Trade Liberalization and the Dominican Republic

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Abstract

Over the last several decades, trade barriers have fallen substantially, and agreements promoting free trade between countries have proliferated. One such agreement, the Central American Free Trade Agreement (CAFTA, or CAFTA-DR), aimed to lower trade barriers between Central American countries and the United States.

1 Context

The Central American Free Trade Agreement was modeled upon the success of the North American Free Trade Agreement between the United States, Canada, and Mexico (?).

In 2003, negotiations began on the Central American Free Trade Agreement, with Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the United States taking part in the discussions. The Dominican Republic joined the negotiations in early January, retitling the agreement the Dominican Republic-Central America Free Trade Agreement. The goal of the bill was to create a free trade zone similar to the one created by the North American Free Trade Agreement in 1994. President George W. Bush of the United States signed CAFTA-DR into law in 2005, but it took another two years for the Dominican Republic to fully implement the agreement, which it did in 2007.

One of the explicit aims of CAFTA-DR was to reduce tariffs uniformly for United States imports into member Central American countries, and to ”progressively eliminate customs duties on originating goods" [Office of the United States Trade Representative, Executive Office of the President]. Tariffs on most products exported to the United States (U.S.) from Central America were already duty-free as part of the Caribbean Basin Initiative, and so CAFTA-DR largely eliminated tariffs on imported American goods, rather than eliminating American tariffs on exports of Central American products. The bill put a moratorium on establishing new tariff lines or raising customs duties between the parties involved, and explicitly defined a time line for each good to have its tariffs reduced. Based upon World Trade Organization data[1], I find CAFTA-DR reduced average Dominican Republic (D.R.) tariff rates on imports from member countries from 12.33% to 2.73% from 2006 to 2007. Many goods were to be declared duty free initially upon implementation of the agreement, but many more were to have their tariff rates phased in a period of generally 5-10 years.

2 Data

Data for this project comes from combining several easily accessible databases, allowing for straightforward replication of my results.

For tariff data in 2002, I use the World Trade Organization Tariff Analysis database, which provides tariff rates at the Harmonized System (HS) six digit level. To compute tariffs in 2013, I employ direct text from the CAFTA-DR bill, provided online by the Office of the United States Trade Representative, Executive Office of the President at the HS eight digit level, as well as the source above.

I use several sources to estimate the share of economic activity in a given municipality in the Dominican Republic.

Information on the number of companies by size in a given industry at the municipality level in the Dominican Republic is provided by Oficina Nacional de Estadística, República Dominicana ONE for 2010 [2]. I then combine this with Integrated Public Use Microdata

[1] Using a import-weighted average of tariff rates for Harmonized System two-digit product codes, the nominal average decrease is larger

[2] Note – this source used to be accessible online, but when I recently went back the site threw an error

Series International (IPUMS) data

3 Exogeneity of Tariff Decreases

Before discussing the impact of tariff changes upon regional and national outcomes in the Dominican Republic, it is first necessary to comment upon the political economy of tariff negotiations. Brock and Magee [1978], as well as others, have observed the potential for special interest lobbies within a country to have a significant impact upon policymakers and their decisions, particularly when deciding which trade barriers to remove and which to leave in place (or, in rarer cases, increase). One consequence of this is that tariff rates and tariff rate reductions could be determined by endogenous factors also affecting regional labor markets. If this is the case, then estimates for the effect of tariffs on either of these two factors will suffer from omitted variable bias. Therefore, I discuss the qualitative and quantitative evidence available on the potential exogeneity of tariff rate reductions as a result of CAFTA-DR. Although each country negotiated tariff rate reductions individually with the United States, as previously stated, the goals of the agreement were to lower tariffs on all incoming goods. If the United States exercised significant power in the negotiating process to lower tariffs uniformly, it is possible that reductions due to CAFTA-DR can be viewed as politically exogenous. Similarly, if policymakers in the Dominican Republic were interested in lowering trade barriers uniformly, they may have been immune to political pressures from local industries and firms. Although I have not found specific evidence of policymakers stated interests, there is sufficient evidence to believe something of the sort occurred. First, 2006 D.R. tariffs resemblance tariff barriers in place in 1996 very closely. Therefore, as many of the tariff barriers were set decades ago, it is less likely that their level is reflective of modern industrial and economic forces, and more likely to be due to institutional constraints and political difficulties in lowering tariffs without an intervention from another country (the United States, in this case). Second, I compare the relationship between pre-CAFTA tariff

when attempting to download the data.

levels and the amount of tariff reduction in figures . If policymakers had the interest in lowering tariffs uniformly, one would expect to see larger tariff reductions on products that had initially high protection levels. Indeed, for average tariffs on SITC 3 digit product codes, we see a nearly linear relationship between the initial amount of protection for a good and the amount of tariff decrease. These results alone suggest that Dominican tariff protection was lowered more or less uniformly by CAFTA-DR.

References

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