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The Democratic Benefits of a Free Trade Agreement with Central America

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Increasing economic opportunity and strengthening homeland security are two of the U.S. government's major goals. Advancing free trade is essential to reaching both of these goals. Hence, the Bush Administration and Congress should be praised for significantly advancing free trade with Australia, Morocco, Chile, and Singapore.

Now the United States has an even more important opportunity to expand trade with countries right on its doorstep through DR–CAFTA, a free trade agreement with the Dominican Republic, Costa Rica, Guatemala, Honduras, El Salvador, and Nicaragua. The Administration should push Congress to approve this free trade agreement promptly.

The DR–CAFTA countries have made enormous progress toward democracy and economic liberalization since the 1970s, when almost all of them were ruled by dictators and opposed free markets.[1] In recent years, each of these countries has implemented positive institutional reforms.

Approving DR–CAFTA would "lock in" these reforms and encourage these governments to institute additional reforms. The United States would benefit significantly from a more open, institutionally stronger Central America, not just because such reforms open a myriad of investment and trade opportunities to U.S. businesses and individuals, but also because they foster long-term peace and prosperity in the DR–CAFTA countries.

Talking Points

- The United States would benefit significantly from a more open, institutionally stronger Central America, not just because such reforms open a myriad of investment and trade opportunities to U.S. businesses and individuals, but also because they foster long-term peace and prosperity in the DR–CAFTA countries.
- As living standards rise and people enjoy better lives, their interest in preserving these benefits also increases. Because they have more to lose from a crisis, they strive to preserve peace and stability. As a result, the likelihood of civil conflict decreases.
- An improved economic situation in DR–CAFTA countries would reduce the incentives to leave home in search of a better life elsewhere. Therefore, people would be less likely to emigrate illegally to other, more prosperous countries like the United States.

This paper, in its entirety, can be found at:
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Table 1 B 1846

The State of Economic Freedom in the DR–CAFTA Countries

Country	Trade	Fiscal Burden	Government Intervention	Monetary Policy	Foreign Investment	Banking	Wages and Prices	Property Rights	Regulation	Informal Market
Costa Rica	×	×	✓	×	✓	×	✓	×	×	×
Dominican Republic	×	×	✓	×	×	×	×	×	×	×
El Salvador	✓	×	✓	✓	✓	✓	✓	×	×	×
Guatemala	×	×	✓	×	×	✓	✓	×	×	×
Honduras	×	×	×	×	×	✓	×	×	×	×
Nicaragua	✓	×	✓	✓	×	✓	×	×	×	×

× Needs greater reform ✓ Greatly advanced reform

Source: Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005), at *www.heritage.org/index.*

From War to Democracy

Throughout the 1970s and into the 1980s, every DR–CAFTA country except Costa Rica was ruled by a dictator, was in a state of civil conflict, or both. These countries suffered from great political instability. Their economies focused inward, and protectionist policies perpetuated widespread poverty.

Eventually, peace accords were signed, democratic government returned, and all of these countries began to promote more open-market policies. According to the annual *Index of Economic Freedom*, published by The Heritage Foundation and *The Wall Street Journal*, all of the DR–CAFTA countries have advanced in their levels of economic freedom since 1995, albeit at different paces. Nicaragua, El Salvador, and Costa Rica have opened their economies the most since 1995 and today are considered "mostly free" economies. Guatemala, Honduras, and the Dominican Republic have advanced reform more slowly and are still considered "mostly unfree" economies.[2]

Advancement occurred primarily in trade policy and monetary policy.[3] (See Table 1.) Since 1995, tariffs, non-tariff barriers, and inflation rates have declined in each country. The level of government intervention—which essentially assesses the degree of privatization in the economy—has also improved in all of these countries except Honduras.[4] In most DR–CAFTA countries, many businesses formerly owned and run by the state have been privatized. Except in the Dominican Republic, the banking and financial sectors have been improved in terms of regulation and privatization.[5] Wages and prices in El Salvador,

1. Brett D. Schaefer and Stephen Johnson, "Congress Should Support Free Trade with Central America and the Dominican Republic," Heritage Foundation *Backgrounder* No. 1822, February 8, 2005, at *www.heritage.org/Research/LatinAmerica/bg1822.cfm.*
2. Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005), at *www.heritage.org/index.*
3. "Past Scores," in Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005), Web ed., at *www.heritage.org/research/features/index/downloads/PastScores.xls.*
4. *Ibid.*

Costa Rica, and Guatemala are set freely by the market, but Honduras and Nicaragua still control prices to some degree.[6]

The DR-CAFTA countries have come a long way from the days of dictators, civil chaos, and conflict, but more reform is needed (see Table 1) and should be encouraged. For example, none of the DR–CAFTA countries has a strong rule of law, and the maze of business regulations (e.g., labor, zoning, and licensing) makes operating a business excessively complex and encourages corruption. With the exception of Costa Rica and El Salvador, all of the countries have extensive barriers to foreign investment and capital flows. Because these barriers make participation in the economy difficult, many of these countries still have large informal economies.

Benefits for the DR–CAFTA Countries

DR–CAFTA is a comprehensive agreement. It would not just reduce tariffs and eliminate quotas; it would also deregulate the services sector, for example, by removing local residency requirements.[7] The agreement expands access to foreign direct investment and fosters transparency rules, which are essential for doing business in the DR–CAFTA countries. According to the International Trade Administration, the agreement "requires regulatory authorities to use open and transparent administrative procedures, consult with interested parties before issuing regulations, provide advance notice and comment periods for proposed rules, and publish all regulations."[8]

Clearly, deregulating the services sector would benefit U.S. companies that are competitive in this area. In addition, it would be just as important—if not more important—to the DR–CAFTA countries' own businesses, enabling them to increase productivity and increasing the skills of millions of workers as new foreign businesses and new technologies enter their economies. With higher skills, workers will be more valuable and earn more money, increasing their living standards.

As living standards rise and people enjoy better lives, their interest in preserving these benefits also increases. Because they have more to lose from a crisis, they strive to preserve peace and stability. As a result, the likelihood of civil conflict decreases. At the same time, the improved domestic situation reduces the incentives to leave home in search of a better life elsewhere. Therefore, they are less likely to emigrate illegally to other, more prosperous countries like the United States.

Benefits for America

From an economics standpoint, DR–CAFTA would open a myriad of opportunities for American businesses, from exporting to the region to new markets for investment opportunities. It would also decrease the flow of illegal immigration to the U.S. However, the ultimate benefit would come from the economic and political stability the agreement would bring to the region. As the living standards of the DR–CAFTA countries' citizens rose, so would their economic stability and, therefore, their ability to preserve a less volatile political environment.

Congress should approve this agreement not just for the sake of the U.S. economy, which would benefit from expanded markets and lower costs for millions of imported products, but also for security reasons. A more stable Central America is key to the long-term fight against terrorism and anti-Americanism.

Conclusion

DR–CAFTA is an extremely important agreement for the United States, for both economic and security reasons. Advancing free trade is one the best foreign policy tools to help the U.S. economy and improve homeland security. The DR–CAFTA coun-

5. *Ibid.*
6. *Ibid.*
7. U.S. Department of Commerce, International Trade Administration, "CAFTA–DR Benefits to U.S. Commerce," at *ita.doc.gov/cafta/key_benefits/services.asp* (April 16, 2005).
8. *Ibid.*

tries have made enormous progress toward democracy and economic liberalization since the 1970s, and the free trade agreement would consolidate their democracies and institutional reforms.

Congress should approve DR–CAFTA promptly, not just to open a myriad of investment and trade opportunities to millions of U.S. business, but also because DR–CAFTA would foster long-term peace and prosperity in these Central American countries.

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