Order Code RS22339
November 30, 2005

CRS Report for Congress
Received through the CRS Web

Trade Liberalization Challenges Post-CAFTA

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Summary

Since taking office in January 2001, President Bush has supported trade liberalization through negotiations on multiple fronts: globally, regionally, and bilaterally. During this period, Congress has approved five free trade agreements (FTAs) that the Bush Administration has negotiated and signed. The FTAs are designed to promote broad economic and political objectives, both domestic and foreign. However, the debate in Congress over the last FTA approved — the Central American Free Trade Agreement (CAFTA) — was contentious, sparking concerns about how Congress might consider future trade liberalizing agreements. This report analyses some of the challenges that became apparent in the aftermath of a divisive trade debate and how they could affect consideration of future trade agreements. This report will not be updated.

Introduction

Since assuming office in 2001, President Bush has been a strong supporter of free trade and trade liberalization. In numerous statements, he has touted the virtues of trade expansion. As he explained: "Our goal is to ignite a new era of economic growth through a world trading system that is dramatically more open and free."[1]

The President has promoted trade liberalization on multiple fronts: globally, regionally, and bilaterally. By pursuing multiple free trade initiatives, the Administration has tried to create "competition in liberalization" and more options. As explained by Robert Zoellick, President Bush's first U.S. Trade Representative, if free trade progress becomes stalled globally, then we can move ahead regionally and bilaterally.[2]

Globally, the Administration is now working to reach an agreement in the so-called Doha Round of multilateral trade talks being held among the 148 members of the World Trade Organization (WTO). Regionally, the administration is pursuing agreements with

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[1] Office of the United States Trade Representative, *2002 Trade Policy Agenda and 2001 Annual Report*, p.1.

[2] Ibid., p.4.

the countries of the Southern African Customs Union, Andean countries, and 34 countries of the Western Hemisphere to create a Free Trade Area of the Americas. Bilaterally, it is currently negotiating FTA's with Thailand, Panama, and the United Arab Emirates. The administration signed an FTA with Bahrain in 2004 and with Oman in 2005, and it is contemplating starting negotiations with a number of other countries. Possible new negotiating partners include Egypt, Malaysia, India and South Korea.[3]

The Bush Administration argues that these negotiations promote a host of U.S. domestic and foreign interests, both economic and political. At home, it views trade liberalization as providing substantial gains to American consumers and companies. Cuts in U.S. trade barriers can help American families to pay less for consumer goods and U.S. companies to lower their operating costs as a result of access to cheaper imported components. Increased competition in domestic markets also promotes innovation, increases in labor productivity, and long-term growth. Better access to foreign markets facilitates increases in U.S. exports, thereby increasing employment in sectors that may pay higher than average wages. U.S. investors can also benefit through rule changes and obligations that assure more dependable treatment by the host country.

Trade liberalizing agreements, particularly FTAs, also promote the U.S. trade agenda and foreign interests in a number of ways. Some FTAs establish precedents or models that serve as catalysts for wider trade agreements. Many FTAs reward and support market reforms being undertaken by the negotiating partner. And still others help to strengthen U.S. ties with various countries and regions of the world. For example, by forging stronger economic ties with countries in the Middle East, such as Morocco, Jordan, and Bahrain, the U.S. hopes to strengthen its strategic position vis-a-vis all countries in the region by promoting economic prosperity and opportunity.

At the same time, trade liberalizing agreements may carry economic and political costs. Increased foreign competition can lead to plant closings and job losses concentrated in certain regions and industries. Critics note that it may contribute to increased anxiety and wage pressures, as well as rising income inequality.

Some of these concerns were central to the divisive debate in Congress this year over CAFTA — an agreement that became a proxy, in part, for more generalized concerns about America's standing in an increasingly globalized world economy. While CAFTA was approved by narrow margins in both houses, it is not clear how the outcome will affect the Administration's future free trade agreement program.

CAFTA Debate

The CAFTA was the most controversial free trade agreement vote taken by Congress since the North American Free Trade Agreement (NAFTA) implementing legislation was passed in 1993.[4] The Senate passed the CAFTA implementing legislation on June 30, 2005 by a vote of 54 to 45 and House passed the legislation on July 28, 2005 by 217 to

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[3] CRS Issue Brief IB10123, *Trade Negotiations During the 109th Congress,* by Ian Fergusson.

[4] Formally known as the Dominican Republic-Central American-United States Free Trade Agreement, (CAFTA-DR), this FTA includes the United States, Costa Rica, El Salvador, Guatemala, and the Dominican Republic.

215. Besides being the lowest margin of victory for any modern FTA agreement, the votes, particularly in the House, were highly partisan. Over 92% of House Democrats voted against the agreement, while over 88% of House Republicans voted in favor.

In both the Senate and House debates, many proponents stressed a combination of economic and political arguments. Those in favor argued that, while imports from the CAFTA countries enter the U.S. virtually duty free, the agreement will level the playing field for U.S. commercial interests by eliminating 80% of the tariffs CAFTA countries impose on U.S. exports. As a result, they maintained the U.S. goes from one-way free trade toward a more reciprocal trading relationship that will increase U.S. exports and jobs. Others emphasized that the agreement would contribute to bolstering more market-oriented and democratic governments in the region, longstanding U.S. foreign policy interests.[5]

Many lawmakers who opposed the agreement cited provisions dealing with the treatment of labor and sensitive industries (sugar and textiles). In addition, the agreement clearly triggered more generalized anxieties concerning globalization's impact on the American economy and labor force. Future congressional consideration of similar trade accords are likely to raise similar controversies and challenges, thereby prompting the administration to address these issues as part of its trade liberalizing agenda.[6]

Labor Issues. Labor issues in the agreement were controversial and may have been a major reason the vote divided largely along party lines. Disagreement revolved around whether the CAFTA countries had laws that complied with the U.S. or International Labor Organization (ILO) similar list of five internationally recognized worker rights (e.g. the right to organize unions and bargain collectively). Such standards have not been required by CAFTA, by trade promotion authority legislation outlining requirements for trade agreements, or by any other bilateral trade agreement. However, they have been required for decades by U.S. trade preference laws, which typically prohibit preferential treatment to countries which are not affording their workers internationally recognized worker rights. Therefore, these FTAs continue to be seen by may Democrats as a step backward from longstanding U.S. trade policy.

Many Republicans argue that the agreement encourages these countries to improve their laws and enforcement as well. Moreover, they argued that the administration's commitment to earmark $40 million in appropriations for capacity building and enforcement over a four-year period would go a long way in strengthening these provisions.[7]

Further exacerbating partisan tensions was a long history over this issue. Some Democrats expressed clear annoyance that their support for stronger labor provisions was characterized by Bush Administration trade officials as being "economic isolationism."

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[5] CRS Report RL31870, *The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR)*, by J. F. Hornbeck.

[6] Edward Gresser, "CAFTA's Close Call A Warning to U.S. Policy Makers," *Yale Global*, August 9, 2005.

[7] CRS Report RS22159, *DR-CAFTA Labor Rights Issues*, by Mary Jane Bolle.

At the same time, many Republicans were upset that they were given little credit by the other side for the compromises they had made over the years in accommodating Democratic concerns. Partisan tensions were further exacerbated by different views on whether the process in producing the agreement and the implementing legislation was inclusive and consistent with consultation requirements provided under the Trade Promotion Authority statute.[8]

Following the CAFTA vote, U.S. Trade Representative Rob Portman has worked to narrow the gap on the divisive labor issue in both the Bahrain and Andean FTAs. House Democrats reportedly have been pleased by the Administration's efforts to obtain higher labor commitments and enforcement standards in the Bahrain agreement.[9] But other reports suggest that the Administration and House Democrats remain far apart on how to handle the labor provisions in the Andean FTA.[10] Thus, it remains unclear whether the FTA labor provisions will become a less divisive and partisan issue.

Protected Industries. A second contentious issue involved liberalization of U.S. restrictions in two industries — textiles and apparel, and sugar — that still benefit from protective barriers. The agreement as signed by the Bush Administration provided some small additional opening of these two still protected markets. These changes, in turn, were opposed vigorously by segments of both industries and by both Republicans and Democrats that had important constituent interests to defend.

To gain support for the agreement, the Bush Administration made some commitments that, on balance, will reduce the commercial benefits of the agreement to CAFTA countries as originally negotiated. Some analysts believe that this action may send a very negative signal to future negotiating partners about U.S. willingness to negotiate reciprocal trade concessions. An underlying problem for the administration may be that the partisan divide in Congress over trade issues, particularly labor standards, provides defenders of protected industries with greater power than in previous eras. As one scholar opined, a partisan divide "renders the basic support margin narrow, making trade policy hostage to any protectionist interests that hold the decisive, marginal votes."[11]

This partisan divide could become a major hurdle for completing agreements that require the reduction and eventual removal of U.S. barriers to imports. In cases where liberalization of protected U.S. industries is necessary to get other countries to reduce their own barriers to U.S. exports, the Bush Administration may have two options. First, it can work to bridge the partisan divide that arguably provides these industries with heightened leverage. Second, it can alter the way it promotes the benefits of trade liberalization. Traditionally, trade liberalization has been pursued by focusing attention

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[8] House Ways and Means Committee, Hearing, *President Bush's Trade Agenda,* March 11, 2004, Serial No. 108-43, pp. 33-42.

[9] *Inside U.S. Trade,* "Ways and Means To Mark Up Bahrain FTA After New Labor Assurances," November 18, 2005.

[10] *Inside U.S. Trade,* "Levin Sees Little USTR Willingness to Compromise on Labor in FTAs," November 11, 2005.

[11] Destler, I.M., *American Trade Politics,* Institute for International Economics, Washington, D.C. June 2005, p. 306.

on gains associated with export expansion through a reduction of foreign trade barriers with little discussion of the gains that reduction of U.S. trade barriers can provide to U.S. companies and consumers. But by highlighting more the two-way gains from trade (both exports and imports), some analysts believe that greater political support can be built for the kinds of actions that are necessary to sustain a trade liberalization policy.[12]

Globalization Anxieties. The CAFTA debate in Congress also served as a proxy for public concerns and anxieties about the effects of trade and globalization on the American economy. Record U.S. trade deficits, the rise of China as a world manufacturing power, and India's growing attractiveness as a source for outsourcing of white collar jobs all raised questions about the effects of trade agreements on U.S. workers. Some Democrats, in part, may have opposed CAFTA because they believe that working class Americans suffer most from attempts to accelerate economic integration. Their opposition may have been buttressed by public opinion polls showing that more that 50% of U.S. households may oppose these trade initiatives if they are not given the tools and training to compete with workers from all around the world.[13]

To ease the anxieties of the American public on globalization and trade agreements that accelerate economic integration, some policymakers are calling for more robust programs that will help American workers obtain the skills that are necessary to compete in the global economy. While the longstanding Trade Adjustment Assistance Program provides retraining and income support for workers displaced by import competition, some argue that a more comprehensive program that would cover not only workers displaced by trade competition but also by technological change and foreign outsourcing is needed to deal with broad distributional costs of globalization and the rise of economic insecurity among American workers. Proponents argue that such a plan could include meaningful retraining, wage and health insurance, and job search aid.[14]

Two obstacles are often cited to moving in this direction — cost and ideology. One estimate of a comprehensive program that extends trade adjustment to all workers, provides a general two-year wage insurance program and adds on business tax incentives comes to $20 billion a year. While this cost could be considered modest compared to an estimated $1 trillion in benefits the U.S. economy gains from globalization (international openness) every year, it also could be considered very costly in the context of an economy experiencing record budget deficits, prompting calls for reductions in government spending. In addition, the fact that some policymakers take a dim view of the ability of these kinds of programs to achieve the intended results, combined with some sense that a growing market economy is the best antidote to adjustment, provide another hurdle.[15]

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[12] Lindsey, Brink. *A New Track for U.S. Trade Policy,* Cato Institute, Trade Policy Analysis 4, September 1998.

[13] Program on International Policy Attitudes/Knowledge Networks Poll, *Americans and CAFTA and US Trade Policy,* July 11, 2005.

[14] Destler, I.M., p. pp. 328-329.

[15] Ibid..

Implications For Future Trade Agreements

The Bush Administration is now actively negotiating a large number of trade liberalizing agreements. The broadest and most ambitious initiative being negotiated is the Doha Round of multilateral negotiations. Negotiations are also taking place with Panama, Thailand, three Andean countries (Colombia, Peru, and Ecuador), and the United Emirates.[16] Assuming that the divisions over labor issues, industry protection, and globalization anxieties that were imbedded in the CAFTA debate persist, these potential agreements could encounter differential obstacles.

An ambitious Doha agreement is the administration's highest priority. With 148 countries involved in the negotiation, this trade negotiation provides the largest potential benefits for U.S. firms, farmers, and consumers. Some analysts maintain that large gains or benefits accruing to a broad spectrum of American stakeholders are necessary to help mobilize political support to eliminate or reduce remaining U.S. restrictions on politically sensitive industries and products. This is based on a belief that an ambitious agreement would require large concessions from trading partners that open substantially new market access opportunities for U.S. companies, and that these potential gains would be too tempting for U.S. industry not to support strongly.

While labor issues are not part of the Doha negotiations, any big commercial agreement would likely trigger globalization anxieties among some segments of the body politic. Whether an ambitious agreement that provides large economic benefits to the U.S. economy might provide some impetus and support for devising a comprehensive adjustment program remains problematic. In the past, implementing legislation for multilateral agreements has included the creation or expansion of adjustment programs.

The FTA's being negotiated with Thailand, Panama, and the Andean countries might encounter some or all the obstacles raised in the CAFTA debate. Thailand's labor conditions and exports of import sensitive products such as sugar and rice could prove contentious. Given that Thailand is a larger trading partner than the five CAFTA countries combined, globalization anxieties could also play a role in this agreement as well. In the case of Panama and the Andean countries, their labor laws and exports of sugar could raise concerns among some Members of Congress. But given that they are both very small trading partners, globalization anxieties are less likely to play a key role.

To date, CAFTA-related controversies appear to be playing a small role in the FTAs concluded with countries of the Middle East — Jordan, Morocco, Bahrain and Oman. These four agreements have received broad bipartisan support not only because they are viewed favorably for advancing U.S. security interests, but also because the countries in commercial terms provide little competitive threat to U.S. producers and workers.

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[16] CRS Report RL32540, *The Proposed U.S.-Panama Free Trade Agreement*, by J.F. Hornbeck; CRS Report RL32314, *U.S.-Thailand Free Trade Agreement Negotiations*, by Raymond J. Ahearn and Wayne Morrison; and CRS Report RL32770, *Andean-U.S. Free Trade Agreement Negotiations*, by M. Angeles Villarreal.