CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 18, 2005

S. 1307
Dominican Republic-Central America-United States Free Trade Agreement Implementation Act

As reported by the Senate Committee on Finance on June 29, 2005, and passed by the Senate on June 30, 2005

SUMMARY

S. 1307 would approve the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) between the government of the United States and the governments of the Dominican Republic and five Central American countries. The agreement, which was entered into with Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua on May 28, 2004, and with the Dominican Republic on August 5, 2004, would provide for tariff reductions and other changes in law related to implementation of the agreement.

The Congressional Budget Office estimates that implementing the agreement would reduce revenues by $3 million in 2006, about $1.1 billion over the 2006-2010 period, and about $4.4 billion over the 2006-2015 period, net of income and payroll tax offsets. CBO estimates it also would increase direct spending by $35 million in 2006, $245 million over the 2006-2010 period, and $621 million over the 2006-2015 period.

CBO has determined that S. 1307 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not directly affect the budgets of state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1307 over the 2005-2015 period is shown in the following table.

	By Fiscal Year, in Millions of Dollars										
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
CHANGES IN REVENUES											
Estimated Revenues	0	-3	-5	-7	-525	-556	-582	-608	-646	-689	-733
CHANGES IN DIRECT SPENDING											
Effect on Farm Programs											
Estimated Budget Authority	0	24	35	41	49	55	55	57	59	61	64
Estimated Outlays	0	24	35	41	49	55	55	57	59	61	64
Merchandise Processing Fee											
Estimated Budget Authority	0	3	4	4	15	15	20	20	20	20	0
Estimated Outlays	0	3	4	4	15	15	20	20	20	20	0
Trade Adjustment Assistance											
Estimated Budget Authority	0	*	*	*	*	*	*	*	*	*	*
Estimated Outlays	0	*	*	*	*	*	*	*	*	*	*
Total Changes											
Estimated Budget Authority	0	27	39	45	64	70	75	77	79	81	64
Estimated Outlays	0	27	39	45	64	70	75	77	79	81	64

Notes: * = Less than $500,000.

Negative changes in revenues and positive changes in direct spending correspond to increases in budget deficits.

BASIS OF ESTIMATE

Revenues

Under the agreement, tariffs on U.S. imports from the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua would be phased out over time. The tariffs would be phased out for individual products at varying rates according to one of several different timetables ranging from immediate elimination on January 1, 2006, to gradual elimination over 20 years. According to the U.S. International Trade Commission (USITC), the United States collected $518 million in customs duties in 2004 on $17.7 billion of imports from those six countries. Those imports consist mostly of various types of apparel articles and produce. Nearly 80 percent of all imports from the region entered the United States duty-free because the United States has normal trading relations with those six countries or because the goods are imported under one of several U.S. trade programs.

However those programs are scheduled to expire in the next three years. The Generalized System of Preferences will expire on September 30, 2006, and the Caribbean Basin Initiative will expire on September 30, 2008.

CAFTA-DR would afford imports from the region preferential treatment similar to what they currently receive. Based on data from USITC and CBO's most recent forecast of U.S. imports, CBO estimates that phasing out tariff rates as outlined in the agreement would reduce revenues by $3 million in 2006, about $1.1 billion over the 2006-2010 period, and about $4.4 billion over the 2006-2015 period, net of income and payroll tax offsets.

This estimate includes the effects of increased imports from the region that would result from the reduced prices of imported products in the United States, reflecting the lower tariff rates. It is likely that some of the increase in U.S. imports from the six countries would displace imports from other countries. In the absence of specific data on the extent of this substitution effect, CBO assumes that an amount equal to one-half of the increase in U.S. imports from the region would displace imports from other countries.

Direct Spending

Effect on Department of Agricultural Sugar Programs. CAFTA-DR would provide the six countries with guaranteed minimum access to the U.S. sugar market. Imports of sugar from these countries would be tariff-free and could increase over time. By increasing the amount of sugar supplied to the U.S. by exporting countries, CBO estimates that the cost of the federal sugar program would likely increase.

Federal government programs support the income of sugar growers primarily by limiting the supply of sugar through domestic marketing allotments—permission to market domestically produced sugar—and import quotas. In addition, a system of nonrecourse price-support loans is used to guarantee sugar growers a minimum price, if the domestic and import restrictions do not result in a sufficiently high market price. The nonrecourse loan program allows producers to pledge their sugar as collateral against a loan from the government at the price-support loan rate. The "nonrecourse" aspect allows them to forfeit their sugar to the government in lieu of repaying the loan when prices are low, resulting in a quantity of sugar being removed from the market, thus supporting the price. The government attempts to limit the supply of sugar through domestic allotments and import quotas to avoid costs in the price-support loan system in most years. Unexpected market events have resulted in substantial costs for the price-support loan program in some recent years (for example, sugar program costs were $465 million in 2000 and $61 million in 2004).

In addition, trade agreements and other commitments have provided other sugar-producing countries with minimum access guarantees to our markets, and tariffs on over-quota U.S. imports from Mexico are scheduled to drop to zero in 2008. Furthermore, if the total amount of U.S. sugar imports in any year exceeds (or is estimated to exceed) a legislated quantity of 1,532 million short tons (excluding some categories, for instance, re-exported sugar), domestic marketing allotments must be canceled under current law, meaning that marketing of domestically produced sugar would be unrestrained.

CBO estimates that by providing additional import access guarantees in compliance with CAFTA-DR, the sugar program will likely cost an additional $500 million over the 2006-2015 period. Annual estimates are shown in the table above. As with programs for most agricultural commodities, conditions in domestic and world markets are highly variable, making estimates of program costs for sugar somewhat uncertain. Actual costs could be either higher or lower in any given year, and these estimated costs represent our best estimate of expected costs over the estimation period. Consistent with the current budget resolution (H. Con. Res. 95), this estimate is relative to CBO's March 2005 assumptions about sugar market conditions. More current information concerning that market indicates that the cost of this legislation would likely be lower in 2006 and possibly lower in 2007, with no significant change in later years.

Merchandise Processing Fee. This legislation would exempt certain goods imported from the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua from merchandise processing fees collected by the Department of Homeland Security. Such fees are recorded as offsetting receipts (a credit against direct spending). Based on the value of goods imported from those countries in 2004, CBO estimates that implementing this provision would reduce fee collections by about $3 million in fiscal year 2006 and by a total of $120 million over the 2006-2014 period, with no effect thereafter because the authority to collect merchandise processing fees expires at the end of 2014.

Trade Adjustment Assistance. Implementing CAFTA-DR could have a negligible effect on the Trade Adjustment Assistance program (TAA). TAA provides extended unemployment compensation, job training, and health insurance tax credits for individuals who lose their job due to increases in imports. Based on information from the International Trade Commission regarding projected employment losses in various industries, CBO estimates that the added costs to TAA would be less than $5 million over the 2006-2015 period, and less than $500,000 in each year over that period.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

S. 1307 contains no intergovernmental mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

CBO estimates that under the act, the tariff rates would be no greater than under current law. Consequently, S. 1307 would not impose any private-sector mandates as defined in UMRA.

PREVIOUS CBO ESTIMATE

On July 18, 2005, CBO also transmitted a cost estimate for H.R. 3045, an identical bill that was ordered reported by the House Committee on Ways and Means on June 30, 2005. The two cost estimates are identical.

ESTIMATE PREPARED BY:

Federal Revenues: Annabelle Bartsch and Emily Schlect

Federal Spending: Mark Grabowicz and David Hull,
Christi Hawley-Sadoti

Impact on State, Local, and Tribal Governments: Melissa Merrell

Impact on the Private Sector: Selena Caldera

ESTIMATE APPROVED BY:

G. Thomas Woodward
Assistant Director for Tax Analysis

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis