jacobsen, Vice Chairman, Kellwood Co., on behalf of AAFA, written submission to the Commission, April 27, 2004, and the United States Association of Importers of Textiles and Apparel (USA-ITA), written submission to the Commission, May 4, 2004.

[26] By contrast, the CBTPA rules of origin generally require that all fabric components of a garment be made of U.S.-formed fabric from U.S.-formed yarns or, with limitations, of regionally formed fabric of U.S. yarn. An industry source noted that a "rule of origin that focuses on the essential character of the

the "essential character component" for imports of most textile and apparel articles from the FTA countries be made from inputs produced in the CA/DR region or the United States, generally from the yarn stage forward. Under this yarn forward rule of origin, only the fibers may be from third countries.[27] The yarn forward rule also applies to certain apparel components (i.e., narrow elastic fabrics, sewing thread, and visible linings). A fiber forward origin rule applies to a limited number of articles (mainly yarns and knit fabrics), which must be made in an FTA party from the fiber stage forward. The FTA contains a de minimis foreign content rule that permits up to 10 percent of the total weight of the "essential character component" to consist of nonoriginating fibers or yarns.[28]

The FTA also provides duty-free treatment for imports of apparel made in the CA/DR region from nonoriginating materials—that is, yarns and fabrics produced in countries other than the United States and CA/DR. These exceptions to the general yarn forward origin rule include tariff preference levels for Nicaragua and Costa Rica, a fabric forward rule of origin for wool apparel, a single transformation origin rule for certain articles such as brassieres and certain woven boxer shorts and certain woven pajamas, a cumulation provision that will permit the use of woven fabrics from Mexico and Canada, and an expanded list of yarns and fabrics deemed to be in short supply in the United States and the CA/DR region.

The tariff preference level (TPL) for Nicaragua, the smallest and least-developed apparel supplier among the FTA countries, extends duty-free treatment for 10 years to cotton and manmade-fiber apparel made in Nicaragua from nonoriginating fabrics, provided that the fabrics are cut and sewn into garments in Nicaragua with regional thread.[29] The TPL is equal to 100 million square meter equivalents (SMEs) of such apparel in each of the first 5 years of the FTA; it will be reduced in equal annual increments over the subsequent 5 years, reaching zero after 10 years. The TPL for Costa Rica grants reduced duties (50 percent of the normal trade relations duty rate) on tailored wool apparel made in Costa Rica from nonoriginating fabrics, up to a cap of 500,000 SMEs of such apparel in each of the first 2 years of the FTA (the TPL is subject to review after 18 months).

The fabric forward rule of origin applies to wool apparel made in the five Central American countries (wool apparel from the Dominican Republic is subject to the yarn

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[26]—*Continued*

garment and contains sufficient flexibilities to ensure that production is not lost because a particular component is not widely available in the United States or the region" will help CA/DR producers to remain commercially viable. James C. Jacobsen, Vice Chairman, Kellwood Co., on behalf of AAFA, written submission to the Commission, April 27, 2004.

[27] In general, the manufacturing progression for textiles is: (1) fibers are processed into yarns, (2) yarns are made into fabrics, (3) fabrics are cut into components, and (4) components are sewn into finished goods. Under a yarn forward origin rule, the manufacture of the yarn, fabric, and apparel must occur in the FTA parties.

[28] By contrast, CBTPA contains a 7 percent de minimis rule, which applies to the total weight of all fabric components in a garment.

[29] Imports in excess of the TPL level are to be subject to the higher normal trade relations (NTR) rates of duty.

forward rule). Under the fabric forward rule, only the yarns may be from third countries—that is, the wool fabrics must be made in an FTA party, regardless of the source of the yarns, and cut and sewn into garments in an eligible FTA country. The single transformation rule permits the use of nonoriginating fabrics in certain articles, provided that the fabrics are cut and sewn in the FTA countries. Articles covered by this rule are brassieres; certain boxers, pajamas, and women's and girls' dresses of woven fabrics; umbrellas; and textile luggage.[30]

The cumulation provision will, when fully implemented,[31] permit the use of woven fabrics from NAFTA partners Mexico and Canada, up to a cap of 100 million SMEs in the first calendar year of the FTA and as much as 200 million SMEs in succeeding years, based on the growth of CA/DR exports of qualifying apparel made of woven fabrics.[32] The short supply list in the FTA is an expanded version of that in the CBTPA and grants unlimited duty-free treatment to apparel made in the FTA countries from yarns and fabrics that are not available in the United States or the CA/DR region in commercial quantities in a timely manner, regardless of the source of the yarns and fabrics.[33]

Representatives of the U.S. textile industry have expressed concern regarding the various exceptions to the yarn-forward origin rule in the FTA and they have attempted to quantify how much impact each of them will have on the domestic textile industry. The National Council of Textile Organizations (NCTO) estimates that, as a result of the exceptions to the FTA rules of origin for apparel, the U.S. textile industry will, on an annual basis, lose 650-750 million square meters of "current" exports and another

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[30] Most fabrics used in the articles covered by the single transformation rule reportedly are not made in the United States (Nicole Bivens Collinson, Vice President of International Trade, Sandler, Travis & Rosenberg, interview by Commission staff, May 14, 2004). Trade sources note that the inclusion of brassieres under the single transformation rule could, in light of U.S. safeguards on such goods from China, encourage former Chinese bra production to move back to the Western Hemisphere. Industry Sector Advisory Committee on Textiles and Apparel (ISAC-15), *U.S.-Central America Free Trade Agreement: Report of the Industry Sector Advisory Committee on Textiles and Apparel*, March 19, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/isac15.pdf*, retrieved June 30, 2004.

[31] The cumulation provision will enter into force only after Canada and Mexico fulfill their promise to provide reciprocal cumulation benefits to U.S. and CA/DR exports of textiles and apparel—that is, Mexico and Canada provide duty-free treatment to imports of goods made in CA/DR from U.S. woven fabrics. The provision is intended to spur "integration of the North and Central American textile industries, and is a step to prepare for an increasingly competitive global market" following quota elimination in 2005. USTR, "Trade Facts: Free Trade With Central America," December 17, 2003, found at *http://www.ustr.gov/new/fta/Cafta/2003-12-17-factsheet.pdf*, retrieved June 30, 2004.

[32] The cap is subject to sub-limits of 45 million SMEs for cotton and manmade-fiber skirts and trousers, 20 million SMEs for certain blue denim trousers and skirts, and 1 million SMEs for certain wool apparel.

[33] Yarns and fabrics identified in the FTA as "not available in commercial quantities" are those specified in NAFTA annex 401 and those designated under the "commercial availability" provisions of the CBTPA as well as the African Growth and Opportunity Act and the Andean Trade Promotion and Drug Eradication Act. The FTA also provides for a streamlined process in which to add or remove yarns and fabrics from the FTA "short supply" list. In addition, the United States intends to conduct an "availability study" to determine whether certain shirting fabrics are in "short supply" and, if so, add any such fabrics to the list before the implementation of the FTA.

350-450 million square meters in "potential" exports. It estimates that the annual dollar losses from the FTA will be between $1 billion and $1.8 billion [34]

To promote the competitiveness and encourage the continued manufacturing of apparel in the CA/DR region, the FTA allows apparel companies in an FTA party to continue to avail themselves of duty drawback, a refund of duties paid on imports of nonoriginating materials used in the assembly of apparel and other fabricated goods that are subsequently exported. The retention of duty drawback offers CA/DR apparel producers considerable duty savings on third-country inputs used in the production of apparel for export to the United States.[35]

The FTA provides for the immediate elimination of duties on all qualifying footwear, except for rubber footwear still made domestically, duties on which will be phased out in equal annual increments over 10 years.[36] The FTA origin rule for most footwear is based on "substantial transformation," which permits the use of non-originating materials, particularly uppers, the most labor intensive of the footwear components.[37] Because the FTA does not limit the use of nonoriginating materials in footwear from the FTA countries, the production of footwear in the CA/DR region, particularly the Dominican Republic, the major source of U.S. footwear imports from the Caribbean Basin region, will likely involve the assembly of components made in third countries, especially China.[38]

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[34] NCTO provided the Commission estimates of lost U.S. export sales for each exception to the yarn-forward rule of origin, as follows: (1) fabric-forward rule of origin for wool apparel (Dominican Republic is not included)—15 million SMEs; (2) fabric-forward origin rule for narrow elastics—221 million SMEs; (3) fabric-forward origin rule for pocketing, waistbands, and interlinings—208 million SMEs; (4) third-country yarns and fabrics are permitted for brassieres—15 million SMEs; (5) single transformation rule for woven boxers, nightwear, dresses, umbrellas, and textile luggage—23 million SMEs; (6) a 3 percent increase in the de minimis rule—65 million SMEs; (7) cumulation rule—100-200 million SMEs; and (8) TPL for Nicaragua—50 million SMEs. Robert DuPree, Vice President, NCTO, written submission to the Commission, May 11, 2004.

[35] Duty drawback encourages continued cost-effective manufacturing of apparel in FTA countries that would otherwise be lost by incorporating dutiable, nonoriginating incidental materials such as zippers, fasteners, and buttons from third-country suppliers. J. Nicole Bivens, Collinson, V.P. International Trade, Sandler, Travis, telephone conversation with Commission staff, July 21, 2004. A U.S. industry source stated that elimination of duty drawback under NAFTA on January 1, 2001, "increased production costs in Mexico and led to a 25 percent drop in U.S. textile and yarn exports to that country" when firms in Mexico's maquilas were no longer eligible for a refund of duties paid on non-originating inputs that had been allowed under NAFTA. James C. Jacobsen, Vice Chairman, Kellwood Co., on behalf of the AAFA, written submission to the Commission, April 27, 2004, p. 8.

[36] The 10-year tariff phaseout applies mainly to rubber or plastic protective footwear and certain athletic and other footwear with rubber or plastic soles and fabric uppers, classified in 6401.1000, 6401.9100, 6401.9290, 6401.9930, 6401.9960, 6401.9990, 6402.3050, 6402.9190, 6402.9920, 6402.9980, 6402.9990, 6404.1190, and 6404.1920.

[37] In contrast, the NAFTA rule of origin requires imported footwear to have a regional value content of not less than 55 percent of the adjusted value of the product (which, in effect, restricts the use of imported uppers because of the high labor content associated with stitching).

[38] A trade source expects that the substantial transformation rule will spur footwear export production in the FTA countries, whereby the uppers will likely be stitched in Asia because so much of the labor cost in footwear is associated with stitching an upper, and assembled into finished footwear in the FTA countries. See Peter T. Mangione, President, Footwear Distributors and Retailers Association (FDRA), testimony at Commission hearing, April 27, 2004, transcript at p. 100.

U.S. exports

The FTA is likely to result in a small increase in U.S. exports of textiles, apparel, and footwear to the FTA countries and will likely have a negligible impact on U.S. production or employment. U.S. exports of textiles and apparel to the CA/DR market, which accounted for 25 percent (or $3.6 billion) of total U.S. exports to these countries in 2003, consisted almost entirely of yarns, fabrics, and garment parts for use in the production of apparel for export to the United States. As such, these apparel production inputs already are duty free. The use of nonoriginating inputs in certain qualifying goods under the FTA could, on the one hand, spur complementary production within the western hemisphere that might otherwise be lost to Asia, but, on the other hand, spur greater use of nonoriginating inputs, mainly from low-cost Asian suppliers.[39] The FTA is likely to have little effect on U.S. exports of finished apparel and footwear because of the low per capita income in the CA/DR region.[40]

Sugar and Sugar-Containing Products[41]

Overview

U.S. industry

The U.S. sugar industry comprises sugarcane growers, sugarcane millers, raw cane sugar refiners, sugarbeet growers, and sugarbeet refiners. The sugar-containing product (SCP) industry includes producers of a wide range of products.[42] Cane sugar production is a two-step process. Sugarcane is milled into raw cane sugar and generally is then transported to a separate refinery. U.S. sugarcane production is concentrated in the Gulf region (Louisiana, Florida, and Texas) and Hawaii.[43] Raw cane sugar refineries are generally located close to ocean ports, as they also refine a significant amount of imported raw cane sugar. In contrast, beet sugar production is a one-stage process that occurs in a single location. U.S. sugarbeet and refined beet sugar production is concentrated in Minnesota, North Dakota, Idaho, and Michigan.[44] Refined sugar from sugarcane and sugarbeets is identical. SCP

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[39] Representatives of the U.S. textile industry assert that FTA provisions permitting the use of non-originating inputs have the potential to benefit third-party countries and create opportunities for illegal transshipment. Representatives of U.S. apparel companies contend that these FTA provisions will help to keep production in the United States, rather than having it sourced entirely from outside the FTA region. ISAC 15, *U.S.-Central America Free Trade Agreement: Report on Textiles and Apparel*, pp. 5-7.

[40] Representatives of the U.S. textile industry contend that, although the FTA countries have substantial capability to produce finished goods for export, they have little ability to consume goods manufactured in the United States because of low per capita income. Ibid.

[41] This sector includes raw sugar, refined sugar, and sugar-containing products included in HTS chapters 17, 18, 19, and 21. This analysis focuses on raw and refined sugar.

[42] Comprehensive data on this sector are not readily available, as a large number of products with varying amounts of sugar are produced by the sector. The bulk of U.S. trade and the focus of U.S. sugar policy is on domestic producers of raw cane sugar and refined cane and beet sugar.

[43] USDA, National Agricultural Statistics Service (NASS), *Crop Production 2003 Summary*, available at *http://usda.mannlib.cornell.edu/reports/nassr/field/pcp-bban/cropan04.pdf*.

[44] Ibid.

producers are located throughout the country and use both domestic and imported sugar.[45]

The U.S. sugar industry comprises approximately 900 farms producing sugarcane, 5,000 farms producing sugarbeets, 9 beet sugar processors, and 23 cane sugar processors.[46] In 2001, there were 36 beet sugar manufacturing facilities, 41 sugarcane mills, and 17 can sugar refineries.[47] Direct employment in the sugarbeet growing and harvesting sector totaled about 23,000 full-time equivalents (ftes) in 2000, while indirect employment totaled about 35,000 ftes.[48] Direct employment in the sugarcane growing and harvesting sector totaled about 19,000 ftes and indirect employment about 28,000 ftes in 2000. Direct employment in the sugarcane milling sector totaled about 4,000 ftes and indirect employment about 6,000 ftes in 2000. Direct employment in the cane sugar refining sector totaled about 4,000 ftes and indirect employment about 6,000 ftes in 2000. Employment in the sugar and confectionery product manufacturing sector totaled about 85,000 in 2001, with about 15,000 of these employees in the sugar manufacturing sector.[49]

U.S. shipments of sugar and confectionery products totaled $25.5 billion in 2001 and have been relatively constant in recent years.[50] U.S. production of sugar totaled about 8.75 million short tons, raw value (strv), valued at $3.7 billion in 2003.[51] This quantity was roughly split evenly between cane and beet sugar. Total U.S. consumption of sugar reached about 10.0 million strv in 2003.[52]

The U.S. sugar industry ranked fifth among world producers of sugar in 2003, accounting for 5.1 percent of the world total.[53] The United States trailed Brazil, India, the EU15, and China that year.

U.S. imports of sugar and SCPs[54] from the CA/DR totaled 325,146 metric tons, valued at $141.3 million in 2003. Almost all of the total was accounted for by raw cane sugar.

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[45] The imported sugar used for exports is mostly imported cane sugar that has been refined in U.S. facilities under the U.S. refined sugar reexport program.

[46] USDA, *2002 Census of Agriculture*, available at http://www.nass.usda.gov/census/census02/volume1/us/st99_1_034.pdf; USDA, Economic Research Service (ERS), *Sugar and Sweeteners Outlook*, SSS-239, January 30, 2004, p. 5.

[47] USDOC, *Statistics of U.S. Businesses* 2001, available at *http://www.census.gov/epcd/susb/2001/us/US31.HTM*. Data are for all establishments for NAICS industry groups 311311 (sugarcane mills), 311312 (cane sugar refining), and 311313 (beet sugar manufacturing). Data are for the most recent year available.

[48] LMC International Ltd, The Importance of the Sugar and Corn Sweetener Industry to the U.S. Economy, August. 2001.

[49] USDOC, *Annual Survey of Manufactures, Statistics for Industry Groups and Industries: 2001*, available at *http://www.census.gov/prod/2003pubs/m01as-1.pdf*. Data are for all employees for NAICS industry groups 3113 (sugar and confectionery products) and 31131 (sugar manufacturing).

[50] bid.

[51] Based on raw value of cane and beet sugar production valued at the U.S. wholesale price of raw cane sugar. Data from the USDA, ERS, available at *http://www.ers.usda.gov/Briefing/Sugar/Data/data.htm*.

[52] USDA, ERS, available at *http://www.ers.usda.gov/Briefing/Sugar/Data/data.htm*.

[53] USDA, FAS, available at *http://www.fas.usda.gov/psd/psdselection.asp*.

[54] SCP imports include products such as syrups, confectionery, drink mixes, sweetened cocoa, bakers' mixes and doughs, and condiments.

The principal suppliers were the Dominican Republic (55 percent of the total value), El Salvador (16 percent), and Guatemala (14 percent). The region accounted for 23 percent of the total value of U.S. imports of sugar and SCPs, and supplied one-third of the value of imports of raw cane sugar in 2003. On a quantity basis, U.S. imports of raw cane sugar from the CA/DR region accounted for approximately 3 percent of U.S. sugar consumption in 2003.[55] The bulk of U.S. imports of sugar and SCPs from CA/DR, 82 percent of the quantity and 91 percent of the value in 2003, enters free of duty under preferential trade arrangements, including the CBERA and GSP.

U.S. sugar policy

The United States maintains a sugar policy consisting of domestic and import elements. The domestic element consists mainly of a price support loan program that maintains guaranteed floor prices for raw cane and refined beet sugar.[56] If the domestic prices of raw and refined sugar fall below the loan rate, U.S. sugar processors may choose to pledge their sugar as collateral and obtain loans from the USDA. In addition, the USDA imposes marketing allotments, which place restrictions on the amount of sugar domestic producers can sell into the open market.[57] These allotments, which the USDA imposes to avoid forfeitures, are in effect as long as U.S. sugar imports are less than 1.532 million short tons in a given marketing year.[58] If imports exceed this amount, marketing allotments may be suspended.[59] In addition, the USDA administers the loan program at no net cost to the Federal Government, to the "maximum extent practicable".[60] The USDA also may utilize a payment-in-kind program, whereby domestic sugar processors can bid for excess raw cane or refined beet sugar in USDA stocks in exchange for reduced production levels. The storage costs for excess production are borne by the industry.

The U.S. trade policy for sugar mainly is determined by U.S. market access commitments made under both NAFTA and the Uruguay Round Agreement on

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[55] Calculated based on data from the USDA and USDOC.

[56] The current nominal loan rate is fixed at 18.0 cents per pound for raw sugar and 22.9 cents per pound for refined sugar. However, the rates vary by location and may effectively be higher as a result of factors such as interest expense, transportation costs, and location discounts. For the 2003 crop, the USDA calculated the minimum price to discourage forfeiture to be between 18.9-20.9 cents per pound for raw cane sugar and between 22.9-25.4 cents per pound for refined beet sugar. USDA, ERS, *Sugar and Sweeteners Outlook*, SSS-239, January 30, 2004, p. 6.

[57] Production in excess of this amount must be held as stocks at the expense of the industry. Such stocks, which vary over time, are commonly referred to as "blocked stocks." Blocked stocks totaled 594,000 strv, as of July 2004, which is the difference between the overall allotment quantity of 8.25 million strv (adjusted in April 2004) and a forecast production of 8.844 million strv. Calculated from USDA data.

[58] Raw value basis, excluding imports under a sugar re-export program. Marketing year is from October through September.

[59] USDA suspends marketing allotments if the overall allotment quantity must be reduced to accommodate imports beyond the 1.523 million short ten trigger. The overall allotment quantity is the total amount of sugar that is permitted to be marketed by domestic producers. The suspension of marketing allotments is to allow domestic producers to compete with imports. However, the USDA is still obligated to purchase domestically-produced sugar at the loan rates in the event marketing allotments are suspended.

[60] This means, in effect, no forfeitures of sugar to the USDA.

Agriculture (URAA). To keep the U.S. domestic price sufficiently above the loan rates,[61] the United States administers a system of TRQs on U.S. imports of sugar and SCPs from Mexico under NAFTA and from WTO member countries in accordance with the URAA. The United States scheduled separate TRQs for raw sugar, refined sugar, SCPs, blended sugar syrups,[62] and cocoa powder containing sugar[63] under the URAA. Imports within the quota are dutiable at a low in-quota tariff rate,[64] while imports above the quota are dutiable at a higher (generally prohibitive) over-quota tariff rate. Also, over-quota imports are subject to additional special safeguard tariffs if certain price levels are triggered.[65] U.S. TRQs for sugar and SCPs are given in table 3-1.

The raw sugar TRQ is by far the largest of the sugar TRQs and is the only one allocated on a country-specific basis.[66] In total, 40 nations hold shares of the U.S. raw sugar TRQ. Under URAA commitments, the United States is required to allocate at least 1,117,195 metric tons, raw value (mtrv) annually. During Fiscal Year (FY) 2003, the TRQ allocations for raw sugar equaled the minimum requirement. The raw sugar TRQ for the CA/DR totaled 311,700 mtrv in FY2003, or about 28 percent of the total U.S. raw sugar TRQ. The Dominican Republic's TRQ totaled 185,335 mtrv that year, the largest of all countries.

The refined sugar TRQ totaled 37,000 mtrv in FY2003. Of this amount, 10,300 mtrv were allocated to Canada, 2,954 mtrv were allocated to Mexico, and 16,656 mtrv were reserved for specialty sugars. Allocations for countries other than Canada and Mexico were on a first-come, first-served (fcfs) basis.

The TRQ for SCPs containing over 10 percent by dry weight of refined sugar, but less than 65 percent, totaled 64,709 mt in FY 2003, of which Canada was allocated 59,250 mt. The remaining amount of the TRQ was allocated on a fcfs basis. The SCP TRQ for articles containing more than 65 percent by dry weight of refined sugar was zero, meaning that all imports are dutiable at the over-quota tariff rate. The TRQ for cocoa powder containing over 10 percent, by weight, of sugar was 2,313 mt and was allocated on a fcfs basis. The blended sugar syrup TRQ quantity was zero, thus subjecting all imports of such products to the over-quota duty rates.[67] In addition, TRQs

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[61] U.S. sugar policy, mainly implemented by a system of TRQs and the domestic price support loan program described above, contributed to a domestic wholesale price for raw sugar of 21.42 cents per pound and refined sugar of 26.21 cents per pound in 2003. By comparison, the world wholesale price for raw cane sugar averaged 7.51 cents per pound and for refined sugar 9.74 cents per pound that year. USDA, ERS, available at *http://www.ers.usda.gov/Briefing/Sugar/Data/data.htm*.

[62] These TRQs are all provided for in the additional U.S. notes 5, 7, 8, and 9 to chapter 17 of the HTS and pertinent subheadings.

[63] This TRQ is provided for in additional U.S. note 1 of chapter 18 of the HTS.

[64] Zero for the subject countries under preferential trade arrangements.

[65] NAFTA and certain other FTAs exempt the relevant countries from these special safeguard duties. See HTS subheadings 9904.17, 9904.18, 9904.19, and 9904.21.

[66] Aside from Canada and Mexico under the NAFTA.

[67] The TRQs for SCPs containing more than 65 percent of refined sugar and for blended syrups were set at zero in order to prevent the circumvention of the raw and refined sugar TRQs. Staff telephone conversation with an official of the USDA, July 20, 2004.

Table 3-1
Sugar and sugar-containing products: U.S. tariff rate quotas (TRQ), by category and by source, FY2003

Category	Source	2003 TRQ	Additional FTA TRQ: Initial (Immediate)	Additional FTA TRQ: Final (15 years)
		metric tons		
Raw cane sugar (HTS chapter 17 additional U.S. note 5)	Canada	-	-	-
	Mexico	7,258	-	-
	CA/DR	311,700	(1)	(1)
	Total	1,117,195	-	-
Refined sugar (HTS chapter 17 additional U.S. note 5)	Canada	10,300	-	-
	Mexico	2,954	-	-
	CA/DR	-	(1)	(1)
	Specialty sugars	16,656	-	-
	Total	37,000	(1)	(1)
Articles containing over 65 percent of sugars (HTS chapter 17 additional U.S. note 7)	Canada	-	-	-
	Mexico	-	-	-
	CA/DR	-	(1)	(1)
	Total	-	-	-
Articles containing over 10 percent of sugars (HTS chapter 17 additional U.S. note 8)	Canada	59,250	-	-
	Mexico	-	-	-
	CA/DR	-	(1)	(1)
	Total	64,709	-	-
Blended syrups (HTS chapter 17 additional U.S. note 9)	Canada	-	-	-
	Mexico	-	-	-
	CA/DR	-	(1)	(1)
	Total	-	-	-
Cocoa powder containing over 10 percent of sugars (HTS chapter 18 additional U.S. note 1)	Canada	-	-	-
	Mexico	-	-	-
	CA/DR	-	(1)	(1)
	Total	2,313	-	-
Mixes and doughs containing over 10 percent of sugars (HTS chapter 19 additional U.S. note 3)	Canada	-	-	-
	Mexico	-	-	-
	CA/DR	-	(1)	(1)
	Total	5,398	-	-
Mixed condiments and mixed seasonings containing over 10 percent of sugars (HTS chapter 21 additional U.S. note 4)	Canada	-	-	-
	Mexico	-	-	-
	CA/DR	-	(1)	(1)
	Total	689	-	-
Total, sugar and sugar-containing products	Canada	69,550	-	-
	Mexico	10,2122	-	-
	CA/DR	311,700	109,000[2]	153,140[2,3]
	Total	1,226,615	109,000[2]	153,140[2,3]

[1] See total.

[2] Includes an additional 2,000 mt granted annually to Costa Rica for organic sugar.

[3] Not including the annual 2,640 mt increase in perpetuity following the staging period.

Source: USITC, *Harmonized Tariff Schedules of the United States; 2003*; and USTR, "USTR Announces Allocation of the Raw Cane Sugar, Refined Sugar, and Sugar-Containing Products Tariff-Rate Quotas For 2002/2003," press release, Aug. 5, 2002.

are allocated for sugar-containing mixes and doughs (5,398 mt) and mixed condiments and seasonings (689 mt). These TRQs are allocated on a fcfs basis and exclude products from Mexico.

U.S. commitments under NAFTA also affect the quantity cushion between the URAA commitment and the trigger quantity.[68] During the initial 15-year NAFTA phase-in period, which ends in 2008, Mexico's duty-free sugar access is limited to its net production surplus (domestic production less domestic consumption), with a minimum of 7,258 mtrv of raw cane sugar. Beginning in 2000, Mexico's[69] duty-free access was to total 150,000 mtrv, increasing 10 percent annually for the remainder of the phase-in period.

Industry in Central America and the Dominican Republic

The CA/DR sugar industries comprise sugarcane growers and sugarcane millers/refiners, which produce both raw and refined sugar. The CA/DR region does not produce sugarbeets. Guatemala is, by far, the largest producer in the region, accounting for approximately 48 percent of the total quantity of regional sugar production in 2003.[70] Following Guatemala were the Dominican Republic (12 percent), El Salvador (12 percent), Costa Rica (10 percent), Nicaragua (9 percent), and Honduras (8 percent). Total sugar production in the region amounted to 3.9 million mtrv in 2003.[71] In 2003, there were 17 sugar mills employing 60,000 full-time workers in Guatemala and 8 sugar mills employing 35,000 workers in the Dominican Republic.[72] Collectively, regional sugar production ranked ninth in the world in 2003, accounting for about 3 percent of the quantity of global production.[73]

Exports of sugar and SCPs from CA/DR to the United States generally correspond to their TRQ levels, with each country usually filling its TRQ.[74] In 2003, such exports totaled about 325,000 mtrv. This represented roughly 14 percent of the region's total exports of sugar that year.[75] Principal CA/DR sugar export markets include Korea,

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[68] NAFTA commitments are independent of URAA commitments.

[69] A side-letter to the NAFTA text, which includes Mexico's consumption of high-fructose corn syrup (HFCS) in the calculation of the surplus, currently provides Mexico duty-free access for its net production surplus to a maximum of 250,000 mtrv. In addition, the over-quota tariff on U.S. imports of sugar and SCPs from Mexico declines to zero over the transition period.

[70] Calculated based on data from the USDA, Foreign Agricultural Service (FAS), psd online, available at *http://www.fas.usda.gov/psd/psdselection.asp*. Data are on a marketing year basis, which may vary slightly by country.

[71] Calculated based on data from the USDA, FAS, psd online, found at *http://www.fas.usda.gov/psd/psdselection.asp*. Data are on a marketing year basis, which may vary slightly by country.

[72] USDA, FAS, *Guatemala Sugar Annual 2003*, GAIN report #GT3010, April 9, 2003, p. 4; USDA, FAS, *Dominican Republic Sugar Annual 2004*, GAIN report #DR4006, April 7, 2004, pp. 3-4.

[73] USDA, FAS, available at *http://www.fas.usda.gov/psd/psdselection.asp*.

[74] The quantity of such exports may be larger than the country-specific TRQ for raw cane sugar owing to exports of products covered under first-come, first-served TRQs for refined sugar and SCPs. Also, data reported on a calendar-year basis generally do not correspond with the TRQs, which are on a fiscal-year basis.

[75] Calculated based on data from USDA, FAS, psd online, available at *http://www.fas.usda.gov/psd/psdselection.asp*. Data are on a marketing year basis, which may vary slightly by country.

Russia, and Canada. The competitiveness of the CA/DR sugar industries with respect to exporting to the U.S. market is determined largely by production and transportation costs. Production costs vary widely among the region's producers, but there is little variation in transportation costs.

The importance of the United States as a sugar market varies by country. Guatemala is a significant sugar exporter, but holds a relatively small U.S. TRQ. Thus, the U.S. market represented about 4 percent of Guatemala's total exports in 2003. The Dominican Republic, a minor exporter but the largest TRQ holder, sent virtually all of its exports to the U.S. market that year. Given the relatively small current TRQ amounts and the modest additional access afforded under the FTA, it is likely that the entire additional TRQ amounts will be filled annually by each country, regardless of the importance of the United States as an export market.

Imports of raw and refined sugar by CA/DR totaled about 21,000 mtrv in 2003.[76] The United States accounts for a negligible share of CA/DR imports.

Potential Impact on U.S. Trade Flows

U.S. imports

The likely impact of the FTA on U.S. sugar and SCP imports will depend on the effect of the increased quantity of sugar and SCPs resulting from the expanded TRQ on U.S. sugar prices and the impact on the cushion between the minimum TRQ commitment under the URAA and the import trigger level to suspend marketing allotments. Any increase in imports likely will be equivalent to the expanded TRQ, as prohibitive over-quota tariffs remain intact under the FTA. Following is a discussion of the FTA provisions and an analysis of the impact of the FTA on U.S. imports of sugar and SCPs.

FTA provisions

The specific FTA provisions related to sugar and SCPs are extensive. First, U.S. over-quota tariffs on imports of sugar and SCPs from CA/DR, which generally are prohibitive, remain in place under the FTA. For raw cane sugar, which represents more than 99 percent of the value of total U.S. imports of sugar and SCPs from CA/DR, the over-quota tariff applicable to the subject countries is 33.87 cents per kilogram.[77]

Next, the regional TRQ has been expanded to include sugar and SCPs not currently included in the country-specific-URAA raw cane sugar TRQ. The additional access includes the TRQs for raw cane sugar, refined sugar, SCPs containing over 65 percent

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[76] USDA, FAS, psd online, available at *http://www.fas.usda.gov/psd/psdselection.asp*. Data are on a marketing year basis, which may vary slightly by country.

[77] Comparing this with the average import unit value of 43.43 cents per kilogram in 2003 for in-quota imports from the region, the over-quota tariff rate was approximately 78 percent ad valorem. Additional price-based safeguards exist for imports of over-quota items. Such additional duties are set forth in HTS heading 9904.

by dry weight of sugars,[78] SCPs containing over 10 percent but 65 percent or less by dry weight of sugars, and blended syrups.[79] Also, the TRQ has increased for each FTA member, with the initial additional regional access totaling 109,000 mt.[80] After a 15-year linear staging period, the additional regional access will total 153,140 mt. Adding the existing regional TRQ of 311,700 mt, the initial access will total 420,700 mt and the access after year 15 will total 464,840 mt. After the 15-year phase-in period, the TRQ will rise by 2,640 mt annually, in perpetuity. The additional amount is within the cushion between the WTO TRQ minimum commitment of 1,117,195 mtrv and the approximately 1,390,000 mt import level that potentially would trigger the suspension of marketing allotments for U.S. producers.[81] This cushion, about 273,000 mt, would be reduced to 164,000 mt the initial year and to 119,860 mt after the 15-year phase-in. Given annual TRQ increases of 2,640 mt, the remaining cushion would be exceeded after about 45 years.

The additional TRQ access is conditional on an individual country's trade surplus position. The access is limited to the lesser of the specified TRQ amount or the quantity equal to the difference between exports and imports for HTS subheadings 1701.11, 1701.12, 1701.91, 1701.99, 1702.40, and 1702.60.[82] Not included in the determination of the country's trade surplus status are exports to the United States of products classified under HTS subheadings 1701.11, 1701.12, 1701.91, and 1701.99 (refined sugar) and imports from the United States of products classified under HTS subheadings 1702.40 and 1702.60 (high fructose corn syrup).

The FTA also includes an article for a sugar compensation mechanism that specifies compensation to a country's sugar exporters in lieu of providing duty-free treatment under the FTA. Compensation would be equivalent to the estimated economic rents that such exporters would have captured by exporting sugar to the U.S. market. The mechanism is not specified and may be negotiated between the United States and the affected party.

The FTA contains a provision for rules of origin. These rules of origin are similar to those in the NAFTA and other bilateral U.S. FTAs, such as with Chile. For sugar and SCPs, in general, the rules of origin require a change in HTS heading or chapter. A notable exception is the rule of origin for HTS subheading 1806.10 (sweetened cocoa powder), which requires a more restrictive origin regarding non-originating sugar of HTS chapter 17. The FTA also exempts parties from safeguard measures under HTS heading 9904.[83]

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[78] Currently, this TRQ is zero.

[79] Imports of sugar and SCPs from the FTA partners under the HTS subheadings for the raw and refined sugar TRQs are to be entered on a raw-value basis.

[80] This includes an annual 2,000 mt TRQ granted to Costa Rica for organic sugar under HTS subheadings 1701.11.10, 1701.12.10, 1701.91.10, 1701.99.10, and 1702.90.10.

[81] The additional TRQ access is extended to sugar products outside the raw cane sugar TRQ, which could mitigate any decrease in the cushion.

[82] These subheadings include raw sugar (1701.11, 1701.12), refined sugar (1701.91, 1701.99), certain glucose products (1702.40), and certain fructose products (1702.60).

[83] HTS heading 9904 provides for additional duties on imports of certain sugar and SCPs depending on import prices.

Impact of FTA

The U.S.-CA/DR FTA is likely to result in a small increase in U.S. imports of sugar and SCPs equal to the additional amount allowed under the TRQ. Although the FTA increases the quota, the prohibitive over-quota tariff rates remain in place. The FTA also restricts access to the lesser of the expanded TRQ or the net trade surplus. In addition, the FTA includes an additional sugar compensation mechanism whereby the United States may provide compensation to a party in lieu of providing duty-free treatment, thus potentially limiting the quantity of imports.[84]

The initial quota increase under the FTA amounts to about 1 percent of 2003 U.S. production and consumption of raw and refined sugar.[85] The import quantity increases under the FTA likely will not trigger the suspension of domestic marketing allotments under the current policy.[86] The cushion between the URAA minimum commitment and the trigger level currently stands at about 273,000 mtrv; the initial additional access under the FTA is 109,000 mtrv; and the final additional access[87] is 153,140 mtrv.

The price effect of increased sugar imports under the FTA is less clear. A recent study concluded that for every 100,000 mt of additional U.S. imports, the U.S. market price for either raw or refined sugar would drop by 3.17 percent.[88] According to this study,

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[84] The nature of the mechanism is not specified in the FTA.

[85] Raw sugar (centrifugal) basis.

[86] The American Sugar Alliance, representing U.S. growers, processors, and refiners of sugarbeets and sugarcane, asserts that it is likely that the increase in the CA/DR FTA sugar TRQ will trigger the suspension of marketing allotments, submission of the American Sugar Alliance, April 13, 2004, p. 4.

[87] Not including the relatively minor annual increases after the phase-in period.

[88] Michael E. Salassi, P. Lynn Kennedy, and Janis B. Breaux, *Impact of Potential Bilateral Free Trade Agreements on Projected Raw Sugar Prices and the Economic Viability of the Louisiana Sugar Industry*, Staff Report No. SP2003-07, Department of Agricultural Economics and Agribusiness, Louisiana State University Agricultural Center, Baton Rouge, LA, Oct. 2003, p. 12. The study used a model known as Modele Internationale Simplifie de Simulation (MISS). The MISS model is a multiproduct, multiregional, nonspatial, partial-equilibrium, comparative static world trade model. The study simulated potential increases in U.S. sugar imports through the expansion of sugar TRQs and the impact on world and U.S. raw and refined sugar prices. The base U.S. raw sugar price used is 22.92 cents per pound; the base refined sugar price is 26.97 cents per pound. The model assumes world raw sugar prices to be 78.5 percent of world refined sugar prices (1998-2000 average) and U.S. raw sugar prices to be 85.0 percent of U.S. wholesale refined sugar prices (1998-2000 average). Elasticities used in the model are as follows:

Type	Short Run				Long Run			
	United States	Mexico	Cuba	Rest of World	United States	Mexico	Cuba	Rest of World
				Supply				
Beet	0.34	-	-	0.10	0.86	-	-	0.43
Cane	0.14	0.18	0.13	0.23	0.40	0.67	0.68	0.62
				Demand				
Sugar	-0.14	-0.73	-1.40	-0.64	-0.50	-0.73	-1.40	0.64

an increase of 150,000 mt, roughly the final phase-in quota level, would depress U.S. market prices by 4.67 percent. A quantitative analysis performed by the Commission using a perfect substitutes, partial equilibrium model resulted in a decrease in the U.S. price of sugar of about 1 percent as a result of the increase in imports under the FTA.[89]

Lower prices resulting from increased imports under the FTA, particularly of raw and refined sugar, likely would have an adverse impact on production and employment for U.S. sugar producers.[90]

However, lower raw and refined sugar prices likely would benefit production and employment for U.S. producers of certain SCPs, particularly for products containing a relatively high proportion of sugar.[91]

U.S. exports

The U.S.-CA/DR FTA is likely to result in a negligible increase in U.S. exports of sugar and SCPs.[92] The United States generally is not competitive with the region's sugar producers,[93] given relative production and transportation costs, as well as relatively high CA/DR import tariffs and long tariff phase-out periods under the FTA. Thus, the export effects of the FTA likely will have a negligible impact on U.S. production and employment.

Current CA/DR tariffs on sugar and SCPs are relatively high and range widely among individual countries. Regional tariff rates for raw cane sugar generally range between 15 percent and 55 percent ad valorem while those for refined sugar range between 20 percent and 55 percent ad valorem. The FTA staging period for most sugar and SCP items is long, with duties typically eliminated after 10 or 15 years.

U.S. exports of sugar and SCPs to the CA/DR region are very small, totaling about $8.8 million in 2003.[94] This represented less than 2 percent of total U.S. exports and less than 0.5 percent of U.S. production of such products that year. Major export items

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[89] The model results indicated a price decline of about 0.8 percent resulting from the initial additional quantity and about 1.2 percent resulting from the final additional quantity (before the small annual increases in perpetuity) offered under the FTA. Sugar is considered on a raw basis. The model assumes domestic and imported sugar are perfect substitutes; the U.S. demand elasticity is -0.5; the U.S. and Mexican supply elasticities are each 1.0; the rest-of-world supply elasticity is 0 (owing to TRQs); additional supplies from CA/DR countries are those provided by the expanded TRQs under the FTA. Data on production and trade are for fiscal year 2003.

[90] See, for example, Jack Roney, Director of Economics and Policy Analysis, American Sugar Alliance, submission, April 27, 2004, p. 3.

[91] See, for example, Thomas Earley, Economics Consultant, Sweetener Users Association, submission, April 27, 2004, p. 4.

[92] U.S. exports of sugar manufacturing are estimated to be significantly larger in the model results shown in chapter 4 of this report (table 4-4) as a result of full implementation of the FTA. The larger increase reported in chapter 4 reflects an increase from a very small base amount.

[93] See, for example, Stephen L. Haley, "U.S. and World Sugar and HFCS Prodcution Costs, 1994/95 - 1998/99," USDA, ERS, [*Sugar and Sweetener Situation and Outlook Report*], September 2001.

[94] Data from USDOC, obtained on the USITC Dataweb.

included SCPs such as certain mixed condiments, mixes and doughs, and certain blended syrups.[95]

Grains (Corn, Rice, and Wheat)[96]

Overview

U.S. industry

The United States is the leading grain exporter in the world, accounting for two-thirds of world corn exports, one-third of world wheat exports, and one-eighth of world rice exports in 2003/2004.[97] The value of U.S. grain production (at the farm level) was about $30 billion in 2003, with an estimated 220,000 U.S. grain farmers growing wheat, corn, sorghum, barley, and rice.[98] The U.S. rice milling industry shipped nearly $2 billion in 2001, and employed about 4,000 persons domestically;[99] U.S. rice exports to the region in 2003 were composed of 80 percent rough (unmilled) rice and 20 percent milled rice.[100] The United States is a highly competitive grain exporter with $10.5 billion in grain exports to all countries in 2003 and supplied 94 percent of all grains imports into the six FTA partners in 2002.[101]

With regard to grain sales in the CA/DR region, Argentina and Brazil are the other leading competitors to U.S. corn exports, and Mexico and South Africa export small amounts of white corn to the CA/DR region as well. Canada and Argentina supply the remaining wheat exports that the United States does not, although Guatemala has imported mainly Canadian wheat in recent years.[102]

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[95] U.S. exports of raw and refined sugar to the region totaled about $157,000 in 2003.

[96] Includes HTS headings 1001 through 1006. The grain sector focuses principally on corn and rice, although wheat exports to the region are important as well. Corn is the primary grain destined for livestock feed in the world; however, in Central America, white corn is used solely in food, and yellow corn both in animal feed and direct food use. Corn, barley, and sorghum are called "coarse grains" or "feed grains." Rice is traded in both unmilled (rough) form and in the milled form. The region imports, but does not grow, wheat and consequently its trade is relatively unimpeded. Wheat is used mainly to make bread, although some is used in pasta as well.

[97] Marketing year 2003/04: USDA, FAS, *Grain: World Markets and Trade*, April 2004, pp. 10, 16, and 24.

[98] Commission estimates: See USITC, *Shifts in U.S. Merchandise Trade*, USITC publication 3611, July 2003, table C-1, sector AG030.

[99] U.S. Census Bureau, *Annual Survey of Manufactures*, 2001, January 2003, for NAICS group 3112.12, rice milling.

[100] Data compiled from official statistics of USDOC.

[101] U.S. export data from official statistics of USDOC. U.S. grain accounted for 94 percent of the 4.7 million metric tons of reported grain imports into the six countries in 2002, according to United Nations data for the Central American countries and U.S. Government data for the Dominican Republic. Data for the Dominican Republic are from USDA, FAS, *Dominican Republic Grain and Feed Corn Update 2002,* GAIN Report No. DR2025, September 10, 2002; *Dominican Republic Grain and Feed Wheat Update 2002*, GAIN Report No. DR2026, September 10, 2002, and *Dominican Republic Grain and Feed Rice Production Update and Imports, 2003*, GAIN Report No. DR3027, December 18, 2003.

[102] Frank Coolidge, USDA, FAS, *El Salvador Agricultural Situation Food Security 2002,* GAIN Report No. ES2005, July 8, 2002, p. 1.

The $600 million in U.S. grain exports to the CA/DR region accounted for about 5 percent of total U.S. grain exports ($10.5 billion) in 2003. U.S. grain exports were fairly evenly distributed among the six countries, with the Dominican Republic the leading market, and Nicaragua the smallest market. U.S. corn exports were the leading grain exported to the region, totaling $295 million, or about one-half of the total; wheat and rice followed with $200 million and $90 million, respectively, of regional exports in 2003. Virtually all U.S. corn exports to the CA/DR region consisted of yellow corn.[103]

Industry in Central America and the Dominican Republic

The CA/DR region grows corn and rice; none of the countries grows wheat. All the countries are substantial importers of rice, corn, and wheat,[104] which supply a substantial portion of the region's domestic consumption. The import to consumption ratio for grain ranged from 20 percent in Nicaragua to 58 percent in the Dominican Republic in 2002.[105]

Central American rice and corn producers generally have higher costs and lower productivity (crop yields) than do U.S. grain producers, and domestic production has not kept pace with population and demand growth. For example, Guatemalan corn yields in 2002 were only about one-eighth of U.S. corn yields, and per acre costs were about five times the U.S. average. [106] In Honduras, many corn growers are small subsistence farmers who are not commercially competitive, although a few large corn growers are competitive with U.S. producers.[107]

In recent years, the CA/DR region, except Costa Rica, has experienced weather disasters (drought and hurricanes) that have cut grain production that provided a high proportion of these nations' calories.[108] International food aid from the United States and elsewhere has been important, supplying about 5 percent of total grain imports into the region in 2001 (the latest year with data available).[109] Honduras and

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[103] Yellow corn is also called "yellow dent" corn. In 2003, 96 percent or $283 million of the $295 million in total U.S. corn exports to the region consisted of yellow dent corn; data compiled from USDOC official statistics.

[104] See USDA, FAS, *Costa Rica Grain and Feed Annual, 2002*, GAIN Report No. CS2001, Feb. 1, 2002; *Dominican Republic Grain and Feed Annual, 2000*, GAIN Report No. DR0011, Aug. 23, 2000; *Dominican Republic Grain and Feed Corn Update 2002,* GAIN Report No. DR2025, September 10, 2002; *Dominican Republic Grain and Feed Wheat Update 2002*, GAIN Report No. DR2026, September 10, 2002, *Honduras Agricultural Situation, 2003*, GAIN Report No. HO3004, July 18, 2003; and *Guatemala Grain and Feed,* GAIN Report No. GT8009, July 1, 1998.

[105] Shahla Shapouri and Stacey Rosen, ERS, USDA, *Food Security Assessment 2003*, Feb. 2003, tables 57 to 61 (Latin American and Caribbean). Consumption includes grain and root crops (mostly manioc (cassava) and tropical yams).

[106] USDA, FAS, *Guatemala Grain and Feed: Tariff Increase in Yellow Corn, 2002,* GAIN Report No. GT2026, Nov. 20, 2002, p. 1.

[107] USDA, FAS, *Honduras Agricultural Situation Domestic Agriculture Policies and USG Development Assistance, 2003,* GAIN Report No. HO3004, July 18, 2003, p. 1.

[108] Shapouri and Rosen, ERS, USDA, pp. 20-22.

[109] Ibid., p. 21.

Nicaragua are the most dependent upon food aid, with many of the recipients in these countries being landless peasants with few skills and job opportunities.[110]

All CA/DR countries have provided some form of price support and other types of government assistance to their domestic rice and corn growers, mostly in the form of border measures and import restraints (such as TRQs), but also government expenditures.[111] Government expenditures can take the form of subsidized bank loans, development assistance or agricultural research and extension. For example, in Costa Rica, most domestic support falls into the green box support category under the WTO,[112] and some amber box support consists of very small amounts of subsidized credit to farmer organizations.[113] In Honduras, government support has included interest rate subsidies, loan rescheduling, forgiveness of some agricultural debt, and new loan guarantees in 2003.[114] The Dominican Republic has price support for its corn growers and an extensive subsidy system for its rice growers that provided about $10 million to domestic rice millers in 2003.[115] Dominican rice prices are negotiated between the Secretariat of Agriculture and the main rice growers group and have been much higher than U.S. and world prices.[116] The Dominican Republic provided export subsidies to dispose of excessive government rice stocks in 2003.[117]

Potential Impact on U.S. Trade Flows

U.S. imports

The CA/DR region is a high-cost producer of grains and generally does not export grains. U.S. tariffs on grains generally are already quite low. Therefore, the FTA is likely to have no impact on U.S. imports of grains.

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[110] About 36 percent of Nicaraguan and 28 percent of Honduran food imports during 1991-2000 were food aid, as contrasted to 17 percent for the entire Latin America and Caribbean (LAC) region. Shapouri and Rosen, ERS, USDA, pp. 21-22.

[111] The FTA does not address agricultural government support programs either in the United States or in the CA/DR region which in any event are relatively minor in comparison to the effect of direct import barriers. Article 3.14, Chapter Three, National Treatment and Market Access, of agreement, covers agricultural export subsidies. *http://www.ustr.gov/new/fta/Cafta/final/03-ma.pdf*. With regard to agricultural export subsidies, the FTA parties agree not to use export subsidies to another party's market except to compete with third party export subsidies. More generally on domestic agricultural subsidies, see J.F. Hornbeck, Congressional Research Service, the Library of Congress, *The U.S.-Central American FTA (CFTA): Challenges for Sub-Regional Integration*, June 1, 2004, p. 19.

[112] Domestic agricultural government support is classified under the WTO as non-trade distorting measures, "green box," or trade-distorting measures, "amber box" which are limited to certain maximum levels, and must be specifically identified or notified to the WTO. However, for developing countries, many amber support measures may be exempt from required reductions or exempt under a de minimis level. See USITC, *Potential Impact on the U.S. Economy and Industries of the GATT Uruguay Round Agreements*, USITC publication 2790, June 1994, pp. II-10 to II-12.

[113] All of the Costa Rican assistance was notified to the WTO. USDA, FAS: *Costa Rica Trade Policy Monitoring Annual Report, 2004*, GAIN Report No. CS4003, March 15, 2004, p. 3.

[114] USDA, FAS, *Honduras Agricultural Situation Domestic Agricultural Policies,* July 18, 2003, p. 2.

[115] USDA, FAS, *Dominican Republic Grain and Feed Rice Production Update and Imports 2003*, GAIN Report No. DR3027, December 18, 2003, p. 2

[116] USDA, FAS, *Dominican Republic Grain and Feed Rice Production*, December 18, 2003, p. 2

[117] Ibid., pp. 2-3.

U.S. exports

The U.S.-CA/DR FTA is likely to provide little immediate additional market access for U.S. grains. Over a period of 15 to 20 years U.S. market access will gradually expand access through the growth of TRQs for rice and corn, after which, quotas on U.S. rice and corn will be eliminated, and U.S. exports are likely to rise substantially.

During its initial years, the FTA imposes restrictive TRQs on corn for four of the six countries (see separate discussion below on yellow corn and white corn). The quotas are restrictive because the initial (first year) quota amount is less than the volume of U.S. exports in 2003 and because over-quota tariffs generally have been prohibitively high, such as an applied 32-percent tariff on out-of quota rice imports, and a 35-percent tariff on out-of-quota corn imports into Guatemala in 2001.[118] In-quota tariffs are free of duty, but the over-quota tariffs will not decline from high base rates for 10 years.[119] With regard to rice, there are restrictive TRQs on rough rice and milled rice from the CA/DR region (as discussed separately below). Chapter 3 of the FTA (annex 3.15) also provides specific safeguard measures for rice and corn that could curtail additional U.S. market access in the event of a price trigger decline. This action would delay U.S. access to the partners' rice and corn markets beyond the staging period of 15 to 20 years and effectively extend the TRQs.

In the short term (in the second year of the FTA), total U.S. exports of grains to the CA/DR region are likely to increase because the allowed quota amounts increase above the level of 2003 U.S. exports. The estimated increase in U.S. exports totals approximately $1 million (equivalent to 0.2 percent of the $600 million of U.S. grain exports to the region in 2003), consisting of $0.3 million (2,300 mt) of white corn and $0.7 million (2,500 mt) of milled rice.[120]

By the end of the 15-20 year phase-out of the rice and corn TRQs, annual U.S. exports of grain to the region are likely to increase by at least 20 percent or $120 million (based on 2003 prices), composed of $75 million (680,000 mt) of yellow and white corn, $35 million (230,000 mt) of rough rice, and $10 million (40,000 mt) of milled rice.[121]

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[118] Guatemalan data reported to the WTO; WTO, *Trade Policy Review :Guatemala, 2002*, p. 36 and 60. The respective quotas for corn and rice were 94 to 98 percent filled in 2000.

[119] TRQs are described in the general notes for the tariff schedules for each partner country in the FTA, and the staging for the reduction of the over-quota tariffs differs among the countries. For example, in the Dominican Republic, the over-quota rate remains unchanged for the first 10 years, and then is reduced by 8.25 percent of the base rate annually during years 11-14, and then by 16.75 percent during years 15-17, becoming duty free in year 18.

[120] This estimate of the short term effects was derived by multiplying the 2003 unit values for U.S. exports to the region in 2003 ($129 per mt for white corn and $270 per mt for milled rice) by the estimated increases in the quotas in the second year of the FTA (2,300 mt for white corn and 2,500 mt for milled rice). Data were rounded.

[121] A partial-equilibrium analysis was used to estimate these long-run effects. A 14-percent AVE tariff decline is assumed to cause a corresponding 12-percent domestic price decline. The estimated export increase is based on the 12-percent price decline effect on demand and supply within the six countries, using a price elasticity of demand of -0.40, a supply elasticity of 0.40, and assuming perfect substitutability. No specific data were available for CA/DR. The price elasticity of demand for grain was

The impact of the long-run, $120 million increase in U.S. grain exports on the $30 billion of U.S. grain production in 2003 and on the $10 billion of U.S. exports of grains worldwide is small (1.2 percent of total exports). However, the potential increase in grains exports offers significant market opportunities for U.S. white and yellow corn growers and U.S. rice growers.

The Central American countries maintain a wide variety of import barriers against imports of corn and rice. Costa Rica has duties and licensing on imports of white corn, yellow corn, and rice; and Costa Rican importers of U.S. rice have reported difficulties gaining entry under sanitary and phytosanitary procedures in recent years.[122] In 2003, Costa Rica applied a 35 percent duty on rice imports, as well as a "sanitary and quality inspection fee" of $20 per mt.[123] In El Salvador, rice imports are subject to TRQs and a 40 percent in-quota duty.[124]

In 2003, the TRQ in Guatemala for yellow corn was 464,000 mt with an in-quota rate of 5 percent and an above-quota rate of 35 percent.[125] Guatemala has TRQs for rice, along with minimum import values that tend to inflate tariff rates.[126] The TRQ for rice in Guatemala in 2003 was 58,000 mt, with 55,000 mt reserved for rough rice and duty free; above-quota rice imports were dutiable at 26.3 percent.[127]

Honduras operates a price band mechanism for imports of yellow corn, sorghum, and corn meal, though only corn is imported in significant volume.[128] The Honduran price band can vary as high as 45 percent, but also has a seasonal surcharge to protect domestic farmers during the peak harvest season. The Honduran price band system is designed to support local white corn at a high price by reducing entry of yellow corn and having local corn millers purchase domestic corn.[129] Honduras also has a

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[121]-*Continued*

found to be -0.405 in Ecuador, -0.380 for Jamaica, and -0.333 in Belize. The supply elasticity for grain in Central America ranges between 0.22 (corn) and 0.58 (rice). Unit values for U.S. exports to the region in 2003 were $110 per mt for yellow corn, $129 per mt for white corn, $270 per mt for milled rice, and $150 per mt for rough rice. Demand elasticities drawn from ERS, USDA, *International Food Consumption Patterns*, using data for 1996, retrieved May 26, 2004, found at *http://www.ers.usda.gov/Data/InternationalFood-Demand/Index.asp?view=PEF*. Supply elasticities from Walter Garinder, et al., USDA, ERS, Elasticities in the Trade Liberalization Database, May 1989, table 34 (Central America and the Caribbean region).

[122] USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers*, found at *http://www.ustr.gov/reports/nte/2003/costa_rica.pdf*, retrieved July 19, 2004. See also USDA, FAS: *Costa Rica Trade Policy Monitoring Annual Report, 2004*, GAIN Report No. CS4003, March 15, 2004, p. 2. SPS provisions of the FTA are discussed in more detail in chapter 5 of this report.

[123] USDA, FAS: *Costa Rica Trade Policy Monitoring Annual Report, 2004*, GAIN Report No. CS4003, March 15, 2004, p. 2. In 2002, Costa Rica also applied a safeguard duty of 19 percent, bringing the total duty to 54 percent (along with a $19 per mt inspection fee); USDA, FAS: *Costa Rica Grain and Feed Rice Situation and Outlook, 2002*, GAIN Report No. CS2013, Nov. 15, 2002, p. 1.

[124] USTR, *2004 National Trade Estimate Report*, p. 102.

[125] USDA, FAS: *Guatemala Food and Agricultural Import Regulations,* p. 8.

[126] Ibid., p. 140.

[127] Ibid.

[128] USTR, *2004 National Trade Estimate Report*, p. 197. The basic system has been in effect since at least 2000; USDA, FAS: *Honduras Trade Policy Monitoring Report 2000,* GAIN Report No. HO0001, March 15, 2000, p. 2.

[129] USDA, FAS: *Honduras Agricultural Situation Domestic Agricultural Policies,* GAIN Report No. HO3004, July 18, 2003, p. 1.

45 percent duty on milled rice, and imports of rice and corn are not allowed during harvest times.[130] Nicaragua has high duties on corn and, in 2003, a 103.5 percent duty on rice.[131]

In the Dominican Republic, reference prices used in customs valuation of corn and rice effectively raise applied tariff rates.[132] The Dominican Republic requires import permits for most agricultural products, and the process for granting such permits can be arbitrary.[133] The announced (but unenforced) TRQ in 2003 for corn was 1.1 million mt with a 5 percent in-quota tariff and a 40 percent above quota tariff rate.[134]

U.S. exports of yellow corn

Costa Rica and the Dominican Republic have no restrictions on imports of yellow corn, except Costa Rica's 1-percent duty on corn that is to be eliminated immediately under the FTA. Therefore, there would likely be no expected change in U.S. yellow corn exports to these countries as a result of the FTA. For the remaining countries, the FTA will provide the following TRQ access for U.S. yellow corn exports:

Country	U.S. exports[1] 1999-2003 average	U.S. exports[1] 2003	First year TRQ
	1,000 metric tons		
El Salvador	350	400	350
Guatemala	463	485	500
Honduras	175	230	181
Nicaragua	64	64	65
Total	1,052	1,179	1,096

[1] Compiled from USDOC official statistics.

The first year TRQ quantity is about equal to the 5-year average of U.S. exports during 1999-2003, but about 10 percent below U.S. exports to these countries in 2003. The quota amount is to increase over a period of 15 years by 5 percent annually and is to be eliminated entirely in the final year.

U.S. exports of white corn

The Dominican Republic has no restrictions on imports of white corn and therefore there would likely be no change in U.S. white corn exports to this country as a result of the FTA. For four of the Central American countries, the FTA will provide the following TRQ access for U.S. white corn exports:

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[130] USDA, FAS: *Honduras Food and Agricultural Import Regulations and Standards Country Report 2002,* GAIN Report No. HO2005, September 16, 2002, p. 10.

[131] USTR, *2003 National Trade Estimate Report*, p. 284.

[132] USTR, *2003 National Trade Estimate Report*, p. 87.

[133] Ibid.

[134] USDA, FAS: *Dominican Republic Grain and Feed Corn Update*, GAIN Report No. DR2025, September 10, 2002, p. 1.

Country	U.S. exports[1] 1999-2003 average	U.S. exports[1] 2003	First year TRQ
	1,000 metric tons		
El Salvador	21	14	35
Guatemala	23	10	20
Honduras	11	16	23
Nicaragua	1	4	5
Total	56	44	83

[1] Compiled from USDOC official statistics.

The quotas are to increase by 2 percent annually into perpetuity. U.S. white corn exports thus could increase by about 2 percent annually, which, in the second year of the FTA, amounts to about 2,300 mt, valued at $0.3 million, based on prices in 2003. For U.S. exports to Costa Rica, there is to be a 15-year phase-out of the duty of 15 percent, with a safeguard provision for a duty snapback to 15 percent. U.S. white corn exports to Costa Rica averaged 17,000 mt annually during 1999-2003 (28,000 mt in 2003).

U.S. exports of rough rice

Under the FTA, the CA/DR governments are to provide increased market access for U.S. exports of rough rice through TRQs that will be gradually increased over 18 years (20 years for Costa Rica). The TRQ access for the first year is as follows:

Country	U.S. exports[1] 1999-2003 average	U.S. exports[1] 2003	First year TRQ
	1,000 metric tons		
Costa Rica	86	132	50
El Salvador	64	73	61
Guatemala	41	47	52
Honduras	106	116	90
Nicaragua	98	112	90
Dominican Republic	0	0	2
Total	397	481	345

[1] Compiled from USDOC official statistics.

In the first year of the FTA, the TRQ for all countries is 345,000 mt, which is less than U.S. exports of 481,000 mt in 2003. The quotas are to increase by 2, 3, or 4 percent annually for 18 years (20 years for Costa Rica and the Dominican Republic), and for Guatemala at 5 percent annually for 18 years. In the 19th or 21st year, quotas are to be eliminated for U.S. rough rice.

U.S. exports of milled rice

Under the FTA, the CA/DR governments are to provide increased market access for U.S. exports of milled rice through TRQs that will be gradually increased over 18 years (20 years for Costa Rica). The TRQ access for the first year is as follows for U.S. milled rice exports:

Country	U.S. exports[1] 1999-2003 average	U.S. exports[1] 2003	First year TRQ
	1,000 metric tons		
Costa Rica	2	2	5.00
El Salvador	10	15	5.25
Guatemala	5	4	8.00
Honduras	8	4	8.50
Nicaragua	10	12	13.00
Dominican Republic	27	8	8.50
Total	61	45	48.25

[1] Compiled from USDOC official statistics.

In the first year of the agreement, the TRQ for U.S. milled rice for all countries is 48,000 mt, about the level of U.S. exports in 2003, but less than the 5-year average of U.S. exports during 1999-2003. The quota amount is to increase by 5 percent annually for 18 years (20 years for Costa Rica; and 7 percent annually for El Salvador). In the 19th or 21st year, quotas are to be eliminated for U.S. rice. In the second year of the FTA, the quota for milled rice is to increase by 2,500 mt, valued at $0.7 million based on prices in 2003.

U.S. exports of wheat

Because the CA/DR region grows no wheat, it depends on imports for their domestic consumption. U.S. wheat exports to the CA/DR region face no tariffs, except for the 1-percent duty in Costa Rica, and thus are not likely to be affected by the FTA.[135]

Services

It is not possible to establish an overall quantitative measure of the effect that the U.S.-CA/DR FTA has on U.S. services trade with CA/DR. However, it appears likely that U.S.-based service firms will benefit from greater regulatory transparency and significantly improved market access conditions, though these benefits will be moderated by the relatively small size of the CA/DR economies. U.S. Industry groups note general satisfaction with the FTA's provisions on investment and electronic commerce, both of which have bearing on U.S. firms' operations. Yet, U.S. industry representatives have expressed concern regarding specific aspects of the investment agreement and the absence of rights to temporary entry.[136] The following provides an

[135] WTO tariff bindings of the Central American countries generally range from 35 percent to 60 percent, but can exceed 100 percent. USTR, "CAFTA: Agriculture-Specific Fact Sheet, found at *http://www.ustr.gov/new/fta/Cafta/2004-04-09-agriculture-specific.pdf*, retrieved July 30, 2004.

[136] Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13), *The U.S.-Central America Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters*, March 17, 2004, pp. 6-7; and *U.S.-Dominican Republic Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters*, April 22, 2004, pp. 6-8.

overview of the service sectors in the United States and in the CA/DR region, discusses the overall effects of the agreements, and summarizes the expected impact of the agreements on U.S. imports and exports of telecommunication, insurance, banking/securities, and distribution services.

Market Overview

The U.S. services sector accounted for 76 percent of U.S. private-sector GDP and 83 percent of private-sector employment in 2002.[137] Globally, the United States is the largest services exporter and maintains the largest cross-border services surplus, measuring $74.3 billion in 2002.[138] Travel and tourism accounts for the largest share of U.S. cross-border service exports (23.8 percent), followed by royalty- and license fee-generating services such as software licensing and distribution (15.8 percent), maritime and air freight transportation (10.4 percent), and professional services (10.3 percent).[139] Sales of services by foreign affiliates of U.S. parent firms, the value of which have surpassed that of U.S. cross-border services exports since 1996, totaled $432.2 billion in 2001. Such sales follow U.S. direct investment in foreign markets, and in part reflect the degree to which foreign markets are open to U.S. service firms.[140]

As in the United States, the service sector accounts for the majority of economic activity in the CA/DR region, ranging from a low of 55 percent of GDP in the Dominican Republic and Honduras to a high of 63 percent of GDP in Costa Rica. In most of these countries, the service sector grew faster than overall GDP during 1992-2002.[141] Among the FTA countries, the Dominican Republic is the leading service exporter, though its total service exports represent just over 1 percent of U.S. service exports (table 3-2). Central American service exports predominantly comprise exports of tourism and transport services, with communication services and business services following at a distance. Freight transportation services, tourism, and business services are leading service imports (table 3-3).

Overall Effects of the FTA on Services

As noted, U.S. firms and their affiliates in the CA/DR region are likely to benefit from improved regulatory transparency and market access as a result of the FTA. Regulatory transparency is an important precursor to robust services trade and

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[137] USITC, *Recent Trends in U.S. Services Trade, 2004 annual Report*, May 2004, pp. 1-3.

[138] USDOC, Bureau of Economic Analysis (BEA), *Survey of Current Business*, May 2003, pp. 14 and D-36.

[139] USITC, *Recent Trends in U.S. Services Trade, 2004 Annual Report*, May 2004, pp. 2-6.

[140] Ibid.

[141] World Bank, "Regions and Countries: Latin America and the Caribbean," found at *http://wbln0018.worldbank.org,* retrieved May 11, 2004.

Table 3-2
Central American countries, the Dominican Republic and the United States: Cross-border service exports, 2001

Service industry	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic	United States
Total services	2,051.0	1,075.8	1,031.0	480.8	331.8	2,998.8	276,370
Passenger transport	134.6	243.7	25.6	3.5	3.1	(1)	18,100
Freight transport	15.3	19.3	21.4	16.6	9.5	4.7	11,940
Other transport	62.3	18.8	52.8	30.4	13.1	62.4	16,380
Travel and tourism	1,358.6	201.1	561.5	256.3	135.3	2,689.8	90,090
Other:							
Communications	85.5	108.8	25.6	82.7	24.3	98.7	5,050
Construction	(1)	15.6	2.8	(1)	(1)	(1)	2,610
Insurance	15.5	406.2	30.3	26.3	2.4	(1)	(1)
Financial	4.8	2.0	8.7	(1)	(1)	(1)	15,210
Computer and information	124.6	0.2	4.7	(1)	(1)	(1)	5,140
Royalties and licences fees	0.8	1.2	(1)	(1)	(1)	(1)	38,660
Other business services	222.7	34.8	200.4	10.0	108.5	56.4	49,670
Personal, cultural, and recreational	(1)	0.4	0.3	(1)	(1)	(1)	6,620
Government services, not included elsewhere	26.3	23.5	96.9	55.0	35.6	86.8	16,900

[1] Not available.

Source: IMF, *Balance of Payments Statistics Yearbook, 2002 Part 1: Country Tables*, January 2003, pp. 211, 261, 278, 365, 390, 645, and 940.

investment because many services are heavily regulated owing to their influence on public health, consumer welfare, and safety. The FTA chapter on transparency (chapter 18) promotes the transparency of both particular regulations and the rule-making process itself. The chapter requires designation of contact points for inquiries about regulation, prompt publication of adopted regulations, advance publication of regulations under consideration, and reasonable notice of proceedings held to adopt or modify regulations. In addition to the chapter on transparency, the chapters on cross-border services, financial services, and investment include provisions that further promote regulatory transparency.[142]

The FTA generally improves upon the commitments scheduled by the CA/DR governments under the GATS,[143] in many instances guaranteeing market access and national treatment in areas where the countries previously had no commitments. This is in part attributable to the "negative listing" methodology employed in all of the bilateral FTAs concluded by the United States. Under this methodology, all trade disciplines enumerated in the investment chapter (chapter 10) and the cross-border services chapter (chapter 11) of the FTA automatically apply to all service industries,

[142] ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004, p. 9; and *U.S.-Dominican Republic Free Trade Agreement: Report on Services*, April 22, 2004, pp. 8-9.

[143] The GATS was signed in 1994 at the end of the Uruguay Round of WTO negotiations. It is the first multilateral trade treaty to include rules for trade in services.

Table 3-3
Central American countries, the Dominican Republic and the United States: Cross-border service imports, 2001

Service industry	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic	United States
Total services	1,275.2	1,077.8	898.0	653.4	353.5	1,295.0	210, 340
Passenger transport	70.4	51.9	40.5	74.5	51.8	133.5	22,410
Freight transport . .	305.4	279.8	423.9	226.2	115.4	627.6	25,660
Other transport	48.1	55.1	1.4	10.1	([1])	2.6	13,160
Travel and tourism	470.7	195.3	195.7	127.6	76.0	286.6	62,670
Other:							
Communications . .	27.4	40.4	10.9	8.4	3.6	37.8	4,730
Construction	([1])	8.6	1.0	35.0	([1])	([1])	480
Insurance	64.8	173.4	77.5	25.9	12.2	93.9	4,890
Financial	2.0	40.1	13.0	([1])	([1])	13.1	4,010
Computer and information	14.2	9.6	1.8	([1])	([1])	([1])	660
Royalties and licences fees	49.2	22.1	([1])	10.5	([1])	22.0	16,360
Other business services	210.2	184.3	95.2	113.0	77.0	42.5	37,530
Personal, cultural, and recreational .	([1])	1.3	0.3	8.2	([1])	([1])	130
Government services, not elsewhere included	12.8	15.8	36.8	14.0	17.5	35.4	17,650

[1] Not available.

Source: IMF, *Balance of Payments Statistics Yearbook, 2002 Part 1: Country Tables*, January 2003, pp. 211, 261, 278, 365, 390, 645, and 940.

except for the specific exemptions contained in the FTA annexes on nonconforming measures. One far-reaching benefit of negative listing is that agreed trade disciplines are automatically extended to services that have yet to be created or brought to market. Such automatic coverage of new services is especially important to industries where market developments, technological advancement, and other innovation continuously result in new service offerings and means of delivery. This is particularly true in sectors such as communications, express delivery, financial, and computer-related services. This type of approach tends to yield greater market access and transparency than the "positive listing" methodology employed in the GATS, wherein countries must schedule commitments to specific industries in order to guarantee market access and national treatment. Under a positive listing approach, each extension of trade disciplines to new services would have to be negotiated individually. One example of the contrasting approaches is express delivery services. Under the GATS, countries typically schedule express delivery commitments as "courier" services. Because express delivery services have evolved to encompass a range of services beyond courier, such as freight transportation, storage and warehousing, and cargo handling, the FTA's negative listing ensures that all related services are covered.[144]

[144] Air Courier Conference of America, written submission to the Commission, May 4, 2004.

A comparison of obligations negotiated under the GATS and the U.S.-CA/DR FTA illustrates the benefits of negative versus positive listing. In the GATS, for instance, Guatemala scheduled no commitments on advertising services.[145] While this did not necessarily mean that Guatemala maintained impediments to trade in such services, its lack of commitments adversely affected regulatory transparency, and made it possible for Guatemala to impose limitations on market access and national treatment in the future without penalty. In the FTA, Guatemala again elected not to address advertising services, but by virtue of negative listing, the market access and nondiscrimination disciplines found in chapter 11 of the FTA applies in its entirety. Under the terms of the FTA, U.S. advertisers would enjoy unfettered market access, national treatment, and a transparent regulatory environment.

Negative listing does not always result in greater market access, but it always promotes transparency. For instance, Costa Rica did not address professional services in its GATS schedule,[146] leaving market access and national treatment limitations unbound.[147] In Costa Rica's first annex to the FTA, it provides additional information about the regulations that pertain to foreign provision of such services. Foreign professionals' right to join professional associations, and thereby participate in the Costa Rican market, is conditioned on reciprocity; foreign professionals' ability to join associations is contingent on obtaining the appropriate immigration status and demonstrating prior experience, varying between 2 and 5 years depending on the association; only Costa Ricans belonging to the Colegio de Ingenieros Agronomos can provide consulting services for agronomical sciences; and foreign professionals in the political science and international relations fields must join professional associations, and their market participation is subject to economic needs tests. Though these restrictions are in certain cases onerous, their delineation in the Central American FTA clearly promotes transparency.

In several cases, market access conditions improved because the FTA bound regulation was significantly less restrictive than commitments in the parties' GATS schedules.[148] For instance, in its GATS schedule, El Salvador's bindings on legal services only pertained to a small segment of the market, and foreign attorneys' market participation was contingent on Supreme Court authorization and possession of a Salvadoran law degree. Provision of notary services was reserved for Salvadoran nationals alone.[149] The FTA bound far more liberal policies. Notaries must still receive Supreme Court authorization and be Salvadoran nationals, but legal service obligations apply to a broader expanse of legal services, including foreign legal consultancies, Supreme Court authorization is not required, and U.S. attorneys need not possess law degrees from Salvadoran universities.

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[145] WTO, *General Agreement on Trade in Services (GATS), Guatemala: Schedule of Specific Commitments* (GATS/SC/36), April 1994.

[146] WTO, *General Agreement on Trade in Services (GATS), Costa Rica: Schedule of Specific Commitments* (GATS/SC/22), April 1994.

[147] "Unbound" signifies that Costa Rica reserves the right to impose market access or national treatment restrictions on foreign providers of such services.

[148] Because GATS schedules are not always transparent, it is unclear whether the bindings under the FTA reflect newly liberalized regulations, or simply bind existing regulatory practices.

[149] WTO, *General Agreement on Trade in Services (GATS), El Salvador: Schedule of Specific Commitments* (GATS/SC/29), April 1994.

Industry representatives report that, aside from greater transparency and improved market access conditions, the FTA generally provides for a favorable investment climate for U.S. service firms. Investment disciplines provide a "stable and predictable framework" for services providers that find cross-border investment essential to conducting business.[150] U.S. industry representatives also note general satisfaction with the agreements' treatment of electronic commerce, an important means of delivering services. The FTA incorporates the concept of "digital" products, prevents the collection of customs duties on these products, requires nondiscriminatory treatment of physical or electronic deliveries, and provides broad national and MFN treatment with respect to electronic deliveries. Further, U.S. firms enthusiastically support the FTA in that it institutes reform of dealer protection regimes, discussed in greater detail below.[151]

Although the U.S. services community has expressed general satisfaction with the FTA, it has noted disappointment with the absence of commitments to facilitate the movement of personnel across borders. U.S. firms indicate that, without the ability to move key personnel rapidly, they are not able to fulfill obligations to global customers. They describe current procedures for obtaining work permits and visas for short-term assignments and intracorporate transferees as "complex, cumbersome, and time-consuming."

Potential Impact of the FTA on U.S. Imports of Services

The U.S.-CA/DR FTA is likely to have little or no effect on U.S. cross-border services imports or on sales by U.S. services affiliates of foreign parent firms. This is largely attributable to the longstanding openness found in most areas of the U.S. services market, and to existing U.S. services commitments scheduled under the GATS. For example, the United States bound its regime for enhanced telecommunication services during the Uruguay Round of trade negotiations and further liberalized its market with commitments undertaken as part of the WTO Basic Telecommunications Agreement in 1998. With very few restrictions, foreign firms may currently establish in the United States to provide local, long distance, and international telecommunication services, for public or nonpublic use, through any means of network technology (e.g., wireline, cellular, or satellite). The only remaining U.S. telecommunication restrictions relate to the issuance of radio licenses and control of satellite capacity. Despite opportunities to participate in the U.S. market, telecommunication service firms from the CA/DR region have chosen not to do so, primarily because they do not have the scale, resources, or

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[150] ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004, pp. 6-7; and *U.S.-Dominican Republic Free Trade Agreement: Report on Services*, April 22, 2004, pp. 6-7. For further information related to the investment implications of the FTA, see chapter 6 of this report.

[151] ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004, p. 6; and *U.S.-Dominican Republic Free Trade Agreement: Report on Services*, April 22, 2004, pp. 9 and 12.

technology to effectively compete in the U.S. market. Central America-based firms provide mostly basic and some value-added services in their home markets, where

they function as wholly or partially state-owned monopolies. Similarly, U.S. financial service commitments under the WTO permit liberal conditions of market access and national treatment. However, financial service firms in CA/DR tend to focus on their domestic markets, often lacking the capital base or expertise to compete in the United States. International financial activity by such firms typically involves the provision of financial and insurance services for domestic firms involved in international trade. Future growth for financial services firms in the CA/DR region therefore will depend to a greater degree on increased goods trade between the United States and other FTA members than on liberalization of U.S. financial services regulations.

Potential Impact of the FTA on U.S. Exports of Services

The U.S.-CA/DR FTA is likely to result in new commercial opportunities for some U.S.-based services firms. This is particularly true in the telecommunication, distribution, and insurance sectors, where the Central American parties to the agreement and the Dominican Republic have made new market access commitments. In the banking and securities market, industry representatives do not expect to see short term gains as a direct result of sector-specific provisions in the agreement, but, as is the case for all service sectors, commercial opportunities will likely develop as economic conditions in FTA countries improve.[152] The following provides a detailed discussion of the effects of the FTA on U.S. exports of telecommunication, distribution, insurance, and banking and securities services. These service sectors were chosen based on the degree of market opening achieved in the FTA and the importance of the industries to the U.S. economy. Table 3-4 provides an overview of these markets in the CA/DR region during 1998 to 2002.

Telecommunication Services

Although the United States' FTA partners began to implement telecommunication service reforms during the 1990s, many market access barriers remain. For example, in Costa Rica, private participation in telecommunications is not presently permitted. In Honduras, the state-owned carrier, Hondutel, is the only provider of fixed telecommunication services and is to maintain its statutory monopoly until December 2005.[153] In Nicaragua, the market for international calls has been open since 1990, and U.S.-based firms, including AT&T, MCI, and Sprint are authorized to interconnect with the local telephony network to provide these services.[154] However, Enitel is still the dominant provider of local and long distance calls in Nicaragua.[155] In 2001, Enitel

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[152] Industry representative, telephone interview with USITC staff, May 24, 2004.
[153] WTO, "Honduras," *Trade Policy Review*, WT/TPR/S/120, August 29, 2003.
[154] WTO, "Nicaragua," *Trade Policy Review*, WT/TPR/S/61, September 24, 1999.
[155] Ibid.

Table 3-4
Central American countries and the Dominican Republic: Selected market data, 1998, 2001, 2002

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic	Total
Telecommunications							
Revenue, 2001 *(US$ millions)*	322	587	448	345	105	NA	1,807
Employment, 2001 *(thousands)*	4.1	3.8	3.2	5.2	2.1	16.2	34.6
Cellular subscribers, 2002 *(thousands)*	460	889	1,577	327	203	1,701	5,157
Insurance							
Premiums *, 2001(US$ millions)*	330	249	212	168	NA	486	1445
Number of insurance companies, 1998	1	18	18	12	5	30	84
Banking and Securities							
Number of banks, 2001	31	13	37	22	9	35	147
Total bank assets, *2001 (US$ millions)*	8,988	17,499	7,028	4,440	1,900	NA	29,855

[1] 2002 data.

Sources: U.S. Federal Communication Commission; International Telecommunications Union; UN Economic Commission for Latin America and the Caribbean, *Latin America and the Caribbean in the World Economy, 2001-2002 Edition,* p. 90; WTO, *Trade Policy Reviews*; United Nations Conference on Trade and Development, *Handbook of Statistics*, "Trade in Services by Sector and Country"; *The Solomon Smith Barney Guide to World Equity Markets 2001*, London, pp. 102-104; International Monetary Fund, *Costa Rica: Financial System Stability Assessment*, April 2003; Central Reserve Bank of El Salvador, *Annual Economic Indicators 1995-2002*; Inter-American Development Bank; U.S. Embassies.

sold a 51-percent stake to private investors, indicating that Nicaragua is moving toward a more open telecommunications market.[156]

Under the FTA, Costa Rica has committed to open certain segments of its telecommunications sector for the first time. Costa Rica committed to introduce legislation that would modernize ICE, Costa Rica's government-owned telecommunication service monopoly. Further, through the FTA, Costa Rica agrees to bind current market access conditions, and commits to the gradual opening of private network services, Internet services, and mobile wireless services.[157] With respect to these and other segments considered in the future, Costa Rica made first-time regulatory commitments on transparency, allocation of scarce resources (namely, radio spectrum) , interconnection,[158] universal service, and network access. It also

[156] U.S. Department of State, "Nicaragua 2004 National Trade Estimate Report," and "Fourth Enitel Privatization Sale Successful Amid Controversy, *State Department Cables*, December 16, 2003 and September 5, 2001, respectively.

[157] Private network services and Internet services are to be opened to competition by January 1, 2006, and mobile wireless services are to be opened by January 1, 2007. Chapter 13 of the FTA.

[158] Costa Rica commits to "regulated interconnection," guaranteeing cost-oriented interconnection on nondiscriminatory terms, but subject to "economic feasibility." Chapter 13 of the FTA.

liberalized provision of information services and access to submarine cable systems, and granted private firms flexibility in the choice of network technology. Costa Rica further agreed to establish an independent regulator, the form of which is currently under debate in the country.[159] Industry representatives are encouraged by Costa Rica's commitments under the FTA and expect U.S. companies, which are competitive in these market segments, to benefit from the new market access opportunities.[160]

In addition to market access gains in Costa Rica, U.S.-based telecommunication firms will benefit from increased regulatory certainty and may experience new commercial opportunities as a result of new economic growth as the FTA takes effect in the region.[161] The FTA for the first time obligates Guatemala, Honduras, and Nicaragua to ensure cost-based interconnection.[162] Honduras and Nicaragua make first-time commitments on licensing, the establishment of independent regulators, allocation of scarce resources, and the prevention of anticompetitive behavior, including cross-subsidization.[163] Demand for certain services, such as Internet and private network services, may increase as companies begin to invest in the region.[164] Commercial opportunities will accrue to U.S.-based firms that are able to provide such services efficiently and on a competitive basis.

Distribution Services

U.S. exports of distribution services are likely to increase, particularly as a result of new investment opportunities and the changes to dealer protection regimes. Dealer protection regimes were problematic in Costa Rica, the Dominican Republic, El Salvador, Guatemala, and Honduras, resulting in significant barriers for U.S. firms. Under dealer protection regimes, foreign manufacturers must enter into exclusive, long-term agreements with local distributors, often without a way to make changes should the dealer prove to be inefficient or otherwise lacking in performance. U.S. firms report cumbersome, ineffective, and inefficient relationships with local distributors as a result of these laws. Firms that distribute a variety of brands are forced to work with many different distributors, some of which only distribute one brand. Reportedly, even when a U.S. firm acquires a new brand or product from another manufacturer, the new firm must adhere to the old firm's existing distribution agreement. It cannot terminate the brand's local distribution agreement, even in order to combine the new product into its own existing distribution operations. In one case, a U.S. firm reported altogether abandoning its operations in one Central American country because of protection laws, while another reportedly changed its business

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[159] U.S. Department of State, "Costa Rica Looks to Establish a Telecommunications Regulator," Cable, April 1, 2004. Costa Rica's regulatory commitments are due to be in place by January 1, 2006. " Chapter 13 of the FTA.

[160] Calman Cohen, testimony before the Commission, April 27, 2004.

[161] Calman Cohen, testimony before the Commission.

[162] ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004.

[163] Ibid.

[164] Ibid.

plan to avoid the laws.[165] Other cases involved costly, time-consuming lawsuits.[166] Ultimately, the costs incurred by these firms were passed on to consumers.[167]

The FTA will create a new legal regime and strengthen the bargaining power of foreign firms in future distribution agreements.[168] Under the FTA, firms will be able to negotiate the terms of their contracts. Firms can determine the exclusivity of their dealer agreements, as well as the need for early termination fees, and the terms under which such fees will be calculated. All of these elements serve to reduce substantial barriers faced by U.S. exporters.[169] The FTA's dealer protection regimes enable U.S. firms to be more efficient in distribution, and to increase the number of products they distribute and the number of retail outlets that sell a particular product, lowering costs for consumers.[170]

Insurance Services

U.S. exports of insurance services to CA/DR are expected to record a measurable increase once the FTA enters into force. As a result of the agreement, Costa Rica has agreed for the first time to liberalize its insurance market, with most segments of the industry to be opened to U.S. firms by 2008.[171] Costa Rica has the most highly developed insurance market in the Central American region, and U.S. insurers have expressed considerable interest in being able to enter all market segments, including retail sales of insurance directly to Costa Rican consumers and wholesale insurance sales targeted to larger Costa Rican firms and U.S. multinational companies located in Costa Rica.[172] Even though liberalization of the Costa Rican insurance market will have a fairly long transition period, U.S. insurers consider it a positive sign that the Agreement includes firm dates for opening the various segments of the market and are pleased with the degree of market opening that will result at the end of the transition period.[173]

Although insurance markets in the remaining Central American countries and the Dominican Republic are largely open to cross-border trade and foreign investment, U.S. insurers noted the importance of new rights to establish through a branch, rather

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[165] Calman Cohen, Emergency Committee for American Trade, testimony at Commission hearing, April 27, 2004; and Industry representatives, telephone interviews with USITC staff, March 3, 2004 and April 30, 2004.

[166] Industry representative, telephone interview with USITC staff March 3, 2004.

[167] Industry representative, telephone interview with USITC staff, April 30, 2004.

[168] Industry representative, telephone interview with USITC staff, April 30, 2004.

[169] Calman Cohen, Emergency Committee for American Trade, testimony at Commission hearing, April 27, 2004; and ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004.

[170] Sarah Thorton, Grocery Manufacturers of America, testimony at Commission hearing, April 27, 2004.

[171] Calman Cohen, Emergency Committee for American Trade, testimony at Commission hearing, April 27, 2004, and industry representatives, telephone interviews with USITC staff, March 9-19, 2004.

[172] Industry representatives, telephone interviews with USITC staff, March 9 and 19, 2004.

[173] Industry representatives, telephone interviews with USITC staff, March 3, 2004.

than a separately capitalized subsidiary, in the CA/DR market.[174] In particular, the right to branch directly from one Central American market to the other is expected to generate interest from U.S. insurers.[175]

Another important outcome of the FTA is the move by all of the parties to bind rules permitting the cross-border provision of marine, aviation, and transportation (MAT) insurance;[176] insurance brokerage activities related to the latter two types of cross-border insurance contracts; reinsurance; and services auxiliary to insurance.[177] The FTA is also expected to increase opportunities for U.S. insurers within the United States. As the FTA generates additional goods trade between the United States and the CA/DR region, U.S. exporters will require additional MAT insurance on their cargoes, which increases business opportunities for U.S. providers of such insurance.[178] This same logic applies to exporters located within the Central American countries and the Dominican Republic, who will be able to purchase MAT insurance directly from U.S. insurers because of the aforementioned cross-border insurance commitments.

Finally, industry representatives noted the importance of the FTA's structure as a multilateral agreement, rather than a set of bilateral treaties. This structure allows U.S. firms to take advantage of expanded free trade opportunities in the CA/DR region, in addition to bilateral trade opportunities between each country and the United States.[179] Outside of Costa Rica, U.S. insurers expect to see the majority of gains from increased sales of policies related to MAT, professional liability, and plant, property, and equipment owned by foreign investors, as the FTA generates more trade in noninsurance businesses.[180]

Banking and Securities

Although the agreement improves market access conditions in some market segments, one industry source indicates that the banking and asset management provisions of the FTA are not likely to result in increased exports of banking and securities services to the CA/DR region in the near term because of the developing nature of financial service markets in the region.[181] However, another industry representative stated that the

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[174] The Dominican Republic and Nicaragua are to allow branches 4 years after the FTA's entry into force. Costa Rica will allow establishment of foreign insurance providers in 2008, through branches or subsidiaries.

[175] Industry representatives, telephone interviews with USITC staff, March 9 and 19, 2004. Regulations regarding such branching will not be finalized until after the FTA enters into force, so the full effect remains uncertain for now. The FTA includes two side letters regarding insurance branching, from Guatemala and from Nicaragua. Both letters confirm that insurance branches established in those countries may be subject to local regulations. The letter from Nicaragua specifies that Nicaraguan regulators may establish requirements related to a branch's capital and reserves, its solvency and integrity requirements, and certain conditions under which a foreign-owned branch may transfer liquid profits out of the country.

[176] MAT insurance includes insurance for goods in transit.

[177] Chapter 12 of the FTA, annex 12.5.1. Services auxiliary to insurance are defined as consultancy, actuarial, risk assessment, and claim settlement services. Chapter 12, art. 20.

[178] Industry representative, telephone interview with USITC staff, March 19, 2004.

[179] Industry representatives, telephone interviews with USITC staff, Feb. 26 and March 2-3, 2004.

[180] Industry representative, telephone interview with USITC staff, March 9, 2004.

[181] Industry representative, telephone interview with USITC staff, March 23, 2004.

probable increase in goods trade will result in rising demand for trade financing from U.S. banks.[182] In the future, U.S. financial services firms are likely to benefit from provisions allowing branching by foreign entities in El Salvador, Guatemala, Honduras, and Nicaragua. While Costa Rican law does not currently support such activity, the country has agreed to pursue legislation that would allow it.[183] The Dominican Republic, on the other hand, retained domestic regulations regarding forms of establishment and other business restrictions.[184]

Asset management firms in particular are likely to benefit from guarantees of national treatment, nondiscrimination, and right of establishment as a result of the agreement. The last provision will give U.S. firms the freedom to establish in the form most conducive to efficient delegation of duties among U.S. parents and their affiliates.[185] Furthermore, under the FTA, the Dominican Republic will place no limitations on the acquisition of financial services or asset management firms by foreign investors, which will work to the benefit of U.S. firms seeking to enter that market. Despite such market access improvements, one industry representative said that the immediate value to the U.S. industry is the improvement in regulatory transparency and precedent in establishing regulations and standards, rather than the creation of new commercial opportunities.[186] None of the CA/DR governments had previously scheduled commitments related to asset management services under the GATS. Therefore, because the FTA contains specific binding commitments related to asset management services, it is generally viewed favorably by U.S. industry representatives.

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[182] Industry representative, telephone interview with USITC staff, May 24, 2004.
[183] ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004.
[184] ISAC 13, *U.S.-Dominican Republic Free Trade Agreement: Report on Services*, April 22, 2004.
[185] Industry representative, telephone interview with USITC staff, May 7, 2004.
[186] Industry representative, telephone interview with USITC staff, March 23, 2004.

CHAPTER 4
Economywide Impact of Market Access Provisions

This chapter provides a quantitative assessment of the likely impacts of those chapters of the U.S.-CA/DR FTA that increase bilateral market access (i.e., tariff elimination or reduction) for the United States and the partner countries considered as a single region. These FTA chapters include chapters 2 through 4, which provide for liberalization of tariffs and quotas. Unlike the assessment conducted in chapter 3, where the impact of market access provisions of the FTA is examined at the specific sector or commodity level, the analysis in this chapter considers the impact of market access provisions of the FTA on all sectors in the U.S. economy, as well as their relative economic importance. In particular, this analysis provides an estimate of the effect on the U.S. economy as a whole of the quantifiable market access provisions of the FTA.

The analyses in chapters 3 and 4 of this report, while directly related, are not directly comparable. Apparent differences in the assessment of impacts may arise, since different degrees of aggregation and different analytical frameworks have been employed in the chapters. That is, the analysis in chapter 3 is based on the staged implementation of the FTA, while the analysis in the current chapter assumes the FTA is fully implemented on January 1, 2005. Furthermore, the analyses in chapter 3 are based on partial equilibrium frameworks while the analysis in this chapter is based on an economy-wide framework. Table 4-1 shows the relationship between the selected sectors analyzed in chapter 3 and the corresponding aggregated model sectors analyzed in the current chapter. For example, the textiles, apparel, and footwear sectors analyzed in chapter 3 do not include some of the miscellaneous leather products included in the chapter 4 sector. Table 4-1 gives a broad picture of the relative sizes of selected sectors in the two analytical approaches, although the imports reported are from different years and data sources.

Simulation Design

The overall assessment of the likely impact of the FTA includes a number of measures of U.S. economic activity, including the impact on U.S. exports, imports, production, employment, and prices paid by consumers. The method chosen for quantitative analysis is a computable general equilibrium simulation. The model includes the social accounts (production and consumption patterns) and trade patterns for multiple regions of the world economy and for multiple products produced in those regional economies. Employing a simulation permits the Commission to quantify the probable impact of the negotiated FTA on individual sectors, labor markets, exports, and imports.

Table 4-1
U.S. imports from Central America and the Dominican Republic: Relationship between selected sectors in chapter 3 and model sectors

Selected sector in chapter 3		Corresponding model sector		Selected sector share of model sector
Sector	2003 imports[1]	Sector	2005 imports[2]	
	Million dollars		*Million dollars*	*Percent*
Grains (rice, wheat, and corn)	0.045	Grains	0.1	45.0
Sugar and sugar-containing products [3]	141.0	Sugar manufacturing[3]	[4]339.3	41.5
Textiles, apparel, and footwear	9,522.0	Textiles, apparel, and leather products	11,763.6	81.0

[1] Compiled from official statistics of the U.S. Department of Commerce.

[2] GTAP database, as adjusted and updated to 2005 (see text and table 4-4).

[3] The GTAP sector "sugar manufacturing" does not include sugar-containing products. "Sugar manufacturing" contains raw (milled) cane sugar, refined cane and beet sugars, sugar syrups, and molasses.

[4] Imports of "sugar manufacturing" are larger than imports of "sugar and sugar-containing products" because the later imports refer to imports subject to TRQs and imports of sugar–containing products are small (see chapter 3). Imports of "sugar manufacturing" refer to TRQ imports as well as non–TRQ imports (e.g. sugar imported for polyhydric alcohol) which are much larger than imports of sugar–containing products.

Note.—The analysis in chapter 3 of this report is based on the staged implementation of the FTA as provided in the agreement, while the analysis in the current chapter assumes that the FTA is fully implemented on Jan. 1, 2005. Imports for chapter 3 and model sectors are based on different years, so the given percentages are only generally indicative of relative sector import sizes.

Source: Official statistics of the U.S. Department of Commerce, GTAP version 6, prerelease 1 data, and Commission calculations, unless otherwise indicated.

Key Assumptions

The Commission's simulation liberalizes trade completely in all goods subject to tariff liberalization under the U.S.-CA/DR FTA. There is no implicit or explicit time elapsing in the model, and no adjustment costs are considered. This assumption means, first, that all provisions of the FTA are assumed to be fully phased in immediately on January 1, 2005, rather than staged in over a period of up to 20 years per the FTA.[1] The assumption also means that the modeled results are long-run effects of a fully implemented FTA in an economy otherwise identical to the benchmark 2005 economy—i.e., an economy with the same resources, population, and other characteristics of the 2005 economy. The qualitative assessment of the likely effects of the FTA on selected sectors in chapter 3 of this report, meanwhile, considers the short- to medium-term effects, as well as the transitional effects as the FTA is phased in.

A full list of the initial measured tariffs in the model is shown in table 4-2. These tariffs essentially constitute price gaps, or wedges, between world prices and domestic prices.[2] As tabulated, they consist of tariffs and other barriers measured in the Global

[1] A summary of the FTA is provided in chapter 2 of this report.

[2] A price gap summarizes the price impact of several border measures: ad valorem duties, specific duties, and variable levies that insulate domestic prices from short-term fluctuations in world markets. These price gaps are modeled as constant ad valorem gaps between domestic and world prices. The Commission selected this approach because this is a long-term analysis that abstracts from all other events that may influence world markets.

Table 4-2
U.S.-CA/DR FTA: Benchmark tariffs, 2005[1]

(Percent)

Sector	Tariffs on U.S. imports from CA/DR	Tariffs on CA/DR imports from the United States
Grains	0	10.58
Vegetables, fruits, and nuts	0	16.67
Other crops	0.25	1.98
Cattle and horses	0	5.69
Animal products n.e.c.	0	4.93
Coal, oil, gas, other mineral	0	4.09
Meat products	2.95	14.71
Dairy products	9.30	19.47
Sugar manufacturing[2]	0.02	32.29
Sugar crops	0	0
Other processed food and tobacco products	0.03	12.77
Textile, apparel, and leather products	4.96	1.28
Wood products	0	9.99
Petroleum, coal, chemicals, rubber, plastic	0.03	5.15
Ferrous metals	0	6.26
Metals n.e.c. and metal products	0	3.48
Motor vehicles and parts	0	11.10
Transport equipment n.e.c.	0	3.44
Electronic equipment	0	1.40
Other machinery and equipment	0	3.95
Other manufactures	0	7.12
Services	NA[3]	NA[3]

[1] Benchmark tariffs include tariff equivalents of agricultural TRQs facing both U.S. and CA/DR imports

[2] Sugar imports to the United States are subject to tariff rate quotas. The FTA would increase these quotas by about 50 percent, which would have a much greater effect on imports of sugar than does the elimination of the 0.02 percent in-quota duty. In the simulation of the FTA, the expansion of the sugar quota is modeled as a quantity increase. See text and appendix D, section on Solution Technique.

[3] Restrictions on services that are identified in chapter 3 of this report are not quantified in the GTAP data or in other sources of protection data.

Source: GTAP version 6, prerelease 1 data and Commission calculations.

Trade Analysis Project (GTAP) database as ad valorem equivalent tariffs.[3] The sectors listed in table 4-2, and their corresponding import tariff equivalent measures, are

[3] Version 6, prerelease 1, of the GTAP data has not been published or publicly released at the time of this writing. Version 5 is described in Betina V. Dimaranan, and Robert A. McDougall (2002), *Global Trade, Assistance, and Production: The GTAP 5 Data Base*, Center for Global Trade Analysis, Purdue University. Version 6 of the GTAP data has several advantages relative to version 5. First, trade flows and national economic data have been updated from 1997 to 2001 (although for this study the Commission has further updated the data to 2005). Second, the protection data have been improved significantly. Rather than relying for the most part on WTO bound tariffs, the new data reflect actual applied tariffs (generally smaller than bound rates); for this reason, apparent duties on some commodities have declined from those in previous versions of the data. This is aside from the fact that further implementation of the Uruguay Round and other trade agreements has actually reduced duties. Also, this new version of the data reflects work that is in progress to develop appropriate methods to quantify TRQs and nontariff measures. Work remains to be done in these areas, but prerelease 1 of version 6 of the GTAP data (the most recent version at the time of this study's initiation) provides the best available data for analyses of current trade policy. Two recent Commission reports used version 6, prerelease 1, of the GTAP database (USITC, *U.S.-Australia Free Trade Agreement: Potential Economywide and Selected Sectoral Effects*,

highly aggregated. For example, the "other crops" category includes such commodities such as coffee, tea, oilseeds, cotton, spices, and tobacco. As a result, the listed import tariff equivalent measures are trade-weighted averages of the measures faced by the individual commodities composing the aggregates; therefore, the aggregation may mask important effects on specific products included in the broader aggregations.

The tariffs listed here are adjusted for existing preferential agreements, including production-sharing arrangements whereby CA/DR imports of certain products such as textiles from the United States are duty free when used to produce finished products re-exported to the United States.[4] As shown in table 4-2, the tariffs on CA/DR imports from the United States (i.e., U.S. exports) are significantly higher than the tariffs on U.S. imports from CA/DR. Restrictions on services that are identified in chapter 3 of this report are not quantified in the GTAP data or in other sources of protection data, precluding a quantitative assessment of the FTA on this sector. Chapter 3 provided a qualitative assessment of the effects of the FTA on the services sector. A study by Brown, Kiyota, and Stern,[5] discussed in chapter 8, makes use of estimates of the size of tariffs in services, to model a hypothetical FTA. The present study models the actual, negotiated tariff liberalization in the FTA. Data are not available to model the actual services liberalization in the negotiated FTA.

An important component of the FTA, as discussed in chapter 2 of this report, is the set of rules of origin that determines the eligibility of goods for the tariff reductions under the FTA. In the simulation, it is assumed that traded commodities are differentiated by country of origin, which implies a limit to the ability of FTA partners to source inputs from a third country. In the case of textile and apparel products, no further adjustment has been made because, as discussed in chapter 3, these rules are not expected to constrain the ability of CA/DR producers to increase their exports. The CA/DR region already relies heavily on the United States as a source of yarns and fabrics, because producers in the region benefit from current trade preferences contingent on the use of U.S. materials. The FTA enhances those preferences by, among other things, including more flexible rules of origin and broader product coverage which provide room for growth in trade (see chapter 3 of this report for a more detailed discussion).

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[3]—*Continued*

investigation No. TA-2104-11, publication 3697, May 2004 and *U.S.-Morocco Free Trade Agreement: Potential Economywide and Selected Sectoral Effects,* investigation No. TA-2104-14, USITC publication 3704, June 2004). Two prior Commission reports used version 5 of the GTAP database (USITC, *U.S.-Singapore Free Trade Agreement: Potential Economywide and Selected Sectoral Effects*, investigation No. TA-2104-6, publication 3503, June 2003; and *U.S.-Chile Free Trade Agreement: Potential Economywide and Selected Sectoral Effects*, investigation No. TA-2104-5, publication 3505, June 2003).

[4] USITC analysis of the textile, apparel, and leather products industries has estimated that approximately 90 percent of U.S. sector exports to the CA/DR region are duty free due to their use under production-sharing arrangements, and that this is not reflected in prerelease 1 of the GTAP version 6 database. Therefore CA/DR tariffs in this sector were adjusted downward from 12.8 percent to 1.28 percent.

[5] Drusilla K. Brown, Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," Feb. 8, 2004, found at *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved March 2004, p. 5.

For manufactured sugar, the reported tariff of 0.02 percent in table 4-2 represents the low rate for sugar imported within the TRQ level. The over-quota rate is not changed, but the low in-quota tariff is removed. Relative to the elimination of this small tariff, a greater effect of the FTA on sugar imports comes from the increase in the quota levels for partner countries, amounting to an increase in imports from these countries of some 50 percent in quantity terms, as described in chapter 3.

For most sectors, trade liberalization is modeled in terms of eliminating a trade barrier (e.g., tariff) to determine the effect on traded volumes, among other things. For sugar, the effect on imports is determined directly by the change in the quota. The analysis in chapter 3 indicates that the quota will be filled at the new level. In the model the effect of the quota increase is treated by adjusting the export price advantage (sometimes referred to in trade literature as an export tax equivalent) that accrues to exporters as a result of the quota, in order to assure an increase in exports equal to the increase in the quota levels negotiated in the FTA. The sugar quota allows foreign holders of the quota to sell in the U.S. market at the U.S. price, higher than the world price. The difference between the U.S. price and the world price (the "price gap") represents a price advantage to the exporters. An initial estimate of the price equivalent of the quota was derived from the difference between the production cost of manufactured sugar in the partner countries (inclusive of transportation and insurance) and the price of manufactured sugar sold in the United States. The U.S. price of sugar is calculated to be about 75 percent higher than the CA/DR production cost, and represents a price advantage to the exporters, who can sell under-quota sugar at the higher U.S. price. The model was shocked to impose the increase in the quota level, by adjusting the price gap to force imports to the new level. After the price gap is adjusted, a substantial price gap remains, i.e. the U.S. price is still significantly higher than the world price, so that all exporters will still have an incentive to fill their quotas. This applies to all exporters who hold sugar quotas to export to the United States, so that while increasing the quota level for CA/DR trade partners, the model holds constant U.S. imports from other trading partners who continued to fill their quotas. (See chapter 3 for a discussion of the complex treatment of sugar and sugar-containing products in the FTA.)

The primary data source for the model is the GTAP database, prerelease 1 of version 6, which provides a snapshot of the world economy for 2001. To the extent feasible, the GTAP data are updated to 2005, the year in which this report assumes the FTA will enter into force. The 2005 benchmark incorporates the scheduled removal of textile and apparel quotas (under the Agreement on Textiles and Clothing); the U.S. FTAs with Chile and Singapore; and Uruguay Round reductions in tariff rates inferred from trade data projected to 2005.[6] The recently approved U.S. FTAs with Australia and Morocco took place too recently to be incorporated into this study, but are unlikely to significantly affect U.S. trade with the CA/DR region.

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[6] The model used in the assessment of the FTA and in the systematic sensitivity analysis is based on the core model available in the GTAPinGAMS software developed by Rutherford and Paltsev. (See Thomas F. Rutherford and Sergey V. Paltsev, *GTAPinGAMS and GTAP-EG: Global Datasets for Economic Research and Illustrative Models*, Department of Economics, University of Colorado Working Paper, September 2000.) A detailed description of the methodology and model are presented in appendix D.

The database does not explicitly include data on the partner countries in this FTA. Rather, it includes two aggregate regions that contain members of the FTA. The GTAP "Central America" region includes Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, as well as two countries, Belize and Panama, which are not parties to this FTA. The GTAP "Caribbean" region includes the Dominican Republic as well as a number of additional Caribbean countries. For the purposes of the USITC analysis the GTAP Central America region was adjusted to remove Belize and Panama from the region, and add the Dominican Republic. Essentially, the Central America input-output matrix[7] was reduced by the share of Panama and Belize's GDP in the region. Added to that was the Dominican Republic's share of the Caribbean input-output matrix, determined by its share of the region's GDP. The size of the economy of the resulting FTA region (Central America, minus Belize and Panama, plus the Dominican Republic) was adjusted by World Bank GDP projections to 2005. The region's trade with the United States was derived from the USITC DataWeb, which in turn is taken from USDOC data. The result is a data set generally representative of CA/DR, represented as a single region. The analysis does not provide effects of liberalized trade for individual countries in the CA/DR region. Effects of the FTA on bilateral trade, as reported in this chapter and elsewhere in the report, refer to bilateral trade between the United States on the one side and the aggregate CA/DR region on the other side. Note that the input-output matrix representing CA/DR is an approximation constructed and abstracted from data that include other countries, and would probably not be adequate for analysis of industry interactions and welfare effects within the national economies of any of the trade partners. Trade data for the aggregate region, however, are aggregated from actual trade flows with the partner countries, so that estimated effects on trade with the United States can be expected to be more robust.

The analysis employs a comparative static framework in which a benchmark equilibrium depiction of the U.S. economy, as of January 1, 2005, is derived through a set of balanced accounts of trade, production, consumption, and taxes. Once this benchmark has been created, policy shocks are imposed on the balanced model. A policy shock simply means a change in policy, typically a tariff removal or reduction, which is imposed on the model in order to measure its effect. In this model the policy shocks consist of the reduction or elimination of tariffs and measurable tariffs shown in table 4-2, as well as the increase in the quota levels for sugar as described below.

To estimate the impact of the market access component of the FTA, the trade policies shown in table 4-2 are replaced with new levels (generally zero) to represent the new, post-FTA economic state. The model is rebalanced, and new values for trade flows, outputs, employment, welfare, and GDP are generated. The difference between the benchmark values of these variables and their new values is the estimated impact of the removal of tariffs and measurable TRQs under the FTA. It is expected that those sectors that face relatively high tariffs will show the largest effects as a result of the implementation of the FTA.

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[7] The input-output matrix tabulates the transactions among sectors of the economy. See appendix D for a description of the model structure.

Economywide Summary Results

The change in economic welfare provides a measure of the comprehensive impact of the simulated FTA in a manner that is consistent with economic theory, summarizing the benefits to consumers, as well as the effects on households in their roles as providers of labor, owners of capital, and taxpayers. Table 4-3 presents the simulated welfare impact of the tariff and quota liberalization under the FTA, as well as the simulated impact on gross domestic product (GDP).[8] The Commission simulation of these components of the FTA suggests that the welfare value to the United States of the tariff and quota liberalization under the FTA would be about $166 million, less than 0.01 percent of U.S. GDP (rounded to 0.00 percent in table 4-3). This can be interpreted as stating that, when fully implemented, and when the economy fully adjusts to its effects, the market access provisions of the FTA would provide benefits to the U.S. economy worth $166 million each year over what the U.S. economy would have had in the absence of the FTA, based on the economy of 2005.[9]

Table 4-3
U.S.-CA/DR FTA: Simulated impacts of tariff and quota liberalization on U.S. welfare and GDP (relative to baseline)[1]

Item	Million dollars	Percent
Welfare	166.3	0.00
Decomposition of GDP:		
Land	106.0	0.18
Unskilled labor	352.1	0.01
Skilled labor	217.5	0.01
Capital	395.3	0.01
Balance for lost tariff revenue[2]	-843.4	NA
Total GDP	227.6	0.00

[1] Unlike the change in welfare, measures of changes to GDP include both price and quantity changes. The general equilibrium model, however, only determines relative prices, thus a unit of measure for real values must be chosen. Throughout the analysis in this chapter and chapter 8 the Commission uses the true-cost-of-living index, as measured by the unit U.S.-household expenditure function, to deflate all nominal results. In this case using the true-cost-of-living index to deflate GDP yields a measure that is a close proxy for welfare changes. In a simple model without government expenditure and other distortions they would be the same.

[2] This transfer compensates the government for lost tariff revenue in order to hold government expenditure and borrowing constant. Holding fixed the government budget position (and by extension government purchases) is necessary for welfare analysis.

Source: Commission calculations.

[8] Unlike the change in welfare, measures of changes to GDP include both price and quantity changes. The general equilibrium model, however, only determines relative prices, thus a unit of measure for real values must be chosen. Throughout the analysis in this chapter and the next the Commission uses the true-cost-of-living index, as measured by the unit U.S.-household expenditure function, to deflate all nominal results. In this case using the true-cost-of-living index to deflate GDP yields a measure that is a close proxy for welfare changes. In a simple model without government expenditure and other economic policies they would be the same.

[9] This welfare measure is often referred to as the "equivalent variation."

The analysis decomposed the $227.6 million change in GDP into specific changes in payments to primary factors of production—land, unskilled labor, skilled labor, and capital, and a change in the net transfer from households to the government. One of the macroeconomic implications of the simulated FTA is that factor payments to land would increase by $106.0 million, an increase of 0.18 percent; payments to unskilled labor and capital would increase by $352.1 and $395.3 million, respectively; payments to skilled labor would increase by $217.5 million. Each of these would represent an increase of about 0.01 percent. The relatively large increase in the value of land is likely due to the increase in exports and production of grains, as is discussed in more detail below. The transfer from households to the government compensates for the loss of tariff revenue to the government.[10]

Simulated Changes in Trade Volumes

Table 4-4 reports the simulated changes in bilateral trade between the United States and the CA/DR region as a result of full implementation of the market access component of the FTA. The trade impacts are reported on a landed, duty-paid basis, and thus reflect changes in the value of trade including tariff payments. As indicated in table 4-2, CA/DR has higher tariffs and tariff equivalents of TRQs than does the United States, across a broader range of traded goods, so the FTA is likely to result in a slightly greater percentage increase in U.S. exports to the partner region (because of the impact of lowering the partners' relatively higher tariffs under the FTA) than in U.S. imports from those countries (the U.S. economy is already relatively open to their imports).

Table 4-4 includes a sectoral decomposition of the bilateral trade equilibrium as a result of full implementation of the market access components of the FTA. In general, as seen in table 4-4, the sectors facing the greatest tariffs would be the ones experiencing the greatest effects of eliminating the tariffs. On the U.S. export side, there are increases in textiles, apparel, and leather products ($803 million), petroleum, coal, chemical, rubber, plastic products ($406 million), other machinery and equipment ($401 million), other manufactures ($235 million), grains ($157 million), and motor vehicles ($180 million). To some extent the increase in exports of textiles and apparel consists of textile inputs to the CA/DR region's expanded production of apparel, and is thus driven by increased demand for inputs to production for their export markets in the United States as well as by the elimination of CA/DR tariffs. As has been noted, the high level of tariff protection currently given to many CA/DR products suggests that the removal of this protection under the FTA is likely to have noticeable effects on CA/DR imports from the United States. Many of the increases in U.S. exports, such as dairy

[10] Without making up for the government's lost tariff revenue, real government spending and net government indebtedness could not be maintained, and national welfare could not be compared between the benchmark and the counterfactual simulation.

Table 4-4
U.S.-CA/DR FTA: U.S. imports from CA/DR and CA/DR imports from the United States (landed, duty paid), 2005

Sector	U.S. imports			CA/DR imports from the United States		
	Base value before FTA	Change after FTA full implementation[1]		Base value before FTA	Change after FTA full implementation[1]	
	— Million dollars—		Percent	— Million dollars —		Percent
Textile, apparel, and leather products	11,763.9	3,067.5	26.08	5,350.0	802.8	15.01
Sugar manufacturing	329.3	113.2	34.38	0.4	0.6	166.38
Meat products	79.4	13.2	16.74	204.0	84.1	41.24
Dairy products	4.7	2.9	62.18	22.9	5.9	25.77
Sugar crops	0.0	0.0	NA	0.0	0.0	NA
Grains	0.1	0.0	-0.99	722.8	157.3	21.77
Cattle and horses	0.7	0.0	-2.06	3.4	0.3	10.23
Transportation equipment n.e.c.[2]	4.5	-0.2	-4.01	170.0	42.0	24.72
Motor vehicles and parts	16.0	-0.4	-2.45	372.9	180.4	48.37
Animal products n.e.c.	61.8	-0.9	-1.44	37.3	1.7	4.51
Wood products	156.5	-7.7	-4.91	127.5	42.5	33.38
Metals nec and metal products	154.6	-10.5	-6.80	134.0	14.2	10.59
Ferrous metals	300.3	-14.4	-4.78	325.8	57.3	17.57
Other manufactures	469.6	-16.9	-3.61	1,031.1	234.6	22.75
Petroleum, coal, chemicals, rubber, plastic	473.8	-17.4	-3.68	3,147.8	406.1	12.90
Other crops	746.0	-19.3	-2.59	237.6	17.3	7.28
Coal, oil, gas, other mineral	220.9	-23.2	-10.49	35.5	13.4	37.86
Other processed food and tobacco products	1,126.2	-25.5	-2.27	639.7	53.5	8.37
Vegetables, fruits, and nuts	1,717.5	-31.5	-1.84	53.8	7.7	14.23
Electronic equipment	1,041.7	-56.4	-5.41	1,976.8	110.2	5.58
Other machinery and equipment	1,902.9	-96.4	-5.07	2,010.7	400.6	19.93
Services[3]	1,738.3	-100.0	-5.75	710.4	32.8	4.62
Total	22,308.6	2,776.2	12.44	17,314.03	2,665.6	15.40

[1] The simulated FTA consists of tariff and quota liberalization.

[2] The decline in U.S. imports of many products is a result of the reallocation of resources in the small economies of the partner countries, as they shift output to take advantage of increased export opportunities in other products such as textiles and apparel, and sugar.

[3] No U.S. tariffs or other quantitative import measures for services were removed in this analysis. The changes in trade arise from trade balance, changes in demand, and factor supply. See text.

Source: GTAP version 6, prerelease 1 data and Commission calculations.

products, represent changes from small initial levels, so that moderate increases in exports represent large percentage changes, due to the reduction of high levels of protection. Other products subject to high levels of protection are grains and meat products, which have moderate but significant current levels of trade and thus U.S. exports of these products can be expected to benefit from the reduction in CA/DR tariffs.

Table 4-4 shows that U.S. imports of textiles, apparel, and leather products increase, accounting for more than the total net increase in imports of about $2.8 billion from CA/DR. As discussed in chapter 3 and shown in tables 4-4 and 4-5, to a large extent

the increase in U.S. textile and apparel imports from CA/DR would displace imports from other countries.

Many of the other goods imported from the CA/DR region do not face tariffs. Since there are no tariffs to eliminate for these sectors, such sectors would not be expected to show increases in their imports. In fact, for many of these sectors the model shows some decline in U.S. imports. This is largely a function of the large increase in CA/DR exports of textiles and apparel products, which are likely to become more profitable relative to sectors that do not benefit from tariff cuts. The expansion of production in textiles, apparel, and leather products, as well as in sugar, would cause these sectors to absorb labor and other resources from other sectors that do not benefit from the reduction in tariffs (which are already near zero). This would have the further effect of displacing U.S. imports of these sectors from other countries, as shown in table 4-5.

Table 4-5
U.S.-CA/DR FTA simulated impacts: U.S. imports (landed, duty paid) from the world and exports (f.o.b.) to the world

Products	Imports			Exports		
	Base	Change	Change	Base	Change	Change
	— Million dollars—		*Percent*	*— Million dollars —*		*Percent*
Textile, apparel, and leather products	127,218.8	683.1	0.54	26,119.5	704.5	2.70
Sugar manufacturing	1,511.0	78.1	5.17	435.5	2.2	0.51
Meat products	6,398.2	9.6	0.15	7,841.5	81.2	1.03
Dairy products	1,893.6	1.7	0.09	842.0	4.8	0.56
Sugar crops	6.7	-0.1	-2.08	0.0	0.0	NA
Grains	1,078.3	1.2	0.11	10,151.3	172.3	1.70
Cattle and horses	2,134.1	1.7	0.08	848.9	0.2	0.02
Transportation equipment n.e.c.	51,524.2	16.1	0.03	70,624.5	-10.3	-0.01
Motor vehicles and parts	178,289.7	16.6	0.01	69,065.6	173.6	0.25
Animal products n.e.c.	2,843.7	1.1	0.04	3,355.1	0.6	0.02
Wood products	21,581.3	3.5	0.02	6,972.9	42.8	0.61
Metals nec and metal products	30,336.2	11.8	0.04	18,701.5	5.1	0.03
Ferrous metals	49,157.1	20.0	0.04	33,544.8	45.7	0.14
Other manufactures	79,517.4	25.6	0.03	37,905.7	224.1	0.59
Petroleum, coal, chemicals, rubber, plastic	165,186.0	54.3	0.03	157,721.9	384.2	0.24
Other crops	10,823.9	3.8	0.04	11,740.2	4.1	0.03
Coal, oil, gas, other mineral	86,667.3	61.5	0.07	8,153.5	0.3	0.00
Other processed food and tobacco products	37,293.1	-2.9	-0.01	20,269.9	64.4	0.32
Vegetables, fruits, and nuts	9,248.1	-4.9	-0.05	4,960.2	7.0	0.14
Electronic equipment	219,685.1	36.9	0.02	166,366.5	-30.4	-0.02
Other machinery and equipment	250,173.4	65.2	0.03	234,641.9	222.0	0.09
Services[1]	223,305.7	68.3	0.03	276,672.6	-189.8	-0.07
Total	1,555,872.9	1,152.2	0.07	1,166,935.4	1,908.5	0.16

[1] No U.S. tariffs or other quantitative import measures for services were removed in this analysis. The changes in trade arise from trade balance, changes in demand, and factor supply.

Source: GTAP version 6, prerelease 1 data and Commission calculations.

The impacts of the simulated market access provisions of the FTA on total U.S. trade with the world as a whole, by sector, are reported in table 4-5. Total U.S. imports of textiles, apparel, and leather products are shown to increase by $683.1 million, or by 0.54 percent. Thus, most of the increase in this sector's imports from CA/DR is likely to be diverted from imports formerly supplied by other countries, as was discussed in chapter 3. In the case of manufactured sugar, the $113.2 million increase in the value of U.S. imports from CA/DR shown in table 4-4 is (like other sectors) partly accounted for by price changes. The new quantity of sugar imported from CA/DR would be equal to the quota increase of about 49 percent, but because prices are estimated to decline, this would amount to a 34.4 percent increase in value terms. Also because of this price decline, imports from the world as a whole are estimated to increase by only 5.17 percent in value terms (table 4-5), rather than the approximately 10 percent in quantity terms implied by the increase in the CA/DR quota, holding imports from other countries constant as they continue to fill their own quotas.[11]

While U.S. imports of services from the CA/DR region are estimated to decrease by $100.0 million (table 4-4), services imports from the world as a whole are shown to increase by $68.3 million (table 4-5). As indicated in table 4-2, no U.S. tariffs or other quantitative import measures to services were removed in this analysis. The reported changes in trade and output in services arise from secondary general equilibrium effects, including trade balance effects, changes in demand for services by other sectors and changes in supply of services resulting from the reallocation of labor and capital resources to other sectors that are growing more strongly as a result of the policy changes. Thus, while the reported results for services reflect effects of the market access component of the FTA, they are indirect effects not resulting from negotiated policy changes in the FTA for services trade. The changes in trade in services that might be expected from nonquantifiable provisions of the FTA are discussed in more detail in chapter 3 of this report.

Aggregate U.S. trade with the world is likely to increase by a small amount as a result of the increased market access under the FTA. The last row in table 4-5 reports the simulated changes in total U.S. trade. Total imports would increase by $1,152.2 million (a 0.07 percent increase) on a landed, duty-paid basis and total exports would increase by $1,908.5 million (a 0.16 percent increase) on an free-on-board (f.o.b.) basis.[12]

For exports, the simulated impacts of the market access components of the FTA shown in tables 4-4 and 4-5 suggest that $757 million of the increase in U.S. exports to CA/DR (i.e., $2,665.6 million increase in CA/DR, less the $1,908.5 million increase in U.S. global exports) is diverted from other U.S. export markets.[13]

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[11] The CA/DR region accounts for about 20 percent of U.S. sugar imports. A 50-percent increase in imports from the CA/DR region, holding imports from other countries fixed, would imply a total quantity increase in U.S. sugar imports of about 10 percent.

[12] Net capital flows are assumed not to change in the simulated FTA, requiring balance between the change in the value of imports on a cost, insurance, and freight (c.i.f.) basis and the change in value of exports on an f.o.b. basis. The smaller change in imports reported in table 4-3 is due to the lost tariff revenue that is included in imports measured on a landed, duty-paid basis.

[13] Since imports in this comparison are measured on a landed, duty-paid basis, and exports on an f.o.b. basis, the actual difference will be smaller than $757 million.

U.S. Gross Output and Employment Effects

Full implementation of the market access provisions of the FTA is likely to result in expansion of those U.S. industries that experience increased export demand due to the removal of tariffs by CA/DR. In addition, the reallocation of resources and direct competition from goods that are given preferential import treatment into the United States is likely to cause the output of some U.S. industries to decline. However, as is suggested by the percentage changes for total U.S. sectoral trade in table 4-5, these changes are likely to be very small. According to the model estimates, there is likely to be minimal to no impact on output or employment for most sectors in the U.S. economy (table 4-6).[14] The largest sectoral increase is for grains, with an output increase of 0.26 percent,[15] a revenue increase of 0.29 percent,[16] and a labor increase of 0.31 percent.[17] This is not an unexpected result, because this sector experiences a large increase in exports under tariff and quota liberalization. This finding is consistent with the relatively high rates of protection in that sector, and with the increase in returns to land shown in table 4-2. Manufactured sugar and its principal input, sugar crops (sugarcane and sugarbeets) have the greatest percentage decrease in domestic output, slightly over 2 percent, and a similar proportional decrease in employment.

Sensitivity of the Commission's Simulated Impacts to the Trade Elasticities

The simulated impacts of a trade policy change on the U.S. economy depend on many data and parameters. Appendix D describes in more detail the USITC model used in this chapter, including its data base and the parameters upon which it depends. The choice of values for these parameters influences the simulated impacts of the market access provisions of the FTA. To assess the sensitivity of the impacts of the market access provisions of the FTA to the values of the model parameters, the Commission analyzed how one outcome of the model (the U.S. welfare measure) responds to a range of values selected for one set of input parameters.

The most important parameters in the model are the Armington trade elasticities, which measure the extent to which imported goods are similar to, and substitutable for, domestically produced goods. These parameters determine to a large extent the responsiveness of trade flows to changes in trade policy instruments (e.g., import

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[14] No U.S. sector is likely to experience a decline in output, revenue, or employment greater than 2.5 percent.

[15] Changes in gross output should be interpreted as pure quantity changes.

[16] Changes in revenues by industry incorporate both the quantity and producer price changes generated in the simulated FTA.

[17] The simulation model does not consider changes in total labor supply, nor does it consider potential unemployment impacts; labor supply in the model is assumed to be fixed, and the labor market clears in equilibrium, as do all other simulated markets either for other factors or for goods or services. The model serves to indicate the ways in which a fixed labor supply would be reallocated among sectors in response to trade policy changes.

Table 4-6
U.S.-CA/DR FTA simulated impacts: Output and employment in the United States, percent changes

	Output[1]		Labor quantity impact
	Quantity impact	Revenue impact	
	Percent		
Services	0.00	0.00	0.00
Petroleum, coal, chemicals, rubber, plastic	0.04	0.04	0.04
Other machinery and equipment	0.02	0.02	0.02
Other processed food and tobacco products	0.02	0.02	0.02
Motor vehicles and parts	0.04	0.03	0.04
Other manufactures	0.05	0.05	0.05
Ferrous metals	0.01	0.02	0.01
Electronic equipment	-0.03	-0.03	-0.03
Textile, apparel, and leather products	-0.07	-0.13	-0.06
Wood products	0.02	0.02	0.02
Transport equipment n.e.c.	-0.02	-0.02	-0.02
Meat products	0.05	0.06	0.05
Metals n.e.c. and metal products	0.00	0.01	0.00
Coal, oil, gas, other mineral	-0.01	-0.01	-0.01
Cattle and horses	0.04	0.06	0.09
Dairy products	0.00	0.01	0.00
Grains	0.26	0.29	0.31
Other crops	0.00	0.03	0.04
Animal products n.e.c.	0.02	0.03	0.07
Vegetables, fruits, nuts	0.03	0.06	0.07
Sugar manufacturing	-2.28	-2.54	-2.28
Sugar crops	-2.28	-2.24	-2.23

[1] The revenue impact reflects changes in the prices as well as the output quantities of the listed sectors.

Source: Commission calculations and GTAP version 6, prerelease 1 data.

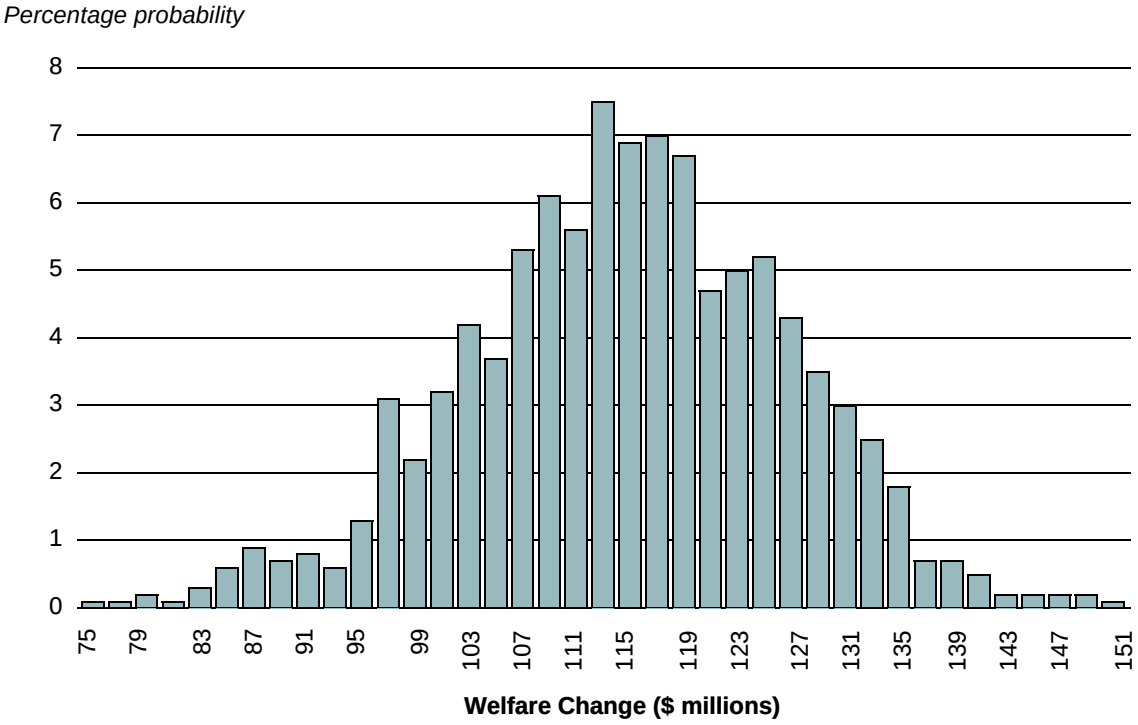
tariffs). Because of the sensitivity of the model to these elasticities, and because there is often uncertainty on the values assigned to these elasticities,[18] the Commission has systematically analyzed the sensitivity of its model to the values assumed for the trade elasticities.

Trade elasticities are drawn from the econometric literature (see appendix D), allowing for the incorporation of uncertainty in the values of these estimates in the CGE simulation. Using 1,000 random draws from the published elasticity distributions, the numeric model was run to generate a distribution of the simulated welfare impacts of the market access provisions of the FTA. This distribution is presented graphically in figure 4-1.

The simulations suggest a 95-percent confidence interval of welfare changes between $135.31 million and $248.17 million. In other words, accepting the distribution of the

[18] Chapter 8 of this report reviews several analyses of an FTA between the United States and the CA/DR region in the economic literature. As is pointed out there, different assumptions on the appropriate values for the trade elasticities, among other things, distinguish some of the models from each other.

Figure 4-1
U.S.-CA/DR FTA: Distribution of simulated U.S. welfare impacts



Source: Commission calculations

Armington elasticities as described in appendix D, and disregarding other sources of uncertainty in the model and its parameters, one could be 95-percent certain that the true welfare change resulting from the market access provisions of the FTA lies in the interval between $135.31 million and $248.17 million. It is important to recognize that, although the trade elasticities are some of the most important parameters, there is unmeasured uncertainty on a number of other parameters (such as demand and supply elasticities) that are required for computation of the model. Furthermore, this confidence interval pertains only to the welfare change—only one of several measures of the effect of outcome measures in the model. Similar analyses could be performed to examine the sensitivity to the Armington elasticities of GDP and aggregate trade flows, for example. However, in this report, the sensitivity analysis focuses on the welfare impact because it provides an economy-wide measure of the impact of the simulated FTA.

CHAPTER 5
Impact of Trade Facilitation Provisions

The U.S.CA/DR FTA contains a number of provisions that may facilitate the movement of goods and the provision of services between the parties. This chapter provides a qualitative assessment of the potential impact of the trade facilitation provisions addressed in the FTA, including customs administration and trade facilitation (addressed by chapter 5 of the FTA); sanitary and phytosanitary measures (chapter 6 of the FTA); technical barriers to trade (chapter 7 of the FTA); electronic commerce (chapter 14 of the FTA); and transparency (chapter 18 of the FTA). Although it is not possible to quantify the economic effects of these provisions, U.S. firms are likely to benefit from the application of these provisions by the CA/DR governments, primarily as a result of improvements in regulatory transparency in the CA/DR region and their application of WTO commitments. However, the overall economic impact of the trade facilitation provisions of the FTA on the United States is likely to be very small because of the small size of the CA/DR economy and the CA/DR market relative to the United States.

The discussion in this chapter relies on the public record for assessments of the trade facilitation provisions of the FTA. For each provision, the analysis in this chapter sets out U.S. negotiating areas and objectives for the FTA,[1] followed by overall assessments of the FTA rendered by the advisory trade committees established by the U.S. Congress. Once an FTA is negotiated, the elements of the U.S. Government advisory committee system submit formal reports regarding the probable effects—both benefits and drawbacks—of the agreement reached. Among those committees are the Advisory Committee on Trade Policy and Negotiations (ACTPN)[2] and the various industry functional advisory committees (IFAC), and industry sector advisory committees (ISACs).[3] Where the advisory committees express a view of results achieved (or not achieved) by the FTA, their assessment is generally in response to the administration's stated negotiating objectives for that area. In negotiating areas that pertain more to public rather than private sector interests—for example, government policy on safeguards or competition policy—the advisory committees at times express little or no opinion.

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[1] The trade negotiating objectives for the FTA were set out in the Executive Branch notifications to Congress regarding the administration's intent to negotiate an FTA with Central America and the Dominican Republic. For further information, see the section "Chronology of the FTA" in chapter 1 of this report.

[2] The ACTPN is the foremost advisory committee to the President on trade policy matters. It examines U.S. trade policy and agreements from the broad context of the overall national interest. It consists of up to 45 members, appointed by the President, who are broadly representative of key economic sectors affected by trade.

[3] The IFACs and ISACs provide specific technical advice concerning the effect that trade policy decisions may have on their respective functional area or sector.

Customs Administration and Trade Facilitation

U.S. trade negotiating objectives regarding customs matters and trade facilitation in the FTA were to (1) obtain rules to require that CA/DR customs operations are conducted with transparency, efficiency, and predictability, and that customs laws, regulations, decisions, and rulings are not applied in a manner that would create unwarranted obstacles to trade; (2) obtain rules of origin, procedures for applying these rules, and provisions to address circumvention matters that will ensure that preferential duty rates under the FTA apply only to goods eligible to receive such treatment, without creating unnecessary obstacles to trade; and (3) obtain terms for cooperative efforts with the CA/DR governments regarding enforcement of customs and related issues, including trade in textiles and apparel.[4]

In its report, the ACTPN states that its members, with the exception of the International Brotherhood of Teamsters, consider that the U.S.-CA/DR FTA "meets or exceeds the negotiating achievements of the recently implemented Chile and Singapore agreements, and in many ways has set the highest standard yet achieved in free trade agreements."[5] The ACTPN also supports the integration of the Dominican Republic into the FTA, and states that it "is particularly pleased that the Dominican Republic, as part of these negotiations, will become a member of the WTO Information Technology Agreement, which provides for dutyfree treatment of information technology products" which, the report says, has been a key objective of U.S. high-tech industries.[6]

The ACTPN considers that the specificity of obligations regarding customs procedures, coupled with the commitments to share information to combat illegal transshipment of goods and to facilitate express shipments, set and maintain a high standard for negotiated trade agreements. The report notes that the FTA's provisions for the rapid release of goods—within 48 hours to the extent possible—is likely to significantly improve customs administration in the CA/DR region, thus achieving a major objective for U.S. businesses. The report also states that transparency and ease of doing business will be greatly improved by provisions for advanced customs rulings as well as for posting customs laws and regulations on the Internet. Such provisions are likely to benefit smaller U.S. exporters in particular.[7]

The Industry Functional Advisory Committee on Customs Matters (IFAC 1) addresses a number of customs issues in its report, including matters involving the FTA's general

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[4] Additional information on U.S. trade negotiating objectives is available from Industry Functional Advisory Committee on Customs Matters (IFAC 1), *Report of the Industry Functional Advisory Committee on Customs Matters on the U.S.-Central American Free Trade Agreement*, March 12, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/ifac01.pdf*, retrieved June 28, 2004.

[5] ACTPN, *U.S.-Central America Free Trade Agreement: Report of the Advisory Committee for Trade Policy Negotiations,*, March 12, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/actpn.pdf*, retrieved June 28, 2004.

[6] ACTPN, *Dominican Republic Provisions in the Expanded U.S.-Central American Free Trade Agreement: Report of the Advisory Committee for Trade Policy Negotiations,* April 22, 2004, found at *http://www.ustr.gov/new/fta/Dr/advisor/actpn.pdf*, retrieved June 28, 2004.

[7] CTPN, *Report on the U.S.-Central America Free Trade Agreement*, March 12, 2004.

provisions, definitions, rules of origin, certification of origin, customs commodity classification, valuation, dispute resolution, trade facilitation, and other provisions.[8] The report states that the FTA includes "so many of the current best practices" with respect to customs administration and trade facilitation, including the 48-hour standard for the release of goods and the provision making customs rules and procedures available to the public.

The IFAC 1 report notes that the FTA provides clear and beneficial descriptions for the customs terms, "temporary admission," "waste and scrap," "used goods," "recovered goods," and "remanufactured products." The report states that the FTA provides clear rules of origin, the ability to request advance rulings, and an avenue to appeal a ruling. The IFAC 1 report also states that the general provisions of the FTA also provide for de minimis nonoriginating components, as well as a mechanism to update those rules as needed. The report finds that these provisions are likely to provide for more efficient administration of the rules.[9]

The IFAC 1 report states that the FTA has "excellent provisions for the handling of certificates of origin," which the committee expects will allow traders to use commercial documents, as well as allow importers to claim preferences up to one year after entry. However, the report voices concern that the FTA does not include a requirement that all parties to the agreement adhere to, and use, the 2002 version of the World Customs Organization's Harmonized Commodity Coding and Classification System (HS). The report recommends that all parties use the same system, since a common commodity classification is central to the tariffrate and market-access provisions in the FTA as well as many of its rules of origin. The report states that the CA/DR governments all employ the HS, although none are parties to the HS Convention nor do they all use the 2002 HS version.[10]

The IFAC 1 report recommends that all of the parties to the FTA be obligated to use the WTO customs valuation system which, the report states, should be transparent in application, include a binding ruling process, and envision the gradual elimination of preshipment inspection firms as a means to certify value.[11]

According to industry representatives, U.S.-based air courier and express delivery firms are likely to benefit from improved customs procedures as a result of the FTA.[12] Industry representatives state that the Dominican Republic, El Salvador, Honduras,

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[8] FAC 1, *U.S.-Central American Free Trade Agreement: Report on Customs Matters*, March 12, 2004.

[9] Ibid.

[10] WCO, Harmonized System Committee, "Position Regarding Contracting Parties to the HS Convention and Related Matters," March 31, 2003, NC0695E1, annex, found at *http://hotdocs.usitc.gov/tata/N_xxx/NCxxx/NC0659E1.pdf*, retrieved July 30, 2004.

[11] IFAC 1, *U.S.-Central American Free Trade Agreement: Report on Customs Matters*, March 12, 2004.

[12] Written statement by Susan M. Prestie, Executive Director, Air Courier Conference of America (ACCA), submitted to the Commission May 4, 2004; and industry representative, telephone interview with USITC staff, Washington, DC, May 7, 2004.

and Nicaragua currently lack clear rules for clearing express shipments, which creates inconsistent procedures and reduced service reliability.[13] In Guatemala, customs hours of operation are limited and there is no service on the weekends,[14] impeding efficiency, especially for express delivery services, in which timesensitive shipments are particularly sensitive to customs' processing delays.[15] The IFAC 1 report states that the FTA requires CA/DR governments to "maintain appropriate measures to ensure efficient and fair Customs facilitation of goods that are imported and/or exported by express delivery services suppliers."[16] The IFAC 1 report also states that the committee would like future trade agreements to negotiate a reduction in the 6-hour release target for express shipments to 3 hours or less.[17]

Sanitary and Phytosanitary Measures

Sanitary and phytosanitary (SPS) regulations are measures designed to protect human, animal, and plant health. The United States has had longstanding concerns about the application of SPS measures by CA/DR governments as barriers to U.S. exports.[18] U.S. trade negotiating objectives with respect to SPS measures were to (1) have CA/DR governments reaffirm their WTO commitments on SPS measures and eliminate any unjustified SPS restrictions, and (2) strengthen collaboration with CA/DR governments in implementing the WTO Agreement on Sanitary and Phytosanitary Measures (SPS Agreement)[19] and enhance cooperation with those governments in relevant international bodies on developing international SPS standards, guidelines,

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[13] Ibid.

[14] Written statement to the Commission by Susan M. Prestie, ACCA, May 4, 2004.

[15] Industry representative, telephone interview with USITC staff, Washington, DC, May 7, 2004.

[16] IFAC 1, *U.S.-Central American Free Trade Agreement: Report on Customs Matters*, March 12, 2004.

[17] Ibid.

[18] The following are examples of U.S. concerns. Costa Rica: lengthy and cumbersome process for obtaining standard SPS documentation; local testing requirement for all foods, pharmaceuticals, agricultural goods, and chemicals and cosmetics for human and animal consumption; and temporary ban on imports of U.S. beef. El Salvador: arbitrary sanitary measures on imports of U.S. poultry; failure to notify WTO of certain SPS measures; local testing requirement for all food imports to be sold at retail outlets; and local sanitary certificate required for all imports of fresh food and agricultural imports. Guatemala: local testing requirement for imported food. Honduras: ban on imports of U.S. poultry based on SPS concerns; lack of transparency in application of SPS requirements; and local sanitary permits required for all food imports. Nicaragua: no regulatory process for approving agricultural biotechnology products for import or sale. USTR, "Costa Rica," "Dominican Republic," "El Salvador," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report on Foreign Trade Barriers*, pp. 103, 112-113, 132, 176, 198, and 347, found at *http://www.ustr.gov/reports/nte/2004/index.htm*, retrieved July 19, 2004.

[19] The WTO SPS Agreement entered into force on January 1, 1995, with the establishment of the WTO. Among other things, the WTO SPS Agreement "allows countries to set their own standards. But it also says regulations must be based on science. They should be applied only to the extent necessary to protect human, animal or plant life or health. And they should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail." WTO, *Understanding the WTO: The Agreements—Standards and Safety*, found at *http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm*, retrieved July 19, 2004.

and recommendations. The United States has longstanding concerns regarding the application of SPS measures against U.S. exports to the CA/DR region.[20]

In its endorsement of the FTA provisions with respect to agriculture, the ACTPN states that the CA/DR governments commit to apply the science-based disciplines of the WTO SPS Agreement, and to move toward recognizing the export eligibility for all processing plants inspected under the U.S. food safety and inspection system.[21] In addition, chapter 6 of the FTA calls for the establishment of a Committee on Sanitary and Phytosanitary Matters that is to work with CA/DR officials to enhance their implementation of the WTO SPS Agreement and enhance consultation and cooperation on SPS matters, but not to require changes in SPS regulations in any of the countries.

Technical Barriers to Trade

U.S. trade negotiating objectives regarding technical barriers to trade (TBT) were to (1) have CA/DR governments reaffirm their WTO TBT commitments and eliminate any unjustified TBT measures; and (2) strengthen collaboration with the CA/DR governments on implementation of the WTO TBT Agreement[22] and create a procedure for exchanging information with CA/DR officials on TBTrelated issues. The United States has longstanding concerns with respect to TBT issues in the CA/DR region. Certain U.S. agricultural exports have experienced difficulty in gaining entry to some countries, while foods, pharmaceuticals, chemicals, and cosmetics for human and animal consumption must be locally tested and certified, sometimes using arbitrary and nonsciencebased measures.[23] Under chapter 7 of the FTA, the CA/DR governments affirm their commitments to the WTO TBT Agreement and make their standards systems more open and transparent.

The report by the Industry Functional Advisory Committee on Standards (IFAC 2) states that the FTA effectively promotes the economic interests of the United States and achieves the overall and principal negotiation objectives. The IFAC 2 report states that

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[20] USTR, "Costa Rica," "Dominican Republic," El Salvador," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report on Foreign Trade Barriers*, pp. 103, 112-113, 132, 176, 198, and 347.

[21] ACTPN, *Report on the U.S.-Central America Free Trade Agreement,* March 12, 2004.

[22] Among other things, the WTO TBT Agreement "tries to ensure that regulations, standards, testing and certification procedures do not create unnecessary obstacles. The agreement recognizes countries' rights to adopt the standards they consider appropriate. . . . Moreover, members are not prevented from taking measures necessary to ensure their standards are met. In order to prevent too much diversity, the agreement encourages countries to use international standards where these are appropriate, but it does not require them to change their levels of protection as a result." WTO, *Understanding the WTO: The Agreements—Standards and Safety*, found at *http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm#TRS*, retrieved July 19, 2004.

[23] USTR, "Costa Rica," "Dominican Republic," "El Salvador," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2004, pp. 103, 112-113, 132, 176, 198, and 347, found at *http://www.ustr.gov*, retrieved July 16, 2004.

the FTA "adequately provides for equity and reciprocity as regards standards and technical trade barriers."[24]

Electronic Commerce

U.S. trade negotiating objectives regarding electronic commerce (e-commerce) were to affirm that CA/DR governments will allow U.S. goods and services to be delivered electronically to their markets and to ensure that they do not apply customs duties to digital products or unjustifiably discriminate among products delivered electronically.[25] U.S. industry representatives suggested that negotiating principles be to: (1) apply current WTO obligations, rules, disciplines, and commitments, including the GATS and TRIPS Agreements, to ecommerce; (2) afford no less favorable treatment to electronically delivered goods and services than to like products delivered in physical form; (3) ensure that governments refrain from enacting trade-related measures that impede e-commerce; (4) ensure that domestic regulations that affect ecommerce are the least trade restrictive, nondiscriminatory, transparent, and promote an open market environment; and (5) make permanent the WTO moratorium on customs duties on electronic transmissions.[26]

The ACTPN report states that the e-commerce provisions and the liberal treatment of services in the FTA "continue the high standard that has been set for these provisions in other recent U.S. trade agreements." The report notes the establishment under the FTA of guarantees of nondiscrimination and binding prohibition on customs duties on products delivered electronically, and concludes that the FTA is likely to create a favorable environment for the development of e-commerce.[27]

The report by the Industry Functional Advisory Committee on Electronic Commerce (IFAC 4) states that the e-commerce provisions of the FTA "promote the economic interests of the United States and provide equity and reciprocity for electronic commerce firms."[28] The report notes that the CA/DR governments commit not to impose customs duties on digital products transmitted electronically, while agreeing to apply customs duties on the basis of the value of the carrier medium in the case of

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[24] Industry Functional Advisory Committee on Standards (IFAC 2), *U.S.-Central American Free Trade Agreement: Report of the Industry Functional Advisory Committee on Standards,* March 9, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/ifac02.pdf*, retrieved June 28, 2004, and IFAC 2, *U.S.-Dominican Republic Free Trade Agreement: Report of the Industry Functional Advisory Committee on Standards,* April 2, 2004, found at *http://www.ustr.gov/new/fta/Dr/advisor/ifac02.pdf*, retrieved June 28, 2004.

[25] ACTPN, *Report on the U.S.-Central America Free Trade Agreement,* March 12, 2004.

[26] IFAC 4, *U.S.-Central America Free Trade Agreement: Report of the Industry Functional Advisory Committee on Electronic Commerce,* March 8, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/ifac04.pdf*, retrieved June 28, 2004.

[27] ACTPN, *Report on the U.S.-Central America Free Trade Agreement,* March 12, 2004.

[28] IFAC 4, *U.S.-Central America Free Trade Agreement: Report on Electronic Commerce,* March 8, 2004.

physical delivery of digital products. The IFAC 4 report states that the ecommerce chapter of the FTA introduces the concept of "digital products" and acknowledges the need for predictability in the treatment of trade in digital products.[29] The report notes that nondiscriminatory treatment of digital products under the FTA represents a broad application of nondiscriminatory national treatment and MFN treatment that the committee views as a step forward in securing liberal trade treatment of digital products.[30]

Transparency

Transparency of laws and regulations is considered an important principle in regulatory reform and a fundamental requirement for good governance.[31] Lack of transparency and regulatory certainty in the CA/DR region presently impedes market access for U.S.-based firms by reducing the ability of firms to make informed trade and investment decisions.[32]

U.S. negotiating objectives with respect to transparency (including anticorruption and regulatory reform) were to (1) make administration of the trade regimes in the CA/DR region more transparent, and pursue rules that will permit timely and meaningful public comment before the CA/DR governments adopt trade-related measures, and (2) ensure that CA/DR governments apply high standards prohibiting corrupt practices affecting international trade and enforce such prohibitions.

U.S.-based service firms are particularly sensitive to transparency issues, which is attributable to the high degree of regulation such firms encounter in foreign service markets.[33] U.S.-based firms are likely to benefit from the transparency provisions of the FTA requiring, among other things, prompt publication of rules; early notification of changes, where possible; and reasonable notice and opportunity to respond to administration of proceedings.[34] The FTA includes separate provisions for transparency in financial services that are deemed consistent with current U.S. practices.[35] The FTA's transparency provisions are likely to facilitate trade in insurance

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[29] Ibid.

[30] Ibid.

[31] Geza Feketekuty, "A Vision for the Millennium Round," p. 3, found at *http://www.commercialdiplomacy.org/articles.htm*, retrieved April 29, 2004.

[32] USTR, "Costa Rica," "Dominican Republic," "El Salvador," "Guatemala," "Honduras," and "Nicaragua," *Reports on Foreign Trade Barriers, 2004*, *http://www.ustr.gov/reports/index.shtml*, retrieved May 7, 2004.

[33] The impact of the FTA with respect to trade in services is discussed in chapter 3 of this report.

[34] ACTPN, *Report on the U.S.-Central America Free Trade Agreement,* March 12, 2004. Transparency provisions with respect to government procurement are discussed in the section on "Government Procurement" in chapter 7 of this report.

[35] Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13), *U.S.-Central America Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters*, March 17, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/isac13.pdf*, and ISAC 13, *U.S.-Dominican Republic Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters*, Apr. 22, 2004, found at *http://www.ustr.gov/new/fta/Dr/advisor/isac13.pdf*, retrieved June 19, 2004.

services, where transparency is deemed important to foreign firms that face a high degree of regulation in these markets.[36] Further, the chapter's anticorruption provisions, which make it a criminal offense to bribe a public official "in matters affecting international trade or investment," also could lead to greater business opportunities in the CA/DR region for U.S.-based firms.

[36] ISAC 13, *U.S.-Central America Free Trade Agreement: Report on Services*, March 17, 2004. The impact of the FTA with respect to the insurance sector is discussed in chapter 3 of this report.

CHAPTER 6
Impact of Investment Provisions

This chapter provides a qualitative assessment of the potential impact of the investment provisions of the U.S.-CA/DR FTA (chapter 10 of the FTA and investment-related aspects of annexes I-III) on the United States. It begins with a brief description of the bilateral investment relationship between the United States and the CA/DR region and a summary of the major investment provisions of the FTA.[1] The chapter concludes with a discussion of the effects of the investment provisions of the FTA on the U.S. economy, taking into account the opinions of U.S. industry representatives. To the extent possible, this discussion considers the potential effects of the investment provisions of the FTA on U.S. industry and the U.S. economy as a whole.

The U.S. trade negotiating objectives with respect to investment were to (1) establish rules that reduce or eliminate artificial or trade-distorting barriers to U.S. investment in CA/DR, while ensuring that CA/DR investors in the United States are not accorded greater substantive rights with respect to investment protections than U.S. investors in the United States; (2) to secure for U.S. investors in CA/DR important rights comparable to those that would be available under U.S. legal principles and practice; (3) to ensure that U.S. investors receive treatment as favorable as that accorded to domestic or other foreign investors in CA/DR and to address unjustified barriers to the establishment and operation of U.S. investments in CA/DR; and (4) provide procedures to resolve disputes between U.S. investors and the CA/DR governments that are expeditious, fair, and transparent.[2]

Investment Relationship between the United States and the FTA Partners

Table 6-1 presents an overview of the inbound and outbound investment of the CA/DR region, along with available information regarding the bilateral investment relationship between the countries of the region and the United States. In 2002, the CA/DR region registered inbound investment stock from all sources of $23.7 billion, with the greatest amount of investment directed to the Dominican Republic and Costa Rica, which recorded total inbound investment stock of $7.3 billion and $6.3 billion, respectively. Direct investment stock from the United States represents 15 percent of the total for the Dominican Republic, and 25 percent of the total for Costa Rica. The level of

[1] Additional background information on investment provisions of the U.S. FTA with Central America and the Dominican Republic is provided in chapter 2 of this report.

[2] The trade negotiating objectives for FTA were set out in the Executive Branch notifications to Congress regarding the administration's intent to negotiate an FTA with Central America and with the Dominican Republic. For further information, see the section "Chronology of the FTA" in chapter 1 of this report.

Table 6-1
Central American countries and the Dominican Republic: Investment data, 2002
(US$ millions)

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Dominican Republic	six-country total
Total inbound investment stock . . .	6,302	2,431	4,155	1,826	1,710	7,254	23,658
Total outbound investment stock . . .	160	39	([1])	36	17	89	341
U.S. as percent of total investment flows . . .	34.1	[3]36.0	([1])	[4]38	([1])	[2]21.2	([1])
U.S. bilateral outbound investment stock . . .	1,602	580	391	184	242	1,123	4,122
U.S. bilateral inbound investment stock . . .	-8	-2	([1])	-2	[5]0.5	57	45
Sales of services by majority-owned U.S. affiliates (2001)	98.3	([1])	106.8	([1])	([1])	1,270.3	([1])
Bilateral Investment Treaty with the United States	No	Yes[6]	No	Yes	Yes[7]	No	([1])

[1] Not available.
[2] 2000 data.
[3] 2001 data.
[4] 2002 data. Excludes production sharing.
[5] Less than $500,000.
[6] Signed March 1999 but never entered into force, since El Salvador has not ratified the treaty.
[7] Signed and ratified by Nicaragua, before the U.S. Senate as of December 2002.

Sources: UNCTAD, *World Investment Report 2003;* BEA, *Survey of Current Business,* Sept. 2003; USDOC, *Country Commercial Guides*; and Costa Rica Ministry of Foreign Trade.

sales by foreign-owned affiliates illustrates the economic activity generated by foreign investment; such information is available for three of the six FTA partners. In 2001, U.S.-owned affiliates in Costa Rica, the Dominican Republic, and Honduras recorded total sales of $2.7 billion, $1.4 billion, and $2.8 billion, respectively.[3] For all three countries, the manufacturing sector accounted for the largest share of employment by U.S.-owned affiliates.[4]

Current Investment Policies in the CA/DR Region

This section summarizes current investment policies in the CA/DR region. Table 6-2 shows the major investment laws and investment climate in the CA/DR region as of 2004.

[3] USDOC, Bureau of Economic Analysis (BEA), *Survey of Current Business,* November 2003, p. 101.
[4] USDOC, BEA, *Survey of Current Business,* November 2003, p. 103.

Table 6-2
Central American countries and the Dominican Republic: Major investment laws and investment climate, as of 2004

Country	Investment laws and investment climate
Costa Rica	Major investment-related laws: Law 6209 governs distribution agreements, 1998 Concessions Law ; Law 7495 on expropriations (1995) requires full and prior payment before any expropriation. Investment climate: Generally good but declining - state monopolies, lack of IPR enforcement, infrastructure problems. No capital controls or portfolio investment controls.
El Salvador	Major investment-related laws: 1999 Investment Law, 1990 Export Reactivation Law, 1998 Law of Commercialization and Industrial Free Zones. Other laws: 1999 Banking Law, Insurance Companies Law, Mining Law, Monetary Integration Law, Stock Market Law, and special legislation governing privatizations. Investment climate: Very welcoming of new investment; dollarization of the economy encourages U.S. investors; transparent bureaucracy; no capital controls.
Guatemala	Major investment-related laws: 1998 investment law streamlined foreign investment procedures. Financial reform package passed in 2002. Investment climate: In spite of the new law, lots of bureaucratic difficulties and delays, along with corruption, make foreign investment difficult. Dispute resolution is time-consuming and unreliable, and corruption is “not uncommon.”
Honduras	Major investment-related laws: 1992 Investment Law, Agrarian Reform Law, Agricultural Modernization Law of 1992, 2001 State Contracting Law; July 2002 law regarding simplification of administrative procedures in establishing a company (domestic and foreign). Investment climate: Legally, there is a favorable investment climate, but Honduras has problems with crime, corruption, juridical insecurity, low education levels, and inadequate financial sector and infrastructure. There are also issues regarding land ownership, particularly within 25 miles of the coast.
Nicaragua	Major investment-related laws: Foreign Investment Law, Law No. 344 of 2000; Government Procurement Law passed in 2000. Investment climate: No profit repatriation problems. The 2000 foreign investment law safeguards the rights of foreign investors, but dispute settlement, especially contract enforcement, and regulatory transparency are reported to be problematic.
Dominican Republic . . .	Major investment-related laws: Foreign Investment Law 16-95 simplified registration of foreign investment, removed foreign equity limits, and opened the following sectors to foreign investment: public services and works, mining, banking, private insurance, media (radio, television, newspapers), agriculture, and transportation. Investment climate: New foreign investment in the Dominican Republic has been strong, particularly in electricity, tourism, mining, communications, and textiles. No currency controls or investment screening, but problems with dispute resolution.

Source: U.S. Department of Commerce, Country Commercial Guides.

Costa Rica

Costa Rica has a fairly open investment regime, with the exception of the telecommunications, electricity, petroleum, and insurance sectors, which are controlled by government monopolies. However, there are concerns among foreign investors that the generally good investment environment is declining, due to problems with excessive bureaucracy and Costa Rican macroeconomic problems.[5] Investors have also complained that the Costa Rican state monopoly in telecommunications has led to relatively less investment in telecommunications infrastructure and new technology in that country, particularly in the areas of Internet and wireless technology. The corresponding high prices and lack of availability of some services in those areas have reduced the incentives to invest in Costa Rica, compared with other countries where competition between privately owned telecommunications firms has led to greater investment in such new technologies in recent years.[6] In addition, U.S. investors report that the state monopolies tend to distort the investment climate, and foreign companies have noted a problem hiring a sufficient number of English-speaking workers to fill certain positions.[7] Enforcement of intellectual property rights has also been a concern for foreign investors. Finally, investors have expressed concerns regarding the slow pace of the Costa Rican legal system, where commercial disputes commonly take 10 years or longer to resolve.[8] According to the U.S. Department of Commerce, there are no controls on transfer of capital into or out of the country and no portfolio investment controls.[9]

El Salvador

El Salvador has made a strong effort to make the country more welcoming to foreign investors, passing several investment-related laws between 1996 and 2001. Privatization laws passed during 1996-98 permitted privatization of electric power and telecommunications facilities and the operation of private pension funds. The 1999 Investment Law established equal treatment for foreign and domestic investors and permits foreign investors to establish businesses in El Salvador, with exceptions only for small businesses. The law also permits free movement of capital. El Salvador also enacted a number of other laws affecting foreign direct investment (FDI) in the late 1990s and 2000, including laws that created new financial sector regulators, reformed the customs process, and established more transparent government procurement processes.[10] However, the United States has expressed concerns that

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[5] USTR, "Costa Rica," *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 106.

[6] Calman Cohen, Emergency Committee for American Trade, testimony at Commission hearing, April 27, 2004.

[7] USDOC, ITA, *Costa Rica Country Commercial Guide FY 2004.*

[8] USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 106.

[9] Ibid.

[10] USDOC, U.S. and Foreign Commercial Service (US&FCS), "El Salvador Country Commercial Guide FY 2003," December 18, 2002, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

new regulations pertaining to the electric power sector may cause problems for U.S. investors in that sector.[11] As of January 1, 2001, the U.S. dollar circulates freely along with the domestic currency in El Salvador and can be used for all transactions.[12]

Guatemala

Guatemala has worked to bring additional foreign direct investment into the country in recent years, as a way to increase capital available for economic development. The country's 1998 investment law enhanced transparency by consolidating most of the regulations affecting FDI into a single law and creating more favorable conditions for foreign capital.[13] There are no capital controls and no limits on land ownership, establishment of a business, or foreign equity ownership, except for ground transportation and domestic airline services, which have foreign ownership limits of 51 percent and 49 percent, respectively. These foreign equity limitations are scheduled to be removed in 2004.[14] Much of the foreign investment in Guatemala is concentrated in the free trade zones, particularly in the textiles and light manufacturing sectors, but foreign investors have also shown interest in infrastructure investment. The telecommunications and electric power industries were both privatized during the late 1990s. A majority share of the Guatemalan telephone service provider was sold to Telmex of Mexico in 1998, and the power plants belonging to Guatemala's state-owned electric company were sold to U.S.-owned Guatemalan Generating Group in 1997 and 1998.[15]

Honduras

In Honduras, foreigners are guaranteed national treatment in most investment, with a few exceptions. Small businesses (with capital less than 150,000 lempiras, or $8,600) are reserved for Hondurans; at least 90 percent of a company's labor force must be Honduran, and 85 percent of the total payroll must be paid to Hondurans. Tax rates for both foreign and local investors were reduced to 5 percent under a 2002 law, and the tax is scheduled to be entirely eliminated in 2004.[16] Government authorization is required for investment in several specific sectors.[17] On paper, foreign firms are

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[11] USTR, "El Salvador," *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 135.

[12] USDOC, US&FCS, "El Salvador Country Commercial Guide FY 2003," December 18, 2002, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

[13] USDOC, US&FCS, "El Salvador Country Commercial Guide FY 2003," December 18, 2002, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004. See also USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 178.

[14] USDOC, US&FCS, "Guatemala Country Commercial Guide FY 2003," December 19, 2002, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

[15] WTO, *Guatemala Trade Policy Review*, WT/TPR/S/94, December 14, 2001.

[16] USDOC, US&FCS, *Honduras Country Commercial Guide FY 2004,* January 26, 2004, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

[17] Basic health services, telecommunications, electric power, air transport, fishing, hunting and aquaculture, exploitation of forestry resources, mining-related investment, agricultural activities exceeding certain limits, insurance and financial services, and private education. USDOC, US&FCS, *Honduras Country Commercial Guide FY 2004,* January 26, 2004, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

granted national treatment in government procurement, but U.S. firms have noted transparency concerns related to government contracts. There are frequent complaints regarding the business dispute resolution system through the Honduran courts, particularly with regard to inadequate land title procedures.[18] The Honduran Constitution prohibits foreign ownership of land within 25 miles of the coast or of an international border. However, laws passed in 1990 permit foreigners to acquire land in designated tourism development zones within these regions, with special permission.[19]

Nicaragua

Nicaragua's foreign investment law of 2000, which ensures national treatment to foreign investors, eliminates a previous requirement for investment contracts and eliminates other restrictions on foreign investment regarding land ownership and capital restrictions. Since 1997, the government of Nicaragua has also embarked on a program of privatization of state-owned enterprises and private road concessions, opening up new opportunities for foreign investors.[20]

Poor enforcement of property rights has led to a large number of property disputes in Nicaragua. Foreign investors in Nicaragua are working with the U.S. Government in an ongoing effort to resolve property disputes stemming from the Sandinista government's expropriation of thousands of privately owned properties during the 1980s. U.S. citizens have filed almost 3,000 claims with the U.S. Embassy since 1992, with fewer than 800 pending as of December 2003. In most cases, the Nicaraguan Government has left property in the hands of the current occupants, while offering the claimants low-interest bonds in compensation.[21]

Dominican Republic

The Dominican Republic's 1995 foreign investment law allows foreign investment without limits in most sectors of the economy. The only exceptions to this law are disposal and storage of toxic, hazardous, or radioactive waste not produced in the country; activities affecting public health and the ecological equilibrium of the country; and the production of materials and equipment directly linked to national security without authorization from the president.[22] The Dominican Republic also passed a new monetary and financial law in 2002, which provides national treatment protections for investors in the financial services area, establishes a new financial

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[18] USTR, "Honduras," *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 201; and USDOC, US&FCS, *Honduras Country Commercial Guide FY 2004,* January 26, 2004, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

[19] Ibid.

[20] USDOC, US&FCS, "Nicaragua Country Commercial Guide FY 2003," December 26, 2002, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

[21] USTR, "Nicaragua," *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 349.

[22] USDOC, US&FCS, *Dominican Republic Country Commercial Guide FY 2002,* August 25, 2001, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

regulatory regime, and permits foreign investment in Dominican financial intermediaries.[23] Under the 1995 foreign investment law, there are no limits on foreign equity ownership or screening of new foreign investment and no controls on remittances of capital or profits. The Dominican standards related to expropriation of foreign-owned property are not consistent with the standards of international law, and the Dominican Republic has a problematic history of inadequately compensated expropriation claims and more recent investment disputes in the electric power sector.[24] However, recent administrations have made efforts to improve this track record, including judicial reforms and the replacement of judges in both the land courts and the Supreme Court.[25] The U.S. Embassy estimated that outstanding U.S. investor claims totaled $300 million as of August 2001.[26]

Nonconforming Measures of the FTA

The investment chapter of the U.S.-CA/DR FTA (chapter 10 of the FTA) contains many provisions similar to those in the investment chapters of previous bilateral FTAs, including the U.S. FTAs with Chile, Singapore, Australia, and Morocco.[27] The chapter also contains provisions for nonconforming measures—i.e., for the treatment of existing or future activities that are inconsistent with certain disciplines (specifically, those concerning nondiscrimination, performance requirements, and senior personnel). Existing measures maintained at the central or regional government level are exempted from these disciplines provided that they are described in annex I of the FTA. Reservations to ensure that a party maintains flexibility to impose measures in the future that may be inconsistent with these disciplines are described in annex II. Nonconforming measures at the local government level are exempted without requiring any notation in an annex. The actual content of the reservations in annexes I and II varies widely. Some reservations are horizontal in nature, meaning that they address general policy provisions that affect all investments, whereas others apply to specific industry segments. All nonconforming measures specific to financial services are addressed in annex III.

The horizontal reservations for the CA/DR governments are described below. The specific sectors for which current reservations are listed in annexes I and III are presented in table 6-3 and the specific sectors for which potential reservations are

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[23] USTR, "Dominican Republic," *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 114.

[24] USTR, "Dominican Republic," *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 115.

[25] USDOC, US&FCS, *Dominican Republic Country Commercial Guide FY 2002,* August 25, 2001, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004; and USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers,* p. 116.

[26] USDOC, US&FCS, *Dominican Republic Country Commercial Guide FY 2002,* August 25, 2001, found at *http://www.stat-usa.gov/,* retrieved February 18, 2004.

[27] A summary of the investment provisions of the U.S.-CA/DR FTA is provided in chapter 2 of this report.

Table 6-3
U.S.-CA/DR FTA: CA/DR industry sectors subject to existing nonconforming measures

Costa Rica
Professional services: public accountants; political scientists and international relations specialists; Pharmacists; geologists; agronomical engineers (forestry or agriculture/livestock appraisers-surveyors); chemists and chemical engineers; physicians and surgeons; veterinarians; lawyers (i.e. notaries); nutritionists, dental surgeons; journalists; medical and surgical technicians; nurses; and official translators and interpreters

Transportation: maritime, land, air

Communications: radio and television

Distribution services: wholesale and retail trade

Other: services incidental to mining: non-hydrocarbon, free zones, services related to fisheries, electric power, higher education, audiovisual, advertising, banking, insurance, wireless services, and sporting services

El Salvador
Broadcasting: radio and television

Other: cooperative production societies; duty-free commercial centers construction; fisheries accounting and auditing; customs agents; road transportation

Guatemala
Forestry; Professional services (all); air transportation; banking; insurance

Honduras
Distribution: fuel stations

Cultural and recreational services: casinos and gambling

Transportation: air, maritime, road, and rail

Financial: banking, insurance, and other financial services

Other: customs agents; agriculture; radio, television, and newspaper services; construction; education, entertainment; investigation and security services; and fishing

Nicaragua
Financial: banking, insurance, pension funds

Other: mining; fishing; customs brokers; free zones; maritime transportation; and telecommunications

Dominican Republic
Audiovisual services: broadcasting

Distribution services: commission agents

Transportation: Air and maritime

Financial services: banking and Insurance

Other: news agency services; free zones; mining; oil exploitation and exploration; fishing; and cooperative associations

Source: Text of the U.S.-CA/DR FTA, annex I and annex III.

listed in annexes II and III are presented in table 6-4 without attempting to characterize the actual substance of the reservation. In many cases, the reservation represents a measure that imposes a potential constraint on foreign investment that may or may not have any significant bearing on the activities of foreign investors. Consequently, the inclusion of a sector in the annex should not be interpreted to mean that the sector as a whole has been exempted from coverage under the investment disciplines. The annexes address nonconforming measures in the services and investment areas in

relation to both investment and cross-border trade. The tables included herein reflect only those nonconforming measures that deal directly with investment. The nonconforming measures which only address cross-border trade in services are discussed in chapter 3 of this report.

Horizontal reservations taken by the United States under annex I reflect the same reservations taken by the United States with regard to previous bilateral FTAs. The reservations address the programs of the Overseas Private Investment Corporation and the registration of public offerings of securities, as well as existing nonconforming

Table 6-4
U.S.-CA/DR FTA: CA/DR industry sectors subject to potential nonconforming measures[1]

Country	Sector
Costa Rica	
	• Cultural industries • Social services • Banking • Insurance
El Salvador	
	• Social services • Minority affairs[2] • Insurance • Banking
Guatemala	
	• Maritime transportation • Minority affairs[2]
Honduras	
	• Telecommunications • Social services • Minority affairs[2]
Nicaragua	
	• Telecommunications • Social services • Minority affairs[2]
Dominican Republic	
	• Communications: radio • Government finance • Social services • Financial services • Minority affairs[2]

[1] Industry sectors in which countries have reserved the right to impose future specific measures that would otherwise contradict their FTA commitments.

[2] The indicated country has reserved the right to adopt special measures in the future that favor minorities (e.g., indigenous minority groups), without specifying a specific industry to which these measures would be applied.

Source: U.S.-CA/DR FTA, annex II and annex III.

measures at the state level. Horizontal reservations listed by the United States under annex II include a reservation that appears to ensure that U.S. obligations under the FTA concerning the cross-border services trade or establishment of a service enterprise are equivalent to those undertaken in the GATS. Annex II of the United States also contains horizontal reservations reserving the right to adopt measures granting special rights to minority groups, and for measures that accord preferential treatment to countries under bilateral or multilateral international agreements that have been signed prior to the entry into force of the FTA, including international agreements involving aviation, fisheries, or maritime matters.

All of the Central American countries and the Dominican Republic include the latter measure, regarding international agreements, in annex II of their own schedules, with the addition of international agreements involving telecommunications matters for the Dominican Republic and Nicaragua. The Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua all reserve the right to adopt measures granting special rights to minority groups as well. Costa Rica does not list any additional horizontal measures in either annex I or annex II.

For the Dominican Republic, annex I contains horizontal reservations requiring that only Dominican nationals perform activities related to the disposal of toxic waste produced outside of the country. Provisions in annex II reserve the right to restrict land ownership within 20 kilometers (km) of the Dominican border and the right to limit foreign equity ownership of newly privatized, state-owned entities or to adopt measures related to the nationality of senior management or the board of directors of those entities. For El Salvador, annex I horizontal reservations state that rural land may not be owned by foreign persons or foreign majority-owned corporations, if the foreign person's country does not permit Salvadoran persons to own rural land. In addition, only Salvadoran nationals, or the nationals of Central American countries, may establish enterprises with a capitalization of less than $200,000.

Guatemala lists several horizontal reservations in annex I. The use of state-owned lands in the Department of El Peten is restricted to Guatemalan nationals who do not own rural real estate exceeding 45 hectares and who do not own industrial, mining, or commercial enterprises. Only Guatemalan nationals and enterprises majority-owned by Guatemalan nationals may take adverse possession of real estate. Non-Guatemalan nationals require special government authorization to acquire real estate located in urban areas and near the ocean, lake shores, navigable rivers, and drinking water sources, and only Guatemalan nationals or 100-percent Guatemalan-owned corporations may possess real estate within 15 km of the borders. Finally, in order to establish in Guatemala, any enterprise organized under foreign law must post a guarantee of at least $50,000, depending on the size of the investment, which shall remain in effect throughout the enterprise's operation in Guatemala.

Honduras lists three horizontal measures in annex I. First, only Honduran nationals are permitted to own land within 40 km of borders and coastlines, except that foreigners may hold such lands under lease for up to 40 years for approved purposes

related to tourism, economic, or social development. Second, small-scale industry, valued at less than 150,000 lempiras, is reserved for Honduran persons. Finally, cooperatives may only be established by non-Hondurans if there is reciprocity with the cooperative's country of origin, and the non-Honduran cooperative maintains at least one permanent legal representative in Honduras.

Nicaragua lists an annex II reservation reserving the right to adopt future measures regarding coastal lands, islands, and river banks, and another reservation allowing Nicaragua to limit foreign equity ownership of newly privatized, state-owned entities, or to adopt measures related to the nationality of senior management or the board of directors of those entities.

Potential Effects on the U.S. Economy

Changes in bilateral investment flows as a result of the FTA are not likely to have a significant overall effect on the U.S. economy because of the small size of the CA/DR regional economy and the CA/DR market relative to the United States. In specific sectors such as footwear, however, the FTA may generate new outbound U.S. investment.[28] The FTA is also expected to contribute to general economic growth in the CA/DR region, which will likely attract additional investment from U.S. firms that focus on sales within the region.[29] Industry representatives have noted several other important benefits of the FTA and see it as a net benefit for U.S. investors particularly because this FTA represents the first time that such strong investor protections have been extended by a group of developing countries.[30]

One of the important facets of the FTA in encouraging new U.S. investment in the region is the FTA's investor-state dispute settlement provision. This provision assures investors from all parties that in case of an investment dispute, an investor has the right to initiate binding arbitration directly with the government of the host country, rather than work through the state-to-state process that exists in the absence of an FTA or Bilateral Investment Treaty (BIT). Industry representatives also noted the importance of the FTA's structure as a multilateral agreement, rather than a set of bilateral treaties, which allows U.S. firms to take advantage of expanded free trade opportunities in the CA/DR region, as well as bilateral trade opportunities between each country and the United States. For U.S. investors, this opens up the possibility of investing in a manufacturing facility in one country and being able to source from or export to the other five countries, which greatly increases an investor's flexibility to search for the best opportunities.[31] However, one of the principal constraints to the free movement of

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[28] Commission hearing, witness testimony, April 27, 2004.

[29] Industry representative, telephone interview with USITC staff, April 30, 2004.

[30] Industry representatives, telephone interviews with USITC staff, February 26, March 11, and April 30, 2004.

[31] Calman Cohen, Emergency Committee for American Trade, Commission hearing testimony, April 27., 2004; and industry representatives, telephone interviews with USITC staff, February 26, March 2-3, and April 30, 2004.

goods in the CA/DR region is the existence of different product standards in each country. According to industry representatives, it is unclear whether the FTA will have a significant impact on this issue, but the provisions of the FTA that address transparency will likely improve the situation by enabling a better understanding of each country's regulations regarding product standards.[32]

Industry representatives would have preferred that the investment protections contained in the FTA apply to investment agreements concluded before the FTA's entry into force, particularly given that the BIT currently in force between the United States and Honduras does include protections for investment agreements signed prior to the entry into force of that treaty. Such existing investment agreements generally apply to natural resources or other assets owned by the government, such as electric power and water treatment plants covered by long-term contracts. Given the long-term nature of these investments, it is particularly problematic for U.S. investors that they are not covered by the FTA in the event of an investment dispute.[33] In addition, industry representatives are concerned about the breadth of the prudential carve-out for financial services, designed to ensure that necessary regulatory oversight of the financial services sector will not come into conflict with the provisions of the FTA. According to industry sources, the procedure that establishes whether a measure properly falls within the area of the carve-out is too lengthy and onerous to be relied upon.

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[32] Industry representatives, telephone interviews with USITC staff, April 30, 2004.

[33] Calman Cohen, Emergency Committee for American Trade, testimony at Commission hearing, April 27, 2004; Industry Sector Advisory Committee on Services for Trade Policy Matters (ISAC 13), *The U.S.-Central America Free Trade Agreement: Report of the Industry Sector Advisory Committee on Services for Trade Policy Matters*, March 17, 2004, and *The U.S.-Dominican Republic Free Trade Agreement: Reports of the Industry Sector Advisory Committee on Services for Trade Policy Matters*, April 22, 2004, found at *http://www.ustr.gov/,* retrieved April 26, 2004; and industry representatives, telephone interviews with USITC staff, February 26 and March 11, 2004.

CHAPTER 7
Impact of Provisions With Respect to the Regulatory Environment

This chapter provides a qualitative assessment of the potential impact of provisions of the U.S.-CA/DR FTA with respect to trade remedies and dispute settlement (chapters 8 and 20 of the FTA), government procurement (chapter 9), intellectual property rights (chapter 15), labor (chapter 16), and the environment (chapter 17).[1]

As stated in chapter 5 of this report, although it is not possible to quantify the economic effects of these provisions, U.S. firms are likely to benefit from the application of these provisions by the CA/DR governments primarily as a result of improvements in regulatory transparency and assumption of WTO obligations and obligations that go beyond WTO commitments. However, the effects are likely to be very small because of the small size of the CA/DR regional economy and the CA/DR regional market relative to the United States.

Trade Remedies and Dispute Settlement

U.S. trade negotiating objectives with respect to trade remedies were to (1) provide a bilateral safeguard mechanism during the transition period to allow a temporary suspension of tariff reductions if increased imports from one or more of the CA/DR parties are a substantial cause of serious injury, or threat of serious injury, to a domestic industry; and (2) make no changes in U.S. antidumping and countervailing duty laws.[2] The U.S. trade negotiating objectives regarding dispute settlement were (1) to encourage the early identification and settlement of disputes through consultation, and (2) to seek to establish fair, transparent, timely, and effective procedures to settle disputes arising under the FTA. A related U.S. negotiating objective regarding customs administration enforcement was to seek terms for cooperative efforts with the CA/DR governments regarding enforcement of customs and related issues, including trade in textiles and apparel.[3] Chapter 8 of the FTA provides the legal framework to allow bilateral safeguards with respect to originating goods, and chapter 20 provides the legal framework for the settlement of disputes.[4]

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[1] The trade negotiating objectives for FTA were set out in the Executive Branch notifications to Congress regarding the administration's intent to negotiate an FTA with the Central America and Dominican Republic. For further information, see the section "Chronology of the FTA" in chapter 1 of this report.

[2] USTR, "USTR letters to Congressional leaders initiating action on trade agreements," October 1, 2002.

[3] Ibid.

[4] For additional information, see the summary of the FTA provisions in chapter 2 of this report.

The report of the Advisory Committee for Trade Policy and Negotiations (ACTPN) states that the FTA provides for the suspension of tariff benefits for all disputes, including disputes over enforcing labor and environmental laws, as a last resort, but,

> there is a clear preference that fines be used for all disputes where consultation fails to resolve matters. . . . [T]rade retaliatory measures should be taken as a last resort, for they have the capability of interfering with trade and causing considerable economic disruption. The committee believes that the best way to deal with trade disputes is through consultation and mutual understanding.[5]

With the exception of the International Brotherhood of Teamsters,[6] the ACTPN report considers that the FTA contains effective dispute settlement provisions that can ensure that the FTA's requirements can be enforced. The committee report concludes that the FTA "sets high standards of openness and transparency for panel procedures," and considers the dispute settlement provisions of the FTA "to advance the state-of-the-art in trade agreements."[7]

Government Procurement

U.S. trade negotiating objectives regarding government procurement were to (1) establish rules requiring government procurement procedures and practices by the CA/DR governments to be fair, transparent, and predictable for suppliers of U.S. goods and services who seek to do business with the CA/DR governments; and (2) expand access for U.S. goods and services to the CA/DR government procurement markets. None of the CA/DR governments are parties to the WTO Agreement on Government Procurement [8]

The ACTPN report considers that the broad coverage of central government purchasing agencies under the FTA is likely to represent a significant improvement for

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[5] ACTPN, *The U.S.-Central America Free Trade Agreement: Report of the Advisory Committee for Trade Policy and Negotiations*, March 12, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/actpn.pdf*, retrieved June 29, 2004.

[6] The report notes that the Teamsters representative considers that the labor and commercial obligations in the FTA are treated in a manner different from one another, where the labor obligations are enforceable through fines but commercial obligations may be enforced through sanctions. ACTPN, *Report on the U.S.-Central America Free Trade Agreement*, March 12, 2004.

[7] Ibid.

[8] The following are examples of U.S. concerns. Costa Rica: unsatisfactory experiences when responding to government tenders. Guatemala: measures taken to avoid competitive bidding; prequalification requirements for foreign suppliers; requirement for bids to be submitted through locally registered representatives. Honduras: requirement for bids in public tenders to be submitted through local agents; lack of transparency in the bidding process. Nicaragua: inadequate notification of pending procurements. USTR, "Costa Rica," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report on Foreign Trade Barriers*, pp. 103-104, 176, 199, and 347, found at *http://www.ustr.gov/reports/nte/2004/index.htm*, retrieved July 19, 2004.

U.S. firms given the provisions that cover central, regional, and municipal governments; provide strong transparent disciplines; and criminalize bribery in government procurement. The ACTPN report further states that additional coverage of government procurement contracts is possible once a sufficient number of U.S. States offer reciprocal access.[9]

The report from the Intergovernmental Policy Advisory Committee (IGPAC) states that the FTA is supported in principle by most IGPAC members, but the report also notes that certain provisions warrant clarification—in particular, market access, investment, investor-state dispute settlement, and the inclusion of the Dominican Republic to the FTA.[10] Moreover, the IGPAC member representing North Carolina indicates that he "is opposed to the [the FTA] on the grounds that it further accelerates the loss of textile jobs without additional protections for North Carolina's workers and communities."[11]

IGPAC members support the basic intent of expanding market access through increasingly fair and open bidding processes. However, they note that coverage of state procurement in the FTA only pertains to those subcentral entities that have affirmatively offered to include their procurement in the FTA and other FTAs. Some state governments that are not covered by the WTO Government Procurement Agreement may be unable or unwilling to comply with certain specific requirements, given potential conflict with state rules, regulations, laws and the exigencies of a particular procurement.[12]

Intellectual Property Rights

U.S. trade negotiating objectives regarding IPR were to (1) establish standards to be applied in CA/DR that build on the foundations established in the WTO TRIPs Agreement and other international intellectual property agreements; (2) have CA/DR governments apply levels of protection and practices more in line with U.S. law and practices in areas such as copyright and patent protection and protection of undisclosed information; and (3) strengthen procedures in the region to enforce IPR protection.

In general, the CA/DR governments have made much progress in strengthening their IPR regimes in recent years. However, a number of problems remain for U.S. industries dependent on IPR. Some of the major U.S. concerns include implementation of all obligations under TRIPs and treaties, conventions, and agreements under the auspices of the WIPO; copyright, trademark, patent, and trade secret protection; and IPR enforcement.[13]

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[9] ACTPN, *Report on the U.S.-Central America Free Trade Agreement*, March 12, 2004.

[10] Intergovernmental Policy Advisory Committee, *Advisory Committee Report to the President, the Congress and the United States Trade Representative on the US-Central America Free Trade Agreement*, March 19, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/igpac.pdf*, retrieved June 28, 2004.

[11] Ibid.

[12] Ibid.

[13] USTR, "Costa Rica," "Dominican Republic," "El Salvador," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report*, pp. 104-105, 113-114, 133-134, 176-177, 199-200, and 348-349.

The intellectual property provisions of the FTA, which afford protections beyond TRIPs, address many of the most significant concerns the U.S. industry has expressed regarding IPR policies in CA/DR.[14] If the CA/DR governments were to implement the IPR provisions of the proposed FTA, the increased level of protection afforded to IPR holders would likely result in increased revenues for U.S. industries dependent on copyrights, trademarks, patents, and trade secrets. However, given the relatively small size of the CA/DR regional economy and the CA/DR regional market relative to the United States, any increases in revenues for the U.S. IPR industry due to the FTA would likely have small effects on the U.S. industry and economy. Further, there would be little, if any, effect on U.S. industries or the U.S. economy based on U.S. implementation of its FTA obligations. The following sections describe the current status of IPR protection by the CA/DR governments, summarize key provisions of the FTA related to IPR, and describe the potential effects of implementation of IPR provisions of the FTA on U.S. industries and the U.S. economy as a whole.

Current Conditions of IPR Protection in Central America and the Dominican Republic

As members of the WTO, the CA/DR governments have assumed obligations under the WTO TRIPs Agreement. According to U.S. government and industry officials, these countries have made significant progress in improving their IPR regimes in the past several years.[15] However, significant problems remain, especially in the Dominican Republic, Costa Rica, and Guatemala.[16] Further, according to the officials, all of the countries could improve, to greater or lesser degrees, satellite signal, patent, trademark, and trade secret protection, as well as strengthen their IPR enforcement efforts.

Copyrights, Trademarks, and Satellite Program Signals

According to U.S. industry representatives, CA/DR governments generally have achieved substantial improvements in the areas of copyright and trademark protection

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[14] Renard Aron, Assistant Vice President for Latin America and Canada, Pharmaceutical Research Manufacturers of America (PhRMA), testimony at Commission hearing, April 27, 2004, transcript at pp. 134 and 171-172; Maria Strong, Vice President and General Counsel, International Intellectual Property Alliance (IIPA), testimony at Commission hearing, April 27, 2004, transcript at p. 148 and 163-164; Industry Functional Advisory Group on Intellectual Property Rights for Trade Policy Matters (IFAC-3), *U.S.-Central American Free Trade Agreement (FTA): The Intellectual Property Provisions*, March 12, 2004, pp. 1-26, found at *http://www.ustr.gov*, retrieved April 5, 2004; IIPA, "The U.S. Copyright Industries Applaud the Conclusion of a U.S.-Central American Free Trade Agreement (CAFTA) with El Salvador, Guatemala, Honduras and Nicaragua," *Press Release*, December 17, 2003, p. 1, found at *http://www.iipa.com*, retrieved February 24, 2004.

[15] USTR "Costa Rica," El Salvador," "Dominican Republic," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2004, pp. 104-105, 113-114, 133-134, 176-177, 199-200, and 347-348, found at *http://www.ustr.gov*, retrieved April 5, 2004, and USTR, *2004 Special 301 Report*, May 3, 2004, pp. 24-26, found at *http://www.ustr.gov,* retrieved May 4, 2004.

[16] USTR, *2004 Special 301 Report*, pp. 24-26.

in recent years.[17] However, problems remain, especially in the Dominican Republic, Costa Rica, Guatemala, and, to a lesser extent, El Salvador. This is particularly the case in the areas of copyright piracy[18] of video, sound, and other entertainment[19] recorded on or copied from digital optical discs, such as compact discs (CDs) and digital video discs (DVDs).[20] Internet and broadcast piracy and theft of satellite video signals are also of concern to U.S. industry representatives.[21] U.S. industry representatives state that the U.S. business software industry is threatened by the unlicensed use of software by CA/DR corporate and government entities,[22] and the U.S. book publishing industry faces piracy in the form of commercial photocopying.[23] Table 7-1 shows estimated U.S. trade losses due to copyright piracy in 2003. Trademark counterfeiting[24] also is a major problem in these countries as infringers take advantage of well established U.S. names, brands, packaging, logos, and other symbols.[25]

In the Dominican Republic, the main U.S. concerns have been widespread piracy of copyrighted materials—especially video and audio recordings and software—and inadequate enforcement of copyright laws.[26] In Costa Rica, the main U.S. concerns have been lack of adequate copyright protection for software, recorded music, and motion pictures; increasing Internet piracy; and theft of satellite television program transmission signals.[27] Guatemala and El Salvador also are frequently cited by U.S. government and industry officials for copyright piracy of videos, software, CDs, and U.S.-made motion pictures.[28] Digital piracy of CDs and DVDs, as well as Internet piracy, are subjects of U.S. concern throughout the CA/DR region. The Dominican Republic is the only FTA party that has not acceded to the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms[29] Treaty

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[17] U.S. industry representatives, in-person and telephone interviews by USITC staff, January-April 2004.

[18] Piracy is a term often used to refer to copyright infringement.

[19] Maria Strong, IIPA, testimony at Commission hearing, April 27, 2004, transcript at p. 151.

[20] Also known as digital versatile discs.

[21] Motion Picture Association of America (MPAA),"Dominican Republic" and "El Salvador, *" Motion Picture Association—2004 Trade Barriers Report,* 2004, pp. 443 and 444.

[22] Maria Strong, IIPA, testimony at Commission hearing, April 27, 2004, transcript at p. 151, and U.S. industry representatives, in-person and telephone interviews by USITC staff, January-April 2004.

[23] Maria Strong, IIPA, testimony at Commission hearing, transcript at p. 151.

[24] Counterfeiting is a term often used to refer to the unauthorized use of a representation or copy of a trademark or service mark.

[25] In addition to counterfeiting of the packaging, appearance, symbols, and other trademark features of entertainment products contained on such pirated media as video cassettes, CDs and DVDs, a broad range of products from a number of other industries are affected by trademark counterfeiting, including apparel, leather goods, toys, cigarettes, pharmaceuticals, beverages, and auto parts. U.S. industry representatives, in-person and telephone interviews by USITC staff, January-April 2004.

[26] USTR, "Dominican Republic," *2004 National Trade Estimate Report*, p. 114.

[27] USTR, "Costa Rica," *2004 National Trade Estimate Report*, pp. 104-105.

[28] USTR, "El Salvador" and "Guatemala," *2004 National Trade Estimate Report*, pp. 134 and 177; IIPA posthearing brief to the Commission, May 4, 2004, p. 2; and Motion Picture Association of America (MPAA), "El Salvador, *" Motion Picture Association—2004 Trade Barriers Report,* 2004, p. 444.

[29] Phonograms are sound recordings.

Table 7-1
Central America and the Dominican Republic: Estimated U.S. trade losses due to copyright piracy, 2003

Industry	Costa Rica	Nicaragua	El Salvador	Guatemala	Honduras	Dominican Republic
	Trade losses (in million of dollars)					
Motion pictures	2.0	(1)	2.0	2.0	2.0	2.0
Records and music	7.2	1.0	1.5	5.0	1.0	9.9
Business software applications	4.8	1.2	4.0	10.6	1.8	3.7
Books	(1)	(1)	(1)	(1)	(1)	1.0
Total	14.0	2.2	7.5	17.6	4.8	16.6

[1] Not available.

Sources: Adapted from the following sources with permission from the International Intellectual Property Alliance (IIPA): "IIPA 2002–2003 Estimated Trade Losses Due to Copyright Piracy" (App. A table for "The Americas"), *IIPA 2004 Special 301 Report*, Feb. 2004; and IIPA, "2003 Estimated Trade Losses Due to Copyright Piracy and Estimated Piracy Levels in the Six CAFTA Countries," IIPA posthearing brief, May 4, 2004, p. 3.

(WPPT)[30] (the Dominican Republic recently ratified the WCT and has submitted the WPPT to its Congress for ratification).[31]

Patents and Trade Secrets

Both patent and trade secret issues, including data exclusivity problems, remain chief concerns of the U.S. government[32] and U.S. companies operating in or exporting to the CA/DR region.[33] Legislation is still required in some of those countries to fully implement their TRIPs obligations in this regard.[34] Implementation of TRIPs provisions forbidding unfair commercial use of test data has been deficient in the CA/DR region,

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[30] The WCT and the WPPT are often referred to as the "Internet Treaties" because they provide new international standards for the protection of copyrights and related rights in the digital economy. The two treaties entered into force in 2002. Among other things, the WCT provides that traditional means for copyright protection (for such products as books, movies, and software) should apply to works transmitted on the Internet or otherwise using digital media or technology. The WPPT similarly provides intellectual property protections to producers of sound recordings, as well as performers, with respect to works on the Internet or in connection with use of digital technology and media. The United States has ratified both treaties and implemented them domestically via the Digital Millennium Copyright Act of 1998. Chris Gibson, WIPO Internet Copyright Treaties Coming Into Force, 2002; and WIPO Copyright Treaty (adopted in Geneva on December 20, 1996) and WIPO Performances and Phonograms Treaty (WPPT) (adopted in Geneva on December 20, 1996).

[31] USTR, "Dominican Republic," *2004 National Trade Estimate Report*, p. 114.

[32] USTR, "Costa Rica," "Dominican Republic," "El Salvador," "Guatemala," "Honduras," and "Nicaragua," *2004 National Trade Estimate Report*, pp. 105, 114, 134, 177, 200, and 348.

[33] Renard Aron, PhRMA, testimony at Commission hearing, April 27, 2004, transcript at pp. 135-136.

[34] For instance, although El Salvador's current patent law generally provides for 20-year terms, as required by TRIPs, it provides pharmaceutical patent terms of only 15 years. Costa Rican law provides for a 20-year term of protection but only if the original filing takes place in Costa Rica, which is considered a "burdensome and unnecessary requirement" by pharmaceutical, chemical, and information technology industry representatives. USTR, "El Salvador," *2004 National Trade Estimate Report*, pp. 105 and 134, and U.S. industry representatives, in-person and telephone interviews by USITC staff, Washington, DC, January-April 2004.

according to U.S. industry sources.[35] U.S. government and industry sources report that none of the CA/DR governments provide sufficient protection from disclosure of trade secrets and other confidential information of U.S. and other foreign companies and individuals.[36] A concern of U.S. pharmaceutical firms in the CA/DR region is inadequate protection of clinical safety and test data submitted to regulatory authorities in order to get approval to market products.[37] A U.S.-based consumer group expressed the concern that the FTA provisions with respect to pharmaceutical patent protection were overly restrictive and would lead to a prohibition on the production of generic products in the CA/DR region.[38]

Enforcement

The CA/DR governments, with some exceptions, including those noted above, generally have enacted legislation to make their IPR laws consistent with TRIPs obligations. However, U.S. industry representatives are concerned that problems in effective administration and enforcement of such laws have limited actual IPR protection in many instances.[39]

Achievements of the FTA in IPR Protection

Despite the aforementioned shortcomings regarding IPR, the FTA makes some significant achievements with respect to IPR protection. The FTA reaffirms the rights and obligations set forth in TRIPs, to which the United States and the CA/DR governments are bound. However, the FTA affords protections beyond TRIPs by (1) increasing

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[35] PhRMA, "Central America," *National Trade Estimate Report on Foreign Trade Barriers (NTE) 2004,* 2004, p. 194, found at *http://www.phrma.org*, retrieved February 24, 2004; and U.S. industry representatives, interview by USITC staff, February 25, 2004. U.S. industry representatives noted a continuing practice in the Dominican Republic, which they pointed out was "totally inconsistent with its TRIPs patent and data exclusivity obligations, to approve copies of products that were supposed to have been granted patent and data protection." Industry Functional Advisory Group on Intellectual Property Rights for Trade Policy Matters (IFAC-3), *The U.S.-Central American Free Trade Agreement (FTA): The Intellectual Property Provisions*, March 12, 2004, pp. 12-15, found at *http://www.ustr.gov*, retrieved April 5, 2004.

[36] Renard Aron, PhRMA, testimony at Commission, April 27, 2004, transcript at p. 135; USTR, *2004 Special 301 Report*, May 3, 2004, pp. 24-26, found at *http://www.ustr.gov,* retrieved May 4, 2004; and USTR, *2004 National Trade Estimate Report*, pp. 104-105, 113-114, 133-134, 176-177, 199-200, and 347-348, found at *http://www.ustr.gov*, retrieved April 5, 2004.

[37] PhRMA, "Central America," *National Trade Estimate Report on Foreign Trade Barriers (NTE) 2004,* 2004, pp. 194-198, found at *http://www.phrma.org*, retrieved February 24, 2004; and U.S. industry representatives, interview by USITC staff, February 25, 2004.

[38] Joy Spencer, Consumer Project on Technology (CPTech), testimony at Commission hearing, April 27, 2004, transcript at p. 140.

[39] U.S. industry representatives indicate that although the Central American countries and the Dominican Republic have largely implemented the substantive provisions of TRIPs, they have not yet fully met their enforcement obligations. Industry Functional Advisory Group on Intellectual Property Rights for Trade Policy Matters (IFAC-3), *U.S.-Central American Free Trade Agreement: The Intellectual Property Provisions*, March 12, 2004, p. 3, found at *http://www.ustr.gov*, retrieved April 5, 2004; IIPA, posthearing brief, p. 4; and U.S. industry representatives, in-person and telephone interviews by USITC staff, January-April 2004.

protection of copyrights and trademarks to take into account advances in digital technology; (2) extending protections for copyrights, patents, and trade secrets; and (3) increasing IPR enforcement for piracy and counterfeiting.[40]

Copyrights, Trademarks, and Satellite Program Signals

According to U.S. industry representatives, an important accomplishment of the FTA is that it addresses Internet and other digital piracy by incorporating a number of requirements included in the WCT and WPPT.[41] In this regard, the FTA provides strict legal protections and remedies against the circumvention of technological measures used by copyright holders to prevent piracy and unauthorized distribution of copyrighted materials over the Internet.[42] Further, the FTA provides that only copyright owners have the right to make their works available online. Such copyright holders retain all rights to copies, including temporary copies, of their works on computers and networks, which protects copyrighted material (including music, videos, software, and text) from unauthorized sharing on the Internet.[43] The FTA also requires government involvement in resolving disputes pertaining to unauthorized use of trademarked names by non-rights holders in Internet domain names (article 15.4 of the FTA). Further, protection for encrypted program-carrying satellite signals is extended to the signals themselves, as well as the programming, in order to deter piracy of satellite television programming (article 15.8 of the FTA). In this regard, the CA/DR governments also are obligated to ratify or accede to the Brussels Convention relating to the Distribution of Program-Carrying Satellite Signals.[44]

The FTA extends copyright terms of protection beyond those required by TRIPs. Under the FTA, where the term of protection of a work (including a photographic work), performance, or phonogram is to be calculated on the basis of a person's life, the term is not less than the life of the author plus 70 years after the author's death (article 15.5.4 of the FTA). There are no corresponding terms of protection based on the life of the author explicitly provided for in TRIPs. However, by reference to the Berne Convention, the term of protection in TRIPs is life of the author plus 50 years after his or her death.[45] In cases where the term of protection of a work is to be calculated on a

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[40] Renard Aron, PhRMA, testimony at Commission hearing, April 27, 2004, transcript at pp. 134 and 171-172; Maria Strong, IIPA, testimony at Commission hearing, April 27, 2004, transcript at p. 148, 153, and 163-165; and IFAC 3, *Report on Intellectual Property Provisions*.

[41] Maria Strong, IIPA, testimony at Commission hearing, April 27, 2004, transcript at pp. 153 and 164; USTR, "Free Trade with Central America," *Trade Facts*, December 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved February 24, 2004; USTR, "Adding Dominican Republic to CAFTA," *Trade Facts*, March 15, 2003, p. 2, found at *http://www.ustr.gov*, retrieved March 17, 2004; and U.S. industry representatives, in-person and telephone interviews by USITC staff, January-April 2004.

[42] USTR, "Free Trade with Central America," *Trade Facts*, December 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved February 24, 2004.

[43] Ibid.

[44] USTR, "Free Trade with Central America," *Trade Facts*, December 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved, February 23, 2004.

[45] Although the term of protection based on the life of a natural person is not specifically stated in the WTO TRIPs agreement, Article 9 of that agreement specifies that WTO members shall comply with Articles 1-21 of the Berne Convention for the Protection of Literary and Artistic Works (1971). Article 7 of the Berne Convention provides that "the term of protection granted by this Convention shall be the life of the author and fifty years after his death." For further information on the Berne Convention, see *http://www.wipo.org*.

basis other than the life of a natural person, the term in the FTA is 70 years from the end of the calendar year of the first authorized publication of the work. The comparable period of protection in TRIPs is 50 years and does not apply to photographic works. Finally, if there is no authorized publication within 70 years from the creation of a work, the FTA term of protection is not less than 70 years from the end of the calendar year of the creation of the work. Again, the comparable period of protection in TRIPs is 50 years and does not apply to photographic works.

Patents and Trade Secrets

The FTA also extends patent and trade secret infringement protections.[46] Patent terms can be extended beyond the 20-year term required by TRIPs to compensate for "unreasonable delays in granting the patent" (article 15.9.6 of the FTA). The FTA also ensures that government healthcare regulatory officials deny marketing approval to patent-violating products.[47] Test data and trade secrets submitted for the purpose of marketing approval are protected against disclosure for 5 years for pharmaceuticals and 10 years for agricultural chemicals (article 15.10. 1. (a) of the FTA). Plant variety protection is also provided. To reinforce some of these provisions, the CA/DR governments also are obligated to ratify or accede to several international IPR agreements (article 15.1 of the FTA), including the Patent Cooperation Treaty, as revised and amended (1970), the Trademark Law Treaty (1994), and the International Convention for the Protection of New Varieties of Plants (1991).

Enforcement

The FTA requires the CA/DR governments to commit to strengthen their IPR enforcement measures.[48] For instance, the FTA requires both "pre-established" statutory and actual damages[49] for copyright and trademark violations (article 15.11.8 of the FTA). This is expected to deter IPR infringement and allow monetary damages to be awarded even when actual economic harm cannot be calculated.[50]

The FTA also provides that criminal procedures and penalties be applied in cases of willful trademark counterfeiting or copyright piracy and that importation or exportation of counterfeited or pirated products be made criminal offenses (article

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[46] USTR, "Free Trade with Central America," *Trade Facts*, December 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved February 23, 2004; and USTR, "Adding Dominican Republic to CAFTA," *Trade Facts*, March 15, 2003, p. 2, found at *http://www.ustr.gov*, retrieved March 17, 2004.

[47] Renard Aron, PhRMA, testimony at Commission hearing, April 27, 2004, transcript at p. 134.

[48] Maria Strong, IIPA, testimony at Commission hearing, April 27, 2004, transcript at pp. 163-164; U.S. industry representatives, telephone interviews by USITC staff, Jan.-Apr. 2004; USTR, "Free Trade with Central America," *Trade Facts*, Dec. 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved Feb. 24, 2004; and USTR, "U.S. and Dominican Republic Conclude Trade Talks Integrating the Dominican Republic into the Central American Free Trade Agreement," press release, March 15, 2004, found at *http://www.ustr.gov*, retrieved March 18, 2004.

[49] Maria Strong, Hearing transcript at p. 164.

[50] USTR, "Free Trade with Central America," *Trade Facts*, December 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved February 23, 2004.

15.11.26 of the FTA). Enforcement stipulations of the FTA also require that provisions be made for the seizure, forfeiture, and destruction of counterfeit and pirated goods. Further, IPR laws are to be enforced not only against infringement originating within each country, but also against goods in transit, to deter violators from the parties' ports or free trade zones to traffic in pirated products.[51] Finally, police and border agents are provided with greater authority to pursue IPR criminal enforcement actions on their own initiative article 15.11.23 of the FTA).

Potential Effects on the U.S. Economy

The intellectual property provisions of the FTA address many of the most significant concerns of U.S. industry representatives regarding the IPR policies of the CA/DR governments.[52] Despite the small sizes of the CA/DR economies and markets, if they were to fully implement and enforce the IPR provisions of the FTA, the increased level of protection afforded to IPR holders would potentially result in increased revenues for U.S. industries dependent on copyrights, trademarks, patents, and trade secrets. Any increases in revenues for the U.S. IPR industry would likely have a limited effect on the U.S. economy as a whole.

Among the U.S. copyright industries that would potentially benefit most due to the increased digital technology features of the FTA are the motion picture, sound recording, business software applications, entertainment software, and book publishing industries. Industries that might benefit from the greater patent and data protections include the pharmaceutical industry and the agricultural chemicals industry. A broad range of U.S. industries should benefit from strengthened trademark and other IPR provisions of the FTA. By comparison, because the United States already meets the relatively high standards of IPR protection and enforcement included in the FTA, there would be little if any effect on U.S. industries or the U.S. economy based on U.S. implementation of its obligations under the FTA provisions.

The U.S. trade advisory committee representing a broad range of U.S. IPR interests indicated that the FTA generally is a strong agreement. This is because, among other things, the FTA "takes into account the significant legal and technological developments that have occurred since the TRIPs and NAFTA agreements entered into force."[53] However, the committee indicated that it would have preferred that the FTA had not included such "long transition periods[54] for implementation [of the IPR

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[51] Ibid.

[52] IIPA, "The U.S. Copyright Industries Applaud the Conclusion of a U.S.-Central American Free Trade Agreement (CAFTA) with El Salvador, Guatemala, Honduras and Nicaragua," *Press Release*, December 17, 2003, p. 1, found at *http://www.iipa.com*, retrieved February 24, 2004; U.S. copyright, trademark, and pharmaceutical industry representatives, in-person and telephone interviews by USITC staff, January-April 2004; and USTR, "Free Trade with Central America," *Trade Facts*, December 17, 2003, pp. 4-5, found at *http://www.ustr.gov*, retrieved February 23, 2004.

[53] Industry Functional Advisory Group on Intellectual Property Rights for Trade Policy Matters (IFAC-3), *U.S.-Central American Free Trade Agreement (FTA): The Intellectual Property Provisions*, March 12, 2004, pp. 2-5, found at *http://www.ustr.gov*, retrieved April 5, 2004.

[54] An IIPA representative also indicated that the organization would have preferred that the FTA had not provided for some of the transition periods that were allowed. Maria Strong, IIPA, hearing transcript, p. 165.

provisions of the agreement]."[55] Overall, however, the committee indicated that the FTA's IPR provisions establish important precedents for other FTAs being negotiated by the United States.

Labor

U.S. trade negotiating objectives regarding labor issues, including child labor, were to (1) obtain an appropriate commitment by the CA/DR governments to effectively enforce their labor laws; (2) establish that the CA/DR governments will strive to ensure that they will not, as an encouragement for trade or investment, weaken or reduce the protections provided for in their labor laws; and (3) establish procedures for consultations and cooperative activities with the CA/DR region based upon review and analysis of labor laws and practices in the region, to strengthen their capacity to promote respect for core labor standards, including compliance with the International Labor Organization (ILO) Convention 182 on the worst forms of child labor and build on technical assistance programs administered by the U.S. Department of Labor.[56]

A range of views were expressed concerning the labor provisions of the FTA. The ACTPN report states that the FTA provides "an effective and balanced means of implementing the negotiating objectives for labor," with the one dissenting exception of the representative of the International Brotherhood of Teamsters (Teamsters).[57] The report states that the FTA "faithfully implements" the requirement set by the Congress when it decided that dispute settlement in labor matters should be limited to a failure to enforce existing laws, and that negotiators should not seek to have countries change their laws. The committee notes in particular the FTA's emphasis on cooperation and mutual agreement in working together on labor issues.[58]

The ACTPN states that the CA/DR governments reaffirm in the FTA their commitments under the ILO Declaration on Fundamental Principles and Rights at Work. The report goes on to note that these commitments "guarantee . . . that [CA/DR] will not fail to enforce their labor laws in a way that could affect trade." The report further notes that the CA/DR governments also commit "to strive to ensure they do not weaken their labor laws in a manner that would affect trade."[59]

The dissenting views of the Teamsters expressed in the ACTPN report state that the FTA "fails to promote the economic interests of the United States and fails to meet congressional negotiating objectives laid out in the Trade Act of 2002."[60] The

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[55] IFAC 3, *U.S.-Central American Free Trade Agreement: The Intellectual Property Provisions*, March 12, 2004, p. 3.

[56] A report by the U.S. Department of Labor on the employment impact of the FTA, pursuant to section 2102(c)(5) of the Trade Act of 2002, was not publicly available as of this writing.

[57] ACTPN, *Report on the U.S.-Central America Free Trade Agreement*, March 12, 2004.

[58] Ibid.

[59] Ibid.

[60] Ibid.

Teamsters criticized the FTA provision requiring the parties to enforce their own labor laws, and stated that "Central America's labor laws are not up to international standards."[61] The Teamsters also criticized the FTA because it "enforces labor obligations through fines while it enforces commercial obligations through sanctions," which the Teamsters argue "violates Congress' mandate in the Trade Act of 2002."[62]

The report by the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC)[63] states that the FTA "neither fully meets the negotiating objectives laid out by Congress in TPA, nor promotes the economic interest of the United States."[64] The LAC states that it "is not opposed in principle to expanding trade with Central America," but finds that the FTA "will most likely lead to bigger deficits and fewer jobs" for the United States. Key findings from the LAC report are:

[The FTA] will not protect the core rights of workers in any of the six countries participating in the agreement, and it represents a huge step backwards from the Jordan FTA and our unilateral trade preference programs. The agreement's enforcement procedures completely exclude obligations for governments to meet international standards on workers' rights. . . . Rules of origin and safeguards provisions invite producers to circumvent the intended beneficiaries of the trade agreement and fail to protect workers from the import surges that may result. . . . The sectorin which trade with Cental America is likely to deteriorate the most is in apparel. . . .[the FTA] also threatens sugar workers in the U.S.[65]

In its report on the integration of the Dominican Republic into the FTA, the LAC expresses many of the same concerns as in its report on Central America.[66]

Environment

U.S. trade negotiating objectives regarding environmental matters were to (1) promote trade and environment policies that are mutually supportive; (2) establish an appropriate commitment by the CA/DR governments to the effective enforcement of their environmental laws; (3) establish that CA/DR governments will strive to ensure that they will not, as an encouragement for trade or investment, weaken or reduce the protections provided for in their environmental laws; and (4) help CA/DR

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[61] Ibid.

[62] Ibid.

[63] The LAC is a committee that is part of the U.S. government policy advisory system described in chapter 5 of this report.

[64] LAC, *The U.S.-Central America Free Trade Agreement: Report of the Labor Advisory Committee for Trade Negotiations and Trade Policy,* March 19, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/lac.pdf*, retrieved June 28, 2004.

[65] Ibid.

[66] LAC, *The U.S.-Dominican Republic Free Trade Agreement: Report of the Labor Advisory Committee for Trade Negotiations and Trade Policy,* April 22, 2004, found at *http://www.ustr.gov/new/fta/Dr/advisor/lac.pdf*, retrieved June 28, 2004.

governments strengthen their capacity to protect the environment through the promotion of sustainable development, such as by establishing consultative mechanisms.

The ACTPN report finds that the environmental provisions of the FTA "provide effective and creative ways of contributing to environmental improvement," through its provisions requiring that "neither country shall fail to enforce its environmental laws in a manner that could affect trade."[67] The report notes that the FTA's environmental provisions provide that all parties are to develop public processes to ensure that views of civil society, including international organizations, are considered in environmental questions—a measure the committee finds ensures "transparency and input both from local as well as international interested parties."[68]

The report of the Trade and Environment Policy Advisory Committee (TEPAC) states that the FTA "meets Congress's negotiating objectives as they relate to environmental matters," and further acknowledges that "environmental issues in this agreement appear to have obtained a higher profile than in last years' agreements with Chile and Singapore."[69] The report points to provisions in the FTA regarding public participation, as well as the U.S. State Department's side agreement on environmental cooperation. The TEPAC report states that these provisions are likely to "enhance the ability of citizens with reasonable environmental concerns to have those concerns heard, and likely responded to, while simultaneously limiting the possibility that frivolous comments will bog down the process."[70]

The TEPAC report expressed concern about the environmental impact on the United States of certain U.S. over-quota tariff reductions under the FTA. Specifically,

> . . . the Committee is extremely concerned about the Agreement's limited reductions in the above-quota sugar tariff rates over an extended period and the slow phase out in tariffs on chicken leg quarters, rice, and dairy commodities. This is of particular concern with regard to sugar, where the overproduction of sugar caused by domestic subsidies places significant stress on delicate and endangered ecosystems like Florida's Everglades.[71]

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[67] ACTPN, *Report on the U.S.-Central America Free Trade Agreement*, March 12, 2004.

[68] Ibid.

[69] TEPAC, *The U.S.- Central American Free Trade Agreement: Report of the Trade and Environment Policy Advisory Committee*, March 19, 2004, found at *http://www.ustr.gov/new/fta/Cafta/advisor/tepac.pdf*, retrieved June 28, 2004. The Commission also reviewed the TEPEC report for the integration of the Dominican Republic into the FTA. TEPAC, *Addition of the Dominican Republic to the U.S.- Central American Free Trade Agreement: Report of the Trade and Environment Policy Advisory Committee*, April 22, 2004, found at *http://www.ustr.gov/new/fta/Dr/advisor/tepac.pdf*, retrieved June 28, 2004.

[70] Ibid.

[71] Ibid.

USTR reported to Congress in August 2003 on the probable effects on the United States of the environmental provisions of the U.S.-Central America FTA.[72] The report is required pursuant to provisions of the Trade Act of 2002.[73] In its report, USTR stated,

> Although the economies of Central America represent important markets for some U.S. producers and exporters, the impact of the . . . [FTA] on total U.S. production through changes in U.S. exports appears likely to be very small. . . . Even if substantial increases in U.S. exports of agricultural and industrial goods to Central America are the result of the . . . [FTA's] reductions in market access barriers, these increases in U.S. production will represent a very small change in the aggregate U.S. economy.

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[72] USTR, *Interim Environmental Review: U.S.-Central America Free Trade Agreement*, August 2003, found at *http://www.ustr.gov/new/fta/Cafta/2003-08-22-cafta-env_reiew.pdf*, retrieved July 5, 2004.

[73] For further information on the environmental review process, see USTR, *Environmental Reviews and Reports*, found at *http://www.ustr.gov/environment/environmental.shtml*, retrieved May 20, 2004.

CHAPTER 8
Literature Review and Comparison With Commission Findings

This chapter reviews the economic literature that is relevant to a U.S.-CA/DR FTA. The chapter begins with a brief discussion on the conceptual issues regarding FTAs, followed by the review of the studies assessing the estimated impact of the FTA on the United States.

General Effects of Trade Agreements

Studying the economic impact of FTAs entails investigating static effects such as trade creation, trade diversion, and the terms of trade (i.e., the price of exports relative to the price of imports). It also involves consideration of issues related to scale effects and nonquantifiable effects. A discussion of these effects is presented below.

Trade Creation and Trade Diversion

Trade liberalization can generally be undertaken in one of two different manners. On one hand, it can be based on the MFN principle, under which improved market access is granted to all trading partners equally. The classical "gains from trade" argument asserts that such nondiscriminatory trade liberalization provides consumers access to more goods at lower prices, and gives producers access to more sources for their inputs and more markets for their products. On the other hand, trade liberalization can be done in a preferential (i.e., discriminatory) way, with better market access granted to some partners but not to others, as in an FTA. Improved market access can result not only from bilateral tariff removal but also from liberalization of nontariff barriers in such areas as cross-border trade in services, telecommunications, electronic commerce, and government procurement, the effects of which are not readily quantifiable.[1]

To the extent that FTAs are designed to liberalize trade, they are likely to create economic gains similar to those of liberalization on an MFN basis. Given their discriminatory nature, however, FTAs create additional economic effects that are not present in MFN liberalization. The traditional way to study an FTA is to categorize the FTA-induced trade expansion into trade creation or trade diversion.[2] Trade creation

[1] While FTA provisions apply only to the parties to the agreement, some provisions, such as those related to customs administration, labor, and the environment, tend to be applied in a nondiscriminatory manner and are closer to the MFN principle.

[2] The seminal works on this issue are J. Viner, *The Customs Union Issue*, New York: Carnegie Endowment for International Peace, 1950; and J. Meade, *The Theory of Customs Union*, Amsterdam: North Holland, 1955.

improves welfare and occurs when partner country production displaces higher-cost domestic production. Trade diversion reduces welfare and occurs when a partner country's production displaces lower cost imports from the rest of the world.[3] The combined effects of an FTA on trade among its partners reflect trade creation as well as trade diversion. Whether the trade-creation (welfare enhancing) effect or the trade-diversion (welfare reducing) effect dominates depends on a variety of factors, including external trade barriers, cost differences, and relative supply and demand responses and other domestic policies. Thus, the overall welfare impact of an FTA can be empirically determined.

Terms of Trade

The impact of an FTA on economic welfare depends on whether the terms of trade improve or deteriorate. If the FTA members are large enough to be able to affect import and export prices by their actions, the FTA is likely to affect the terms of trade for its partners in three different ways. First, tariff reduction under the FTA could result in an increase in the demand for one partner's products, thereby resulting in an increase in the (pretariff) price of imports from another FTA partner, leading to a deterioration in a partner's terms of trade. Second, tariff reduction under the FTA could result in an increase in the demand (and price) for one partner's exports and improve its terms of trade. Finally, the decreased demand for imports from nonmember countries tends to decrease their price and improve the FTA partners' terms of trade.

Scale Effects

To the extent that an FTA integrates (and, hence, enlarges) markets, it can offer firms an opportunity to exploit economies of scale (or increasing returns to scale) and to lower costs by expanding production. Moreover, by increasing the intensity of competition, an FTA has the potential to induce firms to make efficiency improvements in order to raise productivity levels.[4] Canadian firms, for example, have long argued that increased access to the U.S. market would enable them to take advantage of economies of scale and that this access would allow Canadian firms to increase their exports not only to the countries in North America, but also to the rest of the world.[5] Increasing returns also affect the volume of trade in inputs and intermediate goods used by increasing return industries because, as firms expand production and exploit economies of scale, they need to purchase more inputs and intermediate goods. These goods may be imported from inside or outside the FTA.

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[3] Losses from trade diversion occur when lost tariff revenue associated with changes in the pattern of trade exceeds efficiency gains from the decline of the prices paid by consumers. These losses will be larger the greater the FTA's margin of preferences (i.e., the trade barriers facing nonmembers relative to intra-FTA barriers).

[4] A closely related gain comes from increased competition as firms are induced to cut prices and to expand sales, benefiting consumers as the monopolistic distortion is reduced.

[5] H.J. Wall, "NAFTA and the Geography of North American Trade," *Federal Reserve Bank of St. Louis Review*, vol. 85, no. 2, March/April 2003.

The enlarged FTA market also may attract greater FDI, especially investment for which market size is important.[6] In general, the greater the FTA's margin of preference, the more attractive it will be as an FDI destination. In the long run, changes in trade flows can lead to substantial changes in the location of production among FTA partners. These relocations may be determined by comparative advantage (i.e., the removal of barriers might lead each country to produce the goods at which it is best). Alternatively, sectors with strong backward or forward linkages may all relocate to one country and take advantage of the preferential access to cater to the whole FTA market from there. These agglomeration effects are stronger in the presence of economies of scale. The impact of an FTA will depend on the increased level of economic activity within the FTA and on the distribution of the effects among members.

Nonquantifiable Effects

In addition to the generally quantifiable effects discussed so far, regional integration in an FTA can provide other potential benefits that are more difficult to evaluate quantitatively. A World Bank publication discusses a variety of additional effects that may result from regional integration agreements,[7] including enhanced security (either against nonmembers or among FTA partners),[8] increased bargaining power in international forums, and greater policy stability by "locking in" domestic policies under the FTA. The nonquantifiable effects pertaining to the U.S.-CA/DR FTA are associated with market access provisions related to cross-border trade in services, telecommunications, and government procurement; trade facilitation provisions related to customs administration and technical barriers; investment-related provisions; and regulatory environment provisions related to IPR, trade remedies, and labor and environment.[9]

Table 8-1 illustrates the territory in which economists tend to focus their analytical efforts. It shows how limited the area is where effects of trade policy are discernible. An entry marked "yes" indicates that the given effect of the given policy is generally measurable (or can be modeled in a simulation) and/or has been measured. Note that these occur mainly in the static economic effects. The fact that relatively few cells are marked as measurable does not mean that other effects are not important. By focusing attention on a selected number of FTA effects, analysts provide important insights into specific aspects of trade agreements, but it is possible that other nonquantifiable effects dominate.

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[6] In addition to the effects of strictly tariff liberalization, many FTAs have explicit investment provisions (such as improved and secure investment environment) that would further enhance these effects. An assessment of the likely economic impact of the investment provisions of the U.S. FTA with Central America and the Dominican Republic is provided in chapter 6 of this report.

[7] The World Bank, *Trade Blocs,* New York: Oxford University Press, 2000, p. 66.

[8] For additional information, see Maurice Schiff and L. Alan Winters, "Regional Integration as Diplomacy," *World Bank Economic Review*, 1998, vol. 12, no. 2, pp. 271–96. As has been mentioned above, the impact of negotiated commitments of an FTA related to IPR and customs administration and services are not readily quantifiable.

[9] Qualitative assessments of the economic impact on the United States with respect to these provisions of the U.S.-CA/DR FTA are provided in chapters 3, 5, 6, and 7 of this report.

Table 8-1
Quantifiable FTA effects

Effects	Quantifiable
Static economic effects:	
Trade creation and diversion	Yes
Terms of trade	Yes
Scale effects:	
Pro-competitive effects	Some
Efficiency	Some
Investment (including FDI)	Yes
Industrial location	Some
Political Effects:	
Enhanced security	No
Increased bargaining power	No
Locking in reforms	No
Cooperation	No

Source: Compiled by the Commission.

Impact on the United States of an FTA with Central America and the Dominican Republic

The Commission found two studies that directly assess the impact on the United States of a U.S.-CA/DR FTA, or a substantially equivalent FTA for the purposes of this literature review.[10] Given that U.S. tariffs levels are relatively low, and dutiable bilateral trade and investment flows between the United States and the CA/DR region are small relative to total U.S. trade and investment, a priori economywide effects of trade liberalization on the United States resulting from the U.S.-CA/DR FTA are expected to be small.

In a study conducted for the U.S. Department of Labor to assess the potential impact of several FTAs on the U.S. labor market, Brown, Kiyota, and Stern (BKS) estimate the potential impact of a U.S. FTA with Central America using a model that incorporates different market behavior assumptions than the model employed by the Commission.[11] BKS use the Michigan Model, a computable general equilibrium (CGE) model, which has 22 countries/regions and 18 sectors, and allows for monopolistic competition in the nonagriculture sectors (agriculture sector is modeled as perfectly competitive),

[10] The Commission notes that it conducted 2 classified investigations at the request of the USTR concerning a potential U.S.-Central America FTA. USITC, U.S.-Central America Free Trade Agreement: Advice Concerning the Probable Economic Effects, Investigation Nos. TA-131-22 and TA 2104-2, December 2002 and USITC, U.S.-Dominican Republic Free Trade Agreement: Advice Concerning the Probable Economic Effect, Investigation Nos. TA-131-25 and TA-2104-7, December 2003. Consequently, for the purpose of this report, the Commission discussion consists only of external economic assessments and the Commission's present study.

[11] Drusilla K. Brown, Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," February 8, 2004, found at *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved March 2004, p. 5.

increasing returns to scale, and product variety effects.[12] The 1997 database is projected to the year 2005 and incorporates full Uruguay Round implementation and the accession of China and Taiwan to the WTO. In addition, the authors extrapolate labor availability to 2012 and scale up major variables by an average weighted growth rate of 2.5 percent.[13] BKS run four simulations: agricultural protection liberalization, manufactures protection liberalization, services barriers liberalization, and all of the above. The authors note that,

> . . . the focus is on the effects of the bilateral removal of trade barriers, which lend themselves most readily to quantification. The non-trade aspects of the FTAs may also be important but are intrinsically more difficult to incorporate into a modeling framework. This is the case as well for the possible increases in foreign direct investment and the rate of economic growth and improvements in productivity that may be induced over time as the consequence of the FTAs. The computational results presented for the bilateral FTAs are therefore best interpreted as providing a lower bound for the potential benefits involved.[14]

Table 8-2 shows the economic impact, as estimated by the BKS study, of the four scenarios on the United States of a U.S.-Central America FTA (BKS used the GTAP regional aggregate "Central America and the Caribbean" as a proxy for the 6 countries included in the actual FTA—Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic). The first two scenarios, agriculture and manufactures protection liberalization, produce negligible estimated economic impacts on the United States (0.00 to 0.04 percent of GNP), similar to those reported by the Commission. Because of BKS's relatively large tariff equivalent estimates for services barriers,[15] however, the services liberalization scenario estimates a relatively large result of 0.13 percent of U.S. gross national product (GNP), which also drives the results for the fourth (combined) liberalization scenario. The authors also assess the estimated sectoral effects, and conclude that "U.S. employment is reduced primarily in textiles and wearing apparel by 3,186 and 12,320 workers, respectively, which constitute -0.34 percent and -1.58 [percent] of the initial employment levels. There are positive but rather small increases in employment in the other U.S. sectors."[16]

DeRosa estimates the gross merchandise trade impact of several proposed (as of 2000) U.S. FTAs, including a separate estimate for a U.S. FTA with Central America

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[12] In contrast, the GTAP model used by the Commission assumes perfect (not monopolistic) competition, constant (not increasing) returns to scale, and product differentiation by source (not product variety). The product variety approach assumes that the well-being of any consumer is greater than the larger the varieties of goods available and, consequently, a policy change that induces increased variety is welfare enhancing.

[13] Ibid.

[14] Ibid., p. ii.

[15] "The services barriers are based on . . . Hoekman (2000) and adapted for modeling purposes in Brown, Deardorff, and Stern (2002). [These] barriers are applied uniformly across trading partners. These constructed barriers are considerably higher than the import barriers on manufactures. While possibly subject to overstatement, it is generally acknowledged that many services sectors are highly regulated and thus restrain international services transactions." Ibid., p. 7.

[16] Ibid., p. iii.

Table 8-2
Estimated welfare impact on the United States of a U.S.-Central America FTA, estimates by Brown, Kiyota, and Stern

Agricultural protection		Manufacturers tariff		Services barriers		Total	
Percent of GNP	*1997 billion dollars*	*Percent of GNP*	*1997 billion dollars*	*Percent of GNP*	*1997 billion dollars*	*Percent of GNP*	*1997 billion dollars*
0.00	0.09	0.04	3.86	0.13	13.45	0.17	17.41

Source: Drusilla K. Brown, Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," Feb. 8, 2004, table 6, found at *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved March 2004.

and Chile (CA/Chile).[17] DeRosa extrapolates from a gravity model econometric estimate of the typical sensitivity of bilateral trade flows to regional trade agreements.[18] The author applies a Rose (2003) gravity-model sensitivity coefficient estimate of 0.78 to "base" 2000 bilateral trade flows to estimate the proportional change in bilateral merchandise trade flows among the United States and its potential FTA partners.[19] With free trade among all participating countries within each potential FTA, U.S. imports from CA/Chile are estimated to increase by $18.7 billion or 1.5 percent over total U.S. imports from all countries in 2000, while U.S. exports to these potential FTA partners are estimated to increase by $14.9 billion or 1.9 percent over total U.S. exports to all countries in 2000. Imports of CA/Chile from each other and from the United States are estimated to increase by $18.5 billion or 44 percent over 2000 total imports of these countries, while exports of CA/Chile to each other and the United States are estimated to increase by $22.2 billion or 56 percent over 2000 total exports of these countries.[20] DeRosa cautions that the gross trade impacts estimated by

[17] Dean A. DeRosa, "Gravity Model Calculations of the Trade Impacts of US Free Trade Agreements," Institute for International Economics, March 29, 2003. Prospective member countries of the five potential FTAs modeled were the following: 1) Australia and New Zealand combined; 2) Korea, Indonesia, Malaysia, Philippines, Singapore, Taiwan, and Thailand combined; 3) Chile, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua combined; 4) Egypt, Israel, Jordan, and Morocco combined; and 5) Botswana, Lesotho, Namibia, South Africa, and Swaziland combined. Israel already had an FTA with the United States in 2000. Also included in the study were the United States individually and combined with Canada and Mexico as the NAFTA partners in an existing FTA.

[18] A gravity model estimates, using regression techniques, bilateral trade flows in a common currency (adjusted for inflation) based on the gravitational "mass" of explanatory variables describing trading partners, which include their proximity, combined population, combined aggregate output, and presence of common borders and/or language. Most gravity models find that trade between two countries is significantly greater, the larger the combined populations and output and the closer they are to each other.

[19] Andrew K. Rose, "Which International Institutions Promote International Trade?" Haas School of Business, University of California, Berkeley, 2003. This trade sensitivity measure, when converted from its natural log term, asserts that regional free trade areas tend to add 118 percent to bilateral exports and imports between FTA partners. This sensitivity estimate measures year-specific fixed effects accounting for such factors as the value of the dollar, the global business cycle, the extent of globalization, and oil shocks.

[20] DeRosa examined trade flow results under three free trade scenarios: (1) free trade between the United States and each of its partner countries within each FTA; (2) free trade among the United States and all its partner countries within each regional FTA; and (3) free trade among the United States and all its partner countries in all the potential FTAs studied. The increased trade figures shown above are based on the second scenario and are expected to occur over a 1-2 year period. The total trade-flow figures of the U.S. partner countries increase from scenario 1 through scenario 3, but remain the same for the United States in all three scenarios.

his model do not differentiate between trade creation and trade diversion and, therefore, are the upper bounds on the potential magnitude of trade creation (and hence gains in economic welfare) associated with a U.S.-CA/Chile FTA.

Koo, Taylor, and Mattson evaluate the likely impact on U.S. sugar prices of hypothetical increased U.S. raw sugar imports that could be expected from a U.S. FTA with Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) and the FTAA.[21] The authors use a dynamic, partial equilibrium, international trade model called the Global Sugar Policy Simulation Model.[22] Increases in U.S. sugar imports were incorporated into the model through the hypothetical expansion of raw sugar TRQs from the United States' potential free-trade partners, including the Central American countries. The authors assume a beginning U.S. wholesale raw sugar price of 25.8 cents per pound, a U.S. sugarbeet price of $39.80 per ton, and a U.S. sugarcane price of $29.00 per ton. [23,24] The authors impose an annual 500,000 mt increase in U.S. imports of raw sugar[25] that resulted in an estimated U.S. wholesale raw sugar price decrease to 20.51 cents per pound, or a decline of 20.47 percent from the base price; U.S. sugarbeet prices were estimated to fall to $34.77 per ton, and U.S. sugarcane prices were estimated to fall to $24.20 per ton.[26] U.S. domestic consumption of sugar would increase by 3.6 percent from the base level, while U.S. acreage planted/harvested would fall by 1.6 percent for sugarbeets and 0.8 percent for sugarcane. Alternatively, an annual 1 million mt increase in U.S. sugar imports was estimated to cause a decrease in U.S. wholesale raw sugar prices to 15.76 cents per pound, or a decline of 38.9 percent from the base

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[21] Won W. Koo, Richard D. Taylor, and Jeremy W. Mattson, "Impacts of the U.S.-Central America Free Trade Agreement on the U.S. Sugar Industry," Paper prepared for Senator Byron Dorgan, December 2003. This study involved the entire U.S. sugar market, but was conducted from the perspective of the U.S. sugarbeet producers and processors.

[22] The model distinguishes 18 countries and regions and assumes sugar to be a homogeneous commodity. The model is designed for evaluating the effects on the world sugar economy of farm and trade policies by simulating production, consumption, stocks, and trade for sugar over a 10- to 15-year period.

[23] The authors assert that U.S. producers' 2002 break-even prices for sugarbeets in the Red River Valley of North Dakota, reportedly one of the lowest-cost sugar producing regions in the United States, averaged $36.44 per ton, but would fall to $29.07 per ton when unpaid labor and land costs are excluded. This latter figure represents U.S. producers' cash production costs and reportedly is the threshold price level below which these U.S. sugarbeet producers would not produce. Similar figures are not reported for U.S. sugarcane producers.

[24] The authors also use a domestic price elasticity of supply of 0.11 for sugarcane and 0.22 for sugarbeets, and assumed that U.S. import demand and U.S. consumption demand for raw sugar were price inelastic. As U.S. wholesale sugar prices fall below 20 cents per pound, the authors contend that U.S. domestic sugar supply could be expected to become price elastic, and below 18 cents per pound, while U.S. import demand for sugar could be expected to become price elastic.

[25] In addition to potential increases in U.S. raw sugar imports as result of an FTA, the authors assert that sugar imports also could increase under the NAFTA and the FTAA, leading to additional total U.S. raw sugar imports of more than 1 million tons annually. The authors consider these other U.S. FTAs, as well as a U.S.-Central America FTA, in arriving at their estimates of effects on U.S. sugar prices due to increased imports, especially for increased import levels above 300,000-500,000 tons (this figure is what the authors assert could eventually result from a U.S.-Central America FTA, excluding any adjustments for second-tier tariffs in the sugar TRQs).

[26] The authors used metric tons only when referring to imports; otherwise, they use short tons.

level; U.S. sugarbeet prices were estimated to fall to $29.56 per ton and U.S. sugarcane prices were estimated to fall to $19.22 per ton. U.S. domestic consumption of sugar would increase by 7.4 percent from the base level, while U.S. acreage planted/harvested would fall by 75.4 percent for sugarbeets and 45.5 percent for sugarcane.[27] Under this latter scenario, the estimated resulting prices for U.S. producers of sugarbeets and sugarcane are barely above their breakeven levels.[28]

Salassi, Kennedy, and Breaux evaluate the impact on U.S. sugar prices of hypothetical increased U.S. raw sugar imports that could be expected from a number of potential U.S. FTAs,[29] including a U.S.-CA/DR FTA.[30] The authors use a comparative static, partial equilibrium, international trade model called the Modèle Internationale Simplifié de Simulation (MISS).[31] Increases in U.S. sugar imports were incorporated into the model through the hypothetical expansion of raw sugar TRQs from the United States' potential free-trade partners.[32] The authors assumed a beginning U.S. wholesale raw sugar price of 22.92 cents per pound and a world wholesale raw sugar price of 7.70 cents per pound, and a beginning U.S. wholesale refined beet sugar price of 26.97 cents per pound and a world refined sugar price of 9.81 cents per pound.[33] An annual 100,000 mt increase in imports was estimated to reduce the

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[27] The greater proportional fall in acreage for U.S. sugarbeet producers compared with sugarcane producers resulted because sugarbeet processors would experience a more dramatic loss in scale efficiencies and, hence, increase in sugar processing costs. U.S. beet sugar processors depend exclusively on U.S. sugarbeets, while U.S. sugarcane processors use both domestically produced and imported raw cane sugar.

[28] With increased U.S. imports of raw sugar of 2 million tons annually, the authors estimated that U.S. sugarbeet and sugarcane acres planted/harvested would fall to zero.

[29] The authors identify four other potential U.S.-FTAs that also could result in liberalization of sugar quotas—the FTAA, and U.S. FTAs with the South African Customs Union, Australia, and Thailand.

[30] Michael E. Salassi, P. Lynn Kennedy, and Janis B. Breaux, "Impact of Potential Bilateral Free Trade Agreements on Projected Raw Sugar Prices and the Economic Viability of the Louisiana Sugar Industry," Staff Report No. SP2003-07, Department of Agricultural Economics and Agribusiness, Louisiana State University Agricultural Center, Baton Rouge, LA, October 2003. This study involved the entire U.S. sugar market but was conducted from the perspective of the U.S. sugarcane producers and processors.

[31] This is a multiproduct, multiregional, nonspatial, partial-equilibrium, world trade model, which simulates, in a comparative static framework, the effects of alternative policy actions related to international trade in agricultural commodities (L. Mahe, C. Tavera, and T. Trochet, "Analysis of interaction between EC and US Policies with a Simplified World Trade Model: MISS," Background paper for the Report to the Commission of the European Communities on Disharmonies in EC and U.S. Agricultural Policies, Institute National de la Recherche Agronomique Station d'Economie et Sociologie Rurales de Rennes, 1988).

[32] The authors show results of increased U.S. sugar imports in increments of 25,000 mt, up to a total of 3 million tons. According to the authors, annual average Central American raw sugar production was 3.4 million mt during 2001/02-2003/04, of which 2.0 million mt were exported and, of this, 126,365 mt were shipped to the United States. The authors considered several U.S. FTAs, including a U.S. FTA with Central America, that would account for the larger amounts of increased U.S. raw sugar imports.

[33] The authors assert that for the 2003 crop year, the estimated breakeven wholesale selling price to cover total costs to produce sugarcane in Louisiana, at average yields, was equivalent to about 19.8 cents per pound of raw sugar; total production costs included variable costs, fixed costs, and overhead costs of producing sugarcane. But at sugar yields that were 20 percent higher than average yields, the breakeven price was equivalent to about 16.9 cents per pound of raw sugar. In addition, the authors asserted that, although sugar refiners in Louisiana have been consolidating into larger, lower-cost mills, significant decreases in raw sugar prices over an extended period of time would jeopardize the long-term viability of these efficient mills. The U.S. Government supports its sugar price with a base loan rate of 18.0 cents per pound of raw sugar.

average price of U.S. raw sugar to 22.20 cents per pound, or a decline of 3.2 percent from the base level,[34] while world raw sugar prices were estimated to remain unchanged. In addition, U.S. refined beet sugar prices were estimated to decrease to 26.11 cents per pound, or a decline of 3.2 percent from the base level, while world refined sugar prices were estimated to rise incrementally to 9.82 cents per pound. An annual 150,000 mt increase in U.S. sugar imports was estimated to reduce U.S. raw sugar prices to 21.85 cents per pound, or a decline of 4.7 percent from the base level, while world raw sugar prices were estimated to increase incrementally to 7.71 cents per pound. In addition, U.S. refined beet sugar prices were estimated to decrease to 25.71 cents per pound, or a decline of 4.7 percent from the base level, while world refined sugar prices were estimated to rise incrementally to 9.82 cents per pound. Annual increases in U.S. imports of raw sugar of 500,00 and 1 million mt were expected to reduce U.S. wholesale raw sugar prices to 19.51 cents per pound and 16.57 cents per pound, respectively.[35] With the two latter increased import levels, prices were estimated to be below the breakeven prices required by Louisiana sugarcane producers under average yields (for the 500,000 mt increase in imports) and under above-average-yield breakeven prices (for the 1 million mt increase in imports).

The Commission found a few other studies, mostly nonquantitative policy papers, dealing with various aspects of the prospect of a U.S.-CA/DR FTA. These studies included a qualitative analysis by Hathaway on the impact of recent U.S. agricultural and trade policy legislation (with emphasis on the 2002 Farm Bill and Trade Promotion Authority) on U.S. negotiations for the U.S.-CA/DR FTA;[36] a qualitative analysis by Hornbeck, the only other study in the literature that is based on an analysis of the actual negotiated U.S.-CA/DR FTA;[37] and a paper by Salazar-Xirinachs and Granados that

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[34] Economic consultants to the Sweetener Users Association assert that they did not agree with some of this study's conclusions or results, and specifically noted that this 3.2 percent decline in U.S. raw sugar price may be excessive. But they pointed out that the model's estimated percentage price decline applied to refined beet sugar prices would result in only an 0.8- cents-per-pound reduction in refined sugar; this latter price change reportedly was substantially less than normal year-to-year, and even month-to-month, price variability. (See testimony of Thomas Early, Executive Vice President for Promar International and economic consultant for the Sweetener Users Association, testimony at Commission hearing, April 27, 2004, transcript at p. 217.)

[35] At the same time, estimated U.S. wholesale refined beet sugar prices were estimated to fall to 22.96 cents per pound and 19.50 cents per pound, respectively, or by 14.9 percent and 27.7 percent from the base level, respectively.

[36] Dale Hathaway, "The Impacts of U.S. Agricultural and Trade Policy on Trade Liberalization and Integration via a U.S.-Central American Free Trade Agreement," Special Initiative on Trade and Integration, Inter-American Development Bank, October 2003. Hathaway investigated the impact of U.S. export subsidies and TRQs on exports from Central America, and the extent to which those exports would change if U.S. policies were to change.

[37] J.F. Hornbeck, "The U.S. Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration," Congressional Research Service, Library of Congress, Report for Congress, April 25, 2003. Hornbeck provided background on Central American economic integration, a detailed analysis of U.S. trade with the Central American countries, and an analysis of trade negotiations and policy issues arising from the FTA.

analyzes the potential economic and political benefits and costs of a U.S.-Central America FTA.[38]

Alternative Policy Experiment

This section makes an analytical comparison between the results obtained by the USITC model described in chapter 4 and the BKS model results from the literature review above. The purpose of this exercise is to determine the extent to which differences in outcomes reported by the two models are driven by different assumptions about the trade barriers or policy shocks being modeled, and the extent to which these differences depend on other structural differences among the models in, for example, trade elasticity parameters, the characterization of capital formation, returns to scale, and product variety effects. As will be seen, the differences between the USITC results and the BKS results can be attributed to all of these different factors.

Some of the most important inputs into the simulation models are the magnitudes of the simulated changes in trade policy. To put the Commission analysis in the context of the BKS analysis, simulations are performed to examine how different assumptions about the policy experiment influence model outcomes.

The alternative simulations use the USITC model with its underlying structure unchanged; in particular, Armington elasticities (i.e., trade substitution elasticities) and other parameters remain at the values assumed for them in the analysis presented in chapter 4. That is, simulations are run applying the tariff and nontariff barrier policy shocks used by other authors on the USITC model. The Armington elasticities in the USITC model are derived independently by Hertel, et al.,[39] and are generally higher than the standard GTAP values.

The specific alternative scenario considered is that of BKS, discussed in the previous section of this chapter. Their scenario is comparable to the ITC model in that they provide estimates of the effect on U.S. welfare of the U.S.-CA/DR FTA using CGE techniques. However, as mentioned above, BKS do not model the actual U.S.-CA/DR FTA, and BKS use the GTAP regional aggregate "Central America and the Caribbean" as a proxy for the actual FTA partners of Costa Rica, El Salvador,

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[38] José M. Salazar-Xirinachs and Jaime Granados, "The United States-Central America Free Trade Agreement: Opportunities and Challenges," Paper prepared for the Institute for International Economics Conference on Free Trade Agreements and U.S. Trade Policy, Washington D.C., May 7-8, 2003. Salazar-Xirinachs and Granados provide a detailed analysis of the benefits/opportunities and the costs/risks, in economic and political terms, of a potential U.S. FTA with Central America, and identify negotiating strategies for both sides.

[39] Thomas Hertel, David Hummels, Maros Ivanic, and Roman Keeney, *How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?* GTAP Working Paper No. 26, 2003, available at *http://www.gtap.agecon.purdue.edu/resources/*.

Guatemala, Honduras, Nicaragua, and the Dominican Republic. Table D-3, in appendix D, lists the commodities modeled in the BKS scenario, and the tariff and nontariff trade measures assumed to be removed by the FTA in that scenario. Both the USITC study and the BKS study report their trade measures as a combination of tariffs and the tariff equivalents of nontariff measures. No export taxes or export tax equivalents of export quotas or quantitative restrictions are modeled by BKS or by the USITC analysis. Since BKS uses commodity data aggregated in a way that differs from the USITC model, it was necessary to reaggregate the commodities to correspond to those in the USITC model.

The alternative policy shocks as applied to the USITC aggregation are also given in appendix table D-3. In matching the alternative policy shocks of BKS to the sectors in the USITC model, the following simple procedures were used. Where one sector in the alternative model includes more than one USITC sector (such as the BKS agriculture sector, which includes the USITC sectors of grains, sugar crops, other crops, and vegetables, fruits, and nuts), the shock from the alternative model sector was applied to each of the USITC sectors. Where more than one alternative model sector matches a USITC sector (such as the BKS sectors of apparel, textiles, and leather products and footwear, all of which are contained in the single USITC sector of textiles, apparel, and leather products), a simple average of the shocks in the alternative model sectors was applied to the USITC sector. Note that these aggregation differences will also lead to some differences in the estimated outcomes of the models. The USITC analysis did not estimate the impact of services liberalization because necessary quantitative data on the nontariff barriers in services were unavailable[40]. See chapter 3 for a nonquantitative analysis of the effects of services liberalization in the FTA.

Table 8-3 provides an illustration of the magnitude of the differences in the estimated changes in U.S. welfare found by BKS, compared with the welfare change when the alternative scenarios are applied using the USITC model. In comparison to the results obtained by BKS, the USITC model implementation of their shocks generated a far smaller welfare impact from the same liberalization scenario. The BKS reported welfare gain from liberalization is $17.41 billion compared with $1.269 billion using the USITC model with the BKS shocks, and with about $115.6 million obtained from the USITC model as reported in chapter 4.

Table 8-3
U.S.-CA/DR FTA: Comparison of U.S. welfare changes for different scenarios

Author	Reported welfare change ($ millions)	USITC welfare change using BKS policy shocks
USITC	115.6	1,269.9
BKS	17,410.0	

Source: Commission calculations and cited report by Brown, Kiyota, and Stern.

[40] The BKS study reviewed above makes use of quantitative data for trade barriers in services to model a hypothetical FTA and not the negotiated FTA.

This result suggests that the majority of the BKS welfare gains come from aspects of their model that emphasize ways in which trade promotes increases in productivity (through exploitation of returns to scale and increased product variety, among other things). Those gains, in turn, are most likely focused in the services sectors, which are modeled as featuring increasing returns to scale and undergoing substantial liberalization. Further, the services sectors trade barriers themselves are quite large, and as the authors acknowledge, are "possibly subject to overstatement." In comparison to the BKS liberalization scenario, the Commission benchmark liberalization of the FTA does not model either the United States or the partner region as removing quantifiable barriers to services. In the BKS model, the United States has ad valorem equivalent barriers against imports from all countries of 27 percent in trade and transport; 31 percent in other private services; and 25 percent in government services, which is a relatively high degree of trade restrictions. As was mentioned in chapter 4, the sectors facing the greatest trade barriers generally are the ones that experience the greatest effects of eliminating the trade barriers. The scenario consists of removing those barriers against the partner countries (and likewise their barriers against the United States). In comparison with the USITC model, the BKS study assumes much greater shocks in the services industries, but this accounts for only a small part of the difference in welfare effects. The remainder of the very large difference in welfare effects is most likely due to the large-scale economies and other unique features of the BKS model.

CHAPTER 9
Summary of Views of Interested Parties

This chapter summarizes the written submissions received by the Commission in response to the *Federal Register* notice for this investigation and written statements submitted for the Commission's public hearing held in connection with this investigation on April 27, 2004, in Washington, D.C.[1]

Aníbal Acevedo-Vila, Member of the U.S. House of Representatives as the Resident Commissioner, Commonwealth of Puerto Rico

The Honorable Aníbal Acevedo-Vilà, Resident Commissioner, Commonwealth of Puerto Rico, supports the U.S. FTA with Central America and Dominican Republic (U.S.-CA/DR FTA).[2] He states that the FTA will provide opportunities for a variety of Puerto Rico's export-oriented firms because of their advantages in a shared culture and language with, and geographic proximity to, the CA/DR region. The Commissioner notes that the FTA will benefit Puerto Rican trade with the Dominican Republic and will be of particular benefit to the Puerto Rican consumer goods, construction materials, technology, and services industries. He states that the FTA will address many longstanding trade barriers in the Central American-Caribbean region that have impeded Puerto Rican exporters, including arbitrary customs procedures, lack of IPR protection, corruption, and lack of transparency in the judicial and administrative sectors. In addition, the Commissioner states that the FTA will make the industrial and agricultural sectors in the FTA partner countries more competitive by creating export opportunities, modernizing practices and standards, and reducing the role of state intervention in the private sector.

The Commissioner notes that certain sectors of the Puerto Rican economy are sensitive to imports, specifically the coffee, rum, and canned tuna industries. With respect to coffee, he states that Puerto Rico's coffee growing sector is highly vulnerable to imports, and he is pleased that Puerto Rico's special separate levy on coffee imports, authorized by the U.S. Congress in 1930, is not to be altered by the FTA. With respect to tuna, he states that although the FTA provides a 10-year phase-out of current duties on canned tuna, Puerto Rico would prefer that tuna be excluded from all U.S. FTAs.

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[1] A copy of the *Federal Register* notice is in appendix B. The list of hearing participants is presented in appendix C.

[2] The Honorable Aníbal Acevedo-Vilà, Member of the U.S. House of Representatives as the Resident Commissioner, Commonwealth of Puerto Rico, written statement to the Commission, received May 4, 2004.

Commerce and Exports Corporation, Government of the Commonwealth of Puerto Rico

Representatives of the Government of the Commonwealth of Puerto Rico support the U.S.-CA/DR FTA.[3] The state that Puerto Rico's geographical location and language make Puerto Rico an important regional trading base for serving consumers in the CA/DR region. They also note that the FTA will lead to increased Puerto Rican exports of a variety of goods and services for which it has competitive advantages, including food and beverage products, consumer goods, industrial equipment, construction materials, information technology, medical and pharmaceutical goods, and financial consulting services.

Mario M. Canahuati, Honduran Ambassador to the United States

Ambassador Canahuati states that the U.S.-CA/DR FTA is a model agreement that will enrich the economies of all the countries involved.[4] The Ambassador states that the FTA will provide numerous benefits, including increased business opportunities for both Central American and U.S. businesses; expanded access for U.S. exports to the region; increased e-commerce opportunities for U.S. firms; protection for U.S. trademarks and IPR; additional protections for U.S. investors in the region; a dispute settlement mechanism that will resolve disputes between parties in a timely manner; and an increase in labor and environmental standards.

The Ambassador states that trade and investment between the United States and the Central American countries has grown in recent years, and that the FTA will further enhance and expand trade and investment. He notes that the U.S. textile and apparel industry will be one of the main beneficiaries of the FTA because the textile provisions of the FTA will lead to greater integration between the textile and apparel industries of the United States and the Central American countries, thereby increasing their competitiveness relative to Asian producers.

Air Courier Conference of America

The Air Courier Conference of America (ACCA), the trade association representing the U.S. express delivery services industry, supports the U.S.-CA/DR FTA.[5] ACCA

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[3] Milton Segarra, Secretary, and Antonio Sosa Pascual, Executive Director, Commerce and Exports Corporation, Department of Economic Development and Commerce, Government of the Commonwealth of Puerto Rico, written statement to the Commission, received April 20, 2004.

[4] His Excellency Mario M. Canahuati, Honduran Ambassador to the United States, written statement to the Commission, received May 4, 2004.

[5] Susan M. Presti, Executive Director, Air Courier Conference of America, International, written statement to the Commission, received May 4, 2004. ACCA states that its written submission also is supported by its sister association, the Latin American Conference of Express Companies (CLADEC).

states that the FTA meets many of its core objectives for trade agreements, including recognition of express delivery services as a unique service sector; inclusion of a standstill provision; inclusion of provisions to prevent potential cross-subsidization and potential monopoly abuse by the postal administrators of partner countries; and inclusion of provisions to facilitate customs clearance.

American Apparel & Footwear Association

The American Apparel & Footwear Association (AAFA), the national trade association representing the apparel and footwear industries and their suppliers, supports the U.S.-CA/DR FTA.[6] AAFA points to the benefits already afforded U.S. imports from the Caribbean Basin region trade under CBTPA, including a fourfold increase in U.S. exports of yarns and fabrics between 2000 and 2003.

AAFA states that it supported the negotiation of a commercially meaningful FTA with the region because a full FTA partnership offers benefits such as creating additional markets for U.S. inputs and finished products. These benefits result from the reciprocal duty-free status for which U.S. exports of textiles, apparel, and footwear will now qualify; extending import preferences to products not currently eligible for preferential treatment, including fabrics, yarns, and made-up textile articles; simplifying customs procedures; making it easier for existing categories of footwear and textile articles to qualify for duty-free treatment; and fostering business certainty and investment predictability as the FTA is permanent and no longer based on unilateral conditions. AAFA also argues that the FTA poses little risk of injury to the U.S. industry—U.S. apparel and footwear production will not be displaced because import penetration is already high. AAFA states that the production that remains in the United States is dedicated to niche domestic or export markets, responds to specific procurement incentives (such as the Berry Amendment), or exists to serve certain quick-response requirements. AAFA notes that the CA/DR region is one of the most important and fast-growing export markets for the U.S. fiber, fabric, and yarn industry. AAFA states that the FTA will help the region remain competitive in textile and apparel production which, in turn, will help the region to become economically stronger and more stable—ultimately benefitting the U.S. economy.

American Dehydrated Onion and Garlic Association

The American Dehydrated Onion and Garlic Association (ADOGA), an association composed of two firms that produce the majority of all U.S. dehydrated onion and

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[5]—Continued

CLADEC, formed by 21 national trade associations, represents the express delivery services sector throughout Latin America and the Caribbean.

[6] James C. Jacobsen, Vice Chairman, Kellwood Company, on behalf of American Apparel & Footwear Association, written statement to the Commission, received April 22, 2004.

garlic, opposes the U.S.-CA/DR FTA.[7] ADOGA states that imports from the CA/DR region pose a problem for the U.S. dried onion and garlic industry because CA/DR labor and regulatory costs are considerably lower than those in the United States. ADOGA also states that Guatemala, El Salvador, and the Dominican Republic pose a threat to the domestic industry because those countries have exported dehydrated vegetables to the United States in past years. Most of the ADOGA firms' dried onion and garlic production is sold to institutional and food service buyers for use, in very small quantities, as an ingredient in other processed foods. The cost of the dried onions or garlic used in such foods is a small fraction of the overall cost of the end product produced. Demand for the dried onions or garlic is derived from demand for the end-use product. Further, ADOGA states that providing permanent duty-free entry for dried onions and garlic from the CA/DR region will eliminate the President's authority to suspend eligibility for duty-free treatment currently in effect under CBERA, which might lead to possible future injury to the domestic industry.

American Sugar Alliance

The American Sugar Alliance (ASA) is a national coalition of sugar cane, sugar beet, and corn farmers, processors, suppliers, and other workers involved in the U.S. sweetener industry.[8] ASA opposes the U.S.-CA/DR FTA. ASA states that the U.S. sugar market currently is oversupplied and that the increase in sugar access under the FTA will reduce U.S. production and increase U.S. stocks; will trigger the suspension of domestic marketing allotments, leading to the disruption of the U.S. market and increased government costs; and will lead to a loss of domestic jobs and income. ASA states that any reduction in sugar prices resulting from the FTA will not be passed to consumers. ASA further argues that market access should be negotiated in the WTO rather than in FTAs because of numerous sugar producers' trade policies that distort the world sugar market.

The American Yarn Spinners Association

The American Yarn Spinners Association, Inc. (AYSA), the national trade association representing the sales yarn manufacturing industry, opposes the U.S.-CA/DR FTA because of concerns about exceptions to the yarn forward rule of origin.[9] These exceptions include tariff preference levels (TPLs),[10] cumulation, a fabric forward rule for woven wool fabric used in the FTA countries, and a single transformation rule for certain apparel items. AYSA states that it recognizes the need for an FTA with the

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[7] Irene Ringwood, Ball Janik LLP, Washington, DC, counsel for the American Dehydrated Onion and Garlic Association, written statement to the Commission, received May 4, 2004.

[8] Jack Roney, Director, Economics and Policy Analysis, American Sugar Alliance, written statements to the Commission, received April 14, and April 30, 2004.

CA/DR region, particularly in light of the elimination of quotas on January 1, 2005, that will cause sourcing to shift from the region to Asia. AYSA notes that a growing partnership with fabric and apparel producers in the FTA countries will enable its members to remain competitive as quotas and quotas costs are eliminated at the end of 2004. However, AYSA states that U.S. textile producers are likely to lose business and employment as a result of the FTA as it has been negotiated.

Camara Nacional de la Industria Textile

The Camara Nacional de la Industria Textil (CANAINTEX), the national association representing more than 400 manufacturers of textiles (yarns, fabrics, and nonwovens) in Mexico, states that its assessment of the economic impact of the U.S.-CA/DR FTA on regional trade in textiles is mixed.[11] CANAINTEX states that to the extent that the FTA provides for cumulation, the economic effects on the U.S. textile and apparel supply chain and on U.S. consumer welfare will be positive. However, CANAINTEX notes that to the extent that the FTA also establishes preconditions and quantity and production limitations, it introduces significant barriers to establishing a market-based textile regime in the hemisphere. CANAINTEX states that it is still possible to make some improvements to the FTA that would at least meet the minimum required to convince U.S. apparel manufacturers that regional sourcing is a viable alternative to Asia and therefore maintain textile industry capacity, jobs, and incomes in the region.

According to CANAINTEX, the cumulation of Mexican and Canadian inputs under the FTA will allow the hemispheric textile industry to move closer to more economically efficient, integrated operations to better compete with Asian producers. However, CANAINTEX states that benefits of the FTA are likely to be limited by limitations on the type and quantity of apparel allowed, inclusion of the Dominican Republic, a significant regional producer, as a party to the FTA without increasing the cap, and inclusion of individual product limits within the cap. CANAINTEX states that the most significant problems with the FTA can be overcome by expanding the overall cap to reflect the addition of the Dominican Republic, by eliminating the existing sublimits, and by eliminating the preconditions for implementation such as the completion of legislative procedures to provide reciprocal treatment and consensus on customs procedures.

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[9] Michael S. Hubbard, Executive Vice President, American Yarn Spinners Association. Specifically, AYSA represents firms that produce "sales yarn,"—i.e., yarn produced for sale to other firms, as opposed to yarn produced for internal consumption, written statement to the Commission, received May 4, 2004.

[10] TPLs, cumulation, and other technical terms with respect to textiles and apparel are defined and discussed in more detail in the section "Textiles, apparel, and footwear" in chapter 3 of this report.

[11] Maureen R. Smith, Managing Director, International Trade, Public Strategies, Inc., on behalf of the Camara Nacional de la Industria Textile, written statement to the Commission, received April 16, 2004.

Chamber of Commerce of the United States of America and the Association of Chambers of Commerce in Latin America

The U.S. Chamber of Commerce (Chamber) is the world's largest business federation, representing 3 million U.S. businesses of every size, sector, and region.[12] The Association of American Chambers of Commerce in Latin America (AACCLA) represents 23 American Chambers of Commerce in 21 Latin American and Caribbean nations, and its 20,000 member companies account for more than 80 percent of all U.S. investment in the region. The Chamber and AACCLA support the U.S.-CA/DR FTA. They stated that the CA/DR governments all have FTAs with other countries and, as a result, U.S. exports currently face higher duties in the CA/DR region than do exports from many other countries. Among the benefits from the FTA, the Chamber and AACCLA note the loosening of restrictions for distribution agreements, rules to ensure nondiscriminatory treatment in government procurement, and the strengthening of IPR protection and enforcement.

Dominican Republic-United States Business Council

The Dominican Republic-United States Business Council (Business Council), has 20 member companies, including both leading Dominican businesses and U.S. firms conducting business in the Dominican Republic.[13] The Business Council's objective is to promote trade and investment between the Dominican Republic and the United States. The Business Council supports the U.S.-CA/DR FTA and states that it will lead to more trade and investment among the parties, increasing the competitiveness of the region relative to other regions in the world.

The Business Council states that the Dominican Republic, as Caribbean Basin Trade Partnership Act (CBTPA), Caribbean Basin Economic Recovery Act (CBERA), and Generalized Systems Preference (GSP) beneficiary, already enjoys U.S. tariff preferences for a range of products. An FTA will create a broader and permanent framework to protect and encourage investment, guarantee the application of the rule of law, and provide additional confidence and certainty for businesses in both the United States and the Dominican Republic. The Business Council notes that the FTA with respect to the Dominican Republic includes a side letter on co-production, wherein the U.S. Government commits to work with the U.S. Congress to amend CBTPA to ensure that articles currently eligible for CBTPA benefits that are co-produced by Dominican companies in Haiti do not lose that eligibility for benefits once the FTA enters into force.

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[12] Comments of the Chamber of Commerce of the United States of America, written statement to the Commission, received April 27, 2004.

[13] Manuel Tavares, President, Dominican Republic-United States Business Council, written statement to the Commission, received May 5, 2004.

Emergency Committee for American Trade

The Emergency Committee for American Trade (ECAT) is an association of U.S. companies representing all major sectors of the U.S. economy. [14]

ECAT supports the FTA[15] and states that it will create substantial opportunities for economic growth in the CA/DR region as well as to provide reciprocity for U.S. industry and employees by way of improved access to CA/DR markets after many years of those countries having unilateral preferential access to the U.S. market. ECAT states that the FTA will encourage further economic integration in Central American that, in turn, will create more opportunities for U.S. businesses.

The U.S. agricultural and manufacturing industries identified by ECAT as likely to benefit from the FTA are paper; chemicals and pharmaceuticals; feed grains; wheat; rice; poultry; soybeans; pork; beef; paper; information technology; construction; and agricultural, medical, and scientific equipment. U.S. service industries identified by ECAT as likely to benefit from the FTA are telecommunications; banking; insurance; distribution; computer; audio, visual, and entertainment; energy; transportation; construction; and professional services. ECAT also stated that U.S. exports of information technology products will benefit under the FTA as a result of commitments to join the WTO Information Technology Agreement by the Dominican Republic, Guatemala, Honduras, and Nicaragua.

Florida Citrus Mutual

Florida Citrus Mutual (FCM) is a voluntary cooperative association whose active membership consists of more than 11,000 Florida growers of citrus for processing and fresh consumption.[16] FCM represents more than 90 percent of Florida's citrus growers and up to 80 percent of all oranges grown in the United States for processing into juice and other citrus products.

FCM does not oppose the U.S.-CA/DR FTA and its provision for duty-free access to the U.S. market for indigenous orange juice processed exclusively from oranges grown in

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[14] ECAT serves as the secretariat to the Business Coalition for U.S.-Central American Trade, a broad-based grouping of over 125 companies and associations representing all of the principal sectors of the U.S. economy, including agriculture, manufacturing, merchandising, processing, publishing, services, and shipping. Five members of the Business Coalition testified separately before the Commission in favor of the U.S.-CA/DR FTA (the AAFA, FDRA, the Grocery Manufacturers of America, the Pharmaceutical Research Manufacturers of America, and the Sweetener Users Association), and the Business Coalition supports their positions.

[15] Calman J. Cohen, President, Emergency Committee for American Trade, written statement to the Commission, April 13, and May 14, 2004.

[16] Matthew T. McGrath and Amy H. Warlick, Barnes, Richardson & Colburn on behalf of Andrew Lavigne, Executive Vice President and CEO, Florida Citrus Mutual, written statement to the Commission, received May 4, 2004.

the CA/DR region. However, FCM notes that the United States must rigorously enforce the rules of origin. FCM is concerned that the FTA might encourage transshipments of Brazilian orange juice through the CA/DR region under the guise of FTA-qualified product, and that such transshipments would harm the industry in Florida. In order to accurately monitor transshipments, the FCM argues that the FTA should require the CA/DR governments to publish timely, accurate statistics on their citrus industries.

Footwear Distributors and Retailers of America

The Footwear Distributors and Retailers of America (FDRA) is a trade association representing establishments that account for about three-quarters of all footwear sold at retail in the United States. FDRA supports the U.S.-CA/DR FTA, but advocates the immediate elimination of U.S. duties on all footwear, including the 17 rubber footwear articles for which duties are to be phased out over 10 years.[17] FDRA contends that immediate duty elimination for all footwear will not harm the U.S. shoe manufacturing industry and will benefit consumers. FDRA states that there is no connection between maintaining duties on footwear and the continuance of domestic footwear manufacturing jobs because imported footwear is already so much lower priced than comparable domestically manufactured footwear.

FDRA states that the U.S. footwear industry does not compete with imports on price, but instead differentiates its products on the basis of specialized types of footwear (such as size, widths, and hand sewn), quality, exclusive channels of distribution, and, especially, brand names. According to FDRA, duty elimination is inconsequential to the sales of such U.S. products, and the benefits to U.S. consumers as a result of elimination will be considerable arguing that the existing duties on footwear add considerably to the prices U.S. consumers currently pay for these products.

Grocery Manufacturers of America

The Grocery Manufacturers of America (GMA) is the world's largest association of food, beverage, and consumer product companies.[18] With U.S. sales of more than $500 billion, GMA member companies employ more than 2.5 million workers in all 50 states. GMA supports the U.S.-CA/DR FTA. GMA states that the increased market access for U.S. processed food exports will immediately result in savings of $8.8 million and will increase to $28 million upon full implementation. GMA estimates that U.S. exports of processed food products could increase by 84 percent in the first year of the FTA.

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[17] Michael P. Daniels and Marcus A. Kraker, Loeffler, Jonas & Tuggey LLP, on behalf or Footwear Distributors and Retailers of America, written statements to the Commission, received April 20, and May 5, 2004.

[18] Sarah F. Thorn, Senior Director, International Trade, Grocery Manufacturers of America, written statement to the Commission, received April 19, 2004

GMA notes that all of its priority exports will receive duty-free access, although some will not receive duty-free treatment until 15 years after the FTA is implemented. GMA states that it is pleased that sugar is not excluded from the FTA and that the CA/DR region will have additional access to the U.S. peanut market.

International Intellectual Property Alliance

The International Intellectual Property Alliance (IIPA), a private sector coalition representing the U.S. copyright-based industries, comprises six trade associations and represents more than 1,300 U.S. companies producing and distributing materials protected by copyright laws worldwide.[19] IIPA states that it is concerned about losses its members face due to piracy of U.S. copyrighted materials. Those losses are estimated to be $20-$22 billion annually, not including Internet piracy. IIPA states that its goal is a legal and enforcement regime for copyright that not only deters piracy, but that also fosters technological and cultural development.

National Council of Textile Organizations

The National Council of Textile Organizations (NCTO) represents the entire spectrum of the U.S. textile sector, from fibers to finished products and from machinery manufacturers to power suppliers.[20] NCTO opposes the U.S.-CA/DR FTA. It contends that the FTA will have a seriously adverse economic effect on the U.S. textile industry and its workers and will result in the loss of current export sales and thus U.S. production and jobs. According to NCTO, about 206,000 U.S. textile jobs were lost in the last five years—fully 33 percent of the entire textile industry workforce—with 50,000 jobs eliminated in 2003 alone. NCTO states that the FTA will exacerbate U.S. plant closures and job layoffs, rather than create new and enhanced export opportunities.

NCTO is concerned that the cumulation provisions of the FTA will allow Asian inputs to displace U.S. production.[21] NCTO states that it would have preferred a yarn-forward rule of origin with no exceptions in the FTA. According to NCTO, the TPLs, the cumulation provision, the single transformation rule of origin for certain products, the provision allowing duty-free treatment for wool apparel made of Asian yarn, and the provision making duty-free treatment for textiles and apparel retroactive to January 1, 2004, could cost the U.S. textile industry $1.0 billion to $1.8 billion or more in annual lost export sales.

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[19] Maria Strong, Vice President and General Counsel, International Intellectual Property Alliance, written statements to the Commission, received April 12, and May 5, 2004

[20] Robert DuPree, Vice President, National Council of Textile Organizations, written statements to the Commission, April 16, and May 11, 2004.

[21] Technical terms such as cumulation and yarn forward are defined and discussed in more detail in the section "Textiles, apparel, and footwear" in chapter 3 of this report.

National Retail Federation

The National Retail Federation (NRF), the nation's largest trade association representing the retail industry, supports the U.S.-CA/DR FTA.[22] According to NRF, after the elimination of U.S. textiles and apparel quotas in 2005 the CA/DR region will offer retailers the sourcing advantages of proximity to the U.S. market and an established apparel sewing base. NRF states that the FTA will address CBTPA deficiencies that have not promoted the development of integrated textile and apparel industries in the CA/DR region. NRF states the restrictive rules of origin of the FTA are balanced by flexibility with respect to the use of nonoriginating inputs. NRF states that during the FTA negotiations it advocated a cumulation rule that would allow the use of inputs from Mexico and Canada in qualifying apparel production in the CA/DR region, and notes that the cumulation provision is restricted by product and through quantitative caps.

According to NRF, the FTA will not harm U.S. textile and apparel producers because the CA/DR region is a major export market for the U.S. textile industry. NRF states that the FTA will increase U.S. apparel sourcing from the CA/DR region which, in turn, will present U.S. fiber and textile producers opportunities for new business in an environment that will help build their productivity and competitiveness. NRF states that U.S. consumers will be the major beneficiaries of the FTA through lower prices and an increased selection of products.

Payless ShoeSource, Inc.

Payless ShoeSource, Inc., the Western Hemisphere's largest family footwear retailer with more than 5,000 retail stores, it supports the U.S.-CA/DR FTA.[23] Payless states that it has been able to offer its customers affordable, quality footwear, in large part, due to its extensive long-term relationships with overseas footwear producers, primarily in China. Payless states that although it currently sources most of its footwear from Asia, it is committed to diversifying its sourcing base. Payless notes that it already sources some products from Brazil and Colombia and has begun to source products from Peru. Payless states that it considers increased production from Latin America to be a key element of its strategy to diversify its sourcing.

Payless states that the FTA allows for immediate duty-free treatment for most (98 of the 115 tariff rate lines for footwear in the HTS) types of footwear originating in the FTA countries. Payless states that the substantial transformation rule of origin for footwear

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[22] Erik O. Autor, Vice President, and International Trade Counsel, National Retail Federation, written statement to the Commission, received May 5, 2004.

[23] Curtis S. Sneden, Director of Government Affairs, Payless ShoeSource, Inc., written statement to the Commission, April 14, 2004.

in the FTA[24] is important for allowing footwear producers in the FTA countries to develop into world class competitors. Payless states that the substantial transformation origin rule would allow factories in the FTA countries to assemble footwear with completed uppers imported from Asia, thereby creating the basis for a growing footwear manufacturing infrastructure. Payless states that once strong footwear assembly operations are up and running in the CA/DR region, in-country market forces will lead to the development of broader factory operations and, ultimately, the entire shoe could be built from component materials made in the western hemisphere, including the United States. For this reason, Payless states that the FTA offers a win-win situation for producers in the United States and in the CA/DR region, and will help to revitalize the footwear industry in the hemisphere.

Pharmaceutical Research and Manufacturers of America

Pharmaceutical Research and Manufacturers of America (PhRMA) represents the patented pharmaceutical industry, which also includes some of the larger biotechnology companies.[25] Its members are global in scope and develop many of the innovative medicines currently in the market.[26].

PhRMA supports the U.S.-CA/DR FTA, and states that it seeks a stable and predictable legal framework for IPR protection in the CA/DR region. According to PhRMA, U.S. pharmaceutical exports to the CA/DR region will benefit from tariff reductions under the FTA. PhRMA also supports FTA provisions designed to strengthen IPR protection and enforcement in the CA/DR region. According to PhRMA, "the ideal trade agreement is one that commits foreign governments to providing the same level of protection for intellectual property as does the United States."[27]

Sweetener Users Association

The Sweetener Users Association (SUA) represents major users of sugar and other sweeteners, including manufacturers of confectionery, grocery products, dairy foods, soft drinks, and other products, as well as related trade associations.[28] The SUA

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[24] Technical terms such as single transformation rule are defined in the section "Textiles, apparel, and footwear" in chapter 3 of this report.

[25] Renard Aron, Assistant Vice President For Latin America and Canada, Pharmaceutical Research and Manufacturers of America, written statement to the Commission, received April 20, 2004.

[26] In addition to the branded pharmaceutical industry (PhRMA companies), there is also a large global generic pharmaceutical industry and a large over-the-counter pharmaceutical industry, that has a presence in the CA/DR region.

[27] Ibid.

[28] Tom Earley, Economic Consultant, Sweetener Users Association, written statements to the Commission, received April 22, and May 4, 2004.

supports the U.S.-CA/DR FTA. The SUA states that the FTA will increase competition in an increasingly concentrated U.S. sugar market, increase U.S. export opportunities in the CA/DR region for other U.S. food and agricultural sectors, and lead to increased U.S. employment in confectionary and other sugar-using industries.

Travel Goods Association

The Travel Goods Association (TGA) is the national association of the manufacturers, distributors, and retailers of luggage, leather goods, business and travel accessories, business and computer cases, and handbags.[29] TGA supports the U.S.-CA/DR FTA. TGA states that U.S. travel goods companies have had a longstanding partnership with the FTA countries, particularly the Dominican Republic, resulting in U.S. exports of travel goods inputs from U.S. textile manufacturers and leather tanners and the manufacture of those inputs by the FTA countries into travel goods for re-export to the United States. TGA, citing CBTPA provisions and the removal of U.S. quotas on textile travel goods in 2001, notes the competition that travel goods from the FTA countries now face because of exports from Asian countries and the rules of origin and customs procedures that affect travel goods exports from the FTA countries. TGA states that the FTA will result in a simplified and flexible rule of origin for travel goods exported from the FTA countries, with eased customs procedures and documentation requirements, enhancing the important relationship between the U.S. travel goods industry and the CA/DR region.

United States Association of Importers of Textiles and Apparel

The United States Association of Importers of Textiles and Apparel (USA-ITA) is a national association representing manufacturers, distributors, retailers, importers, and related service providers such as shipping lines and customs brokers.[30] USA-ITA supports the U.S.-CA/DR FTA, but states that the FTA falls short of satisfying the objectives and needs of its members. The organization states that it supports a number of the provisions in the FTA, particularly the immediate elimination of duties on all textiles and apparel, which it contends provides a substantial incentive for placing business in a particular country, especially for apparel, which in 2003 carried an average duty rate of about 17 percent. USA-ITA states that it agrees with the January 1, 2004 retroactive implementation date for duty elimination. USA-ITA also states that it supports the increase in the de minimis foreign content rule from 7 percent to 10 percent and the single transformation rule of origin for brassieres, boxer shorts, and

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[29] Michele Marini Pittenger, President, Travel Goods Association, written statement to the Commission, received May 4, 2004.

[30] Laura Jones, Executive Director, the United States Association of Importers of Textiles and Apparel, written statement to the Commission, received May 4, 2004.

nightwear because these provisions offer the sourcing flexibility needed to retain and expand production in the region by allowing complementary manufacturing. For similar reasons, USA-ITA supports the TPLs established for cotton and manmade-fiber garments made in Nicaragua, and for wool apparel produced in Costa Rica, as well as the cumulation provision.[31]

USA-ITA is concerned that certain provisions in the FTA, such as the single transformation rule, the TPLs, and the cumulation provisions, are too limited in scope and duration or may not come into force. USA-ITA states that the single transformation rule is limited to a few products and notes that the incentive to use the TPLs by apparel importers who are not interested in short-term planning is constrained by the uncertainty of the benefit. USA-ITA states that the cumulation provision may never come into force because it is contingent on Canada and Mexico establishing full reciprocity. Furthermore, it views the restriction on the types of garments eligible for cumulation as a deterrent to using the provision. USA-ITA states that although the new short supply provision in the FTA offers quicker resolution of requests than currently exist under CBTPA, it would be preferable to establish more flexible rules of origin rather than rely upon exceptions to the rules.

[31] Apparel industry representatives have noted that under the FTA that, although it is "too early to tell", they expect the paperwork requirements to be "substantially less" than those associated with CBTPA, hearing transcript pp.33,61.

APPENDIX A
Request Letter

EXECUTIVE OFFICE OF THE PRESIDENT
THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON, D.C. 20508

JAN 28 2004

The Honorable Deanna Tanner Okun
Chairman
U.S. International Trade Commission
500 E Street, S.W.
Washington, D.C. 20436

Dear Chairman Okun:

As you know, the United States has recently completed the negotiation of a comprehensive free trade agreement (FTA) with Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua (hereinafter "Central America"). We are also engaged in negotiations with the Dominican Republic on the market access elements of the FTA.

Pursuant to authority delegated to me by the President and in accordance with section 2104(f) of the Trade Act of 2002 (Trade Act), I request the U.S. International Trade Commission ("Commission") to prepare a report as specified in section 2104(f)(2)-(3) of the Trade Act assessing the likely impact of an FTA with Central America and the Dominican Republic on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers.

USTR staff will provide the Commission with the details of the FTA now and will be available to answer questions or provide additional information. We will also provide updates on the status of the ongoing negotiations with the Dominican Republic. Although still subject to legal review, the text of the agreement with Central America is available to the public.

Thank you for your continued cooperation and assistance in this matter.

Sincerely,

Bob

Robert B. Zoellick

APPENDIX B
Federal Register Notice

SUPPLEMENTARY INFORMATION: The Commission instituted this investigation on May 27, 2003, based on a complaint filed by Energizer Holdings, Inc. and Eveready Battery Co., Inc., both of St. Louis, MO, 68 FR 32771 (2003). The complaint as amended alleges violations of section 337 of the Tariff Act of 1930 in the importation into the United States, the sale for importation, and the sale within the United States after importation of certain zero-mercury-added alkaline batteries, parts thereof, and products containing same by reason of infringement of claims 1–12 of U.S. Patent No. 5,464,709. The complaint further alleges that an industry in the United States exists as required by subsection (a)(2) of section 337. The Commission named as respondents 26 companies located in the United States, China, Indonesia, and Japan.

On February 3, 2004, complainants and one respondent, Golden Million Enterprises, Inc., filed a joint motion to terminate the investigation as to the respondent on the basis of settlement agreement and consent order. On February 13, 2004, the Commission investigative attorney filed a response supporting the motion. On February 17, 2004, the ALJ issued the subject ID terminating the investigation as to the respondent on the basis of a settlement agreement and consent order.

No party petitioned for review of the ID pursuant to 19 CFR 210.43(a), and the Commission found no basis for ordering a review on its own initiative pursuant to 19 CFR 210.44. The ID thus became the determination of the Commission pursuant to 19 CFR 210.42(h)(3).

This action is taken under the authority of section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. 1337, and Commission rule 210.42, 19 CFR 210.42.

By order of the Commission.
Issued: March 17, 2004.

Marilyn R. Abbott,
Secretary to the Commission.

[FR Doc. 04–6438 Filed 3–22–04; 8:45 am]
BILLING CODE 7020–02–P

INTERNATIONAL TRADE COMMISSION

[Investigation No. TA–2104–13]

U.S. Free Trade Agreement With Central America and the Dominican Republic: Potential Economywide and Selected Sectoral Effects

AGENCY: United States International Trade Commission.

ACTION: Institution of investigation.

SUMMARY: Following receipt on January 28, 2004, of a request from the United States Trade Representative (USTR), the Commission instituted investigation No. TA–2104–13, *U.S. Free Trade Agreement With Central America and the Dominican Republic: Potential Economywide and Selected Sectoral Effects*, under section 2104(f) of the Trade Act of 2002 (19 U.S.C. 3804(f)).

Background: As requested by the USTR, the Commission will prepare a report as specified in section 2104(f)(2)-(3) of the Trade Act of 2002 assessing the likely impact of the U.S. free trade agreement (FTA) with Central America and the Dominican Republic on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers. The report will assess the likely impact of the agreement on the United States economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the agreement and the interests of United States consumers.

In preparing its assessment, the Commission will review available economic assessments regarding the agreement, including literature regarding any substantially equivalent proposed agreement, and will provide in its assessment a description of the analyses used and conclusions drawn in such literature, and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the agreement.

Section 2104(f)(2) requires that the Commission submit its report to the President and the Congress not later than 90 days after the President enters into the agreement, which he can do 90 days after he notifies the Congress of his intent to do so. The President notified the Congress on February 20, 2004, of his intent to enter into an FTA with Central America. At that time, the President also stated that negotiations were under way to integrate the Dominican Republic into the FTA with Central America.

The ITC has begun its assessment, and it will seek public input for the investigation through a public hearing on April 27, 2004. The date of the hearing is contingent on the successful conclusion of the negotiations with the Dominican Republic and when a public version of the final agreement is made available by the U.S. Trade Representative.

Effective Date: March 11, 2004.

FOR FURTHER INFORMATION CONTACT: James Stamps, Project Leader, Office of Economics (202–205–3227 or *james.stamps@usitc.gov*). For information on the legal aspects of this investigation, contact William Gearhart of the Office of the General Counsel (202–205–3091 or *william.gearhart@usitc.gov*). For media information, contact Peg O'Laughlin (202–205–1819). Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal on (202–205–1810).

Public Hearing: A public hearing in connection with this investigation is scheduled to begin at 9:30 a.m. on April 27, 2004, at the U.S. International Trade Commission Building, 500 E Street SW., Washington, DC. All persons may appear by counsel or in person, to present information, and to be heard. In the event that no requests to appear at the hearing are received by the close of business on April 13, 2004, the hearing will be canceled. Any person interested in attending the hearing as an observer or non-participant may call the Secretary (202–205–1816) after April 13, 2004 to determine whether the hearing will be held.

Statements and Briefs: In lieu of or in addition to appearing at the public hearing, interested persons are invited to submit written statements concerning the investigation in accordance with the requirements in the "Submissions" section below. Persons wishing to appear at the public hearing should file a letter with the Secretary, United States International Trade Commission, 500 E St., SW., Washington, DC 20436, not later than the close of business (5:15 p.m.) on April 13, 2004. In addition, persons appearing should file prehearing briefs (original and 14 copies) with the Secretary by the close of business on April 20, 2004. Posthearing briefs should be filed with the Secretary by the close of business on May 4, 2004.

Written Submissions: Written statements should be received by the close of business on May 4, 2004. Commercial or financial information which a submitter desires the Commission to treat as confidential must be submitted on separate sheets of paper, each clearly marked "Confidential Business Information" at the top. All submissions requesting confidential treatment must conform with the requirements of § 201.6 of the Commission's *Rules of Practice and Procedure* (19 CFR 201.6). All written submissions, except for confidential

business information, will be made available for inspection by interested persons. The Commission intends to publish only a public report in this investigation. Accordingly, any confidential business information received by the Commission in this investigation and used in preparing the report will not be published in a manner that would reveal the operations of the firm supplying the information. All submissions should be addressed to the Secretary at the Commission's office in Washington, DC. The Commission's rules do not authorize filing of submissions with the Secretary by facsimile or electronic means, except to the extent permitted by § 201.8 of the Commission's Rules (19CFR 201.18) (*see* Handbook for Electronic Filing Procedures, *ftp://ftp.usitc.gov/pub/reports/electronic_filing_handbook.pdf*). The public record for this investigation may be viewed on the Commission's electronic docket (EDIS) at *http://edis.usitc.gov*. Hearing-impaired individuals are advised that information on this matter can be obtained by contacting our TDD terminal on (202) 205–1810.

List of Subjects

Central America, Dominican Republic, tariffs, trade, imports and exports.

By order of the Commission.

Issued: March 17, 2004.

Marilyn R. Abbott,

Secretary to the Commission.

[FR Doc. 04–6409 Filed 3–22–04; 8:45 am]

BILLING CODE 7020–02–P

INTERNATIONAL TRADE COMMISSION

[Investigation No. TA–2104–14]

U.S.-Morocco Free Trade Agreement: Potential Economywide and Selected Sectoral Effects

AGENCY: United States International Trade Commission.

ACTION: Institution of investigation.

SUMMARY: Following receipt on March 8, 2004, of a request from the United States Trade Representative (USTR), the Commission instituted investigation No. TA–2104–14, *U.S.-Morocco Free Trade Agreement: Potential Economywide and Selected Sectoral Effects*, under section 2104(f) of the Trade Act of 2002 (19 U.S.C. 3804(f)).

Background: As requested by the USTR, the Commission will prepare a report as specified in section 2104(f)(2)–(3) of the Trade Act of 2002 assessing the likely impact of the U.S. free trade agreement (FTA) with Morocco on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers. The report will assess the likely impact of the agreement on the United States economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports and imports, aggregate employment and employment opportunities, the production, employment, and competitive position of industries likely to be significantly affected by the agreement, and the interests of United States consumers.

In preparing its assessment, the Commission will review available economic assessments regarding the agreement, including literature regarding any substantially equivalent proposed agreement, and will provide in its assessment a description of the analyses used and conclusions drawn in such literature, and a discussion of areas of consensus and divergence between the various analyses and conclusions, including those of the Commission regarding the agreement.

Section 2104(f)(2) requires that the Commission submit its report to the President and the Congress not later than 90 days after the President enters into the agreement, which he can do 90 days after he notifies the Congress of his intent to do so. The President notified the Congress on March 8, 2004, of his intent to enter into an FTA with Morocco.

The Commission has begun its assessment, and it will seek public input for the investigation through a public hearing on April 29, 2004 (*see* below).

Effective Date: March 16, 2004.

FOR FURTHER INFORMATION CONTACT: James Stamps, Project Leader, Office of Economics (202–205–3227 or *james.stamps@usitc.gov*). For information on the legal aspects of this investigation, contact William Gearhart of the Office of the General Counsel (202–205–3091 or *william.gearhart@usitc.gov*). For media information, contact Peg O'Laughlin (202–205–1819). Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal on (202–205–1810).

Public Hearing: A public hearing in connection with this investigation is scheduled to begin at 9:30 a.m. on April 29, 2004, at the U.S. International Trade Commission Building, 500 E Street SW., Washington, DC. Requests to appear at the public hearing should be filed with the Secretary, no later than 5:15 p.m., April 15, 2004, in accordance with the requirements in the "Submissions" section below. In the event that, as of the close of business on April 15, 2004, no witnesses are scheduled to appear at the hearing, the hearing will be canceled. Any person interested in attending the hearing as an observer or non-participant may call the Secretary (202–205–2000) after April 15, 2004, to determine whether the hearing will be held.

Statements and Briefs: In lieu of or in addition to participating in the hearing, interested parties are invited to submit written statements or briefs concerning the investigation in accordance with the requirements in the "Submissions" section below. Any prehearing briefs or statements should be filed not later than 5:15 p.m., April 22, 2004; the deadline for filing post-hearing briefs or statements is 5:15 p.m., May 6, 2004.

Submissions: All written submissions including requests to appear at the hearing, statements, and briefs, should be addressed to the Secretary, United States International Trade Commission, 500 E Street SW., Washington, DC 20436. All written submissions must conform with the provisions of § 201.8 of the *Commission's Rules of Practice and Procedure* (19 CFR 201.8); any submissions that contain confidential business information must also conform with the requirements of § 201.6 of the *Commission's Rules of Practice and Procedure* (19 CFR 201.6). Section 201.8 of the rules require that a signed original (or a copy designated as an original) and fourteen (14) copies of each document be filed. In the event that confidential treatment of the document is requested, at least four (4) additional copies must be filed, in which the confidential information must be deleted. Section 201.6 of the rules require that the cover of the document and the individual pages clearly be marked as to whether they are the "confidential" or "nonconfidential" version, and that the confidential business information be clearly identified by means of brackets.

The Commission intends to publish only a public report in this investigation. Accordingly, any confidential business information received by the Commission in this investigation and used in preparing the report will not be published in a manner that would reveal the operations of the firm supplying the information.

The Commission's rules do not authorize filing submissions with the Secretary by facsimile or electronic means, except to the extent permitted by § 201.8 of the Commission's Rules (19 CFR 201.8)(see Handbook for Electronic

APPENDIX C
Hearing Participants

CALENDAR OF PUBLIC HEARING

Those listed below appeared as witnesses at the United States International Trade Commission's hearing:

Subject:	U.S. Free Trade Agreement with Central America and the Dominican Republic: Potential Economywide and Selected Sectoral Effects
Inv. No.:	TA-2104-13
Date and Time:	April 27, 2004 - 9:30 a.m.

Sessions were held in connection with this investigation in the Main Hearing Room (room 101), 500 E Street, S.W., Washington, D.C.

ORGANIZATION AND WITNESS:

PANEL 1

Footwear Distributors and Retailers of America

Peter T. Mangione, President

Payless ShoeSource, Inc.
Topeka, KS

Curtis S. Sneden, Director, Government Affairs

Public Strategies, Inc.
Washington, D.C.
on behalf of

Camara Nacional de la Industria Textil ("CANAINTEX")

Maureen R. Smith, Managing Director, International,
Public Strategies, Inc.

ORGANIZATION AND WITNESS:

PANEL 1 (continued)

American Apparel & Footwear Association ("AAFA")
Arlington, VA

James Jacobsen, Vice Chairman, Kellwood Company; Member, Executive Committee of the AAFA; and Former Chairman, AAFA

Kevin M. Burke, President and CEO

National Council of Textile Organizations
Washington, D.C.

Robert DuPree, Vice President

PANEL 2

Emergency Committee for American Trade ("ECAT")
and
The Business Coalition for U.S.-Central America Trade
Washington, D.C.

Calman J. Cohen, President, ECAT

Pharmaceutical Research and Manufacturers of America ("PhRMA")
Washington, D.C.

Renard Aron, Assistant Vice President, Latin America and Canada

Essential Information
Washington, D.C.
on behalf of

Consumer Project on Technology

Joy Spencer, Communications, Essential Information

ORGANIZATION AND WITNESS:

PANEL 2 (continued)

International Intellectual Property Alliance ("IIPA")
Washington, D.C.

Maria Strong, Vice President and General Counsel

PANEL 3

Sweetener Users Association
Washington, D.C.

Thomas Earley, Economic Consultant

American Sugar Alliance
Arlington, VA

Jack Roney, Director, Economics and Policy Analysis

Don Philips, Trade Advisor

Grocery Manufacturers of America ("GMA")
Washington, D.C.

Sarah F. Thorn, Senior Director, International Trade

APPENDIX D
Technical Appendix

Appendix D

The general equilibrium modeling system employed to simulate the U.S. FTA with Central America and the Dominican Republic is built around the GTAPinGAMS software developed by Rutherford and Paltsev.[1] The GTAPinGAMS data system was modified to accommodate the most recent prerelease 1 of the GTAP version 6 data. In addition, the actual GTAPinGAMS multi-region comparative-static simulation model was expanded to include appropriate behavioral structures and to report elements relevant to the study. This appendix outlines the important methodological and structural assumptions of the model.

There are several advantages to using the prerelease version of the GTAP data base rather than the most recently published version. For one thing, trade flows and national economic data have been updated in the new data to a 2001 base year from 1997 (although for this study the Commission has further updated the data to 2005). More importantly, much work has been done to improve the protection data in the data base. Rather than relying for the most part on WTO bound tariffs, the new data reflect a strong effort to collect data on actual applied tariffs (generally smaller than bound rates); for this reason, apparent duties on some commodities have declined from those in previous versions of the data set. This is aside from the fact that further implementation of the Uruguay Round and other trade agreements has actually reduced duties. Also, this new version of the data base reflects work that is in progress to develop appropriate methods to quantify tariff rate quotas and nontariff measures. Work remains to be done in these areas, but the current prerelease version 6 of the GTAP data base appears to provide the best available basis for the analyses of current trade policy with appropriate measures of trade and trade policy.

Model Scope

The simulation model represents the world trade equilibrium, and the production and consumption structures of the world economy. The trade equilibrium is defined by the bilateral trade flows between 15 regional economies over 23 aggregate commodities, listed below. These regions and commodities are aggregated out of the regions and commodities available in prerelease 1 of the GTAP version 6 database. The commodity and regional aggregations were driven by the Commission's intention to include the most relevant sectoral detail considering the policy shocks included in the FTA and the benchmarking to the 2005 base year.

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[1] Thomas F. Rutherford and Sergey V. Paltsev, *GTAPinGAMS and GTAP-EG: Global Datasets for Economic Research and Illustrative Models*, Department of Economics, University of Colorado Working Paper, September 2000.

Regions	
Australia	New Zealand
Canada and Mexico	European Union 15
Chile	Morocco
Mercosur	Southern African Customs Union
Rest of the Americas	Rest of Subsaharan Africa
Singapore	United States
East Asia	Other Countries
Rest of Asia	Central America and the Dominican Republic

Commodities	
Grains	Wood products
Sugar crops	Petroleum, coal, chemicals, rubber, and plastic products
Vegetables, fruits, and nuts	Ferrous metals
Other crops	Metals n.e.c. and metal products
Cattle and horses	Motor vehicles and parts
Animal products n.e.c.	Transport equipment n.e.c.
Coal, oil, gas, and other minerals	Electronic equipment
Meat products	Other machinery and equipment
Dairy products	Other manufactures
Sugar	Services
Other processed food and tobacco products	Capital goods
Textiles, apparel, and leather products	

Structure of the Regional Economies

Each region of the model is characterized by three components. First, primary factor endowments determine the overall capacity of the economy. Primary factors include land, labor, and capital. Households earn net of tax income from the primary factors and are assumed not to change the total supply of primary factors across the simulation.

Second, a region is characterized by its production technologies. These production technologies determine the ability of the economy to transform primary factors and intermediate inputs into valuable output. The model employs a nested constant-elasticity-of-substitution production structure. Primary factors are combined in a Cobb-Douglas nest. The primary factors aggregate is then combined with intermediate inputs in a Leontief nest. The resulting production function exhibits constant returns to scale and firms are assumed to be competitive such that marginal cost equals the output price.

Third, a region is characterized by its preferences for commodities. The model is static, and thus abstracts from changes in the aggregate mix of final demand on investment and government spending. Households do react to policy-induced price changes,

however, by changing the mix of goods and services consumed. Household welfare is assumed to be Cobb-Douglas and maximized subject to market prices and income earned from ownership of primary factors.

The database does not explicitly include data on trade with the Central American and the Dominican Republic (CA/DR) partner countries in this FTA.[2] Rather it includes two aggregate regions which contain members of the FTA. In GTAP, "Central America" includes Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, as well as two countries, Belize and Panama, that are not included in this FTA. The GTAP "Caribbean" region includes the Dominican Republic as well as a number of additional Caribbean countries. For the purposes of the USITC analysis, the Central America region was adjusted to remove Belize and Panama from the region and add the Dominican Republic. Essentially, the Central America input-output matrix was reduced by the share of Panama's and Belize's GDP in the region. Added to that was the Dominican Republic's share of the Caribbean input-output matrix, determined by its share of the region's GDP. The size of the economy of the resulting FTA region (Central America, minus Belize and Panama, plus the Dominican Republic) was adjusted by World Bank GDP projections to 2005. The region's trade with the United States was derived from the USITC DataWeb, which in turn is taken from Commerce Department data.

Trade Equilibrium

Consistent with the objectives of the Commission analysis, substantial detail is built into the mechanisms by which the different regions interact through international trade. Goods and services that are traded are assumed to be differentiated by their respective region of origin. Each region has a set of technologies for combining these differentiated goods and services into a composite that may be consumed or used as an intermediate input. The technology is a nested constant-elasticity-of -substitution aggregation; imports from different sources are combined in a lower nest, then the import aggregate and the domestic variety is combined to produce the composite. This is a standard structure adopted by most contemporary trade simulation models.

The trade equilibrium is sensitive to the particular substitution elasticities assumed for the differentiated goods aggregation. Table D-1 reports the central estimates of the substitution elasticity between import varieties, and their respective 95 percent confidence bounds. The central estimates are the trade-weighted averages from disaggregate (GTAP level) econometric estimates presented by Hertel, Hummels, Ivanic, and Keeny.[3] The confidence bounds are generated by making 1000 random

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[2] The FTA includes Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic.

[3] Thomas Hertel, David Hummels, Maros Ivanic and Roman Keeney, *How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?* GTAP Working Paper No. 26, 2003, available at *http://www.gtap.agecon.purdue.edu/resources/working_papers.asp.*

draws from the implied probability density functions of the econometric estimates and then computing the trade-weighted average for the aggregate commodity. Rank ordering these 1000 draws per commodity, the 95 percent lower bound is the 25th draw and the 95 percent upper bound is the 975th draw. Three commodities (sugar crops, services, and capitalgoods) did not have reliable econometric estimates and were therefore assigned a default elasticity of 7. Conditional on the integrity of the estimating procedure, it is likely that the true value of the substitution elasticity for the other commodities falls within the 95 percent confidence interval. Consistent with standard practice, the substitution elasticity between the domestic variety and the import aggregate is set to one-half the import variety substitution elasticity.

Table D-1
Substitution elasticities and confidence intervals

Sectors	Central	Lower 95 percentile	Upper 95 percentile
Grains	6.327	2.273	10.762
Sugar crops	7.000	(1)	(1)
Vegetables, fruit, and nuts	3.700	2.847	4.454
Other crops	5.830	5.068	6.519
Cattle and horses	4.000	2.656	5.291
Other animal products	3.912	3.155	4.672
Coal oil, gas, and other minerals	12.281	6.107	18.804
Meat products	8.382	6.550	10.208
Dairy products	7.300	5.751	8.866
Sugar	5.400	1.724	9.402
Other processed food and tobacco products	3.788	3.524	4.033
Textiles apparel and leather products	7.567	7.371	7.762
Wood products	6.800	6.425	7.202
Petroleum, coal, chemicals, rubber	6.266	5.987	6.549
Ferrous metals	6.676	6.324	7.041
Metals n.e.c. and metal products	8.400	7.652	9.185
Motor vehicles and parts	5.600	4.969	6.159
Transport equipment n.e.c.	8.600	7.840	9.352
Electronic equipment	8.800	8.402	9.168
Other machinery and equipment	8.100	7.896	8.309
Other manufactures	6.757	6.474	7.026
Services	7.000	(1)	(1)
Capital goods	7.000	(1)	(1)

[1] Not applicable.

Source: Thomas Hertel, David Hummels, Maros Ivanic, and Roman Keeney, *How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?* GTAP Working Paper No. 26, 2003, available at *http://www.gtap.agecon.purdue.edu/resources/*.

The policy instruments that are relevant for the trade equilibrium include import tariffs and export taxes. Table D-2 reports the 2005 benchmark trade policy between the United States and the CA/DR region. The benchmark policies include those distortions included in version 6 of the GTAP database and modified to include relevant policy changes between 2001 and 2005.

Table D-2
U.S.-CA/DR FTA: Benchmark tariffs, 2005[1]

(Percent)

Commodity	Tariffs on U.S. imports from Central America and the Dominican Republic	Tariffs on Central American and Dominican Republic imports from the United States
Grains	0	10.58
Vegetables, fruits, and nuts	0	16.67
Other crops	2.00	1.98
Cattle and horses	0	5.69
Animal products n.e.c.	0	4.93
Coal, oil, gas, other mineral	0	4.09
Meat products	2.95	14.71
Dairy products	9.30	19.47
Sugar manufacturing[2]	0.02	32.29
Sugar crops	0	0
Other processed food and tobacco products	0.03	12.77
Textile, apparel, and leather products	6.71	12.80
Wood products	0	9.99
Petroleum, coal, chemicals, rubber, plastic	0.03	5.15
Ferrous metals	0	6.26
Metals n.e.c. and metal products	0	3.48
Motor vehicles and parts	0	11.10
Transport equipment n.e.c.	0	3.44
Electronic equipment	0	1.40
Other machinery and equipment	0	3.95
Other manufactures	0	7.12
Services	NA[3]	NA[3]

[1] Benchmark tariffs include tariff equivalents of agricultural TRQs facing both U.S. and CA/DR imports

[2] Sugar imports to the United States are subject to tariff rate quotas. The FTA would increase these quotas by about 50 percent, which would have a much greater effect on imports of sugar than does the elimination of the 0.02 percent in-quota duty. In the simulation of the FTA, the expansion of the sugar quota is modeled as a quantity increase. See text and appendix D, section on Solution Technique.

[3] Restrictions on services that are identified in chapter 3 of this report are not quantified in the GTAP data or in other sources of protection data.

Source: GTAP version 6, prerelease 1 data and Commission calculations.

Updating the Database

Version 6.1 of the GTAP database has a benchmark year of 2001. In order to better reflect the world economy as of the time of implementation of the FTA, the database was projected to reflect the 2005 economy. This was done by imposing on the database additional data and projections on trade from the U.S. Department of Commerce and the World Bank. In addition, trade flows and barriers were updated to reflect the free trade agreements between the United States and Chile and Singapore, as well as all policy measures ratified under the Uruguay Round Agreement on Textiles and Clothing, and other Uruguay Round provisions insofar as these are reflected in the trade data.

Solution Technique

In comparative static experiments, such as the one conducted in this report, trade is liberalized completely in all goods subject to liberalization under the FTA. There is no implicit or explicit time elapsing in the model. This means, first, that all provisions of the FTA are assumed to be fully phased in immediately, rather than over a 20 year period. And second, it means that all effects of the FTA are felt immediately, without an adjustment period. The modeled results can be considered to be long-run effects of a fully implemented FTA, in an economy otherwise identical to the baseline 2005 economy.

The analysis of the economywide impact of the FTA employs a comparative static framework in which a baseline equilibrium depiction of the U.S. economy, as of January 1, 2005, is derived through a set of balanced accounts of trade, production, consumption, and taxes. Once this baseline has been created, policy shocks are imposed on the balanced model. These policy shocks consist of the reduction or elimination of tariffs, TRQs and quotas agreed to in the FTA.

For sugar, the reported tariff largely represents the rate for sugar imported under the tariff rate quota level. This tariff is removed, and the quota levels are increased for partner countries. The effect of this quota change is modeled by adjusting an export tax equivalent of the quota such that the level of imports from the partner countries increases by the amount of the quota increase, or by about 49 percent.[4] In addition, the level of import quantities from other countries is held fixed at their current levels, since U.S. prices are not expected to fall sufficiently to remove the incentive for other countries to continue to fill their own sugar quotas. See chapter 3 for a discussion of the complex treatment of sugar in the FTA.

Having imposed the policy shock by imposing the new levels of the tariffs and tax equivalents of the trade distortions, the model is rebalanced, and new values for trade flows, outputs, employment, welfare, GDP, and other values are generated. The difference between the baseline values of these variables and their new values is interpreted as the estimated impact of the tariff removal under the FTA.

Model Limitations

Economic models attempt to capture the most important factors for the question under consideration. However, they are limited in their ability to reflect the degree of complexity evident in the real world. One source of possible bias in virtually any quantitative analysis of economic data arises from data aggregation. International trade occurs in thousands of different products and services. The United States collects

[4] The export tax equivalent declines from 75 percent to 54 percent.

trade data under about 17,000 statistical categories and over 10,000 tariff rate lines. For most general equilibrium analysis, these groupings represent far too much detail to be tractable computationally, or to be linked with more aggregate data on production and consumption processes. The aggregation into broader categories introduces two general sources of bias into a modeling exercise.

One source of bias involves the calculation of tariffs for aggregated product categories. In this study, trade-weighted average tariffs were calculated, using the value of imports in a tariff line to weight the tariff in that line. This procedure tends to mask the importance of those products within the aggregate that have particularly high tariffs, and which therefore face a greater barrier to imports than would be the case if all goods within the aggregation had the same average tariff. The relationship between the effect of an import-weighted average tariff and the effects of the individual tariffs of goods within the group depends on the correlation between the level of these tariffs and the price responsiveness of final demand. The effect of a high tariff in a highly price-responsive good will be understated because the high tariff itself will cause less of the good to be imported, giving it a small weight in the trade-weighted average tariff of the aggregate.

Another source of aggregation bias is due to the fact that goods within an aggregate may not be close substitutes for one another. In particular, imported goods of a particular category may be quite dissimilar to the domestically produced product in that category, due among other things to a different mix of the individual goods in the aggregate. Thus a model may overstate the responsiveness of domestic production in response to a given tariff reduction.[5]

Despite these limitations, model simulations such as those performed here can be useful in providing insights on the effects of an FTA on measures of the economy. They present a unified and consistent framework within which to assess the policy.

Modeling Alternative Scenario Shocks

Chapter 8 discussed the comparison of an alternative model of the FTA (the BKS model) with the USITC model. Among the ways in which this study approaches the comparison is by asking, essentially, what results would be obtained in the USITC model if it made the same assumptions made in the other model regarding the tariff shocks to be eliminated. If the same tariff shocks could be imposed in the USITC model as were imposed in the other model, remaining differences between the results could be attributed to other assumptions and structural differences between the models.

In fact, the different tariff shocks could not be directly applied to the USITC model. Since the alternative model uses commodity data aggregated in ways that differ from the

[5] Empirical trade models such as the one used here often apply the Armington assumption, which treats commodities produced in different countries as imperfect substitutes, with the degree of substitution described by the Armington substitution elasticity. This can reduce this type of bias.

USITC model, it was necessary to reaggregate the commodities to correspond to those in the USITC model. Table D-3 shows the alternative policy shocks applied in the BKS model. The table also shows the shocks as applied to the USITC aggregation.

In matching the alternative policy shocks of other authors to the sectors in the USITC model, the following simple procedures were used. Where one sector in an alternative model includes more than one USITC sector (such as the BKS agriculture sector, which includes the USITC sector grains, sugar crops, other crops, and vegetables, fruits and nuts) the shock from the alternative model sector was applied to each of the USITC sectors. Where more than one alternative model sector matches a USITC sector (such as the BKS sectors apparel, textiles, and leather products and footwear, all of which are contained in the single USITC sector textiles, apparel, and leather products), a simple average of the shocks in the alternative model sectors was applied to the USITC sector.

Table D-3
Alternative policy scenarios

(Percent)

	BKS policy shocks	
BKS commodity	**Partner tariffs & non-tariff measures**	**U.S. tariffs & non-tariff measures**
Agriculture	-2.30	0.80
Mining	3.70	0.30
Food, beverages, tobacco	7.10	1.90
Textiles	6.30	0.60
Apparel	25.70	12.40
Leather products & footwear	15.80	4.10
Wood, wood products	9.50	0.40
Chemicals	7.10	1.60
Non-metalic mineral products	5.20	0.20
Metal products	5.90	0.50
Transport equipment	9.60	0.50
Machinery & equipment	4.80	0.20
Other manufacturing	14.60	2.40
Electricity, gas, water	0.00	0.00
Construction	18.00	9.00
Trade & transport	32.00	27.00
Other private services	34.00	31.00
Government services	17.00	25.00

Source: Drusilla K. Brown, Kozo Kiyota, and Robert M. Stern, "Computational Analysis of the U.S. Bilateral Free Trade Agreements with Central America, Australia, and Morocco," Feb. 8, 2004, table 1, found at *http://www.fordschool.umich.edu/rsie/seminar/BrownKiyotaStern.pdf*, retrieved March 2004.