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U.S. Trade Policy and the Caribbean: From Trade Preferences to Free Trade Agreements

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U.S. Trade Policy and The Caribbean: From Trade Preferences to Free Trade Agreements

Summary

For over 40 years, the United States has relied on unilateral trade preferences to promote export-led development in poor countries. Congressionally authorized trade preferences give market access to selected developing country goods, duty-free or at tariffs below normal rates, without requiring reciprocal trade concessions. The Caribbean Basin has benefitted from multiple preferential trade arrangements, the best known being those linked to the Caribbean Basin Initiative (CBI) begun in the mid-1980s. Since then, the growing number of reciprocal U.S. free trade agreements (FTAs) in the region have effectively replaced preferential trade arrangements, signaling a shift in U.S. trade policy and raising questions with respect to the future of those mostly smaller countries still relying on trade preferences. This report discusses the evolution of U.S. trade policy toward the Caribbean, focusing on the implications of moving from unilateral tariff preferences to reciprocal FTAs.

The U.S. Congress has approved multiple trade preference programs over the past three decades (production sharing, GSP, CBERA, CBI II, CBTPA, and HOPE Act of 2006). Each one amended trade rules and tariff preferences in ways designed to increase imports from CBI countries. Trade grew and many of the goals for development were supported. Evaluations of the benefits, however, suggested that they may not have been as robust as originally expected. Benefits tended to be concentrated in a few countries and products, often skirting industries with the greatest potential to stimulate exports. Also, the benefits of preferences are being eroded by multilateral trade liberalization and recently implemented FTAs.

A number of issues and circumstances are converging during the 110th Congress that will be a challenge for U.S. trade policy in the Caribbean region. Among these circumstances are the expiring trade preference programs, their limited use by remaining eligible countries, and the reluctance of these countries to make the transition to an FTA with the United States without some guarantee of a "development component" to the agreement. These concerns persist, despite the promise of permanent market access and increased investment that an FTA holds out. The Caribbean countries, long accustomed to dependent economic relationships, appear content to take a cautious and leisurely path toward any new arrangement with the United States.

For U.S. trade policy, which is still committed to achieving regional integration, these circumstances present a special challenge. Broader integration may be difficult to reconcile with the needs of very small developing countries, which are highly vulnerable to the vicissitudes of global economic trends and may require new and creative solutions, particularly if U.S. policy is still driven by the historical focus on development and regional security issues in addition to trade liberalization. In the context of continuing with trade preferences in similar or altered form, or opting for an FTA, the solution is not immediately obvious. This report will be updated.

For more information on the Caribbean region, see CRS Report RL32160, *Caribbean Region: Issues in U.S. Relations*, by Mark P. Sullivan

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U.S. Trade Policy and the Caribbean: From Trade Preferences to Free Trade Agreements

For over 40 years, the United States has relied on unilateral trade preferences as an integral part of its foreign economic policy. Trade preferences give market access to selected developing country goods, duty-free or at tariffs below normal (NTR)[1] rates, without requiring reciprocal trade concessions. They come in many forms and are intended to promote economic growth and development in poor countries by stimulating export promotion and investment, and to encourage the use of U.S. inputs in foreign manufacturing. Trade preference programs must be authorized by Congress and are usually done so for specific periods of time.

The Caribbean Basin (see **Figure 1**)[2] has benefitted from multiple preferential trade arrangements, the best known being those linked to the Caribbean Basin Initiative (CBI) begun in the mid-1980s. Since then, the growth of free trade agreements (FTAs) in the region has signaled a shift in U.S. trade policy, raising questions about the future path for those few countries still dependent on trade preferences. This report reviews the preference programs, discusses how they have been affected by FTAs in the region, and considers trade policy options for dealing with countries still relying on trade preferences, but that have yet to negotiate an FTA with the United States.

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[1] NTR is the acronym for "normal trade relations," a phrase adopted by the United States in lieu of the often confusing "most-favored-nation" (MFN) term used internationally. Both refer to the application of tariffs on a non-discriminatory basis. Tariff preferences are by definition inconsistent with NTR/MFN treatment, requiring a waiver from the World Trade Organization (WTO). See CRS Report RS22183, *Trade Preferences for Developing Countries and the WTO*, by Jeanne J. Grimmett.

[2] Caribbean Basin countries include Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, British Virgin Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

Figure 1. Map of the Caribbean Basin Region

Source: Map Resources. Adapted by CRS. (K.Yancey 6/30/06)

U.S. Preferential Trade Programs and the Caribbean Region

The United States has a long history of employing various types of trade incentives to encourage specific trade activities. Motivated by commercial, political, and security interests at times, the U.S. Congress has attempted to create trade preference programs that assist developing countries, while minimizing the negative economic impact on domestic producers and workers. Over time, bilateral, regional, and multilateral trade agreements have come to eclipse the importance of preference agreements, a trend that a review of these developments will show has been particularly visible in the Caribbean Basin.

Background: Early Trade Preference Programs

In 1964, the United States Government initiated a preferential tariff program based on production sharing. Production sharing is a cost-reducing business strategy that seeks competitive advantage by locating manufacturing processes in more than one country. U.S. firms specialize in the capital intensive, technology driven stages of production, and outsource assembly and other lower-skill processing to low-wage countries. Under the U.S. production-sharing program, foreign firms that import U.S. component parts and assemble or process them into finished or semi-finished products may then re-export them back to the United States, with duties levied only on the value added abroad (no tariff on U.S. content).[3]

U.S. firms benefit from production sharing by the required use of their inputs (to receive the tariff exemption) and in retaining a portion of the global market for goods that might otherwise go to lower-cost producers that do not use U.S. inputs. Foreign firms using U.S. inputs benefit from the tariff exemption, making their products more competitive in the U.S. market relative to those of other producers who face a duty on the full value of their exports. This type of production arrangement has been commonly used for automobile parts, electronics, and apparel, among other products.[4]

The Caribbean Basin and Mexico were early beneficiaries of the production sharing program, with proximity providing a major advantage at that time. Lower transportation costs and quicker turn around times have provided Mexican, Caribbean, and Central America producers with an additional competitive factor over their more distant, but lower cost Asian competitors. Many Caribbean countries developed their export processing zones around this program, particularly various niches in the apparel business.

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[3] Initially defined under Item 807 of the U.S. tariff schedule, and later in Chapter 98 of the U.S. Harmonized Tariff Schedule (HTS). United States International Trade Commission. *Production Sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1995-1998.* Washington, D.C. USITC Publication 3265. December 1999. pp. 1-1 and 1-2.

[4] Production sharing is also done by European and Asian firms.

By the 1970s, the concept of preference programs for developing countries shifted. Whereas production sharing was based on a mutually beneficial competitive business strategy, developing countries had long advocated unilateral trade preferences as a form of development assistance. Under the auspices of the General Agreement on Tariffs and Trade (GATT), the Generalized System of Preferences (GSP) was conceived as a way for developed countries to respond to this expressed need. The GSP permits developed countries to grant unilateral tariff preferences for selected imports from developing countries to promote export-led growth. The U.S. program provides limited tariff incentives for many, but not all products. The Caribbean region has availed itself of both the GSP and production sharing incentives for many years. The U.S. GSP program requires periodic renewal by Congress and was last reauthorized through December 31, 2008.[5]

The tariff preference model as development strategy continued to evolve in the 1980s. The next step targeted specific regions of the world for deeper preferences, a strategy driven by security, as well as economic and political interests of the United States. Congress enacted the first such geographically targeted program for the Caribbean region in 1983.[6]

The Caribbean Basin Economic Recovery Act of 1983

The impetus to create a Caribbean trade preference program arose from concern over the region's economic collapse and concomitant political radicalization that materialized in the early 1980s. The Caribbean's Basin's "proximity, vulnerability, and instability" has long made it of particular strategic interest to the United States, a notion well established in U.S. political history dating to the Monroe Doctrine.[7] In light of this reasoning, President Reagan and many Members of Congress agreed to consider a comprehensive response to the Caribbean Basin's troubles. Trade preferences would emerge as the primary economic component.

President Reagan unveiled the CBI in a speech before the Organization of American States on February 24, 1982, arguing that ensuring economic and political stability in the Caribbean region was vital to U.S. security interests. He proposed a controversial mix of tax incentives, aid, and trade preferences. The idea was rejected by many, however, particularly import-competing firms and workers. As a consequence, the first bill died in the 97th Congress.[8] In the 98th Congress, however, Congress acted promptly on the Caribbean Basin Economic Recovery Act (CBERA).[9] Although it again drew stiff resistence from labor interests, once scaled back to modest duty-free treatment for only 10% of Caribbean imports, it passed with

[5] See CRS Report RL33663, *Generalized System of Preferences: Background and Renewal Debate*, by Vivian C. Jones.

[6] Other geographically targeted trade preference programs would be created in the Andean Trade Preference Act (ATPA) and the African Growth and Opportunity Act (AGOA).

[7] See Pastor, Robert A. *Exiting the Whirlpool: U.S. Foreign Policy Toward Latin America and the Caribbean, Second Edition*. Boulder: Westview Press, 2001. pp. 19-20.

[8] 1982 CQ Almanac. *Caribbean Trade Plan*. pp. 54-55 and 129.

[9] The CBI was a comprehensive program, with the tariff preferences codified in the CBERA.

overwhelming support in both the House (392-12) and the Senate (90-7).[10] President Reagan signed it into law on August 5, 1983 (P.L. 98-67) and the preferences went into effect on January 1, 1984.

The CBERA stipulated that 27 countries could be designated by the President as beneficiary countries (24 eventually were — see **Appendix 1**) to receive duty-free or reduced-duty access for selected exports provided the countries meet specific conditions. Designation is prohibited if the country: 1) is a Communist country; 2) has seized U.S. property without compensation; 3) fails to recognize or enforce awards arbitrated in favor of U.S. citizens; 4) affords preferential treatment to goods from other countries to the detriment of U.S. commerce; 5) broadcasts U.S. copyrighted material without permission; 6) has not signed an extradition agreement with the United States, or 7) is not taking steps to afford internationally recognized worker rights. Eligibility can be suspended if a country fails to meet these criteria. Thus, the unilateral nature of the arrangement is clear: meet U.S.-defined eligibility criteria and selective imports will be granted trade preferences. No negotiation is involved.[11]

Provided a good is wholly the "growth, product, or manufacture" of, and imported directly from, a beneficiary country, it may enter the United States duty free or at a reduced rate of duty. There were, however, significant exceptions for articles defined by Congress as "import sensitive." These included textiles and apparel subject to textile agreements under the Multi-Fiber Arrangement (MFA),[12] a sector that has seen diminished employment from foreign competition, petroleum products, footwear, handbags, luggage, flat goods, work gloves, leather wearing apparel, canned tuna, and watches or watch parts. Under the rules of origin, 35% of the article's value of labor and parts had to originate in a beneficiary country, although some 15% of the 35% could be of U.S. origin.[13]

A number of special provisions also applied. First, all Caribbean imports were still subject to safeguard measures (resumption of tariffs) if the imports were shown to increase quantities to a level that would hurt U.S. producers. Also, special treatment was afforded to some import-sensitive goods. CBERA gave ethanol imports duty-free entry if produced under certain conditions[14] and sugar imports from the region entered under a tariff rate quota (TRQ) — duty free up to a specified quota and then taxed at prohibitively high levels.

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[10] 1983 CQ Almanac. *Caribbean Trade Plan*. pp. 252-53.

[11] Some of these conditions may be waived by the President for national security reasons. Other requirements were also in force. For a summary, see U.S. Congress. House. 109th Congress. 1st Session. Committee Print. Committee on Ways and Means. *Overview and Compilation of U.S. Trade Statutes*. Part I of II. June 2005. pp. 23-24.

[12] Recast in 1994 under GATT as the Agreement on Textiles and Clothing (ATC), it was the framework for the global bilateral textile quota agreements that were finally phased out on January 1, 2005.

[13] P.L. 98-67, section 213.

[14] Ibid, pp. 26-28 and CRS Report RS21930, *Ethanol Imports and the Caribbean Basin Initiative*, by Brent D. Yacobucci.

Congress also required that the United States International Trade Commission (USITC) produce regular reports on the effects of the preference program. The USITC found that for the first five years, the impact was relatively small, with imports from beneficiary countries expanding at slower rates than imports from the rest of the world. CBERA eligible products, nonetheless, grew from 6.7% of total imports from CBERA beneficiary countries in 1984, to 7.4% in 1985, 11.1% in 1986, 12.7% in 1987, and 13.0% in 1988. Even these numbers overstate the effects because there was an increasing shift from use of duty-free access under GSP to CBERA, so the total value of duty-free goods entering from the CBERA beneficiary countries was nearly steady, rather than expanding.

Special Access Program. Under CBERA, textile and apparel products were excluded from receiving tariff reductions, despite the fact that they are a major manufacturing export (and job creating) sector for the region. Textile and apparel articles are considered highly import sensitive in the United States and elsewhere, and their trade was controlled by quotas defined in bilateral textile agreements permitted under the MFA. In 1986, President Reagan, by executive order, established a Special Access Program (SAP) that granted guaranteed access levels (GALs) for apparel from eligible CBERA countries, provided it was assembled from fabric formed and cut in the United States.[15]

Following implementation of the SAP, there was an immediate large increase in apparel imports from CBI countries. It is important to recognize, however, that this increase occurred because of changes in U.S. textile policy, not the CBERA, which did not provide preferential tariff rates for imports from Caribbean producers. The increase in demand for Caribbean apparel articles at this time was evident nonetheless, driven by their relatively low cost, production proximity, and the higher quota levels that Asian producers still faced. Tariffs on textile and apparel goods from the CBI countries, however, remained a significant barrier and would not be addressed in legislation until 2000.[16]

The Caribbean Basin Economic Recovery Expansion Act of 1990

Soon after the original CBERA went into force, concern over the effectiveness of its trade preferences surfaced. Two issues stood out: 1) expanding the program to include a greater number of Caribbean goods, and 2) making the program permanent. The legislation as initially proposed would have extended additional tariff benefits to textiles, apparel, sugar, petroleum, leather goods, and other items left out of the 1983 legislation. It also would have repealed the September 30, 1995 termination date, making the duty preferences permanent.

[15] USITC, *Production Sharing: Use of U.S. Components and Materials in Foreign Assembly Operations, 1995-1998,* pp. A-4 and A-5.

[16] USITC. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers*. Sixth Report. Washington, DC, 1990. pp. 1-6 and 2-9.

As the initiative made its way through the legislative process, however, many of the preferences that might have had the greatest economic impact on the Caribbean, like the textiles and apparel provisions, were stripped from the bill. This change allowed the Caribbean Basin Economic Expansion Act of 1990 (referred to as "CBI II") to be passed as Title II of the Customs and Trade Act (P.L. 101-382). It made permanent the existing CBI preferences for beneficiary countries, but extended them only to a few new products. Changes included a limited phased-in tariff reduction for handbags, luggage, flat goods, work gloves, and leather goods not eligible for GSP treatment, and duty-free and quota-free treatment for articles other than textiles, apparel, and petroleum products that are assembled or processed from U.S. components. There were also new limited benefits for ethanol imports and a few non-trade incentives. CBI imports were also given an exception from antidumping (AD) and countervailing duty (CVD) cumulation rules, making it harder to show that U.S. firms had experienced material injury from those imports.

The Caribbean Basin Trade Partnership Act and NAFTA Parity

On January 1, 1994, NAFTA took effect, altering the relative tariff situation in the region, thereby igniting a debate over parity issues among competing trade agreements and arrangements. Imports from Mexico received much reduced tariffs or duty-free treatment under NAFTA, which as it phased in over 14 years, would make for an increasingly large benefit to Mexico. Preferential access for textile and apparel goods would be applied not only to the value of U.S. content, but importantly, to the value added in Mexican production. Imports were subject to detailed rules of origin generally limiting content of traded goods to materials made in the NAFTA countries, thus excluding CBI countries. The effects seemed apparent; two-way trade in textiles and apparel between the United States and Mexico rose 218% from 1993 to 2002.[17]

NAFTA eliminated much of the relative trade advantage that the CBI countries had enjoyed over Mexico since 1984, and gave Mexico a distinct advantage in apparel production, which was a dominant export sector for the Caribbean countries as well. Mexico's much larger economy and production capacity for textiles and apparel became an immediate threat to income and employment in the CBI countries, which began to lobby for U.S. trade preferences equal to those of Mexico. This became known as the CBI/NAFTA parity issue.

While some in Congress were sympathetic to CBI country claims, particularly after the region's devastation from Hurricanes Georges and Mitch in 1998, it took years to gather the support to pass legislation. The idea was to provide the CBI countries with NAFTA-equivalent preferences until such a time that they could either accede to NAFTA, or enter into a similar reciprocal FTA with the United States. Because textile and apparel trade was at the heart of the program, the legislation had to overcome resistence from import-competing U.S. manufacturers. Nonetheless, on May 18, 2000, following Congressional passage, the Caribbean Basin Trade Partnership Act (CBTPA — P.L. 106-200) was signed into law, extending additional

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[17] CRS Report RL31723, *Textile and Apparel Trade Issues*, by Bernard A. Gelb.

benefits for a "transition period" of eight years ending September 30, 2008, or until a beneficiary country signs an FTA with the United States.[18]

Eligibility for CBTPA benefits include all those under CBERA, plus an additional emphasis on countries meeting their trade obligations under the World Trade Organization (WTO) and making progress toward some type of FTA with the United States.[19] The most important provisions provide that certain articles excluded from CBERA that meet NAFTA rules of origin may receive NAFTA tariff treatment, specifically: canned tuna, petroleum products, footwear, handbags, luggage, flat goods, work gloves, and leather-wearing apparel.

Textile and apparel articles were also given essentially NAFTA-equivalent treatment. Those assembled in beneficiary countries are eligible for duty-free and quota-free treatment subject to rules of origin, provided they are assembled from fabrics made and cut from U.S. yarns.[20] However, articles in which the fabric is also cut in the CBTPA country may also enter duty free, if the parts are sewn together with U.S. thread. Limited amounts of knit apparel (not socks) using U.S. yarns are also given duty-free treatment, as are certain brassieres, handloomed, handmade, and folklore articles, textile luggage, and articles made from materials not available, or materials demonstrated not to be available in commercial quantities, in the United States. The apparel duty preferences were later modified in the Trade Act of 2002, requiring that imported knit and woven garments using U.S. fabric be dyed, printed, and finished in the United States.[21] The CBTPA also prohibits illegal transshipment of textile and apparel products and directs the President to have the USTR convene meetings with CBTPA beneficiary countries to encourage movement toward a free trade agreement with the United States.

CAFTA-DR and New Parity Issues

When the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) was implemented on March 1, 2006 (P.L. 109-53), the trade preference landscape shifted again.[22] CAFTA-DR leads to nearly full free trade between the United States and member countries when it is fully implemented. Provisions covering textile and apparel, the largest import category from the region,

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[18] The CBTPA is not an amended version of CBERA, but an additional piece of legislation defining a separate and temporary program of tariff preferences.

[19] The irony of formally requiring beneficiary countries to meet their WTO obligations in a preference program that runs contrary to the WTO-enshrined MFN principle was not lost on the Caribbean countries. See Caribbean Community and Common Market. *CARICOM Trade and Investment Report 2005*. Georgetown, Guyana. 2006. p. 69.

[20] For a summary, see U.S. Congress, *Overview and Compilation of U.S. Trade Statutes*. op.cit., pp. 32-33.

[21] For details, see USITC. *The Impact of the Caribbean Asin Economic Recovery Act: Seventeenth Report, 2003-2004*. USITC Publication No. 332-227. September 2005. pp. 1-9 thru 1-12.

[22] To date, El Salvador, Honduras, Nicaragua, Guatemala, and the Dominican Republic have implemented the agreement. Costa Rica's legislature is still considering the FTA.

were enhanced from those offered under CBTPA and made permanent.[23] They provide for immediate elimination of duties on textiles and apparel that meet rules of origin. These rules are even more relaxed than in other preferential agreements and FTAs, including the CBTPA. Stated briefly, provided components are sourced in any one of the member countries, the finished assembled product may be exported to the United States duty free. Generally, the intent of the agreement is to build on the history of increasingly flexible CBI programs that allow apparel producers in the region to combine materials and production in various ways and still receive duty-free access to the U.S. market.[24]

CAFTA-DR, much like NAFTA a decade earlier, created parity problems for other producers in the region that cannot export under these relaxed rules of origin or reduced tariffs. Mexico was one, but the United States agreed in January 2007 to harmonize the rules of origin as applied to NAFTA and CAFTA, which will allow Mexican and Central American producers to use each other's inputs without penalty, further integrating the region's apparel production.[25] Haiti was not included in this deal, which caused Congress subsequently to pass separate legislation covering Haitian apparel imports (see below). The rest of the CBI countries, however, are at a disadvantage relative to NAFTA, CAFTA-DR, and Haiti with respect to trade preferences in general, and apparel trade in particular.

The HOPE Act of 2006: New Haiti Trade Preferences

In part to respond to concerns over Haiti's apparel parity issue, as well as its broader development challenges, Congress made the latest change to the CBI programs with passage of the Haitian Hemispheric Opportunity through Partnership Encouragement (HOPE) Act of 2006, Title V of the Tax Relief and Health Care Act of 2006 (P.L. 109-432). It was implemented on March 19, 2007. Congress provided the poorest country in the hemisphere with trade preferences in addition to those already available under the GSP, CBERA, and CBTPA. Eligibility criteria includes making progress toward achieving a market-based economy, enhancing the rule of law, eliminating barriers to U.S. trade, combating corruption, and protecting internationally recognized human and worker rights, among other institutional goals that have historically proven difficult for Haiti to achieve.[26]

The major benefits are tariff preferences for Haitian produced textile and apparel goods, including more flexible rules of origin than those applied to apparel imports

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[23] USITC. U.S.-Central America-Dominican Republic Free Trade Agreement: *Potential Economywide and Selected Sectoral Effects*. USITC Publication 3717. August 2004. p. 27-28.

[24] Ibid., pp. 28-30.

[25] Latin American Newsletters. *Latin American Mexico and NAFTA Report*. February 2007. p. 14.

[26] For more on Haiti, see CRS Report RS21839, *Haitian Textile Industry: Impact of Proposed Trade Assistance*, by Bernard A. Gelb, and CRS Report RL32294, *Haiti: Developments and U.S. Policy Since 1991 and Current Congressional Concerns,* by Maureen Taft-Morales.

from other countries. Apparel goods wholly assembled or knit to shape in, and imported directly from, Haiti receive duty-free treatment. The major difference is that Haitian firms may use components from third countries. This benefit, however, is limited. A certain percentage of material and processing cost, rising from 50% in year one to 60% in year five, must originate in Haiti, the United States, or a country that has a preference program or FTA with the United States. There are also quantitative restrictions. The Haiti program is set to expire in 2012.

Because 90% of Haiti's exports to the United States are woven and knit apparel, the HOPE Act potentially provides an important competitive advantage to Haitian garment producers over others in the region. Textile and apparel interests in the United States lobbied against the more generous rules of origin precisely because they would encourage apparel producers to move to Haiti from other locations in the region in order to use less expensive Asian inputs, to the possible detriment of U.S. producers.[27] Two issues currently dominate the implementation of the HOPE Act, administering the very complex rules of origin and making a realistic assessment of Haiti's ability to meet the eligibility criteria.

Trade Effects of Tariff Preferences

To promote export-led growth in CBI countries, the U.S. Congress has approved multiple trade preference programs over the past three decades (production sharing, GSP, CBERA, CBI II, CBTPA, and HOPE Act of 2006), as well as two free trade agreements (NAFTA and CAFTA-DR). Each one amended trade rules and tariff preferences in ways designed to increase U.S. imports from CBI countries. Although legislative action at the close of the 109th Congress focused on enhancing Haiti trade preferences, there has been a longer term trend toward the use of free trade agreements in the region. Before considering this change, this section assesses the effects of unilateral trade preference programs by identifying changing trends in U.S. imports from the CBI countries.[28]

Imports by Duty Category

Table 1 displays trends in U.S. imports from CBI countries since the CBTPA program began, with imports presented as entering either as dutiable or duty free under various preference programs.[29] **Table 1** is divided into three major sections. In section one, the dutiable value, calculated duty, and average duty applied to aggregate CBI imports all show a downward trend from 2000 to 2004, reinforcing the corresponding percentage increase in the value of duty-free imports entering the United States shown in the seventh row. In disaggregating these date, as discussed

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[27] CRS Report RS21839, *Haitian Textile Industry: Impacts of Proposed Trade Assistance*, by Bernard A. Gelb.

[28] This discussion draws on a more detailed analysis in USITC, *The Impact of the Caribbean Basin Economic Recovery Act*, Seventeenth Report, September 2005.

[29] To simplify **Table 1**, a small percentage (usually less than 1%) of imports that enter under reduced duties per various programs has been combined with "other dutiable" imports.

below, it is important to distinguish between two types of trends in the tariff preference programs, those that allow new categories of goods to enter the United States duty free, counted as increased trade because of trade preferences, and those that merely switch goods from one preference category to another (e.g. from GSP to CBTPA), accounting for no real preferential trade growth.

Table 1. U.S. Imports from CBI Countries by Dutiable Category, 2000-2004

Duty Import Category:	**2000**	**2001**	**2002**	**2003**	**2004**
- Dutiable Value, all imports ($ mil)	7,778	5,590	5,462	4,902	5,770
- Calculated Duty ($ thousands)	915	578	496	513	457
- Average Duty (%)	11.8	10.3	9.1	10.5	7.9
Dutiable Value — All Imports: (%)	**35.2**	**27.2**	**25.8**	**20.2**	**21.0**
- Production sharing	12.7	6.8	4.7	3.8	3.8
- Other dutiable	22.5	20.4	21.1	16.4	17.2
Duty-free Value — All Imports: (%)	**64.7**	**72.9**	**74.2**	**79.8**	**79.0**
- NTR	30.1	27.3	27.5	33.2	35.4
- Production sharing	21.0	6.7	3.6	2.1	2.2
- CBERA	11.7	12.7	13.7	12.2	11.0
- CBTPA	0.7	24.9	28.6	30.7	28.8
- GSP	0.9	0.9	0.4	1.0	1.3
- Other duty-free	0.3	0.4	0.4	0.5	0.3
Imports entering CBERA/CBTPA (%)	12.6	40.2	47.1	42.6	39.7
Exclusively under CBERA/CBTPA*(%)	6.8	22.9	31.5	30.2	30.1

Data Source: USITC. *The Impact of the Caribbean Basin Economic Recovery Act. Seventeenth Report, 2003-2004*. September 2005. pp. 2-10, 2-11, and 3-4.

* Means goods would not have entered duty free under any other program.

In the second section of the table, note that the dutiable value of total imports has fallen from 35% to 21%, reflecting two trends: final implementation of the WTO Uruguay Round commitments, which shifted some imports from the CBERA to the NTR (other) duty-free category, and more significantly, the implementation of CBTPA for textile and apparel articles. Note that by 2004, most goods with duties entered the United States under the "other dutiable" category or NTR rates.[30]

The real story can be seen in the duty-free categories. The duty-free portion of U.S. imports of CBI goods has grown from 65% to 79% in the four years ending 2004. Note, however, that there has been no significant change in the percentage of duty-free goods entering under the CBERA, GSP, or "other duty free" categories. Articles coming in under the older production sharing program, by contrast, have

[30] USITC, *The Impact of the Caribbean Basin Economic Recovery Act:* Seventeenth Report, pp. 2-10 to 2-12.

fallen sharply. There has also been a slight increase in the portion of goods coming in NTR duty-free, while those entering under CBTPA grew suddenly once it was fully implemented. Taken together, these trends point to both a switch in apparel goods entering under the CBTPA that previously entered under production sharing preferences, and modest increase in the value of new imports eligible for duty-free treatment.[31]

In section three, the last two rows of **Table 1** highlight that the total imports entering under the combined CBERA and CBTPA provisions rose from 12.6% of total CBI imports in 2000 to 39.7% in 2004. In addition, the amount that entered exclusively from these preferences, that is, could not have entered under any other program such as GSP, rose from 6.8% of total imports to 30.1%. This trend reinforces the fact that the original CBERA program appeared to have had limited effect, whereas the CBTPA textile and apparel preferences appeared to have provided a more robust response.[32]

Nearly all these trends are consistent with the intent, expectations, and evolution of the preferences programs, but demonstrate that for nearly 17 years the effects of preference programs were less than might have been expected, until the CBTPA was implemented. The CBTPA trade appeared quickly, but stabilized by 2002. The increase in the NTR duty-free category is the one possible anomaly, which along with understanding the specific effects of each preference program, requires a more detailed analysis at the product level.

Product Trends

Not all CBI exports were affected equally by the various tariff preference programs. Major product categories are shown in **Figure 2**, three of which stand out: knit apparel, woven apparel, and mineral fuels. In 2006, mineral fuels, knitted, and non-knitted apparel composed 57% of U.S. imports from CBI countries. The mineral fuels group stands apart as a combination of products that received new benefits under CBTPA or entered NTR duty free when the final Uruguay Round commitments phased in, and were therefore, switched out of the CBERA category. The percentage increase also reflects recent large increases in energy prices. Liquified natural gas, anhydrous ammonia, heavy fuel oil, and light fuel oil have NTR rates of 0.1% or less, and account for the increase in the portion of duty-free NTR goods.[33]

Trends in the apparel industry are more germane to this report as the key value-added export industry targeted at the United States market, and as a main focus of CBTPA. **Table 1** indicates that there has been an increase in the value of duty-free apparel goods that entered under CBTPA as discussed above, largely attributable to preferences that encouraged a shift in content mix of apparel that for the first time allows fabrics to be cut in the region. Yet, as the USITC has noted, from 2000 to

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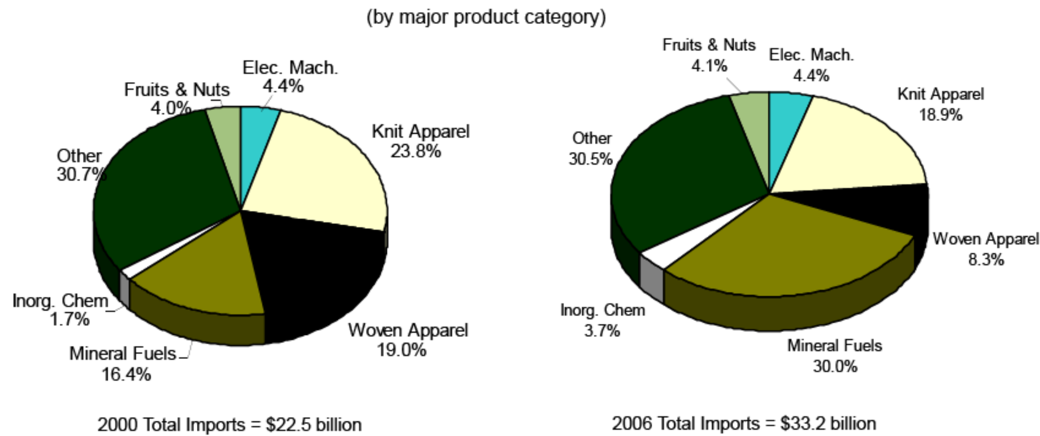
[31] Ibid.

[32] For more detailed data, ibid., pp. 2-11 and 3-4.

[33] Ibid., p. 2-13.

2004, U.S. imports of apparel goods from the CBI countries were unchanged at 12%-13% of total apparel imports worldwide,[34] implying that even with growth in imports from these preferences, the CBI countries have only been able to maintain market share relative to the world's other apparel producers.

Figure 2. U.S. Imports from CBI Countries, 2000 and 2006



Data Source: U.S. Department of Commerce.

Country Trends

There were 24 countries in the original CBERA group until the CAFTA-DR took effect (see **Appendix 1**). Once implemented, the CAFTA-DR benefits replaced those under CBERA and the CBTPA. U.S. imports from all 24 countries from 2000 to 2006 are presented in **Table 2** and by product in **Figure 2**. Among the most noticeable trends for 2005, the last year all 24 countries received CBI preferences, are as follows:

- 51% of U.S. imports originated in only three CBI countries; 90% in the top eight;
- the number one exporter by value is Trinidad and Tobago, which with Aruba's high trade value, is explained by energy exports (see also **Figure 2**);
- the other top exporters to the United States (Dominican Republic, Costa Rica, Guatemala, Honduras, El Salvador) are all major apparel manufacturers, with Costa Rica's trade increasingly dominated by semiconductors, which enter NTR duty free (details not shown);
- the top six CBI exporting countries, not including energy producers Trinidad and Tobago and Aruba, accounted for 95.6% of textile and apparel exports to the United States;

[34] Ibid., p. 2-18.

- For 2006, the first year that CAFTA-DR was in effect, imports from the five countries that have so far implemented the agreement (**bolded in Table 2**) were valued at $14.7 billion, or 44% of total imports from the CBI countries. With the inclusion of Costa Rica (a presumed future CAFTA-DR country), this total becomes $18.6 billion, or 56% of total imports from the CBI countries;

- If imports from CAFTA-DR and energy exporting countries are not included, the remaining U.S. imports from the region amount to only 10% of the current total from beneficiary countries, and only a portion of that amount would be eligible for tariff preferences.

To summarize, benefits have been concentrated only in a few key beneficiary countries because of their well-endowed energy related products. The non-energy exports appear to support the conclusion that the CBTPA has had some influence on the export patterns of CBI countries, but the data trends also highlight a shift in duty category (from HTS9802 production sharing to CBTPA), as well as an increase in trade value or volume. As mentioned earlier, total U.S. imports of textile and apparel goods from the CBI countries as a percent of the world import total has remained fairly constant (13%-14%) from 2000 to 2004, and when CAFTA-DR is fully implemented, over half of the exports from eligible countries that account for most of the apparel manufacturing will no longer enter under a CBTPA program.[35] The preferences are effectively being phased out in favor of reciprocal FTAs.

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[35] USITC, *The Impact of the Caribbean Basin Economic Recovery Act:* Seventeenth Report, pp. 2-12 to 2-18.

Table 2. U.S. Imports by CBI Country, 2000-2006
($ millions)

Country	2000	2001	2002	2003	2004	2005	2006#
Trinidad and Tobago	2,228	2,380	2,440	4,334	5,842	7,891	8,370
Dom. Rep.	4,383	4,183	4,169	4,455	4,527	4,604	**4,529**
Costa Rica	3,539	2,886	3,142	3,364	3,333	3,415	3,844
Honduras	3,090	3,126	3,261	3,313	3,640	3,749	**3,718**
Guatemala	2,607	2,589	2,796	2,947	3,154	3,137	**3,100**
Aruba	1,536	1,034	774	955	1,776	2,920	2,845
El Salvador	1,933	1,880	1,982	2,020	2,052	1,989	**1,856**
Nicaragua	588	604	680	770	990	1,181	**1,526**
Neth. Antilles	719	485	362	632	435	922	1,119
Jamaica	648	461	396	423	320	376	520
Haiti	297	263	255	332	371	447	496
Bahamas	275	314	450	479	638	700	453
Panama	307	291	303	302	316	327	378
Belize	94	97	78	102	107	98	147
Guyana	140	140	116	119	122	120	125
St. Kitts/Nevis	37	41	49	45	42	50	50
Barbados	39	40	34	44	37	32	34
Brit. Virgin Is.	31	12	41	35	17	34	26
St. Lucia	22	29	19	13	14	32	30
Antigua/Barbu.	3	4	4	13	5	4	6
Grenada	27	24	7	8	5	6	5
St. Vincent/the Grenadines	9	23	17	4	4	16	2
Dominica	7	5	5	5	3	3	3
Montserrat	0*	0*	0*	1	0*	1	1
Total	22,559	20,911	21,380	24,715	27,750	32,054	33,183

Data source: U.S. Department of Commerce.
Notes: *less than 0.5 million. # Preliminary estimates. **Bold** figures reflect imports no longer eligible for CBI benefits because country has implemented the CAFTA-DR agreement.

Trade Preference Programs in Perspective

Since implemented in 1984, the various Caribbean tariff preference programs were intended to assist beneficiary countries with creating an export-led development strategy. The target countries have combined U.S. trade preferences with their own market niching strategies based on proximity to the U.S. market that has allowed them to maintain their market share. It is a strategy that may have led to some growth in exports and helped promote the development agenda in many countries. The effects, however, may have run their course given the growth of large low-cost producers in China, India, Malaysia and other Asian countries. In addition, many

economists have long been skeptical about the efficacy of trade preferences as a development strategy, pointing to two areas in particular: design and administration of the preference programs and weak trade effects.

Structural design flaws that limit the effectiveness of unilateral trade preferences is a common concern. Trade preferences are paternalistic in nature; designed by developed countries to give "generous" one-way benefits to developing countries, but as unilateral concessions, they are self-limiting often for political reasons. For example, critics argue that:[36]

- unilateral agreements are non-binding, often subject to renewal, and can be denied or suspended (and have been) on a product or country basis, which can hinder investors from committing more fully to developing economies;

- eligibility criteria are based on foreign policy and political goals of the developed country, often unrelated to enhancing trade performance, so they are not a costless proposition; and

- program details are subject to domestic economic pressures, typically excluding articles that are import sensitive, which can cause the developed country to apply higher than average tariffs on these goods for non-beneficiary countries.

The CBI programs are not immune to some of these criticisms. Beneficiary countries have no say in the design of the tariff preferences, must lobby the U.S. Congress and Executive Branch to make a case for their continuance, must comply with numerous foreign policy and political requirements to maintain eligibility, and have not always been able to export key products under preference programs. Results of the CBERA program disappointed some because of its many limitations. Even with CBI II making the program permanent and the CBTPA adding many new products to the list of eligible exports, including textile and apparel articles, success has not been overwhelming.

Critics also fault preferences for their limited trade effects and the distortions they can introduce into the economies of recipient countries and the global trading system. U.S. tariff preferences offered to the Caribbean countries often:[37]

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[36] Srinivasan, T. N. *The Costs of Hesitant and Reluctant Globalization: India*. p. 31. [http://www.econ.yale.edu/~srinivas/] and Özden, Caglar and Eric Reinhardt. Unilateral Preference Programs: The Evidence. In: Evenett, Simon J. And Bernard M. Hoekman, eds. *Economic Development and Multilateral Trade Cooperation*. World Bank. Washington, D.C. 2006. p. 190-192, 197-198 and 204-205, and CARICOM Secretariat. *Caribbean Trade and Investment Report 2005*. Caribbean Community Secretariat. Georgetown, Guyana. 2006. p. 61.

[37] Özden and Reinhardt, *Unilateral Preference Programs: The Evidence*, p. 191, and *CARICOM Trade and Investment Report 2005*, pp. 61-62.

- replaced tariff with nontariff barriers, usually quantitative restrictions, as is the case for some goods entering under the CBERA, CBTPA, and HOPE Act;

- have complicated rules of origin that are costly, cumbersome to implement, and frequently inhibit use of preferences;

- required use of relatively higher-cost U.S. inputs, offsetting the cost competitiveness benefit of the tariff concessions;

- induce trade growth explicitly through trade diversion (Caribbean apparel instead of Asian);

- can bias a country's investment pattern toward particular industries, limiting incentives to diversify their economies, and also prolonging other market-based adjustments;[38]

- can induce recipients to limit export promotion and increase barriers to entry in industries facing CBI quantitative restrictions, and;

- can act as a disincentive to participate in multilateral trade negotiations, given they lead to an erosion of regional preference margins.

U.S.-Caribbean Basin Trade Relations: Policy Options

For over 40 years, the United States has provided some type of trade preference program to the countries of the Caribbean Basin. A central reason has been to promote an export-led development strategy with an eye on encouraging long-term political and social stability — on balance, all considered in the best commercial and strategic interests of the United States. The time for evaluating these programs is ripe because multilateral liberalization and Asian low-cost producers are eroding the effects of tariff preferences. In addition, U.S. trade policy in the region has been moving toward reciprocal free trade agreements, reducing the number of beneficiary countries and amount of trade eligible under these preferences.

With the largest of the CBI economies now part of CAFTA-DR, a remaining U.S. trade policy question is what to do with the smallest Caribbean nations. These, by definition, are the smallest and some of the most economically vulnerable countries that have banded together in their own regional arrangement known as the Caribbean Community and Common Market (CARICOM — see **Appendix 1**). Options include 1) allow trade preference programs to expire; 2) renew them as is or with more generous and flexible preferences; or 3) negotiate an FTA.

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[38] In fact, the two major industries affected show limited promise for growth. Energy-based exports are limited by available resources and manufacturing is done on such a small scale as to be increasingly less competitive with Asian producers.

Allow Trade Preference Programs to Expire

One option is to allow the trade preference programs to expire. The CBTPA, perhaps the most effective of the programs, is set to expire on September 30, 2008. CBERA is permanent and would require an act of Congress to terminate. The CARICOM countries have expressed a preference to retain the trade preferences, even though they have not been big users of the program. Allowing the programs to expire would likely raise the stakes on consideration of a bilateral FTA with the United States. In any case, even if the preferences are not widely used, eliminating them is a step backwards in the CARICOM countries' strategy of seeking special and differential treatment.

Renew Trade Preference Programs

A second option is to consider redefining the trade preference programs in a way that might provide more benefit to the CARICOM countries.[39] This option recognizes that while the trade preference programs have not been perfect, they have evolved over time in an attempt to become more economically relevant to the countries they were designed to be helping. The evolution from CBERA through CBI II to CBTPA bears witness to this fact, even if the current preferences are being eroded by broader trade trends and policies.

The central problem is that except for the energy and chemical exports, which constitute 80% of CARICOM's merchandise exports to the United States, there is little for the CARICOM countries to take advantage of in the CBI preference programs. Apparel goods amount to slightly less than 5% of total exports to the United States and the complexities of U.S. rules of origin and Caribbean supply constraints raise doubts about the ability of CARICOM countries to expand this sector significantly. Unless apparel rules of origin are relaxed even further, those products would not be competitive with those receiving benefits under CAFTA-DR or with Asian goods.

It is conceivable that the CBI programs could be amended to target the specific export sectors of the CARICOM countries and perhaps deepen existing benefits for certain industries. The opportunities, however, may be limited. The CARICOM countries are largely service sector economies (tourism, financial services, professional services) and do not view U.S. market access for goods with the same sense of necessity that many other countries in the Western Hemisphere have, even if rules of origin and cumulation could be made more flexible. Trinidad and Tobago, the country that benefits the most from CBTPA given its large energy related exports, is also most likely to consider an FTA of benefit relative to the smaller island economies.

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[39] Rangaswami, Viji. *Nickel and Diming the Poor: U.S. Implementation of the LDC Initiative*. Carnegie Endowment for International Peace. Policy Outlook. July 2006. p. 7.

A Reciprocal FTA and CARICOM

A third option is to approach the CARICOM countries regarding a bilateral FTA similar to those in place for much of the region, which might provide some appeal if crafted in a way that would benefit the small Caribbean nations. It is far from clear, however, that such a transition could be easily achieved, given the different commitments involved between the two types of trade arrangements. FTAs operate much differently than unilateral trade preferences. Trade preferences are unilateral concessions of one country to another, offering little in the way of recourse to the recipient country if a dispute arises. FTAs, by contrast, are negotiated agreements, with mutual obligations and disputes subject to a resolution mechanism defined in the FTA. Preferences are also limited commitments, usually focusing on market access. FTAs are comprehensive, covering a vast array of rules, practices, and obligations from investment to labor and environment provisions. Preferences are often time limited and subject to unilateral suspensions, whereas FTAs are permanent arrangements, codified by each member in domestic law.

An FTA would be consistent with U.S. trade policy in the rest of the region. The United States vision for hemispheric integration has revolved around the comprehensive FTA model as implemented with Mexico, Canada, Central America, Chile, and possibly in the near future, Peru, Panama, and Colombia. If the integration path were to emanate from a harmonization of these agreements, having an FTA in place with CARICOM would appear to further the broader U.S. trade agenda.

The CARICOM countries, by contrast, are a diverse group of mostly island countries with vastly different economies, and therefore, varying perspectives on trade policy and an FTA with the United States.[40] The more developed economies (energy-rich Trinidad and Tobago and tourism-driven Barbados) are far more open to the prospects of an FTA than the natural resource-based countries (Guyana and Jamaica) and the micro economies of the Eastern Caribbean, which have a fearful reluctance to begin negotiations. All of the CARICOM countries, however, have expressed some overriding concerns over the limitations of small economies to undertake the obligations of an FTA without some type of "compensatory mechanism" to replace trade preferences. Among the major concerns are:[41]

- questions over the United States' willingness to accommodate their need for special and differential treatment (SDT) such as long phase-in periods to meet FTA commitments, trade capacity building (TCB)

[40] For a recent historical survey of the different trade regimes, see McBain, Helen. Challenges to Caribbean Economies in the Era of Globalization. In: Knight, Franklin W. And Teresita Martínez-Verque. *Contemporary Caribbean Cultures and Societies in a Global Context*. University of North Carolina Press. Chapel Hill. 2005.

[41] Based in part on author interviews during a two-week trip through the Eastern Caribbean in 2006 and *CARICOM Trade and Investment Report*, p. 61.

assistance, trade adjustment assistance (TAA), and perhaps a financial component to implement these options;[42]

- the high transition costs of fiscal adjustment (from a high tariff dependency), discontinuing protection for manufacturing and agriculture sectors, implementing obligations like government procurement, intellectual property rights, labor, environment, sanitary and phytosantiary (SPS) regulations;

- supply-side constraints (dearth of arable land, small-scale production) that limit their ability to take advantage of market access;

- a perceived lack of support for their growing services trade, particularly movement of professionals, and concerns over U.S. agricultural subsidies, two issues the United States is reluctant to address, and

- asymmetrical negotiating capacity.

Outlook

A number of issues and circumstances are converging during the 110th Congress that will be a challenge for U.S. trade policy in the Caribbean region. Among these circumstances is the expiring trade preference programs, the benefits of which, in any case, have been eroded over time by multilateral trade liberalization and new reciprocal bilateral FTAs. Further, these programs are little used by the remaining eligible beneficiary countries, which also have expressed a reluctance to move toward an FTA with the United States without some guarantee of a "development component" to the agreement, despite the promise of permanent market access and increased investment that an FTA holds out. The Caribbean countries, long accustomed to dependent economic relationships, appear content to take a cautious and leisurely path toward any new trade arrangement with the United States.

For U.S. trade policy, which is still committed to achieving regional integration, these circumstances present a special challenge. Broader integration may be difficult to achieve and still meet the needs of very small developing countries. Their economies are highly vulnerable to the vicissitudes of global economic trends and may require new and creative solutions to make the adjustment to reciprocal free trade. U.S. trade policy toward the region has also long had a historical focus on development and regional security issues in addition to trade liberalization, suggesting that trade liberalization will not be the only factor to determine policy specifics. In the context of continuing with trade preferences in similar or altered form, or opting for an FTA, the solution is not immediately obvious.

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[42] CARICOM Trade and Investment Report 2005, p. 61.

Appendix A: Country Groups

A. Beneficiary Countries Designated under the CBERA:[43]

Antigua and Barbuda
Aruba
Bahamas
Barbados
Belize
Costa Rica
Dominica
Grenada
Guyana
Haiti
Jamaica
Montserrat
Netherlands Antilles
Panama
St. Kitts and Nevis
Saint Lucia
St. Vincent and the Grenadines
Trinidad and Tobago
British Virgin Islands

B. Beneficiary Countries Designated under the CBTPA:[44]

Barbados
Belize
Costa Rica
Guyana
Haiti
Jamaica
Panama
Saint Lucia
Trinidad and Tobago

C. Caribbean Community (CARICOM) Countries:

Antigua & Barbuda
Bahamas
Barbados
Belize
Dominica
Grenada
Guyana
Haiti (provisional)
Jamaica
Montserrat
St. Kitts and Nevis
St. Lucia
St. Vincent and the Grenadines
Suriname
Trinidad and Tobago

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[43] The CAFTA-DR implementing Act (P.L. 109-53) modifies the CBERA legislation by adding the term "former beneficiary country," meaning a country that ceases to be designated as a beneficiary country under CBERA because it has become a party to the CAFTA-DR. To date, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic have implemented the CAFTA-DR, essentially trading their benefits under CBERA for equal or better treatment under the free trade agreement.

[44] P.L. 109-53, as with the CBERA, amends CBTPA status by including a new category of "former beneficiary country." In cases where a good is produced in both a former and current CBTPA country, it shall not receive any less treatment than as if it had been produced by a CBTPA country.