United States General Accounting Office

150662

GAO

Report to Congressional Requesters

December 1993

FOREIGN ASSISTANCE

U.S. Support for Caribbean Basin Assembly Industries

GAO/NSIAD-94-31

Notice: This is a reprint of a GAO report.

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-251648

December 29, 1993

The Honorable Tom Harkin
United States Senate

The Honorable Patrick Leahy
United States Senate

The Honorable George Brown
House of Representatives

The Honorable Lee Hamilton
House of Representatives

As requested, we have reviewed U.S. policies and programs that encourage the growth of assembly industries in the Caribbean Basin, the impact of these policies and programs on U.S. investment in such industries, the impact of assembly industry growth on Basin countries, and related issues. This report raises several issues to consider in the debate over U.S. assistance approaches and objectives.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to appropriate congressional committees, officials of the U.S. agencies whose operations we reviewed, and other interested parties. This report was prepared under the direction of Harold J. Johnson, Director, International Affairs. He can be reached at (202) 512-4128 if you or your staff have any questions. Other major contributors to this report are listed in appendix V.

Frank C Conahan

Frank C. Conahan
Assistant Comptroller General

Executive Summary

Purpose

Prompted by concern that U.S. foreign assistance might be encouraging the movement of jobs from the United States to countries in the Caribbean Basin, Congress passed section 599 of the fiscal year 1993 Foreign Operations Appropriations Act. This provision prohibits U.S. government agencies from providing (1) financial incentives that induce businesses located in the United States to relocate jobs overseas, (2) assistance to export processing zones abroad, and (3) assistance to activities that contribute to violation of worker rights. Congress also included these restrictions, with some clarification, in the fiscal year 1994 Foreign Operations Appropriations Act. Throughout this report, GAO refers to this provision as section 599.

In response to congressional requesters, GAO reviewed (1) the impact that U.S. policies and programs have had on the growth of Basin assembly industries and on the decisions of U.S. companies to invest in these industries, (2) the relationship between section 599 and other foreign assistance objectives, and (3) implications for the future of U.S. foreign assistance and trade policies in the Basin. This report focuses on four countries—Costa Rica, the Dominican Republic, El Salvador, and Honduras.

Background

As U.S. labor costs increased in the post-war period, lower-skilled, labor-intensive industries in the United States became increasingly less competitive. Reacting to competitive pressure, manufacturers in certain sectors, especially apparel, have reduced their costs by moving labor-intensive assembly operations to offshore locations, such as the Basin. Under production-sharing arrangements, Basin workers assemble parts made in the United States, and completed products are returned to the U.S. market.

The United States has provided significant amounts of bilateral foreign assistance to the Caribbean Basin—about $16.8 billion between 1980 and 1992. The Agency for International Development (AID) is the primary agency responsible for implementing U.S. bilateral foreign assistance programs, including programs aimed at encouraging industrial development, trade, and investment in the recipient countries. Other U.S. agencies with important roles in promoting such trade and investment are the Departments of Commerce and State, the Overseas Private Investment Corporation (OPIC), and the U.S. Export-Import Bank (Eximbank).

Controversy about U.S. agency support for Basin assembly industries is part of a broader public policy debate concerning the challenge faced by U.S. industry in meeting international competition and the goals of U.S. foreign assistance programming in the post-Cold War era. Critics of U.S. support for Basin assembly industries base their opposition on the fact that employment in apparel assembly and other industrial occupations is declining in the United States.

Results in Brief

U.S. foreign assistance programs have been one element of a U.S. government strategy, which includes trade policies, tax measures, and tariff preferences, to encourage the growth of Basin assembly industries. Until section 599 was enacted, foreign assistance programs supported the development of export processing zones. However, the economic assistance programs have not been a significant factor in the decline in U.S. industrial employment. Much more important have been the pressures of foreign competition and U.S. industries' changing production strategies to become more competitive. Officials of U.S. companies with Basin assembly operations told GAO they were attracted to the region primarily by the plentiful low-cost labor in close proximity to U.S. markets, rather than by the benefits of foreign assistance programs. They did assign some importance to U.S. trade measures that encourage Basin assembly. While section 599 will reduce U.S. expenditures on programs directly supporting Basin assembly industries, it does not appear the legislation will have a significant impact on the movement of jobs from the United States.

Among AID's many priorities has been the objective to encourage economic growth in, and trade with, developing countries and support private sector initiatives. Programs designed to fulfill this objective could indirectly result in the loss of some U.S. jobs and the addition of others; thus, AID cannot currently guarantee that U.S. jobs will not be lost as the result of its activities.

The United States continues to support Basin industrialization through a variety of means. Section 599 will likely have little impact on either the ongoing transition in U.S. industry that results in certain types of jobs being moved offshore or the enforcement of worker rights in Basin countries. Nevertheless, issues raised by section 599 should be considered during the current deliberations about the future of foreign assistance. They include (1) the extent to which AID programs should be designed with potential U.S. domestic interests in mind and (2) whether a dichotomy exists between U.S. initiatives designed to help other countries develop their economies to become more competitive in the world market and overall U.S. economic interests.

Principal Findings

U.S. Policies and Programs Support the Growth of Assembly Operations in the Caribbean Basin

During the 1980s, the threat that communism could spread in the Caribbean Basin spurred development of a U.S. government strategy to promote political stability and economic growth, with heavy emphasis on increasing trade and investment. This "trade not aid" approach is embodied in the Caribbean Basin Economic Recovery Act and other measures that reduce tariffs, provide tax breaks, and otherwise encourage imports from, and investments in, the Basin. For example, the "Super 807" program reduces duties and effectively eliminates quotas on certain apparel assembled in the Basin from U.S. materials. This program, developed from the general duty reduction available for U.S. parts in foreign products under the Harmonized Tariff Schedule subheading 9802.00.80—popularly known by its former designation as Item 807 of the now superseded U.S. Tariff Schedule—was intended not only to assist Basin countries, but to help U.S. companies to compete with increased imports through production-sharing operations offshore.

U.S. government agencies have developed programs in support of these policies. AID, in particular, joined other donors in emphasizing development of nontraditional export industries, including assembly plants, as a means to replace such traditional commodity exports as sugar when these exports could no longer meet Basin country needs. AID supported trade and investment promotion organizations, provided funding for the development of export processing zones, and attached conditions to foreign assistance aimed at improving the business climate for foreign investors.

Over the last 10 years, AID provided about $69 million to promotion agencies in the four countries we visited for trade and investment promotion activities, and over $250 million in loan capital to finance investments, with emphasis on nontraditional exports and tourism. In addition, the Commerce and State Departments, OPIC, and the Eximbank provided some support to the development of Basin assembly industries. OPIC reported that $43.2 million was committed to companies which either manage or are located within Basin export processing zones.

Foreign Assistance Programs Not a Decisive Factor in Investment Decisions

U.S. company officials cited a number of factors in their decision to establish assembly operations in the Caribbean Basin. Foremost among these was access to cheap labor in close proximity to U.S. markets. Company officials also cited U.S. trade measures that encourage the use of U.S. parts as a consideration. Assembly operations were often located in export processing zones in order to avoid bureaucratic problems and take advantage of readily available industrial space.

AID contributed to the growth of assembly industries, primarily through policy dialogue aimed at improving the business climate in these countries and through financing the development of export processing zones. However, U.S. company officials told us they would have invested in Basin assembly operations without encouragement from AID. Lending support to this view is Mexico's "maquiladora" phenomenon. U.S. companies have invested heavily in Mexican assembly industries without U.S. foreign assistance funds being expended on investment promotion or related programs. U.S. support in the Basin may, however, have allowed countries popularly perceived as less desirable locations to benefit from the growth in offshore assembly.

Assembly Industries Create Jobs but Provide an Uncertain Basis for Future Development

Assembly industries have demonstrated their potential for creating significant numbers of jobs in the Basin. However, unemployment remains a serious problem. It remains to be seen whether these industries can serve as a basis for further economic development. Technology transfer has been limited, and proposed changes in international trade rules, including the phased elimination of multilateral apparel trade restraints, may soon result in substantial new challenges from other low-wage producers, like China.

Mixed Impact on Workers

Assembly plants provide employment for workers—predominantly women—who otherwise have very few alternatives, none superior to assembly plant jobs. Worker salaries are commensurate with those of other opportunities open to these workers. Nonetheless, these salaries provide individuals only a subsistence-level income, and worker families must often pool their resources to get by. Working conditions vary. Most of the 53 plants GAO visited appeared to provide a reasonably safe and healthy environment; but some did not. In most cases, workers have not been able to exercise their rights to organize and bargain collectively. State Department officials and other observers agreed that while prevailing laws usually protect most worker rights in theory, they have often been ineffective in practice. Efforts to improve respect for worker rights are underway, with the United States playing a role.

Section 599 Leaves Issues Unresolved

Prior to section 599, Congress had adopted several other provisions intended to limit possible adverse U.S. domestic impacts of trade measures and agency programs that support industrial growth abroad, including in the Basin. Agencies must balance these restrictions against other provisions that permit and encourage support for Basin assembly operations. For example, the "Lautenberg Amendment" prohibits AID from helping to establish manufacturing facilities that will compete with U.S. production of "import sensitive" articles, including textiles and apparel. However, this provision permits the agency to assist Basin companies participating in the 807 program, in support of the Caribbean Basin Initiative.

Since passage of section 599, AID has terminated programs intended specifically to support export processing zones. However, section 599 does not provide AID with a clear mandate to take a new direction in its private sector development and trade and investment programming. Agency guidance to its overseas offices on implementing the law was imprecise and confusing, and the legislation has had different impacts in different countries.

For several reasons, section 599 will likely have little impact on the movement of U.S. jobs to, or worker rights conditions in, the Basin. The foreign assistance programs affected by the law are relatively unimportant in determining company investment patterns. AID continues to provide general support for Basin industrial development, and the United States continues to offer trade measures that have more influence on investor decisions. The indirect nature of AID assistance programs places the agency in a poor position to monitor worker rights practices among the companies that benefit from its programs. With continued support for Basin industrialization, some U.S. workers will be adversely affected, while others will benefit. AID cannot ensure that its trade and investment programs ultimately will not cause U.S. job losses. The precise net impact, however, is unknown.

Implications for the Future of Foreign Assistance and Trade Policies in the Basin

Recent studies, including several by GAO, have concluded that AID has lacked a clearly articulated strategic direction. GAO has also concluded that AID's future orientation with respect to private sector development is uncertain and that the U.S. government in general has lacked an overall export promotion strategy. AID is in the process of producing new strategy papers and reorganizing the agency, while the executive branch's Trade Promotion Coordinating Committee has taken steps toward defining the roles of each agency in promoting U.S. exports. Additionally, in November 1993, the executive branch submitted for congressional deliberation a discussion draft for revising the foreign assistance act. However, as all these actions are in process, their final impact cannot yet be fairly judged.

Recommendations

GAO makes no recommendations in this report, but raises several issues that should be useful in the debate over U.S. foreign assistance approaches and objectives.

Agency Comments

In commenting on a draft of this report, AID and the Department of State suggested technical clarifications on various points but did not take issue with the report's findings and conclusions. Commerce agreed with the report's conclusion that the type of support prohibited by section 599 has not been a determining factor in most private sector investment decisions, and said that section 807 programs should not be seen as a major cause of job losses in the U.S. apparel industry. GAO has incorporated the changes where appropriate in the text. AID, State, and Commerce comments are presented in appendixes II, III, and IV, respectively, along with GAO's evaluation.

Contents

Abbreviations

AID	Agency for International Development
AIFLD	American Institute for Free Labor Development
CBERA	Caribbean Basin Economic Recovery Act
CINDE	Costa Rican Coalition for Development Initiatives
FIDE	Foundation for Investment and Development of Exports
FUSADES	Foundation for Economic and Social Development
GAO	General Accounting Office
IPC	Investment Promotion Council
OPIC	Overseas Private Investment Corporations

Introduction

Members of Congress have expressed concern that some foreign assistance programs are inducing American companies to close their U.S. plants and move operations to the Caribbean Basin,[1] thereby contributing to a decline in U.S. manufacturing employment. The apparel industry, in particular, has been a focal point of concern because this industry has been the leader in developing offshore assembly operations in the Basin. Congress has also raised concerns that Basin country workers may be subject to exploitative labor practices, particularly in special export processing zones where many assembly operations are located. Prompted by these concerns, Congress passed section 599 of the fiscal year 1993 Foreign Operations Appropriations Act.[2] This provision prohibits U.S. government agencies that receive funds under the act from providing (1) financial incentives that induce businesses located in the United States to relocate jobs abroad, (2) assistance to export processing zones, and (3) assistance to activities that contribute to the violation of worker rights.

Competitive Pressures Have Resulted in Changes in Mature U.S. Manufacturing Industries

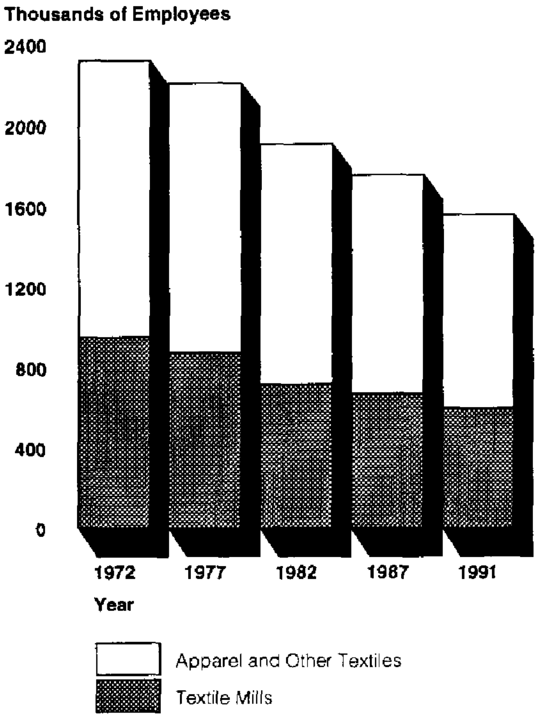
Mature U.S. manufacturing industries, including textiles and apparel, have been faced with increasing competition from imports. For example, apparel imports in 1991 constituted 61 percent of the U.S. market. In reaction to increased competition, U.S. companies have taken a number of countermeasures. Among them are (1) improving productivity through a variety of technological advances and (2) moving some labor-intensive operations offshore—a strategy known as production sharing. These cost-cutting actions, which displace many U.S. workers, are part of an ongoing transition in the U.S. economy in which manufacturing employment is declining while employment in service industries grows.

Between 1972 and 1991 the number of production employees in U.S. manufacturing dropped by about 7 percent. The textile and apparel industry accounted for slightly more than three-fifths of this decline (see fig. 1.1).

[1]For the purposes of this report, the Caribbean Basin includes those countries designated as beneficiaries under the Caribbean Basin Economic Recovery Act. As of January 1992, these were: Antigua and Barbuda, Aruba, the Bahamas, Barbados, Belize, the British Virgin Islands, Costa Rica, Dominica, the Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Honduras, Jamaica, Montserrat, the Netherlands Antilles, Nicaragua, Panama, St. Kitts-Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago. Haiti is also included, though this country's participation was suspended in November 1991 under an Organization of American States-endorsed trade embargo.

[2]P.L. 102-391, section 599, 106 Stat., 1633, 1696 (1992). Section 599 prohibitions were included in section 547 of the fiscal year 1994 Foreign Operations, Export Financing, and Related Programs Act. Section 547 clarifies that the law does not apply to micro and small-scale enterprises that were not the focus of concern in enacting the original legislation. Throughout this report, we refer to this provision as section 599.

Figure 1.1: Decline in U.S. Textile/Apparel Employment (1972-91)



Source: Department of Commerce Annual Survey of Manufacturers.

Many workers displaced from their manufacturing jobs find other employment as the economy transitions toward a greater role for service industries. However, the transition into other careers can be difficult, financially and emotionally. The individuals most likely to be affected are members of groups that traditionally have difficulty finding new jobs at comparable wages—women, older workers, minorities, and less educated workers.[3]

[3]For discussion of U.S. government programs to assist workers dislocated by changing international trade patterns, see Dislocated Workers: Comparison of Assistance Programs (GAO/HRD-92-153BR, Sept. 10, 1992) and Plant Closings: Limited Advance Notice and Assistance Provided Dislocated Workers (GAO/HRD-87-105, July 17, 1987).

Textile Manufacturers Incorporate Technological Advances

By adopting technological advances, companies may improve productivity and need fewer employees to perform the work. U.S. textile manufacturers have adopted advanced, capital-intensive technologies, permitting them to compete successfully while reducing employment. While demand has risen and textile mill production has increased, the industry experienced a 37-percent decline in production jobs between 1972 and 1991. This represented nearly one-fifth of the U.S. manufacturing jobs lost during this period. A 1992 study by the Congressional Research Service found that virtually all of the recent job losses in the textile sector were attributable to increased productivity.[4]

Apparel Manufacturers Turn to Production Sharing

Although some segments of the apparel industry have remained competitive in the United States by adopting improved technologies, the industry has not had as much success integrating advanced technology into assembly operations—sewing pieces of cloth together into garments. These operations remain largely labor-intensive. Assembly of commodity-type apparel like underwear and informal pants and shirts has been "de-skilled" to the point that people with minimal training can perform the work. Consequently, these operations have become largely the province of developing countries, where large pools of unskilled labor are available at low wages.

Some apparel companies now design products for the U.S. market but hire contractors to produce these garments overseas from non-U.S. materials. A growing number of companies, however, have established production sharing in developing countries, especially the Caribbean Basin. These companies take advantage of low labor costs for assembly operations while continuing to use components like cloth, zippers, and buttons that are produced in the United States.

Many industry experts believe that U.S. apparel production will continue to move offshore. To survive, companies producing certain types of garments will either use production sharing or purchase finished products of entirely foreign origin. However U.S. companies choose to react, some workers will lose their jobs in the transition. Appendix I provides additional discussion of the U.S. domestic impact of growth in Basin assembly industries.

[4] Industries and World Markets: A Sampling of the U.S. Experience in the 1980s (Congressional Research Service Report 92-302E, Mar. 23, 1992).

Section 599 Restrictions on U.S. Foreign Assistance

In response to criticism that U.S. foreign assistance programs were supporting the development of offshore assembly operations in the Caribbean Basin, Congress included language in the fiscal year 1993 Foreign Operations Appropriations Act that circumscribes relevant U.S. activities. Section 599 states that no funds appropriated under the act may be obligated or expended to provide

"(a) any financial incentive to a business enterprise currently located in the United States for the purpose of inducing such an enterprise to relocate outside the United States if such incentive or inducement is likely to reduce the number of employees of such business enterprise in the United States because United States production is being replaced by such enterprise outside the United States;

"(b) assistance for the purpose of establishing or developing in a foreign country any export processing zone or designated area in which the tax, tariff, labor, environment, and safety laws of that country do not apply, in part or in whole, to activities carried out within that zone or area, unless the President determines and certifies that such assistance is not likely to cause a loss of jobs within the United States; or

"(c) assistance for any project or activity that contributes to the violation of internationally recognized workers rights, as defined in section 502(a)(4) of the Trade Act of 1974, of workers in the recipient country, including any designated zone or area in that country."

The export processing zones referred to in subsection (b) are secured areas that are officially outside of a country's customs territory.[5] Foreign-made inputs imported into these zones for export-oriented manufacturing are therefore exempt from import duties. Companies locating in these zones often receive tax exemptions and waivers from various restrictions that may not apply to businesses functioning in the mainstream economy, including restrictions on foreign ownership and repatriation of profits.

The worker rights referred to in subsection (c) are defined in the Trade Act of 1974, as amended, as (1) the right of association; (2) the right to organize and bargain collectively; (3) a prohibition on forced labor; (4) a minimum age for employing children; and (5) acceptable work conditions (minimum wage, hours and occupational health and safety).[6]

[5]The United States itself has a large Foreign Trade Zones Program, including general purpose zones at nearly every port in the country and "subzones" granting benefits to more than 100 individual U.S. factories. For more information, see International Trade: Foreign Trade Zones Program Needs Clarified Criteria (GAO/NSIAD-89-85, Feb. 7, 1989).

[6]See 19 U.S.C. section 2462(a)(4).

These provisions, included in the fiscal years 1993 and 1994 Foreign Operations, Export Financing, and Related Programs Appropriation Acts, apply to any program receiving appropriations under those acts. The Agency for International Development (AID) is the primary agency responsible for administering U.S. bilateral foreign assistance programs, including programs aimed at helping developing countries to address fundamental problems in the areas of population and health, the environment, democracy, and economic growth (including activities to encourage trade and job creation). AID programs aimed at encouraging industrial development, trade, and investment were the main focus of concern by advocates of the section 599 restrictions. The law also affects programs at the Department of State, the Overseas Private Investment Corporation (OPIC), and the Export-Import Bank of the United States (Eximbank). The Department of Commerce also has an important role in promoting trade and investment. Restrictions similar to section 599 apply to activities of the Commerce Department's Foreign Commercial Service.[7]

Restrictions Reflect Larger Debates on Regional Free Trade

The concerns that led to passage of section 599 are part of a larger and long-standing public policy debate about whether initiatives aimed at encouraging regional free trade are harmful to some U.S. interests. In this instance, workers whose jobs are threatened by competition from cheap Basin labor are aligned against company owners and managers, who gain a competitive advantage from reducing their labor costs by employing Basin labor, and against others, like textile companies and shipping concerns, which benefit from increased offshore assembly. U.S. consumers may also benefit from lower prices, but consumer groups have not been vocal participants in debating this issue. This same conflict forms part of the controversy over the North American Free Trade Agreement, which establishes a free trade zone with Mexico and Canada.

Objectives, Scope, and Methodology

In response to congressional requesters, we reviewed (1) the impact that U.S. policies and programs have had on the growth of Basin assembly industries and on the decisions of U.S. companies to invest in these industries, (2) the relationship between section 599 and other foreign assistance objectives, and (3) implications for the future of U.S. foreign assistance and trade policies in the Basin. Our report focuses on four countries—Costa Rica, the Dominican Republic, El Salvador, and Honduras.

[7]See 22 U.S.C. 2151 note.

To understand trends in U.S. manufacturing, we interviewed and obtained documentation from analysts at the U.S. International Trade Commission; the Departments of the Treasury, Commerce, and Labor; and experts from industry, labor groups, and academia. We also obtained trade and employment data from the Census Bureau, the Customs Service, and other sources. We retrieved data on U.S. trade with Basin countries from the Department of Commerce. We adjusted the data to constant 1987 dollars using the Merchandise Exports Price Index from the Commerce Department's Bureau of Economic Analysis. We calculated the growth rates of exports through a regression analysis, using ordinary least-squared growth rates.

To identify U.S. government policies and programs encouraging trade with, and investment in, the Basin, we consulted with officials at AID, OPIC, the Eximbank, the Trade and Development Agency, the State and Commerce Departments, and the Office of the U.S. Trade Representative. Our ability to present precise information on funding devoted to relevant activities was limited, however, by the incomplete data in agency records. The nature of AID operations, in particular, makes it difficult to compare programs among countries and to add together amounts devoted to disparate programs over varying time periods.[8] For example, most agency assistance is provided indirectly through a variety of intermediaries. Also, many projects are multifaceted. Programs supporting private sector development may, for instance, contain elements aimed at rural development or general policy reform. Unless otherwise specified, we present funding amounts in current dollars.

We reviewed legislation governing U.S. trade and foreign assistance programs in the Basin and U.S. government activity concerning worker rights in developing countries. We consulted with Offices of General Counsel in AID, OPIC, the Department of Commerce, the Eximbank, and the Trade and Development Agency to clarify and evaluate these agencies' response to section 599. Since our initial review indicated that the Trade and Development Agency does not support operations that are of interest within the scope of this report, we excluded this agency from further review.

We visited four countries in the Caribbean Basin—Costa Rica, the Dominican Republic, El Salvador, and Honduras—to gather information on relevant U.S. government policies and programs and the development

[8]For additional discussion of difficulties in AID records, see Financial Management: Inadequate Accounting and System Project Controls at AID (GAO/AFMD-93-19, May 24, 1993).

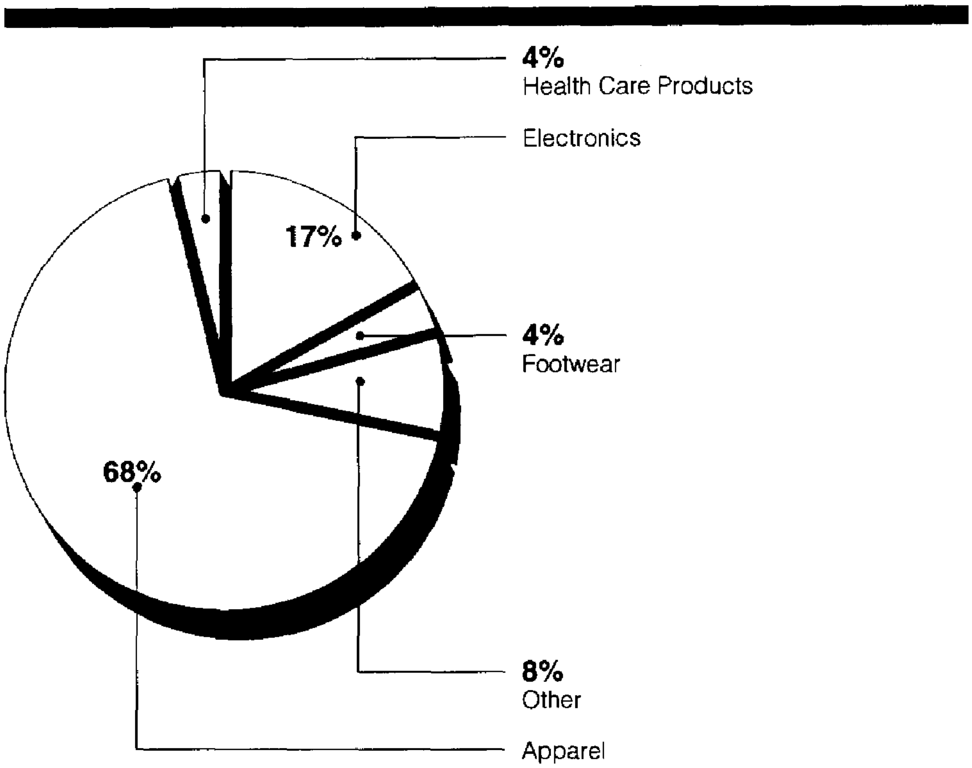
impact of growth in assembly industries, including the impact on workers. We selected these four countries for several reasons, including (1) particular congressional interest, (2) substantial levels of export-oriented assembly activity, and (3) significant U.S. government-financed programming in support of such activity.

In these countries, we interviewed U.S. agency officials, contractors and grantees, local government officials, academic and other experts on economic development, industrialists and plant managers in affected sectors, and labor union representatives. We also visited the Miami area, where we contacted the local offices of Basin country trade and investment promotion organizations and toured a highly automated U.S. apparel plant.

We compiled lists of export-oriented companies operating in the four countries using information provided by a number of sources, and selected a sample of companies representing a variety of types of ownership and industrial sectors. We excluded agricultural exports from our scope. Within the general area of manufacturing, we concentrated on apparel since this industry is the focal point for offshore assembly in the Basin.

In the 4 countries, we visited 53 plants, including 36 apparel plants. However, we also visited plants in a number of other industries, including electronics, footwear, and health care products. The distribution of plants among sectors is illustrated in figure 1.2. Of the plants we visited, 29 were subsidiaries of U.S. corporations, 4 were joint ventures, 15 were locally owned, and 5 were owned by Asian investors. Most operated within zones, but a number operated outside of zones. Some plants were part of major multinational corporations, while others independently contracted work for a number of different U.S. buyers. We also contacted the U.S. firms that own or contract with more than 50 percent of the plants that we visited.

Figure 1.2: Plants GAO Visited, by Industrial Sector



We performed our work from October 1992 to July 1993 in accordance with generally accepted government auditing standards. AID and the Departments of State and Commerce provided written comments on this report. These comments and our evaluation of them appear in appendixes II, III, and IV, respectively. The Eximbank, the Department of the Treasury, and the Office of the U.S. Trade Representative orally suggested minor changes in the text, which were incorporated as appropriate. OPIC reviewed the report but provided no comments.

U.S. Policies and Programs Encourage Increased Basin Trade and Investment

The U.S. government provides a number of incentives that encourage the growth of offshore assembly industries in the Caribbean Basin. AID activities complement U.S. trade and tax programs in an overall effort intended to develop Basin economies through increased trade and investment, while also helping U.S. manufacturers to compete with imports.

United States Adopted "Trade Not Aid" Strategy for the Basin

During the early to mid-1980s, the U.S. government developed a foreign policy toward the Caribbean Basin that emphasized the proposition that "trade not aid" would encourage economic growth to resolve the region's political and social problems. Adoption of this policy, embodied in policy initiatives and assistance programs, was motivated by concern over communist successes in Nicaragua and Grenada, an active insurgency in El Salvador, and political instability in several other countries, including Honduras, Guatemala, and Jamaica. The United States provided about $16.8 billion in bilateral economic assistance to the region between 1980 and 1992.[1]

Basic economic and demographic changes contributed to political instability in the Basin during this period. Basin economies were typically built on the expectation that traditional commodity exports, such as sugar, coffee, and some minerals, would continue to generate substantial foreign exchange earnings. These earnings would be used to purchase necessary imports and would make feasible high tariffs on foreign imports to protect inefficient domestic industries. However, market conditions changed and earnings from commodity exports declined precipitously, putting these countries in a precarious position. National governments responded to this problem by borrowing heavily on international markets, with the result that their economic situation worsened further. Many countries quickly found themselves under a massive debt burden. These difficulties exacerbated the problems faced by Basin countries in generating employment opportunities for their steadily increasing populations.

Faced with political unrest grounded in high unemployment and a pressing need among Basin countries for new sources of foreign exchange, the United States and other donors encouraged development of "nontraditional exports" as a key element in revamped national economic planning. This new emphasis was expected to attract private investment,

[1]This figure, expressed in 1993 constant (real) dollars, includes all types of bilateral economic assistance provided to countries eligible for assistance under the Caribbean Basin Economic Recovery Act. These countries, listed in chapter 1, received about another $2.5 billion in military assistance through the Foreign Operations accounts during this period, in 1993 constant (real) dollars.

generate foreign exchange, and create substantial numbers of new jobs. Nontraditional exports included agricultural products, such as winter vegetables and cut flowers, handicrafts, and export-oriented assembly operations.

In 1982 the United States adopted the Caribbean Basin Initiative. The initiative was based on broad private sector participation and was designed to promote investment and expand the region's economies. It specifically called for increased exports to markets outside the region, including the United States.

The National Bi-Partisan Commission on Central America—known as the Kissinger Commission—was subsequently tasked with developing a strategy for U.S. assistance to the region aimed at bringing these countries out of their economic and political crises. In a 1984 report to Congress, the Commission proposed addressing the region's underlying problems through a combination of military activity, foreign assistance programs, and trade policy measures. Among other things, it recommended technical and financial support for trading and export marketing companies and improvement in investment conditions. The commission concluded that "these countries could eventually become important production centers for low- and medium-technology goods to be exported to the United States."

In 1990 President Bush announced the Enterprise for the Americas Initiative. The initiative called for creating economic growth in the region through encouraging trade, investment, and debt reduction. It also called for negotiation of trade and investment framework agreements between the United States and Latin American countries as a step toward a hemispheric free trade zone.

Trade Programs in the Region Encourage Basin Assembly Operations

Trade measures designed to encourage growth in Basin country exports to the United States have been an important element in U.S. trade and development policy in the region. The measures concentrate on duty reduction in order to spur trade, and in some cases virtually eliminate quotas on exports to the United States from the region.

Many of the region's exports to the United States are already eligible for tariff preferences under the Generalized System of Preferences. The system applies to most developing countries, offering duty-free entry for designated products. By improving these countries' ability to compete, the system is intended to encourage development of manufacturing and export capabilities in their economies. However, only 18 percent of eligible products from the Basin came into the United States duty-free under this program in 1992.

Participation in the Generalized System of Preferences is relatively low for Basin products because most eligible items may also enter duty-free under the provisions of the Caribbean Basin Economic Recovery Act (CBERA), and most Basin exporters choose to use CBERA provisions. CBERA, enacted in 1983, codifies trade incentives for the Caribbean Basin, authorizing nonreciprocal trade benefits for Basin products.[2]

Concern about possible adverse impact on U.S. producers from increased Basin exports prompted Congress to exclude certain goods from the tariff preferences available under the Generalized System of Preferences and CBERA. Among the goods deemed "import sensitive" were textiles and apparel, handbags, luggage, and footwear (except parts).

However, section 9802.00.80 of the Harmonized Tariff Schedule—popularly known by its former designation as Item 807 of the now superseded U.S. Tariff Schedule—provides for reduced duties on goods partially or wholly assembled abroad of U.S. components and returned to the United States. Duty is assessed only on the value added through offshore assembly. The 807 program can be used by any industry, but in the Basin it is most popular with the apparel industry.

Offshore apparel assembly, in particular, was further encouraged by the creation in 1986 of the Special Access Program—otherwise known as Super 807. Under this program, Basin countries are granted the opportunity to enter into bilateral agreements that provide virtually quota-free access to the U.S. market for particular categories of garments, so long as they are assembled from fabric formed and cut in the United States.[3] The program is intended both to promote development under the terms of the Caribbean Basin Initiative and to help U.S. companies. According to Commerce Department officials, the textile and apparel industry, fearing a loss of market share from import competition, formed a coalition with unions to try to save some U.S. jobs by encouraging the adoption of Super 807. About 80 percent of apparel imports from the region in 1991 came in under the 807 and Super 807 programs.

[2]See 19 U.S.C. 2701.

[3]These agreements are now negotiated under item 9802.00.8010 of the Harmonized Tariff Schedule.

In 1990, Congress amended CBERA to extend benefits to some goods that were not previously eligible for reduced duties (including luggage, work gloves, leather wearing apparel, etc.) and to eliminate the original act's 1995 termination date.[4] Congress also amended the Harmonized Tariff Schedule to permit duty-free access for articles assembled in beneficiary countries from components produced in the United States.[5] This provision, however, excludes textiles and apparel, as well as petroleum and petroleum products.

U.S. Tax Code Encourages Basin Investment

The U.S. Tax Code, particularly section 936, also encourages U.S. investment in the Basin, including investment in assembly plants. The purpose of section 936 of the Internal Revenue Code, is to stimulate economic development in U.S. possessions by granting U.S. corporations a tax credit equal to the full amount of their income tax liability on income earned in the possessions. Section 936 also exempts from U.S. taxation income earned by these firms on qualified investments made with profits earned in the possessions. Qualified investments include direct investment in eligible projects and investments in local financial institutions. Changes in the Omnibus Budget Reconciliation Act of 1993 place limitations on the deductions available.[6] The primary beneficiary of these provisions has been Puerto Rico.

In 1986 the law was amended to permit the profits invested in financial institutions, known as section 936 funds, to be used for development projects in CBERA countries, subject to certain conditions.[7] As amended, CBERA requires the government of Puerto Rico to take such steps as may be necessary to ensure that at least $100 million in section 936 funds is invested annually in qualifying projects in CBERA countries.[8] According to the Department of Commerce, about $183 million in section 936 funds was invested in such projects during 1992.

Section 936 funds are privately owned bank deposits. For eligible projects, companies can use their profits deposited in such accounts or borrow

[4]P.L. 101-382, title II, 104 Stat. 655 (1990).

[5]P.L. 101-382, section 222, 104 Stat. 658 (1990).

[6]P.L. 103-66, section 13227, 107 Stat. 312, 489. This section amends 26 U.S.C. 936.

[7]Qualified investments include any that are (1) consistent with the goals and purposes of CBERA in active business assets, (2) development projects, or (3) in accordance with a specific authorization granted by the Commissioner of Financial Institutions of Puerto Rico.

[8]26 U.S.C. section 936(d)(4)(D)(i).

section 936 funds through Puerto Rico's Caribbean Development Program. The government of Puerto Rico and the U.S. Treasury enforce numerous regulations governing loans made with these funds.

More than $13.2 billion in funds qualifying under the provisions of section 936 were available in Puerto Rican banks as of May 1993. As of January 31, 1993, funds generated in Puerto Rico had supported 122 projects in 13 Caribbean countries and territories, according to the Puerto Rican government. These projects represent an investment of about $1.2 billion in Caribbean Basin countries. About $885 million (or 74 percent) of this investment was provided through section 936 loans. These loans were used for a wide range of purposes, such as infrastructure projects (including at least one export processing zone), agribusiness and tourism development, and projects in the apparel and electronics industries.

AID Has Encouraged Development of Export-Oriented Industries

Several provisions of the Foreign Assistance Act of 1961, as amended, direct U.S. foreign assistance programs to encourage growth in trade and investment relations between the United States and developing countries. For example, section 601 states that U.S. policy is to "encourage the efforts of other countries to increase the flow of international trade . . . and to encourage the contribution of United States enterprise toward economic strength of less developed friendly countries, through private trade and investment abroad . . . ." Moreover, section 601 instructs the President to "make arrangements to find, and draw the attention of private enterprise to opportunities for investment and development in less developed countries and areas . . . ."

Since announcing its "Private Enterprise Initiative" in 1981, AID has increased its emphasis on encouraging the growth of competitive markets and private business as a vehicle for economic development. The initiative has had its greatest influence on programming within the agency's Latin America/Caribbean Bureau, where it reinforces overall U.S. regional foreign policy. As of September 1992, the Bureau was supporting private sector-oriented activities through 120 projects with life-of-project funding of approximately $1.96 billion to be disbursed over an average of about 3 years.

Trade and investment promotion, specifically, is a major point of emphasis within the initiative. This is demonstrated, for example, in AID's "Economic Assistance Strategy for Central America, 1991 to 2000," which states that "increased trade and investment are key" to economic development in

Central America and commits AID to "place increased emphasis on trade and investment within its programs and explicitly link them to business outreach activities with and in the United States."

AID policy focuses trade development efforts on establishing a supportive policy environment, encouraging technology and skills transfers for export production, promoting trade and investment, introducing competition in trading sectors, providing greater U.S.-developing country trade opportunities, and encouraging appropriate infrastructure investment.

All four of the AID missions we visited placed great emphasis on private sector support in general, and trade development in particular, as key elements in their strategy for promoting economic growth. For example, AID/Dominican Republic's recent goals statement focused on "increased and diversified trade" as one of four strategic objectives within the overall goal of supporting broad-based and sustainable economic growth within a democratic environment. In these countries, we found that AID promoted growth in nontraditional exports, including production sharing, through (1) policy dialogue aimed at reducing barriers to private sector investment and trade, (2) assistance to national trade and investment promotion agencies, (3) support for export processing zone development, and (4) assistance to individual companies.

Policy Dialogue Improves Investment Climate

Creating a legal and regulatory environment that will facilitate private sector activity, attract foreign investment, and increase exports was a major focal point for AID missions in the Basin. Through policy dialogue and other means, AID encourages national governments to take such measures as eliminating price controls, dismantling trade barriers (including high tariff barriers that protect inefficient domestic industries), decontrolling exchange rates, and reducing bureaucratic barriers to private sector activity. AID's policy reform agenda has been similar to that of other donors, including multinational financial institutions, and has often been pursued in concert with them.

AID pursues these goals partially by making cash balance-of-payments support from the Economic Support Fund contingent on specific steps being taken by recipient governments. For example, AID/Honduras obligated $178 million in balance-of-payments support over fiscal years 1990 and 1991, representing 68 percent of the agency's overall program in the country in those years (excluding food aid). Disbursement of these funds was conditioned on the Honduran government's making progress on actions to reduce tariffs, privatize industry, allow market-determined exchange rates, encourage private investment, and reform the agricultural sector. AID also linked disbursements to loan conditions imposed by the International Monetary Fund, World Bank, and Inter-American Development Bank.

Trade and Investment Promotion Encourages Growth in Assembly Industries

Another key element of AID's efforts to encourage the development of nontraditional exports has been the creation of national trade and investment promotion organizations. Programming aimed at this objective was a prominent part of mission activity in all four of the countries we visited. Table 2.1 lists these organizations.

Table 2.1: AID-Supported Trade and Investment Promotion Organizations

Country	Organization	Acronym
Costa Rica	Costa Rican Coalition for Development Initiatives	CINDE
Dominican Republic	Investment Promotion Council	IPC
El Salvador	Salvadoran Foundation for Economic and Social Development	FUSADES
Honduras	Foundation for Investment and Development of Exports	FIDE

These organizations have undertaken a variety of functions, including serving as private sector advocates in internal policy debate over commercial and trade issues and promoting agricultural exports. However, promoting foreign investment and manufacturing exports have been their core activities.

Over the last decade, these agencies received approximately $69 million through AID for trade and investment promotion activities (see table 2.2).[9] Representatives of these organizations agreed with AID officials that the organizations owed their existence to AID support.

[9]This total includes both appropriated dollars and host country-owned local currencies generated through AID programs. AID generates local currencies in two ways. First, when the agency provides a country with cash transfers, the dollars themselves are generally used to pay bills that require hard currency. As a condition to receiving this assistance, recipient governments make available an equivalent amount in local currency, which is then programmed for purposes agreed to by AID officials, pursuant to congressional guidance. Local currencies are also generated through sales of U.S. agricultural commodities provided through the Food for Peace Program. These currencies are programmed in a similar fashion. See Foreign Assistance: Use of Host Country-Owned Local Currencies (GAO/NSIAD-90-210BR, Sept. 25, 1990).

Table 2.2: U.S. Support for Organizations' Trade and Investment Promotion Activities

Dollars in millions

Country	Organization	Years included	Source of funds	Amount
Costa Rica	CINDE	1982-92	Development Assistance and local currency	$24.1[a]
Dominican Republic	IPC	1986-92	Development Assistance and local currency	12.0[b]
El Salvador	FUSADES	1984-92	Development Assistance	24.8[c]
Honduras	FIDE	1984-92	Development Assistance	8.0[d]
Total				**$68.9**

Note: The amounts in this chart are presented in nominal (current year) dollars and are intended to give some perspective of the level of assistance going to these organizations. Information was not available to convert to constant (real) dollars.

[a]This figure includes $2.5 million in dollar grants and $21.6 million in host country-owned local currencies. Local currency figures were converted into dollars by AID.

[b]This figure includes $7.2 million in Development Assistance funds and $4.8 million in host country-owned local currencies. Local currency figures were converted into dollars by AID.

[c]Of this amount, $5 million was specifically directed at promoting the establishment of export processing zones.

[d]The government of Honduras contributed an additional 15.3 million lempiras in host country-owned local currencies. Of that amount, 11.3 million lempiras were generated through U.S. balance-of-payments support, while 4 million lempiras were generated through the Food for Peace Program. This amount was contributed over an 8-year period, making conversion into dollars difficult because of exchange rate fluctuations.

These organizations have aggressively worked to increase exports to foreign markets, especially the United States, and to persuade foreign (including U.S. and Asian) companies to locate production facilities in their countries. All except IPC have maintained offices in the United States, while CINDE has had representatives in several other foreign countries as well. The organizations have organized and operated booths at trade fairs, such as the annual garment industry "Bobbin Show," to attract the attention of those considering investing in the Basin or contracting with offshore firms. FUSADES helped to defray the expenses of Salvadoran companies that wished to gain clients by participating in the shows. They facilitate other promotional travel by local businessmen and arrange trips to their countries for potential investors and contractors.

AID Encouraged Development of Export Processing Zones

Supporting the creation and expansion of export processing zones has been part of AID's decade-long strategy for encouraging growth in nontraditional exports from the Basin. In Costa Rica, for example, $23.4 million in host country-owned local currencies was provided to establish central bank credit lines for productive activities, including zone development and tourism projects.[10] The mission also provided $5.4 million to support zone construction through local development banks. In 1988, AID/El Salvador provided $20 million through the central bank to establish a credit line for private zone developers.[11] In Honduras, $9.7 million in local currencies was provided to establish commercial credit lines to support zone development,[12] while about $4.9 million in local currencies was provided for this purpose in the Dominican Republic.[13]

In addition to providing financial support, AID encouraged the expansion of zone activity in a variety of other ways. For example, AID-supported organizations in Honduras and the Dominican Republic were largely responsible for developing the legal frameworks that currently govern zone development in those countries. In Costa Rica and the Dominican Republic, AID-supported trade and investment promotion organizations sponsored studies and seminars on zone operations. In 1989, for example, AID/Costa Rica allocated $300,000 to provide technical assistance in designing, building, and marketing zones.[14]

AID Provided Support for Assembly Operations

AID also encouraged growth in nontraditional exports by funding programs that provided support to individual companies. From 1982 through 1992, AID missions in Costa Rica, El Salvador, and Honduras generated about $258 million in loan capital to finance individual company investments in a

[10]Local currency figures were converted into dollars by AID. Records were not readily available to determine how much was actually used for zone development.

[11]This figure excludes (1) $6 million in balance-of-payments support directed toward financing supportive infrastructure outside of zones and (2) nearly $4.5 million and 51.2 million colones generated through balance-of-payments support designated for infrastructure improvements at the single zone that continued operations during El Salvador's civil war. Exchange rate fluctuations over the 4-year period during which these local currencies were generated make their conversion into dollars difficult.

[12]Through August 1992 these credit lines had supported construction at five of eight Honduran zones, covering about 16 percent of the total construction cost of the eight zones. Local currency figures were converted into dollars by AID.

[13]Local currency figures were converted into dollars by AID.

[14]According to AID, only about $30,000 was actually used because investors did not come up with the matching funds needed to access this technical assistance.

variety of areas, with emphasis on nontraditional exports and tourism. AID also provided training and technical assistance to export-oriented firms through promotion agencies and other mechanisms. AID-supported projects assisted both locally owned and foreign-owned firms. In commenting on a draft of this report, AID stated that most of the companies receiving support were locally owned.[15]

Most of these assistance funds were provided by AID/Costa Rica. About $169.5 million in host country-owned local currencies was provided through the Central Bank, and another $47.7 million in dollar loans was provided through development banks.[16] A portion of this funding went for assembly plants. For example, one AID-supported institution provided about 25 percent of its loans, or $10.1 million, to assembly operations exporting to the United States, while approximately 22 percent of another's loans, or $3 million, went for such purposes. Because of the complexity of the various institutions' records, we could not readily determine the overall total provided for assembly operations. In El Salvador, AID authorized $15.8 million to capitalize an Export Investment Fund. In Honduras, AID Development Assistance funds and local currencies combined provided more than $24.8 million in credit for exporting firms, including assembly plants.[17]

All four missions supported sizable training programs aimed at upgrading worker skills in nontraditional export industries. However, these programs were not aimed specifically at plants in zones or at assembly industries in particular. In Honduras, for example, AID supported the establishment of 16 vocational training centers. However, only about 25 of the thousands of students enrolled in these facilities each year were trained specifically for the apparel industry. Similarly, AID/El Salvador designated $14 million to support the efforts of a local private voluntary organization to improve worker vocational and technical skills, but the programs have little direct connection to zones or export processing production.

Promotional organizations, however, did support activities aimed directly at improving the capabilities of export processing plants. FUSADES, for

[15]We could not verify this point because AID records were incomplete and a "locally owned" company was not clearly defined. For example, some companies incorporate as a "local" firm in order to conduct business in the country and were therefore listed as locally owned although U.S. investors were involved.

[16]Another $1 million was allocated as a technical assistance grant to a participating development finance organization.

[17]This figure includes 96 million lempiras in host country-owned local currencies converted at 5.7 lempiras to the U.S. dollar.

example, could provide up to 50 percent of the costs incurred by export-oriented firms for consulting advice on improving quality control, production volume, inventory control, and so forth. In 1991, FUSADES reported spending approximately $743,000 to benefit 86 firms, of which 38 were textile and apparel companies. Since 1984, AID/Honduras provided about $1.3 million in Development Assistance funds to develop and support in-plant training for specific companies, while balance-of-payments support generated an additional $793,000 in host country-owned local currencies to support this effort. Beneficiaries included two U.S. corporations and one joint venture.[18]

Other Agencies Have Provided Limited Support

The Commerce and State Departments, OPIC, and the Eximbank have provided some support to the development of offshore assembly industries in the Caribbean Basin. The Commerce Department focuses on promoting U.S. exports and providing information to potential U.S. investors, while the State Department provides general assistance to U.S. businesses overseas. OPIC and the Eximbank provide financial support for U.S. investments and exports.

Commerce Department Assists U.S. Investors

The Commerce Department has responsibilities abroad in the areas of promoting U.S. exports and providing information to or otherwise assisting U.S. companies doing business in foreign countries. The Department's U.S. and Foreign Commercial Service has 133 posts in 70 countries, 5 of them in the Basin.[19] In diplomatic posts that lack Commerce Department representation, State Department economic officers and local nationals employed by the embassies or consulates perform these functions.

Commercial officers in the field are tasked with promoting U.S. business interests. They provide information to U.S. companies interested in investing in or purchasing from other countries, and attempt to resolve difficulties these businesses may encounter in their affairs. Because commercial information is made readily available to all U.S. companies, commercial officers may provide some assistance to companies interested in investing in Basin assembly plants or in contracting with locally owned firms.

[18]The U.S. companies involved benefitted from about $242,450 in grants and $324,050 in loans expended through the Honduran Advisory Center for Human Resources Development.

[19]The Service maintains a regional office for the Caribbean in the Dominican Republic, as well as offices in Costa Rica, Honduras, Guatemala, and Panama.

The Commerce Department also supports the objectives of the Caribbean Basin Initiative more directly through the activities of the Latin America/Caribbean Business Development Center. AID supports the Center via an interagency agreement.[20] The Center's mission is to encourage increased U.S. trade and investment relations with Latin American countries. Its main functions are to provide information on trade and investment opportunities in the region, including information on export processing zones and production sharing, through a series of publications, activities, and direct contact with U.S. companies. The Center does not provide financial assistance.

State Department Provides General Assistance to U.S. Businesses

According to the State Department, in addition to providing commercial assistance in the eight diplomatic missions in the region without Foreign Commercial Service representation, the State Department provides general assistance to U.S. businesses overseas. This assistance includes providing political and economic analysis and security briefings; engaging in policy dialogue with foreign government officials to open markets and provide clear, fair ground rules for U.S. businesses; advocating on behalf of U.S. companies; and assisting in settling trade and investment disputes.

OPIC Has Provided Some Support for Assembly Plant Construction

OPIC's mission is to promote economic growth in developing countries by encouraging U.S. private investment. OPIC assists U.S. investors by (1) financing projects through direct loans and loan guarantees; (2) insuring projects against political risks; and (3) providing investor services, such as advisory services, computer-assisted project/investor matching, country and regional information, and investment missions.

OPIC has promoted the zones concept in the Basin and other parts of the world. In the Basin, OPIC reported supporting three zone projects, one of which was later denied funding because of section 599.[21] OPIC also reported providing financing to six companies located in zones. As of March 1993, OPIC had committed $433.7 million in financing to investments in Central America and the Caribbean region. OPIC reported that about 10 percent of this amount, or $43.2 million, was committed to companies which either manage or are located within Basin export processing zones. This amount may be understated, however, because OPIC records do not always indicate whether assisted companies are in zones.

[20]The agreement provided the Center with about $728,000 in AID funds for the period 1986-92.

[21]The project in question was a proposal for funding to build a power plant for a zone in the Dominican Republic.

OPIC does not generally target particular industries, markets, or types of projects. However, in order to encourage growth in nontraditional exports in Latin America and the Caribbean, AID negotiated an interagency agreement that gives OPIC additional resources to increase its emphasis in this region.[22]

In concurrence with AID, OPIC has sponsored investment missions and other activities to encourage investment in Latin America and the Caribbean. However, primary emphasis has been placed on larger markets in South America. Only one of the six OPIC investment missions for the region in 1992, for example, went to a Basin country (El Salvador). According to OPIC documents, this mission did not focus on export-oriented assembly.

Eximbank May Provide Some Financing Support

The Eximbank is the primary federal agency providing export financing. The Bank states that its mission is "to facilitate export financing of U.S. goods and services by neutralizing the effect of export credit subsidies from other governments and by absorbing reasonable credit risks that are beyond the current reach of the private sector." The Bank's financing concentrates on developing countries. The Bank's programs support a small portion (about 2 percent in fiscal year 1991) of total U.S. exports. The Bank offers a wide range of export financing assistance, including direct loans, loan guarantees, and export insurance covering commercial and political risks. According to Bank officials, it does not target specific markets or industries or set credit limits by country.[23]

The Eximbank did not provide medium- or long-term financing to investors in offshore assembly plants in the four countries we visited.[24] However, the Bank does not record whether projects are in zones, and has not considered zone status in its decisions to finance exports to the region. It is possible, therefore, that the Bank could have supported zone projects in other countries. In addition, the Bank's short-term trade finance operations may have provided assistance to companies working to establish or support offshore assembly operations. However, the Bank's data collection system is not designed to capture this information.

[22]The agreement provided OPIC with about $610,000 in AID funds for the period 1991-93.

[23]See Export Finance: The Role of U.S. Export-Import Bank (GAO/GGD-93-39, Dec. 23, 1992).

[24]We did not review the Bank's records on financing for projects in other countries.

Until the end of fiscal year 1992, AID and the Eximbank cooperated in a Trade Credit Insurance Program for Central America. From the beginning of the program in 1985 through June 1992, the Bank insured about $1.2 billion in shipments to Central America under this program. This program was allowed to expire due to reduced demand for risk insurance and accounting changes under the Credit Reform Act.

Conclusions

Motivated largely by concern about economic stagnation and unrest in the region, the U.S. government adopted a policy of encouraging increased trade and investment relations with Caribbean Basin countries. Within this overall "trade not aid" strategy, the United States encouraged the development of Basin assembly industries, as well as other nontraditional exports, through a variety of trade measures and foreign assistance programs. Production sharing, in particular, was encouraged through trade measures like the Super 807 program—both to encourage Basin economic growth and to help U.S. textile companies to become more competitive. AID's support for Basin assembly industries, provided through a variety of programs, was intended to complement—or take advantage of—such trade measures. OPIC also provided some support to growth in Basin assembly industries. The Eximbank did not provide medium- or long-term financing to investors in assembly plants we visited, but had financed exports to the region. The Commerce and State Departments facilitated U.S. investment in the region.

U.S. Foreign Assistance Not Deciding Factor in Growth of Assembly Industries

Our review indicated that gaining access to cheaper labor was the most important factor in U.S. companies' decisions to invest in Basin assembly plants. U.S. trade measures and foreign assistance programs had some influence, but were not determinative factors. Company representatives did not cite the opportunity to locate in an export processing zone as a factor in their investment decisions. However, they did say that zones offered a number of benefits—most prominently the ability to avoid problems with Basin country bureaucracies.

Though unacknowledged by most company representatives, AID helped to facilitate the growth of Basin assembly industries by encouraging economic reforms that improved the general business climate and by providing assistance for zone development. Although our review indicated that U.S. companies would have moved assembly operations to the Basin without AID's encouragement, its programs may have helped countries perceived as less attractive investment locations to share in the benefits of growth in offshore assembly.

Access to Cheap Labor Most Prominent Consideration

U.S. company officials we spoke with generally cited a number of factors behind their decisions to establish or expand Basin assembly operations. Reducing labor costs through access to cheaper labor was the most prominent of these, but company officials also cited labor availability, proximity to the United States, political stability in the chosen location, and U.S. trade policies in the region as important considerations.

A 1988 U.S. International Trade Commission report reached similar conclusions.[1] The Commission visited facilities in Costa Rica, the Dominican Republic, and Haiti and found that low labor costs and proximity to the United States were the most frequently cited reasons for U.S. corporations to locate assembly facilities in the Caribbean Basin. Other factors such as duty concessions and stability of the foreign government were also highly rated as incentives for locating operations in Costa Rica and the Dominican Republic.

At the 53 plants we visited, hourly wages ranged from an average of \$0.66 in Honduras to \$1.11 in Costa Rica. One company representative said that whereas a particular apparel line could be produced in the United States for 35 cents a minute, the same line could be produced in their Caribbean plants for about 5.5 cents a minute. The largest difference in this

[1]The Use and Economic Impact of the Tariff Schedules of the United States Items 806.30 and 807.00 (International Trade Commission Publication 2053, Jan. 1988).

calculation is the cost of labor, which is much more expensive in the United States.

Basin countries have available workers who can be quickly trained to perform low-skill assembly tasks. All of the countries we visited, with the exception of Costa Rica, have large numbers of unemployed workers ready to fill assembly positions. For example, unemployment and underemployment in Honduras is estimated to be as high as 45 percent. Some company officials said that once these workers are properly trained, they can be just as productive as U.S. workers. Others said that productivity rates were somewhat lower than in the United States but that lower wages offset this disadvantage.

Many company executives said that the proximity of Basin countries to the United States made them convenient locations to establish production-sharing operations. Such proximity allowed for easier oversight from the United States, better communications within the same time zone, and shorter lead times for production. For example, one company moved its assembly operations from the Far East to the Basin to reduce its product delivery time from 60 days to 5 days. Ease of communications and shorter shipping times were cited as helping make U.S. companies more responsive to their customers and, therefore, more competitive. In addition, the countries in the region have steadily improved zone-related infrastructure, making operations within the zones easier.

Political stability in Costa Rica and the Dominican Republic was also cited by U.S. companies as a factor in their investment decision-making. Costa Rica in particular was cited as a safe location. Civil war in El Salvador during the 1980s reduced the attractiveness of that country, while Honduras was beset by an economic crisis. However, improvements in both countries' situations have led to recent increases in foreign investment.

U.S. trade measures also had an impact on company decision-making. Quota restrictions and high duties, which remain a problem for products produced in the Far East, do not apply to many of the items currently produced in the Basin. Far East firms are aware of this benefit, and many have located in Basin countries to maintain or increase their volume of shipments to the U.S. market after quota limits on home country production have been met.[2] (This issue is discussed further in app. I.) In fact, restraints on the growth of imports to the United States from such sources as Bangladesh and, most importantly, China under the General Agreement on Tariffs and Trade's Multi-Fiber Agreement are a significant factor behind the growth of Basin assembly industries.

Some U.S. company officials we spoke with said 807 duty reductions keep production costs low enough to justify locating facilities in the Basin, rather than in other foreign locations. One official commented that although Basin labor is more expensive than labor in certain Far East locations, like China, this difference is offset by lower costs of transporting U.S. content to the Basin. Without the combined benefit of reduced duties and lower transportation costs, these companies would likely attempt to relocate their assembly operations to the Far East, buy cheaper components from somewhere other than the United States, or simply buy finished products from the Far East.

Zone Location Viewed as a Means to Avoid Bureaucratic Problems

The company representatives we interviewed did not specifically mention the existence of export processing zones as a reason for their deciding to invest in Basin countries. However, company officials said that locating in a zone did offer a number of benefits.

Locating in a zone was viewed primarily as a means of escaping from the bureaucratic problems that companies typically experience when trying to conduct business in developing countries—especially delays and other difficulties with customs authorities. Companies often preferred locating in a zone for this reason even when the zone offered no advantages over other locations in the country regarding rental rates or tax and tariff treatment.

Company officials also pointed out that zones provided ready facilities for companies looking for an immediately available location. Zones often have empty factory shells waiting for tenants and offer security systems, utilities, and other services to ease a company's transition into the country. Some companies used zones as their initial location when first investing in a new country and later built additional space outside the zones.

[2] Access to low-cost, available labor is also a consideration for Asian investors. One Taiwanese investor commented, for example, that workers at home were no longer interested in low-paying garment assembly jobs now that the economy had advanced and was providing better alternatives.

Financial incentives have also encouraged companies to locate in zones. Companies mentioned tax forgiveness, ease of repatriation of profits, and absence of duties as some of the incentives that made a difference to them. However, these incentives are also available in varying degrees outside of zones.

Future Role of Export Processing Zones Unclear

Each of the countries we visited have extended some zone-type benefits to companies outside of zones. These arrangements, including temporary admission, duty drawback, and programs permitting access to zone-type privileges for individual plants, allow duty-free importation if materials are used in production for export.[3] Duty exemptions can also apply to machinery and other items used in production. However, non-zone firms may still experience more restrictions than zone firms in other areas, like repatriation of profits and local taxes.

Zone-type arrangements were most widely used in El Salvador and Costa Rica. About 90 percent of the assembly plants granted special customs status and tax breaks under Salvadoran law are located outside of zones. In Costa Rica, assembly operations under non-zone incentive programs accounted for almost 89 percent of export earnings and about 84 percent of employment among such operations in 1991. Zones are still being built in the country, but they are being promoted more for their tenant services than for their other benefits. One zone manager told us that he advertises the water and telephone services at his zone because acquiring these services outside zones can take more time.

The Dominican Republic has the Basin's oldest and most developed zone industry. In 1991, Dominican zones accounted for 62 percent of all zone exports, 60 percent of all zone workers, and 42 percent of all companies in zones in the region. The country continues to rely on zones as the primary medium for assembly industry growth. Although the Dominican Republic's Export Incentive Law offers zone-type benefits to companies outside zones, the law is considered unclear and difficult to deal with. For example, customs clearance for imported materials under this law can take anywhere from 20 to 60 days. In several instances, officials of companies operating in zones said that easier compliance with customs requirements was one reason for their locating in a zone as opposed to operating under the Export Incentive Law.

[3]Customs drawback allows for the refund of duties paid on imported materials and components used in production for export. In temporary admission and "in-bond" programs, customs authorities allow clearance of imported materials for use in export production without payment of duties.

In El Salvador, zone-like regimes existed before zones became a real factor. The Salvadoran assembly industry started up again as the civil war was ending and has grown without the help of zones. Special provisions provided in its 1990 legislation gave these companies all the standard zone benefits without the need of a zone. Even now, though new zones are being completed, most assembly plants operate outside of them. According to FUSADES, most of El Salvador's 181 assembly plants have special customs status outside of zones. Although companies have expressed interest in the new zones, the capacity of these zones is limited, and the withdrawal of AID assistance (see ch. 6) raises doubts about future zone growth.

The number of zones in Honduras has grown rapidly in the past 5 years. From 1990 through 1992, 8 private zones opened, attracting more than 40 foreign-owned assembly companies from the United States and Asia. Zone-type benefits are available to companies located outside zones, but these benefits have been used more by local concerns than by foreign companies. Non-zone companies are not exempt from local taxes, and they must pay a customs brokerage fee. It appears likely that inefficiencies in the general economy and superior zone services will ensure continued zone growth in Honduras for the foreseeable future.

It should be noted that a number of studies have concluded that the importance of zones in developing economies is likely to decline as zone-type benefits become available to companies locating outside of zones.[4]

Foreign Assistance Programs Have Had Some Impact

While not considered the most important factor in companies' decisions to establish assembly operations in Basin countries, U.S. foreign assistance programs have had some impact on this phenomenon, particularly by helping to improve the business climate in these countries and through credit lines for zone construction. AID-supported promotion activities and technical assistance were of lesser importance.

Policy Reforms Made a Difference

Policy reforms encouraged by the United States and other donors have improved the environment for private investment in Basin countries, including investment by foreigners. For example, AID and other donors encouraged adoption of market-determined exchange rates. This has typically led to devaluation of local currencies, with the result that worker

[4]See for example, the World Bank's 1992 report, Export Processing Zones.

salaries and other local inputs to production have become less expensive in dollar terms for foreign investors. This linkage was particularly clear in the Dominican Republic. Improved laws governing foreign investment have also made these countries more attractive places to do business.[5] Private investment, whether domestic or foreign, has become more secure as these countries have liberalized their laws; stabilized their economies; and, in the case of El Salvador, worked to resolve political disputes leading to internal violence.

AID officials believe that zone development is complementary to the agency's policy work. Zones are seen partially as a tool to encourage the implementation of broad private sector reforms. AID's 1984 Guidebook on Free Zones states that "free zones represent an excellent 'proving ground' for liberalizing reforms before extending them on a nationwide basis." A 1989 AID study, Zone Contributions to Development, states that "a favorable experience with [zones] often creates pressure for economic liberalization and reform of the entire economy, thereby diffusing these policy benefits to a wide range of communities." A government official in Honduras said that his country's experience with zones has increased the confidence of the Honduran private sector.

AID and OPIC Provided Seed Monies for Private Investment in Zone Construction

AID and OPIC programs have provided "seed money" that has encouraged more private investment in zones. Privately owned zones are a recent phenomena in some of the countries we visited. Initial zones in Costa Rica, El Salvador, and Honduras, established during the late 1970s and early 1980s, were government-owned and -operated. In the mid-1980s, private investors became more involved. For many years, El Salvador had only one zone, and it was operated by the government. However, private investment in zone construction is increasing, due at least partially to AID's financial assistance. In Honduras, initial AID and OPIC financing for new zones was quickly dwarfed by subsequent private investment. Private investors recently purchased an unsuccessful government zone in Costa Rica.

Circumstances in the Dominican Republic were somewhat different. The country's zone development started in the 1960s through private investment. Later zones were built with both private and government funds, and AID and OPIC funds were also used to expand these zones. Though AID, OPIC, and section 936 funds also went to companies located in

[5] Some legal reforms were specifically aimed at encouraging assembly industry development, such as reforms permitting private investment in zone development.

zones, most company officials we interviewed said that their capital came from other private sources.[6]

Promotional Activities Had Marginal Impact

Our review indicated that the promotional activities conducted by AID-supported organizations such as CINDE, IPC, FUSADES, and FIDE have had a marginal impact on company decisions to locate a facility offshore. Production sharing is a widely known strategy—particularly in the apparel industry. A number of the companies with whom we spoke have a long-standing tradition of offshore assembly in Puerto Rico and other Basin locations. Some have been in the Basin since the mid-1970s. Promotional activities by host country organizations apparently functioned primarily to provide detailed information that would allow interested companies to choose among various options for location of offshore plants. FUSADES was the most aggressive organization, subsidizing the travel of local company officials to trade shows as well as the travel of potential zone investors. Much of this activity can be attributed to FUSADES's attempt to reestablish investment in El Salvador in the wake of the country's recent civil war.

In general, the primary impact of AID-funded investment promotion operations appears to have been to permit these countries to compete with one another for new investment and sales. In a sense, such competition is similar to the aggressive contests waged among the investment promotion arms of U.S. state governments to attract plants that foreign investors have already decided to locate somewhere in the United States.[7] Promotion agency campaigning may have influenced some companies to invest in locations perceived to be less desirable, like El Salvador, as opposed to countries with established reputations, like the Dominican Republic.

[6]AID-backed funding to companies was difficult to identify because of the various intermediaries involved. Eight of the companies we visited said that they had received OPIC assistance. Five benefitted from a total of $16.4 million in loans, and five used OPIC insurance. Two companies used both. Five of the companies we visited were using section 936 funds, in all instances reinvesting company profits from operations in Puerto Rico.

[7]Our report, International Trade: Foreign Trade Zones Program Needs Clarified Criteria, discusses this trend among states, noting that "various state and local governments have engaged in intense competitions for proposed transplant factories and also domestic company plants. These governments have offered such companies incentive packages worth tens of millions of dollars. In some cases, this support amounts to well over $100 million."

Training and Technical Assistance May Have Had an Impact in Some Instances

We identified a few instances in which U.S.-supported training programs and technical assistance may have had an impact on investment decisions and the competitiveness of Basin firms. In El Salvador, FUSADES provided more than $100,000 in technical assistance to three of the locally owned plants we visited. In two cases, company officials considered this assistance critical to their success in winning contracts with U.S. companies. An AID/Honduras project provided in-plant training at two of the plants we visited, one U.S.-owned and one Honduran. Plant managers said this assistance was useful, though not critical, to their success. An AID official said that another plant we did not visit, a U.S.-Honduran joint venture, was saved from closing because the in-plant training increased worker productivity.

Most assembly plants we visited, however, had not received AID-sponsored assistance of this type. One AID technical assistance contractor commented that assembly plants usually do not need much in the way of technical assistance because the companies for which they are working provide them with all the help they need. This is particularly true for U.S. companies establishing wholly owned subsidiaries in the region. In commenting on a draft of our report, AID stated that most training and technical assistance financed by AID benefitted local firms,[8] and no U.S. firm indicated that it relocated U.S. production or employment as the result of AID-financed assistance.

Mexican Maquiladora Industry Developed Without U.S. Foreign Assistance Program Support

The view that foreign assistance program support was a critical factor in the growth of Basin assembly industries becomes less supportable when the growth of Mexico's similar "maquiladora" industry is considered.[9] This industry, which originated in 1965 in Mexico's Border Industrialization Program, is larger than all Basin assembly operations combined. Maquiladora exports to the United States were valued at $15.8 billion in 1991, according to Mexican trade data, representing over 46 percent of all Mexican exports to the United States. By the end of 1991, a total of 1,925 maquiladora companies employed more than 467,000 workers. As of the end of 1991, total U.S. private direct investment in Mexico totaled

[8] We could not verify this point because of the incompleteness of agency records and problems in defining "locally owned" companies, as discussed earlier.

[9] For more information, see U.S.-Mexico Trade: The Maquiladora Industry and U.S. Employment (GAO/GGD-93-129, July 20, 1993).

about $21.5 billion, according to Mexican government data, and about 52 percent of this total was in maquiladoras.[10]

Mexico's maquiladora operations were born and have grown because of its supply of low-cost labor, a location convenient to U.S. markets, U.S. trade measures that provide reduced duties on goods assembled using U.S. parts, and incentives similar to those offered by Basin export processing zones. Since 1965, the U.S. foreign assistance program in Mexico has consisted primarily of food aid and anti-narcotics support. U.S. foreign assistance funds did not support investment promotion or related programs in Mexico.

Conclusions

Basin production sharing has become popular primarily because it permits U.S. companies to respond to competitive pressures by accessing cheaper labor, in a geographically convenient location, for certain steps in production that have remained labor-intensive. AID and other U.S. agencies have made a contribution to the growth of these industries—through policy dialogue, export processing zone financing, and other programs—but this support was not the deciding factor in company investment decisions. Companies located their assembly operations in export processing zones for a number of reasons, especially to avoid bureaucratic problems.

As illustrated by the growth of Mexico's maquiladora industry, U.S. foreign assistance funds did not have to be expended to support growth in production sharing—U.S. companies are well acquainted with the concept. U.S. government support may, however, have helped countries popularly perceived as less desirable locations to benefit from the growth in offshore assembly.

[10]North American Free Trade Agreement: U.S.-Mexican Trade and Investment Data (GAO/GGD-92-131, Sept. 1992).

Production Sharing Creates Jobs, but Long-Term Impact Uncertain

Growth in Basin assembly industries has generated a significant number of jobs—an important consideration in a region with high unemployment. However, the long-term impact of growth in these industries, which are essentially isolated from indigenous economies, is less certain. It remains to be seen whether they can serve as a basis for advancement toward more diversified industrial growth.

Job Creation Is an Immediate Benefit

Many government officials, development economists, and labor leaders we interviewed regard zones, and assembly industries generally, first and foremost as vehicles for generating jobs. Many developing countries, including those in the Caribbean Basin, have rapidly expanding populations of poorly educated people. These countries must generate jobs or face the possibility of serious social strife like that experienced in El Salvador in recent years. Traditionally, most workers were absorbed into the agricultural labor force. However, large numbers of people are now moving into the cities and larger towns in search of employment. Many migrate to the United States, either legally or illegally, in search of employment.

Offshore assembly industries can generate substantial numbers of jobs. In the Dominican Republic, plants in export processing zones employ about 132,000 people.[1] In Costa Rica, about 71,000 people are employed in zones and in plants operating under other export processing arrangements.[2] FUSADES estimates that over 19,000 jobs were generated in the Salvadoran apparel industry from 1985 through 1992. Honduran assembly plants, including those outside of zones, employ about 27,000 people.

These totals increase when those who owe their employment indirectly to assembly operations, such as food vendors, are added. However, because these assembly plants purchase relatively little from the local economy, they indirectly generate fewer jobs than would be generated by other types of industries. We found no agreement on the magnitude of indirect job creation by assembly plants. However, one study in the Dominican Republic estimated that 8 jobs were indirectly created for every 10 in a zone assembly plant.[3] At this ratio, the overall employment attributable to Dominican zones increases to nearly 238,000 people.

[1]This figure was provided by the Dominican Export Free Zones National Council. Other authorities provided higher estimates.

[2]This figure excludes agro-industrial operations.

[3]This estimate represents a mid-point between the findings of two other studies of the Dominican Republic that found indirect job creation rates of 2 and 15 per 10 direct jobs, respectively.

Despite such job creation, unemployment and underemployment remain severe problems in all of the countries we visited, except Costa Rica. Dominican unemployment is estimated at approximately 30 percent, with over 900,000 unemployed in a labor force of about 3 million. At current growth rates, the Dominican Republic's work force increases by more than 100,000 persons each year. Unemployment in Honduras and El Salvador is estimated at a comparatively low 10 percent, but nearly half the work force is characterized as "underemployed." The Costa Rican labor ministry did not believe unemployment—running at about 4 percent in 1992—to be a severe problem. However, the ministry did characterize underemployment—estimated at 10 percent—as a problem.

Increased Investment, Exports, and Foreign Exchange Earnings

Development of offshore assembly as a production strategy has generated a significant amount of new investment in Basin countries. This development has encouraged construction of a substantial amount of new factory space—most often in zones—as well as associated infrastructure. As shown in table 4.1, nearly 550 plants are located in export processing zones in the four countries we visited.

Table 4.1: Zone Assembly Plants by Country and Nationality of Ownership

Country	U.S.	Korean/ Taiwanese	Other foreign	Domestic	Total
Costa Rica	45	8	29[a]	18	100
Dominican Republic	203	49	32	78	362
El Salvador	8	6	0	5	19
Honduras	30	32	2[b]	3	67
Total	**286**	**95**	**63**	**104**	**548**

Note: Table compiled from latest estimates available from national trade promotion organizations or export processing zone organizations. Identification of investors as local or foreign, and by nationality if foreign, is problematic. Some Asian investors, for example, have established parent companies in the United States, and foreign investors may be regarded as local companies.

[a]Seven of these are joint ventures with local investors.

[b]These plants are U.S.-Honduran joint ventures.

Basin assembly plants make a noteworthy contribution to exports and foreign exchange earnings. However, their ability to generate foreign exchange is less than might be expected at first glance because most of the value of the final product is composed of imported materials. Among the companies we surveyed that could provide an estimate, most claimed to add between one-fifth and one-third of the final value of finished products through the labor applied in Basin assembly plants.

By including the value of foreign inputs, conventional U.S. trade data had overstated the value derived by Basin countries from assembly plant exports.[4] However, as an indication of the significance of the assembly plants' actual export earnings, the Dominican government estimated that assembly plants generated about $250 million in foreign exchange earnings in 1991, exclusive of the value of foreign inputs to production. This amounted to more than one-fourth of the country's earnings through merchandise exports.

Earnings reported in the other countries we surveyed were lower, but were growing along with the expansion in assembly plant activity. For example, El Salvador reported earnings from assembly plants amounting to about $36 million in 1991 and increasing substantially in 1992—to about $47 million. Though still overshadowed by agricultural products, assembly plant earnings are growing rapidly in Honduras. The impact of processing plants on Costa Rica's balance of payments is unclear.[5]

Limited Integration With Local Economy and Technology Transfer

Export-oriented assembly plants are isolated from local economies through location in a zone or through the use of similar legal provisions. Many firms rent factory buildings, rather than purchase them. Local value-added is limited essentially to the value of workers' wages. Procurement from the local area is generally limited to such things as office supplies and utilities, though some of the companies we visited did claim to obtain some inputs to production locally, including thread and boxes. Nearly all components and the machinery to assemble them are brought in from abroad. Also, purchases from the local economy increase the foreign value-added on which duty is assessed upon return to the United States under the 807 program, and this constitutes a disincentive to local procurement. In any case, many items needed by these plants are not produced by local manufacturers.

[4]The Department of Commerce began to change the way it presented this information in July 1992.

[5]In the Dominican Republic and El Salvador, which have sent large numbers of emigrants to the United States, foreign exchange earnings from assembly plants are overshadowed by dollar remittances sent from these emigrants back to family members in their countries of origin. It is estimated that about 1.7 million people from these countries are currently living in the United States. The Dominican Republic conservatively reported remittances of about $330 million in 1991. Remittances to residents of El Salvador, reported at $702 million in 1992, exceed the total value of all of that country's export earnings.

Assembly industries have a limited favorable impact on local capabilities. Though employing primarily relatively unskilled assembly line workers, they do help to create a work force accustomed to the discipline of modern industry. Growth in these industries has also helped to increase the number of persons with managerial and technical skills suited to internationally competitive industrial operations.[6]

In addition, the propensity of U.S. retailers and clothing wholesalers to obtain much of their inventory from independent contractors has encouraged some local entrepreneurs to go into business for themselves. For example, more than 20 percent of the plants in Dominican zones are now locally owned. Eighteen of the 100 assembly plants in Costa Rican zones are locally owned, while 7 are Costa Rican-U.S. joint ventures. However, these local businesses are still operating within the limited realm of contracted production sharing. It remains to be seen whether the skills learned from these plants will help transform domestic economies as governments continue to open their economies to competitive forces.

Several observers, including development economists in the countries we visited, noted that while assembly plants provide jobs today, progressing beyond these low-wage jobs will require a greater investment in education. They indicated that without an investment in education, movement into higher skill lines of work is difficult, if not impossible.

While apparel assembly remains the predominant activity in three of the four countries we visited, there is evidence that diversification is taking place. Costa Rica's export processing industry is already particularly diverse, with textiles accounting for less than 20 percent of the companies in free zones. More typical is the Dominican Republic, where approximately two-thirds of all zone plants are involved in apparel assembly. A number of other industries, including shoes, jewelry, and health care products, make up small shares of offshore assembly activity.

Other than apparel, the other major focus of zone activity around the world is electronics. Electronics assembly has made a substantial contribution to industrialization in some rapidly growing Asian countries, like Malaysia. Electronics assembly companies have located operations in three of the four countries[7] we visited, and all would like to attract more.

[6]For further discussion of this point, see the International Labor Organization's report, Economic and Social Effects of Multinational Enterprises in Export Processing Zones.

[7]A large electronics firm recently announced its intention to locate a plant in Honduras.

The impact of attracting electronics assembly should not be overstated, however. The electronics operations that we observed did not appear to require a level of skill among workers that substantially exceeded that required of apparel workers. (See fig. 4.1.) The same observation can be made of health care products assembly operations that we observed.

Figure 4.1: Basin Electronics Assembly Operations

U.S. electronics industry analysts said that Basin assembly remains a very minor factor in their industry. The Far East remains the location of choice for such operations. Some companies attempted to establish capital-intensive operations, such as computer component manufacturing, in the Dominican Republic in the late 1980s, but these operations declined because of a lack of skilled labor and management.

Uncertain Basis for Further Development

Many critics of zone development have questioned whether the limited benefits generated by zones justify the expenses incurred by governments in supporting zone development, including infrastructure support and foregone tax revenues. The extended tax exemptions and other incentives offered to export-oriented investors mean that the plants generate very little tax revenue for Basin governments. In some instances, growth associated with zone development has over-taxed the capacity of local infrastructure.

Many trade experts point out that the viability of Basin assembly plants as a basic building block for economic development depends upon a comparative advantage in the form of cheap, plentiful labor in close proximity to the United States. These countries' success in expanding this market niche depends in large measure on the continuation of current conditions in world markets—especially world textile and apparel trade. If negotiations within the General Agreement on Tariffs and Trade are resolved and apparel trade restraints are phased out, as is currently proposed, Basin plants and their partners in the United States will face a greater competitive challenge.

Should competitive conditions change, U.S. and other foreign investment in, and procurement from, Basin countries would be relatively easy to cut back. Several executives with whom we spoke commented that production could be moved relatively easily should the terms of trade change to favor production in another location. The most frequently mentioned source of increased competition is China and other Asian countries. Mexico, under the North American Free Trade Agreement, could also become more competitive in attracting assembly industries.[8]

Conclusions

Changing trade patterns over the coming years will test Basin assembly industries as a path to development. Basin economies have not yet attained a level of industrial development that would permit them to be competitive in more technologically advanced industries. If these countries can use existing operations as a step toward more advanced, diversified industrial growth, new challenges from China and other countries may not severely harm their interests. If they fail to diversify beyond simple assembly concentrated in garments, the consequences may be very severe.

Assembly industries have demonstrated their potential for quickly creating significant numbers of jobs in Basin countries. The advent of assembly industries has also generated a significant amount of new investment in

[8]According to a recent study by the U.S. International Trade Commission, however, approval of a North American Free Trade Agreement, including Mexico, would have little impact on the cost competitiveness of Basin assembly plants. See Potential Effects of a North American Free Trade Agreement on Apparel Investment in CBERA Countries (U.S. International Trade Commission Publication 2541, July 1992).

Basin countries, and this investment has become an important source of foreign exchange for some countries. Despite these benefits, however, unemployment continues to be a major problem. Furthermore, assembly industries are relatively isolated from local economies, and their viability as a foundation for further economic development is open to question.

Mixed Impact on Basin Workers

The worker rights enumerated in the Trade Act of 1974 can be divided into two general categories: (1) standards for treatment of workers, including minimum wages, health and safety conditions, and regulation of overtime and child labor, and (2) protection for union activity, including the rights to organize and bargain collectively with management.

Our review revealed a mixed picture regarding worker rights in Basin assembly plants. Salary levels were generally commensurate with those provided by alternative jobs in the countries we visited. Working conditions, while varied, were generally acceptable. Zones provide jobs for women, who otherwise have few employment options. However, assembly plant workers, particularly those employed in zones, have in most cases not been successful in exercising their rights to organize unions and engage in collective bargaining.

The U.S. government has established procedures to work for improved worker rights protection in developing countries—generally through the leverage that the United States can exercise through granting or withdrawing unilateral trade benefits. The State Department and the Office of the U.S. Trade Representative play leading roles in this process. AID has traditionally played a supportive role in the U.S. effort, but worker rights have not been a focal point in agency programming. U.S. government efforts have had some impact on the movement toward improved protection for worker rights in these countries, although this impact is impossible to quantify.

Wages Provide Subsistence Income

In the countries we visited, assembly plant workers typically earn a base wage equivalent to the legal minimum wage, which generally is set at the foreign exchange equivalent of between 40 and 60 cents per hour. Workers can, and often do, increase their earnings through improving their productivity above established minimum levels, thereby earning piecework differentials. As previously mentioned, the plants we visited informed us that the average wages actually paid ranged between \$0.66 and \$1.11 per hour.

These wages provide the typical individual worker in the countries that we visited with a subsistence level income. Because this income is generally not sufficient, by itself, to meet the needs of a small family, workers often pool their salaries with those of other family members. Government officials and economists agreed that assembly plant jobs, like many others in Basin countries, do not provide an income sufficient to lift employees out of poverty. The large supply of equally qualified unskilled laborers in Basin countries keeps wages low for most workers, including those in assembly plants. As noted in a recent State Department report, for example, approximately 40 percent of the Salvadoran population—whatever their line of work—have incomes below the official poverty line.[1]

Wages in offshore assembly industries are competitive with the wages available in alternative lines of work. For example, one study in the Dominican Republic found that zone wages averaged about 15 percent less than comparable employment opportunities in the tourism sector, but about 20 percent more than in agro-industrial occupations. The fact that large numbers of people want to work in assembly plants is indicative of the desirability of these jobs in comparison with the alternatives. For many, a likely alternative is unemployment. One Dominican zone claimed to have 30,000 job applicants available.

Working Conditions Varied

Working conditions varied considerably in the plants that we visited. Generally, wholly owned subsidiaries of large U.S. corporations offered more comfortable working conditions, with orderly, air-conditioned plants providing a variety of worker services. Figure 5.1 shows working conditions in a U.S. subsidiary. Executives at many plants believed that if they provided better than average working conditions and wages, union organizers would find little interest among the workers in pressing demands for improvements.

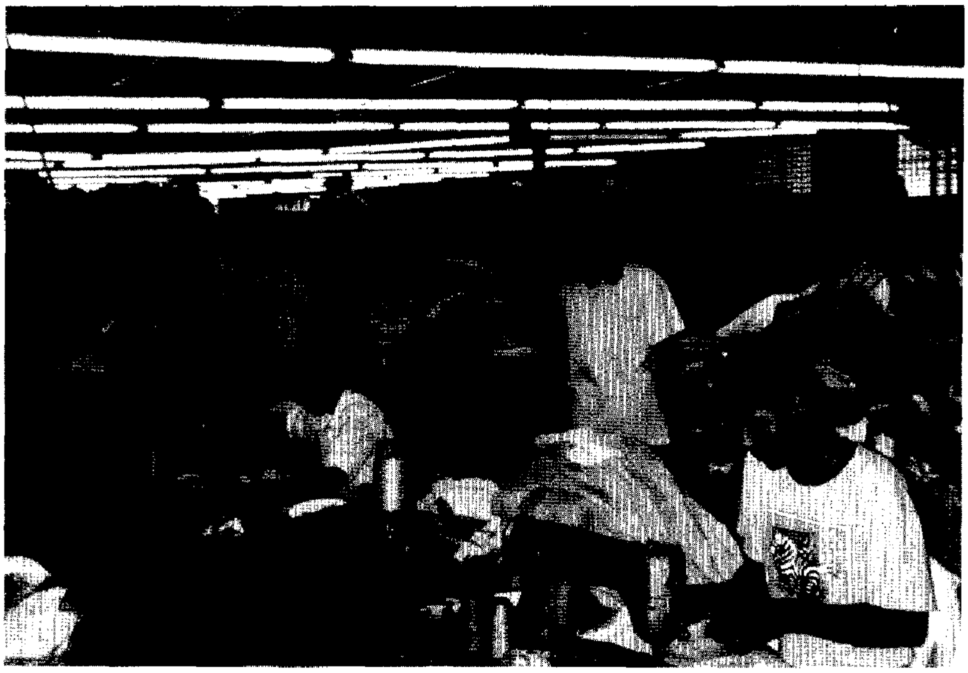
[1]Country Reports on Human Rights Practices for 1991, House Committee on Foreign Affairs and Senate Committee on Foreign Relations (Feb. 1992).

Figure 5.1: Working Conditions at a U.S.-Owned Garment Plant

Conditions at other plants—particularly those owned by local or other foreign entrepreneurs—suffered by comparison. Most plants offered acceptable working environments, from a developing country perspective, with ventilation provided by large fans and rudimentary provisions in such areas as food service and emergency medical care. Some, however, contained safety hazards like low beams and crowded, sometimes impassable, aisles, or lacked adequate plumbing. In the Dominican Republic, government-owned and -operated zones sometimes lacked basic services like routine trash pickup and maintenance. Figures 5.2 and 5.3 illustrate working conditions in locally owned plants.

Figure 5.2: Working Conditions in a Locally Owned, Unionized Garment Plant

Figure 5.3: Working Conditions in a Locally Owned, Non-Union Garment Plant



Extent of Child Labor and Overtime

Illegal employment of children in assembly plants was not a major concern in any of the countries we visited. All of these countries have laws establishing minimum ages for employment of any kind—generally 14 years.[2] Restrictions usually apply to employment of young workers. For example, Honduran companies may employ workers between the ages of 14 and 16 only with parental permission. Company policy at most plants we visited was to hire employees of at least 16, and most often 18 years of age. Two companies in Honduras acknowledged employing younger workers, after obtaining the required clearance. We encountered a handful of workers in the plants we visited who appeared to be younger than the applicable legal minimum.[3]

Generally, normal working hours are set at 44 hours per week.[4] Overtime beyond 44 hours is common for assembly plant workers, and there have been allegations that workers are forced to work overtime to enable companies to fill contract orders. The plant managers we spoke with all stated that overtime was voluntary and that workers were paid legally required differentials. Managers also observed that overtime was popular with workers, given workers' low base rates of pay.

Zone Employment Provides Women an Alternative

The large majority of zone workers are women—typically under age 30. Many are first-time entrants into the work force. Women predominate for several reasons. Among other things, they are perceived to be more suited to the deft movements required in assembly work.[5]

Assembly plant employment offers low wages for long hours of tedious labor and, since large numbers of the employees are mothers, their working full-time may pose a problem regarding child care. Day care is seldom available through the plants or zone management authorities. Nonetheless, these jobs do provide an alternative to women who otherwise have very few employment opportunities. We made extensive inquiries into the alternatives that female workers in assembly plants might expect to explore. Chief among them were domestic service in a middle- or upper-income home, intermittent agricultural labor, small retail

[2]The legal minimum in Costa Rica is 12 years.

[3]Out of concern for possible repercussions for these workers, we did not attempt to verify their ages. Labor and company officials in Honduras stated that younger workers sometimes falsified documents so that they can work before their 16th birthday.

[4]The standard work week in Costa Rica is 48 hours.

[5]A number of observers in Honduras and the Dominican Republic noted that increasing numbers of men are seeking employment in zones, however.

operations, and, for many, prostitution. None of these alternatives provides a life that is clearly superior to employment in an assembly plant.

Worker Rights to Organize Not Exercised

Workers in zone assembly plants in Basin countries generally have not been able to exercise their rights to organize and bargain collectively. Except in Honduras, there were no active unions in zones in the countries that we visited.[6] We were informed of a number of cases in which workers were fired for attempting to organize unions. Union representatives alleged that blacklists are sometimes circulated to discourage the hiring of workers identified as union organizers. We were provided with examples of such lists in the Dominican Republic and Honduras.

State Department labor attaches and other observers agree that while Basin countries' labor codes usually protect most worker rights in theory, they have often been ineffective in practice. Labor ministries often lack the resources needed to effectively carry out their enforcement functions. For example, the Salvadoran labor minister stated that he did not have enough inspectors to cover the entire country. Also, penalties for violations are often insufficient to constitute a real deterrent to violators. For example, the top penalty for certain violations in Costa Rica amounted to less than $4 under current exchange rates. Until recently, Dominican workers could be fired for any reason so long as the workers were paid the accumulated severance pay that they had earned.[7] The newly adopted labor code, discussed below, provides labor organizers with improved legal protection.

Regarding Costa Rica, a recent State Department publication commented that "collective bargaining is allowed in the private sector but, due to the dearth of unions, this is more a de jure than de facto right." "Solidaristas"—employer-sponsored associations that conduct some union functions, but are prohibited from collective bargaining—are common in

[6]The State Department estimated in 1991 that about one quarter of Honduran assembly plants were unionized. The Honduran labor code is unusual in that it grants union powers, including the right to conclude collective bargaining agreements, to groups of as few as 30 workers. Dominican law, in contrast, grants the right to engage in collective bargaining only to groups comprising at least 50 percent of the workers in a plant. Workers in a number of Dominican plants have organized union committees, which can receive official recognition with 20 members. However, as of the time of our visit, none of these had managed to enroll enough members to enable them to undertake such union functions as collective bargaining.

[7]Under the Dominican labor code in effect until 1992, severance pay was accumulated at the rate of 15 days pay for each year of service. At the average rate of pay cited in the factories we visited, a worker with 4 years of service could be dismissed upon payment of about $328 in severance pay.

Costa Rica.[8] These organizations are not regarded by the International Labor Organization as legitimate substitutes for traditional unions.

While unions are more widely accepted in Honduras than in other countries we visited, progress on labor-management relations in all countries has been slowed by a profound sense of mistrust. Unions in these countries have a history of functioning as political organizations, and efforts at organizing particular plants are typically regarded by business owners as politically motivated. Owners often believe that labor leaders have their own advancement in mind, rather than the interests of the workers. One added that negotiations with people who "truly represent the workforce" would be unobjectionable. Several commentators, including labor leaders, an economist, and an AID contractor, observed that business owners' opposition to unionization arises at least partially from their understanding that zone plants would never be subject to unionization. Labor leaders, for their part, accuse management of negotiating in bad faith and resisting attempts at compromise.

Efforts to Improve Worker Rights Protection

Efforts are underway to improve protection for worker rights in the region. In the Dominican Republic and El Salvador, outdated labor codes are being replaced. The Dominican legislature adopted a revised labor code in 1992, and as of February 1993, workers had filed complaints against 11 free zone companies under the revised law. As part of the peace accords in El Salvador, the government agreed to establish a forum with representatives from business and labor that would deal with labor rights issues. In February 1993, the members of the forum signed a pact agreeing to begin work on a new labor code, among other tasks. During 1992 the Honduran labor ministry instituted a policy concerning inspection of zone plants and adopted a schedule of fines for plants resisting inspection.

Even if attempts at reaching consensus on legal regimes to govern labor-management relations are successful, union organizers are likely to continue to experience difficulties in these countries. As already indicated, labor ministries often lack the resources to carry out inspections and undertake other enforcement actions, and corruption is sometimes a problem. Creating legal systems that can provide effective, impartial due process of law in labor disputes is important to a long-term resolution of the current atmosphere of mistrust.

[8]Solidaristas also exist in Honduras.

U.S. Government Exercises Some Influence

U.S. trade law currently makes an explicit connection between continuation of certain trade benefits available to developing countries and their respect for internationally recognized worker rights. The Trade Act of 1974, as amended, prohibits the President from designating countries as eligible for Generalized System of Preferences benefits when, among other things, these countries have not taken or are not taking "steps to afford internationally recognized worker rights to workers in the country (including any designated zone in that country)."[9] This same requirement is in effect with regard to CBERA trade benefits.[10] The Office of the U.S. Trade Representative chairs an annual interagency review process wherein petitioners may challenge beneficiary country practices. Benefits can be suspended for failure to take steps to improve inadequate practices.[11] This review process has no explicit legal connection with AID programming being continued or suspended.

State Department labor attaches are responsible for monitoring worker rights conditions. The Department reports annually on human rights conditions in developing countries, including respect for worker rights. Section 116(a) of the Foreign Assistance Act, as amended, prohibits assistance from being provided to the government of any country that engages in "a consistent pattern of gross violations of internationally recognized human rights."

AID's administration of justice programs have not specifically focused on reforms in labor law. For many years, however, AID has provided grants to the American Institute for Free Labor Development (AIFLD), an affiliate of the AFL-CIO, to support development of democratic trade unions in Basin countries. Except in El Salvador and Nicaragua, AIFLD activities in the Basin have been supported by a series of regionally focused cooperative agreements. The current agreement provides $36 million over 5 years, beginning in 1993, to support AIFLD's program of assistance to labor organizations in their educational activities, social/economic programs, union organizing campaigns, agrarian development, and political

[9]19 U.S.C. 2462(b)(7).

[10]19 U.S.C. 2702(b)(7). H.R. 1446, 103rd Cong., 1st Sess. (1993), proposes to extend the principle of making trade benefits contingent on adequate worker rights protection by building standards in this area into any free trade area negotiations pursuant to the Enterprise for the Americas Initiative.

[11]The review process is conducted by the Generalized System of Preferences Subcommittee of the Trade Policy Staff Committee, with members from the Office of the U.S. Trade Representative and the Departments of State, the Treasury, Labor, Commerce, the Interior, and Agriculture. AID is a non-voting member.

education.[12] In addition, through another cooperative agreement, AID provides AIFLD with funds to support the activities of eight AFL-CIO unions in fostering professional and fraternal ties with counterparts in the region.[13]

Although AID supports AIFLD's operations, AIFLD officials' primary points of contact in these countries are State Department labor attaches.[14] AID missions may be kept generally informed of AIFLD activities and worker rights conditions in the country. However, AID private sector development offices have not usually concerned themselves with labor-management relations generally or worker rights conditions specifically. AID private sector officers do not generally have any expertise in labor-management relations.

The U.S. government is able to exercise some influence on worker rights conditions in Basin countries, but State Department officials pointed out that U.S. initiatives regarding worker rights must be balanced against other U.S. foreign policy goals and objectives. In El Salvador and the Dominican Republic, State Department officials believed that U.S. leverage applied through the review process for Generalized System of Preferences and CBERA benefits helped encourage improvement in labor practices. Economic Support Fund balance-of-payments support was also conditioned on labor rights progress in El Salvador and the Dominican Republic. AID and the Department of Labor co-sponsored a regional conference on labor-management cooperation in the Dominican Republic in February 1993.

Conclusions

Assembly plants provide workers, particularly women, with employment in an environment where there are few alternatives. Working conditions vary. While most of the 53 plants we visited appeared to provide a reasonably safe and healthy environment, some did not. While commensurate with other opportunities, these jobs provide only a subsistence-level income, and, in most cases, workers have not been able to exercise their rights to organize and bargain collectively.

[12]AIFLD activities in El Salvador are supported by bilateral grants. The most recent of these provided AIFLD with more than $15 million for activities in fiscal years 1990 through 1993.

[13]The eight unions are Amalgamated Clothing and Textile Workers; American Federation of State, County, and Municipal Employees; American Federation of Teachers; Communication Workers of America; Department of Professional Employees; Glass, Molders, Pottery, Plastics, and Allied Workers; Transportation-Communications Union; and the United Food and Commercial Workers.

[14]El Salvador is an exception. Here, AIFLD officials receive funding from the AID Office of Democratic Initiatives, and their primary point of contact is that office.

The United States has established procedures, primarily in trade law, to encourage developing countries to improve their protection for worker rights. We were told that these procedures have had some impact. AID has provided funds to support union development in Basin countries, but worker rights have not been a focal point in the agency's trade and investment or administration of justice programming.

AID's Mandate for Private Sector Development Is Unclear

AID does not have a clearly articulated strategic mission. The Foreign Assistance Act of 1961, as amended, contains more than 30 separate directives, including private sector development, but with no clear prioritization.[1] In addition, the long-term economic development goals of the recipient countries often conflict with short-term U.S. foreign policy and domestic objectives. The enactment of section 599, which is designed to protect U.S. jobs, appears to run counter to various efforts to promote private sector development and investment in developing countries. AID's multiple objectives create confusion as to the direction Congress believes the foreign assistance program should take. More specifically, AID's mandate with respect to private sector development is confusing and somewhat contradictory.

Other agencies with more narrowly defined mandates did not find that section 599 required significant changes in their operations. AID, however, has had difficulty articulating guidance to the field, and the law has had differing consequences in the missions we visited. While causing some changes in AID programming, section 599 will have little real impact on the growth of Basin production sharing and associated job losses, or on worker rights in Basin assembly plants. AID continues to provide broad support for Basin industrial development, while trade measures encouraging offshore assembly also continue. The precise net impact of this support on U.S. workers is unpredictable—some will benefit while others will be adversely affected.

Domestic Impact Restrictions Must Be Balanced Against Other U.S. Goals

Prior to section 599, Congress had adopted several other provisions intended to limit the possible adverse U.S. domestic impact of trade measures and agency programs that support industrial growth abroad. Some of these provisions make specific reference to the Basin. As noted in chapter 2, for example, CBERA tariff reductions may not be applied to certain goods that have been deemed "import sensitive."

AID, OPIC, and the Eximbank are restricted by the annual foreign operations appropriations acts from using their funds to establish or expand production "of any commodity for export by any country other than the United States, if the commodity is likely to be in surplus on world markets

[1]For further discussion of basic issues regarding AID's objectives and management practices, see AID Management: Strategic Management Can Help AID Face Current and Future Challenges (GAO/NSIAD-92-100, Mar. 6, 1992) and Foreign Assistance: AID Strategic Direction and Continued Management Improvements Needed (GAO/NSIAD-93-106, June 11, 1993). For further information on AID's private sector support, see Foreign Assistance: AID's Private Sector Assistance Program at a Crossroads (GAO/NSIAD-93-55, Dec. 11, 1992).

at the time the resulting productive capacity is expected to become operative and if the assistance will cause substantial injury to United States producers of the same, similar, or competing commodity."[2] Additional restrictions apply to Eximbank and OPIC operations,[3] while controversy over Commerce Department advocacy of the Mexican maquiladora industry resulted in fiscal year 1987 legislation prohibiting the Department from supporting activities aimed at encouraging U.S. companies to relocate assembly plants abroad.[4]

Agencies must apply these restrictions in a manner that permits them to go forward in meeting their mandates to support trade and investment in the region. The balance that agencies, including AID, must achieve is perhaps best reflected in the "Lautenberg Amendment," included in foreign operations appropriations acts each year since fiscal year 1987.[5] This amendment prohibits AID from directly funding feasibility studies or assisting in the establishment of manufacturing facilities that will compete with U.S. production of "import sensitive" articles, including textiles and apparel, as well as footwear. The amendment does, however, permit AID to provide financing for the manufacture of other products.

Of greater significance for the present discussion, the amendment also specifically exempts funds made available to assist firms conducting 807 operations in the Basin, in support of the Caribbean Basin Initiative. In other words, AID is permitted to assist Caribbean Basin assembly operations—even when "sensitive" industries are involved—as long as companies use the 807 program.

Other Agencies Require Minimal Changes to Operations to Comply With Section 599

Most affected agencies did not find that section 599 required major changes in their operations. OPIC and the Eximbank already employed analytical procedures to determine whether a project will adversely affect U.S. production or employment. Both institutions review specific financing proposals—for example, proposed financing for particular factories—to determine whether providing support will result in "substantial" injury to U.S. production.

[2]Section 513(a) of the fiscal year 1994 Foreign Operations Appropriations Act.

[3]The Eximbank is restricted from using its funds to establish or expand production abroad if there is a possibility of substantial harm to U.S. production or employment. (12 U.S.C. 635(e)). OPIC is prohibited from assisting any project where the investor is likely to "significantly reduce the number of employees in the United States because he is replacing his United States production with production from such investment." (22 U.S.C. 2191(k)(1)).

[4]P.L. 99-500, 100 Stat. 1783-41, 42 (1986) and P.L. 99-591, 100 Stat. 3341-42 (1986).

[5]P.L. 103-87, 3513(c), 107 Stat. 943 (1993).

OPIC reviews the net economic impact of proposed loans, insurance, and guarantees before approving them. According to OPIC, it has declined to support proposals that were found, in effect, to finance the relocation of plants from the United States to other countries. OPIC financing for export processing zones in the countries we visited was provided on a contingency basis. Individual firms seeking to locate in these zones had to submit applications so that OPIC could determine whether the project (1) had a potential adverse impact on the United States and (2) met agency standards for such things as environmental impact and protection of worker rights.[6] OPIC made minor adjustments to its screening procedures in response to section 599.

The Eximbank's Office of General Counsel stated that although that agency receives a subsidy appropriation, it does not engage in any of the practices prohibited by section 599.[7] The Bank has procedures for evaluating the U.S. impact of most of its operations. Eximbank economists assess the economic impact of export transactions proposed for support through its medium- and long-term programs.[8] As part of this analysis, they determine whether (1) the project will compete directly with U.S. production, (2) the Bank's involvement in the project will be significant,[9] and (3) the injury to U.S. production and employment caused by the project will be substantial.[10]

Commerce Department officials pointed out that the U.S. and Foreign Commercial Service conducted a strategic review of its programming beginning in 1989 and subsequently refocused its activities to emphasize direct support for U.S. exporters, with a high priority on infrequent exporters. Commerce Department officials do not believe that their

[6]OPIC employs a "no U.S. job loss" standard in reviewing the probable impact of financing proposals. OPIC's review procedures were revised in 1987 when Congress raised questions about the potential adverse impact of the corporation's activities on the United States. For further information on OPIC review processes, see Foreign Aid: Overseas Private Investment Corporation's Management of Loans (GAO/NSIAD-88-161, May 6, 1988) and Foreign Aid: Impact of Overseas Private Investment Corporation Activities on U.S. Employment (GAO/NSIAD-87-109, May 5, 1987).

[7]Section 599 restricts the use of any funds appropriated under the fiscal year 1993 Foreign Operations Appropriations Act, and the Bank received a $757 million appropriation under this act for the subsidy costs of direct loans, loan guarantees, and tied-aid grants (106 Stat. 1655).

[8]Short-term transactions are not subject to this Eximbank review.

[9]The Eximbank generally considers its role in a project to be "significant" if Bank financing covers 10 percent or more of the total project cost and the U.S. goods and services supported directly and substantially impact on the proposed expansion.

[10]Section 2(e)(3) of the Export-Import Bank Act specifies that Eximbank support will cause "substantial" injury if that portion of capacity likely to directly compete with U.S. production equals or exceeds 1 percent of U.S. production.

operations will be substantially affected by language found in the Jobs Through Exports Act of 1992, which is similar to section 599, as the Department does not (1) provide financial incentives for relocating plants or (2) support establishment of zones in foreign countries. In commenting on this report, Commerce said that it is an active participant in the interagency process that considers worker rights petitions and conducts investigations.

State Department officials stated that they believe that their business support services will not be substantially affected by section 599 since the Department does not (1) provide financial incentives for relocating plants, (2) support establishment of zones, or (3) provide assistance to projects that contribute to violating worker rights.

AID Has Had Difficulty Implementing Section 599

Unlike other agencies, AID has not traditionally included substantive analyses of potential U.S. domestic impacts in its project planning. AID's private sector development and trade and investment programs focus primarily on their likely effect on a particular developing country. Further, AID has been more concerned with developing sustainable institutions that will further development than with promoting individual business transactions.

The modest scale of AID operations makes their specific impact in the United States difficult to ascertain. With regard to U.S. domestic impact, AID justifies its private sector development and trade and investment programming with the general assertion that economic growth among developing countries generally, and Latin American/Caribbean countries in particular, will benefit the United States in the long run by providing these countries with the wherewithal to purchase larger amounts of U.S. exports. While most economists agree with this proposition, the net impact on the United States of growth in Basin assembly industries is unclear. This issue is discussed in appendix I.

AID missions use project checklists of legislative requirements and restrictions (about 20 pages in length) to ensure that they have addressed the numerous requirements that are placed on agency activities. Like OPIC and the Eximbank, for example, AID must decide if a product whose production is to be supported is for export; whether it is a commodity in surplus on the world market; and whether assistance is likely to cause substantial injury to U.S. producers. In project planning, mission officials answer yes or no to questions about the applicability of various restrictions and provide some elaboration as deemed necessary. Discussion of such matters was cursory in the numerous AID project papers that we reviewed.

Most missions' investment activities have avoided either import sensitive industries or exports that compete with U.S. products. However, AID officials interpreted the Lautenberg Amendment as permitting Latin America/Caribbean missions to support assembly industries because (1) these programs were administered indirectly and (2) most of the investment would support 807 operations.

AID's Policy Directorate issued preliminary guidance to agency missions in November 1992.[11] This guidance was imprecise and confusing. Furthermore, the guidance presented AID missions with compliance difficulties because it extended section 599's requirements to funds obligated in prior years. While the missions that we visited generally made a good faith effort to comply, these difficulties resulted in section 599 having different impacts in different countries. For example, aid to trade promotion organizations continued in some countries but not in others.

Guidance Does Not Provide Clarity on Financial Incentives

Mission officials indicated that the initial guidance did not help them determine which activities provide a financial incentive that will induce U.S. companies to move offshore, as prohibited by the legislation. AID's guidance on this point states that most support for trade and investment promotion activity is not prohibited. However, the guidance does prohibit support to intermediaries that provide services such as training and technical assistance, as well as credit and other services, because such services might be construed as providing companies an incentive to move offshore. The guidance attempts to differentiate between those activities that would persuade U.S. firms to relocate plants (prohibited) and those activities that would promote entirely new U.S. investment (permitted). AID's guidance states that where prohibited activities cannot be "disentangled" from those which are not prohibited, agency programs must be terminated or redirected to eliminate the possibility of violations.

This imprecision reflects continuing difficulty within the agency in reconciling various AID goals and restrictions. Specifically, the agency is attempting to continue to support private sector development and trade and investment generally, and the Caribbean Basin Initiative in particular, without violating section 599's provisions regarding adverse impact on

[11]The Directorate had not issued final guidance as of October 1993.

particular U.S. jobs. In practice, this guidance has not helped AID missions to make a clear differentiation between programs that are allowed and those that are not allowed.

For example, some of the AID missions we visited continued to support promotion organizations and other relevant programs, while others discontinued their assistance. AID/Honduras stopped supporting FIDE's offices in the United States, but the overall level of support being provided to FIDE has remained stable. FIDE's director stated that without AID's continuing support, the organization would cease to function. In contrast, AID/El Salvador suspended fiscal year 1993 assistance for FUSADES' trade promotion activities upon receiving notice that section 599 had been enacted. FUSADES officials are attempting to develop other sources of support, as they were planning to do after the previously planned termination of AID assistance in 1994.[12]

Difficulty Managing Funds Already Committed

Although section 599 does not apply to funds appropriated prior to fiscal year 1993, AID decided as a matter of policy to apply the same restrictions to local currencies generated through the Food for Peace Program, cash transfers, and funds appropriated in preceding fiscal years. Missions have had difficulty managing these funds in compliance with this policy.

Most AID programs are operated by intermediaries, such as host government agencies, institutional contractors, and private voluntary organizations. AID retains oversight authority but exercises only limited control over day-to-day activities in these programs.[13] In working through intermediaries, AID missions enter into agreements with them that, among other things, establish requirements for the use of U.S. funds. Mission officials said that they could not unilaterally change these agreements unless a clause permits them to do so. As a result, we found instances where missions could not prevent the use of prior year funds for certain activities. For example:

[12]AID support for the Dominican Republic's IPC was terminated during fiscal year 1992 because IPC had been found to be unsustainable. The termination of support in the Dominican Republic and action planned in El Salvador prior to enactment of section 599 are part of an ongoing transition in AID's trade and investment programming. See Foreign Assistance: AID's Private Sector Assistance Program at a Crossroads (GAO/NSIAD-93-55, Dec. 11, 1992).

[13]For example, the agency commonly provides funds to support industrial development through host country intermediaries. Direct control over loan awards lies with lending institutions, within general guidelines established by AID. Loan recipients may be several steps removed from AID, with the result that the agency has little control over, or even knowledge of, the beneficiaries. For example, AID/Dominican Republic did not maintain complete information to identify the zones assisted through the local currency financing it generated. The mission had no information on the firms that subsequently occupied the buildings financed by these loans.

- AID/Costa Rica determined that it could not close its existing lines of credit with the Central Bank of Costa Rica. According to the mission, "AID has no formal agreement with the [Central Bank] which would allow us to modify the terms of use for these [Central Bank]-owned local currency special lines of credit."
- AID/Costa Rica also believed that a 1990 endowment of $27.15 million in local currencies to a nonprofit foundation could not be reprogrammed because AID had limited legal authority to alter the terms of previously concluded agreements and because the funds were provided in the form of "sectorial" rather than "projectized" assistance (AID's guidance for applying section 599 to prior year funds refers to "projectized" assistance).
- While AID/El Salvador ceased providing new funds to FUSADES for promotional activities, it concluded that it had no legal basis for preventing FUSADES from spending prior fiscal year funds that had already been provided.

Section 599 Will Likely Have Little Impact on Job Movement, Worker Rights

While reducing some forms of assistance, section 599 will do little to ensure that ongoing industrial transition does not result in some U.S. workers losing their jobs; nor will it have an appreciable impact on worker rights conditions in Basin assembly plants.

AID has been able to identify and terminate some programs providing assistance to export processing zones. For example, an AID/Dominican Republic program aimed at preparing local firms to supply zone companies was ended shortly after the mission received notice of section 599's adoption. However, AID has proposed to ensure compliance with section 599's provisions on no relocation of U.S. jobs and respect for worker rights by including these considerations in project checklists and requiring certification from program participants concerning relocation of U.S. jobs and respect for worker rights. It is doubtful whether this approach can guarantee that no AID-supported investment will result in any U.S. worker losing his or her job, or that no firms receiving AID support will violate worker rights.

Affected Assistance Programs Not a Major Influence on Investor Behavior

We found that the foreign assistance programs affected by section 599 were a minor influence on investment decisions by U.S. companies. AID continues to provide general support for industrial development in the Basin, through policy dialogue and other means. This support has encouraged Basin countries to reorient their economies, making them more attractive to private investment, including investment from the

United States. In addition, growth in Basin assembly operations continues to be supported by a number of trade measures—such as the Super 807 program—that were viewed by company officials as having a greater impact on investment behavior than foreign assistance programs. Beyond this, growth in Basin assembly has been driven primarily by response to market considerations, not government programs. With regard to worker rights, AID's traditionally low level of involvement in this issue, coupled with the indirect nature of its assistance, places the agency in a poor position to monitor compliance by companies receiving agency assistance.

Precise Impacts of Supporting Industrial Growth Unpredictable

Ensuring that grantees and contractors do not conduct activities that violate the letter and spirit of section 599 presents AID with analytical and administrative problems related to the broad scope of its programs and the indirect manner in which they are administered.

First, many assembly plant investments are made outside of zones and, therefore, may not be affected by the law's prohibition on zone assistance. Second, programs encouraging industrial development may, by their very nature, damage the interests of some U.S. companies by creating new competitors, whether these competitors sell products directly back to the United States or in other foreign markets where some U.S. companies may be competing. At the same time, this industrial development could create other jobs for U.S. workers by generating new demand in the developing countries, such as demand for production machinery. The broad focus and indirect administration of many relevant AID programs make it difficult to predict or control all of their effects. To the extent that AID (and other agencies) support industrial growth in the Basin, they will continue to have a variety of impacts, both good and bad, in the United States.

Some U.S. Workers May Be Harmed by Section 599

Some U.S. workers may be adversely affected by section 599. This may occur because, while focusing attention on direct relocation of specific jobs from the United States to developing countries, section 599(a) does not address the indirect implications of growth in Basin assembly industries for U.S. employment, which may be equally important. For example, to the extent that U.S. apparel companies engage in Basin production sharing, using U.S. textiles rather than importing finished products from the Far East, U.S. textile workers benefit. To the extent that section 599 discourages this trend, U.S. textile workers may be adversely affected.

Section 599 is also silent regarding assistance being provided to locally or Asian-owned, as opposed to U.S.-owned, assembly operations. While the primary market for most Basin assembly plants is the United States, non-U.S.-owned companies are less likely to use U.S. inputs. As noted in chapter 2, promotion organizations have encouraged the development of locally owned companies, as well as Asian investment in Basin countries. AID-supported technical assistance and financing programs have drawn no distinction between U.S.- and non-U.S.-owned companies.[14] Section 599, however, may result in comparatively less assistance being provided to U.S. companies. For example, AID/Costa Rica officials told us that they have modified their private sector training support program to ensure that international companies (including U.S. companies) will pay the full costs of any services they obtain, while local firms continue to be partially subsidized. Additional discussion of the overall U.S. impact of growth in Basin assembly industries is presented in appendix I.

Conclusions

In light of other provisions, including the Lautenberg Amendment, that permit and encourage continuation of relevant support, section 599 does not provide AID with a clear mandate to take a new direction in its private sector development and trade and investment programming. The contradictory signals being sent by Congress, coupled with management difficulties, have prevented the agency from implementing the law in a clear and uniform manner.

For a number of reasons, section 599 will likely have little impact on either the ongoing transition in U.S. industry that results in certain types of jobs being moved offshore or worker rights practices in Basin countries. Among other things, foreign assistance programs affected by section 599 are not sufficiently important in company decision-making, and U.S. trade measures continue to provide incentives that are more important to investors. AID continues to support general industrial growth in Basin countries, and this growth will benefit some U.S. interests while harming others. Section 599 may actually harm the interests of some U.S. workers because it does not address the indirect implications of growth in assembly industries.

[14]For example, AID-generated local currencies supplied nearly three quarters of the financing needed to establish a Korean assembly plant in Honduras.

Implications for the Future of Foreign Assistance Programs and Trade Policies in the Caribbean Basin

Controversy about U.S. support for Caribbean Basin assembly industries is one element in a broader public policy debate concerning the challenge faced by U.S. industry in adjusting to increased international competition and the goals of U.S. foreign assistance in the post-Cold War era. Resolution of ongoing controversy surrounding the future of U.S. foreign assistance and clarification of U.S. policy regarding assembly industries in the Caribbean Basin would help to provide AID with a more clearly defined direction regarding its support for industrial development in the region.

Critics of U.S support for Basin assembly industries base their opposition on the fact that employment in apparel assembly and other industrial occupations is declining in the United States. However, this decline—driven by foreign competition and U.S. industries' changing production strategies in attempts to become more competitive—has been going on for decades and is likely to continue regardless of AID's activities.

As discussed in chapter 2, concern about economic stagnation and resulting unrest in the Caribbean Basin prompted the United States to develop a foreign policy toward the region that encouraged growth in nontraditional exports, supported by U.S. investment and directed largely at the U.S. market. Within this overall "trade not aid" policy, AID programs have complemented trade measures like the 807 program that encouraged production sharing by U.S. firms. Production sharing was encouraged not only because it was viewed as a potential growth industry for the Basin, but also because it would assist the U.S. textile and apparel industry in competing with increasing imports.

While the Foreign Assistance Act of 1961, as amended, permits AID to focus on trade and investment support, as the agency has done in the Caribbean Basin, it does not indicate that this type of programming should be emphasized over others. As several recent studies, including our own, have concluded, AID has lacked a clearly articulated strategic direction based on consensus among key external and internal groups.[1]

As we have also pointed out in a previous report, AID's future orientation with specific reference to private sector development has been uncertain.[2] The agency has lacked a clear conception of the extent to which it should

[1]See Foreign Assistance: Reforming the Economic Aid Program (GAO/T-NSIAD-93-20, July 26, 1993) as well as AID Management: Strategic Management Can Help AID Face Current and Future Challenges and Foreign Assistance: AID Strategic Direction and Continued Management Improvements Needed.

[2]See Foreign Assistance: AID's Private Sector Assistance Program at a Crossroads (GAO/NSIAD-93-55, Dec. 11, 1992).

focus on advancing U.S. commercial interests, or the precise role it should adopt in this regard. In fact, the United States has lacked an overall export promotion strategy, and, until just recently, the roles that should be played by particular agencies, including AID, in supporting U.S. foreign trade had not been defined in relation to one another.[3]

Section 599 raises questions concerning the degree to which AID programs must be designed with U.S. domestic interests in mind, as well as questions concerning how these interests should be defined. However, section 599 does not answer these questions. Rather, it adds one more consideration to an already extensive list of objectives, restrictions, and concerns that AID must take into consideration when designing programs. These objectives include support for industrial growth in and trade with developing countries.

In acting to achieve these objectives, AID programs indirectly contribute to an ongoing transition in which some U.S. workers will lose their jobs while others gain new opportunities. While section 599 in effect reduces foreign assistance expenditures on programs directly supporting Basin assembly industries, it does not appear that the legislation will have a significant impact on either the movement of jobs from the United States or possibly the observance of worker rights in Basin countries. The United States continues to encourage growth in Basin assembly industries through trade measures that companies deemed to be of greater significance in investment decision-making than foreign assistance programs, as well as through general AID efforts aimed at encouraging economic liberalization and industrial growth in the region.

In prior reports, we recommended that the Administrator of AID develop a strategic management process that would clarify AID priorities and improve agency management, and that the Secretary of Commerce, as chairman of the interagency Trade Promotion Coordinating Committee (which includes AID), work to develop a unified export promotion strategy. We recommended that the Administrator work with the other members of the committee and with Congress to define AID's role, if any, in directly advancing U.S. commercial interests in developing countries. A key element in these discussions would be AID's role in supporting trade and investment relations with the Basin pursuant to CBERA and related measures.

[3]See Export Promotion: Federal Programs Lack Organizational and Funding Cohesiveness (GAO/NSIAD-92-49, Jan. 10, 1992).

Some progress is being made in this area. In commenting on a draft of this report, AID reported that it is working with Congress and the development community to produce simplified foreign assistance legislation, and a discussion draft was submitted to Congress in November 1993. AID is also revising its basic strategies, while reorganizing the agency and working to implement the findings of the administration's "reinventing government" exercise. Also, the executive branch's Trade Promotion Coordinating Committee has taken steps toward defining agency roles in promoting U.S. exports. AID's primary role has been preliminarily defined as "promoting growth and fostering demand in promising new markets overseas."[4] These efforts may help to resolve the difficulties identified in this and prior reports.

Issues to Consider

While Congress debates the proposed revisions in the foreign assistance act, there are a number of factors to consider. For example, if Congress wants AID to continue supporting private sector-led development, including growth through increased trade and investment, it may want to ensure that relevant agency programs, such as its private sector programs, do not adversely affect U.S. workers. This could be done by requiring AID to prepare analyses of the likely net impact on U.S. jobs of proposed programs or projects. Such analyses could take into account, for example, the impact of terminating assistance to U.S. investors in Basin assembly operations in light of rising Asian investment in such industries. However, it should be understood that AID can never ensure that its broad economic development programs will not harm the interests of any individual worker in the United States. If foreign assistance programs are ultimately successful in raising the level of economic development in developing countries, U.S. job losses in some less competitive industries will inevitably occur, but U.S. workers in other industries and U.S. consumers may benefit. The precise net impact is unknown.

If Congress wants to take more direct action to ensure that foreign assistance funds do not contribute to the growth of developing country operations in specific "import sensitive" industries, it could remove the Lautenberg Amendment's exception for 807 operations. This would effectively deny AID the authority to assist Basin assembly operations in

[4]In September 1993, the committee issued its first annual report on efforts to develop a strategic plan for federal trade promotion programs, as required by the Export Enhancement Act of 1992. The plan presented in the report is a status report on progress to date, laying out some specific changes while making a commitment to completing more fundamental tasks within the context of the fiscal year 1995 budget. For more information, see Export Promotion: Initial Assessment of Governmentwide Strategic Plan (GAO/T-GGD-93-48, Sept. 29, 1993).

such industries.[5] However, in considering such action, Congress should take into account the fact that several other features of U.S. policy, including trade measures such as CBERA and the 807 program, as well as the 936 program, would still continue to encourage development of Basin assembly industries.

[5]Language proposing a restriction applying specifically to agricultural, textile, and apparel commodities was proposed during deliberations of the Senate Committee on Foreign Relations on AID's fiscal year 1994 appropriations, with the qualification that the restriction would apply only when the commodities would be in direct competition with U.S. exports or cause substantial injury to U.S. exporters.

Overall U.S. Impact of Growth in Assembly Industries Uncertain

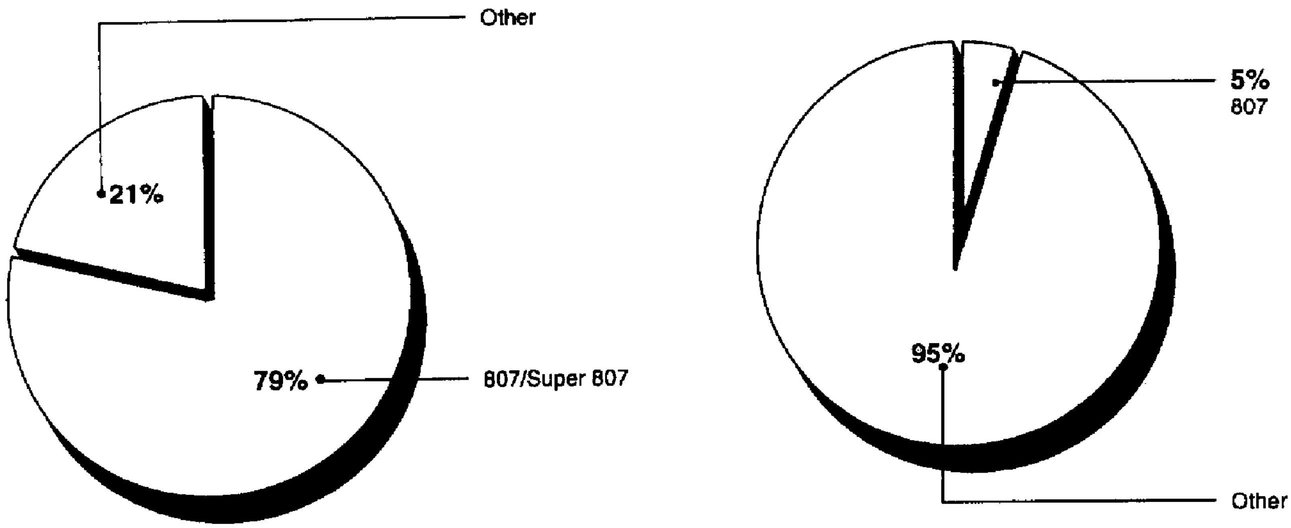
The growth of offshore assembly industries in the Caribbean Basin is due primarily to U.S. companies' adoption of production sharing as a strategy for competing against imports from low-cost labor markets. However, the net impact of this growth on U.S. employment and industry is uncertain. While some U.S. jobs may have been preserved, apparel industry employment continues to decline. Also, Asian companies have invested heavily in Basin assembly operations for export to the United States. Furthermore, assembly industry growth has not had a noticeable favorable impact on growth in U.S. exports to the Basin.

Growth in Basin Assembly Has Uncertain Impact on U.S. Textile and Apparel Employment

Proponents of production sharing believe that while U.S. employment may continue to decline in some areas, particularly assembly, production sharing encourages the use of U.S. inputs and creates employment in other areas like textile manufacturing and cutting. While U.S. inputs comprise more than two-thirds of the value of products from Basin assembly plants, it is unclear how much this favorably affects U.S. employment. Even if the effects of the growth of production sharing are positive in light of the alternative (increased imports of wholly foreign-origin products), the Caribbean Basin is still a minor player in the U.S. apparel market. Low-cost imports from other regions will continue to overshadow the positive effects of production sharing with the Basin.

U.S. inputs in textile and apparel imports from the Basin represent a significantly greater percentage of the total value of finished apparel than is the case with imports from other parts of the world. While 79 percent of apparel imports from Basin countries entered under special trade programs that encourage use of U.S. inputs (discussed in ch. 2), only 5 percent of the apparel imports from the rest of the world entered under these programs. This dichotomy is illustrated in figure I.1.

Figure I.1: Percentage of Apparel Imported to the United States Under the 807 and Super 807 Programs in 1991



Basin Imports

Source: Commerce Department.

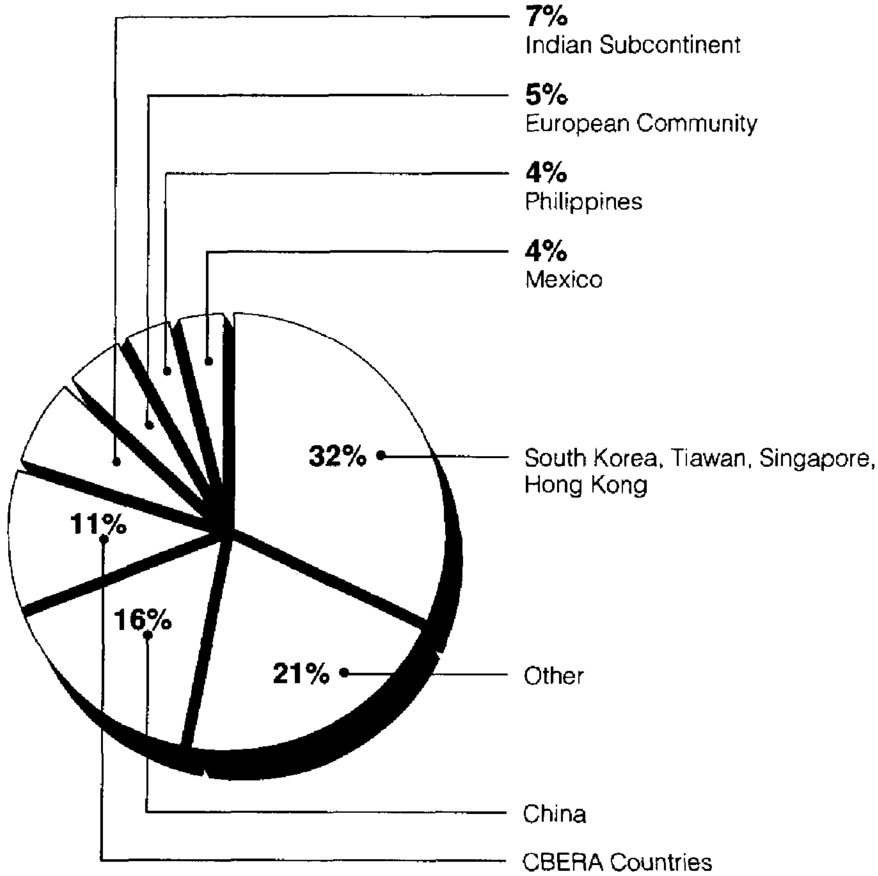
Imports from Rest of the World

Source: Commerce Department.

Importance of Basin Assembly Operations Should Not Be Overstated

While U.S. industries manufacturing these inputs benefit from Basin production sharing, the positive effects of this production sharing on U.S. employment should not be overstated. As noted in chapter 1, the U.S. textile industry, the greatest beneficiary of these special trade programs, has experienced severe drops in employment due to increased automation and productivity. Further, although apparel production in the Basin has dramatically increased over the last 10 years, these imports still represent only 11 percent of all U.S. apparel imports (see fig. I.2). Asian imports are largely foreign content and contain very few U.S. components.

Figure I.2: U.S. Apparel Imports by Source Country (1992)



Note: South Korea, Taiwan, Singapore, and Hong Kong are commonly referred to as Asia's "Newly Industrialized Countries."

Source: Commerce Department.

Hong Kong, Taiwan, South Korea, and Singapore accounted for roughly one-third of all U.S. apparel imports in 1992, even though import quotas have restrained growth from these countries over the last few years. Their exports to the United States grew at a rate of about 2 percent a year from 1985 through 1992. The People's Republic of China was the largest single source country in 1992, accounting for 16 percent of all apparel imports.[1] Analysts expect China's share of imports to continue to rise given low wages and the opening of China's economy to international trade.

Asian Companies Use the Basin as an Export Platform

While Basin production sharing may help U.S. industries compete against low-cost importers, Asian companies have invested heavily in the region and use these countries as an export platform to the United States. The United States has imposed quotas on many apparel items imported from Asian countries, such as Taiwan and South Korea. Companies from these countries have increasingly turned to producing their goods offshore, in less developed countries, where quotas are less restrictive or nonexistent, for export to the United States. Like U.S. investment, Asian investment in the Basin is growing.[2]

In the four countries we visited, Asian companies represented approximately 18 percent of the companies operating in export processing zones, ranging from about 8 percent of zone occupants in Costa Rica to about 48 percent of zone occupants in Honduras. Almost all of this investment is in apparel assembly, and we found that Asian companies are more likely to use Asian textiles in their apparel production than are U.S. or locally owned companies. In addition, Asian companies have started to locate in zones to service other zone assembly plants. In Honduras, for example, Asian companies manufacture thread and packing boxes for other Asian companies in the region as well as for some U.S. companies.

[1]Experts believe this estimate to be understated, as a significant portion of Chinese exports are mislabeled as originating in neighboring countries, like Hong Kong.

[2]It is difficult to determine whether a particular investment should be classified as an Asian investment. Some Asians starting businesses in the region may use foreign capital but are officially local residents. Other Asian companies have established parent companies in the United States.

Assembly Growth Has Not Had a Noticeable Positive Impact on U.S. Exports

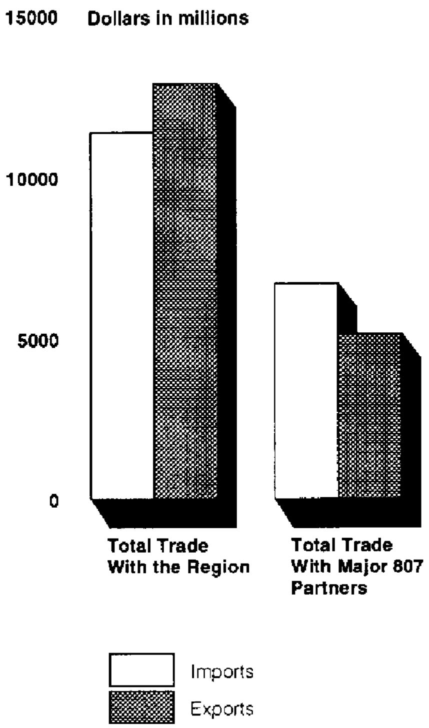
Proponents of policies and programs that encourage Basin assembly industries assert that as these industries grow, new sources of income in the region benefit the U.S. economy by creating new markets for U.S. goods. While overall trade with the Basin has grown in recent years, Basin markets are still relatively insignificant to the U.S. economy, and exports to this region have not grown as fast as overall U.S. exports. While U.S. exports to the Basin have increased by nearly 9.5 percent annually since 1983, total U.S. exports to the Basin remain less than 3 percent of total U.S. exports, and in fact have declined since 1983 from 2.9 percent to 2.6 percent of overall U.S. exports. The region's importance as a trading partner is no greater now than it was 10 years ago.

Furthermore, an analysis of trade with the Basin indicates that apparel constitutes 13 percent of 1992 U.S. exports to the region. U.S. Customs Service data does not differentiate between piece goods destined for Basin assembly and finished goods exported for sale abroad. However, industry analysts and embassy economists indicated that nearly all U.S. apparel exports to the Basin are shipments of piece goods. Excluding apparel, the Basin's share of U.S. exports has decreased over the last 10 years, from 2.8 percent to 2.3 percent, and U.S. exports to the Basin during that period have grown 8.4 percent annually, well below the annual growth rate of all U.S. exports —11.4 percent.

The United States Has Trade Deficit With Major 807 Partners

Proponents of U.S. trade policies that encourage trade with the Basin point out that the United States has enjoyed a trade surplus with the region for the last 3 years. However, the United States has a trade deficit with three of the Basin countries that have taken the greatest advantage of U.S. programs encouraging production sharing with U.S. companies—the Dominican Republic, Costa Rica, and Guatemala (see fig. I.3). Imports from these countries represent 50 percent of all imports from the region.

Figure I.3: 1992 U.S. Trade Balance With the Caribbean Basin Region and Three Major 807 Partners.



Source: Commerce Department.

Comments From the Agency for International Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

NOV 1993

Mr. Frank C. Conahan
Assistant Comptroller General
United States General
Accounting Office
441 G Street, N.W. - Room 5055
Washington, D.C. 20548

Dear Mr. Conahan:

I am pleased to provide the formal response of the Agency for International Development (A.I.D.) to the draft GAO report entitled "FOREIGN ASSISTANCE: U.S. Support for Caribbean Basin Assembly Industries" (October; 1993).

We appreciate the opportunity to contribute A.I.D.'s perspective to this broad review of U.S. trade, tariff, tax, and foreign assistance programs and policies designed to stabilize countries of the Caribbean Basin and to promote their growth during the past decade through increased openness to trade.

We agree with the conclusion of the draft GAO report that U.S. foreign assistance is "not a deciding factor" for U.S. companies investing in Basin assembly plants. We also agree that the "multiple mandates" contained in current foreign assistance legislation contribute to the difficulty of implementing a private sector growth strategy in general, and Section 599 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1993 in particular. We look forward to working closely with the Congress and the development community in producing simplified foreign assistance legislation.

In the meantime, A.I.D. is in the final stages of producing a series of six new strategy papers, including one outlining A.I.D.'s strategy for encouraging broad-based economic growth. As a development agency, we cannot afford to ignore the potential for sustainable economic growth that can be achieved by working with the private sector in host countries. A.I.D. would disagree with any recommendation that it retreat from the task of developing the private sector where this is an appropriate growth strategy. We agree with the draft GAO report that it would be desirable to adopt an approach, historically utilized by OPIC and EXIM, that considers the net impact of our activities on the U.S. economy. Overall, we believe that growth and development abroad

See comment 1.

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

-2-

mean better customers for the U.S., more exports, and more U.S. jobs, not fewer. We believe that A.I.D. can do a good deal to develop private sector-led market economies abroad, as well as to support and encourage greater protection for workers rights and labor unions.

See comment 1.

The draft GAO report reiterates the need for A.I.D. to develop a strategic management process that will clarify A.I.D. priorities and improve agency management. The current reorganization at A.I.D., and implementation of the findings of the on-going "reinvention of government" exercise, will go a long way toward implementing recommendations contained in the draft GAO report. A clarified mandate, a more focused strategy, and improved management systems will certainly contribute to promoting broadly based economic growth.

See comment 1.

Section 599 prohibitions have been recently included in Section 547 of the Foreign Operations, Export Financing, and Related Programs Act, 1994. Important changes have been made to clarify the application of the legislation to sectors important to our development efforts, including those in the informal sector, micro and small-scale enterprises, and smallholder agriculture. Based on the revised legislation, strategy and management changes, input from our field Missions, and additional analysis, including that contained in the draft GAO report, revised Section 599/547 guidelines will be issued in the near future.

See comment 2.

Additional comments on more specific aspects of the draft GAO report are also enclosed.

Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,

Michael D. Sherwin
Acting Assistant Administrator
Bureau for Management

Enclosure: a/s

The following are GAO's comments on the Agency for International Development's letter dated November 2, 1993.

GAO Comments

1. The text of the report has been modified to reflect this comment.

2. The additional comments, which have not been reproduced here, included suggested editorial changes, clarifications, and technical corrections. We have incorporated these comments in the text of the report where appropriate.

Comments From the Department of State

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of State

Washington, D.C. 20520

NOV 2 1993

Dear Mr. Conahan:

Thank you for the opportunity to comment on your draft report, "FOREIGN ASSISTANCE: U.S. Support for Caribbean Basin Assembly Industries," GAO Job Code 472319. Comments and suggested changes are enclosed. The Department would appreciate any comments not incorporated in the text to appear as an appendix.

If you have any questions concerning this response, please call David Searby, EB/IFD/OIA, at 647-1448.

Sincerely,

Carolyn S. Lowengart
Director
Management Policy

Enclosure:
As stated.

cc:
GAO - Mr. Kushner
State - Mr. Searby

Mr. Frank C. Conahan,
Assistant Comptroller General,
National Security and International Affairs,
U.S. General Accounting Office.

GAO DRAFT REPORT:
"U.S. SUPPORT FOR CARIBBEAN BASIN ASSEMBLY INDUSTRIES"
Job Code 472319

Overall, the report is a balanced review of the full array of U.S. programs in the Caribbean Basin. However, the report would be improved with the following changes:

See comment 1.

U.S. Caribbean Basin Policy and U.S. Export Growth: Although the Caribbean Basin Initiative (CBI) and other related programs were origionally envisioned as means of economic development and export diversification for Basin countries, U.S. export growth to the region has been a welcome development. U.S. exports to the region have jumped from $5.5 billion in 1983 (the year of passage of the Caribbean Basin Economic Recovery Act, or CBERA) to $11.3 billion in 1992, an increase of 11.7 percent annually. This places the Caribbean Basin region as the tenth-largest market for U.S. exports, ahead of Belgium, Singapore, Hong-Kong, and Australia. Furthermore, the United States has enjoyed a trade surplus with the region in every year since 1986. In 1992, the surplus was $1.8 billion.

Now on p. 78.

See comment 2.

The assertion that "Assembly growth has not had a noticeable positive impact on U.S. exports" (p.121) is too sweeping a conclusion given the available evidence. We believe that our Caribbean policy has helped promote U.S. exports by encouraging growth in a region that has a high propensity to import from the U.S. Many assembly industries are significant importers of U.S. manufactured goods. It is true that export growth to CBI countries has been slower than our export growth worldwide and that overall exports to Basin countries represent only a small share of our total exports. This fact, however, is primarily a reflection of the fact that Basin countries have small economies and that their growth rates have been hampered by stagnation of their traditional industries. Without our Caribbean policy, these countries growth rates and our exports to them would have been lower. An accurate indication of the effect of assembly growth on U.S. exports would require a more detailed sectoral analysis that is present in the GAO report.

See comment 3.

Moreover, it is important to note that U.S. policy, by encouraging investment in the Caribbean Basin, may have prevented some U.S. companies from establishing production in Asian countries, where the benefits of investment in terms of increased U.S. exports are much smaller. For every dollar of CBI apparel exports to the U.S., the CBI countries import 60¢ in U.S. textile or apparel goods. For the Asian NICs, the corresponding figure is 2¢. The relationship is true not just for textiles and apparel, but overall: a dollar invested in the Caribbean Basin is likely to yield much greater benefits in terms of increased U.S. exports and jobs than a dollar invested in Asia.

See comment 4.

1 Appendix 1 should be amended to reflect better the effect of U.S. Basin policy on U.S. exports along the lines of the above argument.

UNCLASSIFIED

-2-

Now on p. 7.

See comment 5.

Now on pp. 70-71.

2 Page 10 of report says "the U.S. government in general lacks an overall export promotion strategy". On September 29, the President announced the 19-agency Trade Promotion Coordinating Committee report, Toward a National Export Strategy which sets forth specific actions and recommendations to coordinate Federal export promotion strategies and eliminate unnecessary obstacles to U.S. exports. This is not explained in the GAO report until page 112 (an incomplete footnote) and page 113. The report should be noted when this lack of strategy is first mentioned, on pg 10.

Now on p. 14.
See comment 5.

3 Pg 19 - In the last sentence, the word "job" should be inserted before losses.

Now on p. 16.
See comment 5.

4 Pg 23 - If the subject is the benefits of free trade, some mention should be made of cheaper products for U.S. consumers.

Now on p. 30.
See comment 5.

5 Pg 45 - 1st sentence, "State Department" should be inserted after "Commerce Department."

See comment 5.

6 2nd sentence - "the State Department provides general assistance to U.S. businesses overseas," should be inserted after "potential U.S. investors."

Now on p. 31.

See comment 5.

7 Pg 46, should insert between Commerce and OPIC sections:

"State Department Provides General Assistance to U.S. Business

In addition to providing commercial assistance in the eight diplomatic missions in the region without Foreign Commercial Service representation, the State Department provides general assistance to U.S. businesses overseas including: providing political and economic analysis and security briefings, engaging in policy dialogue with foreign government officials to open markets and provide clear, fair ground rules for U.S. businesses, advocating on behalf of U.S, companies and assisting in settling trade and investment disputes."

Now on p. 63.
See comment 5.

8 Pg. 98, should insert:

"State Department officials do not believe that their overseas business support services will be substantially affected by section 599 since the Department does not: (1) provide financial incentives for relocating plants, (2) support establishment of export processing zones in foreign countries; or (3) provide assistance for any project or activity which contributes to the violation of workers rights. In fact, the State Department, through its labor attaches, is the principal agency responsible for monitoring any workers rights violations."

UNCLASSIFIED

-3-

Now on p. 23.
See comment 5.

9 There is a factual error on page 33, in the sentence that reads "The revised legislation (1990 amendment to the CBERA) reduces, but does not completely eliminate, tariffs on textiles and apparel." There are no tariff breaks in the CBI on textiles (the break on 807 is available to anyone who uses those programs, not just the CBI). The Department of Commerce and US Customs confirm this.

Now on p. 74.
See comment 6.

10 The conclusion in Appendix 1, page 117, is incorrect. It states that "...the Caribbean Basin is still a minor player in the U.S. apparel market."

- The Dominican Republic is the fourth largest single exporter of apparel to the U.S. market, behind only the PRC, Taiwan and Hong Kong.
- While world imports of apparel grew only 9 percent for the year ending 6/93, imports from the CBI grew by 27 percent, accounting for 18 percent of world imports. The CBI share of the market will most likely continue to increase.

Now on p. 4.
See comment 5.

11 On page 6, third sentence: the phrase "effectively eliminates quotas" should replace "eliminates." The Guaranteed Access Level is negotiated; it is not a right.

UNCLASSIFIED

The following are GAO's comments on the Department of State's letter dated November 2, 1993.

GAO Comments

1. U.S. exports to the Basin have indeed grown during the last few years. However, U.S. exports to the Basin have not grown any faster than exports to the world in general (in fact, they have grown more slowly). U.S. policies in the region likely contributed to that growth.

2. Where Basin economies would stand had all of the various U.S. policies of the 1980s never been adopted is not known. For example, while the United States provided Basin countries with increased opportunities in the assembly industries during this period, U.S. policies also included increased restrictions on Basin sugar exports.

While more detailed analysis would indeed provide a clearer picture of the impact of assembly industries on U.S. export growth, we point out that it is misleading to say that "assembly industries are significant importers of U.S. manufactured goods." Assembly industries do indeed ship large volumes of U.S. parts to the Basin. However, these parts are then promptly sent back to the United States in the form of finished products.

3. We point out in appendix I that apparel assembled in the Basin is much more likely to be made with American fabric than apparel imported from other locations.

4. The text of appendix I was not modified. See comments 1, 2, and 3.

5. The text of the report has been modified to reflect this comment.

6. We acknowledge in appendix I that Basin apparel exports to the United States have increased dramatically in recent years. However, the figures provided by the State Department show that total imports from the rest of the world still amount to approximately 82 percent of all U.S. imports. Further, as we point out in chapter 4, the future of Basin assembly operations is open to question in light of possible changes in world trading patterns in textiles and apparel that could come about if current trade negotiations are successfully concluded.

Comments From the Department of Commerce

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

November 22, 1993

Mr. Frank C. Conahan
Assistant Comptroller General
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

Thank you for the opportunity to provide informal comments on the draft General Accounting Office (GAO) report, "Foreign Assistance: U.S. support for Caribbean Basin Assembly Industries."

We agree with the conclusion of the draft report that the type of support prohibited by Section 599 of the Foreign Operations Appropriations Act of 1993 has not been a determining factor in most private sector investment decisions. We disagree with the implications in the report that the 807 tariff provision and the 807A textile program are a major cause of job loss in the United States apparel industry.

See comment 1.

Specific comments on the draft report are enclosed. If you have questions on our comments, please contact Jay Dowling at (202) 482-1648. On issues related to 807/807A, you may wish to contact William J. Dulka at (202) 482-4058.

Sincerely,

Ronald H. Brown

Enclosure

The Department of Commerce concurs with the conclusion of the draft report that USAID programs have had little impact on private sector investment decisions and that section 599 will have little impact on employment patterns. We are concerned, however, about the discussion in the report regarding the 807 tariff provision and the 807A textile program.

Following are comments about particular sections of the report. These are followed by comments about the 807 tariff provision and the 807A textile program.

Now on p. 21.

P. 31. "Trade Programs in the Region Encourage Basin Assembly Operations."

See comment 2.

The Caribbean Basin Initiative (CBI) and Generalized System of Preferences (GSP) programs contain overlapping product coverage, with CBI having wider coverage. In assessing the impact of the Caribbean Basin Economic Recovery Act (CBERA), it is important to examine imports from eligible countries that otherwise would not have entered the United States duty free or under reduced duties through most-favored-nation (MFN) or GSP. According to the International Trade Commission's annual CBI report for 1993, products eligible for duty free treatment only under CBERA in 1992 were only 6.8 percent ($645 million) of total U.S. imports from CBERA countries. The top ranking of these products was footwear uppers, which is an assembly sector product, but none of the other top ten "CBERA only" products are inputs to, or products of, the assembly sector.

Now on p. 23.
See comment 3.

P. 34. "U.S. Tax Code Encourages Basin Investment."

Tax advantages to companies operating in Puerto Rico were provided long before 1976 when section 936 of the Internal Revenue Code was enacted, and began to be used extensively immediately following World War II as part of "Operation Bootstrap".

The amount of section 936 funds supporting investment in CBI beneficiary countries now substantially exceeds the $100 million minimum established by law. In 1992 the figure was $183,013,000.

See comment 4.

The report should note the changes made to the criteria for eligibility of 936 funds in the Omnibus Budget Reconciliation Act of 1993, Section 13227.

Now on p. 30.
See comment 4.

P. 45. "Commerce Department Assists U.S. Investors."

Paragraph 1: Correction - US&FCS manages 133 posts in 70 countries.

-2-

See comment 4.

Paragraph 2: Replace with the following language - Commercial Officers in the field are responsible for promoting U.S. business interests. Specifically, commercial officers in the field provide direct and indirect support to U.S. exporters through coordinating trade events, collecting and disseminating commercial information, and conducting market analysis.

Commercial information generated by commercial sections is utilized by U.S. companies interested in exporting, and those interested in investing overseas, particularly in privatization and infrastructure projects which provide important opportunities for U.S. exporters.

See comment 4.

Because commercial information is made readily available to all U.S. companies, commercial officers may provide some assistance to companies interested in investing in assembly plants in Basin countries or in contracting with locally-owned firms.

See comment 2.

Paragraph 3: Replace with the following language - The Commerce Department's Latin America/Caribbean Business Development Center works with U.S. and foreign companies and foreign government agencies to foster commercial environments in Latin America and the Caribbean that are conducive to private sector business expansion. Through a Participating Agency Service Agreement with AID, the Center can provide technical assistance in the areas of intellectual property rights, environment, telecommunications and standards. The Center also has an active publications program designed to promote business opportunities in the region. The Center's premier publication is the monthly LAC Business Bulletin with over 10,000 subscribers. As is the case with US&FCS generated commercial information, the Center's publications are available to any individual or company and could be used by companies considering investments in the assembly sector. The Center provides no financial incentives to businesses nor does it provide assistance to export processing zones.

Now on p. 56.

P. 87. "Efforts to Improve Worker Rights Protection."

The Clinton Administration has taken strong steps to link worker rights to trade concessions. Among CBI beneficiaries, GSP worker rights petitions were accepted for review this year for the Dominican Republic, Haiti and Costa Rica. In addition, investigations begun in previous years covering El Salvador and Guatemala are ongoing. U.S. government officials also raise these issues with CBI beneficiaries in annual Trade and Investment Council meetings and other fora. As noted in the following section, the Commerce Department is an active participant in the Administration's worker rights policy formulation.

-3-

Now on pp. 62-63.

See comment 4.

P. 98. Commerce Implementation of Section 599

Replace with the following language - Commerce Department officials pointed out that the US&FCS mandate since its establishment has been the promotion of U.S. exports. The US&FCS carried out a strategic review of its programs to better define the US&FCS target audience of U.S. exporters in an effort to improve the effectiveness of the ongoing U.S. export promotion mandate of the agency. Commerce Department officials do not believe that their operations will be substantially affected by language found in the "Jobs Through Exports Act of 1992" similar to section 599 as the Department does not (1) provide financial incentives for relocating plants or (2) support establishment of export processing zones in foreign countries. Furthermore, Commerce is an active participant in the interagency process that considers worker rights petitions and conducts investigations.

Now on p. 67.

See comment 5.

P. 106. "Precise Impacts of Supporting Industrial Growth Unpredictable"

We agree that it is difficult to assess the impact of policies to support industrial development. However, the Department of Labor annually produces a report on the impact of CBI on employment in the United States and trade. The International Trade Commission produces a report on the impact of CBI on U.S. industries and consumers. Consulting these reports may enable GAO to provide a useful elaboration of this section.

Now on p. 71.

See comment 4.

P. 111. "Implications for the Future of AID and Trade Policy in the Caribbean Basin."

The language regarding the lack of an overall export promotion strategy should be revised to reflect the TPCC announcement of the National Export Strategy.

The TPCC Report explicitly defined AID's role in the commercial area, as outlined in the attached excerpt from the TPCC National Export Strategy. This includes an Executive Branch determination that AID would focus on the most promising, least sophisticated markets to prepare these markets for U.S. Government commercial programs administered by Commerce, TDA, OPIC and Eximbank. AID's planned phase-out of the more advanced developing countries should be closely monitored for adherence to this TPCC commitment, including in the annual TPCC report to Congress.

-4-

807 Tariff Provision and 807A Textile Program

See comment 1.

We are greatly concerned about the implication in the report that the 807 tariff provision and the 807A (Super 807) textile program are the major cause of job loss in the U.S. apparel industry due to the shift of production to the Caribbean Basin countries. The report states that lower labor costs are the primary factor influencing investment decisions in the Caribbean Basin. We disagree. Inexpensive labor is available in many parts of the world, including South America and the Far East. However, our experience shows that the primary factor for increased investment in the Caribbean Basin is quota-free access to the U.S. market, along with the logistical benefits of ready access to U.S. fabric components from the U.S. textile industry, not the inexpensive labor.

The major flaw of the drafter's analysis is the failure to mention the vital importance of the 807 tariff provision and the 807A textile program to the continuing growth and success of the U.S. textile and apparel industries.

Utilization of the 807 tariff provision and the 807A textile offshore operations has become vital to the survival of the U.S. apparel industry. Operations under the 807 tariff provision and the 807A textile program have allowed the U.S. apparel industry to remain competitive with imports from low cost manufacturers in the Far East. U.S. apparel manufacturing companies have relocated labor intensive elements of the production process (such as assembly) to the Caribbean Basin, while maintaining U.S. employment in the production and marketing processes that require more specialized skills (such as the cutting of fabric components). If the 807 tariff provision and the 807A textile program had not been in existence, the garments manufactured under these programs would instead have been imported from Asia. Many U.S. apparel firms would have been driven out of business, with a consequent greater loss of employment not only in the U.S. apparel industry, but also the U.S. textile industry which supplies most of the fabric consumed by these operations. Since 1987, U.S. imports under the 807A textile program (apparel made from U.S. cut and formed fabric) have grown at over 70 percent per year. In 1992, imports brought in under 807A (from the Caribbean Basin and Mexico) ranked as the fourth largest supplier of apparel to the domestic market accounting for 427 million square meters equivalent of domestic fabric or $1.4 billion (Customs Value). These programs have helped the U.S. apparel industry remain competitive in the face of stiff international competition, and have helped to maintain existing U.S. jobs which otherwise would have been lost altogether.

-5-

The report asserts that the 807 tariff provision and the 807A textile program have not contributed to the growth of U.S. exports. It argues that apparel exports to the Caribbean Basin should be excluded from U.S. export statistics since most of the apparel exported are piece goods that are destined to return to the U.S. after assembly. We disagree strongly with this approach, since U.S. goods that exit our national borders are in fact exports. This report asserts that if apparel is excluded, U.S. exports to this Caribbean Basin region declined as a share of total exports. This argument is statistically correct, but logically flawed. The 807 tariff provision and 807A textile program allow U.S. firms to split their production process between the U.S. and Caribbean Basin. The piece goods that are shipped out are exports. When assembled garments re-enter, they are imports. However, U.S. firms usually maintain ownership of these goods during the entire manufacturing process, both in the U.S. and the Caribbean Basin. Moreover, apparel cut in the U.S. for assembly in the Caribbean Basin under the 807 tariff provision and the 807A textile program is in fact counted as part of U.S. domestic apparel production by the U.S. Census.

See comment 6.

If the authors of the report want to discount apparel exports to the Caribbean Basin, then they should also discount the corresponding apparel imports. Otherwise, the statistics reflect a bias about the effects of the 807 tariff provision and the 807A textile program on U.S. trade patterns.

The authors of the report seem to assert that U.S. jobs have been lost because of the 807 tariff provision and the 807A textile outward processing program. However, the economic evidence, along with anecdotal evidence from U.S. firms involved in these programs indicates that these programs have been instrumental in helping U.S. apparel manufacturers maintain their competitiveness vis-a-vis low cost manufactures in Asia. The economic benefits of these trade policies are many:

See comment 1.

- Improves the competitiveness of U.S. firms by allowing them to shift labor-intensive assembly operations to low wage countries.
- Reduces the cost of cross-border transfers of both in-process and final goods.
- Allows manufacturers to consolidate manufacturing to fewer locations, in both the U.S. and foreign countries.

-6-

- Stimulates demand for U.S. made textiles, and other components, by preserving the traditional customers of these industries (apparel manufacturers).
- Preserves employment in the U.S., especially of skilled workers, in both of the textile and apparel industries.
- Stimulates U.S. exports by offering a competitive advantage to those companies (both foreign and domestic) that use U.S. made products (such as fabrics) in their production processes.

A GAO report addressing the programs administered by USAID is an inappropriate forum to debate the merits of the 807 tariff provision and 807A textile program. The arguments presented about the 807 tariff provision and 807A textile program are systematically and fundamentally flawed. They should not be used as a basis for decisions on U.S. trade policy.

Attachment

The following are GAO's comments on the Department of Commerce's letter dated November 22, 1993.

GAO Comments

1. Our report does not imply that the 807 tariff provision and the Super 807 textile program are a major cause of job losses in the U.S. apparel industry. Throughout the report, where these matters are discussed, we clearly indicate that manufacturers in certain sectors, especially apparel, were driven by competitive pressures to move low-skill, labor-intensive assembly operations to offshore locations. We discuss that 807 and Super 807 were intended not only to help Basin countries, but also to help U.S. companies to compete with increased imports through production-sharing operations offshore. Our report further states that the textile industry, along with the unions, encouraged the adoption of Super 807 in an effort to save some U.S. jobs, and we agree that the economic benefits listed by Commerce on pages 5 and 6 of its comments can be attributed to these trade policies.

2. Commerce's comment is consistent with our report, but adds some information that, in our opinion, is not germane to the key point of this section.

3. We have deleted reference to 1976 since the historical context on section 936 is less important than the fact that the U.S. tax code, as currently written, is another mechanism through which the United States encourages economic growth in the Caribbean Basin.

4. The final report has been modified to reflect this information.

5. We considered both the Labor Department's and the International Trade Commission's reports during our review; however, neither report was helpful in analyzing the extent to which AID's overall programs that support industrial growth may run counter to the intent of section 599.

6. The debate about the collection and use of U.S. trade statistics is unresolved; however, because this issue is not germane to the key issues discussed in this report, we have deleted the reference to U.S. export statistics to which Commerce objected.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

Ronald A. Kushner, Assistant Director
Michael McAtee, Evaluator in Charge
Debra Logan, Senior Evaluator
Walter Bayer, Evaluator
Bill J. Keller, Evaluator

Office of General Counsel

Mark Speight, Attorney

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066.

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested