■ WILL CAFTA HELP CENTRAL AMERICA'S POOR?

TRADE

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AP/GINNETTE RIQUELME

TRADE BENEFITS: Skilled workers, such as this woman sewing clothes at a factory in Honduras, may benefit from a free-trade agreement with the United States.

Over the next few weeks, Congress may finally begin a great debate on the Bush administration's Central American Free Trade Agreement, a deal to extend tariff-free access to the United States for five Central American nations plus the Dominican Republic. Ways and Means Committee Chairman Bill Thomas, R-Calif., wants to bring CAFTA to a vote in the House before Memorial Day. Senate Finance Committee Chairman Charles Grassley, R-Iowa, has said he thinks a Senate vote can be held sometime in the next few months.

In the days and weeks ahead, much congressional discussion will focus on the potential impact of Central American sugar imports on the incomes of U.S. cane- and beet-sugar farmers. Impassioned floor speeches about the plight of U.S. textile and apparel workers who may lose their jobs because of the trade pact will be broadcast on C-SPAN. And behind the scenes, the White House will carefully weigh the impact of a CAFTA victory or defeat on President Bush's declining public-approval ratings.

Little time, however, will be spent on assessing the deal's effects on farmers and workers in Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. A small group of development experts and members of Congress think this would be a missed opportunity.

"There needs to be more concern for the impact of CAFTA on the poor in Central America," said Rep. Sander Levin, D-Mich., at a recent meeting of the Council on Foreign Relations. "They have to share in the benefits of trade," he added, because "addressing income inequality [in the region] is central to the development of democracy in these countries."

The Bush administration, the GOP majority in Congress, and their allies in the business community argue that trade liberalization stimulates growth, with this rising tide lifting all boats—including those of the Central American poor. But that argument is based on economic theories that, soon-to-be published research suggests, are "not consistent with reality."

For their part, Democrats, including Levin, have largely focused their CAFTA efforts on improving protections for laborers in Central America. They argue that this will empower workers to defend their own standard of living. But a third of Central Americans work in agriculture, and many others labor in the informal economic sector, largely beyond the reach of local laws. Strengthening labor laws may be necessary, but it's not sufficient to help Central America's poor.

"More trade does not necessarily mean less poverty," concludes a new multicountry study by InterAction, a Washington-based coalition of development and humanitarian groups. "One of the key premises for drawing developing countries into the global trading system and urging them to liberalize their trade policies is that this should promote growth and poverty reduction," the study states. To make that work, the coalition argues, what is needed is "programs geared to promoting the growth of trade-related economic activities that benefit the bottom tiers of developing-country economies—the poor, with a focus on women, who make up the vast majority of the poor in many countries."

So far, Congress has largely ignored this fundamental issue—the effect of trade on incomes in Central America and how to alleviate the adverse consequences of trade liberalization on the poor.

The White House says not to worry. "Free markets and open trade are the best weapons against poverty," President Bush said in 2002, in explaining his intention to pursue a free-trade agreement with the countries of Central America.

The president's faith in trade is based on economists' long-standing beliefs that the poor and the unskilled in developing countries are the most likely to gain from trade liberalization, because they are the ones producing the sugar, shoes, and apparel that rich countries, such as the United States, want to import. But Ann Harrison, a professor of agricultural and resource economics at the University of California (Berkeley) and the editor of the forthcoming book *Globalization and Poverty*, said at a recent conference at the Woodrow Wilson International Center for Scholars, "This Washington consensus 'to just open up' [markets] is just plain wrong."

One reason is that labor in developing countries is not nearly as mobile as trade theorists assume. In Central America, for trade to benefit unskilled workers—farm laborers, for example—they need to be able to move out of jobs that will face greater competition from efficient U.S. producers thanks to CAFTA—such as growing corn—and into jobs in exporting industries that are likely to be selling more products to the American market, such as apparel manufacture.

But mobility is not always a given. In both India and Colombia, trade liberalization has increased poverty among workers in some industries or locales precisely because labor cannot automatically move from one industry to another.

Similarly, economists have long argued that when trade barriers fall, unskilled laborers in a developing country will benefit more than skilled labor in that same society because, in a more open market, foreign demand rises faster for the goods produced by unskilled workers. But in Colombia, trade reform has been associated with rising income inequality, as skilled workers have captured most of the benefits of globalization.

Today in Central America, income equality is better than it is in Colombia. The challenge for CAFTA, say some development economists, is to avoid making the rich richer and the poor poorer in Central America.

And finally, traditional economic theory holds that when two countries trade, each has a comparative advantage in making and exporting some goods, and in importing those goods that it does not make as efficiently. But in a global economy, such neat divisions of labor can get more complicated. Take Mexico. Even though it has ample unskilled workers to produce low-cost goods for the U.S. market, China has even cheaper labor. So today, many Mexican-based industries are closing up shop and moving to China to supply the U.S. market from there.

Central America may find itself hard-pressed to realize many of the advertised benefits of CAFTA, thanks to that same Chinese dragon looming large in its rear-view mirror. In fact, in March, two dozen manufacturers left Guatemala alone to relocate to Asia, according to Guatemala's ambassador to the United States, José Guillermo Castillo.

This globalization doesn't mean that trade cannot benefit the poor in some circumstances, as CAFTA supporters contend and as several of the country-level studies in Harrison's book substantiate.

AP/KENT GILBERT

TRADE COSTS: Less-skilled workers, such as this cilantro farmer in Costa Rica, may lose out to the competition under a free-trade agreement with the United States.

In the mid-1990s in Panama, for example, unemployment fell following trade liberalization. In Zambia, poor consumers have gained from trade liberalization because the goods they buy have gotten cheaper, while producers in exporting sectors of the economy have benefited from higher prices for their goods. And as Neil McCulloch, a senior economist on poverty with the World Bank Group in Indonesia, reminded the audience at the Woodrow Wilson center, "There is no empirical support for the proposition that trade liberalization has an *adverse* impact on the poor."

Harrison countered, however, that "trying to say there are no losers [from trade liberalization] is patently absurd." Since the North American Free Trade Agreement took effect in the mid-1990s, for instance, Mexico has lost 1.3 million jobs, and most Mexicans' real wages have fallen, according to a 2003 Carnegie Endowment for International Peace study. This is not encouraging news for Central America.

According to Harrison's book, opening markets clearly helps some and hurts others. In Colombia, individuals working in those sectors of the economy facing increased competition from imports have gotten poorer. Those producing for the export market have grown richer. In Mexico, where NAFTA led to falling corn prices thanks to a flood of corn from the United States, really poor farmers with less than five hectares of land, who are net consumers of corn because their farms are too small to produce enough for their own use, have benefited from lower corn prices. Rich farmers—those with more than 15 hectares—have come out ahead, probably because they are efficient enough to remain competitive, or because they can switch to other crops. Those in the middle have suffered the most, because they are still growing corn and getting much lower prices.

Such outcomes from trade liberalization lead Harrison to conclude that "targeted compensation for losers is terribly important." If struggling Mexican corn farmers had not received income support from their government, their real incomes would have been halved during the 1990s, she said.

But the CAFTA deal now before Congress makes little provision for the poor.

The Bush administration touts its doubling of funds for trade-capacity building. "Trade-capacity building" refers to programs aimed at helping producers in poor countries become better exporters by providing such things as local road and bridge improvements; more money for local institutions that promote trade and worker training; and aid to help vulnerable sectors of Central American economies find new niche export markets.

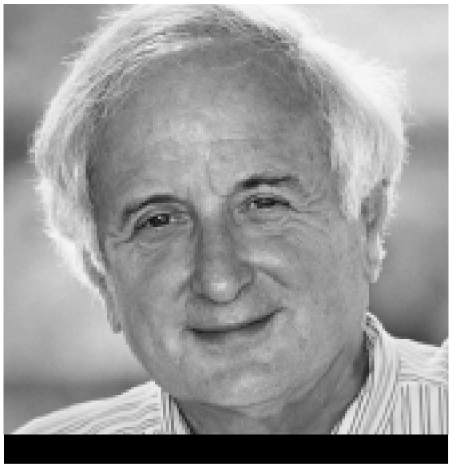
And in fact, spending by the U.S. Agency for International Development on such programs in the five Central American countries and in the Dominican Republic has grown from $24.6 million in 2002 to $53.2 million in 2004, thanks in large part to the efforts of Rep. Jim Kolbe, R-Ariz.

Most of this money, however, is aimed at improving Central America's competitiveness: in 2004, $17.1 million for export promotion and training, and $16 million to help expand agricultural exports. Such funds are certainly useful in preparing Central America for the rigors of global competition, but they are hardly Harrison's "targeted compensation for losers."

Moreover, poverty reduction is not even a primary purpose of the U.S. effort. As the InterAction paper notes, "In USAID's definition of [trade-capacity building], poverty reduction is mentioned in passing." The development coalition asserts that it doesn't have to be this way. It says that in the United Kingdom, London requires spending on trade-capacity building to "help countries work up a development plan or poverty-reduction strategy that incorporates trade and growth."

USAID's efforts are not the only ones in Central America, however. In 2003, the Inter-American Development Bank approved $319 million in financing for Central American projects designed to help improve competitiveness and raise productivity. Nearly a third of that money went to El Salvador, where much of it is being used to help privatize state-run maritime and air transport facilities. More-efficient ports and airports may be necessary to enable El Salvador to take better advantage of access to the U.S. market. But such investments will, at best, have only an indirect impact on poverty.

As Vincent McElhinny, an InterAction analyst, noted in a CAFTA critique last year, what the Bush administration's trade package notably lacks is funds aimed specifically at helping Central American trading partners adjust to the changes that could come from CAFTA. In many ways, he notes, the administration's efforts fall way short of those by the European Union, which is spending billions of dollars to raise the living standards of the poor in Poland, Latvia, and other nations that have recently become part of the European single market.



SANDER LEVIN: "There needs to be more concern for the impact of CAFTA on the poor in Central America."

Democrats on Capitol Hill, meanwhile, are focusing more on labor rights under CAFTA and not at all on trade-adjustment assistance for the Central American poor. Democrats want Central American countries to strengthen their labor laws, and they want the deal to include provisions for trade sanctions to ensure that governments in the region enforce such rules. "Strengthening unions would allow workers to bargain over wages, severance, and other working conditions," said Kimberly Ann Elliott, co-author of the Institute for International Economics book *Can Labor Standards Improve Under Globalization?* This could, if done right, clearly help poor workers improve their lot, she said.

Other economists worry that new labor rules could limit the flexibility of companies to hire and fire, as well as hinder workers from moving from job to job. The World Bank's McCulloch warned that flexible labor markets are needed to maximize the positive impact of trade liberalization on employment and wages while mitigating the adverse consequences. In Indonesia, the official minimum wage is six times the designated poverty-level income. That wage is so high, it has become a disincentive for companies to hire new workers, or at least an incentive to hire them off the books, where they are denied other benefits and protections and cannot be taxed.

Although most economists agree on the need for labor-market flexibility, what businesses see as flexibility, laborers may see as a license to exploit. Harrison said that more research is needed to assess whether labor legislation protects only the rights of the small fraction of workers who labor in the formal sector of the economy. More research is also needed to determine whether different kinds of labor rules and enforcement could cushion some of the short-term adjustment costs for displaced workers.

Economist Howard Rosen, executive director of the Trade Adjustment Assistance Coalition, in a paper being prepared for the World Bank on labor-market adjustment in developing countries, said, "Governments should aim to replace the 'stick' of employment laws, which make it difficult to terminate workers, with the 'carrot' of incentives to firms to retain workers."

Regardless of what labor rules ultimately get adopted, workers in Central America who are laid off because of CAFTA will be mostly out of luck. Not one of the CAFTA countries has an unemployment insurance program to provide a safety net for those who lose their jobs because of trade liberalization. "The International Labor Office, the World Bank, and other international institutions should provide technical assistance to help countries design and implement their own unemployment insurance system," Rosen recommends.

In addition, to train workers for the new jobs that trade liberalization is supposed to create, writes Rosen, "governments should offset the costs of training dislocated workers, either through direct government expenditures and/or through contributions from former employers."

All of this will require money, far more than is now available from USAID. Rosen suggests that the International Monetary Fund will have to get into the game, to help countries address their new financial burdens.

Although development economists don't agree on how to reform labor markets following CAFTA's implementation, they do agree on the importance of providing services and subsidies for the rural poor, who are likely to be most adversely affected by CAFTA. In both China and India, for example, agricultural extension services have helped reduce rural poverty by improving farm practices and productivity. In Mexico, income-support payments helped with rural poverty. In Central America, which has an even larger percentage of its populations living in rural areas, this will be a big challenge.

The Mexican experience offers a cautionary lesson. Thanks to local politics, government payments to farmers were based on acreage, which had the perverse effect of increasing production at a time of falling crop prices, and that worsened the problem. The lesson: Government must attack poverty, but must do it smartly.

To date, said McCulloch, "this debate [about the impact of trade on poverty] is very much based on assertion and anecdote." More of the same can be expected on Capitol Hill over the next few weeks.

What is clear from new research, however, is that CAFTA is not the win-win proposition its proponents claim. Trade liberalization creates both winners and losers. And even within the same country, CAFTA may lead to income losses for some rural agricultural producers and urban workers, while other consumers and producers in the same country gain. With such divergent outcomes, the plight of the poor cannot simply be assumed to improve as import barriers fall. Without a safety net, training, and job-placement efforts for those dislocated by trade, many Central Americans may rue the day that CAFTA passes the U.S. Congress. ■

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