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REBUILDING THE CARIBBEAN

A Better Foundation for Sustainable Growth

by Robert E. Scott

For five days in late October 1998, Hurricane Mitch pounded Central America with torrential rains and sustained hurricane-force winds. Eighteen thousand people died or were missing, 13,000 were wounded, and 1.7 million, or 24% of the region's total population, were evacuated or placed in shelters.[1] The fragile economies of this region were swept away along with its fields, highways, and homes. Damages to housing, agriculture, industry, and roads and other infrastructure exceeded $8.5 billion.[2]

The Clinton Administration has requested a $1 billion supplemental appropriation for disaster relief and reconstruction.[3] This request, however, falls far short of the amounts needed to repair the damage done by Hurricane Mitch. Instead of tackling the underlying problems that exacerbated the devastation, the central element in the administration's plan for rebuilding Central America is a proposal for trade enhancement.[4]

The president's fiscal year 2000 budget proposes to "give expanded trade benefits to eligible countries under the Caribbean Basin Initiative," established in 1983 by then-President Ronald Reagan.[5] The focus of the new trade initiative is to give these countries parity with the trade benefits that Mexico received in 1994 under the North American Free Trade Agreement (NAFTA).

Costa Rican President Miguel Angel Rodriguez recently claimed that the Caribbean Basin Initiative (CBI) has "been undermined by NAFTA," and called for the "restoration of parity of access to the U.S. market" for the Caribbean and Central America.[6] In reality, trends in trade flows between the United States and the Caribbean show that NAFTA has not undermined the benefits of CBI and related programs in apparel and that the economic problems of the CBI countries have been caused by other factors, not by a lack of trade parity with its regional neighbors.

For these reasons, an approach to Central American reconstruction that focuses on expanded trade

benefits under the CBI is fundamentally flawed. In practice, NAFTA-like parity is likely to bring more harm than good to the Caribbean. It will disrupt agricultural markets, reduce external income flows, and set the stage for a future financial crisis. Any benefits of such a plan will expire within a few short years, leaving the region worse off than it is today after the hurricane's devastation.

Central America needs and deserves a meaningful package of development and reconstruction aid that provides the foundation for sustainable growth in the future. The essential ingredients of such a program include substantial increases in debt forgiveness and development aid in amounts much larger than those proposed by the Clinton Administration. Any relief package also should focus on two additional priorities — the enforcement of internationally recognized labor rights and the upgrading of environmental practices, both of which are necessary to improve the distribution of incomes and the quality of life in Central America.

NAFTA did not undercut the CBI

For the Caribbean, NAFTA parity is all about the apparel market. The U.S. maintains quotas on apparel imports from most countries in the world, and also imposes tariffs averaging 16% on imported apparel. But quotas on apparel imports from Mexico, the Caribbean, and Central America were eliminated in the past decade, giving producers in these countries a decided advantage in the U.S. market. The elimination of these quotas occurred well before NAFTA.

NAFTA did, however, eliminate all tariffs on qualified apparel[7] from Mexico, giving its producers a small (less than 6%) cost advantage over the Caribbean in U.S. markets. This residual difference in tariffs is the basis for the claim that NAFTA has undermined the CBI.

Figure 1 shows the U.S. balance of trade with the Caribbean Basin countries between 1983 and 1997. The trade balance is the difference between exports from and imports to the United States.

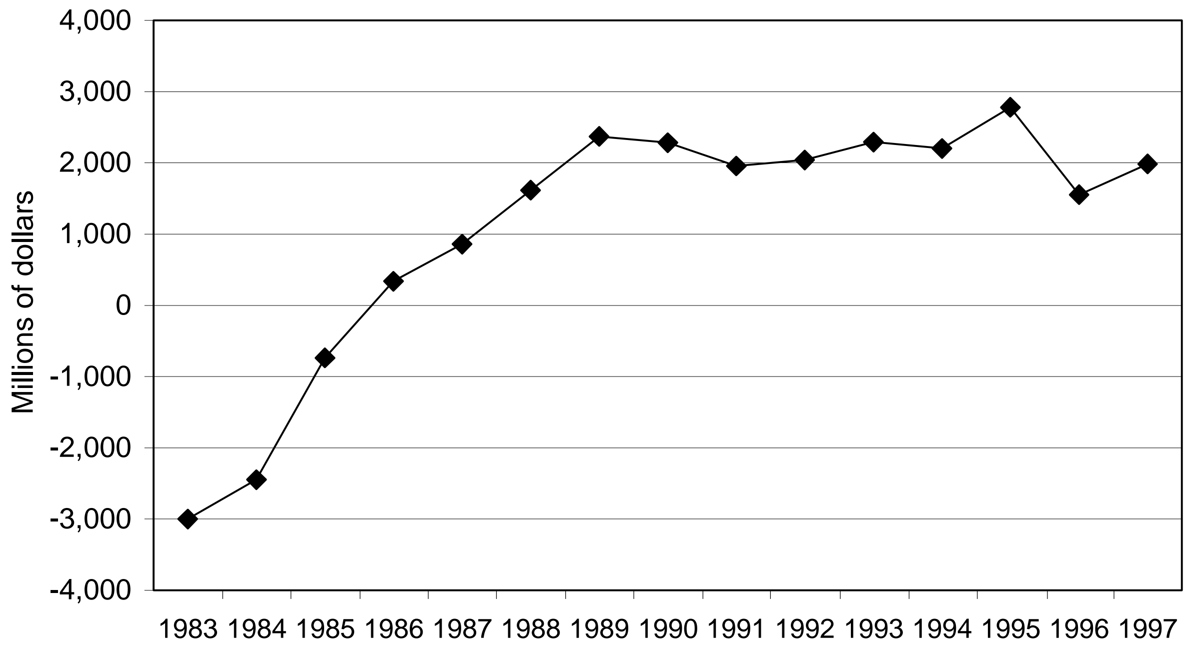
Since 1989, the U.S. trade balance with the Caribbean and Central America has been roughly constant, ranging between two and three billion dollars. NAFTA, which went into effect in 1994, has had little influence on the overall U.S. trade balance with this region. Thus, overall trade with the Caribbean has not significantly affected overall employment in the region, although changes in trade flows in particular industries (e.g., apparel) have.

Central America, on the other hand, has substantially *improved* its trade position with the United States since 1994, as shown in **Figure 2**. The United States had a $1.4 billion surplus with Central America in 1994, a surplus that has since declined steadily to only $200 million in 1997. Exports from Central America to the United States have been rising more rapidly than imports. Changes in trade with the United States have stimulated the economies of Central America since 1994.

Since NAFTA went into effect in 1994, Central America has improved its trade balance with the United States by $1.2 billion. U.S. imports from the region increased by 71% during this period, while exports grew only 36%. Tens of thousands of U.S. jobs were eliminated as the trade surpluses with these countries declined. There is no evidence that Central America was hurt by NAFTA. If anything, the benefits of an increasingly porous U.S. market were shared with the entire region.

FIGURE 1

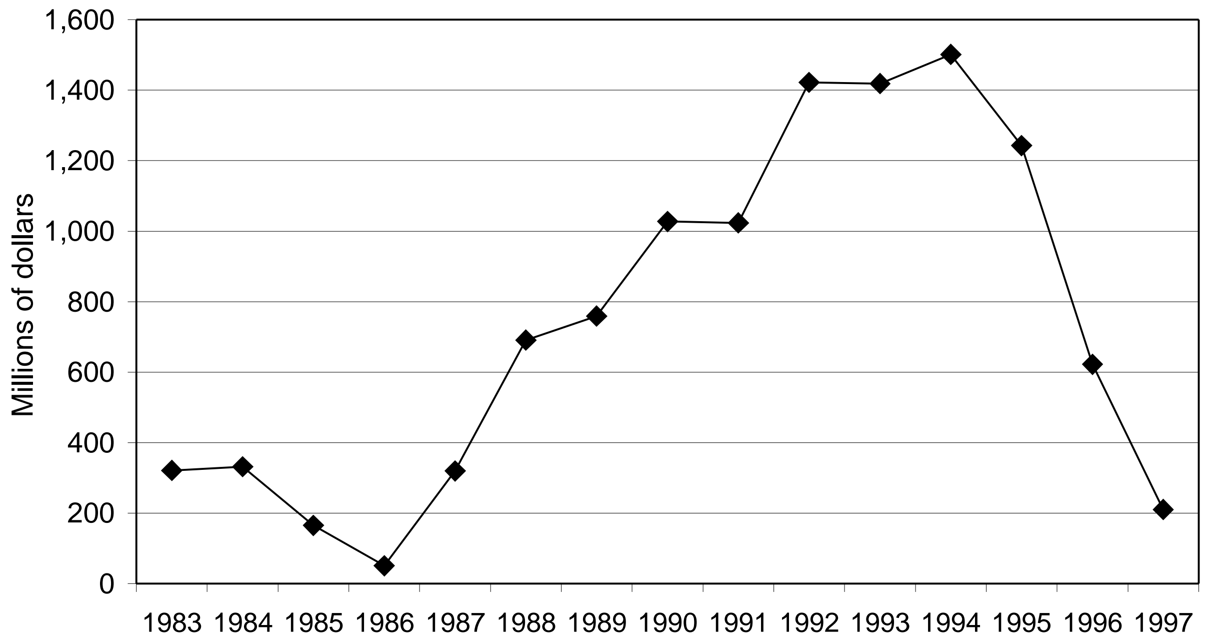
U.S. trade balance with Caribbean Basin Initiative countries



Source: Economic Policy Institute analysis of U.S. Department of Commerce (1999).

FIGURE 2

U.S. trade balance with Central America



Source: Economic Policy Institute analysis of U.S. Department of Commerce (1999).

Caribbean economic problems are due to Asian crisis, not NAFTA

Since 1994, U.S. imports have risen 19.7% per year from Central America and 20.1% per year from Mexico, as shown in **Table 1**. However, the global financial crisis sharply reduced the growth of U.S. imports from the entire region in 1998. The rate of growth of imports from Mexico and Central America was cut in half, and U.S. imports from the Caribbean Islands actually declined in 1998, after several years of strong growth.

TABLE 1
U.S. imports from Central America and Mexico, 1994 - September 1998
(Total imports, $billions)

	January - September			
	1998	1997	1997	1994
Costa Rica	$1.87	$1.72	$2.32	$1.65
El Salvador	1.10	1.00	1.35	0.61
Guatemala	1.59	1.48	1.99	1.28
Honduras	1.96	1.69	2.32	1.10
Nicaragua	0.35	0.34	0.44	0.17
Total Central America	7.11	6.51	8.79	5.12
Dominican Republic	$3.32	$3.20	$4.33	$3.09
Jamaica	0.58	0.56	0.74	0.75
Haiti	0.20	0.14	0.19	0.06
Carribean, other	1.74	2.30	2.93	2.55
Total Caribbean	5.84	6.19	8.18	6.45
Mexico	$69.72	$62.83	$85.83	$49.49

	Percent growth, Sept. 1997 - Sept. 1998	Average annual growth rate, 1994-97
Costa Rica	8.8%	12.2%
El Salvador	10.2	30.3
Guatemala	7.4	15.8
Honduras	15.7	28.4
Nicaragua	3.3	38.1
Total Central America	9.2	19.7%
Dominican Republic	3.8%	11.8%
Jamaica	3.8	-0.4
Haiti	46.6	47.5
Carribean, other	-24.3	4.7
Total Caribbean	-5.7	8.3
Mexico	11.0%	20.1%

Source: Economic Policy Institute analysis of U.S. Department of Commerce (1999).

U.S. imports from the Caribbean Island nations vary greatly from country to country. Imports from the Dominican Republic and Haiti, which are dominated by apparel production, grew rapidly between 1994 and 1997. Imports from Haiti have continued to expand rapidly even in 1998.

Many of the other Caribbean countries tend to specialize in the export of primary commodities such as oil (e.g., Netherlands Antilles and Aruba) and aluminum ore and related products (Jamaica). Mineral fuels, food, and live animals constituted 47% of the total exports of the CBI countries to the United States in 1996.[8] Prices of many of these primary commodities, especially food and petroleum products, have declined precipitously as a result of the Asian financial crisis and resulting commodity surpluses on global markets.[9] The smaller Caribbean island states, as a group, are much more dependent on primary commodity exports, and they have suffered disproportionately since the onset of the crisis in mid-1997.

U.S. apparel imports from the Caribbean have been growing even more rapidly than total imports, as shown in **Table 2**. The Asian crisis has reduced the rate of growth of apparel imports noticeably in the past year. However, average growth rates of 14.1% to 29.9% in 1998 suggest that the apparel industries in these countries are still highly competitive. Furthermore, the United Nations Economic Commission for Latin America (ECLAC) found that the "export processing zones for maquila industries [in Central America] do not appear to have sustained a great deal of direct damage" from the hurricane, though they have been hurt by shipping problems.[10]

CBI enhancement will provide little help to the Caribbean

Almost all apparel products were excluded from the benefits provided by the original CBI program, which was implemented under the Caribbean Basin Economic Recovery Act (CBERA) of 1983. This program provides duty-free access to the U.S. market for a particular list of products. These products constituted $3.2 billion, or 19%, of U.S. imports from the CBERA countries in 1997.[11] Some of the leading duty-free imports were electrical goods, sugar, tobacco, footwear, and optical and medical instruments.

Apparel products that were excluded from CBERA were given special treatment in 1986 under what is commonly known as the "807A program."[12] In addition, six CBERA countries — Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Jamaica — have qualified for special "guaranteed access levels" that provide essentially unlimited quotas for apparel shipments to the United States.[13]

Apparel products imported into the United States under the 807A program were assessed an average duty (tariff) of only 5.6%, as compared with average duties of 15.5% on apparel from all other sources.[14] So the rapid growth of apparel production in the CBI/CBERA countries in the past decade is the result of a combination of three factors: reduced duties, lower labor costs, and unlimited quotas (for those with guaranteed access levels). Of these, unlimited quotas were probably most important, with labor cost advantages next, and tariff preferences of least importance.

Since 1994, NAFTA has allowed 807A-type apparel products from Mexico to enter the United States duty-free.[15] CBI producers maintain that the resulting difference in duty rates has given Mexican apparel a competitive advantage, and that apparel production in the CBI countries is suffering as a

TABLE 2

U.S. apparel imports from Central America and Mexico, 1994 - September 1998

(apparel imports, SITC 60-61, $billions)

	January - September			
	1998	1997	1997	1994
Costa Rica	$0.60	$0.61	$0.85	$0.68
El Salvador	0.88	0.77	1.05	0.40
Guatemala	0.85	0.72	0.96	0.59
Honduras	1.44	1.22	1.69	0.65
Nicaragua	0.17	0.14	0.18	0.03
Total Central America	3.95	3.46	4.75	2.38
Dominican Republic	$1.70	$1.60	$2.19	$1.54
Jamaica	0.32	0.35	0.47	0.45
Haiti	0.16	0.10	0.14	0.03
Carribean, other	0.04	0.03	0.05	0.06
Total Caribbean	2.21	2.09	2.85	2.08
Mexico	$4.96	$3.82	$5.25	$1.79

	Percent growth, Sept. 1997 - Sept. 1998	Average annual growth rate, 1994-97
Costa Rica	-1.1%	7.5%
El Salvador	15.1	38.3
Guatemala	18.9	17.6
Honduras	17.9	37.5
Nicaragua	24.5	85.4
Total Central America	14.1	25.9
Dominican Republic	5.8%	12.5%
Jamaica	-9.0	1.3
Haiti	61.8	66.3
Carribean, other	1.8	-5.7
Total Caribbean	6.0	11.1
Mexico	29.9%	43.2%

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	Apparel share of total imports from each country			
Costa Rica	32.1%	35.3%	36.4%	41.32%
El Salvador	80.1	76.7	78.2	65.34
Guatemala	53.4	48.2	48.4	46.24
Honduras	73.3	72.0	72.6	59.08
Nicaragua	49.2	40.8	41.4	17.13
Total Central America	55.5	53.1	54.0	46.42
Dominican Republic	51.0%	50.1%	50.6%	49.71%
Jamaica	54.9	62.6	63.8	60.68
Haiti	81.3	73.6	76.1	53.09
Carribean, other	2.0	1.5	1.6	2.17
Total Caribbean	37.8	33.7	34.8	32.22
Mexico	7.1%	6.1%	6.1%	3.61%

Source: Economic Policy Institute analysis of U.S. Department of Commerce (1999).

consequence. President Clinton's CBI trade proposal is designed specifically to give the CBERA countries "NAFTA parity" in apparel exportation to the U.S. [16]

Mexico has also had unlimited access to U.S. apparel markets since 1989, when it was granted guaranteed access levels.[17] Mexico's competitiveness with the CBERA countries was also greatly increased by the 50% devaluation of the peso in late 1994 and early 1995, which significantly reduced dollar prices of Mexican goods in the U.S. market.[18]

Despite the 1994-95 peso devaluation, CBI apparel producers (excluding Jamaica) have not been hurt by NAFTA. While growth rates for all of Central America were slightly lower than for Mexico, they are still quite robust. Within Central America, apparel imports from El Salvador, Guatemala, Honduras, and Nicaragua have all increased rapidly, exceeding Mexican growth rates between 1995 and 1997 in several cases.

The ability of apparel producers in the CBI countries to prosper, despite the tariff benefits provided to Mexico, reflects the persistence of substantial wage differentials within the region that tend to favor the Caribbean. For example, average manufacturing wages in Mexico in 1997 were $1.75 per hour, or $14 per eight-hour day. The reported prevailing wage in Guatemala was $5 per day.[19] Given this wage difference, it is not clear that the elimination of an average 5.6% tariff on CBI apparel imports will significantly affect the location of production throughout the region.

Thus it appears that the Central American apparel industries will continue to thrive despite the effects of Hurricane Mitch and the Asian financial crisis, with or without the benefits of further CBI enhancements. However, provision of CBI benefits is an important signal to the region that export-led growth will be the preferred model of development in the future. Such a signal would ultimately be setting the region up to fail again in the future.

The market for apparel from CBI countries is likely to collapse in the near future, as textile and apparel quotas are phased out under the 1994 World Trade Organization (WTO) agreement.[20] Thus, the CBI program is really a get-rich quick scheme for a few apparel contractors, who will shift production to the region for a few years, and others who will profit from the illegal transshipment of goods from other countries. Most of these operations will disappear as soon as the global system of apparel quotas is eliminated in 2005.

The apparel shakeout of 2005

Global quotas on apparel imports will be phased out over the next five years under the terms of the 1995 WTO agreement. Most of the quotas will be eliminated in 2005, when the structure of the world apparel industry will be radically transformed. A significant share of world production will move almost overnight to China, where apparel wages of 10 to 15 cents per hour are common, and to other countries in Asia where wages are quite low, such as Indonesia and Vietnam.

Workers in the Caribbean, where wages of $5 per day are typical, could suddenly be priced out of the apparel-production market.

Extending NAFTA would hurt the CBI countries

Economic integration under free trade agreements involves benefits and costs for both trading partners. Economists frequently argue that the benefits of trade include higher wages and productivity for some workers, as they move into jobs that reflect each nation's comparative advantages, and lower prices for consumers of traded goods. These benefits are usually low when integration begins (or increases), and they grow over time.

The costs of trade integration are many — the wages lost when jobs are eliminated by rising imports, the resulting social dislocation and community costs, retraining expenses (for workers and communities), and, in many cases, an increase in wage inequality.[21] Proponents of free trade frequently argue that the benefits of trade liberalization accumulate over time, while the costs of liberalization are most concentrated in the near-term.

But the costs of further integration could be particularly high for the Caribbean and the benefits will prove ephemeral. The United States will eventually demand and obtain economic concessions in return for increased access to U.S. apparel markets. The NAFTA agreement required Mexico to make a number of costly concessions, such as forcing Mexico to open its markets to corn and other feed-grains from the United States. The resulting decline in Mexican corn prices forced many subsistence farmers off the land and into cities, greatly increasing unemployment among unskilled workers as well as the need for public expenditures for education and retraining. [22] Real wages in Mexico, measured in local currency units, declined 22% between 1994 and 1997.[23]

NAFTA also required Mexico to abide by stringent investment and intellectual property requirements. Similar rules would deprive Central American countries of the right to establish performance requirements for foreign investors, key elements in many development strategies. They will also greatly increase the costs of intellectual property, and lead to greater current account outflows in profits, rents, and royalties.[24] Finally, in the current international environment, the United States may also impose harsh International Monetary Fund-style preconditions that will force the region to adopt highly contractionary economic policies before countries qualify to receive CBI benefits.

A NAFTA-style trade agreement will be particularly costly to CBI countries for several reasons. First, apparel products represent a large (50-80%) and growing share of total exports to the United States for Central America and many Caribbean countries, as shown in Table 2. Apparel is less than 10% of Mexico's exports to the United States (although that share is also growing). Ultimately, the apparel shakeout of 2005 will decimate the CBI countries, long before the alleged long-term benefits of economic integration materialize.

Furthermore, since educational levels are much lower in the Caribbean than in Mexico (see Table 4), transition problems will be worse and import liberalization will have even more devastating effects on the incomes and wages of unskilled workers. Add to that the surging imports of cheap grain from the United States that could decimate subsistence agriculture throughout the CBI region.

Finally, just as the costs of dislocation and adjustment begin to accumulate in the wake of a NAFTA-style agreement, the indirect effects on external flows of income (discussed below) will deepen the economic contraction gripping the region. In this sense, CBI parity would create the perfect conditions for financial collapse in the region within a few short years, just as NAFTA did in Mexico in 1994.

Extending CBI to include apparel would increase quota circumvention and undercut remittances

In addition to offering limited benefits, the proposed CBI enhancements will greatly increase the risk that Central America will be used by foreign exporters who wish to play a trade "shell game." In such a scenario, CBI countries would be used as conduits by foreign exporters around the world to avoid trade quotas and tariffs. The U.S. Department of Commerce recently reported that "tremendous amounts" of apparel were being sold in Guatemala from China and Taiwan, via Panama, but when this material was imported into Guatemala, it was recorded as "imports from Panama."[25] Thus, even if U.S. imports from the Caribbean were increased by CBI enhancement, the direct benefits may not flow to Central America. The proposed measure could, instead, facilitate illegal circumvention of U.S. limits on Chinese apparel imports.

Although the benefits of CBI enhancement for Central America and the Caribbean could be small, the measure could cause U.S. apparel imports to rise rapidly because of transshipment problems. Such an increase could have a devastating impact on textile and apparel workers in the United States. Immigrants make up a large share of the labor force in these industries, and they would suffer disproportionately if job losses in these sectors accelerate in the future.

For this reason, any benefits of liberalization to the Caribbean must be weighed against possible losses in remittance flows. El Salvador, Guatemala, Honduras, and Nicaragua received $2.7 billion in transfers from around the world in 1997.[26] Most of these transfers are remittances from émigrés who have settled in various countries to earn a better living. The payments this region's expatriates send to relatives in their home countries are a huge source of supplemental support to families throughout Central America. Many of the U.S. apparel workers who would be displaced by increased imports are immigrants from these regions. CBI-NAFTA parity will undermine a badly needed flow of family aid into this desperately poor region.

In summary, the United States is, on balance, a significant importer from Central America, which adds to demand and creates jobs in the region. In 1997 the United States had imports of $2.3 billion in goods from Honduras and exports of $2.0 billion, yielding a bilateral trade deficit of $0.3 billion.[27] The United States thus provided a net stimulus of $0.3 billion to Honduras in 1997, a significant injection of demand in a country with a gross domestic product of $4 billion (Table 3). However, net exports to the United States were still less than 10% of total demand in a country that is extremely dependent on the U.S. market. Honduras and other countries in the region would be well advised to pay much greater attention to development of their own domestic markets. A strategy emphasizing domestic-led growth will also reduce regional vulnerability to external shocks, such as the collapse in apparel demand that is likely to occur in 2005, or shortly thereafter.

CBI-NAFTA parity poses greater threat to the U.S. apparel industry

In effect, President Clinton is asking many poor workers in the United States to subsidize apparel contractors in Central America and the Caribbean. Apparel workers in the United States have been among the hardest hit by growing imports from Mexico and the Caribbean. Since 1994, 340,000 jobs have been lost in the textile and apparel industries, primarily because of a flood of imports from Mexico and the Caribbean. By eliminating all remaining barriers to apparel imports from the CBI, U.S. job losses in these industries will accelerate in the future. However, since a significant share of the qualified imports under CBI enhancement would actually be transshipped from countries outside of the region, it is likely that fewer jobs will be created in the Caribbean than are lost in the United States.

The roots of poverty in Central America

If CBI-NAFTA parity will not help Central America recover from Hurricane Mitch, then what will? Some answers can be found by reviewing the region's political history and economic fundamentals. El Salvador, Guatemala, and Nicaragua have each suffered through more than a decade of armed guerrilla struggle, which has involved substantial U.S. intervention in each case. Military governments have dominated for long periods of time in each of these countries. The armed conflicts were settled early in the 1990s in each of these countries, and nascent democratic governments put in place. As a result, the institutions of civil society and public governance are not well established.

Costa Rica is the only exception to the pattern described here. It has the region's only stable, long-term, democratically elected government. A comparison of Costa Rica's economy with other countries in the region provides useful insights into Central American development problems.

The total output (GDP) of El Salvador, Guatemala, Honduras, and Nicaragua was $24.2 billion in 1997, as shown in the first column of **Table 3**. The 26.8 million people living in these countries had an average GDP per capita of $905 per year, ranging from a low of $493 in Nicaragua to a high of $1,294 in El Salvador (as shown in the last column of the same table). Costa Rica's 3.6 million people generated $7.4 billion in 1997, or $2,081 per person, more than twice the average of the countries devastated by the hurricane.

Income is also distributed more equally in Costa Rica than elsewhere in the region. For example, the top 20% of households earned 51% of income in a recent survey, versus 55% in Nicaragua, 57% in Honduras, and 63% in Guatemala.[28] Greater income equality is usually a necessary precondition for development, in part because it provides families with the resources needed to support educational investments that are an essential requirement for rapid growth.

Despite widespread inequality, GDP has grown relatively rapidly across the region during the 1990s. But during the period of widespread conflict in the 1980s, output declined in El Salvador and Nicaragua, and growth was slower in each country than in the 1990s.

Guatemala and Nicaragua are also burdened with extremely high levels of foreign debt, exceeding 100% of GDP in each. Total debt in the four countries hardest hit by Hurricane Mitch was $16.4 billion

TABLE 3
Debt-to-GDP ratios in Central and Latin America
(millions of 1990 U.S. dollars)

Country	GDP 1997p	Annual GDP growth rate 1970-1980	1980-1990	1990-1997	Total debt 1997	Ratio of Debt to GDP	Debt service payments 1997 ($millions)	Debt service ratio* 1997p	Population 1997p (thousands)	Per capita GDP 1997p
Costa Rica	$7,441	5.6%	2.2%	3.5%	$3,410	45.8%	$635	14.2%	3,575	$2,081
El Salvador	$7,663	—	-1.5%	5.2%	$2,680	35.0%	$887	32.8%	5,924	$1,294
Guatemala	10,433	5.7%	1.1	4.0	3,741	35.9	244	7.7	10,519	992
Honduras	3,983	5.3	2.3	3.2	4,138	103.9	494	22.5	5,981	666
Nicaragua	2,145	0.0	-1.1	2.4	5,887	274.5	228	43.9	4,349	493
Mitch countries, total	24,224				16,445	67.9	1,852		26,773	905
Latin America	$1,443,918	6.0%	1.5%	3.2%	$635,010	44.0%	$114,528	—	474,736	$3,042

* Debt service to exports of goods and (non-factor) services.
p = preliminary

Note: Totals reported for regional aggregates are based solely on the available country data reported.

Source: IDB Statistics and Quantitative Analysis Unit calculations based on official statistics of member countries.

in 1997, a figure that is likely to climb rapidly because of the cost of rebuilding. Massive debt burdens are another major impediment to growth and economic development, because large shares of national income must be devoted to external debt service, draining income that might otherwise be invested in human and physical capital.

Debt service payments (principal plus interest) from the region were almost $2 billion in 1997, as shown in Table 3. Debt service payments at these levels make it very difficult for these countries to make needed investments in infrastructure and human development resources (e.g., education, health and child care, etc.). Consequently, debt service payments alone are roughly twice as large as the total aid and reconstruction package proposed by the Clinton Administration.

Debt service ratios across the region — the ratio of debt service payments to export earnings — are accordingly very high in all countries except Guatemala, as shown in Table 3.[29] Debt service absorbed 29% to 44% of all export earnings in 1997 in El Salvador, Honduras, and Nicaragua.

Another constraint on development is the comparatively low level of education throughout the region, as shown in **Table 4**. Secondary school enrollment is a particularly important indicator of development, because the high-wage jobs in manufacturing and services usually require a high school education. The victims of Hurricane Mitch have low levels of secondary school enrollment, even relative to other countries in Latin America.

Secondary school participation is particularly low for males in El Salvador, Guatemala, and Honduras, ranging from 25% to 29% of the population in this age group. Participation levels are much higher in neighboring Nicaragua and Costa Rica. Male participation rates in the worst cases are less than half those of Mexico, which helps explain why Mexico has much higher levels of overall economic performance. The World Bank (1998, 226, Table 7) reports that the average level of male high school participation was 65% in low-middle income countries in 1993, indicating that this entire region is well below average.

TABLE 4
Secondary school enrollments in Central America and Mexico, 1993
(School enrollment as a share of age group population)

	Female	Male
Costa Rica	49%	45%
El Salvador	30	27
Guatemala	23	25
Honduras	37	29
Nicaragua	44	39
Mexico	58%	57%

Source: World Bank (1997).

The combination of low levels of investment in education and wide disparities in income distribution imply that large segments of the labor force are unprepared to participate in modern sectors of the economy. As a result, larger numbers of workers and their families are consigned to a marginal existence in the subsistence agricultural sectors and related low-wage resource-extracting industries. Unfortunately, these very conditions helped increase the magnitude of the recent devastation.

Environmental roots of the disaster

Large amounts of land in the region have been deforested in recent years. Most of this land is cleared not for agricultural purposes, but simply to provide firewood for poor families (Barahona *et al.* 1999). In Honduras alone, more than 800 square kilometers of forests are being cut down each year, and 30% of its forest has been destroyed since 1960 (Vidal 1998).

The destruction of forests and the resulting elimination of ground cover have increased the rate of rainfall runoff and soil erosion. These factors contributed to increased flooding and mudslides in the wake of Hurricane Mitch. The U.S. government is well aware of these problems and their causes. Mark Schneider, assistant director of AID for Latin America, recently noted that:

> In Honduras, we have two watersheds — one where we've been working for five years with sustainable agriculture and sustainable forestry where you still have trees and another watershed where you didn't. And [the] U.S. Geological Survey has photographs that show the difference. The mudslides that took away people's houses occurred on the watersheds where you don't have trees and where you didn't have any kinds of sustainable agriculture. No terracing, no efforts to create the kinds of crops that hold the land.

However, the export-oriented development models that are the foundation for CBI expansion will only exacerbate clear-cutting, monocrop agriculture, and other forms of resource-based exploitation that increase the vulnerability of the region to future environmental disasters.

The existence of unsustainable development patterns in Central America and their contribution to the damages caused by Hurricane Mitch demonstrates that long-term relief must attack the root causes of poverty and underdevelopment in Central America. This is a disaster-prone region. Humanitarian assistance and relief designed to simply replace what was lost will only set the stage for future disasters of even greater magnitude. Nothing less than a new approach to development is needed to tackle the fundamental causes of both the crisis and the resulting social destruction.

Policy alternatives: creating the foundation for sustainable growth

A sustainable development program must take into account a number of critical structural problems, including widespread poverty (poverty rates of at least 50%); inadequate access to social services, especially education, child care, and health care; and rapid deforestation (Barahona 1999). In addition, successful strategies must generate sufficient demand for local goods and services to reflate the econo-

mies of the region. All of these goals will require significant injections of external resources and a redirection of domestic resources from the payment of external debt to investments in local human and social capital.

A sustainable development strategy would include at least four priorities:

- Debt forgiveness, coupled with measures and agreements to redirect public resources into areas of high domestic need.
- Greatly increased aid inflows tied to investments in infrastructure, human resources (education, health care delivery systems, etc.), and sustainable development (e.g., reforestation).
- Implementation and enforcement of internationally accepted labor rights and increased environmental standards, both needed for improving the distribution of incomes and the quality of life.
- Increased regional integration, incorporating proposals for a Mezo-American Biological Corridor (Barahona 1999), and also deepening regional economic linkages through the Central American Common Market (CACM) and integration with CARICOM, the Caribbean Common Market.

How much will it cost?

Increased flows of resources, for the right purposes, are the key to development in this region. Proper allocation of new resources requires extensive local input and participation in the planning process, as well as reliable controls in disbursing agencies to limit waste, fraud, and corruption. Table 3 provides several indicators of the scale of resources required.

Debt forgiveness and restructuring must be central elements of any plan for rebuilding Central America. Few poor countries can sustain non-inflationary growth while devoting more than 15% to 20% of export income to debt service. The same can be said for countries with debt-to-GDP ratios in excess of 30% to 40%. Furthermore, each of these countries will require substantial inflows of new capital to finance reconstruction.

Reducing debt-to-GDP ratios to 20% in Nicaragua and Honduras, the hardest hit and most heavily indebted poor countries, would require approximately $9.1 billion of debt forgiveness at current income levels (88% of total outstanding debt in 1997, Table 3). Multilateral debt (to international financial institutions) constitutes 48% of total external debt in Honduras, and 28% in Nicaragua. Bilateral public debt (e.g., owed to the U.S. government) represents an unknown additional amount. These debts are obvious targets for debt forgiveness. Other private debts of sovereign governments should be reduced through debt reduction agreements with private creditors.

With lower levels of damage, El Salvador and Guatemala could tolerate slightly higher levels of residual indebtedness, perhaps 25% of GDP. Achieving these levels would require an additional $3.4 billion in debt relief, or 52% of total outstanding debt.

Together, debt relief alone would thus require about $12.5 billion. Additional funds for reconstruction, which could approach $10 billion, are also needed. The United States and other members of the IDB have pledged a total of $4 billion (including the $1 billion proposed by the United States for reconstruction and disaster relief), which appears severely inadequate, relative to these needs.

In the long run, spending on social services, education, and other forms of human and social capital must increase greatly in the region in order to provide the foundations for sustainable growth. Ideally, 10% to 20% of the GDP of the region should be invested in such activities, or $2.5 billion to $5 billion per year. Debt relief, as described above, could release as much as $1.4 billion per year for domestic social needs. Continuing external aid flows on the order of $1 billion to $3 billion per year would therefore be needed to help the region build this foundation. While these amounts are very large relative to current U.S. foreign aid budgets, two factors should be kept in mind. First, inflows of this level would rapidly stimulate the growth of demand in these countries, resulting in increased demand for goods and services from the United States. Second, reflation of Central America's economies would also greatly reduce immigration pressures on the United States, which could have important benefits for low-wage workers in this country.

Conclusion

Much work remains to be done in the design of locally based reconstruction strategies for Central America and the Caribbean. The destruction caused by Hurricane Mitch has provided an important opportunity to re-evaluate the region's economic and social needs and to develop plans for sustainable development in the future. In doing so, we must also avoid the mistakes of the past. Proposals to make CBI-NAFTA parity the centerpiece of reconstruction programs will divert attention from the region's deeper needs, and set the stage for even greater disaster in Central America and the Caribbean in the future.

The reconstruction of Central America in the wake of the hurricane provides an important opportunity for the United States to take responsibility for decades of covert and overt intervention in the economic and political affairs of the region. These ill-informed ventures ranged from support for repressive military juntas in El Salvador and Guatemala to the embargo on Nicaragua that deprived the region's people of the education, training, and effective social systems needed to support development. In this regard, the contrast between these three countries and Costa Rica, which never benefited from such U.S. "assistance," is striking.

It is time to repay our debts to Central America. We can also use this opportunity to demonstrate that both rich and poor countries can benefit from a social approach to development, one that emphasizes the improvement of living standards for all citizens, not just the privileged few.

Endnotes

1. United Nations Development Program (UNDP), 1998, p. 1.

2. UNDP (1998), Table 1, p. 3.

3. The White House, Office of the Press Secretary (1999), p.1.

4. The administration plans to submit separate requests for hurricane relief and for Caribbean Basin Trade enhancement (*Inside U.S. Trade 1999b).* However, a bipartisan group of senators has introduced a measure (S. 371, The *Central American and Caribbean Relief Act of 1999)* that combines hurricane relief with trade enhancement (*Inside U.S. Trade 1999a)*. The administration has not "reached any conclusion" as to whether the two measures should be combined or not (*Inside U.S. Trade 1999b)*.

5. Executive Office of the President (1998), p. 129.

6. Miguel Angel Rodriguez (1998).

7. Apparel trade benefits (removal of quotas and reduced duties) are available only for clothing that is assembled from fabric that is made and cut in the U.S., as explained below.

8. USITC (1998), Figure 4-5, p. 63. The figure reports exports from the countries eligible for trade benefits under the Caribbean Basin Economic Recovery Act (CBERA), the formal legislation authorizing the CBI program. Food and live animals were 26% of CBERA exports to the United States in 1996, and mineral fuels, lubricants, and related materials were 21% of the total.

9. See forthcoming EPI issue brief on the farm crisis, available at http://www.epinet.org.

10. ECLAC (1999), p. 3.

11. USITC (1998), Table 2-6, p. 23.

12. Products qualifying for this program must be made from fabric that is "made and cut in the United States." Duties for these products only are assessed on the value added offshore — the U.S. content is exempt from duties.

13. USITC (1998, p. 13-15). This estimate includes textiles and a more complete definition of apparel products, and is therefore larger than the apparel import estimate shown in Table 2, above.

14. USITC (1998), footnote 19, p. 14.

15. USITC (1998), p. 14.

16. The CBI measure proposed by the Clinton Administration only would provide temporary relief to apparel producers from these countries, according to the president's budget request. "The administration proposes to provide, through September 30, 2001, expanded trade benefits mainly on textiles and apparel to Caribbean Basin Countries that meet new eligibility criteria to prepare for a future trade agreement with the United States." Executive Office of the President (1998). *Analytical Perspectives,* p. 58. The proposed Senate bill would provide benefits through 2005 (*Inside U.S. Trade* 1999a).

17. USITC (1998), p. 3.

18. USITC (1998) p. 14.

19. Average manufacturing wages in Mexico are reported by the Bureau of Labor Statistics (1998, Table 2). The BLS does not report statistics on wage levels in Central America or the Caribbean. Vidal (1998) reports that workers in the Chiquita banana export operation earn a salary of $5 per day. In 1997, the minimum wage in Guatemala was $3.38 per eight-hour day in commerce, or $0.43 per hour (U.S. Dept. of Commerce, ITA 1998, Country Commercial Guides).

20. The USITC concludes that "import competition in the U.S. apparel market is likely to continue to intensify as a result of the ongoing phaseout of U.S. import quotas on sector goods, as called for under the WTO Agreement on Textiles and Clothing (ATC)." USITC (1998), p 14.

21. See Scott (1998) for a summary of the impacts of globalization on income distribution in developed and developing countries.

22. See Economic Policy Institute et al. (1997), pp. 12-14.

23. Change in nominal wages divided by the change in the consumer price index. Source: *IMF Financial Statistics (1999:1).*

24. See Blecker (1996).

25. The U.S. Department of Commerce reports that "even though import statistics don't show large apparel imports from Taiwan and China, the Guatemalan market sells tremendous amounts of apparel from these two countries." Reliable sources said that almost all imports from Panama are for apparel made in either China or Taiwan. When this apparel is re-exported from Panama to Guatemala, it is recorded in Guatemalan customs as "imports from Panama." In addition, sources said that some U.S. firms manufacture apparel in Taiwan and China under Item "807" and that apparel that does not pass quality controls (known as "seconds") is exported to other countries and then contrabanded into Guatemala (Urrutia 1996, 10).

26. Interamerican Development Bank (1999).

27. U.S. trade statistics, as reported by the National Trade Data Bank, <http://www.stat-usa.gov>.

28. World Bank (1997), Selected World Development Indicators, Table 5, pp. 222-223.

29. Debt service ratios vary greatly from year to year, ranging from a high of 39% of exports in 1991 to 14% in 1996. This pattern probably reflects cyclical rollover patterns in short- and medium-term debts. Source: IDB Statistics and Quantitative Analysis Unit (1999). Debt service ratios have declined steadily for Guatemala since 1992.

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