

TLC (DR-CAFTA) Reconsidered

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During my two-month stay in Xela, no week passed without a conference or public talk on the topic of the free trade agreement TLC (in English: DR-CAFTA). Though I didn't have the opportunity to listen to each one, I felt that the ones that I attended were in fact leaving out much of the rationale applied by multinational agencies and governments. Understanding this rationale is key to understanding the idea behind TLC, or free trade in the wider sense, and how it is meant to reduce poverty. Instead, many of the presentations depicted the TLC as just another tool of the imperialist USA to control its Central American backyard, of neoliberal or neocolonial behavior, or as a big business-sponsored piece of legislation advanced by corrupt politicians. Though not a friend of TLC myself, several times I felt compelled to play the "devil's advocate", arguing that it was actually not as simple as it was portrayed. This article lays out the arguments applied by multinationals, governments and many economists; understanding these arguments (and their shortcomings) is crucial to arguing effectively with proponents of TLC.

First, free trade is not an inherently bad idea. While free trade between similar strong economies (e.g. US-Canada; UK-France-Germany) has a proven record of creating mutual economic benefits, much valid criticism has been voiced in regard to free trade between unequal partners. Nonetheless, a number of free trade agreements can also be found in which economically weaker states indeed benefited. About 25 years ago, Portugal, Spain, Greece and Ireland were regarded as developing or transitional economies; today, all of those countries have rather strong economies and are part of the developed world. Ireland for instance hosts one of the healthiest economies within the European Union with exceptional low unemployment rates and numerous multinational high-tech companies. Simultaneously, new Eastern European member states have been rapidly growing for the last few years as statistics of Slovenia, the Czech Republic, Slovakia, Poland, Hungary and the Baltic States attest. Though this growth was (still is) not without pain for much of the population, an economic convergence between old and new European Union member states can be observed,

with rising living standards for poor populations.

TLC is of course nothing like the European Union. It comprises the free flow of goods and capital only; thus, it leaves out several crucial elements needed in the convergence process within the European Union, such as the political dimension, the free flow of labor, financial transfers from stronger to weaker economies, and equal agricultural subsidies to all farmers in EU member states. First, the political dimension of the EU - institutionalized in the European Parliament and the European Council - expresses itself in common EU politics: economic policies that are roughly coordinated with each other, the harmonization and standardization of domestic legislations, and - for the economies that have introduced the Euro or are in preparation to fulfill the prerequisites to do so in the near future - responsible fiscal policies. These common policies ensure good governance, reasonable economic and fiscal policies within member countries as well as among countries that would like to join the Union. With EU-membership within reach, Romania is, for instance, obligated to improve its record of corruption. Turkey has been improving human rights legislation in recent years (though much of it still needs to be put into practice) in order to qualify for EU membership talks. Good governance and well-managed institutions are indisputably perceived as one major requisite to economic growth and for improving standards of living of all parts of society.

A second element missing in TLC is a financial transfer of funds between member states, aiming at eliminating infrastructural differences between member countries. As a result, highways, bridges and other infrastructure projects are built in Eastern European states with tax money from the UK, France, Spain, Germany, and other EU member countries. Though this may increase inter-country competition in the short run, this will lead to mutual economic benefits as well as stable democratic societies and less migration and trafficking to Western Europe in the long run. Lastly, Eastern European farmers receive the same agricultural subsidies from the centralized European Commission as do Western European farmers. Though technological differences between farmers in East and West are still high, equal subsidies soften the immediate negative impact on the agricultural sectors of East European states.

So, what is wrong with the TLC? I would argue that instead of too much, there may be actually too little integration! A sincere and equality-based collaboration between North American states (Canada, USA) and Central American states would include the creation of

political structures and commitments that surpassed pure economic dimensions as represented by TLC. Financial transfer to improve Central American infrastructure from North American countries with a simultaneous commitment of Central American governments for ensured good governance would be needed. Is this totally utopian? I would argue that it's not. First, a similar U.S. scheme labeled the "Alliance for Progress" was in fact introduced by the US in 1961 to create economic growth in Central American states and thereby erode popular support for leftist movements that increasingly threatened US-backed dictatorships. Increased economic aid, foreign investments and regional free trade through the Central American Common Market (CACM) between Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica led to economic growth hikes in the region during the 1960s. Second, the combined geographic sizes of TLC-countries are about the size of California, and the population in TLC-countries equals 12% of the population of the US. Moreover, the combined economies of the TLC-member states equal a mere 0.75% of the economy (GDP) of the United States, or, put differently, the US produces in just 2 working days as much as all TLC-countries together in one year. The combined annual government budgets equal \$16.5 billion (including the prosperous Dominican Republic as part of TLC), or 3% of the US military budget. These numbers should make clear that infrastructural projects in Central American countries on a considerable scale would be financially feasible as well as promising. Not only would this constitute a valuable contribution to fighting poverty, but it would also stabilize young fragile democracies, may lessen migration to the US and could be seen as an act of reconciliation after several decades of US support for dictatorial regimes.

If TLC lacks political collaboration and financial transfers, does this automatically render it ineffective, or even harmful for Central American populations? Governments and the World Bank disagree. What is their rationale for this statement? First, a permanent reduction in poverty is not achievable through redistribution and hand-outs only; instead - and this is especially true for developing societies - the overall amount of existing wealth in a society needs to increase. This implies economic growth. Economic growth manifests in more employment and higher wages for workers. Even in countries with strong inequalities, growth has still shown a significant correlation with poverty reduction. Economic growth is achieved by raising productivity which subsequently lowers consumer prices of goods and services and make them more attractive for purchasers. Productivity in turn results from a combination of physical capital (machines), human capital (workers) and technology (methods) applied in the production process. Economies of scale further lower costs per unit.

According to the World Bank, two aspects result from this: first, small-scale farming cannot result in productivity increases that can lift wages sufficiently for considerable poverty reduction. Second, only industrialization can bring sufficient productivity increases and profits that allow for considerable wage increases. This is confirmed by historical data: No single today developed country has become rich on the basis of a strong agricultural sector only; instead, rising standards of living were always accompanied by a rise of the manufacturing sector and a decline in employment in the agricultural sector. Shifting an economy from an agricultural to a manufacturing-based economy, referred to as "structural change", is therefore perceived as the key to a reduction of poverty and higher standards of living. Free trade is perceived as a major economic tool to enforce this structural change in a rapid manner. It should be kept in mind however, that this structural change is not a clean, easy process: among other consequences it includes the destruction of small-scale farming, increased urbanization, and a fundamental change in the values and traditions of a society. Moreover, a rapid structural change is most challenging and hurtful for those individuals that are less able to manage a transition to the manufacturing base, such as the elderly, less-skilled, or indigenous populations. Is there a way to avoid structural change yet lift wages and standards of living in a sustainable manner? Most economists and historians say no, but point out that at least structural change is usually a gradual process that takes at least one or two generations (20-40 years). Another way to soften the blow created by structural change is to channel financial support to groups that are less able to make the transition successfully. The US, for instance, pays trade-adjustment assistance to firms that are negatively affected by free trade agreements, and unemployed workers receive unemployment benefits as well as retraining.

So is an enforced rapid structural change through TLC the solution to the underdevelopment problem of Guatemala and other Central American societies? I would argue that it is not that simple. As small-scale farming is destroyed, a sufficient number of jobs in the manufacturing sector need to be created in order to avoid deepened poverty among then-unemployed small-scale farmers. Building a manufacturing-sector that is internationally competitive however is expensive and capital at cheap interest rates in Guatemala is scarce. The Guatemalan economy would need a considerable inflow of capital from external sources, such as foreign direct investments or credits. It is doubtful whether a sufficient inflow of capital can be realized given the record of other developing nations after financial and trade liberalizations.

So the yet to be answered question which will decide the success of TLC for Guatemala is whether enough new jobs can be created in the manufacturing sector that can compensate the loss of jobs in the agricultural sector. Only with sufficient economic growth and an increased tax base will the Guatemalan government be able to manage the shift from an agricultural to a manufacturing-based society successfully and deliver transfer payments to those not able to manage the transition on their own.

To conclude, it is not beneficial to advance the discussion of TLC with catchphrases such as "imperialistic" or "neocolonial behavior". Instead, a critical discussion of the philosophy behind TLC is needed in order to address the substantial doubts for future benefits from free trade agreements such as TLC. TLC will likely destroy much small-scale farming in Guatemala and cause major changes in society. This is not a side-effect of TLC, but indeed one of its main goals to achieve a shift from a agricultural-based economy to a manufacturing-based economy in the long run (which is referred to as "structural change"). TLC is not yet doomed to fail, however it remains to be seen whether the economy can create sufficient new jobs to offset the expected loss of agricultural jobs. To avoid deepened poverty, the government needs to find mechanisms to target the poor effectively with aid during the transition as well as mechanisms that enable the poor to gain from the shift to manufacturing. More integration between purely economic partners, as seen within Europe, would increase the chances for an economic convergence process, but - though financially feasible and also in the interest of North American countries - this remains for the moment unlikely.

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Addendum: (Aug 8th) (*not part of the published article anymore*)

I just read in Cypher & Dietz (2004: 226) about the “peasant economy”, which to me seems related to the discussion on DR-CAFTA. According to the modernization theory, employment as well as the amount of producers in the agricultural sector should be during a structural change on the decline, while an urbanization process and a shift of jobs towards the manufacturing and service sector should be observable.

Empirical studies of groups that have a tradition for one specific economic activity however lower expectations: William Reddy, an historian from Duke university, shows in his infamous study *The Rise of Market Culture* that a generation of handloom weavers during the British industrial process (which is hailed by many economists as a successful structural change process) had to literally die out after the introduction of the steam-powered loom under miserable living conditions in order to abolish the handloom-trade. The remoteness, closeness and tradition of the community combined with several structural barriers such as missing knowledge, education and capital prevented them from making a successful job transition to the manufacturing area as suggested by the economic theory of structural change.

Though distances may have shrunk and knowledge about living in the city certainly has increased nowadays, human conduct of clinging to well-known and well-established traditions and environments is continuously a strong notion. This is in particular true for communities that define themselves through their common identity, culture and language, have been repeatedly attacked by outside and natural forces and therefore have been required to cooperate closely to guarantee survival of the group. This is a suiting description of many indigenous communities in the highlands of Guatemala.

Cypher and Dietz point out that “large numbers of peasant cultivators have clung tenaciously to their landholding. Once landless, many have continued to reside in the countryside. ... Without doubt, the number of small cultivators is declining, and the realm of purely capitalist farmers is expanding ... [b]ut the pace of this change has been relatively slow.”(2004:327). Schejtman (1992: 278) confirms this by stating that “the concept of peasant economy encompasses that sector of domestic agriculture activity in which family-type units engage in the process of production with the aim of ensuring, from one cycle to another, the reproduction of the living and working conditions.”

As a result, small-scale peasants do not engage in profit-maximizing thinking including the notion of the 'opportunity costs' of farming compared to possible non-agricultural wages, but instead seeks to guarantee survival and to sustain themselves. These farmers operate outside of the market-context and are influenced only little by market incentives to change professions. Only impoverishment and a threat to survival may eventually prompt a migratory behavior as observable in Mexico after the introduction of NAFTA: while men migrate seasonally to urban areas or internationally, sending money back home, families stay behind. This has prompted worries of developmentalists of new cycles of dependency among rural families (see e.g. Cortés, 2006: 13).

To conclude, the structural change which is hoped to be achieved through DR-CAFTA may in fact not lead to a rapid shift of labor from agriculture to the manufacturing sector, but instead result in a sluggish urbanization process that first worsens living conditions of family and subsistence farmers considerably. Only a true impoverishment combined with a real threat to survival may eventually prompt a change in deeply entrenched behavioral patterns and community structures. It can be fairly doubted that impoverishment and creating threats to people's survival should be the goal of development politics and economics.

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