

# Backgrounder

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## Congress Should Support Free Trade with Central America and the Dominican Republic

*Brett D. Schaefer and Stephen Johnson*

Despite considerable challenges, the Bush Administration has made significant progress in opening foreign markets for American goods and services. Congress has approved free trade agreements with Australia, Chile, Morocco, and Singapore.

Congress and the Administration should be congratulated for approving accords that will bring real benefits to producers and consumers in America and its trading partners. Congress now has an opportunity to follow up on these achievements by approving the Dominican Republic and Central American Free Trade Agreement (DR–CAFTA), which includes the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

While not a perfect free trade agreement, DR–CAFTA supports America’s economic and political interests by reducing barriers to trade and investment among all signatories. Moreover, the agreement would lock in advances made toward economic liberalization in Central America and the Dominican Republic and set a schedule for further liberalization—policies that are linked to greater economic growth and development. Increasing economic growth would bolster political stability and help create jobs for workers who might otherwise migrate illegally to the United States.

While the Senate is expected to support DR–CAFTA, the agreement’s fate in the House of Representatives is uncertain. Congress should waste no time in approving DR–CAFTA, which will open overseas markets for American businesses, protect the

### Talking Points

- Approving DR–CAFTA would demonstrate America’s commitment to the region and advance the nation’s economic interests by reducing barriers to trade and investment.
- The agreement would lock in advances made toward economic liberalization in Central America and the Dominican Republic and encourage further liberalization, which will lead to greater economic growth and development.
- The agreement contains provisions on labor and the environment that are virtually identical to those in the Jordan and Morocco free trade agreements, which Congress approved by large bipartisan margins.
- Free trade helps to increase environmental and labor standards because countries that embrace economic freedom experience stronger economic growth.
- Increasing economic growth would bolster political stability and help create jobs for workers who might otherwise migrate illegally to the United States.

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homeland by reducing the flow of illegal immigrants, and help stabilize friendly, fledgling democracies by facilitating trade with America.

### The Economic Case for DR–CAFTA

The Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua are small countries that have an economic importance to the United States that exceeds their size. Their combined gross domestic product (GDP) was nearly \$73 billion in 2003—roughly equivalent to the GDP of New Zealand or Venezuela—with a combined population just larger than Canada.<sup>1</sup> Even so, total U.S. trade with them outstrips that with Australia, Brazil, India, Russia, and many European nations. Taken as a group, these six countries amounted to America's 13th largest trading partner in 2003 with total trade of nearly \$32 billion.<sup>2</sup> Only Mexico was a larger U.S. trading partner in Latin America (\$236 billion in 2003). Moreover, trade with the region is growing. The first 11 months of 2004 saw a \$1.3 billion increase in trade over the first 11 months of 2003.<sup>3</sup>

Seizing an opportunity to enhance America's mutually beneficial economic ties with Central America and the Dominican Republic, the Bush Administration concluded a free trade agreement with five Central American countries in March 2004. This agreement—the Central American Free Trade Agreement—was signed in May 2004. Negotiations with the Dominican Republic were conducted separately, but the two agreements were combined for congressional consideration into the Dominican Republic–Central American

Free Trade Agreement. DR–CAFTA was signed on August 5, 2004.

DR–CAFTA is not perfect. Among other things, a perfect free trade agreement would immediately liberalize trade in all goods and services. As with every other free trade agreement, DR–CAFTA has made concessions to political pressures in the U.S. and its prospective free trade partners. While a large majority of tariffs are eliminated upon enactment, some tariffs will be phased out over a period of years (in a few cases, over 20 years), and some sectors are not fully liberalized or are excluded (notably sugar and textiles).<sup>4</sup>

But while the flaws of DR–CAFTA are worth noting, they are far outweighed by the agreement's considerable economic benefits. Specifically, DR–CAFTA would help America, the Dominican Republic, and the countries of Central America in four ways.

**Elimination of Barriers to Goods, Services, and Agricultural Commodities.** According to the World Bank's *World Development Indicators 2004*, the weighted average tariff rates in the DR–CAFTA countries are significantly higher than America's 2.6 percent. Specifically, the most recent data available list weighted average tariffs of 10.1 percent in the Dominican Republic, 5.8 percent in Costa Rica, 6.1 percent in El Salvador, 5.8 percent in Guatemala, 7.3 percent in Honduras, and 2.3 percent in Nicaragua.<sup>5</sup>

DR–CAFTA would “eliminate eighty percent of the tariffs immediately, with the remaining tariffs phased out over 10 years,”<sup>6</sup> including immediately

1. Data are in constant 1995 U.S. dollars. World Bank, *World Development Indicators 2004*, on-line ed., at [publications.worldbank.org/WDI](http://publications.worldbank.org/WDI) (February 4, 2005; subscription required).
2. U.S. Department of Commerce, Office of Trade and Industry Analysis, “Monthly Foreign Trade Data,” at [www.ita.doc.gov/td/industry/otea/usftd/index.html](http://www.ita.doc.gov/td/industry/otea/usftd/index.html) (February 4, 2005).
3. Trade data for December 2004 are not yet available. U.S. Department of Commerce, “Monthly Foreign Trade Data.”
4. Dan Griswold and Daniel Ikenson, “The Case for CAFTA: Consolidating Central America's Freedom Revolution,” *Cato Institute Trade Briefing Paper* No. 21, September 21, 2004, pp. 3–5, at [www.freetrade.org/pubs/briefs/tbp-021.pdf](http://www.freetrade.org/pubs/briefs/tbp-021.pdf) (February 4, 2005).
5. World Bank, *World Development Indicators 2004*.
6. Press release, “Dominican Republic Joins Five Central American Countries in Historic FTA with U.S.,” Office of the U.S. Trade Representative, May 8, 2004, at [www.ustr.gov/Document\\_Library/Press\\_Releases/2004/August/Dominican\\_Republic\\_Joins\\_Five\\_Central\\_American\\_Countries\\_in\\_Historic\\_FTA\\_with\\_U.S.html](http://www.ustr.gov/Document_Library/Press_Releases/2004/August/Dominican_Republic_Joins_Five_Central_American_Countries_in_Historic_FTA_with_U.S.html) (February 4, 2005).

reducing restrictions on “80 percent of U.S. industrial exports and more than 50 percent of agricultural exports to the region.”<sup>7</sup> By committing the DR–CAFTA countries to eliminating tariffs, the agreement would lower the cost of trade, which would benefit consumers in all countries involved in the agreement. America in particular would benefit from DR–CAFTA because the Dominican Republic and Central America already have preferential access to the U.S. market. The benefits to America therefore come at very little cost.

**Enhanced Economic Opportunities in Central America and the Dominican Republic.** The DR–CAFTA countries currently enjoy preferential access to the U.S. market. According to the U.S. Trade Representative, “Eighty percent of DR–CAFTA imports already enter the United States duty free.”<sup>8</sup> This preferential access is through the Caribbean Basin Initiative and the United States–Caribbean Basin Trade Partnership Act. However, unlike a free trade agreement, this access is based solely on U.S. law and can easily be changed or allowed to expire.

DR–CAFTA would make permanent the trade preferences enjoyed by the Dominican Republic and the Central American countries and expand that access into new sectors. Permanent duty-free access to the U.S. is a major incentive for investors and promises new opportunities for existing businesses: America’s \$9.5 trillion economy is more than 130 times the size of the combined DR–CAFTA economies.<sup>9</sup>

The agreement also obligates the countries to remove trade and investment barriers among themselves. Such access would help existing businesses and encourage new industries in those countries to take advantage of expanded opportunities in the region. However, the biggest winners would be consumers and producers, who would be able to purchase goods at cheaper prices—delivering an immediate improvement in the standard of living and production capabilities in DR–CAFTA countries.

**Economic Liberalization.** Evidence from the *Index of Economic Freedom*, published annually by The Heritage Foundation and *The Wall Street Journal*, reveals a clear relationship between economic freedom and prosperity. Rigid labor policies, high regulation and bureaucratic red tape, high official taxation, corruption, and trade barriers are obstacles that create a drag on economic growth. The greater the level of government intervention in the economy, the lower the probability that individuals, investors, and businesses will be able to prosper because costs on private economic activity become higher. In addition, a market economy cannot operate profitably without the supporting structure of the rule of law.

DR–CAFTA would liberalize economic policies in the Dominican Republic and Central America and require their governments to enforce existing laws. For instance, restrictions on U.S. investment in sectors such as energy, finance, insurance, telecommunications, transport, and tourism would be eliminated and protection for U.S. patents, trademarks, and other intellectual property would be enhanced.

By locking in these liberal economic policies, DR–CAFTA offers investors certainty that policies will not suddenly reverse—a key component in investment decisions. Similarly, the U.S. is required to liberalize its existing trade barriers. While broader economic liberalization is necessary for the countries of Central America and the Dominican Republic, DR–CAFTA moves participating countries in the right direction and will yield economic benefits.

**Improvement in Labor and Environmental Standards.** One of the recurring criticisms of free trade is that it discourages higher labor and environmental standards. Economic studies show that the single greatest cause of environmental degradation and low labor standards is poverty. Wealthier societies are more likely to demand and implement greater environmental and labor protections

7. Business Roundtable, “2005: A Crossroads for U.S. International Trade Policy,” January 2005, p. 7, at [www.businessroundtable.org/pdf/20050112002TradeTaskForce.pdf](http://www.businessroundtable.org/pdf/20050112002TradeTaskForce.pdf) (February 4, 2005).

8. Press release, “Dominican Republic Joins Five Central American Countries in Historic FTA with U.S.”

9. Data are in constant 1995 U.S. dollars. World Bank, *World Development Indicators 2004*.

because they can better afford the costs of those policies.<sup>10</sup> They also show that the desire for such protection increases as income grows. Economic liberalization is the most effective means of increasing environmental and labor standards because countries that embrace economic freedom—including free trade—experience stronger economic growth than those that seek to thwart the market through barriers to investment and trade.<sup>11</sup>

While DR–CAFTA could be improved by accelerating tariff reductions and expanding the agreement to cover all sectors, the time for negotiations is past. The bottom line is that DR–CAFTA offers substantial liberalization of trade and investment and encourages further economic liberalization among America’s trade partners. These policies open economic opportunities for the United States, Central America, and the Dominican Republic and set the stage for market-driven economic growth and development.

### Protecting America’s Future

It is in the best interest of the United States to be surrounded by stable, friendly neighbors that can control their territory and trade goods in an open marketplace. Free trade agreements help remove barriers to commerce, enabling countries to achieve the kind of prosperity necessary for democracy, economic opportunity, and stability to take root. It promotes economic growth so that industries and jobs may proliferate, keeping migrant workers at home. Growing economies provide tax revenues so that law enforcement can protect citizens and curb transnational crime threats such as drug and arms trafficking.

**Support for Stable, Democratic Governments.** In the 1970s, every Central American country except Belize and Costa Rica was ruled by a military dictator, supported by closed markets that protected state and family-owned monopolies. Limits on political and economic freedoms made the region vulnerable to Soviet-backed guerrilla movements that would have challenged U.S. security. At great cost to U.S. taxpayers, Washington confronted the Soviet bloc both economically and diplomatically while helping Central American democrats to defeat Marxist insurgencies with security assistance and ballots.

Although the transition to peace, elections, and more open markets has been impressive, the transformation is by no means complete. DR–CAFTA would promote further reform, offer market opportunities, and signal a continuation of genuine U.S. interest in the region.

**Jobs Instead of Illegal Immigration.** Central America’s economies still need help, but not the kind that development aid handouts can provide. Some 57 percent of these countries’ citizens are informally employed, and underemployment averages 51 percent where data have been collected.<sup>12</sup> Assembly plants that once thrived in Central America have moved to China, where workers earn as little as 25 cents per hour without workplace protections or labor standards. Meanwhile, families seeking to put food on the table are migrating to the United States.

DR–CAFTA is essential to help provide work at home for Dominicans and Central Americans, whose economies are struggling to become better

10. Ana I. Eiras and Brett D. Schaefer, “Trade: The Best Way to Protect the Environment,” Heritage Foundation *Background* No. 1480, September 27, 2001, at [www.heritage.org/Research/TradeandForeignAid/BG1480.cfm](http://www.heritage.org/Research/TradeandForeignAid/BG1480.cfm), and Daniel T. Griswold, “Trade, Labor, and the Environment: How Blue and Green Sanctions Threaten Higher Standards,” Cato Institute *Trade Policy Analysis* No. 15, August 2, 2001, at [www.freetrade.org/pubs/pas/tpa-015b.pdf](http://www.freetrade.org/pubs/pas/tpa-015b.pdf) (February 4, 2005).
11. Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O’Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005), p. 2, at [www.heritage.org/index](http://www.heritage.org/index), and John C. Hulsman, Ph.D., Brett D. Schaefer, and Anthony Kim, “The Benefits of a Global Free Trade Alliance,” in Miles *et al.*, *2005 Index of Economic Freedom*, p. 38–40.
12. The informal employment average includes the latest data from all six DR–CAFTA countries while the underemployment figure is an average of the Costa Rica, El Salvador, Guatemala, and Honduras rates. International Labor Organization, Sub-regional Office for Central America, Haiti, Panama and Dominican Republic, “Decent Work Indicators Database,” at [www.oit.or.cr/estad/td/indexe.php](http://www.oit.or.cr/estad/td/indexe.php) (January 31, 2005).

integrated into the global system and provide a more secure environment for commerce. As much as President George W. Bush intends for America to consolidate its “ownership society,” the Dominican Republic and Central America should be encouraged to establish their own.

**Combating Transnational Crime.** Crime rates in Central America are among the highest in the world (154 murders per 100,000 inhabitants in Honduras in 1998), and delinquent mobs affiliated with major U.S. gangs are proliferating.<sup>13</sup> Transnational drug and arms traffickers employ local delinquents to support illicit operations, while the scarcity of jobs and economic opportunity ensures a constant pool of recruits.

Growing threats posed by local and transnational crime will destabilize these fragile democracies and send ever-larger waves of migrants northward—many at the mercy of gangs and human traffickers. Sadly, most who reach their destination will be consigned to marginal lives in the shadows of U.S. communities that do not have the resources to support them. Economic growth and higher employment rates abroad are crucial to confronting international crime.

The free trade agreement with the Dominican Republic and Central America would help to advance American interests in the region. Moreover, DR–CAFTA would be a vital stepping-stone in constructing the Free Trade Area of the Americas, which would integrate most of the economies of the hemisphere and, in turn, advance American interests throughout the region.

### Challenges to DR–CAFTA

DR–CAFTA faces two major threats in Congress: opposition from protectionists in the sugar and

textile industries and those who want to use trade agreements to force countries to adopt strict labor and environmental standards. This opposition should be dismissed for the following reasons.

**Sugar and Textiles.** Despite clear evidence that American consumers and the U.S. economy would be better off if the sugar and textile industries were forced to compete evenly with international rivals, these U.S. industries have successfully maintained protections in America’s free trade agreements. American negotiators specifically refused to liberalize sugar and textile trade in DR–CAFTA out of fear that Congress would not approve the agreement.

- **Sugar.** Many of America’s sugar producers are not globally competitive. They remain in business only through guaranteed prices backed by subsidized loans, strict quotas, and market-strangling tariffs. Consequently, Americans pay two to three times the average world price for sugar—a direct transfer of wealth from consumers to U.S. sugar producers.

In 1998, government support cost the U.S. economy about \$900 million according to the U.S. Government Accountability Office (GAO).<sup>14</sup> The GAO further estimated that U.S. consumers of sugar—sugarcane refineries, food manufacturers, and final consumers—would have saved \$1.9 billion in 1998 if the U.S. had eliminated its sugar program.<sup>15</sup> A 2004 study by the U.S. International Trade Commission estimated that liberalizing the trade in sugar would provide a net benefit of \$1.09 billion to the U.S. economy.<sup>16</sup>

U.S. sugar producers have successfully fought to maintain this wealth transfer by opposing subsidy cuts, lower tariffs, and elimination of quotas

13. International Labor Organization, “Decent Work Indicators Database.”

14. This is the net welfare estimate, which subtracts the benefits to sugar producers from the overall cost to consumers. U.S. Government Accountability Office (formerly General Accounting Office), “Sugar Program: Supporting Sugar Prices Has Increased Users’ Costs While Benefiting Producers,” GAO/RCED–00–126, June 2000, p. 21.

15. *Ibid.*

16. U.S. International Trade Commission, *The Economic Effects of Significant U.S. Import Restraints: Fourth Update 2004*, Investigation No. 332–325, Publication 3701, June 2004, p. 20, at [hotdocs.usitc.gov/docs/pubs/332/pub3701.pdf](http://hotdocs.usitc.gov/docs/pubs/332/pub3701.pdf) (February 4, 2005).

on foreign sugar. DR–CAFTA is no exception. U.S. sugar tariffs (after quotas), which exceed 100 percent, will not change under DR–CAFTA. DR–CAFTA sets strict quotas starting at 107,000 metric tons in the first year and increasing to 151,000 tons over 15 years, about 1.4 percent of 2003–2004 U.S. production in the first year.<sup>17</sup> According to the U.S. Trade Representative, “In the first year, increased sugar market access for Central America and the Dominican Republic under the CAFTA–DR will amount to about 1.2 percent of current U.S. sugar consumption, growing very slowly over 15 years to about 1.7 percent of current consumption.”<sup>18</sup> The truth is that DR–CAFTA would only negligibly affect U.S. sugar producers.

- **Textiles.** As with uncompetitive sugar producers, the U.S. government protects U.S. textile and yarn manufacturers from international competition and has done so for decades through high tariffs, strict requirements on U.S. content in foreign garment imports, and extensive quotas.<sup>19</sup> These policies are often defended as necessary to protect jobs in the U.S. However, textile protection is extremely inefficient and costly.

As noted in 1992 by the Congressional Budget Office, “the annual net welfare costs of these restrictions to the economy (that is, the amount by which the costs to consumers and

the government exceed the benefits to U.S. firms, workers, and the government) are in the range of \$3,600 to \$19,200 for each job retained in the textile and apparel industries.”<sup>20</sup> A 2004 study by the International Trade Commission estimated that liberalizing quotas and tariffs on textiles and apparel would result in a net benefit to the U.S. economy of \$9 billion to \$14 billion, of which approximately \$2 billion would be gained through eliminating tariffs.<sup>21</sup>

DR–CAFTA would permit garments made in the region to enter the U.S. duty-free only if they are made from fabric or yarn from regional producers.<sup>22</sup> The free trade agreement is nearly identical to the access that the Dominican Republic and Central America already have through the United States–Caribbean Basin Trade Partnership Act, except that it would extend duty-free access to garments made with inputs from Canada or Mexico—free trade partners with the U.S. through NAFTA. In other words, DR–CAFTA would effect little real change in U.S. policy toward the region on textile and garment trade.

While the failure to fully liberalize trade in textiles and garments is disappointing from a free trade perspective, U.S. textile manufacturers should be delighted because DR–CAFTA would help Central American manufacturers

17. Office of the U.S. Trade Representative, “Sugar: Putting CAFTA into Perspective,” February 23, 2004, at [www.ustr.gov/Document\\_Library/Fact\\_Sheets/2004/Fact\\_Sheet\\_on\\_Sugar\\_in\\_CAFTA.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2004/Fact_Sheet_on_Sugar_in_CAFTA.html) (February 4, 2005).

18. Office of the U.S. Trade Representative, “Fact Sheet on Sugar in CAFTA–DR,” January 26, 2005, at [www.ustr.gov/Document\\_Library/Fact\\_Sheets/2005/Fact\\_Sheet\\_on\\_Sugar\\_in\\_CAFTA-DR.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2005/Fact_Sheet_on_Sugar_in_CAFTA-DR.html) (February 8, 2005).

19. The U.S. agreed to eliminate its quotas through the Agreement on Textiles and Clothing (ATC), which entered into force along with the World Trade Organization in 1995. The ATC requires the United States, Canada, and the European Union to gradually eliminate textile and apparel quotas by January 1, 2005. The ATC supercedes the Multifiber Arrangement, which had set global policy on textile and apparel trade since 1974. U.S. International Trade Commission, *The Economic Effects of Significant U.S. Import Restraints*, p. 60.

20. Jan Paul Acton, Assistant Director, Natural Resources and Commerce Division, Congressional Budget Office, statement before the Subcommittee on Asian and Pacific Affairs and the Subcommittee on International Economic Policy, Committee on Foreign Affairs, U.S. House of Representatives, April 29, 1992, at [www.cbo.gov/showdoc.cfm?index=5012&sequence=0](http://www.cbo.gov/showdoc.cfm?index=5012&sequence=0) (February 4, 2005).

21. Most of the gains would be through the elimination of quotas.

22. Office of the U.S. Trade Representative, “Free Trade with Central America,” May 28, 2004, at [www.ustr.gov/Document\\_Library/Fact\\_Sheets/2004/Free\\_Trade\\_with\\_Central\\_America.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2004/Free_Trade_with_Central_America.html) (February 4, 2005).

compete against Asian competitors that export goods made with Asian textiles and materials.<sup>23</sup> The six DR–CAFTA countries are the third largest purchaser of U.S. textiles.<sup>24</sup> Many U.S. textiles and yarns are used in local factories to make clothing that is then exported to the U.S. This mutually beneficial trading relationship helps manufacturers in the U.S. and in the DR–CAFTA countries.

Congress is doing American consumers a disservice by failing to liberalize the sugar and textile sectors, but Members of Congress should not compound their error by rejecting a free trade agreement that would have little impact on those favored sectors and that promises economic gains for America.

**Labor and Environmental Standards.** Congressional opposition to DR–CAFTA on the basis that the agreement is not strong enough on labor and environmental standards also lacks merit. The agreement contains provisions on labor and the environment that are virtually identical to those contained in the Jordan and Morocco free trade agreements, which essentially require America's trade partners to enforce their existing labor and environmental laws. If anything, DR–CAFTA provisions in these areas exceed those in previous agreements. Congress approved the Jordan and Morocco agreements by large bipartisan margins. If Congress rejected DR–CAFTA over these provisions, it would signal U.S. rejection of closer ties with the region.

## Conclusion

It is in America's economic interest to expand trade by lowering barriers to goods and services in the U.S. and other countries. Trade is an increasingly vital part of the U.S. economy from which

Americans have benefited tremendously.

The political case for liberalizing trade is equally important. Countries that adopt economic freedom, including market liberalization, tend to grow faster than less free countries. Faster growth translates into higher standards of living, less poverty, and more stable and secure societies.<sup>25</sup>

DR–CAFTA will be the first test on trade for the 109th Congress. The economic and political arguments in favor of the Dominican Republic–Central American Free Trade Agreement are strong. The agreement would expand markets for Central America, the Dominican Republic, and the United States. It would help to integrate these countries into the global economy, encourage needed economic reforms, and bolster positive political trends. Moreover, the agreement will signal the entire hemisphere that Washington is serious about market integration and helping its neighbors to develop.

As the first vote on trade for the new Congress, DR–CAFTA will set the tone for future debates. Congress should support DR–CAFTA based on the merits of the agreement, but the potential long-term costs of failing to support DR–CAFTA give the vote even more importance.

—Brett D. Schaefer is Jay Kingham Fellow in International Regulatory Affairs in the Center for International Trade and Economics, and Stephen Johnson is Senior Policy Analyst for Latin America in the Douglas and Sarah Allison Center for Foreign Policy Studies, a division of the Kathryn and Shelby Cullom Davis Institute for International Studies, at The Heritage Foundation.

23. A better alternative would be to eliminate requirements for the garments to include U.S. textiles or yarn, which may not be the most cost-effective source.

24. Christopher A. Padilla, Assistant to the U.S. Trade Representative, "The Case for DR–CAFTA," remarks to the San Antonio Free Trade Alliance, San Antonio, Texas, November 05, 2004, at [www.usafta.org/policy/view.asp?POLICY\\_ID=75](http://www.usafta.org/policy/view.asp?POLICY_ID=75) (February 7, 2005).

25. Ana Isabel Eiras, "Why America Needs to Support Free Trade," Heritage Foundation *Backgrounder* No. 1761, May 24, 2004, at [www.heritage.org/Research/TradeandForeignAid/bg1761.cfm](http://www.heritage.org/Research/TradeandForeignAid/bg1761.cfm), and Brett D. Schaefer, "Expand Freedom to Counter Terrorism," Heritage Foundation *Backgrounder* No. 1508, December 6, 2001, at [www.heritage.org/Research/TradeandForeignAid/BG1508.cfm](http://www.heritage.org/Research/TradeandForeignAid/BG1508.cfm).