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Central America and the Dominican Republic in the Context of the Free Trade Agreement (DR-CAFTA) with the United States

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Summary

This report provides background on the political and economic conditions in five countries in Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) and one country in the Caribbean (Dominican Republic) that will be partners with the United States in the U.S.-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) if it is approved by Congress. The Administration reached agreement with four of the Central American countries in December 2003, with Costa Rica in January 2004, and with the Dominican Republic in March 2004. The Central American countries and the United States signed the CAFTA agreement on May 28, 2004, and all of the partners signed the DR-CAFTA agreement on August 5, 2004. The Administration will decide when to submit the package to Congress for approval. The other regional partners are required to submit the agreement to their respective legislatures for approval as well.

The prospective DR-CAFTA partners are basically small countries with limited populations and economic resources, ranging in population from Costa Rica with a population of 4.0 million to Guatemala with a population of 12.3 million, and ranging in Gross National Income (GNI) from $4.0 billion for Nicaragua to $23.5 billion for Guatemala. While El Salvador, Guatemala, and Nicaragua experienced extended civil conflicts in the 1970s and 1980s, all of the countries have had democratically elected presidents for some time, and several of the countries have experienced recent electoral transitions. For each of the countries the United States is the dominant market as well as the major source of investment and foreign assistance, including assistance and trade preferences under the Caribbean Basin Initiative (CBI) and assistance following devastating hurricanes.

The Bush Administration and other proponents of the DR-CAFTA pact argue that the agreement will create new opportunities for U.S. workers and businesses by eliminating barriers to U.S. trade and services in the region. Regional officials favor the pact because it provides new access to the U.S. market and makes permanent many of the existing temporary one-way duty free trade preferences. Critics argue that the environmental and labor provisions are inadequate and will lead to the loss of jobs for workers in the United States and for subsistence farmers in Central America, and that concessions in the textile/apparel and sugar sectors will be damaging to U.S. industries. After winning re-election in November 2004, President Bush is expected to press for passage of DR-CAFTA in 2005 and to deal with a Congress that is presumed to be more friendly toward the regional pact. USTR has threatened to exclude the Dominican Republic from the implementing legislation to be presented to Congress because of a dispute with the country over its recent tax on soft drinks made with imported high fructose corn syrup (HFCS).

Related information may be found in CRS Report RL31870, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenge for Sub-Regional Integration*, by J.F. Hornbeck; and CRS Report RL32110, *Agricultural Trade in a U.S.-Central American Free Trade Agreement (CAFTA)*, by Remy Jurenas.

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Introduction[1]

On October 1, 2002, the Bush Administration notified Congress of the intention to enter into negotiations leading to a free trade agreement with five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua). Negotiations for a U.S.-Central America Free Trade Agreement (CAFTA) were launched in January 2003 and were completed on December 17, 2003, although Costa Rica withdrew from the negotiations at the last minute. Negotiations with Costa Rica continued in early January 2004, and were completed on January 25, 2004.[2] On February 20, 2004, President Bush notified Congress of his intention to sign the CAFTA pact, and it was signed on May 28, 2004. In August 2003, the Administration notified Congress of plans to negotiate a free trade agreement with the Dominican Republic and to incorporate it into the free trade agreement with Central American countries. Negotiations with the Dominican Republic began in January 2004, and were completed on March 15, 2004. The new pact, to be known as the United States-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), was signed by all seven countries on August 5, 2004.

Regional Characteristics

The term "Central America" is often used as a geographical term to apply to all of the countries in the Central American isthmus, and it is also used to apply to five core countries — Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica — long associated with each other. These five countries were linked during colonial times and formed a confederation for a number of years following independence in 1821. Two other countries in Central America have distinctive backgrounds. Panama was a part of Colombia until it achieved independence in 1903, and had special links to the United States because of the Panama Canal. Belize was a British territory known as British Honduras until it achieved independence in 1981, and has close ties to the English-speaking countries of the Caribbean Community (Caricom).

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[1] Prepared by K. Larry Storrs, Specialist in Latin American Affairs.

[2] For details on the DR-CAFTA agreement, see CRS Report RL31870, *The U.S.-Central America Free Trade Agreement: Challenges for Sub-Regional Integration*, by J.F. Hornbeck.

In a first wave of regional integration in the 1960s, the five core countries formed the Central American Common Market (CACM) in 1960 to encourage economic growth. The CACM performed extremely well in the first decade of its existence, but it largely collapsed in the 1970s and 1980s as the countries, many with military-controlled regimes, were embroiled in long and costly civil conflicts that exacerbated the region's economic and social problems.

A second wave of regional integration developed in the 1990s, following peace initiatives in El Salvador, Nicaragua, and Guatemala that eventually led to peace accords and democratically elected governments. In 1991 and 1993, the presidents of the Central American countries, including Panama, signed two protocols that created a new integration mechanism known as the Central American Integration System (SICA) that is designed to facilitate the creation of a customs union among the countries and to encourage cooperation in a range of activities. Belize joined the regional integration system in December 2000, and the Dominican Republic became an associate member in December 2003.[3]

The prospective DR-CAFTA countries are basically small countries with limited population and economic resources, with some differences in level of development (see Table 1). They range in size from El Salvador (with just over 8,000 square miles) to Nicaragua (with over 50,000 square miles). The combined population of the countries is 44 million, ranging from Costa Rica with a population of 4.0 million to Guatemala with a population of 12.3 million.

Table 1. Central American Countries and the Dominican Republic: Size, Population, and Major Economic Variables,2003

Country	Area in square miles	Population in millions, 2003	GNI, $ billions, 2003	GNI per capita, $ 2003	GDP growth rates, 2003 (in %)	GDP per capita growth rates, 2003 (in %)
Costa Rica	19,652	4.0	17.2	4,280	5.6	3.9
Dominican Republic	18,704	8.7	18.1	2,070	-1.3	-2.2
El Salvador	8,260	6.5	14.4	2,200	2.0	1.8
Guatemala	42,000	12.3	23.5	1,910	2.1	4.2
Honduras	43,270	7.0	6.8	970	3.0	-0.5
Nicaragua	50,446	5.5	4.0	730	2.3	-0.2
Total	182,332	44.0	84.0			

Sources: Area in square miles from State Department Background Notes; Gross National Income (GNI) and Gross Domestic Product (GDP) data from World Bank Development Report 2005, and World Bank Data Profile Tables.

[3] See "Central American Integration System" in The Europa World Yearbook 2003, Vol. I; and various notices on the website of the General Secretariat of the SICA at [http://www.sgsica.org].

With a combined national income of about $84 billion, the Gross National Incomes (GNI) of the countries range from $5.5 billion for Nicaragua to $23.5 billion for Guatemala. In per capita terms, the countries range from Nicaragua with a GNI per capita of $730, which the World Bank classifies as a low-income country, to Costa Rica with per capita income of $4,280, which is classified as an upper middle-income country. The rest of the countries are classified as lower middle-income countries by the World Bank. In terms of rates of growth, the countries have experienced fairly modest economic growth, ranging from 2.0-3.0%, except for Costa Rica on the positive side with growth of 5.6% and the Dominican Republic on the negative side with declining (-1.3%) growth. In per capita terms, three of the six countries experienced negative rates of growth, one country experienced under two percent growth, and only Guatemala and Costa Rica had growth rates around four percent.

Turning to some key developmental indicators, Table 2 shows that, with the exception of Costa Rica (which performs at higher levels), the countries generally have similar levels of performance, and that performance falls below the Latin America and Caribbean regional aggregates. Using the United Nations Development Program's Human Development Index, which measures achievements in terms of life expectancy, educational attainment, and adjusted real income, Costa Rica is classified as having high human development, and is ranked as 45th in the world. The other countries are classified as having medium human development, and have rankings that are fairly similar: Dominican Republic (98), El Salvador (103), Honduras (115), Nicaragua (118) and Guatemala (121). Except for Haiti, which ranks even lower, the DR-CAFTA countries are among the lowest performers in Latin America and the Caribbean.

Table 2. Central American Countries and the Dominican Republic: Key Development Indicators, 2002

Country	Life expectancy at birth (years)	Infant mortality rate (per 1,000 live births)	Child malnutrition (% of children under 5)	Illiteracy (% of population age 15+)	Human Development Index
Costa Rica	78	10	5	4	0.834
Dominican Republic	67	38	5	16	0.738
El Salvador	71	31	12	20	0.720
Honduras	69	31	17	24	0.672
Nicaragua	69	40	11	19	0.667
Guatemala	66	40	24	30	0.649
Latin America & Caribbean	71	28	9	11	0.777

Sources: Human Development Index from UNDP's Human Development Report 2004; all other data from World Bank's Country at a Glance reports, generally showing 2002 or most recent estimates.

Relations with the United States

In view of the proximity of Central America and the Caribbean, the United States has had close, sometimes controversial, ties to the regions for many years. For these regional countries, the United States has always been the dominant market, as well as the major source of investment and bilateral assistance, while U.S. interest in Central America has been fairly sustained for more than two decades.

In the early 1980s, with a revolutionary regime in Nicaragua and a threatening insurgency in El Salvador, Congress responded to President Reagan's 1982 call for a Caribbean Basin Initiative by increasing economic assistance to the Central American and Caribbean region, and by providing one-way duty free trade preferences for the region for 12 years in the Caribbean Basin Economic Recovery Act (CBERA).

In the mid-1980s, responding to the 1984 report of the National Bipartisan [Kissinger] Commission on Central America, Congress dramatically increased assistance to Central America over the next several years (see Appendix 1) As a result of these programs, the United States provided more than $11 billion in economic and military assistance to the Central American region from FY1978 to FY1990, especially assistance to El Salvador.[4]

In 1990, Congress responded to continuing concerns in the region by passing the Caribbean Basin Trade Partnership Act (CBTPA) that expanded and extended the original CBI legislation. In 1999, Congress responded again, by providing over a billion dollars of assistance to deal with Hurricane Mitch in Central America and Hurricane Georges in the Caribbean.[5]

In part because of the CBI legislation, the United States is by far the most important trading partner of the regional countries, representing the most important source of imports and the major market for exports (see Table 3). With regard to exports, the relationship ranges from Costa Rica where 25% of its exports are U.S.-bound, to the other countries that send more than 50%, up to the Dominican Republic that sends 84% of its exports to the United States. With regard to imports, the relationship ranges from Nicaragua that receives 23% of total imports from the United States, to Honduras that depends upon the United States for 51% of its imports.

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[4] CRS Report 89-374, *Central America: Major Trends in U.S. Foreign Assistance, Fiscal 1978 to Fiscal 1990*, June 19, 1989, by Jonathan E. Sanford (out of print; for copies, contact the author at 7-7682.

[5] See CRS Report 98-1030, *Central America: Reconstruction After Hurricane Mitch*, October 12, 1999, by Lois McHugh, Coordinator; and *Mission Accomplished: The United States Completes a $1 Billion Hurricane Relief and Reconstruction Program in Central America and the Caribbean,* Agency for International Development, 2003.

Table 3. Central American Countries and the Dominican Republic: Total Trade and Trade with the United States, 2003

Country	Total Exports, $ millions	Exports to U.S., $millions	Exports to U.S. as % of Total	Total Imports, $ millions	Imports from U.S., $ millions	Imports from U.S. as % of Total
Costa Rica	12,978	3,256	25%	11,354	3,756	33%
Dominican Republic	4,910	4,143	84%	8,608	4,214	49%
El Salvador	3,289	1,888	57%	5,579	2,007	36%
Guatemala	5,184	2,865	55%	7,567	2,501	33%
Honduras	4,805	3,140	65%	6,101	3,130	51%
Nicaragua	1,249	728	58%	2,455	553	23%
Total	32,415	16,020	49%	41,664	16,161	39%

Source: International Monetary Fund's *Direction of Trade Statistics Quarterly,* June 2004.

DR-CAFTA Status and Major Issues

Status of Negotiations and Consideration. The United States announced the conclusion of a U.S.-Central America Free Trade Agreement (CAFTA) with El Salvador, Guatemala, Honduras, and Nicaragua on December 17, 2003, keeping to the originally announced schedule. The delegation from Costa Rica withdrew from the negotiations in the last few days to seek further consultations with their government and were not part of the December agreement. The Costa Rican delegation resumed negotiations in early January 2004 and the United States and Costa Rican delegations announced that they had reached agreement on January 25, 2004. President Bush notified Congress of his intention to sign the pact with the Central American countries on February 20, 2004, and the CAFTA pact was formally signed on May 28, 2004.[6]

Negotiations with the Dominican Republic began in mid-January 2004, and were completed on March 15, 2004, with the idea that the agreement would be linked to the CAFTA pact and that a single legislative package would be submitted to Congress for approval under the terms of the Trade Promotion Authority in the Trade Act of 2002. The Administration notified Congress of its intention to sign the agreement on March 25, 2004, and it could have signed the agreement any time after June 24, 2004. Representatives of the seven countries met in Washington, D.C. and signed the agreement, to be known as the United States-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), on August 5, 2004. Following the

[6] See the USTR webpage [http://www.ustr.gov/new/fta/cafta.htm] for the press releases and texts of the agreement and the reports of the Trade Advisory Groups.

signing of the pact, the regional presidents are required to submit the agreement to their respective legislatures for approval.

USTR Representative Zoellick indicated that the Administration would not submit the proposal to Congress until after the November 2004 election because of the limited time available on the legislative calendar and the contentiousness of the issue. Most observers argue for the same reasons that the agreement will not be considered during the lame duck session in mid-November 2004 that is expected to last only one week. Congressional consideration is also complicated by the U.S. dispute with the Dominican Republic over the country's recent tax on soft drinks sweetened with imported high fructose corn syrup (HFCS), and the option of submitting implementing legislation that excludes the Dominican Republic is being weighed. According to informed sources, following President Bush's re-election in early November 2004, he is expected to press his announced trade policy agenda in 2005, including passage of the DR-CAFTA pact, with a Congress that is presumed to be more favorable to the regional pact.[7]

Overview of Provisions. Under the pact, over 80% of U.S. consumer and industrial products will receive duty-free treatment from regional countries immediately, and that percentage will rise to 85% within five years and to 100% within ten years. More than 50% of U.S. farm products will have immediate duty free status, and tariffs on more sensitive products will be phased out within 15-20 years. Textile and apparel will be duty-free and quota-free if they meet the rules of origin. Consumer and industrial goods from regional partners already entering the United States duty free under the Caribbean Basin Trade Partnership Act will have consolidated and permanent treatment so that nearly all industrial goods will enter the United States duty free immediately. The agreement also contains provisions on service, intellectual property rights, government procurement, and labor and environmental protections.[8]

Views of the agreement vary considerably. According to U.S. Trade Representative Zoellick, the original CAFTA agreement "will streamline trade; promote investment; slash tariffs on goods; remove barriers to trade in services; provide advanced intellectual property protections; promote regulatory transparency; strengthen labor and environmental conditions; and, provide an effective system to settle disputes."[9] The U.S. Business Roundtable said that "this agreement can serve

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[7] See USTR Seeks CAFTA Passage by Mid-Year, Zoellick to Consult Congress, *Inside U.S. Trade*, November 12, 2004; and Trade Policy: President Bush to Continue Pursuing Free Trade Pacts, Pushing Global Trade Talks, *International Trade Reporter*, November 11, 2004.

[8] For more details, see CRS Report RL31870, *The U.S. Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration*, by J.F. Hornbeck. For details of the agreement and estimates of the impact on the U.S. economy, see the report by the U.S. International Trade Commission, "U.S.-Central America-Dominican Republic Free Trade Agreement: Potential Economywide and Selected Sectoral Effects," Investigation No. TA-2104-13, Publication 3717, August 2004, available at [http://www.usitc.gov].

[9] See "U.S. & Central American Countries Conclude Historic Free Trade Agreement," USTR Press Release, December 17, 2003; "Free Trade with Central America: Summary of

as a model of how developing and industrial nations can work together to find consensus on trade liberalization."[10] On the other hand, labor and environmental groups and some members of Congress have found the labor and environmental provisions to be inadequate.[11] The Alliance for Responsible Trade, a coalition of non-governmental organizations, has criticized the CAFTA for having weak labor and environmental provisions while containing strong investor and intellectual property rights for businesses.[12] The Dominican Participation and Consultation on Free Trade, a coalition of Dominican church and cultural groups in New York City, expresses similar concerns about the integration of the Dominican Republic into the CAFTA agreement.[13] On the eve of the signing of the CAFTA pact with Central American countries on May 28, 2004, several Democratic Members from the House and the Senate criticized the labor and environmental provisions of the agreement.[14] About the same time, presumptive Democratic presidential candidate John F. Kerry indicated that he would renegotiate the agreement if he is elected President to strengthen the labor and environment provisions.[15]

Major Issues. The four most contentious issues when Congress considers the agreement are likely to be agriculture, apparel/textiles, and the labor and environment provisions.

Agriculture. Under the agreement, more than 50% of U.S. farm products will have immediate duty free status in Central American markets, and tariffs on more sensitive products will be phased out within 15-20 years. For white corn, recognized as the most sensitive product for Central America because it is produced by subsistence farmers and is used as a staple in the making of tortillas, a quota equal to the current import level will increase about 2% each year, while the high over-quota tariff will remain in force. While nearly all Central American farm products

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the U.S.-Central American Free Trade Agreement," USTR Trade Facts, December 17, 2003; "U.S. and Dominican Republic Conclude Trade Talks Integrating the Dominican Republic into the Central American Free Trade Agreement," USTR Press Release, March 15, 2004; "Adding Dominican Republic to CAFTA," USTR Trade Facts, March 15, 2004; and "Dominican Republic Joins Five Central American Countries in Historic FTA," USTR Press Release, August 5, 2004, for information on the provisions of the agreements.

[10] See "Quotes of Support — What They Are Saying About The CAFTA," on the USTR website at [http://www.ustr.gov/new/fta/cafta/quotes.htm]; and "U.S. Officials, Industry Groups Hail Conclusion of Dominican Republic FTA Talks," on the website for Inside Trade.

[11] See "Key House Democrats Fault USTR's Labor Proposals for CAFTA," *International Trade Reporter*, October 30, 2003; and "U.S. Central American Countries Ink Deal; Senator Says Green Provisions Inadequate," *International Environment Reporter*, January 14, 2004.

[12] See the Alliance for Responsible Trade press release of 23 March 2004 and the study entitled "Why We Say No to CAFTA" on the ART website [http://www.art-us.org]].

[13] See the statement of June 22, 2004, on the Inside U.S. Trade website.

[14] See "Zoellick Floats Lame-Duck CAFTA Vote, Levin Seeks Labor Report," *Inside U.S. Trade*, May 28, 2004.

[15] See "Kerry Vows to Renegotiate CAFTA, Costa Rica Leaves Option Open," *Inside U.S. Trade*, June 4, 2004.

will have permanent duty-free status in U.S. markets, quotas for more sensitive products (sugar, beef, peanuts, dairy products, tobacco, and cotton) will increase gradually. For sugar, recognized as the most sensitive product for U.S. negotiators, the regional countries received an immediate 107,000 metric tons increase in their current sugar quota and regular yearly increases, but the high over-quota tariffs remain fully in force.[16] USTR notes that the permitted increases in sugar imports from regional countries would be equal to about 1.3 percent of U.S. sugar production in the first year, and would grow to only 1.9 percent in 15 years. While many U.S. commodity organizations support the DR-CAFTA agreement, the U.S. sugar industry opposes it on grounds that the increase in the quota sets a precedent for other free trade agreements and would result in a substantial increase in sugar imports that would be damaging to U.S. producers.[17] Other critical groups argue that it is unfair to pit highly subsidized U.S. agricultural interests against the poor subsistence farmers in Central America, and they argue that the result will be that these rural farmers will lose their livelihoods as they did in Mexico under NAFTA.[18]

Apparel/Textiles. Under the agreement, textiles and apparel will be duty-free and quota-free immediately under more liberal rules of origin, and the coverage will be retroactive to January 1, 2004. Duty-free treatment will be accorded to some apparel produced in Cental America and the Dominican Republic that contains certain fabrics from NAFTA partners Mexico and Canada, or from other countries in the case of fabrics and materials deemed to be in "short supply" in the United States and Central America. U.S. textile groups have announced that they will oppose DR-CAFTA because of the more liberal rules of origin that, in their view, would lead to the closure of more textile mills in the United States.[19]

Labor. According to the USTR, DR-CAFTA labor provisions go beyond the provisions in the Chile and Singapore free trade agreements to create a three-part strategy to strengthen worker rights. Under the agreement, the countries are required to enforce their own domestic labor laws and that obligation is enforceable through the regular dispute resolution procedures. In addition, the countries agree to work with the International Labor Organization (ILO) to improve existing laws and enforcement, and technical assistance is provided to enhance the capacity of Central

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[16] See "Agriculture in the U.S.-Central American Free Trade Agreement" by Remy Jurenas in the CRS Electronic Briefing Book on Agriculture Policy at [http://www.congress.gov/brbk/html/ebagr70.html].

[17] See "CAFTA Supporters Worry About Absence of Costa Rica ... While Sugar Groups Decide to Oppose CAFTA Pact," *Congress DailyPM*, December 18, 2004; and "U.S. Sugar Companies Urge Bush to Eliminate CAFTA Sugar Concessions," *International Trade Reporter*, January 22, 2004.

[18] See the WOLA Issue Guide entitled *Fair Trade or Free Trade: Understanding CAFTA*, on WOLA's website.

[19] See CRS Report RL31870, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration*, by J.F. Hornbeck; USTR, "Free Trade with Central America: Summary of the U.S.-Central American Free Trade Agreement," December 17, 2003; and "Trade Deal Still Under Attack; Textile Groups Say CAFTA Unfairly Favors Workers from Outside the U.S.," *Greensboro News Record*, December 24, 2003, p. B8.

American countries to monitor and enforce labor rights. The Emergency Committee for American Trade, composed of leading U.S. international business enterprises, argues that the labor rights protections in the CAFTA pact are as strong or stronger than those found in the U.S.-Jordan FTA.[20] The AFL-CIO has argued that the FTA labor provisions are deficient, because they would require only the enforcement of current domestic labor laws, which are viewed as woefully inadequate, and would lead to continuing job losses in the United States. The U.S. labor organization argues that the provisions in the agreement are weaker than the existing beneficiary requirements under the Generalized System of Preferences and the Caribbean Basin Trade Promotion Act that require that a country be taking steps to afford workers "internationally recognized worker rights."[21] A number of members of Congress have argued that the agreement should include an enforceable commitment by the countries to implement internationally recognized labor standards.[22] Seeking to bridge the gap between the critics and the proponents, a scholar at the Center for Global Development has argued for greater enforcement of existing laws while continuing to strengthen workers rights,[23] and the Ministers responsible for trade and labor in the DR-CAFTA countries met in Washington, D.C. on July 13, 2004, and committed to strengthen and enhance labor law compliance and enforcement.[24]

Environment. USTR claims that DR-CAFTA contains an innovative environmental chapter that goes beyond the Chile and Singapore agreements to develop "a robust public submission process to ensure that views of civil society are appropriately considered." It also includes provisions on cooperative actions and the establishment of an Environmental Cooperation Commission. A number of members of Congress have argued that the environmental provisions are weaker than those found in the NAFTA pact, and they have been arguing for a more effective citizen petition process that could be used to encourage a country's compliance with environmental laws.[25]

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[20] Emergency Committee for American Trade, "ECAT Releases Analysis of Labor and Dispute Settlement Provisions in the CAFTA and U.S.-Jordan FTA," on the ECAT website: [http://www.ecattrade.com].

[21] See the Statement by AFL-CIO President John Sweeney on Central American Trade Agreement, December 17, 2003; the Testimony of Thea M. Lee, Assistant Director for International Economics; and other material on CAFTA on the AFL-CIO website at [http://www.aflcio.org/issuespolitics/globaleconomy/caftamain.cfm].

[22] See "Key House Democrats Fault USTR's Labor Proposals for CAFTA," *International Trade Reporter*, October 30, 2003; and "Zoellick Floats Lame-Duck CAFTA Vote, Levin Seeks Labor Report," *Inside U.S. Trade*, May 28, 2004.

[23] See Kimberly Ann Elliott, "Trading Up: Labor Standards, Development, and CAFTA, *CGD Brief*, May 2004.

[24] See "CAFTA Ministers Unveil Program to Boost Labor Standards," on the Inside U.S. Trade website.

[25] See "Senate Dems Warn Zoellick on CAFTA Environment Provisions," *Congress Daily*, November 21, 2003; "U.S. Central American Countries Ink Deal; Senator Says Green Provisions Inadequate," *International Environment Reporter,* January 14, 2004; and sources cited in footnotes 12 and 13..

Costa Rica[26]

Political Situation

Costa Rica is considered the most politically stable and economically developed nation in Central America. Since its independence in 1848, the country has developed a tradition of political moderation and civilian government despite having some interludes of military rule. A brief civil war that ended in 1948 led to the abolition of the Costa Rican military by President Jose Figueres, and continuous civilian governments since then. The Constitution, in effect since 1949, prohibits the creation of a standing army. The Ministry of Public Security and the Ministry of the Presidency share responsibility for law enforcement and national security with a police force including Border Guard, Rural Guard, and Civil Guard, of approximately 8,400 officers.

The United Nations' Human Development Report for 2004 ranks Costa Rica 45th out of 175 countries based on life expectancy, education, and income levels. This puts the country far ahead of its Central American neighbors. Life expectancy at birth is 77.9 years. Its population, 4 million in 2003, is the best educated in Central America, with a literacy rate of 95%. Both the literacy rate and life expectancy are higher than the Latin American average. Some 42% of the country's land is devoted to agriculture and cattle raising, while 38% consists of jungle, forest or natural vegetation. Its National Protected Areas Scheme encompasses 22% of the total land area, and contributes to Costa Rica's growing reputation as an ecotourism destination. The country is not considered a major drug transit point, and has low levels of corruption by regional standards.

The current president, Abel Pacheco, was inaugurated in May 2002. A leader of the center-right Social Christian Unity Party (PUSC), Pacheco won the election in a second round of voting against Rolando Araya of the National Liberation Party (PLN.) Pacheco ran on an anti-corruption, good governance platform, but has since become embroiled in his own corruption charges, forcing him to admit to having received illegal campaign contributions from a Taiwanese businessman, and several related businesses. During Pacheco's first two years in office, he has been plagued with a large number of changes in his cabinet, some resulting from disagreements on economic and fiscal policies. Public opinion polls show that his support fell precipitously from around 60% in September 2002 to a low of 28% in September 2003, but rebounded slightly to 31% by December 2003.[27] Until a decision in April 2003 by the Constitutional Chamber, the country's highest judicial body, former presidents were prohibited from running for both consecutive and non-consecutive, four-year terms. In 2003, the Chamber ruled that a prohibition on non-consecutive re-election prevents citizens from exercising their right to choose their government. This change is expected to benefit former President Oscar Arias, who governed from

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[26] Prepared by Connie Veillette, Analyst in Latin American Affairs.

[27] Costa Rica Country Report, December 2003; and Cost Rica Country Outlook, *Economist Intelligence Unit*, April 27, 2004. In a December 2003 poll, 31% said Pacheco's performance was good, 38% said it was passable, and 28% said it was bad.

1986 to 1990, winning the Nobel Peace Prize in 1987 for his work on the peace process in Central America. Relations with the other nations of Central America are close. This is due in part to their attempts at economic integration that date from the creation of the Central American Common Market in 1960, to the more recent CAFTA negotiations. During guerrilla conflicts that characterized much of Central America in the 1980s, Costa Rica often served as mediator. Some tensions still remain with Nicaragua over navigation rights on the San Juan River and the growing number of Nicaraguan immigrants attracted to Costa Rica's better economic climate.

Economic Conditions

With its stable democracy, relatively high level of economic development, and highly educated population, Costa Rica has been cited as the most attractive investment environment in Central America.[28] Until the 1980s, Costa Rica followed a social-democratic development model that saw a greater role for the state in economic development. The state held a monopoly on banking, insurance, telephone and electrical services, railroads, ports, and refineries. During a regional recession in the 1980s, Costa Rica borrowed heavily, to the point that it defaulted on its foreign debt in 1983. Succeeding structural adjustment agreements with the International Monetary Fund and other international financial institutions brought about a liberalization of the economy, and the privatization of most of its state-owned enterprises. However, seaports, airports, railroads, sewage, water distribution, insurance, telecommunications and energy are still state-owned sectors.

State monopolies of telecommunications and insurance posed difficulties in Costa Rica's participation in CAFTA, and led to Costa Rica withdrawing from the negotiations on December 16, 2003. In January 2004, bilateral negotiations between the United States and Costa Rica resumed, and on January 25, U.S. Trade Representative, Robert Zoellick, announced that an agreement had been reached to include Costa Rica. Under the agreement, Costa Rica has committed to opening its private network services and Internet services by January 2006, and its cellular phone market by 2007. Liberalization of the insurance market is targeted to begin in phases in 2008, and to be completed by 2011.

Costa Rica invested about 6.9% of gross domestic product (GDP) between 1990 and 1998 in public health, one of the highest rates in the developing world. Costa Rica also developed a more equitable distribution of income than its neighbors, a situation that exists to this day. In recent decades, the country has pursued foreign direct investment, the development of its export sector, and diversification from agriculture-based exports. GDP amounted to $17.5 billion in 2003, with a growth rate of 3%, despite a downturn in prices for two of its major agricultural exports — bananas and coffee — and a decrease in demand for computer components. The country has developed a thriving computer sector in recent years since attracting U.S. companies to locate manufacturing plants there. In 2001, more than half of US foreign direct investment in Central America was in Costa Rica. The country's

[28] Global Insight, [http://www.globalinsights.com], 2003, accessed December 15, 2003.

unemployment rate in 2003 was 6.7%. Manufacturing represents nearly 21% of GDP, with agriculture contributing 9% and services and utilities 66%.[29]

Costa Rica is the world's second largest banana exporter after Ecuador. Coffee is its second most important agricultural export. Both are grown on small- and medium-sized farms. Apparel exports are not as important to Costa Rica as to its Central American neighbors. The country has been successful in attracting foreign high technology companies to locate operations in Costa Rica through the establishment of free trade zones. In 1998 and 1999, Intel constructed two plants to assemble computer chips, providing the country with a major export generator that has attracted additional foreign direct investment. Intel announced in November 2003 that it would invest $110 million more in its Costa Rican operations, increasing its employment from 1,900 to 2,400. Intel reports that it expects its operations at these two plants to generate $1.2 billion in exports in 2003.[30] Microsoft awarded a major software development project in 2001 to a Costa Rican firm, Artinsoft, and several other Costa Rican firms have strategic alliances with major U.S. and European companies. These Costa Rican companies are estimated to be exporting $60 million worth of goods a year to the United States, Europe, South America and Asia.[31] The export of high technology electronics grew by 52.8% in 2003, earning $1.4 billion in revenues, and representing 22.5% of the country's total export earnings. The export of medicine and medical equipment is also important, representing 10.4% of total exports.[32] Other industries that are important to the economy are food processing, chemical products, textiles, and metal processing.

Relations with the United States

Relations with the United States have been strong. President Pacheco supported the U.S. military mission in Iraq, despite Costa Rica's traditional neutrality. He came under severe criticism from the public and previous presidents for this support. Former President Oscar Arias, who it is believed will run for the presidency in 2006, was especially vocal in his criticism of U.S. policy in Iraq.[33] Costa Rica initially joined the G20 group of nations whose opposition to the U.S.-EU positions precipitated the collapse of the WTO Ministerial Conference in Cancun, Mexico, September 2003, but it subsequently withdrew in October, as did El Salvador and Guatemala. Soon after Cancun, U.S. Trade Representative Robert Zoellick traveled to Central America where he suggested that if Costa Rica did not open its service sector, specifically its telecommunications and insurance sectors, it could be left out of CAFTA. As discussed below, privatization of the telecommunications and electricity monopoly is opposed by most Costa Ricans, and Zoellick's comments

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[29] Ibid., EIU.

[30] "U.S. Intel Exports from Costa Rica to Reach $1.2 bln in 2003," *Spanish News Digest*, July 15, 2003, *La Prensa Grafica,* July 14, 2003.

[31] Ibid., EIU.

[32] Costa Rica Industry: Manufacturing Update, *Economist Intelligence Unit*, March 23, 2004.

[33] "Costa Ricans Defend Neutral Tradition Against Pacheco," *Noticen: Central American & Caribbean Affairs*, April 10, 2003.

were not well received.[34] On December 16, 2003, one day before a CAFTA agreement was announced, Costa Rica withdrew from the negotiations, citing a lack of resolution on these sensitive issues. Subsequent negotiations between the United States and Costa Rica in January 2004 produced an agreement to include Costa Rica in the regional pact.

Costa Rica is not a major U.S. aid recipient. It received some economic assistance during the early 1990s, averaging about $25 million from 1990 to 1996. Since 1997, economic assistance has averaged less than $1 million per year. In FY2003, it received less than $400,000 in International Military Education and Training (IMET) funds, and approximately $1 million for Peace Corps. Although Costa Rica has no military, IMET funds are used to train law enforcement officers and coast guard personnel. The State Department proposed no funding in FY2004 in IMET funds, and has requested $50,000 for FY2005. In 2002, Costa Rica signed an agreement with the United States to establish an International Law Enforcement Academy for the training of police, prosecutors, and judges from the Western Hemisphere with a focus on transnational crimes like terrorism and drug trafficking. The country receives no direct, bilateral U.S. counterdrug funds, although State Department regional programs support strengthening law enforcement capabilities.

U.S. Trade and Investment. The United States is Costa Rica's major trading partner. It annually sends approximately 50% of its exports to the United States and imports 53%. A sizeable portion of U.S. investment in Central America is found in Costa Rica. Foreign Direct Investment (FDI) from all sources in 2003 totaled $590 million of which approximately 65% was from the United States.[35] Despite the country's efforts to attract foreign investment, a World Bank report notes that Costa Rica has heavier regulation of business than many other developing countries, which causes inefficiency, delays, higher costs, and opportunities for corruption.[36]

Major U.S. companies currently invested in Costa Rica include the following by sector.[37] In the agriculture sector, companies include Chiquita, Dole, Standard Fruit, Fresh Del Monte. Manufacturing companies include 3M, Unilever, Colgate-

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[34] Tim Rogers, "Markets Must Open, U.S. Warns," *The Tico Times*, Weekly Edition, Vol. VIII, No. 86, San Jose, Costa Rica, October 3-9, 2003. Oscar Núñez Olivas, "Indignación Y Repudio en Costa Rica por Declaraciones de Zoellick Sobre TLC," *Agence France Presse*, October 2, 2003.

[35] Information on U.S. aid funding levels is from U.S. Agency for International Development Green Book, 2003, and U.S. State Department Budget Justification, FY2004. Information on trade and investment is from *The Economist Intelligence Unit* Country Profile, 2003, and *Caribbean Rim Investment Initiative, Business Environment Report — Costa Rica*, Inter American Development Bank and the Organization for Economic Cooperation and Development, April 20, 2003.

[36] See [http://rru.worldbank.org/DoingBusiness/default.aspx], accessed October 8, 2003.

[37] Costa Rican-American Chamber of Commerce Membership Directory & Business Guide, [http://www.amcham.co.cr/membership_dir/], accessed September 10, 2003. See also Department of Commerce, U.S. Commercial Service, *Costa Rica Country Commercial Guide 2002.*

Palmolive, Gillette, Eaton, Novartis Consumer Health, Heinz, Kimberly-Clark, Xerox, Bridgestone Firestone, Alcoa, Conair, H.B. Fuller, and Phillip Morris. There are also a number of producers of medical products and pharmaceuticals, such as Abbott Laboratories, Baxter Health Care, GlaxoSmithKline, and Eli Lilly. The high technology sector has located several facilities in the country and include Intel, Microsoft, Hewlett Packard, Cisco Systems, Lucent, Oracle and Unisys. Other companies from other sectors such as business services, chemicals and tourism include Deloitte & Touche, KPMG, Price Waterhouse Coopers, DHL, FedEx, UPS, Citibank, Ernst & Young, Procter & Gamble, Bristol-Myers Squibb, H.B. Fuller, Monsanto, Marriott, Radisson, and Hampton Inns.

DR-CAFTA-Related Issues

Costa Rican leaders across the political spectrum support liberalized trade and President Pacheco has been a leading advocate of the CAFTA and the DR-CAFTA agreements. But disagreements with the United States with regard to opening the state-owned telecommunications and insurance sectors led Costa Rica to withdraw from the initial CAFTA negotiations one day before the final agreement was announced. Following bilateral negotiations between the United States and Costa Rica in January 2004, Costa Rica was included in the CAFTA agreement. Costa Rica also has signed free trade agreements with Canada, Chile, Mexico, the Dominican Republic and the Republic of Trinidad and Tobago. The countries of Central America now have tariff-free access to the U.S. market on approximately three-quarters of their products through the Caribbean Basin Trade Partnership Act (P.L. 106-200, Title II) which expires in September 2008.[38] The CAFTA and DR-CAFTA agreements would make the arrangement permanent and reciprocal. While the five Central American nations agreed to present a unified negotiating position to the United States, each had its own interests and objectives. Costa Rica sought greater foreign investment in certain strategic areas, such as electronics assembly, health care products and business service centers. While agricultural products have been important to its economy, their decreasing export value has meant that the focus instead has shifted to manufacturing. Costa Rica also anticipated that an FTA with the United States would have a positive impact both on tourism and the productivity of its export sector.[39]

Telecommunications and Insurance. The telecommunications sector is the most sophisticated in Central America, but unlike its neighboring countries, it is state-owned, and proposals for privatization have been very controversial. The use of the Internet and electronic commerce is relatively advanced, but the system is inadequate given the demand. Although most of the country's state-owned companies were privatized in the 1990s, Costa Ricans strongly oppose privatizing the Costa Rican Electricity Institute (ICE), which operates both power and telecommunications. President Pacheco is interested in restructuring ICE in some form in order to reduce its burden on the national budget and to modernize its

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[38] "Latin America Economy: What's at Stake With CAFTA," *Economist Intelligence Unit*, May 14, 2003.

[39] *Agenda Integral de Cooperación*, Ministry of External Trade, Government of Costa Rica, [http://www.comex.go.cr/negociaciones/usa/default.htm], accessed September 16, 2003.

infrastructure to attract more high technology firms to the country. Intel's General Manager has stated that the lack of modernization, especially Internet connections and speed, were directly hindering the company's growth in Costa Rica.[40]

The U.S. negotiating position was that all suppliers of telecommunications and insurance services be compatible and that there is non-discriminatory treatment between domestic and foreign suppliers. Costa Rica's has long resisted calls to liberalize its telecommunications and insurance sectors. This disagreement came into sharper focus during U.S. Trade Representative Robert Zoellick's trip to the region in early October 2003 during which he stated to Costa Rican officials that an open telecommunications sector was necessary in order to conclude an agreement, and that a CAFTA agreement could proceed without Costa Rica. These comments were met with displeasure from both Costa Rican union leaders and business executives who argued that the NAFTA agreement allows Mexico to maintain state ownership of oil and the U.S.-Chile Free Trade Agreement allows Chile the same privilege in regard to copper. They contend that this sets a precedent for Costa Rica to keep its state monopoly. At the final round of CAFTA negotiations, Costa Rica decided that the agreement, as it stood, was not in its best interests, and its negotiators withdrew. Later comments from U.S. officials clarified that complete privatization of the telecommunications sector would not be necessary as long as the private sector could participate in some telecommunications activities, such as mobile phone and internet service.[41] The issue of insurance was not raised until the last round of negotiations, and Costa Rica believed there was not enough time remaining to resolve differences. The United States had called for total access to the insurance industry. The final agreement between the United States and Costa Rica provides for access to private network services and Internet services by January 2006, and to the cellular phone market by 2007. Opening the insurance market would be accomplished in phases between 2008 and 2011.

Apparel. Costa Rica's apparel industry is less important to its economy than its neighbors. Nonetheless, Costa Rica supported the region's single negotiating position of wanting a more liberal rule than is now included in the Caribbean Basin Trade Preference Act, which provides for a "yarn forward" rule in which U.S. made fabrics must be from U.S. produced yarn. For a CAFTA agreement, the Central Americans preferred that apparel makers could acquire yarn from the United States, Central America, or third countries that have trade agreements with either. This means that potential suppliers could also be from Mexico, Canada, or Chile. U.S. negotiators proposed a rule allowing for the use of third country providers where components are in short supply. The Central Americans wanted tariff preference levels to provide duty-free access, under a negotiated cap, for apparel that is

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[40] Ibid., Global Insights.

[41] Diego Mendez, "Zoellick Pushes Trade Pact; Commerce Officials from Costa Rica Demand that Telecommunications be Left Out of Treaty," *The Miami Herald*, October 3, 2003; "Costa Rica Weighs Costs, Alternatives in Telecom Trade Clash," *EFE News Service*, October 3, 2003.

assembled in the region from fabric that is made elsewhere. This position was opposed by the U.S. textile industry.[42]

Agriculture. Agriculture promised to present difficulties in negotiations, as the Central Americans wanted the United States to address its farm subsidies, while they wanted unhindered access to the U.S. market for their agricultural products. Costa Rica's two main agricultural exports, bananas and coffee, have experienced declining prices on the world market in recent years. In September, 2003, Chiquita announced a buying lull of ten weeks of bananas from independent producers in Costa Rica, citing lower demand in Canada, Europe, and the United States, and overproduction in countries such as Colombia and Guatemala. Instead, it will purchase from cheaper producers in the region. The Costa Rican banana industry estimates that it could incur $10 million in losses.[43] In the final agreement, Costa Rica negotiated an increase in its sugar export quota that will reach 14,860 tons by the 15th year of the agreement, and won general protection for fresh onions and potatoes in the agreement.

Environment. According to a report by the Office of the U.S. Trade Representative, Costa Rica has a full complement of domestic environmental laws. Legislation enacted in 1994 created the post of Environmental and Maritime Land Attorney, who is tasked with taking legal action to guarantee a healthy and ecologically sound environment, and to ensure the enforcement of international treaties and national laws. The 1995 Environment Act requires environmental impact studies for most construction projects, including commercial and residential construction, and mining projects. The government can halt projects and impose fines for non-compliance with environmental laws. Costa Rica is party to 68 multilateral, regional and bilateral environmental agreements, including the U.N. Convention on Biological Diversity, the Convention on the International Trade in Endangered Species of Wild Flora and Fauna, the U.N. Framework Convention on Climate Change, the Kyoto Protocol, and the Montreal Protocol on Substances that Deplete the Ozone Layer.[44] Costa Rica has been a pioneer of "clean air exports" in which it sells credits to companies in developed countries who need to offset their greenhouse gas emissions as part of the 1992 Rio Earth Summit and the 1997 Kyoto Protocol commitments.

Labor. The power of organized labor has declined since the 1980s. The strongest unions represent civil servants, teachers, public utilities employees, and oil refining and ports employees. According to the State Department's *2003 Country Reports on Human Rights Practices*, Costa Rican law guarantees the right of workers to join unions, and workers are able to exercise this right. The report estimates that 12% of the labor force is unionized, and that some 80% of all union members are

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[42] Martin Vaughan, "Textile Industry Reft Brews Over CAFTA Apparel Rules," *Congress Daily,* August 13, 2003.

[43] "Costa Rican Farmers Fearful of Chiquita Buying Freeze," *Reuters*, September 4, 2003;Marianela Jimenez, "Costa Rica Asks U.S. Government to Urge Chiquita to Cancel Plans for Banana Buying Freeze," *Associated Press*, September 3, 2003.

[44] *Interim Environmental Review: U.S.-Central America Free Trade Agreement*, Office of the U.S.Trade Representative, August 2003.

public sector employees. Unions operate independently of the government. The International Labor Organization (ILO) noted delays in addressing workers' formal grievances and the enforcement of reparations. The Constitution and Labor Code restrict public sector workers from striking, although a 2000 Supreme Court ruling clarified that public sector strikes were allowed, but only if a judge approved them in advance and found that necessary services for the public's well-being would not be affected. There are no restrictions on private sector unions being able to bargain collectively or to strike, although few private sector employees belong to unions. In 2002, there were no major private sector strikes, according to the State Department.

The Constitution provides for a minimum wage that is set by a National Wage Council, composed of representatives from government, business, and labor. The Ministry of Labor was reported to have enforced minimum wages in the area of the capital, San Jose, but was less effective in rural areas in 2002. The State Department reports that the minimum wage was not sufficient to provide a worker and his family at the lower end of the wage scale with a decent standard of living. Costa Rican law on health and safety in the workplace requires industrial, agricultural and commercial firms with ten or more workers to establish a joint management-labor committee on workplace conditions, and allows the government to inspect workplaces and to fine employers. The State Department reports that insufficient resources have been provided to the Ministry of Labor to enforce health and safety legal requirements.

Intellectual Property. Costa Rica is party to the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS), and has enacted or amended its regulations to harmonize them with its international obligations. The U.S. Trade Representative's 2003 Foreign Trade Barriers Report noted that enforcement remains a problem with regard to the protection of copyrights, patents, and trademarks. Despite this, USTR placed Costa Rica on its less severe Special 301 Watch List in 2002, 2003, and 2004. The International Intellectual Property Alliance, a U.S.-industry organization, also cites Costa Rica's insufficient enforcement activities and levels of fines, which they argue do not deter the infringement of intellectual property. The group estimates that trade losses due to piracy in Costa Rica totaled $17.6 million in 2002.[45]

Approval Status. The CAFTA agreement has not been formally presented to the unicameral Costa Rican National Assembly, nor has it been determined by the legislature whether such an agreement requires a simple majority or super majority for passage. In early July 2003, President Pacheco announced that he would delay sending the agreement to the National Assembly since it appeared that the U.S. Congress would not take up the bill in an election year.

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[45] Office of the U.S. Trade Representative, *Foreign Trade Barriers Report, 2003;* and *Special 301 Watch List, 2004.* See also the International Intellectual Property Alliance's *2003 Special 301 Report*, available online at [http://www.iipa.com].

Dominican Republic[46]

Political Situation

During the1990s, the Dominican Republic underwent rapid economic growth and developed stronger democratic institutions. The "Pact for Democracy"in 1994 paved the way for free and fair elections by removing the aging Joaquin Balaguer from power after a shortened two-year term and preventing consecutive presidential re-elections. Balaguer was succeeded by attorney Leonel Fernández (1996-2000) of the Dominican Liberation Party (PLD), a center-left party of middle class professionals, who presided over a period of strong economic growth. After top PLD officials were charged with misusing public funds, Hipólito Mejía (2000-2004), an agrarian engineer of the populist Dominican Revolutionary Party (PRD), easily defeated the PLD candidate, Danilo Medina, by promising to promote rural development . Mejía lost popular support, however, by spending excessively and deciding to bail out all deposit holders after three massive bank failures in 2003 at a cost of between 15 and 20% of GDP.[47] Observers noted that Mejía focused more on his re-election bid, which required a Constitutional amendment reinstating presidential re-election, than on resolving the country's deep economic crisis.[48]

On May 16, 2004, Leonel Fernández won a convincing first round victory with 57% of the popular vote compared to Mejía (PRD) receiving 34% and Eduardo Estrella of the Social Christian Reformist Party (PRSC) receiving 9%. Record numbers of Dominicans turned out to support Fernández, whom they associated with the country's economic boom of the 1990s. President Fernández took office on August 16, 2004, and is seeking to use his strong electoral mandate to launch a period of austerity necessary to solve the country's fiscal shortfall, rising Central Bank debt, and chronic power shortages.

Fiscal Reform and DR-CAFTA. In September 2004, the Dominican legislature, which is dominated by the PRD, passed the President's fiscal package. The fiscal bill contained important provisions including an increase in sales taxes and a 20% cut in public spending.[49] Its passage hastened the renewal of a $600 million stand-by agreement with the International Monetary Fund (IMF), which is likely to be signed by the end of 2004. The fiscal reform bill has become controversial, however, because it contains a 25% tax on high fructose corn syrup (HFCS), a major U.S. export, which is in conflict with the recently signed DR-CAFTA agreement.

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[46] Prepared by Clare Ribando, Analyst in Latin American Affairs, and Lenore Sek, Specialist in International Trade and Finance. For additional information, see CRS Report RS21718, *Dominican Republic: Political and Economic Conditions and Relations with the United States,* by Clare Ribando, and CRS Report RS21868, *U.S. - Dominican Republic Free-Trade Agreement,* by Lenore Sek.

[47] Leo Goldstein, "Dominican Republic: A Look Ahead," *Citigroup,* August 18, 2004.

[48] "Fernández Wins as Mejía Roundly Rejected," *Latin American Regional Reports,* May 25, 2004.

[49] "Poor Feel Pain of President's Cure for Economic Ills," *Financial Times,* October 20, 2004.

Corruption. Former President Mejía was linked to a number of corrupt activities for which observers believe he is unlikely to be held accountable. An official investigation recently found that Mejía was able to increase his personal wealth by $800,000 during his four-year presidential term.[50] Mejía, officials of all major political parties, and other individuals reportedly received money and gifts from Ramon Baez, owner of the now defunct Banco Intercontinental (Baninter).[51] The Mejía government later took control of Baninter's associated companies, including Listin Diario, the country's largest publishing company, and fired many editors and management officials, even if they were not party to the scandal. There are corruption cases pending against Mr. Baez and other prominent Dominican bankers associated with the scandals. President Fernández has promised to fight corruption; however, some analysts are questioning his commitment to that pledge after his recent decision to give four posts to officials from his previous administration who have been charged with misusing public funds.[52]

Human Rights. According to the State Department's Country Report on Human Rights Practices covering 2003, although the Dominican government has made some progress, it still has a poor human rights record. Official estimates of extrajudicial killings by Dominican police forces range from 150 to as high as 292. Human rights groups reported a decline in the use of torture against criminal suspects, although uniformed vigilantism persisted. In response to allegations of police misconduct, President Fernández recently forced 300 to 400 police agents into retirement. He has also expressed his willingness to employ the army to assist the police if necessary in response to a recent upsurge in violent crime that left 20 people dead in two incidents in September 2004.[53]

In addition to deficiencies within the police force, serious problems remain in other areas of the Dominican criminal justice system. For example, 14,500 prisoners are currently being held in overcrowded prisons designed to hold only 9,000 inmates. Finally, despite the enactment of an anti-trafficking in persons law in August 2003, the State Department has placed the Dominican Republic on a Tier 2 Watch List for failing to arrest and prosecute those accused of human trafficking.[54]

Status of Haitians and Dominican-Haitians. The Dominican government continues to receive international criticism for its treatment of an estimated one million Haitians and Dominican-Haitians living within its borders. Each year thousands of migrants, many without proper documentation, flock from Haiti, the poorest country in the hemisphere, to the Dominican Republic. The Dominican

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[50] "Former Dominican Leader Defends His Own Wealth," *Reuters*, October 22, 2004.

[51] "Dominican Republic: Bank Bust," *Economist Intelligence Unit*, May 26, 2003.

[52] "Dominican President Assigns Four Charged in Scandal to Top Posts," *Dow Jones International News,* August 20, 2004.

[53] "Dominican Republic: Fernández Shocked by Surge in Violent Crime," *Latin American Regional Report*, October 19, 2004.

[54] According to the Trafficking Victims Protection Reauthorization Act of 2003 (P.L. 108-193), countries that do not make adequate progress in combating human trafficking may be subject to sanctions.

economy, especially the sugar and construction industries, has long profited from a constant influx of cheap Haitian labor. More than 90% of the country's seasonal sugar workers, and two thirds of its coffee workers, are Haitians or Dominicans of Haitian origin.[55] In 2002, the Dominican Directorate of Migration forcibly deported more than 12,000 Haitians, including children born of Haitian parents in the Dominican Republic.[56] According to most Dominican officials, including President Fernández, the recent crisis in Haiti, which resulted in the ousting of President Jean-Bertrande Aristide in early 2004, has accelerated the level of illegal migrants heading to the Dominican Republic and placed further strain on the struggling Dominican economy.[57]

Economic Conditions

Fueled by rapid expansion in both the tourism and free-trade zone (FTZ) sectors, the Dominican economy grew rapidly throughout the 1990s at an annual rate of 6-8%. Despite the increased employment and earnings in those two sectors, mining and agriculture continued to be the country's highest export earners. Remittances from Dominicans living abroad contributed an additional $1.5 billion per year to the country's stock of foreign exchange. Economic expansion was also facilitated by the passage of several market-friendly economic reforms in the late 1990s by then President Leonel Fernández. One critical reform was a 1997 law allowing the partial privatization of unprofitable state enterprises. Since that time, several state-owned entities have been privatized including a flour mill, an airline, a hotel chain, sugar mills, and three state-owned regional electricity distribution companies. Some observers criticized Fernández's privatization of the electric sector, however, noting that it failed to remedy power shortages and financial difficulties.[58]

The success of both tourism and export-processing zones is extremely dependent upon the global economy. Although the Dominican tourism industry has begun to recover since late 2002, it suffered a significant decline in 2001-2002 as a result of the global recession, a weak Euro, and the aftermath of the September 11, 2001 terrorist attacks. More significantly, the country's free trade zones have had to compete with cheaper goods coming from Central America and China. The trade deficit of the Dominican Republic with the Central American countries stood at $85.6 million in 2003.

In 2002, the Dominican economy, despite strong performance in the mining and telecommunications sectors, entered a recession. The country's public finances were

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[55] Philip Martin, Elizabeth Midgley, and Michael S. Teitelbaum, "Migration and Development: Whither the Dominican Republic and Haiti?" *The International Migration Review*, New York: Summer 2002, Vol. 36, Issue 2.

[56] U.S. Department of State, *Country Reports on Human Rights Practices 2003: Dominican Republic*, February, 2004.

[57] Alois Hug, "Somos el Patio Trasero de Estados Unidos, no Podemos Enfrentarnos," *El Pais*, July 19, 2004.

[58] Bacho Perez, "Widespread Blackouts Leave President Scrambling to Boost Power," *Agence France-Presse*, February 8, 2000.

placed under strain after President Mejía, in violation of the monetary code, elected to bail out the country's third largest bank, Banco Intercontinental (Baninter), which collapsed in May 2003 after a record fraud. The Baninter scandal was a direct result of weak banking regulations that enabled bank executives to defraud depositors and the Dominican government of U.S. $2.2 billion worth of account holdings — an amount equal to almost 67% of the Dominican Republic's annual budget. Ramon Baez, former president of Baninter paid out more than $75 million worth of gifts and payments to government officials, including President Mejía and Leonel Fernández.[59] The Mejía administration negotiated a $600 million loan from the IMF in August 2003 to counter the effects of the Baninter bailout but only received $120 million before failing to comply with conditions. A renegotiation in February 2004 allowed a disbursement of an additional $62 million but the administration soon fell out of compliance with targets. In addition to the failure of Baninter, two other commercial banks were bailed out in late 2003, resulting in approximately $700 million in losses to the Dominican Central Bank.

By the end of 2003, inflation reached 42%, unemployment stood at 16.5%, and the peso had lost more than half of its value. Since August 2004, the peso has regained some of its value, inflation has decelerated, and the economy has begun to grow. The fiscal bill should help cut the budget deficit, but measures of austerity that will be necessary to meet fiscal targets, which include the elimination of a subsidy on propane gas, may have deleterious consequences on the country's poor and middle classes. Moreover, electricity providers, saddled with dollar-denominated debts, are still struggling to provide service to a Dominican populace angry at expensive power bills and continued blackouts. Although the National Salary Council recently negotiated a 25% salary increase for private sector employees below a certain wage cap, this increase is unlikely to compensate for the purchasing power they have lost due to inflation. Public sector wage increases are unlikely to occur until after January 2005. Since January 2004, the U.S. Coast Guard has intercepted some 7,300 undocumented Dominican migrants en route to Puerto Rico, providing further evidence of the severity of the economic crisis.[60]

Relations with the United States

The Dominican Republic enjoys a strong relationship with the United States that is evidenced by extensive economic, political, and cultural ties between the two nations. The Dominican Republic is one of the most important countries in the Caribbean because of its large size, diversified economy, and close proximity to the United States. Reforms of the Dominican justice system, as well as a number of market-friendly economic laws, were well-received by the U.S. government. Despite these reforms, and the country's strong economic performance during the 1990s, the Baninter scandal, as well as the ongoing economic crisis, have concerned investors in the United States. Although the Dominican Republic withdrew its contribution of 300 troops to the coalition in Iraq in May 2004, the Bush administration has expressed appreciation to the Dominican government for its participation. The

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[59] Jose de Cordoba, "Caribbean Cloud,"*Wall Street Journal*, June 30, 2003.

[60] "Dominican Authorities Arrest Would-be Migrants But Some Escape During Shootout," *Associated Press*, October 20, 2004.

United States hopes to assist the Fernández administration to restore economic prosperity through free trade, to build solid democratic institutions, to fight crime and corruption, and to promote regional stability. These cooperative efforts could be hampered, however, if the Dominican Republic's tax on the use of corn syrup causes it to be excluded from the DR-CAFTA agreement.

Foreign Aid. The United States is the largest bilateral donor in the Dominican Republic, followed by Japan, Venezuela, and Germany. For FY2004, the United States allocated an estimated $31.8 million to the Dominican Republic, and the Administration has requested $28.2 million in assistance for FY2005. These amounts include support for a variety of Development Assistance and Child Survival and Health Programs, as well as a Peace Corps staff of some 185 volunteers and a small military aid program. In response to a May 24, 2004, flood that left 414 dead, and more than 1,600 families homeless in the Dominican-Haitian border region of Jimani, USAID has donated a total of $300,000 to various NGOs, such as World Vision and the Red Cross.

Counter-Narcotics Issues. In September 2004, President Bush designated the Dominican Republic as one of four major drug transit countries in the Caribbean. In 2003, 8% of all the cocaine entering the United States flowed through the Dominican Republic. To counteract those illicit activities, the Dominican government, acting with Haitian and U.S. officials, has stepped up drug-related seizures, arrests, and extraditions. The Dominican Republic is also on the State Department's list of major money laundering countries. In 2002, the Dominican Republic enacted a tough anti-money laundering law aimed at combating drug trafficking, corruption, and terrorism.

Trade and Investment. The United States is the Dominican Republic's main trading partner. The United States exported $4.2 billion in goods to the Dominican Republic in 2003, with apparel and clothing (15%) and textiles (15%) the leading items. In the same year, the United States imported $4.5 billion in goods, almost the same value as exports. Just over half (52%) of U.S. imports were apparel and clothing, and most of those imports (81%) entered under Caribbean Basin Initiative-related programs. As these data show, the textile and apparel industries of the Dominican Republic and the United States are highly integrated. The Dominican Republic has benefitted more from its involvement in CBI than any other Caribbean country. It was also one of the first countries in the region designated to participate in the expanded trade benefits of the Caribbean Basin Trade Partnership Act (CBTA) of 2000. It has a U.S. sugar quota of 180,000 tons, the largest of any of our trading partners. More than 254 U.S. companies operate in the Dominican Republic's 51 free trade zones (FTZs), which were the engine for the country's rapid growth throughout the 1990s. Major U.S. companies in the Dominican Republic include Codetel (Verizon), Central Romana Corporation, E. Leon Jimenes, C. por A. (Philip Morris), Citibank, Esso Standard Oil, Texaco Caribbean, Colgate Palmolive, AES, Enron, Coastal, Seaboard, and Tricom (Motorola).[61]

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[61] United States Department of Commerce, *Country Commercial Guide: Dominican Republic*, 2003/4.

DR-CAFTA-Related Issues

On March 15, 2004, the United States and the Dominican Republic concluded a free-trade agreement (FTA) that would integrate the Dominican Republic into the recently concluded CAFTA. In a press release, the Office of the USTR said that the FTA with the Dominican Republic "opens many opportunities for American exporters, farmers, workers, consumers and businesses, and it will promote economic growth, opportunity and prosperity in the Dominican Republic and the region."[62] Negotiations were held in three rounds in January, February, and March 2004. The Dominican Republic signed the DR-CAFTA agreement on August 5, 2004 in Washington, D.C.

In a Fact Sheet on the Dominican Republic FTA, the USTR explained that the Dominican Republic is the largest economy in the Caribbean and notes that adding the Dominican Republic to CAFTA "will become the second largest U.S. export market in Latin America."[63] Under the market access provisions of the FTA, 80% of U.S. exports of consumer and industrial goods would become duty-free immediately, with the remaining tariffs phased out over 10 years. More than half of current U.S. agricultural exports would become duty-free immediately, and tariffs on most U.S. agricultural products would be phased out over 15 years, with total elimination by 20 years. Sugar exports from the Dominican Republic would have a higher U.S. quota, but the increase would be less than for Central American sugar exports. Most Dominican products already enter duty-free under CBERA.

The American Chamber of Commerce in the Dominican Republic, which represents U.S. businesses in the Dominican Republic and Dominican businesses that export to the United States, supports an FTA. Four reasons the Chamber gives for its support are: (1) maintain parity with regional competitors; (2) improve market access in textiles and attain more flexible rules of origin; (3) ensure a more stable investment climate; and (4) "strengthen, deepen and further promote the institutional and policy reform process already underway in the Dominican Republic."[64] However, the Chamber warns that since the two economies are so different in size, there could be social unrest in the Dominican Republic during the transition period, and it calls for better safeguards to allow for adjustment and flexibility on tariff reduction schedules.[65]

The Dominican Republic currently has a free-trade agreement with the Central American Common Market (CACM) countries, and a year ago (March 26, 2003),

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[62] Office of the USTR. U.S. & Dominican Republic Conclude Trade Talks Integrating the Dominican Republic into the Central American Free Trade Agreement. Press Release. March 15, 2004.

[63] Office of the USTR. Zoellick Statement at Signing of U.S.- D.R.- Central America FTA.. Press. Release. August 5, 2004.

[64] Testimony of William M. Malamud, Executive Vice-president, American Chamber of Commerce of the Dominican Republic, before the Trade Policy Staff Committee of the USTR. October 8, 2003.

[65] Ibid.

four of the five CACM countries signed a statement supporting a possible U.S.-Dominican Republic FTA.[66] In addition, in testimony before the Trade Policy Staff Committee of the USTR on October 8, 2003, the Resident Commissioner of the Commonwealth of Puerto Rico, The Honorable Aníbal Acevedo-Vilá, also expressed strong support for a U.S.-Dominican Republic FTA, saying that an FTA could provide opportunities for a range of Puerto Rican products and services, "including food and beverage products, consumer goods, industrial products, construction materials, information technology, medical and pharmaceutical products and financial services."

Corn Syrup Tax and DR-CAFTA. In September 2004, the Dominican Congress passed a fiscal reform package that included a 25% import tax on high fructose corn syrup (HCFS) used in the production of soft drinks. That portion of the law appears to be a protectionist measure that conflicts with the recently signed DR-CAFTA agreement. The USTR and some Members of Congress have threatened to exclude the Dominican Republic from the FTA unless it repeals the HCFS tax. Other Members of Congress have criticized the Administration for its attempt to strong arm the Dominican Republic over the tax. Rather, they have suggested that the Administration should take its objections to the WTO as it did with a similar tax enacted by Mexico.[67] President Fernández, who opposes the tax, has sent a bill to the Dominican Senate to repeal the portion of the law that levies the tax. However, at this time the PRD-dominated Congress seems unlikely to overturn the corn syrup tax.

Textiles and Apparel. Under the FTA, textile and apparel products would be traded duty-free and quota-free immediately, if they met the rules of origin. The Dominican Republic would fall under the CAFTA cumulation provisions, which provide benefits for incorporating Mexican or Canadian inputs, as long as certain conditions are met. Regarding co-production along the border with Haiti, the Administration pledged to work with Congress to assure that Haiti still received benefits under CBERA.[68] One of the chief benefits of an FTA to the Dominican Republic would be to ensure U.S. preferential treatment for textiles and apparel. This benefit is important, since the Dominican Republic may be one of the countries losing U.S. market share to China, once quotas are eliminated world-wide on January 1, 2005.[69]

The positions of U.S. textile and apparel groups probably depend on whether a group competes with imports or whether it benefits from imports. For example, in testimony on October 7, 2003, before a U.S. International Trade Commission

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[66] U.S. Weighs Proposal to Add Dominican Republic to CAFTA Agreement. *Inside U.S. Trade.* March 14, 2003. The article says that the reason was not clear why Costa Rica did not sign the March 26 statement.

[67] "USTR Reiterates Threat to Drop Dominican Republic from DR-CAFTA," *International Trade Reporter*, October 28, 2004.

[68] Office of the USTR. Adding Dominican Republic to CAFTA.

[69] U.S. International Trade Commission. Textiles and Apparel. Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market. Investigation No. 332-448. January 2004. Available at [http://hotdocs.usitc.gov/pub3671/main.html].

hearing, the American Apparel and Footwear Association (AAFA), which is the trade organization for the North American apparel industry and its suppliers, endorsed an FTA, saying that "because many U.S. companies maintain production-sharing relationships with the [Dominican Republic], swift implementation of the [FTA] will likely have a positive economic impact in the United States."[70] On the other hand, the American Textile Manufacturers Institute (ATMI) has stated that CAFTA could lead to reduced U.S. employment in the textile industry and has called for protections, such as strong rules of origin, and the organization might take the same position with the Dominican Republic.

Environment. The Dominican Republic is party to a number of multilateral agreements related to the environment, including the Convention on Biological Diversity, the Convention on the International Trade in Endangered Species of Wild Flora and Fauna, the Vienna Convention, and the Kyoto Protocol. Although erosion and deforestation were major problems during the 1980s, the Dominican government and civil society took steps to expand public awareness on environmental issues during the 1990s. This process culminated in the passage of the Environmental Law (64-00) and the establishment of the Secretariat for the Environment in late 2000. Despite this progress, a new National Parks bill that was passed in July 2004, despite protests from environmental groups, a number of foreign embassies and the dissenting PLD may open up to 20% of the country's protected areas to foreign tourism developers.[71] In addition, observers have noted that the disastrous floods that resulted in hundreds of deaths in Jimani in June may have resulted from deforestation in Haiti and the building of towns on dry riverbeds in the Dominican Republic.

Labor. There is a range of views on the issue of labor. In testimony before the Trade Policy Staff Committee on October 8, 2003, the Secretary of Labor of the Dominican Republic, Minister Milton Ray Guevara, stated that the Dominican Republic has been a member of the International Labor Organization since 1924, and that Dominican labor law "establishes the right to form unions and to negotiate the collective bargaining agreement ... [and] protects the members of the negotiating commission of a collective bargaining agreement." He also said that the labor law regulates the right to strike.

In a 2003 report on human rights practices, the U.S. Department of State states that the Constitution of the Dominican Republic and its 1992 Labor Code provide for broad worker rights, but there are widespread problems with putting these rights into practice. For example, the report states that under the Constitution, workers in the Dominican Republic are free to organize labor unions, and the 1992 Labor Code specifies the steps required to establish a union. However, the report also says "enforcement of labor laws was sometimes unreliable, inhibiting employees from freely exercising their rights."[72] It also explained that collective bargaining is legal,

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[70] Statement of Rachel Subler, Manager of Government Relations and Communications.

[71] Nancy San Martin, "Dominican Bill is Being Called a 'Mortal Blow' to Environment," *The Miami Herald*, May 22, 2004.

[72] According to the 2002 State Department Report on Human Rights Practices, organized unions represented an estimated 10% of the work force.

but continued that the International Labor Organization considered the requirements for collective bargaining rights to be excessive. It mentioned the same situation — a guarantee of legal rights, with problems in practice — for trade union membership and court action on labor disputes. On child labor, the State Department report said "the Labor Code prohibits employment of children less than 14 years of age and places restrictions on the employment of children under the age of 16; however, child labor was a serious problem." According to data in the report, almost one-fifth of children ages 5 to 17 work, and over half (56%) of these children were less than 14 years of age. Compulsory labor by children is illegal, but the State Department reports that "such practices persisted in the informal sector ... ."

Representatives of the AFL-CIO and the Dominican labor group Consejo Nacional de Unidad Sindical (CNUS) have testified that there are serious violations of worker rights in the Dominican Republic.[73] They point out that the most serious violations are in the export processing zones and that there are problems also in the sugar industry. The AFL-CIO representative claimed that reviews under unilateral U.S. programs, such as the Generalized System of Preferences, helped to monitor labor practices and that this oversight would be lost under an FTA. She called for further reform of Dominican laws, effective enforcement provisions that allow for trade sanctions, and protection against trade law violations.

Intellectual Property. Annually from 1998 through 2002, the Dominican Republic was put on the USTR's Special 301 "Priority Watch List," which is a mid-level list of countries that, according to the USTR, deny adequate protection of intellectual property rights. In 2003, the Dominican Republic was moved to the lower-level "Watch List." The USTR identifies continuing problems in a report on foreign trade barriers: "Dominican law does not provide adequate and effective protection ... particularly with respect to the trademark and patent regimes."[74]

The International Intellectual Property Alliance (IIPA), a coalition of trade associations representing the copyright industries, estimates that those industries lost about $13.5 million due to copyright piracy in the Dominican Republic, with losses by industry group: motion pictures, $2.0 million; records and music, $6.9 million; business software, $3.6 million; and book publishing, $1 million.[75] The IIPA said that "broadcast piracy in the Dominican Republic remains the worst in the entire hemisphere," and urged that unless the Dominican government reduces piracy levels, trade benefits such as the FTA "should be withheld."[76] In testimony before the Trade Policy Staff Committee on October 8, 2003, the Motion Picture Association (MPA) also stated that the United States should not negotiate an FTA until the Dominican Republic improves enforcement of copyright laws. Brendan Hudson, vice president

[73] Testimonies of Thea M. Lee, AFL-CIO, and of Maribel Batista Matos, CNUS) on a U.S.-Dominican Republic FTA before the Trade Policy Staff Committee. October 8, 2003.

[74] U.S. Trade Representative. 2003 National Trade Estimate Report on Foreign Trade Barriers. Available at [http://www.ustr.gov/reports/nte/2003/dominican_republic.pdf].

[75] Testimony of Maria Strong, Vice President and General Counsel, Before the Trade Policy Staff Committee. Submitted October 1, 2003.

[76] Ibid.

and Latin America regional director for anti-piracy for MPA, said that "'at least two' entities engaging in copyright piracy in the Dominican Republic have ties to both the current and previous governing administrations, and this enables them to receive 'subjective and political exceptions' to the enforcement of copyright laws."[77]

Approval Status. President Fernández came out in support of the DR-CAFTA agreement soon after taking office on August 16, 2004. His Industry and Trade Minister later reiterated that support and has encouraged groups opposed to the agreement to present their objections before the Dominican Congress. DR-CAFTA must be presented to the Dominican Congress, approved by both chambers, and then published in the Official Gazette in order to be ratified. The timing of its submission and the likelihood of its passage seem uncertain at this time.

El Salvador[78]

Political Situation

El Salvador achieved notable stability and economic growth in the 1990s, but its growth has stagnated for the past five years, making it increasingly dependent on remittances from citizens living abroad.[79] A 1992-negotiated peace accord brought the country's protracted 12-year civil war, which had resulted in 75,000 deaths, to an end. The agreement formally assimilated the former guerrilla forces, the FMLN, into the electoral process. The current president, Antonio (Tony) Saca, was elected in March 2004, along with Ana Vilma de Escobar, El Salvador's first female Vice President, and was inaugurated as President on June 1, 2004 for a five-year term. He is the fourth consecutive, democratically-elected president from the conservative ARENA party that has governed the country since 1989.

In March 2004, Saca (ARENA), a well- known businessmen and sports announcer, won the Salvadoran presidential election handily with 57.7% of the vote. He soundly defeated his nearest rival, Shafick Handal, an aging former guerrilla and Communist party member, of the FMLN who obtained 35.7% of the vote. The failure of either of the two third party candidates to receive even 5% of the vote reflected the continuing polarization of the country between the FMLN and ARENA. Throughout the campaign, Handal vocally opposed ARENA's free market economic policies, including various privatization schemes, the dollarization of the economy, participation in DR-CAFTA, and the sending of Salvadoran troops to Iraq.

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[77] "Hollywood Opposes Trade Deal, GSP Status For Dominican Republic, Citing IPR Violations." Bureau of National Affairs, Inc. *Daily Report for Executives*. October 9, 2003.

[78] Prepared by Clare Ribando, Analyst in Latin American Affairs, Foreign Affairs, Defense, and Trade Division.

[79] El Salvador, is among a handful of Latin American countries currently relying on remittances for more than 10 % of its GDP. "All in the Family: Latin America's Most Important International Financial Flow," *Inter-American Dialogue*, January 2004.

President Saca's first round victory was a serious setback and cause for assessment for the FMLN that had gone into the campaign with high expectations based on the party's strong performance in the March 2003 legislative and municipal elections. In those elections, the FMLN won more seats in the Legislative Assembly than ARENA, the mayoralty of San Salvador for the third consecutive time, and 7 of the 14 departmental capitals. The FMLN is preparing for internal elections scheduled to be held on November 7, 2004, that some reformists within the party hope will move it in a more moderate, mainstream direction.

President Saca maintains the free market economic policies of his predecessors, but is also looking for ways to increase tourism and to build up his country as a logistical hub in order to boost employment and economic growth. At his inauguration, boycotted by the FMLN, he called for dialogue to achieve consensus and invited the FMLN to the presidential palace for a meeting. Less than three weeks after his inauguration, President Saca crafted an agreement that led to the passage of the long-stalled 2004 budget, largely by agreeing to spend more funds on health and education sectors and to channel a larger share of the funds to the municipalities. The budget approval was followed quickly by an increase in the country's minimum pension, and, in late July, by the unanimous approval of the "Super Firm Hand" package of anti-gang reforms. Designed along the lines of former President Flores' "Firm Hand" plan passed in July 2003, the package includes reforms stiffening the penalty for gang membership to up to five years in prison and gang leadership to nine years. The anti-gang legislation was approved despite vocal criticisms by the United Nations and other religious and humanitarian groups that its tough provisions, especially those allowing convictions of minors under 12 years of age, violate international human rights standards.[80]

While nearly 60% of Salvadorans approve of President Saca's overall job performance, 73% disapprove of his August decision to send more Salvadoran troops to Iraq.[81] The FMLN, which controls 31 of 84 seats in the National Legislature, has withdrawn its support from the multi-party commission developed by President Saca to discuss important national social, economic and political issues. Some analysts predict the FMLN will launch a legislative fight against the 2005 budget and DR-CAFTA.[82]

Economic and Social Conditions

In the 1990s, El Salvador adopted a "neo-liberal" economic model, cutting government spending, privatizing state-owned enterprises, and adopting the dollar as its national currency, which has resulted in steady, albeit stagnating, economic growth. The economy averaged an annual growth rate of 4.5% between 1990 and

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[80] Stephen Temple, "Legislative Success for El Salvador's New President as Anti-Criminal Gang Reforms Passed," *WMRC Daily Analysis,* July 30, 2004.

[81] "El Salvador: Saca Launches New Anti-Crime Initiative," *Latin American Regional Report,* September 21, 2004.

[82] "El Salvador: FMLN Goes its Own Way," *Latin American Regional Report*, October 19, 2004.

2001, but registered only 2% growth in the past few years. However, bankers and investors reportedly continue to consider the country to be one of the three best places (along with Chile and Mexico) to invest in Latin America, and it has attracted $500 million in new foreign capital over the last two years.[83] While remittances and reconstruction projects remained steady in 2003, high oil prices and a slump in the maquiladora sector (large assembly plants operating in free-trade zones) may keep growth rates below 3% in 2004. Remittances now contribute 15% of El Salvador's annual GDP, and the country's economic success has become increasingly dependent on the success of the global economy.

El Salvador's recent economic stagnation may be linked to disruptions that resulted from Hurricane Mitch in 1998, two major earthquakes in 2001, a decline in coffee prices, and the slowdown in the U.S. economy following September 11, 2001. The earthquakes in particular caused the country significant damage, leaving more than 100,000 people homeless and tens of thousands without jobs. Total damage estimates were placed as high as $3 billion.[84] This series of natural disasters occurred as El Salvador's coffee industry was recording record losses due to international coffee prices having fallen nearly 70% since 1997. Some 100,000 coffee growers and peasants work in the Salvadoran coffee sector. Since the United States is El Salvador's largest trading partner, the recent U.S. recession and sluggish recovery have lowered the demand for Salvadoran exports.

Although El Salvador has fared better than other countries in the hemisphere, when population increases are taken into account, the country's modest growth, averaging 2% or less for the past four years, is not enough to produce dramatic improvements in standards of living. With 48% of the population living in poverty and more than 25% reportedly feeling they must migrate abroad in search of work, some critics argue that the average Salvadoran household has not benefitted from neoliberalism.[85] Dollarization has raised the cost of living while its primary benefits, lower interest rates and easier access to capital markets, have not resulted in an overall decline in poverty levels. During the 16 years that ARENA has governed, poverty levels have actually risen from 47% to 51%.[86] With prices rising, privatization has been vigorously opposed. A nine-month doctors' strike, the longest in the country's history, ended in June 2003, when the privatization of the country's social security system was halted. Finally, the fruits of stable economic growth have not been equitably distributed as the income of the richest 10% of the population is 33.6 times higher than that of the poorest 10%.[87]

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[83] Joseph Contreras, "A Country's Rebirth," *Newsweek International*, July 21, 2003; U.S. Embassy San Salvador, "El Salvador's Economic Update: Second Quarter 20002," Sept. 16, 2003.

[84] USAID, "El Salvador Earthquakes: Final Fact Sheet (FY2001)," Sept. 7, 2002.

[85] Ibid, Contreras.

[86] "Election 2004: El Salvador's Ruling Party Maintains Narrow Lead Over Former Rebel Leftists," *WMRC Daily Analysis*, Feb. 18, 2004.

[87] United Nations, *Human Development Report 2003.*

Gangs and Violence. Pervasive poverty and inequality, combined with 15% unemployment and significant underemployment, have contributed to the related problems of crime and violence that have plagued El Salvador since its civil war. An estimated 10,500 Salvadoran youth belong to *maras* (street gangs), which have been held responsible for killing sprees that have occurred in San Salvador and its surrounding areas. Between January and June 2004, the Salvadoran National Police estimated that 1,257 homicides were committed in the country, 70% of which were gang-related.[88] These gangs are increasingly involved in human trafficking, drug trafficking, and kidnaping, and pose a serious threat to the country's stability. The anti-gang legislation enacted by former President Flores in July 2003 has produced mixed results; while the arrest rate is high, conviction rates have averaged less than 10 percent.[89] It remains to be seen whether President Saca's new legislation will be enough to contain this incipient social crisis.

Relations with the United States

Throughout the last two decades, the United States has maintained a strong interest in the political and economic situation in El Salvador. During the 1980s, El Salvador was the largest recipient of U.S. aid in Latin America, as its government struggled against the armed FMLN insurgency. After the 1992 peace accords were signed, U.S. involvement in El Salvador shifted towards helping the government transform the country's struggling economy into a model of free-market economic development. Since that time, successive ARENA governments have sought to preserve the political and economic stability of El Salvador by maintaining a close relationship with the United States. The primary U.S. policy goals in El Salvador include bolstering democracy, building the economy, fighting drugs and crime, minimizing illegal immigration, and promoting U.S. exports. On December 17, 2003, El Salvador, signed the CAFTA, which later was changed to now include the Dominican Republic and is referred to as "DR-CAFTA," that, if approved, could strengthen the economic linkages between all parties to the agreement. El Salvador is the only Latin American country that has maintained a troop presence in Iraq, since 2003 despite protests from the FMLN and terrorists threats against the ARENA government from an extremist group claiming to be linked to Al Qaeda.[90]

U.S. Foreign Aid. In the 1990s, total U.S. foreign assistance to El Salvador declined from wartime levels ($570.2 million in 1985), and shifted from military aid towards development assistance and disaster relief. Military aid to El Salvador reached a peak of $196.6 million in 1984, but fell to $0.4 million a decade later. The United States provided $37.7 million in assistance to El Salvador following Hurricane Mitch in 1998 and an additional $168 million in reconstruction assistance since the two earthquakes in 2001. For FY2004, Congress appropriated an estimated $42 million for El Salvador, and the Administration has requested $33.2 million in

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[88] "Saca: Dos Meses de Gobierno Caracterizado por la Concertación en El Salvador, *Agence France Presse*, August 2, 2004.

[89] Ibid, McDermott.

[90] "El Salvador: Troops Head to Iraq Amid Threats from Extremists," *Latin American Regional Report*, August 17, 2004.

assistance for FY2005. These amounts support a wide variety of Development Assistance and Child Survival and Health Programs, as well as 169 Peace Corps volunteers.

Counter-Narcotics Issues. Not a major producer of illicit drugs, El Salvador serves as a transit country for narcotics, mainly cocaine and heroin, cultivated in the Andes and destined for the United States. El Salvador, along with Ecuador, Aruba, and the Netherlands Antilles, serves as a Forward Operating Location for U.S. anti-drug forces. Since August 2000, U.S. forces based at Comalapa airport in San Salvador have successfully intercepted more than 50 metric tons of cocaine.

Support for U.S. Military Operations in Iraq. El Salvador immediately supported the United States following the September 2001 terrorist attacks, and sent a first contingent of 360 soldiers to Iraq in August 2003 and a replacement contingent of 380 soldiers in February 2004. Salvadoran forces suffered one fatality and 12 soldiers were injured in an attack on April 4, 2004, prompting the FMLN to call for the withdrawal of the forces, in part because they have not been involved exclusively in reconstruction tasks as provided in the authorizing legislation. While other Spanish-speaking countries, Spain, Nicaragua, Honduras, and the Dominican Republic, have withdrawn their troops, the first part of a third contingent of 380 Salvadoran troops departed for Iraq on August 19, 2004.

Migration Issues. The United States responded to the recent natural disasters in El Salvador by granting Temporary Protected Status (TPS) to an estimated 290,000 undocumented Salvadoran migrants living in the United States. That TPS status is scheduled to expire in March 2005. On a recent visit to Washington, President Saca lobbied both President Bush and Congress to grant Salvadorans a third TPS extension. Saca was criticized by some for failing to achieve an extension of TPS in exchange for strong Salvadoran support for the war in Iraq.[91] TPS is an important bilateral issue for El Salvador, whose migrants living in the United States sent home almost $2.11 billion in remittances in 2003. The exodus of large numbers of poor migrants to the United States has also eased pressure on the Salvadoran social service system and labor market.

U.S. Trade and Investment. For the past decade, the United States has played a pivotal role in helping El Salvador develop a market-friendly economy based on the principles of privatization, foreign investment, and free trade. Few sectors remain under government control, the U.S. dollar is the country's legal tender, and tariffs on foreign goods average just 7.4%. Despite these policies, negative external factors prompted traditional exports from El Salvador to fall 26.4% in 2002, as compared to maquila growth of 6.5%.

The United States is El Salvador's main trading partner, purchasing 60% of its exports and supplying 50% of its imports. More than 300 U.S. companies currently operate in El Salvador, many of which are based in the country's 17 free trade zones.

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[91] "El Salvador: Saca Returns from the U.S. Empty-Handed," *Latin American Caribbean and Central American Report*, July 20, 2004.

The composition of U.S. imports from El Salvador have changed dramatically since the gradual expansion of the Caribbean Basin Initiative (CBI) trade preference system. In 2000, El Salvador, along with the other countries of Central America, got duty free access to the U.S. market on approximately three-quarters of its products as a result of the Caribbean Basin Trade Partnership Act or CBTPA (P.L. 106-200, Title II), which expires in September 2008.[92] In 1990, traditional products, such as coffee and spices, accounted for the bulk of the $237.5 million worth of Salvadoran exports to the United States. By 2002, however, exports jumped to $1.98 billion, with apparel products accounting for 79% of that total. Major U.S. companies in El Salvador include AES Corporation (electricity), AIG Insurance, Avery Dennison (clothing labels), Citi Corp, Digitecel, Duke Energy, El Paso Corporation, Esso Standard Oil, International Paper, Price Smart, Sara Lee Knit Products, Shell El Salvador, and Texaco Caribbean.[93]

DR-CAFTA would make permanent and reciprocal the duty- and quota-free treatment status provided by CBTPA for apparel made in Central America from U.S. fabrics formed from U.S. yarns. The agreement would relax the CBTPA's "yarn forward" provision, which limits duty free access to Central American apparel made with U.S. materials, by extending that status to garments made from materials originating in either the United States or Central America. Finally, for some products (boxers, nightgowns), duty-free access would be given for apparel that is assembled in the region from imported fabric.

By vigorously supporting DR-CAFTA, El Salvador hopes to promote greater U.S. investment into developing its local capacity to produce paper/paperboard, plastic materials/resin, and processed foods. Because of its interest in securing U.S. investment, some observers maintain that El Salvador folded to pressure from the United States when it withdrew from the G-20 group of developing countries at the World Trade Organization's meeting in Cancun in September 2003. These reports were denied, however, by El Salvador's Economy Minister, Miguel Lacayo, who stated, "El Salvador responds to its own interests, and the consensus of G-21 did not respond to its interests."[94] The G-20 group, which includes powerful countries such as Brazil, India, and China, challenged the United States and European countries to remove agricultural subsidies as part of the trade negotiations.

DR-CAFTA-Related Issues

President Flores tried to develop favorable markets for El Salvador's non-traditional exports. Accordingly, El Salvador has signed bilateral free trade agreements (FTAs) with Mexico, Chile, Panama, and the Dominican Republic, and is in the process of negotiating a larger FTA with Canada and four other countries in

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[92] "Latin American Economy: What's at Stake With CAFTA," *Economist Intelligence Unit*, May 14, 2003.

[93] United States Department of Commerce, *Country Commercial Guide: El Salvador*, 2003/4.

[94] "Region Feels Pressure of Free-Trade Disagreements with U.S.," *Central American & Caribbean Affairs*, October 2, 2003.

the region. As noted above, El Salvador is one of the leading proponents of DR-CAFTA. However, critics within the country warn that without adequate safeguards, DR-CAFTA may make El Salvador's small farmers more vulnerable to downturns in the global economy. Additionally, they note that those farmers may be unable to compete against highly subsidized producers in the United States. A number of other sensitive issues arose in the negotiations, which are summarized below.

Apparel. The bulk of exports from El Salvador to the United States are apparel or related goods. In 2002, virtually all of El Salvador's $1.75 billion in maquila clothing exports went to the United States. The government of El Salvador reportedly fears that although it would still benefit from the CBTPA and its proximity to the United States, fierce Asian competition could overtake its nascent textile industry when worldwide textile quotas are lifted in 2005. To date, CBTPA has had a minimal effect on the Salvadoran apparel sector.[95] Early predictions that surrounded the legislation — 150,000 new jobs to be created, 25% growth in the maquila industry, and the establishment of a larger local textile industry — never materialized. Salvadoran officials hope that DR-CAFTA, combined with favorable external circumstances, can help achieve some of the lofty targets previously predicted for CBTPA and protect the apparel sector from Chinese competition. El Salvador also seeks to develop its textile industry beyond simple cutting and sewing operations into firms capable of producing finished goods.

Environment. In May 1997, the government of El Salvador passed an Environmental Law to complement its existing domestic environmental provisions protecting the country's remaining flora and fauna. El Salvador is also a signatory of more than 51 international environmental agreements, including the Convention on Biological Diversity, the Convention on the International Trade in Endangered Species of Wild Flora and Fauna, and the Kyoto Protocol. Despite these conservation measures, some observers argue that El Salvador has the worst environmental situation in Central America.[96] According to this report, El Salvador is the second most deforested country in Latin America, 90% of its river water is contaminated, soil erosion is pervasive, and air pollution is increasing. A lack of forest cover has increased El Salvador's vulnerability to natural disasters, evidenced by the disastrous effects of Hurricane Mitch and the earthquakes of 2001. El Salvador's environmental problems are exacerbated by the fact that it is the most densely populated country in the region. As in the Chilean free trade agreement, DR-CAFTA requires countries to enforce their own environmental laws. Observers note that this type of environmental provision may be inadequate, however, as many countries in the region do not effectively enforce their environmental laws. Additionally, the Central American governments have not requested a significant amount of technical assistance and capacity building grants to improve their enforcement abilities.

Labor. El Salvador has ratified the International Labor Association's (ILO) conventions against discrimination, forced labor and child labor. It has not, however,

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[95] U.S. Embassy- San Salvador, *Caribbean Basin Investment Survey*, El Salvador, July 2, 2003.

[96] David Begg, "El Salvador: An Environmental Disaster," *Concern USA*, January 18, 2001.

signed the ILO conventions protecting trade union rights. As a result, Human Rights Watch recently reported that only 5% of the labor force in El Salvador is unionized, and even those that are unionized are minimally protected by a weak Ministry of Labor (MOL) and a corrupt judicial system.[97] In June 2001, the ILO Committee on Freedom of Association noted that the country's existing labor code restricts freedom of association. The labor code requires burdensome union registration procedures, prohibits union formation and strikes among public sector employees, and does not require the reinstatement of workers unfairly dismissed.[98] Corruption is prevalent among labor inspectors and in the labor courts, as the MOL dismissed five inspectors in 2001 for accepting bribes from companies. Further evidence of deficiencies within the MOL can be seen in its failure to use the power it was given by a 1996 law to inspect companies operating in the free trade zones (FTZs) and then sanction ones which exhibit substandard working conditions. These conditions often include low pay, health and safety risks, 12-14 hour work days, minimum toilet and rest breaks, mandatory pregnancy tests, and the firing of workers who are pregnant.[99] Opponents of DR-CAFTA point out that the agreement may serve to perpetuate these abuses as its weak provisions merely require signatories to enforce their existing labor laws, rather than reforming those laws to meet international standards. They further assert that the penalties for countries not enforcing their labor laws are relatively weak. In July 2004, El Salvador's Ministers of Trade and Labor attended a meeting held in Washington, DC with their counterparts from across Central America and the Dominican Republic to form a working group to develop ways of enhancing labor law compliance and enforcement in their respective countries.

Despite these obstacles, there have been some positive successes for the Salvadoran workforce in recent years, some of which may have been hastened by the CAFTA negotiations. Following the publication of an internal report on the deplorable conditions in the maquila sector written in August 2000 by the MOL, the Salvadoran government acknowledged the problems in the maquila sector and stepped up its monitoring efforts. A second positive step for the Salvadoran labor force occurred when El Salvador was selected as one of the first countries to get Department of Labor funding (through the ILO) for a program to stop the worst forms of child labor. Finally, although they are held infrequently, some recent strikes have proven relatively successful in achieving the goals which they set out to accomplish. For example, workers of the Salvadoran Social Security Institute (ISSS) shut down hospitals and clinics from September 2002 until the government agreed to stop its efforts to privatize the health care industry in June 2003.

Intellectual Property Rights. El Salvador is party to the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) and a bilateral intellectual property agreement with the United States. The government of El Salvador passed

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[97] "Deliberate Indifference: El Salvador's Failure to Protect Worker's Rights," *Human Rights Watch*, Vol. 15, No. 5(B), December 2003.

[98] International Labor Organization, *Complaint Against the Government of El Salvador Presented by Communications International (CI)*, Report No. 313, Case No. 1987, Vol. LXXXII, 1999, Series B, No. 1, para 117 (a).

[99] International Confederation of Trade Unions (ICTFU), *Annual Survey of Violations of Trade Union Rights,* 1999-2002.

an Intellectual Property and Promotion and Protection (IPR) Law in 1993 and was subsequently removed from the U.S. Trade Representative's (USTR) Special 301 Priority Watch List in 1996. The Law of Trademarks and Other Distinctive Signs (2002) was established in order to bring El Salvador into better compliance with TRIPS. The Attorney General's office is charged with enforcement of these laws, conducting periodic raids against manufacturers and distributors of pirated goods. As of 2002, the focus of these raids has shifted from software to pirated CDs. Despite better laws protecting intellectual property and increased raids, U.S. companies in El Salvador incurred trade losses of $4.0 billion in 2003 due to software privacy and $1.5 million because of music piracy.[100] These substantial losses continue to occur due to a lack of expeditious court proceedings and tough punishments for pirates in either the criminal or civil courts in El Salvador. These violations provide a significant barrier impeding increased U.S. trade and investment in El Salvador.

Approval Status. President Saca continues to strongly support the DR-CAFTA agreement, but in order for it to be ratified, the agreement must pass through a series of steps that could take several months. DR-CAFTA has been signed by President Saca and is currently being reviewed by the Ministry of Foreign Relations. Following this review, the agreement, which is considered a treaty in El Salvador, will be submitted to the unicameral Legislative Assembly for a review by the relevant committees before a plenary vote. A simple majority is required for approval. If all the FMLN deputies, which comprise 31 of 84 seats in the Assembly, vote against the agreement, President Saca may have a difficult time ensuring passage of the agreement.

Guatemala[101]

Political Background

Since the 1980s, Guatemala has been consolidating its transition from a centuries-long tradition of mostly autocratic rule toward representative government. A democratic constitution was adopted in 1985, and a democratically-elected civilian government inaugurated in 1986. Eighteen years later, democratic institutions remain fragile. Of all the conflicts that ravaged Central America in the last decades of the 20th century, Guatemala's conflict lasted the longest. Guatemala ended its 36-year civil war in 1996, with the signing of the Peace Accords between the government and Guatemalan National Revolutionary Unity (Unidad Revolucionaria Nacional Guatemalteca, URNG), a group created in 1982 from the merger of four left-wing guerrilla groups. Some of these groups were inspired by the ideologies of the Cuban and Nicaraguan revolutions and by liberation theology. Some had bases in the

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[100] United States International Trade Commission, "U.S. Central America - Dominican Republic Free Trade Agreement: Potential Economywide and Selected Sectoral Effects," August 2004.

[101] Prepared by Maureen Taft-Morales, Specialist in Latin American Affairs.

highlands with mostly indigenous populations and incorporated the historical grievances of the Mayans into their agendas for social and economic reform.

The Peace Accords not only ended the civil conflict but constituted a blueprint for profound political, economic, and social change to address the conflict's root causes. Embracing 10 other agreements signed from 1994 to 1996, the accords called for a one-third reduction in the size and budget of the military; major investments in health, education, and other basic services to reach the rural and indigenous poor; and the full participation of the indigenous population in local and national decision making. They required fundamental changes in tax collection and government expenditures, and improved financial management. The accords also outlined a profound restructuring of state institutions, especially of the military, police, and judicial system, with the goal of ending government security forces' impunity from prosecution and consolidating the rule of law. While noting that insufficient enactment of peace accord reforms are mainly the responsibility of the government, the United Nations Verification Mission in Guatemala (MINUGUA) states that civil society also shares the blame, such as for failing to support tax increases to fund social programs.

Former Guatemala City mayor Oscar Berger, of the center-right coalition Great National Alliance, won free and fair elections with 54% of the vote in November 2003. The new president was inaugurated on January 14, 2004, for a four-year term. Since taking office, Berger has launched major initiatives to fight corruption, reduce and modernize the military, enact fiscal reforms, and implement the Peace Accords. He has pursued corruption charges against his predecessor, Alfonso Portillo of the Guatemalan Republican Front (FRG), whose administration was widely criticized for inadequate implementation of the peace process, increased human rights violations, increases in drug trafficking and common crime, extensive corruption, and the slow pace of economic growth. Berger's economic reforms include new income tax rates and a temporary tax to fund programs related to the peace process.

Despite his decisive loss in the first round presidential elections, retired General Efrain Rios Montt of the FRG remains a destabilizing force. Rios Montt was military dictator from 1982-1983, while the army carried out a counter-insurgency campaign resulting in what is now characterized as genocide of the Mayan population. Berger's top defense official, General Otto Perez, resigned in May 2004 to protest negotiations between Berger officials and the FRG, of which Rios Montt is still leader. Perez charged that Berger offered to protect Rios Montt from prosecution in exchange for his party's support of fiscal reform legislation (Associated Press, 5/24/04). Berger has been noncommittal about whether his administration will prosecute the former dictator.

Socio-Economic Background[102]

Guatemala has the largest population in Central America with 12 million people. Approximately half the population is indigenous, with about 23 different ethno-linguistic groups. The indigenous population is economically and socially marginalized and subject to significant ethnic discrimination. Distribution of income and wealth remains highly skewed in Guatemala. According to the World Bank's Poverty Assessment of Guatemala, Guatemala ranks among the more unequal countries of the world, with the top 20% of the population accounting for 54% of total consumption. Indigenous people, constituting about 50% of the population, account for less than 25% of total income and consumption.

According to the World Bank's report, past free market policies have resulted in the exclusion and impoverishment of the indigenous population. Massive land expropriations, forced labor, and exclusion of the indigenous from the educational system all served to develop coffee as Guatemala's primary export crop yet inhibit development among the indigenous rural population. By 1960, Guatemala had double the per capita GDP of neighboring Honduras and Nicaragua, but lower social indicators, a situation that continues into the present.

Guatemala's per capita GDP is $3,630, in the mid-range internationally. Its total GDP, $20.5 billion, is the largest in Central America. Yet the World Bank says data suggest that poverty is higher in Guatemala than in other Central American countries. Estimates of the portion of Guatemala's population living in poverty vary: the U.S. State Department reports that 80% of Guatemalans live in poverty, with two-thirds of that number living in extreme poverty. The World Bank reports that 54% of the population lives in poverty.[103] Poverty is highest in rural areas and among the indigenous: 75% of all people living in the countryside live in poverty, and 25% in this category live in extreme poverty. Poverty is significantly higher among indigenous people, 76% of whom are poor, in contrast to 41% of non-indigenous people.

Guatemala's GDP for 2003 was $24 billion. GDP growth rate was 3.3% in 2000, but low worldwide coffee prices contributed to Guatemala's slowed growth over the last couple of years. GDP growth rate was 2.4% in 2003. Despite the downturn in commodity prices, traditional exports such as coffee and sugar continue to lead Guatemala's economic growth. Over the last decade, non-traditional exports, such as assembled clothing, winter fruits and vegetables, furniture, and cut flowers, have grown dramatically. Tourism also has grown, though continued growth may depend on the government's ability to address security issues. Problems limiting growth include illiteracy and low levels of education, high crime rates, and an inadequate capital market.

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[102] Socio-economic data in this section are primarily from *Guatemala Poverty Assessment*, The World Bank, February 2003; and *Background Note: Guatemala*, U.S. Department of State, Sept. 2003.

[103] The difference in the figures is probably due to methodology.

Guatemala's social indicators continue to be among the worst in the hemisphere. Its malnutrition rates are among the worst in the world. Its infant mortality rate is 43 per 1,000 live births, and its under-5 mortality rate is 58 per 1,000 children.[104] Guatemala's illiteracy rate is extremely high: at 31%, only Nicaragua and Haiti have worse levels in the hemisphere. The average level of schooling is an extremely low 4.3 years; among the poor it is less than two years. Schooling is lowest among women, indigenous people, and the rural poor. As a result of malnutrition, 44% of children under five years of age have stunted growth. Drought and low coffee prices triggered a rural economic crisis beginning in 2001, which has caused severe malnutrition among the rural poor.

Implementation of the elements of the Peace Accords relating to improving the living conditions and the rights of indigenous people and women are far behind schedule. Access to education, according to the Inter-American Commission on Human Rights, is "still far from becoming a reality." MINUGUA reported in 2003 that the amounts allocated to key social ministries "remained extremely low in relation to the needs of the country." The indigenous population and women continue to face limited opportunities and discrimination in the labor market. According to the World Bank's Poverty Assessment, "The indigenous appear limited to lower-paying jobs, primarily in agriculture," which, the report says, is "unlikely to serve as a major vehicle for poverty reduction." Other obstacles hindering social and economic advancement among the indigenous poor, which the report says the government still must address, are: higher malnutrition rates, less coverage by basic utility services, wage discrimination, and discriminatory treatment by public officials and other service providers.

International donors and others have criticized Guatemala for not increasing the tax base to the minimum target of 12% of GDP agreed upon in the Peace Accords. Guatemala's 2003 tax base, at about 10% of GDP, was one of the lowest in Latin America.[105] At a May 2003 meeting of the Consultative Group for Guatemala, donors told the Guatemalan government it needed to increase its tax revenue, decrease spending on the armed forces, and increase social spending as mandated in the accords. The Consultative Group is made up of over 20 donor countries and international organizations, including the U.S., Canadian, and Japanese governments, the World Bank, and the IDB. In its report prepared for that meeting, MINUGUA said the organized private sector shares the responsibility for inadequate social budgets because it systematically opposes efforts to increase taxes, thereby limiting funding available for key social ministries and institutions of justice.

The Berger Administration has taken steps toward implementing the goals set forth by the Peace Accords and the Consultative Group. It has developed a more inclusive development strategy. It dramatically cut the military budget, and is shifting those funds to education and health programs. In June 2004, the Congress passed a tax package which included a Temporary Tax to Support the Peace

[104] *Guatemala Country Profile*, The World Bank Group, August 2003.

[105] *"Central America Pins Hopes on Free Trade," Euromoney*, London, June 2004.

Agreements. Despite the government's commitment to increase tax revenues to 12 %of GDP by year's end, tax revenues will probably remain at 10.3% for 2004.[106]

Relations with the United States

U.S. policy objectives in Guatemala, as set forth by the State Department, include strengthening democratic institutions and implementation of the Peace Accords; encouraging respect for human rights and the rule of law; supporting broad-based economic growth, sustainable development, and mutually beneficial trade relations; combating drug trafficking; and supporting Central American integration through resolution of territorial disputes.[107] Relations between Guatemala and the United States have traditionally been close, but strained at times by human rights and civil-military issues. The Bush Administration repeatedly expressed concerns over the failure of the Portillo Administration to implement the Peace Accords, a perceived high level of government corruption, and lack of cooperation in counter-narcotics efforts.[108] The Bush Administration says that the change of government in Guatemala "affords an important opportunity to reverse negative trends in the country. Donor support will remain essential, however, to keep Guatemala on the positive democratic path and avoid any fall towards a failing state so near to U.S. borders."[109]

U.S. Assistance. From 1997 through 2003, U.S. assistance to Guatemala centered on support of the Peace Accords, providing almost $400 million to support their implementation. There is no longer a project in direct support of the Implementation of the Peace Accords as of FY2004. Some activities, such as the development of justice centers, and efforts to support increased transparency of Guatemalan government institutions, and to reduce corruption, will continue in other programs. U.S. assistance to Guatemala has declined by over a third in the past three years, from almost $60 million in FY2002, to $38 million requested for FY2005. The request for FY2005 includes $9.7 million in Child Survival and Health Programs funds; $6.6 million in development assistance, $4 million in Economic Support funds, and $17.6 million in P.L. 480 Title II food assistance programs.

From the inauguration of a democratically-elected government in 1986 to 1990, Congress placed conditions related to democratization and improved respect for human rights on military assistance to Guatemala. It also prohibited the purchase of weapons with U.S. funds. In 1990, the George H. W. Bush Administration

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[106] U.S. Embassy in Guatemala, *Guatemala: Country Commercial Guide FY 2005*, July 2004. Sec. 2, C.

[107] *Background Note: Guatemala*, U.S. Department of State, September 2003, p.9.

[108] See, for example, testimony of U.S. officials at hearing on *Drug Corruption and Other Threats to Democratic Stability in Guatemala and the Dominican Republic*, before House Committee on International Relations' Subcommittee on the Western Hemisphere, Oct. 10, 2002; and Ambassador Michael Kozak, State Dept. Bureau for Democracy Human Rights and Labor, Congressional Human Rights Caucus Members' Briefing: *Guatemala: A Human Rights Update*, Oct. 16, 2003.

[109] US AID Budget Justification to Congress FY2005, "Guatemala."

suspended military aid because of concerns over human rights abuses allegedly committed by Guatemalan security forces, especially the murder of a U.S. citizen. Congress has continued to prohibit foreign military financing to Guatemala since then, although it has allowed some International Military Education and Training (IMET) assistance. Currently, Congress allows Guatemala only expanded IMET, which is training for human rights, and of civilian personnel in defense matters, and requires notification to the Appropriations Committees prior to allocation. In recent years Congress has also asked federal agencies to expedite the declassification and release of information related to the murder of U.S. citizens in Guatemala.

Human Rights. The first of the Peace Accords was the Comprehensive Agreement on Human Rights, which was signed and became effective in 1994. The Peace Accords established a Historical Clarification Commission, commonly referred to as The Truth Commission, to investigate human rights violations and acts of violence that occurred during the armed conflict from 1960 to 1996. In its 1999 report, "Guatemala: Memory of Silence," the Commission reported that more than 200,000 people died or disappeared because of the armed conflict, and that over 80% of the victims were indigenous Mayans. The Commission concluded that the systematic direction of criminal acts and human rights violations at the civilian Mayan population amounted to genocide. The Commission attributed responsibility for 93% of the violations to agents of the state, principally members of the army, and stated: "The majority of human rights violations occurred with the knowledge or by order of the highest authorities of the State." The Commission concluded that, although much of the state's actions were taken in the name of counterinsurgency efforts, "[t]he magnitude of the State's repressive response" was "totally disproportionate to the military force of the insurgency...," and that the vast majority of the state's victims were not guerrilla combatants, but civilians. [110]

Regarding respect for human rights, Guatemala has made enormous strides, but significant problems remain. The armed conflict has definitively ended, and the state policy of human rights abuses has been ended. Civilian control over military forces has increased . On the other hand, security forces reportedly continue to commit gross violations of human rights with impunity, and Guatemala must still overcome a deeply embedded legacy of racism and social inequality. The U.N., the OAS, and the United States have all expressed concern that human rights violations have increased over the past several years, and that previous Guatemalan governments have taken insufficient steps to curb them or to implement the Peace Accords. President Berger has made implementing the Peace Accords a top priority. He has slashed the size of the military and its budget by more than that required by the Peace Accords and is modernizing defense policy. He has also initiated programs to improve the rights of women and of the indigenous population.

The previous Guatemalan administration agreed to the establishment of a U.N. High Commissioner for Human Rights in December 2003, but it has still not been put in place. The Berger Administration is working to resolve legal obstacles to the establishment of the UN Commission for the Investigation of Illegal Groups and

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[110] Commission for Historical Clarification, *Guatemala: Memory of Silence*, Conclusions and Recommendations, at [http://hrdata.aaas.org/ceh/report/english/toc.html].

Clandestine Security Organizations (CICIACS), whose mission will be to investigate and prosecute clandestine groups, through which many military officers allegedly engage in human rights violations, drug trafficking, and organized crime. CICIACS was approved by the Portillo Administration but has yet to be approved by the Guatemalan Congress. The UN Verification Mission in Guatemala (MINUGUA) is scheduled to close in December 2004, after verifying compliance with the Peace Accords for ten years. In September 2004, UN Secretary General Kofi Annan said that Guatemala's political process had matured to the point where the country should now be able to deal peacefully with all of its unresolved issues.

A climate of security remains elusive, however, as violent crime has increased in recent years, up 15% from the first six months in 2003 to the same period in 2004. President Berger has called the lack of security the most important problem facing his administration. He initiated a "national crusade against violence" in July 2004.[111] Some have criticized the effort for removing security forces from one area to increase protection in others.

Narcotics. Guatemala is a major drug-transit country for both cocaine and heroin en route from South America to the United States and Europe. According to the State Department , up to half of all cocaine on its way to Mexico and the United States passes through Guatemala, the preferred country in Central America for the storage and consolidation of northward bound cocaine. In January 2003, President Bush designated Guatemala as one of three countries in the world that "failed demonstrably" during the previous year to fulfill its international counter narcotics obligations. He granted a national interest waiver to allow continued U.S. assistance to be provided to Guatemala, however. Eight months later, in September 2003, the President determined that Guatemala had made efforts to improve its counter narcotics practices, and did not include it in the "failed demonstrably" list. Among the steps taken were passage by the Guatemalan Congress in August 2003 of a measure allowing U.S. security forces to enter Guatemalan airspace and waters during joint counter narcotics operations or when in pursuit of suspected drug traffickers.

In July 2004, the Financial Action Task Force, an intergovernmental organization dedicated to enhancing international cooperation in combating money-laundering, removed Guatemala from its list of non-cooperative countries .[112] Guatemala had been on the list of nine countries — the only one in the Americas, during the Portillo Administration.[113] The Task Force welcomed progress made by Guatemala in enacting and implementing anti-money laundering legislation. In its March 2004 International Narcotics Control Strategy Report, the Bush Administration reported that "In spite of improvements in the Government of

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[111] *"Violence in Guatemala up 13 [stet] percent in First Half of 2004,"* EFE News Service, Aug. 1, 2004. Note: Numbers cited calculated to be 15 percent increase.

[112] *"FATF Tackles Terrorism Financing, Delists Guatemala,"* Financial Action Task Force, July 2, 2004.

[113] Financial Action Task Force on Money Laundering, *Annual Review of Non-Cooperative Countries or Territories*, June 20, 2003. Paris, France.

Guatemala's counternarcotics efforts in 2003, large shipments of cocaine continue to move through Guatemala by air, road, and sea."

Guatemala has a growing domestic drug abuse problem. According to the State Department, the Guatemalan government has an aggressive demand reduction program.

U.S. Trade and Investment. Guatemala and the United States signed a framework agreement on trade and investment in 1991, through which they established a bilateral Trade and Investment Council. The signing of the Guatemalan Peace Accords in 1996 removed a major obstacle to foreign investment there. Guatemala was certified to receive export trade benefits in 2000 under the Caribbean Basin Trade and Partnership Act (P.L.106-200, Title II), which gives preferential tariff treatment, and also benefits from access to the U.S. Generalized System of Preferences. The United States is Guatemala's top trade partner. Guatemala's primary exports are coffee, sugar, bananas, fruits and vegetables, cardamom, meat, apparel, petroleum, and electricity; 55.3% of Guatemalan exports go to the United States. Primary import commodities are fuels, machinery and transport equipment, construction materials, grain, fertilizers, and electricity; 32.8% of Guatemalan imports are from the United States.[114] The U.S. trade deficit with Guatemala was $758 million in 2002, with U.S. exports to Guatemala at $2.0 billion, and U.S. imports from Guatemala at $2.8 billion. Guatemala is the 40th largest export market for U.S. goods.

U.S. foreign direct investment in Guatemala was $907 million in 2000, and dropped by almost half, to $477 million, in 2001; it is concentrated in the manufacturing and finance sectors.[115] Major U.S. companies operating in Guatemala include ACS, American Cyanamid Co., Avon Products, BellSouth, Cargill, Citibank, Coastal Power, Colgate Palmolive, Constellation Power, Exxon, Gillette, Goodyear Tire and Rubber, Kellogg Co., Kimberly Clark Corp., Levi Strauss and Co., Marriott Hotels, 3M, Phillip, Morris, Inc., Proctor and Gamble, Railroad Development Corp., Ralston Purina, Sabritas-Frito Lay, TECO Power Services, Texaco, Warner Lambert, and Xerox.[116] President Berger has made attracting domestic and foreign investment a priority, believing it will revive the economy and create jobs.

DR-CAFTA-Related Issues

The Guatemalan government supports the DR-CAFTA agreement as a further step toward economic integration with its neighbors. It established a free trade area with El Salvador, Honduras, and Nicaragua in 1993, to which the Dominican Republic was later added. Negotiations to add Chile to the group are underway.

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114 Figures for 2001, *The World Factbook*, "Guatemala." Central Intelligence Agency, updated August 1, 2003.

115 U.S. Trade Representative, *2003 National Trade Estimate Report on Foreign Trade Barriers*, "Guatemala," p. 140.

116 U.S. & Foreign Commercial Service and U.S. Dept. of State, *Guatemala Country Commercial Guide FY2003*, September 2003, pp.66-67.

Along with El Salvador and Honduras, Guatemala implemented a free trade agreement with Mexico in 2001. Guatemala signed a customs agreement with El Salvador in March 2004 as part of a strategy to improve trade within the region.

Some observers believe that Guatemalan groups with concerns about possible negative outcomes of DR-CAFTA, such as small farmers, were limited in their opposition because of the secretive nature of the CAFTA negotiations.[117]

Despite a foreign investment law passed in 1998 to facilitate foreign investment, "time-consuming administrative procedures, arbitrary bureaucratic impediments, corruption, and a sometimes anti-business attitude of the current administration are a reality," according to a U.S. government report.[118] A recent World Bank report listed Guatemala as one of nine countries that regulate businesses the most heavily. The report concluded that those countries also had the weakest systems for enforcing the laws and were therefore susceptible to bribery and corruption as well.[119]

Agriculture. Those who support DR-CAFTA argue that the agreement will help farmers, especially those who grow non-traditional crops not grown in the United States. They also argue that it will help slow migration to the United States of Central American farm laborers seeking work.

Others are not so sure. Central American governments wanted to negotiate the elimination of U.S. farm subsidies as part of CAFTA talks. They feared that small subsistence farmers will be unable to compete against subsidized, and therefore lower-priced, U.S. commodities. They acquiesced to the U.S. position that the issue should be addressed in the World Trade Organization. The executive director of the Central American and Caribbean Agricultural Federation, a Guatemalan, says that Guatemalan farmers "are afraid [CAFTA] is going to be like NAFTA, which massacred the campesinos in Mexico." Whether or not NAFTA has hurt subsistence farmers is disputed, however. A recently-released World Bank report says that NAFTA "has probably had little impact on small farmers in the Southern [Mexican] states who have suffered a long history of social, political and economic neglect..."[120]

Other analysts are concerned that opening basic food production in Central America to competition from U.S. imports will have a negative impact on Central American food security and employment rates. The Central American governments agreed to include all of these staple food crops in the concluded agreement, however. The agreement establishes quotas on sensitive agricultural commodities imported from the U.S. that will increase over time; by the year 2020, most quotas and tariffs will be eliminated. White corn, however, will receive some protection in perpetuity. Although a quota on U.S. white corn imports will increase annually, the high tariffs on white corn imports above the quota level will remain in place indefinitely.

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[117] Tim Rogers, "Blind Man's Bluff," Latin Trade, Sept. 2003.

[118] Ibid, p.60.

[119] "Poor Nations Have Most Business Red Tape- World Bank," Reuters News, Oct. 7, 2003.

[120] "NAFTA is Positive for Mexico but Not Enough, Says New World Bank Report," World Bank News Release no. 2004/188/LAC, December 17, 2003.

Also of concern to Guatemala was how sugar would be treated in CAFTA. Currently, the U.S. allows a quota of 126,400 metric tons of sugar to enter duty free from the five Central American countries every year. About 2/5 of that amount, or 50,546 metric tons, is allocated to Guatemala. Central American sugar growers wanted CAFTA to guarantee an expansion of the quota. As concluded, the agreement establishes an additional quota of 32,000 metric tons for Guatemala, one-third of the additional access granted to the five Central American countries, for sugar exported to the United States. The quota will increase annually in perpetuity, but the tariff on any shipments over that quota will remain prohibitively high.[121]

Apparel. There are 13 free trade zones operating in Guatemala, with 7 more authorized to be created. The most frequent beneficiaries of Guatemala's free trade/maquiladora laws are textile assembly operations. In 2000 the Caribbean Basin Initiative was enhanced to give more benefits to the textile industry. Whereas previously garments could only be sewn in Guatemala in order to be shipped back into the United States tariff free, since the enhancement, textiles can be cut, sewn, and finished in Guatemala and still receive those tariff benefits. These benefits would become permanent under DR-CAFTA. Some U.S. producers have objected to DR-CAFTA for this reason, saying it will harm their businesses.

Corruption.[122] In recent years, the U.S. government, international organizations, and independent watchdog organizations criticized Guatemala for extensive corruption, which allegedly increased under the Portillo Administration. The Bush Administration called corruption "the number-one obstacle to increasing the effectiveness of all USG[ovt.] programs in Guatemala." Transparency International said Guatemala was perceived as the 33rd most corrupt country out of 133 countries in 2003. According to U.S. government reports, "corruption is a serious problem that companies may encounter at nearly any level," in Guatemala, and which has tended to be most pervasive in customs transactions. A semi-autonomous Superintendency of Tax Administration was established in 1999 to improve customs operations, but under the previous administration corruption apparently increased instead. In 2001, Guatemala ratified the Inter-American Convention against Corruption.

President Berger has made improving governance and attacking corruption priorities. His administration introduced a code of ethics for cabinet members and is actively investigating corruption under the previous FRG government. The former Vice President, Finance Minister, Coomptroller General, and Superintendent of Tax Administration are in jail awaiting trial. Former President Portillo, also under investigation for embezzlement, fled the country in February 2004, the day after his

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[121] For further information on agricultural issues, see CRS Report RL32110, *Agricultural Trade in a U.S.-Central American Free Trade Agreement (CAFTA)*, and CRS Issue Brief IB95117, *Sugar Policy Issues,* by Remy Jurenas.

[122] Sources include Hearing on *Drug Corruption and Other Threats to Democratic Stability in Guatemala* ... op. cit., testimony of Asst. Sec. Of State for Western Hemisphere Affairs Otto Reich; Transparency International Corruption Perceptions Index 2003, at [http://www.transparency.org/cpi/2003/cpi2003.en.html]; *Guatemala Country Commercial Guide* op. cit.; U.S. Trade Representative, op. cit.

immunity from prosecution was lifted. Partly in response to ongoing investigations, 11 FRG legislators have left the legislature. The Berger Administration is making government finances — including, for the first time, the military budget — transparent, enacting reforms such as making procurement processes publicly available online.

Environment.[123] Guatemala is party to 57 multilateral, regional, and bilateral agreements related to the environment. It is the only Central American country not to have ratified the Cartagena Protocol on Biosafety, and one of two not to have signed the Rotterdam Convention on Prior Informed Consent for Certain Hazardous Chemicals and Pesticides in International Trade. It is part of the Central American Commission on Environment and Development, established in1989 to enhance the development of regional environmental initiatives. According to an environmental review by the U.S. Trade Representative, "Guatemala has not passed a wide spectrum of environmental laws, and lacks specific laws dealing with the major issues of water, forests, solid wastes, biodiversity, etc. that many of the other [Central American] countries possess." A general Law for Environmental Protection and Improvement was passed in 1986, and a forestry law was passed in 1996. There is a Ministry of Environment and Natural Resources, and an Environmental Attorney within the Human Rights Commission to ensure compliance with constitutional articles related to the environment. As the U.S. Trade Representative report noted, however, the Central American nations' "ability to effectively implement and enforce environmental laws is limited by the lack of fiscal and human resources."

Water pollution and deforestation are among Guatemala's greatest environmental problems, and are exacerbated by poverty in the densely populated central highlands. Forest loss over the past 10 years has averaged almost 2% annually. Guatemala's tourism sector now contributes more to the economy than the coffee sector. While Guatemala's natural environment is an important aspect of tourism, expansion of tourism-based development can add to the degradation of the environment. Tourism-related threats to ecosystems include air and water pollution, solid waste disposal, land degradation, loss of wildlife habitats and species, and increased demand for limited supplies of fresh water (i.e. for hotels and swimming pools).

Labor.[124] Legally, Guatemalans' right to freedom of association and to form and join trade unions are protected by the Constitution and the Labor Code. Practically, however, those rights are inadequately protected by the government. According to the State Department's Human Rights report covering 2003, employees in all sectors of the economy hesitate to exercise their right of association for fear of

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[123] Sources for this section include *Interim Environmental Review: U.S.-Central America Free Trade Agreement*, Office of the U.S. Trade Representative, August 2003; John Audley, *The Art of the Possible: Environment in the Free Trade Area of the Americas*, Issue Brief, Carnegie Endowment for International Peace, November 2003; and *CAFTA's Environmental Chapter*, Quixote Center/Quest for Peace, in WOLA, op. cit.

[124] Sources include *Country Reports on Human Rights Practices 2002: Guatemala*, U.S. Dept. of State, March 2003; *Stronger Labor Provisions Needed in CAFTA*, AFL-CIO, in WOLA, op. cit.

reprisals by employers, the most common reprisal being the dismissal of workers for unionizing activities. The report said that "the weakness of labor inspectors, the failures of the judicial system, poverty, the legacy of violent repression of labor activists during the internal conflict, the climate of impunity, and the deep-seated hostility of the business establishment toward independent and self-governing labor associations constrained the exercise of worker rights." The Guatemalan legislature passed two sets of reforms to the national Labor Code in 2001. Many of the reforms were seen by the labor movement as a "significant step forward" in the protection of workers' rights. Other so-called reforms, such as the requirement that one-half plus one of the workers in an industry must join a union before it can be legally recognized, is seen by labor activists as a practically insurmountable obstacle to the formation of new industrial unions.

Critics argue that the labor provisions under DR-CAFTA are less stringent than those currently in place under U.S. preferential trade arrangements. Under the Caribbean Basin Initiative and the General Agreement on Preferences, the United States may withdraw trade benefits if Central American governments do not take steps to meet international labor standards. Under DR-CAFTA, critics, such as the AFL-CIO, argue that governments would only be required to enforce their existing, flawed laws, but not to reform laws to meet international labor standards.

Advocates of DR-CAFTA argue that accompanying technical cooperation programs will help improve the enforcement of labor laws in the region. In October 2003, the U.S. Trade Representative announced a $6.75 million grant to educate the public in CAFTA countries about labor laws and to ensure that workers' rights are respected, saying that the four-year grant is designed to complement CAFTA.[125] While acknowledging the importance of such technical assistance, the AFL-CIO maintains that it is insufficient to "change deep-seated indifference and hostility towards workers' rights."

Although Guatemala's constitution prohibits children under 14 years of age from working without written permission from the Ministry of Labor, MINUGUA reported in 2000 that just over a third of children 7 to 14 years old worked. Most children were employed in the informal economy, including household chores, subsistence agriculture, and family-run enterprises. In November 2002, then-President Portillo created a National Commission for the Elimination of Child Labor to coordinate the implementation of the National Plan to Eradicate Child Labor.

Intellectual Property. Piracy of copyrighted material, especially for business software applications, is widespread in Guatemala. Guatemala has taken steps to address the piracy issue. It is a member of the World Intellectual Property Organization, and recently ratified two of the organization's agreements. In 2000, the Guatemalan legislature passed laws to increase the protection of intellectual property rights, including providing patent protection for pharmaceutical and agricultural products for the first time. In 2001, the government appointed a special prosecutor responsible for pursuing intellectual property rights violations. In 2002,

[125] "USTR Announces Grant to Improve Central American Labor Conditions," Washington File, Oct. 2, 2003.

Guatemala passed intellectual property rights legislation. The U.S. Trade Representative called the laws "greatly improved," but noted that a month after its passage further legislation suspended the processing of pharmaceutical and chemical patents until 2005 and otherwise weakened the protection of intellectual property rights.[126] According to the U.S. State Department's Country Commercial Guide, enforcement of intellectual property rights and prosecution of their violation remains inadequate in Guatemala.

Approval Status. The Guatemalan Congress is currently holding a series of seminars to educate its members about DR-CAFTA related issues. Public sessions for civil society are also being held. The Berger Administration has indicated it plans to present the DR-CAFTA to the Guatemalan legislature in January. Some observers say that if the U.S. Congress votes on the agreement during its lame-duck session, Guatemala may move to vote on it earlier as well. The unicameral Congress has 158 members. A simple majority is needed to pass the DR-CAFTA.

Honduras[127]

Political Situation

Honduras has enjoyed 22 years of uninterrupted civilian democratic rule since the military relinquished power in 1982 after free and fair elections. In the November 2001 presidential elections, National Party candidate Ricardo Maduro defeated his Liberal Party rival Rafael Pineda Ponce 52-44%, a wider margin than some had anticipated, although neither of the two major parties gained a majority in the 128-member unicameral Congress. For most of this century, the Liberal and National parties have been the two dominant political parties. Both are considered center-right parties and there appear to be few major ideological differences between the two. In the electoral campaign, Maduro — a Stanford University-educated economist and businessman — ran on a strong anti-crime platform, which appealed to many Hondurans concerned about the dramatic increase in gang violence in the country over the past several years. Maduro's own son was kidnaped and murdered in 1997.

When he was inaugurated to a four-year term in January 2002, Maduro became the 6th elected president since the country's return to civilian rule. President Maduro has faced enormous challenges in the areas of crime, human rights, and improving overall economic and living conditions in one of the hemisphere's poorest countries. Although the next national elections are not scheduled until November 2005, there already are signs that the campaign has begun. Under the Honduran Constitution, anyone who has served as president may not be re-elected.

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[126] U.S. Trade Representative, *2003 National Trade Estimate Report on Foreign Trade Barriers*, "Guatemala," pp. 140-141.

[127] Prepared by Mark P. Sullivan, Specialist in Latin American Affairs. For additional information see, CRS Report RS21103, *Honduras: Political and Economic Situation and U.S. Relations.*

Crime and Human Rights. Upon taking office, crime and related human rights issues were some of the most important challenges for President Maduro. Kidnaping and murder had become common in major cities, particularly in the northern part of the country. Youth gangs known as *maras* terrorized many urban residents, while corresponding vigilantism increased to combat the crime, with extrajudicial killings increasing. Honduras, along with neighboring El Salvador and Guatemala have become fertile ground for gangs, which have been fueled by poverty, unemployment, leftover weapons from the 1980s, and the U.S. deportation of criminals to the region.[128] President Maduro, who campaigned on a zero-tolerance platform, increased the number of police officers and cracked down on delinquency. The Maduro government signed legislation in July 2003 making *maras* illegal and making membership in the gangs punishable with 12 years in prison. A wave of killings in August 2003 were thought to be a response by gangs to the government's crackdown. While the crackdown has reduced crime significantly (for example, an 80% decline in kidnaping and a 60% decline in youth gang violence[129]) and is popular with the public, some human rights groups have expressed concerns about abuses and the effect of the crackdown on civil liberties, and there have been concerns that poor conditions in already overcrowded prisons will be exacerbated.[130] In May 2004, 104 inmates — predominately gang members — were killed in a fire in an overcrowded San Pedro Sula prison.[131]

Economic Conditions

Another significant challenge for President Maduro has been his ability to improve the overall state of the Honduran economy and living conditions. Traditional agriculture exports of coffee and bananas are still important for the Honduran economy, but nontraditional sectors, such as shrimp farming and the maquiladora, or export-processing industry, have grown significantly over the past decade. With a per capita income of $970 (2003, World Bank estimate), Honduras remains one of the poorest countries in the hemisphere. Among the country's development challenges are: an estimated poverty rate of 79%; an infant mortality rate of 34 per 1,000; chronic malnutrition (33% of children under five years); an average adult education level of 5.3 years; and rapid deterioration of water and forest resources, according to the U.S. Agency for International Development.[132] Honduras

[128] Kevin Sullivan, "Spreading Gang Violence Alarms Central Americans," *Washington Post*, December 1, 2003, p. A1.

[129] John Authers and Sara Silver, "Death of Son Persuades Honduran to Take Political Stage," *Financial Times*, August 11, 2004.

[130] Economist Intelligence Unit, "Honduras Country Report,"December 2003; Raphaele Bail, "Marked Men with No Place to Hide," *Christian Science Monitor*, August 17, 2004.

[131] Michael A. W. Ottey, "Safety Hazards Behind Fire Remain; Honduran Officials Say They Are Powerless to Fix Dangerous Overcrowding and Overloaded Electrical Circuits in the Country's Prisons," *Miami Herald*, May 21, 2004.

[132] U.S. Agency for International Development. Congressional Budget Justification FY2004, Latin America and the Caribbean volume

also has a significant HIV/AIDS crisis, with an adult infection rate of 1.8%.[133] The Garifuna community (descendants of freed black slaves and indigenous Caribs from St. Vincent) concentrated in northern coastal areas has been especially hard hit by the epidemic.

In February 2004, the International Monetary Fund (IMF) approved in principle a three-year PRGF program for Honduras that could ultimately make the country eligible for some $950 million in debt relief under the IMF and World Bank's Highly Indebted Poor Countries (HIPC) Initiative. The objectives of the program, according to the IMF, are to alleviate poverty and move the economy to a path of higher economic growth and lower inflation.[134] As part of the agreement, the Honduran government would continue to lower the fiscal deficit and undertake structural reforms, including financial system reform and democratic institution building. The IMF acknowledged that broad public support for the program is crucial for its success. Street demonstrations against economic reforms have made it politically costly for the government. In late August 2003, some 12,000 protestors blocked entrances to the capital and forced their way into Congress. The government faces the dilemma of balancing the IMF's calls for reducing public expenditures and the public's demands for increased spending, especially protecting the wages of teachers.

Relations with the United States

The United States has had close relations with Honduras over the years, characterized by significant foreign assistance, an important trade relationship, a military presence in the country, and cooperation on a range of transnational issues, including counternarcotics efforts, environmental protection, and most recently the fight against terrorism. The bilateral relationship became especially close in the 1980s when Honduras returned to democratic rule and became the lynchpin for U.S. policy in Central America. At that time, the country became a staging area for U.S.-supported excursions into Nicaragua by anti-Sandinista opponents known as the contras. Today, overall U.S. policy goals for Honduras include a strengthened democracy with an effective justice system that protects human rights and promotes the rule of law, and the promotion of sustainable economic growth with a more open economy and improved living conditions. If approved, DR-CAFTA would lead to increased U.S.-Honduran economic linkages. The Bush Administration views DR-CAFTA as a means of solidifying democracy in Honduras and promoting safeguards for environmental protection and labor rights in the country, while those opposed question whether the agreement would lead to improvements in the protection of the environment and labor rights.

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[133] For more information, see CRS Report RL32001, *AIDS in the Caribbean and Central America*, by Mark P. Sullivan.

[134] International Monetary Fund, "IMF Approves in Principle Three-year US$107.6 million Poverty Reduction and Growth Facility Arrangement for Honduras and Grants Additional Interim Assistance under the Enhanced HIPC Initiative," Press Release No. 04/29, February 18, 2004.

U.S. Foreign Aid. The United States has provided considerable foreign assistance to Honduras over the past two decades. In the 1980s, the United States provided about $1.6 billion in economic and military aid to Honduras as the country struggled amid the region's civil conflicts. In the 1990s, U.S. assistance to Honduras began to wane as regional conflicts subsided and competing foreign assistance needs grew in other parts of the world. Hurricane Mitch changed that trend as the United States provided almost $300 million in assistance to help the country recover from the devastation of the storm. As a result of the new influx of aid, U.S. assistance to Honduras for the 1990s amounted to around $1 billion.

With Hurricane Mitch funds expended by the end of 2001, U.S. foreign aid levels to Honduras have declined. Foreign aid funding amounted to $41 million for FY2002, $53 million for FY2003, and an estimated $44 million for FY2004. The Bush Administration has requested almost $50 million for FY2005. These amounts include support for a variety of development assistance projects, food aid, and the largest Peace Corps presence in the world, with over 200 volunteers. Looking ahead, Honduras could receive substantial U.S. foreign assistance under the Bush Administration's Millennium Challenge Account (MCA), a performance and results-based assistance program intended to focus exclusively on development goals without regard for other U.S. foreign policy objectives.[135] In early May 2004, the Millennium Challenge Corporation's Board deemed Honduras eligible to compete for MCA grants in FY2004. Almost $1 billion in assistance will be available for eligible MCA countries in FY2004.

Military and Counternarcotics Issues. The United States maintains a troop presence of about 550 military personnel known as Joint Task Force (JTF) Bravo at Soto Cano Air Base. JTF Bravo was first established in 1983 with about 1,200 troops, who were involved in military training exercises and in supporting U.S. counterinsurgency and intelligence operations in the region. Today, U.S. troops in Honduras support such activities as disaster relief, medical and humanitarian assistance, counternarcotics exercises, and search and rescue operations that benefit Honduras and other Central American countries. Regional exercises and deployments involving active and reserve components provide training opportunities for thousands of U.S. troops. In the aftermath of the Hurricane Mitch in 1998, U.S. troops provided extensive assistance in the relief and reconstruction effort and were involved in delivering relief supplies, repairing bridges and roads, rebuilding schools, and operating medical clinics.

While Honduras is not a significant producer of illicit drugs, the country is a transshipment point (via air, land, and sea) for cocaine from South America destined to the United States. The State Department's March 2004 International Narcotics Control Strategy report noted that cocaine seizures in 2003 were higher than the past five years combined, although it maintained that corruption tempered some of the law enforcement successes.

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[135] For background on the initiative, see CRS Report RL31687, *The Millennium Challenge Account: Congressional Consideration of a New Foreign Aid Initiative*, by Larry Nowels.

Honduras was among the coalition of the willing supporting U.S. military operations in Iraq, and in July 2003, Honduras began providing a military contingent of 370 troops to Iraq, joining other contingents from El Salvador, Nicaragua, and the Dominican Republic. The Maduro government's proposal to send the troops was approved by the Honduran Congress, but the narrow margin of 66-62 reflected strong opposition by some sectors, including the opposition Liberty Party.[136] The Honduran troops served under a brigade commanded by Spain, but when Spain decided to bring home its troops, Honduras followed suit and removed all its troops by June 1, 2004.

In early November 2004, Honduras announced that it would contribute to the U.N. Stabilization Mission in Haiti (MINUSTAH) in 2005. Other Central American nations were expected to contribute as well.

Migration Issues. A significant issue in bilateral relations has been the migration status of some 87,000 undocumented Hondurans living in the United States. In the aftermath of Hurricane Mitch in 1998, the United States provided temporary protected status (TPS) to the undocumented Hondurans, protecting them from deportation, because the Honduran government would not be able to cope with their return. Originally slated to expire in July 2000, TPS status for undocumented Hondurans has been extended four times — most recently on November 1, 2004 — and is now scheduled to expire in June 2006.[137] The undocumented Hondurans send back millions of dollars annually in remittances to their families in Honduras.

U.S. Trade and Investment. U.S. trade and investment linkages with Honduras have increased since the early 1980s. In 1984, Honduras became one of the first beneficiaries of the Caribbean Basin Initiative, the one-way U.S. preferential trade arrangement providing duty-free importation for many goods from the region. In the late 1980s, Honduras benefitted from production-sharing arrangements with U.S. apparel companies for duty-free entry into the United States of certain apparel products assembled in Honduras. As a result of these production sharing arrangements, maquiladoras or export-assembly companies flourished, with some 36 industrial parks now operating in the country, most concentrated in the north coast region. The passage of the Caribbean Basin Trade Partnership Act (P.L. 106-200, Title II), which provides Caribbean Basin nations with NAFTA-like preferential tariff treatment, is expected to further boost Honduran maquiladoras, as is DR-CAFTA.

The United States is by far Honduras' major trading partner, and is the destination of about half of Honduran exports and the origin of about half of its imports. In 2003, U.S. exports to Honduras amounted to about $2.8 billion, with knit and woven apparel inputs accounting for almost half. U.S. imports from Honduras amounted to about $3.3 billion, with knit and woven apparel (assembled products from the maquiladora sector) accounting for the lion's share. Other important

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[136] "Debate on Sending Central American Soldiers to Iraq," *Inforpress: Central America Report*, July 18, 2003.

[137] For more on TPS, see CRS Report RS20844, *Temporary Protected Status: Current Immigration Policy and Issues*, by Ruth Ellen Wasem and Karma Ester.

Honduran exports included coffee, bananas, seafood, minerals, and other fruits and vegetables.[138]

U.S. foreign investment in Honduras is estimated at $840 million, over 60% of total direct foreign investment in the country, and the two countries have a bilateral investment treaty that entered into force in July 2001. There are more than 150 U.S. companies in Honduras, with almost 100 concentrated in the maquiladora or export assembly sector, including such companies as Cross Creek, Hanes, Jockey, Levi Strauss, Osh Kosh B'Gosh, and Wrangler. Other investments are in such economic activities as banana and other fruit production (especially Chiquita and Standard Fruit), tourism, energy generation, shrimp farming, cigar manufacturing, insurance, brewing, food processing, fuel distribution, and furniture manufacturing. In addition, a number of U.S. fast-food restaurants, hotels, and stores have licensing agreements to operate franchises in Honduras, including such companies as Applebee, Bennigan's, Best Western, Burger King, Church's Chicken, Domino's Pizza, Holiday Inn, McDonald's, Pizza Hut, Popeye's, Price Smart, Ruby Tuesday, Star Mart, Subway, TGI Friday, and Wendy's.[139]

DR-CAFTA-Related Issues

Over the past decade, Honduras has moved toward closer economic integration with its Central American neighbors and has negotiated, or is in the process of negotiating, free trade agreements with several nations as a means of stimulating economic development. It joined with Guatemala, El Salvador, and Nicaragua to establish a free trade area in 1993; the four countries signed an agreement with Dominican Republic and are currently negotiating one with Chile. In 2000, Honduras joined with Guatemala and El Salvador in signing a free trade agreement with Mexico that entered into force in 2001.

Honduras views DR-CAFTA as a way to make the region more attractive for investment, as a way to protect the existing preferential trade arrangement for exports to the United States, and as a mechanism to help transform the country's agricultural sector. There have been concerns in Honduras about the adverse effects of the regional agreement in opening the Honduran market to U.S. agricultural products, especially for several sensitive products such as corn, rice, beef, poultry, and pork.[140]

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[138] Trade statistics and information drawn from U.S. Department of State, "Background Note: Honduras," May 2003; Office of the United States Trade Representative. 2004 Foreign Trade Barriers.

[139] Statistics on foreign investment and U.S. companies invested in Honduras are drawn from U.S. Department of Commerce, U.S. Commercial Service. "Honduras Country Commercial Guide, FY2003." Listings of the numerous U.S. firms and franchises operating in Honduras, including maquiladoras, can be found in the Commerce Department's "Honduras Country Commercial Guide, FY2002."

[140] For more, see CRS Report RL32110, *Agricultural Trade in a U.S.-Central American Free Trade Agreement (CAFTA)*, by Remy Jurenas; and CRS Electronic Briefing Book, *Agriculture Policy*, page on "Agriculture in the U.S.-Central American Free Trade Agreement (CAFTA)," by Remy Jurenas,
at [http://www.congress.gov/brbk/html/ebagr70.html].

As a result, in the final agreement, most tariffs for sensitive products into the Honduran market have longer phase-out periods, with some ranging as high as 15-20 years. For white corn, the agreement includes a tariff rate quota that would increase 2% annually into perpetuity; there would be no tariff reduction for the out of duty quota.[141] Honduran officials are also concerned about the loss of jobs, which could led to social unrest if not addressed properly through long-term investment to help transform the agricultural sector to make it more competitive.

Apparel. Honduras is the third largest exporter of apparel to the United States after Mexico and China. The maquiladora or export assembly industry in Honduras developed in the 1980s and 1990s under special access programs for eligible apparel products under production sharing arrangements associated with the Caribbean Basin Initiative. In 2000, the Caribbean Basin Trade Partnership Act (CBTPA) provided NAFTA-like benefits to Caribbean Basin countries to ensure that Mexico's trade benefits under NAFTA did not result in a substantial advantage over the trade benefits of Caribbean Basin countries. The benefits under CBTPA are scheduled to expire in September 2008 or upon entry into force of the Free Trade Area of the Americas, whichever comes first. Honduran officials have fears of not being able to compete with China and other Asia apparel producers after quotas are removed in 2005 under the WTO Agreement on Textiles and Clothing.[142] Because of its large maquiladora sector (which employed almost 124,000 people at the end of 2003[143]), Honduras is interested in DR-CAFTA to ensure that its apparel trade benefits under CBTPA are continued beyond September 2008. In the CAFTA negotiations, the Central Americans advocated liberalizing the rules of origin for apparel to allow the duty-free export of apparel made with yarn from third countries as well as special quotas for apparel assembled in the region from fabric imported from third countries.[144] Liberalized rules of origin and the special quotas would be especially significant for Honduras because of its large export-assembly sector.

The CAFTA agreement completed in December 2003 included provisions that would liberalize the rules for apparel trade.[145] According to USTR, "an unprecedented provision will give duty-free benefits to some apparel made in Central America that contains certain fabrics from NAFTA partners Mexico and Canada."[146] Liberalized rules of origin would also allow duty-free entry for certain apparel (boxer shorts, pajamas, and nightwear) made from third-country fabric; brassieres would

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[141] United States Trade Representative. "CAFTA — Agriculture, Specific Fact Sheet," February 10, 2004.

[142] U.S. Department of Commerce. U.S. Commercial Service. "2003 Investment Climate Statement for Honduras," August 15, 2003.

[143] "Honduras Industry: Maquila Leads Manufacturing Growth," *EIU ViewsWire*, April 22, 2004.

[144] "Central America./U.S.: CAFTA Talks Advance," *Oxford Anlaytica*, April 8, 2003.

[145] For more, see CRS Report RL31870, *The U.S.-Central America Free Trade Agreement (CAFTA): Challenges for Sub-Regional Integration*, by J. F. Hornbeck.

[146] Office of the United States Trade Representative, "Trade Facts: Free Trade with Central America, Summary of the U.S.-Central America Free Trade Agreement," December 17, 2003.

also be duty-free with third country fabric if it was cut and sewn in Central America.[147] Apparel deemed to include certain content in short supply could also qualify for duty-free treatment. Another provision would allow limited amounts of third-country content fabric to go into CAFTA apparel.

Environment. According to a report by the Office of the U.S. Trade Representative, Honduras "has a more limited slate of domestic environmental legislation" than its Central American neighbors.[148] Honduras passed a general environmental law in 1993, and the Ministry of Natural Resources and Environment is the agency ensuring compliance with environmental law and coordinating environmental policies. Honduras is party to 54 bilateral, regional, and multilateral agreements, including the Convention on Biological Diversity and the Kyoto Protocol. The most significant environmental challenges facing Honduras include deforestation and forest degradation and proper watershed management. The devastation caused by Hurricane Mitch in 1998 highlighted poor watershed management. With regard to deforestation, illegal logging by lumber companies has been a problem in eastern Honduras. In May 2003, death threats against Father Andrés Tamayo, who has been vocal in criticizing forest product companies and has called for a moratorium on forest exploitation, prompted President Maduro to increase security for the forests in eastern Honduras and to initiate plans for developing a new forestry policy.[149] Father Tamayo led a second national "March for Life" protest in June 2004 calling for an end to illegal logging in Olancho province. In response, President Maduro promised to set up committees (with government and environmental representatives) to evaluate petitions to ban logging in some areas.[150]

Labor.[151] About 14% of the Honduran work force is unionized, with public sector unions having more strength than those in the private sector. Overall, the economic and political influence of unions reportedly has diminished in recent years, according to the State Department's February 2004 human rights report. Honduras has three major labor confederations: the Confederation of Honduran Workers (CTH), the General Workers' Central (CGT), and the Unitary Confederation of Honduran Workers (CUTH). The growth of "solidarity" associations in private companies, an alternative to unions that provide credit and other services to workers,

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[147] "CAFTA Textile Rules Pave Way for Increase in Foreign Fabric Use," *Inside U.S. Trade*, December 19, 2003.

[148] Office of the United States Trade Representative, *Interim Environmental Review, U.S.-Central America Free Trade Agreement,* August 2003.

[149] "Honduras: Activist Demand End to Logging," *Central America Report*, June 27, 2003.

[150] Catherine Elton, "Honduran Marchers Decry Logging," *Miami Herald*, July 5, 2004; "Honduran President Maduro Vows To End Danger to Nation's Forests," *ACAN-EFE*, Panama City, July 2, 2004.

[151] Material in this section is drawn from U.S. Department of State. "Honduras Country Report on Human Rights Practices, 2003," February 2004; U.S. Department of Commerce. U.S. Commercial Service. "2003 Investment Climate Statement for Honduras," August 15, 2003; and Office of the United States Trade Representative, "Fourth Report to Congress on the Operation of the Caribbean Basin Economic Recovery Act," December 31, 2001.

has been criticized by organized labor as employer-dominated and an attempt to stop the growth of independent unions.

Workers in both unionized and non-unionized companies are covered by the Labor Code, with the right to seek redress from the Ministry of Labor. The Labor Code prohibits blacklisting, but according to the Department of State's human rights report, there is credible evidence that blacklisting has occurred in the maquiladoras because of employees' union activities. The Office of the U.S. Trade Representative (USTR) reported in 2001 that there were widespread reports of dismissal and other reprisals against workers for their union activities. USTR and the Ministry of Labor signed a memorandum of understanding in 1995 that had recommendations to enforce the Labor Code and resolve disputes. Labor unions maintain that the ministry has not made sufficient progress toward enforcing the Labor Code, including inspections of the maquiladora industry. An estimated 400,000 children work illegally in Honduras, occurring frequently in rural areas and in small companies. The illegal employment of children in the maquiladora sector may occur, according to the Department of State, but not on a large scale.

There has been substantial criticism of labor sector conditions in Honduras by U.S.-based labor groups and the International Federation of Free Trade Unions (ICFTU). A report by the AFL-CIO asserts that the "Honduran government tolerates a broad and systematic pattern of worker rights violations, particularly in maquiladoras producing apparel for export to the U.S. market."[152] The ICFTU maintains that while Honduran law recognizes the right to form and join trade unions, there are a number of restrictions. It further asserts that in practice "workers are harassed and even sacked for trade union activities, and some unionized workers are blacklisted in the export processing zones."[153]

In late October 2003, the New York-based National Labor Committee began a campaign focusing attention on alleged worker rights violations at a Honduran maquiladora factory producing shirts for the fashion company of hip-hop performer Sean P. Diddy Combs. The owner of the factory called the charges a total fabrication, and the Honduran Ministry of Labor maintains that an inspection of the factory did not uncover abuses alleged by the labor activists.[154] Critics of the National Labor Committee argue that the group specializes in campaigns involving celebrities whether the allegations are true or not.[155]

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[152] "Central America: Labor Rights and Child Labor Reports, Pursuant to the Trade Act of 2002, Section 2102(c)(8)-(9), AFL-CIO, Union of Needletrades, Industrial and Textiles Employees (UNITE!), June 5, 2003

[153] International Federation of Free Trade Unions. "Annual Survey of Violations of Trade Union Rights (2003): Honduras."

[154] Steven Greenhouse, "A Hip-Hop Star's Fashion Line is Tagged with a Sweatshop Label," *New York Times*, October 28, 2003; "Honduran Officials Inspect Sean John Shop," *Associated Press*, October 31, 2003.

[155] "Review and Outlook (Editorial)," *Wall Street Journal*, November 4, 2003.

Intellectual Property Rights. In 1998, Honduras's Caribbean Basin Initiative and Generalized System of Preferences (GSP)[156] benefits were partially suspended for several months because of the piracy of U.S. televison broadcasts and videos. The benefits were restored after Honduras took action to stop the piracy. Today, the Office of the United States Trade Representative (USTR) maintains that Honduras has largely complied with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), but notes that the Honduran Congress has yet to enact reforms related to integrated circuit designs and plant variety protection to be in full compliance with TRIPS. According to USTR, the piracy of books, sound and video recordings, compact disks, and computer software is widespread in Honduras because of limited enforcement capacity. The United States and Honduras initialed a bilateral intellectual property rights agreement in 1999, but both parties agreed to fold the provisions into CAFTA and DR-CAFTA. USTR maintains that the agreement would strengthen intellectual property rights protection in all areas. The illegal registration of well known trademarks has also been a problem in Honduras, although USTR maintains that the agreement's enforcement provisions are designed to help reduce trademark piracy.[157]

Approval Status. The Maduro government is expecting to introduce legislation in the Honduran Congress to approve the DR-CAFTA before the end of 2004 and reportedly is not linking its consideration of the agreement to U.S. congressional approval.

Nicaragua[158]

Political Situation

Nicaragua began a transition to democracy in 1990 after a decade-long struggle between a leftist regime and U.S.- backed counter-revolutionary forces. A country plagued by generations of dictatorial rule, civil war and poverty, Nicaragua has successfully begun to develop democratic institutions and create a framework for economic development. Progress has been made in key social sectors, as the country's infant and child mortality rates, total fertility rates, and malnutrition levels have declined. Nicaragua recently received substantial debt relief under the International Monetary Fund's heavily indebted poor countries (HIPC) initiative, and has signed a major free trade agreement with the United States and its Central American neighbors. It has also been selected as one of only three Latin American countries to receive a substantial injection of foreign aid under the Millennium Challenge Account, a new program which rewards poor countries for curbing corruption and improving governability. Nonetheless, Nicaragua remains poor, and its institutions are weak.

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[156] GSP is a U.S. preferential trade program providing duty-free treatment to certain products from designated developing countries.

[157] Office of the United States Trade Representative, "2004 Foreign Trade Barriers."

[158] Prepared by Clare Ribando, Analyst in Latin American Affairs, and Maureen Taft-Morales, Specialist in Latin American Affairs.

The current political situation in Nicaragua has been shaped by the interplay between several prominent political figures. President Enrique Bolaños, of the Liberal Constitutionalist Party (PLC), was elected to a five-year term in November 2001, in elections widely regarded as being free and fair. Bolaños, a businessman in the agricultural sector, defeated Daniel Ortega, a prominent figure in Nicaraguan politics for over 25 years (see below). During the 1980s, Bolaños's farm service company was nationalized, and he was jailed for his opposition to the Sandinista government. During the 2001 presidential campaign, Bolaños emphasized the importance of maintaining positive relations with the United States. He faces the challenges of stimulating economic growth in the hemisphere's second poorest country, and promoting democratic reform while pursuing prosecutions for corruption in the previous administration. The Bush Administration has praised and supported Bolaños's anti-corruption efforts.

Daniel Ortega was a leader of the Sandinista National Liberation Front (FSLN) when it overthrew the Somoza dictatorship in 1979. He served as President from 1985-1990, having won elections which much of the international community deemed fair, but which were boycotted by much of the opposition and deemed unfair by the Reagan Administration. Ortega's administration was marked by a bloody civil war with the U.S.-backed "contras," and charges of corruption. In the context of the Central American Peace Plan, Ortega's Sandinista government agreed to internationally monitored democratic elections in February 1990. Ortega ran for president, and lost, in 1990, 1996, and 2001. The Sandinistas control 38 of the 92 seats in the National Assembly. They appear to have capitalized on divisions between President Bolaños and the PLC, which is controlled by imprisoned former president Arnoldo Aleman, to garner important victories in the municipal elections held on November 7. The Sandinistas swept those polls, winning some 87 of 152 municipal seats. Ortega is also reportedly planning to run again for President in 2006.

In a country with a long tradition of government corruption, Bolaños took the landmark step of prosecuting former President Arnoldo Aleman (1997-2002) and 13 of his associates for embezzling about $100 million in public funds while in office. The United Nations recently named Former President Aleman as one of the world's five most corrupt living ex-leaders.[159] The effort is particularly notable, because Bolaños and Aleman not only belong to the same political party, but Bolaños also served as Aleman's Vice-President until he stepped down to run for president. Mr. Aleman was sentenced to 20 years in prison in December 2003 for fraud and money-laundering. His vocal PLC supporters are still trying to negotiate his release, however.

Currently, there are pending charges of electoral fraud against Bolaños, alleging that former President Aleman laundered public funds into his party's election campaign and that Bolaños knowingly benefitted from those funds. President Bolaños has denied those charges, but has declined requests that he open the banking accounts that allegedly contained public funds used to back his campaign for

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[159] "Fujimori, Nicaragua's Aleman on World Corruption List," *EFE News Service*, August 4, 2004.

inspection.[160] The PLC confirmed its opposition to the Bolaños Administration at a party convention held on July 11, 2004, ending speculation that the President's small "Alliance for the Republic" (AR) of six small parties would reach some sort of deal with Aleman.

In October the Comptroller General's office, whose panel consists of members of the Sandinista and Liberal parties in opposition to Bolaños, issued a report renewing charges of fraud against the President. The opposition has used the report to promote impeachment efforts, despite the Supreme Electoral Council's having earlier certified that Bolaños had not committed election finance irregularities. The U.S. State Department said it "stands firmly with the democratically elected government of President Bolaños" and "deplore[s] recent politically motivated attempts, based on dubious legal precedent, to undermine the constitutional order in Nicaragua and his presidency."[161] The OAS sent a special mission to Nicaragua to encourage all parties to preserve and follow democratic order there.

The ongoing influence of both Aleman and Ortega in Nicaraguan politics has made governing difficult for President Bolaños. Bolaños has limited legislative support, mainly the nine members of the Azul y Blanco (Blue and White) faction of the PLC. During 2004, President Bolaños will be forced to make strategic alliances in order to pass any legislation, including the ratification of DR-CAFTA and social security reform. In order to counter the continuing corruption in the Sandinista-dominated legal system, the President is encouraging the Assembly to pass three laws that would overhaul the judiciary. The proposals have been fiercely debated, however, paralyzing the Assembly for several months early in 2004.

Economic Conditions

Nicaragua began free market reforms in 1991, after what the State Department has described as "12 years of economic free-fall under the Sandinista regime." The Sandinista guerrillas led a coalition of forces that overthrew the four-decade-long Somoza family dictatorship in 1979, inheriting a stagnant economy, a $1.6 billion debt, and a country devastated by war. The FSLN shortly thereafter established a pro-Soviet government that nationalized rural properties owned by the Somozas or their associates, as well as financial institutions, which had gone bankrupt during the war. Sandinista "state-led" economic policies, an eight-year civil war with U.S.-backed contras, and U.S. economic sanctions all contributed to Nicaragua's economic decline.

In 1990, the first post-conflict democratic government was elected, and it pursued significant democratic and economic reforms. Significant progress has been made since then: the post-Sandinista governments have privatized 351 state enterprises; reduced inflation from 13,500% prior to 1990 to 3.6% in 2002; and substantially reduced foreign debt. In late January 2004, the IMF forgave 80% of

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[160] "Bolaños se Niega a Aclarar Fondos que Financiaron su Campaña," *Agencia EFE*, August 9, 2004.

[161] "*Statement on the Situation in Nicaragua,*" Richard Boucher, spokesman, US Dept. of State, Wash., DC, Oct. 16, 2004.

Nicaragua's foreign debt of roughly $6.5 billion under the HIPC program, and in May 2004 Nicaragua was one of only three Latin American countries selected to receive increased foreign aid as part of the Millennium Challenge Account program. Significant challenges remain, however. The country remains heavily dependent on foreign aid (25% of GDP in 2001), and remittances sent from Nicaraguans living abroad (15% of GDP).[162] Its economy also remains extremely vulnerable to external economic conditions and natural disasters. For example, economic growth faltered in 2002 when a global recession, extreme drops in export coffee prices, and a drought caused Nicaragua's economy to retract to less than 1% growth.

These economic crises have also led to severe malnutrition in parts of Nicaragua. Almost half of Nicaragua's 5 million inhabitants live in poverty; unemployment and underemployment rates remain as high as 40% to 50%; and income distribution is extremely unequal. Per capita GDP in 2003 was only $470, making Nicaragua the second poorest country in the Western Hemisphere after Haiti. Although the Nicaraguan government has made a concerted effort to improve basic health indicators and school enrollment rates, significant gaps exist. While close to 90% of children ages 7 to 12 now attend primary school, less than 50% of 13 to 18 year olds attend secondary school.[163] The government aims to further social progress with a World Bank loan of $75 million for social sector projects.

Relations with the United States

After the 1990 Central American Peace Plan was signed, U.S. involvement in Nicaragua shifted from providing military support to the "contras" towards pressuring the Nicaraguan government to enact political reforms. The United States provided extensive foreign assistance to Nicaragua after Hurricane Mitch in 1998, and has repeatedly extended the Temporary Protected Status (TPS) of some 6,000 Nicaraguans living within its borders. Recently the two countries have negotiated agreements related to intellectual property, trade, and counter-narcotics efforts. Nicaragua contributed 113 mine-clearing troops to the coalition forces in Iraq, and has passed legislation giving President Bolaños the power to destroy anti-aircraft missiles left over from its civil war as the U.S. has recommended. The main U.S. policy goals for Nicaragua include reducing poverty, increasing economic growth through free trade, strengthening democracy, and improving human capital investments. Nicaragua enjoys debt relief under the HIPC initiative and was recently selected to receive Millennium Challenge Account funding. In December 2003, Nicaragua signed the CAFTA, and in August 2004, it signed DR-CAFTA, which, if approved, would provide expanded access to the U.S. market.

U.S. Foreign Aid. The United States has provided Nicaragua with $1.2 billion in assistance from 1990, when Violeta Chamorro defeated the Sandinistas in national elections, to 2003. Since the mid-1990s, Congress has restricted U.S. assistance to Nicaragua, pressuring the government there to make greater progress in such areas as prominent human rights cases, resolution of property claims, and military, judicial,

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[162] Global Insight, *Nicaragua Country Report*, January 2004.

[163] United States Agency for International Development, *2004 Budget Justification to Congress*.

and economic reforms. From 1999 through 2001, an additional $93 million was provided to assist in reconstruction efforts following the massive destruction caused by Hurricane Mitch. The Bush Administration states that strengthening democracy is its first priority in Nicaragua. The United States provided $6.2 million dollars in assistance to support the 2001 election process. The Administration provided about $37.5 million to Nicaragua in FY2003, including $16 million in food aid, and requested $39 million annually for FY2004 and FY2005. These totals are likely to increase significantly as the country submits proposals to be funded by the newly-established Millennium Challenge Account program.

Democratic Reform. The Bolaños Administration has committed itself to attacking government corruption. It has already convicted the former chief tax collector, and arrested over a dozen other high level officials in the previous administration on fraud or corruption charges. This anti-corruption campaign reached a climax in December 2003 as Bolaños' predecessor, former President Arnoldo Aleman, was sentenced to 20 years in prison for money laundering and other crimes. As a former President, Aleman had received an automatic seat in the legislature, along with legislative immunity from prosecution. In 2002, the unicameral National Assembly voted to remove Aleman as its president and took the historic step of stripping Aleman of his immunity from prosecution. Bolaños's efforts are being thwarted, however, as the Liberal party is working against the Bolaños government and is trying to obtain the former President's release through a pardon or an amnesty.

Nicaragua is engaged in a structural reform program of the judicial system, but the system remains weak and susceptible to corruption and political influence. In its December 2003 *Background Note* on Nicaragua, the U.S. State Department describes the country's judicial system as "still largely ineffective and overburdened." President Bolaños has increased his criticisms of the Sandinista-dominated judiciary in response to the recent conviction of one of his top allies on charges of corruption. The U.S. Ambassador to Nicaragua, Barbara Moore, has asserted that recent judicial decisions have been "damaging" to the country's reputation and its ability to attract foreign investment.[164]

Human Rights. Under Nicaragua's authoritarian regimes, and during its civil war, human rights abuses were widespread. Since the end of the civil war in 1990, however, respect for human rights has improved, and human rights observers no longer accuse Nicaraguan governments of systematic human rights violations. According to the State Department's 2003 report on Human Rights Practices, the Nicaraguan government "generally respected the human rights of its citizens" although serious problems remain. There were 20 reported extrajudicial killings by members of the security forces, and there were allegations of torture and other mistreatment of detainees by police. The government punished some members of security forces who committed human rights abuses, but, according to the report, "a degree of impunity persisted."

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[164] "Nicaragua" Bolaños Rages Against the Judiciary," *Latinnews Daily*, August 18, 2004.

Resolution of Property Claims. During the 1980s, the Sandinistas appropriated nearly 30,000 properties. Resolution of property claims by U.S. citizens arising from those expropriations remains the most contentious area in U.S.-Nicaraguan relations. The Nicaraguan National Assembly passed a law in November 1997 establishing new property tribunals with the goal of resolving longstanding property disputes. The new property tribunals began accepting cases in July 2000. Procedures of the new property tribunals include mediation, binding arbitration, and expedited trials. Through technical assistance for judicial reform, U.S. assistance is helping to improve the mechanism for settling property disputes. U.S. law prohibits aid to countries that have confiscated assets of U.S. citizens, but since 1993, U.S. administrations have granted annual waivers to allow Nicaragua to receive U.S. aid.

Narcotics and Arms Trafficking. According to the State Department's *2003 International Narcotics Control Strategy Report*, Nicaragua is an important transit zone for narcotics traffic from South America to the United States and Europe. In 2002, U.S. and Nicaraguan officials conducted joint investigations resulting in the capture of 2,100 kilograms of cocaine and almost 50 kilograms of heroin. Gunrunning to guerrillas in Colombia is also a problem in Nicaragua, as it is in many Central American countries and in Mexico. In November 2001, arms supposedly exchanged between the Nicaraguan and Panamanian police forces ended up in the possession of right-wing paramilitaries in Colombia. The Organization of American States (OAS) reported in January 2003 that Nicaraguan police and military officers were negligent in not verifying that those conducting the transition were indeed Panamanian police, as was presumed. After receiving the OAS report, Bolaños reportedly told former U.S. Ambassador Morris Busby, the report's author, about steps his government would take to close loopholes in Nicaraguan arms control legislation that contribute to regional arms smuggling. Also in January 2003, President Bolaños proposed a disarmament process in Central America, to reduce the number of arms in the region.

U.S. Trade and Investment. The success of the Nicaraguan economy is highly dependent upon its external trade relationship with the United States. Trade and investment linkages between the two countries began developing in the early 1980s as Nicaragua gained duty free access to the U.S. market for the majority of its products under the Caribbean Basin Initiative. These linkages were strengthened by the passage of the Caribbean Basin Trade Partnership Act (P.L. 106-200, Title II), which provides Caribbean Basin nations with NAFTA-like preferential tariff treatment.

Nicaraguan exports, which consist primarily of traditional products like coffee, shrimp, seafood, beef, and gold, are primarily destined to the United States (32%) and other Central American nations (37.8%). Most of the country's imports (27.4% of the total), such as machinery and transport equipment, industrial raw materials, and consumer goods, originate in the United States. About 25 wholly or partly owned subsidiaries of U.S. companies operate in Nicaragua. In 2002, U.S. exports to Nicaragua amounted to $438 million, with the largest category being machinery and transport equipment (23% of that total). U.S. imports totaled $679 million, with apparel accounting for 26% of all import categories. Those totals are likely to increase substantially if the free trade agreement is approved.[165] Major U.S. companies operating in Nicaragua include Esso Standard Oil, E.D. and F. Man (agricultural supply and financing firm), Bellsouth, Texaco Caribbean, Pepsi-Cola, Kraft Foods-Nabisco, Gulf King (shrimp boat fleet), Coca-Cola, and Cinemark theaters.

DR-CAFTA-Related Issues

Although agriculture continues to be one of the most important sectors of the Nicaraguan economy, the country's nascent maquiladora industry, which primarily manufactures apparel products and whose success is extremely reliant on favorable external trade conditions, is rapidly expanding. Accordingly, the Nicaraguan government has become a major proponent of free trade, having signed and ratified bilateral investment agreements with the United States, Spain, Taiwan, Denmark, the United Kingdom, the Netherlands, Korea, and Ecuador. Nicaragua is among the most open economies in Central America. It has recently taken further steps to foster regional integration by joining the Central American customs union, also comprised of Guatemala, El Salvador and Honduras. The Nicaraguan negotiating team for the recently signed free trade agreement with the United States believes that the outcome of the negotiations are highly positive for the country.[166]

Evidence of this positive outcome includes the fact that Nicaragua gained duty-free access to the U.S. market for 68% of its farm products and 100% of its industrial products, while ensuring significant protection for its domestic farmers against U.S. imports. DR-CAFTA would afford Nicaraguan rice farmers a 28-year period of adjustment before they would be subjected to full competition with U.S. producers. Nicaragua was also allowed to implement the strictest quotas on imports of U.S. corn of any of the five Central American countries. In addition, Nicaraguan textile exporters were the only such exporters in Central America to receive permission to use up to 100 million square meters per year of cloth from non-U.S., non-Central American suppliers to make apparel products that would still enjoy duty free access to the U.S. economy.

Despite these positive observations, skeptics have noted that Nicaraguans had little bargaining leverage in the CAFTA negotiations.[167] Moreover, despite some protections for Nicaraguan farmers, U.S. producers will be able to export 10 times as much yellow corn to Nicaragua than in years past. Unable to compete against competition from capital and technology-intensive U.S. farmers, unemployment in the agricultural sector in Nicaragua will increase in the short term and must be replaced by new employment in the manufacturing sector. A number of specific sensitive issues arose in the negotiations, which are summarized below:

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[165] Trade statistics and information drawn from Global Insight, *Nicaragua Country Report*, January 2004; United States International Trade Administration, 2003 Trade Report.

[166] Economist Intelligence Unit, *Nicaragua Country Report*, January 2004.

[167] Bruce Stokes, "Will Free Trade Help Nicaragua?" *National Journal*, June 5, 2004.

Environment. Nicaragua has a significant amount of environmental legislation in place, anchored by a general law on the Environment and Natural Resources passed in 1996. The Nicaragua Ministry of Environment and Natural Resources (MARENA) regulates national policy on the management and protection of the country's natural resources. Additionally, Nicaragua is a party to 57 multilateral, regional and bilateral environmental agreements, which include the Convention on Biological Diversity, the Convention on the International Trade in Endangered Species of Wild Flora and Fauna, and the Kyoto Protocol. Despite these conservation efforts, and the fact that Nicaragua's environment benefits from relatively abundant forest reserves and a low population density, deforestation and lake contamination threaten its environment. Between 1990 and 2000, Nicaragua had the second highest rate of deforestation among its Central American neighbors. Deforestation, resulting in soil erosion, has increased the country's vulnerability to natural disasters, such as Hurricane Mitch (1998), and periodic droughts.[168] Conditions in the country's major freshwater lake, Lake Nicaragua, the world's twentieth largest aquifer, deteriorated between 1994 and 2003 at a "rate equivalent to that normally observed in European lakes over a period of 150 to 200 years."[169] Critics of CAFTA have questioned whether merely requiring countries to enforce their existing laws is enough to ensure adequate environmental protection.

Labor. The Nicaraguan labor force, comprised of roughly 2.25 million workers, is largely rural-based and unskilled. An estimated 45% of those workers are employed in the agricultural sector, 42% in services, and 15% in manufacturing. Though it expanded by 2.3% in 2003, the Nicaraguan economy continues to be plagued by unemployment and underemployment rates as high as 40% to 50%. Along with declining confidence in union leaders, this has eroded the strength of the Nicaraguan labor movement. Half of the unionized labor force belongs to militant Sandinista labor unions.

Nicaragua is a party to 54 International Labor Organization conventions and agreements, including the 1998 Declaration of Principles and Fundamental Labor Rights. Although the 1996 Labor Code removed many restrictions on trade union rights, the Nicaraguan Labor Ministry acknowledges that it still takes about six months for a union to go through all the procedures necessary to hold a legal strike.[170] As a result, there has only been one legal strike since 1996, and companies continue to exact severe reprisals against "illegal" union activities. The worst labor rights violations in Nicaragua reportedly occur in the export processing zones (EPZs) where 62 EPZ companies, or maquilas, employ 52,000 people, only 3% of whom are unionized.[171] An estimated 9,500 workers in Chinadega, Nicaragua have spent the

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[168] Office of the United States Trade Representative, *Interim Environmental Review, U.S.-Central America Free Trade Agreement*, August 2003.

[169] Javier Rayo, "Nicaraguan Mayors Seek to Halt Death of World's 20th Largest Lake," *EFE News Service*, October 5, 2003.

[170] International Labor Organization, *Nicaragua: Annual Survey of Violations of Trade Union Rights (2003).*

[171] "Denuncian Violaciones a Derechos Laborales en Maquilas en Nicaragua," *Agencia Mexicana de Noticias*, November 25, 2003.

last five years pursuing million-dollar lawsuits against international banana conglomerates for health damages caused by pesticide exposure. Some critics of the free trade agreement fear that as companies arrive in pursuit of cheap labor, "the vulnerability of the maquila and farming ... could lead the way to greater exploitation of workers, and greater exposure to unsafe working conditions."[172]

Intellectual Property. Nicaragua signed a bilateral agreement on intellectual property protection with the United States in January 1998, the first of its kind in Central America and only the fourth in Latin America. Since that time, the Nicaraguan legislature has enacted modern laws on copyrights, transmission of satellite signals, plant variety protection, integrated circuit systems, patents, and trademarks. The government launched two major efforts to crack down on music recording privacy in 2001, and is now targeting software piracy in public offices. Despite these efforts, the Business Software Alliance estimates that Nicaragua had a 77% piracy rate in 2002, following a 78% record in 2001. Estimated losses from piracy reached $2.6 million in 2002, down from $3.3 million in 2001.[173] These losses, though significant, were not enough to put Nicaragua on the U.S. Trade Representative's "Special 301" list of countries with inadequate protection of intellectual property rights. Nicaragua took further steps to protect intellectual property rights in 2002 by signing the World Intellectual Property Organization's "Internet Treaties."

Approval Status. Nicaragua is the first of the six signatories to the DR-CAFTA to send the agreement to its legislature. President Bolaños submitted the bill to the unicameral National Assembly for ratification on October 5, 2004. A specially appointed commission is scheduled to examine it. Observers do not expect them to take action before the U.S. Congress does so.

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[172] "Central America: Working Can Be Hazardous to Health," *Inter Press Service*, November 29, 2003.

[173] "Nicaragua: Licensing and Intellectual Property," *EIU Viewswire*, January 26, 2004.

Appendix 1. U.S. Economic and Military Assistance to Central America and the Dominican Republic, FY1977-FY2004

(in $U.S. millions, current)

	Costa Rica	Dominican Republic	El Salvador	Guatemala	Honduras	Nicaragua	Total
1977	17	16	7	21	15	6	82
1978	9	7	11	11	20	14	72
1979	18	49	11	25	31	19	153
1980	16	59	64	13	57	39	248
1981	15	42	149	19	45	60	330
1982	54	88	264	16	112	6	540
1983	219	70	327	30	154	0	800
1984	179	104	413	20	173	0	889
1985	231	179	570	107	296	0	1,383
1986	165	106	444	122	198	0	1,035
1987	183	41	574	193	259	0	1,250
1988	121	60	396	142	198	0	917
1989	122	82	388	157	129	4	882
1990	96	28	328	118	214	223	1,007
1991	45	24	295	93	157	219	833
1992	27	24	291	62	96	75	575
1993	28	26	226	69	63	150	562
1994	12	91	57	68	48	93	369
1995	6	16	64	40	30	31	187
1996	2	14	79	37	26	27	185
1997	0	15	32	62	29	27	165
1998	1	18	41	83	22	54	219
1999	1	34	49	102	106	66	358
2000	1	18	34	67	38	32	190
2001	1	43	91	65	43	52	295
2002	1	22	91	68	41	47	270
2003	2	27	40	61	45	42	217
2004	2	31	41	54	46	46	220
Total	**1,574**	**1,334**	**5,377**	**1,925**	**2,691**	**1,332**	**14,233**

Source: AID, U.S. Overseas Loans and Grants. Data for FY2003 are estimated amounts and for FY2004 are the requested amounts.

Appendix 2. DR - CAFTA Pact Partners

Source: Map Resources. Adapted by CRS. (K.Yancey 9/24/04)