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## Towards A New Generation in Central American Trade: Proposals for Modernizing CAFTA-DR

Julia E. Johnson

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# TOWARDS A NEW GENERATION IN CENTRAL AMERICAN TRADE: PROPOSALS FOR MODERNIZING CAFTA-DR

**Julia E. Johnson**

*“Free trade, far from protectionism, is the path that we should take to make Latin America a thriving actor in the global economy.” – Enrique Pena Nieto*

## TABLE OF CONTENTS

Introduction .....	105
I. Background.....	106
A. The CAFTA-DR Region. ....	106
1. Guatemala .....	106
2. Honduras .....	108
3. Nicaragua .....	108
4. Costa Rica .....	109
5. El Salvador .....	110
6. Dominican Republic.....	110
B. What is CAFTA-DR? .....	111
C. Understanding CAFTA-DR’s Provisions. ....	115
1. General Rules of Origin.....	115
2. Customs Administration .....	116
3. Legal Protections for Investors .....	117
4. Investor-State Dispute Settlement Mechanisms .....	119
II. Analysis .....	123
A. CAFTA-DR has Increased Bilateral Trade Flows and has Altered Trade Composition.....	124
B. CAFTA-DR has Increased Foreign Direct Investment.....	125
C. CAFTA-DR has Promoted Labor Rights, but More Remains to be Done. ....	126
D. The Failed TPP and Lessons Learned. ....	128
E. How CAFTA-DR and Other Regional Trade Agreements have Assisted where Multilateral Negotiations have Fallen Short. ....	129

III. Recommendations .....	131
A. Continue Emphasis on Monitoring and Policing Labor Rights Violations. ....	132
B. Address Climate Change and Environmental Externalities. ....	132
C. Modernize CAFTA-DR's Terms to Align with Multilateral Goals. ....	134
D. Promote Trade Capacity Building and Economic Growth in the Region. ....	134
E. Improve Safeguards for Investors. ....	135
Conclusion .....	136

## INTRODUCTION

To the surprise of many, the Trump Administration has signaled its intent to renegotiate the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR).<sup>1</sup> Why is the possible renegotiation of CAFTA-DR a surprise? CAFTA-DR has been largely favorable to the United States (U.S.)—the U.S. has enjoyed significant trade surpluses with CAFTA-DR countries since its ratification.<sup>2</sup> CAFTA-DR has also promoted regional integration and co-production in Central America.<sup>3</sup> Trade flows in and out of Central America have increased significantly.<sup>4</sup> On balance, CAFTA-DR has benefitted all signatory nations from a trade standpoint, though it has left unaddressed a myriad of social, humanitarian, and governance issues. Consequently, as CAFTA-DR is renegotiated, U.S. policymakers can build upon these successes and also make sure to take particular care to shore up certain aspects that CAFTA-DR, in its current form, has fallen short. Of note, CAFTA-DR does not incentivize or mandate efforts to improve labor conditions in Central America, leaving millions of Central Americans facing sub-par working conditions and low pay.<sup>5</sup> CAFTA-DR has also been inept to address environmental externalities associated with increased economic development, particularly in the manufacturing and natural resources sectors, which often pollute or cause environmental harms as part of their operations.<sup>6</sup> Further, CAFTA-DR, like other regional trade

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<sup>1</sup> The Dominican Republic-Central America-United States Free Trade Agreement, Aug. 2, 2005, Pub. L. No. 109-53, 119 Stat. 462 [hereinafter CAFTA-DR].

<sup>2</sup> See OFFICE OF THE UNITED STATES TRADE REP., CAFTA-DR (DOMINICAN REPUBLIC-CENTRAL AMERICA FTA), <https://ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta> (last visited Oct. 12, 2019) [hereinafter USTR] (stating that the U.S. goods trade surplus with CAFTA-DR countries was \$ 7 billion in 2018).

<sup>3</sup> J. F. HORNBECK, CONG. RESEARCH SERV., R42468, THE DOMINICAN REPUBLIC-CENTRAL AMERICA-UNITED STATES FREE TRADE AGREEMENT (CAFTA-DR): DEVELOPMENTS IN TRADE AND INVESTMENT 6 (2012).

<sup>4</sup> PETER J. MEYER, CONG. RESEARCH SERV., RL34027, HONDURAS: BACKGROUND AND U.S. RELATIONS (2019).

<sup>5</sup> MAUREEN TAFT-MORALES, CONG. RESEARCH SERV., R42580, GUATEMALA: POLITICAL AND SOCIOECONOMIC CONDITIONS AND U.S. RELATIONS 26–27 (2019).

<sup>6</sup> See Otto T. Solbrig, *The Environmental Agenda in Latin America: The Issue of the 21st Century*, REVISTA,

agreements, has not fostered coalitions that were previously associated with multilateral trade agreements—preventing unification on key issues affecting trade flows, and preventing a cohesive response to social and environmental concerns.<sup>7</sup>

This article will first review the economic, political, and social conditions in countries that have ratified CAFTA-DR. The article then considers CAFTA-DR's provisions and how these provisions build upon previous efforts at regional integration in Central America. This article will subsequently analyze how CAFTA-DR has changed both regional and intercontinental trade relationships in Central America, as well as how CAFTA-DR fits within broader trends in regional trade facilitation. Finally, this article will postulate certain proposals to modernize and improve CAFTA-DR as its terms are renegotiated in the coming years.

## I. BACKGROUND

### A. *The CAFTA-DR Region.*

Before delving into the nuances of CAFTA-DR, a general understanding of its member states is necessary. Along with the United States, the Central American nations of Guatemala, Honduras, Nicaragua, Costa Rica, El Salvador, and Dominican Republic are members of the trade agreement. Each of these nations will be briefly discussed in turn.

#### 1. Guatemala

Guatemala is a nation in Central America that has a population of roughly 16.91 million people.<sup>8</sup> Guatemala has been particularly befallen by civil wars and turmoil; the country faced a 36-year internal war between 1960 and 1996.<sup>9</sup> Facing high rates of violence and poverty,<sup>10</sup> the country has been unable to halt drug trafficking due to high levels of corruption amongst

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<https://revista.drclas.harvard.edu/book/environmental-agenda-latin-america> (describing environmental challenges faced by Central American nations).

<sup>7</sup> See discussion *infra* Section E.

<sup>8</sup> TAFT-MORALES, *supra* note 5, at 1.

<sup>9</sup> *Id.* at 2.

<sup>10</sup> *Id.* at 2–3.

its government leaders.<sup>11</sup>

Guatemala has taken strides toward democracy and elected governance, installing its first democratic government in 1986.<sup>12</sup> Despite economic poverty and insecurity, the country retains Central America's largest economy and has seen increased economic growth in recent years.<sup>13</sup> Guatemala's economic growth rate peaked at a high of approximately 3.2% in 2018-19, but is expected to slightly decline until 2022.<sup>14</sup> Unfortunately, strong economic growth in the private sector has not materially raised living conditions for citizens. Among other research groups and international institutions, the World Bank has emphasized that Guatemala needs to improve living conditions in the country through additional public investment spending.<sup>15</sup> The U.S. and Guatemala have traditionally had a strong relationship; however, this relationship has become tense in recent years due to civil turmoil in the country, as well as violations of international human rights laws.<sup>16</sup> Guatemala has sought amnesty for its human rights violations, which has largely been opposed by the international community.<sup>17</sup> The U.S. continues to provide bilateral assistance to Guatemala, which assists with improving the country's economic and social conditions, as well as addressing security issues that Guatemala is not equipped to fight.<sup>18</sup> As part of these initiatives, the U.S. created its Strategy for Engagement in Central America to promote living conditions and enhance economic development in the region, of which Guatemala remains a key recipient of funding.<sup>19</sup>

Although largely rejected by Congress, the Trump Administration has sought to substantially cut aid to

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<sup>11</sup> *Id.* at 3.

<sup>12</sup> *Id.* at 2.

<sup>13</sup> *Id.* at 15.

<sup>14</sup> TAFT-MORALES, *supra* note 5 (Summary).

<sup>15</sup> TAFT-MORALES, *supra* note 5, at 16.

<sup>16</sup> TAFT-MORALES, *supra* note 5 (Summary).

<sup>17</sup> *Id.* ("Bills introduced in the 116<sup>th</sup> Congress regarding Guatemala address immigration, order security, corruption and other governance issues, and include H.Res. 18, H.R. 1630, and S. 716.")

<sup>18</sup> TAFT-MORALES, *supra* note 5, at 20–22.

<sup>19</sup> *Id.*

Guatemala.<sup>20</sup> In March 2019, the Trump Administration also took action to stop all U.S. military aid to Guatemala after the country misused armored vehicles that had been delivered to the country to address drug trafficking.<sup>21</sup>

## 2. Honduras

Honduras is a Central American country with a population of 9.1 million people.<sup>22</sup> The country has enjoyed close relations with the U.S., and even served as a U.S. military base in the 1980s.<sup>23</sup> Honduras already had a significant trading relationship with the U.S. prior to CAFTA-DR, and the agreement has bolstered this trade relationship.<sup>24</sup> Despite this history, Honduras has recently been beset by instability and a wave of Honduras citizens seeking asylum status in the U.S., which signals a need to improve the living conditions in the country.<sup>25</sup>

## 3. Nicaragua

Nicaragua is one of the poorest countries in the region and has been subject to civil war and dictatorship.<sup>26</sup> However, beginning in the 1990s, Nicaragua began taking strides toward democracy.<sup>27</sup> Attempts at promoting democracy have not eradicated the country's significant poverty.<sup>28</sup> Like other Central American countries, the U.S. provides bilateral aid to Nicaragua. For example, in the 2008 fiscal year, Nicaragua received \$28.6 million in assistance from the U.S., a figure that has trended upward.<sup>29</sup>

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<sup>20</sup> TAFT-MORALES, *supra* note 5 (Summary) (“Congress rejected much of those cuts in the reports to and language in the Consolidated Appropriations Acts of 2018 (P.L. 115-141), and 2019 (P.L. 116-6).”).

<sup>21</sup> TAFT-MORALES, *supra* note 5, at 19–20.

<sup>22</sup> MEYER, *supra* note 4, at 2.

<sup>23</sup> MEYER, *supra* note 4 (Summary).

<sup>24</sup> MEYER, *supra* note 4, at 11.

<sup>25</sup> MEYER, *supra* note 4 (Summary).

<sup>26</sup> CLARE RIBANDO SEELKE, CONG. RESEARCH SERV., RS22836, NICARAGUA: POLITICAL SITUATION AND U.S. RELATIONS (Summary) (2008).

<sup>27</sup> SEELKE, *supra* note 26, at 1.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 3.

The U.S. has demonstrated its support of Nicaragua in other capacities, such as promoting democracy and good governance practices. The U.S. has backed recent democratic leaders in the country, including Daniel Ortega, a former Sandinista official (despite concerns regarding his authoritarian proclivities and ties to Iran and Venezuela).<sup>30</sup> The U.S. has also worked with Nicaragua to reduce its crime rates and drug trafficking.<sup>31</sup>

#### 4. Costa Rica

Costa Rica is a nation in Central America with a population of 5.1 million people.<sup>32</sup> The country has traditionally been economically and politically stable.<sup>33</sup> As a result of this stability, it has been a key partner to the U.S. in promoting democracy in Central America and elsewhere.<sup>34</sup> In 2018, two-way trade between the U.S. and Costa Rica measured \$11.2 billion, with U.S. exports equaling \$6.3 billion, and Costa Rica exports equaling \$4.9 billion.<sup>35</sup> This means that the U.S. has enjoyed a trade surplus of \$1.5 billion with Costa Rica.<sup>36</sup> Trade with the U.S. accounted for over 41% of the country's total trade in 2018.<sup>37</sup> The U.S. primarily exports medical equipment, plastics, machinery, and refined oil products to Costa Rica.<sup>38</sup> Costa Rica primarily exports fruit, coffee, rubber, and medical equipment to the U.S.<sup>39</sup> In 2017, the U.S. Bureau of Economic Analysis determined that U.S. foreign direct investment (FDI) in Costa Rica totaled \$1.6 billion.<sup>40</sup> Of this figure, 86% of FDI came from the manufacturing sector.<sup>41</sup>

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<sup>30</sup> SEELKE, *supra* note 26 (Summary).

<sup>31</sup> SEELKE, *supra* note 26, at 5.

<sup>32</sup> PETER J. MEYER, CONG. RESEARCH SERV., IF10908, COSTA RICA: AN OVERVIEW (2019).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> MEYER, *supra* note 32.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*



## 5. El Salvador

El Salvador was the first nation to ratify and implement CAFTA-DR.<sup>42</sup> Despite its support for the trade agreement and openness of bilateral trade, El Salvador's trade flows have lagged behind other CAFTA-DR nations.<sup>43</sup> This trend is likely due to governance and public security issues, as well as insufficient investment in the country.<sup>44</sup> Even though its trade has not matched that of other CAFTA-DR countries, the U.S. remains the top trading partner with El Salvador—in 2018, the U.S. bought 44% of the items it exported.<sup>45</sup> El Salvador primarily exports sugar, coffee, apparel, and equipment into the U.S., and in 2018, exported \$2.5 billion into the U.S.<sup>46</sup> The U.S. primarily exports plastics, cereals, electrical machinery, fuel oil, and nuclear parts to El Salvador, and in 2018, was valued at \$3.4 billion.<sup>47</sup> This means that the U.S. received approximately \$888 million in trade surplus annually from its trade relationship with El Salvador.<sup>48</sup>

## 6. Dominican Republic

The Dominican Republic is a large Central American country located on Hispaniola, which is an island in the Caribbean.<sup>49</sup> The Dominican Republic has traditionally been considered to be important to the U.S. policy interests.<sup>50</sup> In 2017, two-way trade between the U.S. and the Dominican Republic amounted to over \$12.5 billion, up from \$9.8 billion prior to CAFTA-DR.<sup>51</sup> In 2017, the U.S. enjoyed a \$3 billion trade surplus with the Dominican Republic.<sup>52</sup> However, foreign traders of counterfeit and illicit goods also find a ready market

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<sup>42</sup> CLARE RIBANDO SEELKE, CONG. RESEARCH SERV., R43616, EL SALVADOR: BACKGROUND AND U.S. RELATIONS 27 (2019).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> SEELKE, *supra* note 42.

<sup>49</sup> CLARE RIBANDO SEELKE, CONG. RESEARCH SERV., IF 10407, DOMINICAN REPUBLIC (2018).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

in the country. In its *2017 Special 301 Report*, the Office of the United States Trade Representative (USTR) determined that the Dominican Republic has failed to prosecute persons selling counterfeit goods, which remain readily available in the country.<sup>53</sup>

The U.S. has supported the Dominican Republic in its efforts to address health and security concerns.<sup>54</sup> The U.S. Department of Labor also tracks the Dominican Republic's efforts to minimize child labor.<sup>55</sup> Despite earlier efforts, the Trump Administration has recently suggested it will reduce aid efforts in the region, as it has in other foreign nations.<sup>56</sup>

*B. What is CAFTA-DR?*

The Dominican Republic-Central American Free Trade Agreement, frequently abbreviated as CAFTA-DR, constitutes the first free trade agreement entered into by the U.S. with six Central American countries described above—Dominican Republic, El Salvador, Honduras, Nicaragua, Guatemala, and Costa Rica.<sup>57</sup> CAFTA-DR was enacted to improve relations and promote openness of trade between these nations and the U.S.<sup>58</sup> CAFTA-DR's impact has been significant—the combined six countries constitute the 18th largest trading partner with the U.S., measuring two way flows of goods valued at \$57.4 billion in 2018.<sup>59</sup> Of this figure, the U.S. exported \$32.2 billion into CAFTA-DR countries and \$25.2 billion was exported into the U.S. by the same countries.<sup>60</sup> This resulted in a trade surplus of \$7 billion—meaning that U.S. exporters benefited from trading with CAFTA-DR countries.<sup>61</sup> The U.S. Department of Commerce has estimated that CAFTA-DR has created or supported approximately 134,000 American jobs.<sup>62</sup> CAFTA-DR

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<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> SEELKE, *supra* note 49.

<sup>56</sup> *Id.*

<sup>57</sup> USTR, *supra* note 2.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

has also promoted labor conditions in the six nations through various mechanisms that enforce the labor laws of each nation.<sup>63</sup> For example, Guatemala was subject to the first labor rights contest after it failed to allow its workers their rights guaranteed to them by the laws of Guatemala.<sup>64</sup> The U.S. has provided assistance to promote labor rights in Guatemala to ameliorate some of the burden on Guatemala to rectify labor conditions; despite U.S. aid, living conditions in the country generally remain poor.<sup>65</sup>

Proponents of CAFTA-DR have argued that the trade agreement promotes regional stability and economic growth.<sup>66</sup> CAFTA-DR has also promoted transparency, which increases investors' proclivity to invest in these countries.<sup>67</sup> A stable economy, in turn, improves communities and living conditions for local residents.<sup>68</sup>

CAFTA-DR was implemented by each member nation separately,<sup>69</sup> with El Salvador first, implementing the agreement on March 1, 2006, and Costa Rica last, implementing it on January 1, 2009.<sup>70</sup> Pursuant to CAFTA-DR, most goods of these nations may be imported into the U.S. duty-free and will not be subject to the merchandise processing fee (MPF).<sup>71</sup> On January 1, 2025, the date which CAFTA-DR will be fully implemented, all goods imported under CAFTA-DR will not be encumbered by these restrictions.<sup>72</sup>

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<sup>63</sup> USTR, *supra* note 2.

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> U.S. CUSTOMS & BORDER PROT., CENTRAL AMERICA-DOMINICAN REPUBLIC FREE TRADE AGREEMENT (CAFTA-DR) (2019), <https://www.cbp.gov/trade/free-trade-agreements/cafta-dr> [hereinafter U.S. Customs and Border Prot.].

<sup>70</sup> See U.S. CUSTOMS & BORDER PROT., CAFTA-DR SUMMARY (2015), <https://www.cbp.gov/sites/default/files/documents/CAFTA%20Sum%20Page.pdf> (providing CAFTA-DR's implementation date for each country as: El Salvador: 3/1/06; Nicaragua: 4/1/06; Honduras: 4/1/06; Guatemala: 7/1/06; Dominican Republic: 3/1/07; and Costa Rica: 1/1/09).

<sup>71</sup> U.S. Customs and Border Prot., *supra* note 69.

<sup>72</sup> *Id.*

Negotiations relating to CAFTA-DR's implementation started in January 2003,<sup>73</sup> and CAFTA-DR was ultimately signed on August 5, 2004.<sup>74</sup> On June 30, 2005, the U.S. Senate approved legislation implementing the agreement, and the U.S. House of Representatives followed suit on July 28, 2005.<sup>75</sup> On August 2, 2005, President George W. Bush signed the agreement into effect.<sup>76</sup> Subsequently, Central American countries approved the agreement.<sup>77</sup>

CAFTA-DR was implemented pursuant to the U.S.-Dominican Republic-Central America Free Trade Agreement Implementation Act.<sup>78</sup> The Implementation Act enables CAFTA-DR to take effect as to those countries that have abided by CAFTA-DR's requirements.<sup>79</sup> Under Sections 201–203 of the Implementation Act, the President may create tariff modifications as well as rules of origin provisions for preferential tariff treatment with respect to goods provided for in the Agreement.<sup>80</sup> El Salvador implemented CAFTA-DR pursuant to Presidential Proclamation 7987, with the agreement taking effect on March 1, 2006.<sup>81</sup> Honduras and Nicaragua implemented CAFTA-DR pursuant to Presidential Proclamation 7996, with the agreement taking effect on April 1, 2006.<sup>82</sup>

CAFTA-DR is significant because it builds upon efforts to eliminate barriers to trade that were started by the 1983

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<sup>73</sup> M. ANGELES VILLARREAL & KATARINA DE LA ROSA, CONG. RESEARCH SERV., IF10394, DOMINICAN REPUBLIC-CENTRAL AMERICA-UNITED STATES FREE TRADE AGREEMENT (CAFTA-DR) (2019).

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *See id.* (stating the dates of CAFTA-DR's adoption as "El Salvador, Honduras, Nicaragua, and Guatemala by July 1, 2006, the Dominican Republic on March 1, 2007, and Costa Rica on January 1, 2009.").

<sup>78</sup> Memorandum from the Exec. Dir., Trade Enf't and Facilitation Office of Field Operations, to the Dirs., Field Operations 1 (Apr. 26, 2006), [https://www.cbp.gov/sites/default/files/documents/us\\_dominican.pdf](https://www.cbp.gov/sites/default/files/documents/us_dominican.pdf) (stating that the Implementation Act, codified in Public Law 109-53; 119 Stat. 462; 19 U.S.C. 4001 note, was signed into law on August 2, 2005) [hereinafter Memo for Directors & Field Operations].

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 2.

<sup>82</sup> *Id.*

Caribbean Basin Initiative (CBI).<sup>83</sup> CAFTA-DR also symbolizes the U.S.'s commitment to promoting security and democracy in Central America.<sup>84</sup> Proponents of CAFTA-DR believe the agreement represents an increasing focus toward creating a regional approach to trade with Central American countries and supersedes prior unilateral trade agreements, including the Caribbean Basin Trade Partnership Act (CBPTA) and the Caribbean Basin Economic Recovery Act (CBERA).<sup>85</sup> CAFTA-DR additionally creates a binding agreement between the countries, replacing a series of trade preference agreements.<sup>86</sup> The increased flexibility afforded by the rules of origin provisions has promoted regional integration in Central America.<sup>87</sup> CAFTA-DR has had a particular effect in stabilizing rules for the service sector, including investment and intellectual property.<sup>88</sup> However, most imports from CAFTA-DR countries into the U.S. had been duty-free prior to CAFTA-DR, meaning that the enactment of CAFTA-DR has had a limited effect on the U.S. economy.<sup>89</sup>

In particular, CAFTA-DR has promoted regional integration by harmonizing rules of origin and promoting market access.<sup>90</sup> The reduction of market barriers has led to increased co-production and economies of scale.<sup>91</sup> CAFTA-DR also installs reciprocal trade rules allowing for enhanced duty-free treatment.<sup>92</sup> For example, if fabric is made in the U.S. but the final clothing product is produced in Central America, then the final product would receive duty-free treatment upon return shipment to the U.S.<sup>93</sup>

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<sup>83</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>84</sup> *Id.*

<sup>85</sup> *See id.* ("Supporters also view the agreement as a way to reinforce economic stability and encourage regional economic integration.").

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

### C. Understanding CAFTA-DR's Provisions.

CAFTA-DR has twenty-two chapters, which include “provisions on tariff and nontariff barrier elimination, rules of origin, customs procedures, sanitary and phyto-sanitary measures, government procurement, investment, trade in services, intellectual property rights protection, labor, environment, and dispute settlement.”<sup>94</sup>

#### 1. General Rules of Origin

The general rules of origin, which assist with determining whether a good may receive preferential tariff treatment, are laid out in Section 203 of the CAFTA-DR Implementation Act.<sup>95</sup> To determine the origin of a good under CAFTA-DR, GN29 provides definitions and specific rules of origin to assist in making a determination.<sup>96</sup> CAFTA-DR was drafted based upon similar rules of origin criteria as was used in a number of other trade agreements, including the Australia Free Trade Agreement and the U.S.-Chile Free Trade Agreement.<sup>97</sup> The burden is on the importer to substantiate a good's origin.<sup>98</sup> A non-textile good is deemed to have originated where it was obtained or produced entirely in one or more of the countries that abide by the CAFTA-DR, so long as each of the materials used in its production are classified pursuant to GN29(n), and the goods meet all other requirements; it also could be deemed to have originated where it was obtained or produced if the good is produced entirely in a country that abides by the CAFTA-DR and is created solely from originating materials from that country.<sup>99</sup>

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<sup>94</sup> *Id.*

<sup>95</sup> Memo for Directors & Field Operations, *supra* note 78, at 2.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 9.

<sup>99</sup> *Id.* at 2–3 (“Generally, under the CAFTA-DR, a non-textile good is originating where: (a) The good is wholly obtained or produced entirely in the territory of one or more of the Parties (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Dominican Republic or the U.S.); (b) The good is produced entirely in the territory of one or more of the Parties and (i) Each of the non-originating materials used in the production of the good undergoes an applicable charge in the tariff classification specified in GN29(n); or (ii) The good otherwise satisfies any applicable regional value content (RVC) specified in GN29(n); and the good satisfies all other applicable requirements; or (c) The

Most goods, except those enumerated in GN29, are subject to a de minimis provision of 10 percent.<sup>100</sup> Textile goods are subject to a separate de minimis provision outlined in GN29(d)(i).<sup>101</sup> The de minimis rule provides that “a good that contains materials that do not undergo a required change in tariff clarification (tariff shift) as specified in GN29(n), may still qualify as originating if the value of all non-originating materials, used in the production of the good, that do not undergo the required change in classification does not exceed 10% of the adjusted value of the good.”<sup>102</sup> Further, “[t]he de minimis provision applies provided that the value of such non-originating materials will be included in the total value of non-originating materials for any applicable RVC requirement.”<sup>103</sup> Certain exceptions to the de minimis provision are located in GN29(e)(ii) of the HTS.<sup>104</sup>

## 2. Customs Administration

After a rule of origin determination is made, customs must be administered. CAFTA-DR is drafted so that goods can clear customs quickly.<sup>105</sup> Customs officials are required to release goods meeting customs requirements within forty-eight hours of arrival; they must release goods at their point of arrival without sending such goods to a storage facility first; and they must allow goods to be withdrawn by importers at any point before a final fee decision is rendered.<sup>106</sup> Express shipments must be approved within six hours after the shipment has reached an entry point and all appropriate documentation is provided.<sup>107</sup> CAFTA-DR has a number of provisions designed to bolster transparency during customs administration.<sup>108</sup> CAFTA-DR countries must openly publish their customs law and relevant

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good is produced entirely in the territory of one or more of the Parties exclusively from originating materials.”).

<sup>100</sup> *Id.* at 3.

<sup>101</sup> Memo for Directors & Field Operations, *supra* note 78, at 3.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> Lisa A. Crosby & Michael J. Smart, *CAFTA: New Rules, New Opportunities*, 12 INT'L TRADE L. & REG. 41, 41 (2006).

<sup>106</sup> CAFTA-DR, *supra* note 1, art. 5.2.

<sup>107</sup> *Id.* art. 5.7(e).

<sup>108</sup> *Id.* art. 5.1.

regulations; must accept questions regarding customs issues;<sup>109</sup> must publish any proposed customs regulations and allow for public comment prior to adoption;<sup>110</sup> must provide tariff rules and classifications in an advance writing;<sup>111</sup> and must ensure that importers can have customs decisions reviewed by an independent judicial body.<sup>112</sup> CAFTA-DR also requires that customs information remain confidential.<sup>113</sup>

### 3. Legal Protections for Investors

CAFTA-DR enhances protections for investors within CAFTA-DR member countries. In particular, CAFTA-DR guarantees non-discriminatory treatment to investors and requires “no less favorable” treatment to the investors of any CAFTA-DR member country.<sup>114</sup> CAFTA-DR also affords the right to repatriate profits and make other capital transfers relating to an investment;<sup>115</sup> protects against expropriation without prompt, adequate, and effective compensation;<sup>116</sup> and guarantees fair and equitable treatment as well as full protection and security of their investments.<sup>117</sup>

Under CAFTA-DR, an investment is broadly defined to include a number of intangible and tangible assets; including: commercial enterprises, stocks, equity, bonds, shares, debentures, options or other derivatives, futures, intellectual property, licenses and permits, movable or immovable property, contracts, and other property including leases, liens, and mortgages.<sup>118</sup>

As will be discussed in the following section, CAFTA-DR promotes investment from U.S. investors by ensuring the

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<sup>109</sup> *Id.* art. 5.1(1).

<sup>110</sup> *Id.* art. 5.1(3).

<sup>111</sup> *Id.* art. 5.5.

<sup>112</sup> CAFTA-DR, *supra* note 1, art. 5.8.

<sup>113</sup> *Id.* art. 5.4.

<sup>114</sup> CAFTA-DR, *supra* note 1, arts. 10.3, 10.4.

<sup>115</sup> *Id.* art. 10.8.

<sup>116</sup> *Id.* art. 10.7.

<sup>117</sup> *Id.* art. 10.5.

<sup>118</sup> *Id.* art. 10.28; Crosby & Smart, *supra* note 105, at 43.



availability of arbitration for investor-state disputes.<sup>119</sup> The investor and state may initially engage in communications regarding the dispute, but if such negotiations fail, then CAFTA-DR guarantees that a panel of three arbitrators—one arbitrator selected by each party and a third arbitrator selected pursuant to the agreement—may decide the dispute.<sup>120</sup> The arbitral panel has the authority to award restitution, money damages, attorney's fees, and other costs.<sup>121</sup>

CAFTA-DR enhances protections for cross-border service suppliers. CAFTA-DR guarantees that service suppliers will receive “treatment no less favourable than [a nation] accords to its own service suppliers or service suppliers from any third country.”<sup>122</sup> Cross-border service suppliers also cannot be required to establish a local presence in a region prior to providing services.<sup>123</sup> CAFTA-DR creates exceptions to the foregoing rules due to specific economic needs of each CAFTA-DR member country.<sup>124</sup>

CAFTA-DR guarantees that U.S. banks and financial institutions will not be discriminated against when they establish, expand, operate, or sell their investments in CAFTA-DR countries.<sup>125</sup> U.S. financial institutions also may not be discriminated against when providing specific services, such as “maritime shipping and commercial aviation insurance, reinsurance and financial advisory services, such as investment advice and advice on mergers and acquisitions.”<sup>126</sup> Finally, U.S. financial institutions cannot be discriminated against when

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<sup>119</sup> CAFTA-DR, *supra* note 1, arts. 10.15–10.27; Crosby & Smart, *supra* note 105, at 43.

<sup>120</sup> CAFTA-DR, *supra* note 1, arts. 10.15, 10.16, 10.19.

<sup>121</sup> Crosby & Smart, *supra* note 105, at 43.

<sup>122</sup> *Id.* at 43–44; CAFTA-DR, *supra* note 1, arts. 11.2, 11.3.

<sup>123</sup> CAFTA-DR, *supra* note 1, art. 11.5; Crosby & Smart, *supra* note 105, at 44.

<sup>124</sup> CAFTA-DR, *supra* note 1, art. 11.6; Crosby & Smart, *supra* note 105, at 44.

<sup>125</sup> CAFTA-DR, *supra* note 1, art. 12.2; Crosby & Smart, *supra* note 105, at 44.

<sup>126</sup> Crosby & Smart, *supra* note 105, at 44; CAFTA-DR, *supra* note 1, art. 12.5.

providing portfolio management services.<sup>127</sup>

#### 4. Investor-State Dispute Settlement Mechanisms

CAFTA-DR has a dispute settlement mechanism in place for when one party believes that the agreement's terms are not being properly implemented, thus preventing that party from receiving benefits it believes it should receive.<sup>128</sup> The first step in the dispute settlement process is for the parties to consult with the Free Trade Commission for mediation.<sup>129</sup> If this step fails, the parties may then seek the assistance of arbitration.<sup>130</sup> Upon review of the case, the arbitral panel will issue a report with its determination of the matter and may make recommendations—if the disputing Parties requests them—as to how the dispute may be resolved.<sup>131</sup> This report will dictate how the dispute should be resolved.<sup>132</sup> If disputing parties are unable to reach an agreement as to how the dispute should be resolved, the parties will be required to negotiate an acceptable compensation amount.<sup>133</sup> If a compensation amount cannot be agreed upon, then the aggrieved party may seek trade sanctions.<sup>134</sup>

CAFTA-DR expands upon the WTO's dispute mechanism.<sup>135</sup>

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<sup>127</sup> Crosby & Smart, *supra* note 105, at 44; CAFTA-DR, *supra* note 1, art. 12.9(2).

<sup>128</sup> Crosby & Smart, *supra* note 105, at 44; CAFTA-DR, *supra* note 1, arts. 20.2, annex 20.2.

<sup>129</sup> CAFTA-DR, *supra* note 1, art. 20.5; Crosby & Smart, *supra* note 105, at 44.

<sup>130</sup> CAFTA-DR, *supra* note 1, art. 20.6; Crosby & Smart, *supra* note 105, at 44.

<sup>131</sup> CAFTA-DR, *supra* note 1, art. 20.13; Crosby & Smart, *supra* note 105, at 44.

<sup>132</sup> See CAFTA-DR, *supra* note 1, art. 20.15 (describing the process once a final report is received as “[o]n receipt of the final report of a panel, the disputing Parties shall agree on the resolution of the dispute, which normally shall conform with the determinations and recommendations, if any, of the panel.”).

<sup>133</sup> *Id.* art. 20.16.

<sup>134</sup> See *id.* 20.16(2) (describing the process of giving notice to issue sanctions as “any such complaining Party may at any time thereafter provide written notice to the Party complained against that it intends to suspend the application to the Party complained against of benefits of equivalent effect.”).

<sup>135</sup> *Id.* art. 20.3(1) (“Where a dispute regarding any matter arises under this Agreement and under another free trade agreement to which the disputing

CAFTA-DR is unique in that it provides parties with opportunities to consult on measures before they are required to adhere to the final agreement.<sup>136</sup> The intention behind allowing consultation prior to becoming part of the final agreement was to provide foreign investors with the ability to state their position before a measure was adopted, thereby easing certain concerns held by foreign investors in the event of a dispute.<sup>137</sup>

Signatory countries are also provided the right to state their position as to how the agreement should be interpreted or applied during another party's adjudicatory proceedings.<sup>138</sup> An aggrieved party must choose between CAFTA-DR or the WTO's dispute resolution procedures.<sup>139</sup> To prevent parties from seeking judicial assistance in both forums, a forum selection clause requires the selection of a forum.<sup>140</sup>

CAFTA-DR's Chapter 10—which houses the agreement's investor-state dispute settlement mechanism—is created in the shadow of NAFTA's Chapter 11.<sup>141</sup> Currently, five investor-state arbitrations have been brought pursuant to CAFTA-DR disputes: “(1) *Railroad Development Corp. v. Guatemala* (2007); (2) *TCW Group Inc. v. Dominican Republic* (2007); (3) *Pacific Rim Cayman v. El Salvador* (2008); (4) *TECO Energy Inc. v. Guatemala* (2009); and (5) *Commerce Group Corp. and San Sebastian Gold Mines Inc. v. El Salvador* (2009).”<sup>142</sup> Each of

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Parties are party or the WTO Agreement, the complaining Party may select the forum in which to settle the dispute.”).

<sup>136</sup> *Id.* art. 20.4(1) (“Any Party may request in writing consultations with any other Party with respect to any actual or proposed measure or any other matter that it considers might affect the operation of this Agreement.”).

<sup>137</sup> *See id.* art. 10.15 (“In the event of an investment dispute, the claimant and the respondent should initially seek to resolve the dispute through consultation and negotiation, which may include the use of non-binding, third-party procedures such as conciliation and mediation.”).

<sup>138</sup> CAFTA-DR, *supra* note 1, art. 20.20.

<sup>139</sup> *Id.* art. 20.3(1).

<sup>140</sup> *Id.* art. 20.3(2) (“Once the complaining Party has requested a panel under an agreement referred to in paragraph 1, the forum selected shall be used to the exclusion of the others.”).

<sup>141</sup> *See* Daniel E. González et al., *Investment-Related Legal Documents in Central America. and the Dominican Republic*, in 76 INT'L J. ARB., MEDIATION & DISP. MGMT. 70 (2010) (discussing investor-state dispute settlement mechanisms).

<sup>142</sup> *Id.* (alteration in original).

these arbitrations are related to natural resources and infrastructure development disputes.<sup>143</sup> Chapter 10's investment provisions are not retroactive.<sup>144</sup> Thus, foreign investors may only contest government actions arising after CAFTA-DR took effect.<sup>145</sup>

CAFTA-DR has been particularly effective in enabling foreign investors to assist with meeting Central America's natural resource and infrastructure needs.<sup>146</sup> CAFTA-DR has increased foreign investment relating to natural resource manufacturing, including metal mining and extractive industries.<sup>147</sup> The Inter-American Development Bank has provided additional assistance in helping foreign investors develop infrastructure projects in Central America, and in January 2009, provided a \$60 million loan for the Central American Mezzanine Infrastructure Fund (CAMIF).<sup>148</sup> CAMIF seeks to increase its available loan assistance to \$150 million over time.<sup>149</sup>

Under CAFTA-DR, U.S. investors may also begin an arbitration pursuant to the ICSID Convention.<sup>150</sup> Only the Dominican Republic is not a member of the ICSID Convention.<sup>151</sup> The advantages of utilizing ICSID include that the forum has established investor-state case law and enacted procedural rules.<sup>152</sup> Furthermore, ICSID is located in Washington, D.C., which may be a more convenient location for U.S. investors.<sup>153</sup> ICSID has already proven important to resolving disputes under CAFTA-DR, with three of the five

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<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at 72.

<sup>147</sup> González et al., *supra* note 141, at 72.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.* at 75; *see also* CAFTA-DR, *supra* note 1, art. 10.16(3) (providing that "a claimant may submit a claim . . . (a) under the ICSID Convention . . . (b) under the ICSID Additional Facility Rules . . . or (c) under the UNCITRAL Arbitration Rules.").

<sup>151</sup> González et al., *supra* note 141, at 76.

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

disputes having been adjudicated in this forum.<sup>154</sup>

CAFTA-DR includes a fee-shifting provision, which permits the award of attorney's fees to the prevailing party if a frivolous action is brought against that party.<sup>155</sup> This fee-shifting provision was created to deter a financially-strapped CAFTA-DR country from "pro forma challenging the jurisdiction of an investor's claim."<sup>156</sup> Because such jurisdictional objections frequently only delay arbitration proceedings, such provisions will reduce unnecessary time and expense associated with arbitration.<sup>157</sup> The fee-shifting provision likely means that CAFTA-DR respondent nations will be less likely to file jurisdictional objections to an investor's claims.<sup>158</sup>

CAFTA-DR Chapter 10 employs a U.S. definition of indirect expropriation.<sup>159</sup> Pursuant to Annex 10-C(4), indirect expropriation it is defined as:

[A]n action . . . by a Party [that] has an effect equivalent to direct expropriation without formal transfer of title or outright seizure . . . and requires [that a reviewing arbitral panel conduct] a case-by-case, fact-based inquiry that considers, among other factors: (i) the economic impact of the government action . . . (ii) the extent to which the government actions interferes with distinct, reasonable investment-backed expectations; and (iii) the character of the government action.<sup>160</sup>

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<sup>154</sup> *Id.*

<sup>155</sup> *Id.*; see also CAFTA-DR, *supra* note 1, art.10.20(6) ("When it decides a respondent's objection . . . [to jurisdiction], the tribunal may, if warranted, award to the prevailing disputing party reasonable costs and attorney's fees incurred in submitting or opposing the objection. In determining whether such an award is warranted, the tribunal shall consider whether either the claimant's claim or the respondent's objection was frivolous . . .").

<sup>156</sup> González et al., *supra* note 141, at 76.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* at 77; see also R.R. Dev. Corp. v. Guatemala, ICSID Case No. ARB/07/23 (2007) (rejecting Respondent's objection to jurisdiction based on the validity of the Claimant's waivers of right to initiate).

<sup>159</sup> CAFTA-DR, *supra* note 1, annex 10-C; González et al., *supra* note 141, at 77.

<sup>160</sup> CAFTA-DR, *supra* note 1, annex 10-C; González et al., *supra* note 141, at 77.

This three-pronged test is derived from U.S. law—it is modeled after the U.S. Supreme Court’s landmark standard set forth in *Penn Central Transportation Co. v. City of New York*.<sup>161</sup> The intention behind modeling the indirect expropriation standard after U.S. law is so that U.S. investors receive the same protections investing in CAFTA-DR countries as they would be afforded had they invested domestically.<sup>162</sup>

The CAFTA-DR standard provides a clearer interpretation as to which type of acts can constitute indirect expropriation, thus reducing uncertainty between investors.<sup>163</sup> By contrast, NAFTA Chapter 11 employs a more ambiguous “tantamount to expropriation” standard.<sup>164</sup> However, it is important to note that arbitration tribunals have not yet regularly interpreted the *Penn Central* indirect expropriation standard, so any differences between the CAFTA-DR and NAFTA indirect expropriation standards remain to be seen.<sup>165</sup>

## II. ANALYSIS

CAFTA-DR has been a boon to Central American trade—increasing overall trade and foreign direct investment flows; trade composition has also shifted favorably.<sup>166</sup> CAFTA-DR fits within the broader international trade landscape, which is shifting towards trade regionalization.<sup>167</sup> CAFTA-DR has strengthened regional integration where multilateral trade agreements have failed, though limitations associated with regional trade agreements remain.<sup>168</sup> To a lesser extent,

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<sup>161</sup> See *Penn Cent. Transp. Co. v. City of N.Y.*, 438 U.S. 104, 123–125 (1978) (holding that to determine if a regulatory action that diminishes the value of a Claimant’s property constitutes a “taking” of that property, the court must consider the economic impact of the regulation on the Claimant, the extent to which the regulation has interfered with distinct investment-backed expectations, and the character of the governmental action); see also González et al., *supra* note 141, at 77 (stating the factor to determine where an action constitutes an indirect expropriation).

<sup>162</sup> González et al., *supra* note 141, at 77.

<sup>163</sup> CAFTA-DR, *supra* note 1, annex 10-C.

<sup>164</sup> González et al., *supra* note 141, at 76.

<sup>165</sup> *Id.*

<sup>166</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

CAFTA-DR has promoted social change, such as improving working conditions for laborers. However, living and working conditions for many, perhaps the majority, persons in Central America remain poor.<sup>169</sup> Each of the foregoing trends will be discussed in turn.

*A. CAFTA-DR has Increased Bilateral Trade Flows and has Altered Trade Composition.*

CAFTA-DR has increased trade flows and has altered trade composition. The U.S. has traditionally been the top trading partner with CAFTA-DR nations, though the U.S.' prominence has recently decreased somewhat.<sup>170</sup> In 2018, CAFTA-DR nations exported 45% of their total exports to the U.S.; 39% of the goods imported into these countries were imported from the U.S.<sup>171</sup> After CAFTA-DR's passage, U.S. exports to CAFTA-DR countries have increased at a faster rate than imports from CAFTA-DR countries into the U.S.<sup>172</sup> Since CAFTA-DR took effect, bilateral trade flows, originating from both CAFTA-DR countries and the U.S., have grown in the aggregate.<sup>173</sup>

Coupled with increased overall trade, trade composition has shifted since CAFTA-DR took effect—CAFTA-DR nations have increasingly exported more expensive and sophisticated goods, such as semiconductors and medical equipment, while traditional exports, such as apparel and textile, have waned.<sup>174</sup>

In 2018, the U.S.'s exports into CAFTA-DR countries consisted of “petroleum and coal products (22%); fibers, yarns and threads (5%); oilseeds and grains (5%); resin and synthetic rubber products (3%); and communications equipment (3%).”<sup>175</sup> The U.S. has imported from CAFTA-DR countries a variety of goods, including “apparel (32%); fruits and tree nuts (13%); medical equipment and supplies (11%); motor vehicle parts (5%);

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<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

tobacco products (4%); and electrical equipment (1%).”<sup>176</sup>

CAFTA-DR has reduced the tariff rates on goods from 8.5% in 2006 to 1.9% in 2010.<sup>177</sup> This resulted in an increase in imports from the U.S. and elsewhere (including China, Mexico, and Venezuela) into the Dominican Republic.<sup>178</sup> China sent a variety of manufactured goods, such as footwear, equipment, and electronics into the country.<sup>179</sup> Venezuela largely imported oil, and Mexico imported electronics and oil.<sup>180</sup> In 2011, Dominican Republic received 10% of its imports from China, 6.9% from Venezuela, and 6.1% from Mexico.<sup>181</sup>

*B. CAFTA-DR has Increased Foreign Direct Investment.*

CAFTA-DR has increased foreign direct investment flows, which depicts the amount of foreign investment flowing into the country.<sup>182</sup> Foreign direct investment flows generally bear a close relationship to free trade agreements.<sup>183</sup> Free trade agreements can promote foreign investment by protecting foreign investors and stabilizing market access.<sup>184</sup> U.S. investors have traditionally been the top investors in CAFTA-DR nations, though underlying macroeconomic conditions make it difficult to determine the exact magnitude of this investment and how CAFTA-DR’s safeguards have affected these trends.<sup>185</sup> Most foreign direct investment in Central America relates to the services sector.<sup>186</sup> In 2018, El Salvador, the Dominican Republic, and Costa Rica had the highest FDI flows originating from the U.S.<sup>187</sup> In particular, Costa Rica and Dominican Republic’s FDI flows may be attributed to the nations’ economic and political

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<sup>176</sup> *Id.*

<sup>177</sup> Chad P. Bown & Mark Wu, *Safeguards and the Perils of Preferential Trade Agreements: Dominican Republic–Safeguard Measures*, 13 *WORLD TRADE REV.* 179, 187 (2014).

<sup>178</sup> *Id.*

<sup>179</sup> *Id.* at 188.

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

<sup>182</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> *Id.*



stability, as well as high productivity levels in these nations.<sup>188</sup>

*C. CAFTA-DR has Promoted Labor Rights, but More Remains to be Done.*

CAFTA-DR was one of the earliest trade agreements to particularly incorporate labor capacity building provisions.<sup>189</sup> Under CAFTA-DR, a country must “not fail to effectively enforce its labor laws, through a sustained or recurring course of action or inaction, in a manner affecting trade.”<sup>190</sup> Monetary penalties are capped in labor disputes.<sup>191</sup> A labor cooperation mechanism, labor affairs council, and labor capacity building device all assist with implementing labor commitments under CAFTA-DR.<sup>192</sup>

Labor rights under CAFTA-DR have been a particular point of contention. Several key issues have arisen, including whether CAFTA-DR countries had promulgated laws in accordance with the principles set forth by the International Labor Organization (ILO), and whether countries were adequately able to enforce such laws.<sup>193</sup> Leaders in CAFTA-DR countries have recognized that they lack adequate financial resources.<sup>194</sup> Avenues for improving working conditions remain a key concern.<sup>195</sup> Further, in three instances, the U.S. has taken action after finding that Guatemala, Honduras, and the Dominican Republic did not abide by their promises relating to working conditions.<sup>196</sup> In each instance, the U.S. attempted to engage with the offending country and devise a labor plan to rectify the labor violation.<sup>197</sup> Despite these efforts, tangible improvements in working conditions have been slow and uneven.<sup>198</sup>

For example, in April 2008, the American Federation of

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<sup>188</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>189</sup> *Id.*

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

<sup>193</sup> *Id.*

<sup>194</sup> VILLARREAL & DE LA ROSA, *supra* note 73.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

Labor and Congress of Industrial Organizations (AFL-CIO) and six labor unions based in Guatemala launched a complaint asserting that Guatemala had not adequately enforced its labor laws by failing to provide appropriate working conditions and had impinged upon workers' rights to bargain, organize, and associate with others.<sup>199</sup> In January 2009, an OTLA report was published summarizing these findings.<sup>200</sup> In 2010, the U.S., finding that Guatemala had “not undertaken effective steps to correct systemic failures’ in labor law enforcement,” began consulting with the country.<sup>201</sup> After these consultations did not yield meaningful change, the U.S. had an arbitral panel installed in August 2011.<sup>202</sup>

In April 2013, Guatemala and the U.S. entered into a labor enforcement agreement with eighteen points of improvement.<sup>203</sup> However, Guatemala was unable to meet the terms of the labor enforcement agreement, and the dispute was arbitrated from 2014 to 2017.<sup>204</sup> Ultimately, the arbitral panel sided with Guatemala, finding that “while Guatemala failed to enforce certain laws, the evidence did not provide it was ‘sustained or recurring’ *and* ‘in a manner affecting trade,’ and thus did not violate FTA provisions.”<sup>205</sup>

The WTO rules do not include labor standards, while the ILO is generally the formal body that oversees labor issues.<sup>206</sup> Due to the lack of labor protections pursuant to WTO rules, many free trade agreements specifically include labor provisions.<sup>207</sup> For example, the U.S. requires that workers be given specific rights in exchange for Central American and other developing countries to receive particular trade benefits.<sup>208</sup> Trade agreements entered into by the U.S. and developing

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<sup>199</sup> CATHLEEN D. CIMINO-ISAACS, CONG. RES. SERV., IF 10972, LABOR ENFORCEMENT ISSUES IN U.S. FTAS (2019).

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> CIMINO-ISAACS, *supra* note 199 (alteration in original).

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

<sup>208</sup> *Id.*

nations have been particularly noted for their emphasis on labor rights.<sup>209</sup> This trend has also increased labor provisions in trade agreements across the world, with a report by the ILO finding that “as of 2016, 77 out of 267 FTAs globally included labor provisions, compared to 21 to 2005.”<sup>210</sup> Labor provisions found in trade agreements not entered into by the U.S. differ from those by the U.S. because dispute settlement for labor provisions is generally not required in non-U.S. trade agreements.<sup>211</sup> Most of these labor provisions employ a collaborative approach that promote capacity building, monitoring, and discussions with the offending nation.<sup>212</sup> Rather than impose trade sanctions upon the offending country, a cooperative approach is generally sought.<sup>213</sup>

*D. The Failed TPP and Lessons Learned.*

At one time, the proposed Trans-Pacific Partnership Agreement (TPP) was thought to be the future of trade, and many CAFTA-DR countries had demonstrated an interest in signing the TPP had it taken effect.<sup>214</sup> Although the TPP never took effect (and is unlikely to ever do so), this willingness suggests that new possibilities exist to further bolster the trade relationship between the U.S. and Central America.<sup>215</sup> One way to benefit from this enhanced relationship would be to expand the harmonized rules of origin with other Central American nations that are not CAFTA-DR members and to look for avenues to bolster co-production.<sup>216</sup> The U.S. could also work with Central American countries to shape its existing trade facilitation agenda to further enhance shared goals.<sup>217</sup> Through these efforts, Central American countries and the U.S. can further facilitate economic growth in the region.<sup>218</sup> Finally, the U.S. could engage in increased formal or informal discussions

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<sup>209</sup> *Id.*

<sup>210</sup> *Id.*

<sup>211</sup> CIMINO-ISAACS, *supra* note 199.

<sup>212</sup> *Id.*

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> CIMINO-ISAACS, *supra* note 199.

<sup>218</sup> *Id.*

with Central American countries and solicit their opinions on mechanisms to promote trade and use these recommendations to create a multinational strategy.<sup>219</sup>

*E. How CAFTA-DR and Other Regional Trade Agreements have Assisted where Multilateral Negotiations have Fallen Short.*

Before 2000, multilateral negotiations were the predominant mechanism for trade negotiations.<sup>220</sup> The increased use of trade agreements resulted from the failure of the 1999 Seattle Ministerial and the 2003 Cancún Ministerial to achieve a trade consensus.<sup>221</sup> Since multilateral negotiations have often failed, WTO members have increasingly looked to regional trade agreements to fill these gaps.<sup>222</sup> Regionalization of trade agreements can be attributed, in part, to the break-up of the Soviet Union and instability in Eastern Europe.<sup>223</sup>

The 1999 Seattle Ministerial served as a turning point for support of regional trade agreements.<sup>224</sup> Most countries now negotiate a variety of regional trade agreements to incorporate issues relevant to a particular region.<sup>225</sup> Moreover, those nations that did not have regional trade agreements in place before 1999 have increasingly begun to enter into such agreements.<sup>226</sup>

Depictive of this trend, prior to 1999, the U.S. only had

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<sup>219</sup> *Id.*

<sup>220</sup> Bryan Mercurio, *The WTO and Its Institutional Impediments*, 8 MELBOURNE J. INT'L L. 198, 217 (2007).

<sup>221</sup> *Id.*; see also Jo-Ann Crawford & Roberto V. Fiorentino, *The Changing Landscape of Regional Trade Agreements* 16 (World Trade Org., Working Paper No. 8, 2005) (discussing the motivations for the increased use of regional trade agreements).

<sup>222</sup> Crawford & Fiorentino, *supra* note 221, at 5–6.

<sup>223</sup> *Id.* at 6; see also Mercurio, *supra* note 220, at 218 (finding the development of thirteen goods agreements and eleven agreements covering trade in the 1990s unsurprising due to the break-up of the Soviet Union).

<sup>224</sup> Mercurio, *supra* note 220, at 217.

<sup>225</sup> *Id.*; see also John Whalley, *Recent Regional Agreements: Why So Many, Who So Much Variance in Form, Why Coming So Far, and Where Are They Headed?*, 31 WORLD ECON., 517, 519–21 (2008) (finding that nations such as the United States and Canada have made efforts to go regional with one another).

<sup>226</sup> Whalley, *supra* note 225, at 520–21; Mercurio, *supra* note 220, at 218–21.

entered into regional trade agreements with Israel, Mexico, and Canada.<sup>227</sup> After 1999, the U.S. entered into regional trade agreements with a number of countries, including “Australia, Bahrain, Chile, CAFTA-DR (Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua), Jordan, Morocco, Oman, and Singapore.”<sup>228</sup>

The shift away from multilateral trade agreements confers certain benefits.<sup>229</sup> Because regional trade agreements are only entered into between smaller groups of countries, they can be entered into more efficiently and allow for good-faith discussions during the negotiation process.<sup>230</sup> This also means that regional trade agreements may be more effective than multilateral trade agreements in increasing market access, reducing non-tariff barriers, promoting efficiency, and solidifying shared commitments.<sup>231</sup> Regional trade agreements may also build support for issues, such as environmental, labor, and investment policies, that do not yet have multilateral support.<sup>232</sup> They can also include heightened threshold protections for enforcement standards and other rights.<sup>233</sup> Further, these agreements can assist nations in diversifying their trade portfolios and promoting a competitive advantage through economies of scale.<sup>234</sup> Finally, regional trade agreements can promote regional economic and political security.<sup>235</sup>

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<sup>227</sup> Mercurio, *supra* note 220, at 218.

<sup>228</sup> *Id.*; Australia-United States Free Trade Agreement, signed 18 May 2004 [2005] ATS I (entered into force 1 January 2005); Bahrain-United States Free Trade Agreement, signed 14 September 2004 (entered into force 1 August 2006); Jordan-United States Free Trade Agreement, signed 24 October 24, 2001 (entered into force 7 December 2001); Morocco-United States Free Trade Agreement, signed 15 June 15, 2004 (entered into force 1 January 2006); Oman-United States Free Trade Agreement, signed 19 January 19, 2006 (entered into force 26 September 2006); Singapore-United States Free Trade Agreement (signed 6 May 6, 2003 (entered into force 1 January 2004).

<sup>229</sup> Mercurio, *supra* note 220, at 221.

<sup>230</sup> *Id.*; see also Michael Ewing-Chow, *Southeast Asia and Free Trade Agreements: WTO Plus or Bust?*, 8 SING. Y.B. INT'L L. 193, 196 (2004) (discussing the likelihood of success in bilateral trade negotiations over multilateral trade negotiations).

<sup>231</sup> Mercurio, *supra* note 220, at 221.

<sup>232</sup> *Id.*

<sup>233</sup> *Id.*

<sup>234</sup> *Id.*

<sup>235</sup> *Id.*

However, regional trade agreements are characterized by certain drawbacks.<sup>236</sup> First, those nations that are not members of the regional trade agreement are placed at a disadvantage when they seek to trade with member nations.<sup>237</sup> Second, concerns have arisen that regional trade agreements could affect the WTO's authority to oversee international trade.<sup>238</sup> Regional trade agreements may also promote market access and reduce tariff rates, promoting trade inefficiencies, when a more efficient trading partner would otherwise be selected.<sup>239</sup> More efficient or less expensive producers of the same good in a non-member country would thus lose out on trading opportunities.<sup>240</sup> Further, the increase in regional trade agreements may also promote confusion—a number of regional trade agreements could conflict or be otherwise inconsistent with the rule set forth in another trade agreement, leading to confusion and trade insecurity.<sup>241</sup> Regional trade agreements also have not proven sufficient to address larger-scale trading issues, such as installing appropriate trading remedies and imposing fishery subsidies in shared waters.<sup>242</sup> Additionally, regional trade agreements may reduce developing countries' ability to create coalitions to influence trading policies set forth by stronger nations.<sup>243</sup> Finally, regional trade agreements have largely been ineffective in coalition building.<sup>244</sup>

### III. RECOMMENDATIONS

Because CAFTA-DR has greatly benefited Central American trade and has created a trade surplus in the U.S., it can readily be modernized for the next generation of Central American trade, so long as bilateral support is achieved.<sup>245</sup>

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<sup>236</sup> *Id.*

<sup>237</sup> Mercurio, *supra* note 220, at 221.

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Id.* at 222.

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> Mercurio, *supra* note 220, at 222.

<sup>244</sup> *Id.*

<sup>245</sup> SEELKE, *supra* note 42 (“Although U.S. Trade Representative Robert Lighthizer has asserted that CAFTA-DR and other trade arrangements

Certain key considerations should be incorporated into upcoming revisions to CAFTA-DR. First, continued emphasis should be placed on monitoring and policing labor rights violations. Second, new provisions can be installed to address environmental externalities associated with increased development in Central America. Third, CAFTA-DR can be modernized to assist with coalition building and other goals that multilateral trade agreements previously sought to address. Western nations can also use CAFTA-DR to further trade capacity building and economic growth in Central America. Finally, safeguards for investors should be improved to promote economic growth even if the region shows signs of instability.

*A. Continue Emphasis on Monitoring and Policing Labor Rights Violations.*

As described above, the living and working conditions in a number of Central American nations remain significantly worse than those conditions in their developed counterparts. As depicted in the Guatemala arbitration, the creation of these poor living and working standards has, for the most part, not been caused by willful behaviors by the Guatemalan government nor by the local employers.<sup>246</sup> Consequently, imposing sanctions or any other penalty on CAFTA-DR nations for violating labor rights standards is not likely to be effective. Instead, a policy of providing assistance to these nations should be employed. For example, large scale foreign investors could receive incentives—such as U.S. tax breaks or other fiscal incentives—if they provide particular wages or working conditions to their workers. Improving workers' rights is good business practice and is likely to be the most effective mechanism in improving labor conditions in Central America.

*B. Address Climate Change and Environmental Externalities.*

As CAFTA-DR countries increasingly develop and modernize, these countries are often unable to address the environmental externalities associated with their increased

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throughout Latin America 'need to be modernized,' the Trump Administration has not yet sought to renegotiate the agreement.”).

<sup>246</sup> See *supra* Section III.C.

growth. Research has found that climate change can be particularly attributed to the rapid industrialization of developing nations.<sup>247</sup> To this end, foreign investors should be required to adhere to stringent environmental regulations (such as those that would be found in the U.S.) during the development of large and small-scale projects within CAFTA-DR nations. Loan assistance from outside nations, NGOs, corporations, and other governments should also require that a small percentage of the funds be dedicated to environmental efforts and remediation.

Even on a smaller scale, CAFTA-DR countries are often beset by local environmental issues, such as deforestation, soil erosion, and water and air pollution.<sup>248</sup> Here too, foreign investors could be required to allocate a small portion of their project funds to address the environmental remediation and any possible environmental impacts associated with infrastructure projects or other developments for which their goods are subsequently used. Small-scale foreign investors, as well as traders of finished goods for personal use, could receive U.S. and other tax breaks to dedicate to environmental assistance, especially where the trade of a good causes negative environmental impacts in Central America (such as refined oil, building materials, and other goods used for infrastructure development). These efforts would introduce a collaborative approach to solve both large-scale and small-scale environmental issues affecting both local communities in Central America and the world.

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<sup>247</sup> See IMF, *Seeking Sustainable Growth: Short-Term Recovery, Long-Term Challenges*, World Economic Outlook (Oct. 2017) (explaining that developing countries often lack resources to address environmental issues associated with industrialization); see, e.g., *Developing Countries Need Urgent Support to Adapt to Climate Change*, UNITED NATIONS (Oct. 12, 2017), <https://unfccc.int/news/developing-countries-need-urgent-support-to-adapt-to-climate-change> (explaining that developing countries often lack resources to address environmental issues associated with industrialization).

<sup>248</sup> Solbrig, *supra* note 6.



*C. Modernize CAFTA-DR's Terms to Align with Multilateral Goals.*

As described, trade agreements have become increasingly regionalized, replacing prior efforts at multilateral agreements.<sup>249</sup> While the demise of multilateral agreements has been associated with lack of coalition building and lack of unification, regional agreements, such as CAFTA-DR, provide an opportunity to enhance relationships with trading partners in new ways. For example, increased regionalization of trade agreements opens up the opportunity for discussions between smaller groups of countries facing similar concerns—such as corruption, economic instability, environmental disasters, or severe poverty.<sup>250</sup> These trade negotiations could place heightened emphasis on rectifying these issues and could enable a dialogue by which shared interests may be advanced. The improved trading relationship between the U.S. and Central America could also create an opportunity for dialogue on other issues, such as corporate governance, increased minimum wages, access to health care, and leading social issues. Through these efforts, Central American countries and the U.S. could further facilitate economic growth and promote living and working conditions in the region.<sup>251</sup> This process—if designed more as an opportunity for increased bilateral dialogue, rather than formal trade negotiations—could promote trade while granting an occasion to address the shared goals that multilateral agreements once sought to address.<sup>252</sup>

*D. Promote Trade Capacity Building and Economic Growth in the Region.*

The U.S. already assists with trade capacity building in Central America, meaning it supports these nations with developing their internal industries for trade, as well as other avenues for economic growth. Such efforts—typically in the form of loans or other financial assistance—have proven beneficial in promoting economic growth in Central America to

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<sup>249</sup> Crawford & Fiorentino, *supra* note 221, at 6.

<sup>250</sup> Mercurio, *supra* note 220, at 221.

<sup>251</sup> *See id.* (describing what Central American countries and the U.S. can do through agreement).

<sup>252</sup> *Id.*

some extent. However, prior efforts by the government of the U.S. and other nations to provide this assistance have fallen short. Consequently, to further promote trade capacity building, CAFTA-DR could be modernized so that foreign investors play a heightened role in bringing new technologies and business concepts to Central America. Foreign investors could also assist domestic companies in modernizing their inventory and operational strategies. For example, as part of a trade deal, foreign investors could be required to provide a particular number of outreach and/or education hours, during which time these investors would provide instruction and guidance to more provincial businesses.

There are already encouraging signs that trade capacity building efforts by the U.S. and other nations have been well-received by CAFTA-DR nations. Currently, each CAFTA-DR country has developed a “National Action Plan for Trade Capacity Building,” in which it identifies particular areas where outside assistance is needed to bolster trade and other aspects of economic growth.<sup>253</sup> A number of international institutions, corporations, NGOs, as well as the U.S. government, provide assistance to meet these needs.<sup>254</sup> However, increasing the role of Central American business leaders, who oversee locally the creation of goods for trade on both a large and small scale, may help improve the efficacy of these efforts and promote self-determination of national trade policies in these countries.

#### *E. Improve Safeguards for Investors.*

As CAFTA-DR is modernized, safeguards for investors should be improved. Due to continued economic and political instability in many Central American nations, many foreign investors remain uneasy about investing in CAFTA-DR countries. Further, arbitration is often cumbersome and slow, leading investors to choose to invest in a more stable nation where such a forum may be perceived as less likely to be needed. Although CAFTA-DR allows for negotiations and consultations

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<sup>253</sup> OFFICE OF THE UNITED STATES TRADE REP., CAFTA-DR TCB, <https://ustr.gov/issue-areas/trade-development/trade-capacity-building/cafta-dr-tcb> (last visited Oct. 12, 2019).

<sup>254</sup> *Id.*

prior to seeking arbitration, such efforts should be reinforced. In particular, a timeline for resolution of the dispute should be imposed, and a timeline for expected relief or compensation should be mandated.

Additionally, when arbitration tribunals are interpreting “indirect expropriation” provisions, foreign investors should be allowed to introduce the body of U.S. case law to assist in an interpretation of whether indirect expropriation has occurred to show that the investor’s reasonable interpretation of its rights were derived from this standard.

Finally, increased emphasis should be placed upon developing relationships between foreign investors and loans set aside for economic and infrastructure development in large-scale projects. For example, foreign investors may be able to increase imports of natural resources or manufacturing goods relating to a large-scale infrastructure project funded through international development aid in instances where the CAFTA-DR nation does not have access to such resources domestically. Such imports would be profitable (because the CAFTA-DR country lacks a cost-effective substitute domestically) and would promote social and economic goals within the CAFTA-DR country, while simultaneously maintaining strong trade flows between the U.S. and Central America.

## CONCLUSION

In conclusion, CAFTA-DR changed Central American trade by reducing trade barriers and by promoting regional integration. Heightened attention to social, political, and environmental issues, as well as new protections for technological innovation, will help to further bolster CAFTA-DR’s ability to promote growth and improve living and working conditions in Central America.