Central American Report

SIECA

2004

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Integration and Regional Programs Department
Institute for the Integration of Latin America and the Caribbean - INTAL

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Central American Report N° 2.

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SISTEMA DE LA INTEGRACION CENTROAMERICANA

CENTRAL AMERICAN REPORT

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The Subregional Integration Reports Series, to which this Central American report belongs, represents an effort by INTAL to promote knowledge and the spread of information on the dynamic process of integration underway in Central America.

As part of this integrationist trend, the Central American Common Market, comprising Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, signatories of the General Treaty on Economic Integration in 1960, is a test case for assessing the achievements and challenges of the initiative.

In publishing this periodic report, INTAL aims to facilitate access to information for a broad readership interested in the Central American integration process, from the public and private sectors as well as among the subregion's general public. It seeks also to go beyond the interest that the process arouses at the subregional level, by making the report available to an international audience through this version in English.

This Report N° 2 was prepared by Edgar Alfredo Balsells Conde, an economist and international consultant.

Juan José Taccone, Director of INTAL, and Uziel Nogueira, INTAL's Integration Economist, were responsible for the coordination of the report and for its general and technical editing. Thanks are due to Ennio Rodríguez, Principal Economist of the IDB's Integration, Trade and Hemispheric Issues Division, for his valuable comments.

In order to meet the expectations raised by the Reports in this Series, readers are invited to send their comments and/or suggestions for the purposes of improving the scope or focus of these publications in the future.

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EXECUTIVE SUMMARY

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In recent years the integration process among the Central American countries has unfolded in a context of little economic dynamism but one of macroeconomic stability, both internal and in terms of the external accounts. Economic growth has not been high but some structural transformations that began in the 1980s intensified in the 1990s, including a significant increase in currency inflows as a result of the growth of remittances, tourism and garments exports (*maquila*).

In that context, the share of intra-subregional imports in total Central American imports increased slightly, from 12.4% in 1995 to 13.3% in 2002, while the share of imports coming from the United States, the subregion's main trading partner, fell from 42.7% to 40.2% in the same period. From another perspective, and adjusting the data so as to take account of *maquila* exports, intrasubregional sales grew by about 16% between 1995 and 2002. Only clothing exports, remittances, and tourism grew at higher rates. Intra-Central American exports accounted for 14.6% of total exports in 1995, and for 16.4% by 2002.

Intra-subregional trade continued to display a higher degree of intra-industrial specialization than trade with other regions, but two trends are changing that circumstance. Agricultural products' share of intra-subregional trade has risen significantly, from a quarter in 1995 to a third in 2002. Part of that trade, such as Nicaragua's sales of livestock, is based on a pattern of inter-industrial specialization. Mounting integration with the United States through *maquila* operations in textiles and electronic goods is also marked by increasing intra-industrial specialization.

In tandem with the growth of intra-Central American trade, economic interdependence in the subregion has intensified as a result of direct investment in neighboring countries, especially in textiles, pharmaceutical goods, white goods, beverages, sugar production, commerce, the financial sector and tourism. Both Central American and foreign (especially US) firms have taken part in this process. The latter companies established themselves early in the subregion, and have increasingly adopted a comprehensive and subregional approach to trade and investment.

Apart from coffee and sugar (as well as exceptions peculiar to one or two countries), all goods produced in Central America are now traded freely within the subregion. In recent years, significant progress has also been made on eliminating non-tariff barriers (mainly special technical or phytosanitary standards, illicit levies and administrative procedures) on intra-Central America trade. About 60 such barriers were identified in 2000. These were reduced to 35 in 2002 and to 13 in 2003. It is likely that the remaining barriers will be addressed through the new dispute settlement mechanism agreed upon in 2003, which should help lessen uncertainty in intra-Central America trade. Because of this substantial degree of trade liberalization, as well as macroeconomic stability (which has kept the growth of each country's domestic demand under control and obviated significant changes in relative prices prompted by sharp exchange rate fluctuations), the increase in intra-subregional trade has been driven mainly by geographic proximity and each country's growth.

Simultaneous progress has been made on customs modernization, especially by establishing integrated or juxtaposed customs services among the countries of the subregion. This has facilitated intra-Central American trade. There have also been some experiences with peripheral or tripartite customs, in which several governments have taken part. These serve to track extra-subregional imports moving within Central America, which might provide a basis for the more effective unification of the Central American market and could bring it closer to a customs union.

Tariffs on third country imports have fallen substantially in Central America during recent years. Weighted by the preponderance of imports, the levels are low. According to the Secretariat of Central American Economic Integration (SIECA), they stand at 8.7% in Honduras, 6.2% in Nicaragua, 6.1% in El Salvador, 6.0% in Guatemala and 4.2% in Costa Rica. More than 85% of the tariff lines in the common external tariff (CET) have been harmonized, but in practice the bilateral negotiation of tariff commitments in free trade agreements with extra-subregional countries has eroded the commonality of the Central American tariff structure. Still to be determined is the exact extent to which this circumstance has eroded the CET. In any case, reducing protection by lowering the tariffs in the CET, as well as through free trade agreements with external trade partners, reflects the effort to ensure that the integration process does not foster industrialization by means of protection. This is also evident in the growing importance of agricultural goods trade within the subregion.

In other areas of integration there has been progress with the Plan Puebla-Panama, which has become the main framework for fostering infrastructure investment in Central America. In the political field, the Central American presidents have prioritized social development issues, to be specified in the future, and the negotiation of the free trade agreement (FTA) with the United States, which was successfully concluded in 2003.

The FTA between the Central American countries and the United States, which the Dominican Republic signed later, is similar to those concluded by the United States with Chile, Singapore, Mexico and Canada. It covers most of the issues included in those accords but not the temporary admittance of business people, nor policies on competition and state enterprises. On the other hand it is more detailed in areas such as intellectual property, the elimination of corruption, and streamlining customs procedures. It gives the Central American countries longer periods (up to 20 years) than those offered to other countries with which the United States has signed agreements (10 to 15 years); it includes favorable conditions for garments exports (albeit subject to rules of origin that impose restrictions); and it contains quite substantial provisions on safeguards, especially those applied to agriculture. Finally, it recognizes the importance of Central America integration.

The future agenda of Central American integration includes the challenge of harmonization, and of securing a mutual effort for integration among the Central American countries themselves, on the one hand, and for their new integration with the United States, on the other. The challenge ranges from reducing transaction costs among the Central American countries to the possibility of applying the rules negotiated with the United States to economic relations among the countries of the subregion. This latter is a controversial issue that will probably have to be addressed in an issue-specific manner rather than in general terms. The vulnerability of people employed in rural areas, where poverty is concentrated, also demands attention to agriculture and investment in rural development, as well as other financial resources, as a basis for responding to the challenges posed by the FTA with the United States. That response also demands social coordination and local development processes that facilitate the formulation and implementation of complementary policies designed to exploit the opportunities and lower the risks of the trade accord.

Contents

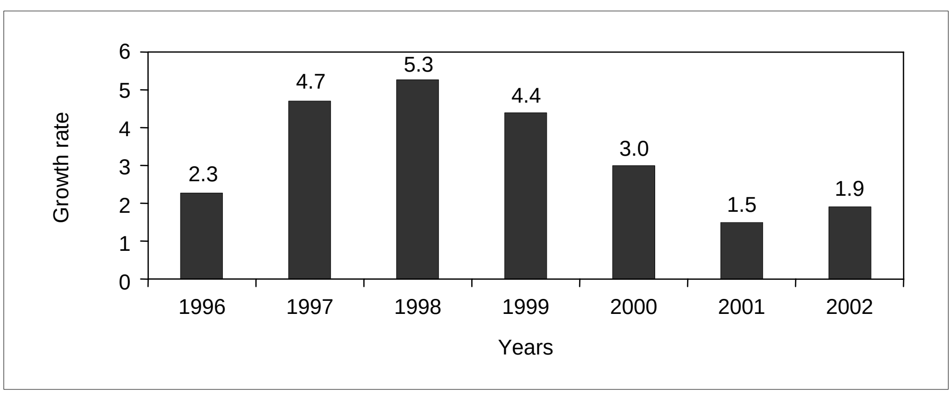
INTRODUCTION

This report assesses the Central American integration process in recent years, locating it in the context established by the nature of the subregion's international insertion, its macroeconomic performance, and the negotiation of the Central American Free Trade Agreement (CAFTA) with the United States. The first part provides a summary analysis of the macroeconomic context. The second examines the features of the subregion's external insertion, including an appraisal of trade and investment among the Central American countries. The third part reviews the determinants of these processes. The fourth part of the report describes the processes of political, social and environmental integration in the subregion, and the fifth addresses the negotiation and substance of the FTA between Central America (and later the Dominican Republic) and the United States. The final part identifies a tentative agenda arising from the challenges of Central American integration and from the agreement with the United States.[1]

CHAPTER I. GROWTH, STABILITY AND EQUITY IN CENTRAL AMERICA

According to the Economic Commission for Latin America and the Caribbean (ECLAC), per capita growth in the isthmus fell for the second successive year in 2002. The subregion's annual average growth of gross domestic product (GDP) was 1.9%, having been 1.5% the previous year and 3% in 2000 (Figure 1). As a result, per capita GDP fell by 0.6%. The only countries that resisted this trend were El Salvador and Costa Rica, whose per capital output grew by 0.4%. In the other countries the decline ranged from -0.6% in Guatemala to -2.1% in Nicaragua.

FIGURE 1
CENTRAL AMERICAN ISTHMUS: GROSS DOMESTIC PRODUCT
1996-2002



Source: CEPAL, *Istmo Centroamericano: Evolución Económica durante 2002*.

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[1] SIECA collaborated in the preparation of the study, providing data and insight on the Central American integration process. The collaboration also anabled the author to secure data from other Central American institutions such as the Central American Integration System (SICA), the Executive Secretariat of the Central American Monetary Council, and the Central American Bank of Economic Integration (BCIE). The author also benefited from the advice of Juan Alberto Fuentes K.

These reversals were influenced by the drop in the value of exports, which fell for the second consecutive year in Guatemala, Honduras, Nicaragua and Panama, and especially the decline in the value of coffee exports (-8.7%), bananas (-3.4%) and sugar (-13.2%). The terms of trade deteriorated in all countries, largely because of the fall in the price of coffee, but this was offset in El Salvador and Costa Rica by an increase in total export volumes. Nonetheless, and despite the drop in the price of coffee and high oil prices, in general the Central American countries continued to enjoy macroeconomic stability, with low inflation, little change in exchange rates, a slight reduction of fiscal imbalances, and no great change in the current account deficit.

The adverse external environment was exacerbated by the events of September 11, 2001, which accentuated weak growth in most industrial centers of the developed world that year. In addition to the problems facing the Japanese economy, with its prolonged recovery problems, there were signs of recession in the United States and the leading countries of the European Union (EU). The situation was little different in 2002. US growth increased but falling growth in the other developed countries was unchecked (Table 1).

TABLE 1
ECONOMIC GROWTH RATES
(April 2003)

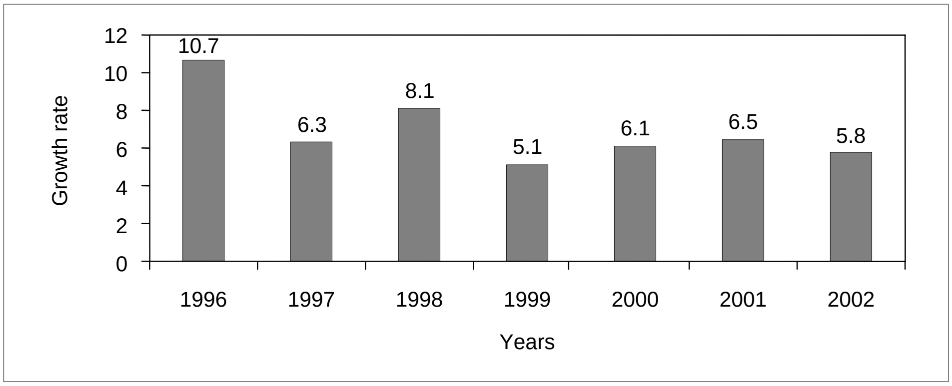
	1999	2000	2001	2002
World output	3.6	4.7	2.4	3.0
Advanced economies	3.3	3.9	1.0	1.8
United States	4.1	4.1	0.3	2.4
Euro area	0.7	2.2	1.5	0.9
Japan	2.6	3.4	0.4	0.2
Asian newly indust. countries	7.9	8.2	0.8	4.8
Developing countries	3.9	5.8	4.1	4.6
China	7.1	8.0	7.5	8.0
Western Hemisphere	0.1	4.1	0.7	-0.1

Source: IMF, 2003.

The basic macroeconomic features of the global situation were reflected in low interest rates and the gradual depreciation of the US dollar relative to currencies such as the euro and the Canadian dollar. It is worth noting that there was a relative recovery in emerging economies and stock markets. In overall terms, recessive trends were evident in the Latin American economies during the period under consideration (2001-2002). Per capita GDP growth was negative, in contrast to the situation in 1997, when the region grew by 5% overall.

In view of the external environment, austerity dominated the Central American macroeconomy. This gave rise to lower internal demand, as evidenced by a slight fall in inflation, which declined from 6.5% in 2001 to 5.8% in 2002 (Figure 2).

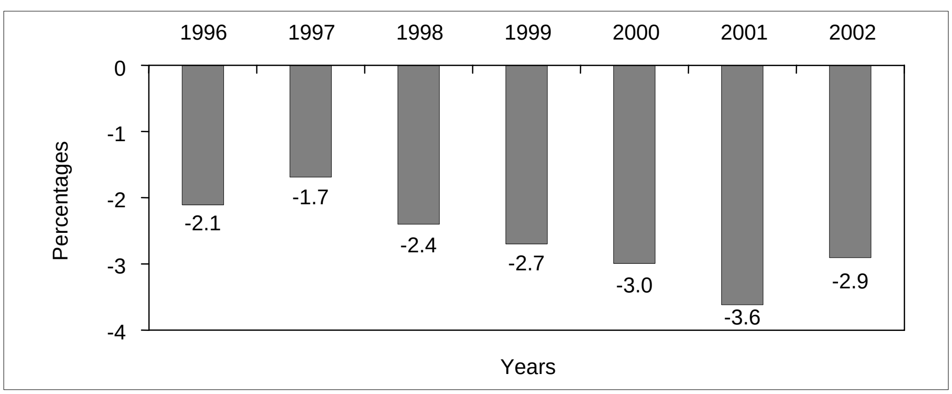
FIGURE 2
CENTRAL AMERICAN ISTHMUS: CPI (DECEMBER-DECEMBER)
1996-2002



Source: CEPAL, *Istmo Centroamericano: Evolución Económica durante 2002* (preliminary evaluation).

Three countries (Guatemala, Honduras and Nicaragua) reached agreement with the International Monetary Fund (IMF). Except for Costa Rica, the fiscal imbalances were smaller than in the previous year (Figure 3) and monetary policy became highly restrictive. This was to ensure price and exchange rate stability and avert greater external imbalances.

FIGURE 3
CENTRAL AMERICAN ISTHMUS: FISCAL DEFICIT/GDP
1996-2002



Source: ECLAC, *Istmo Centroamericano: Evolución Económica durante 2002* (preliminary evaluation).

The fragility of the financial sector in some countries (Guatemala, Honduras and Nicaragua), as well as higher demands in the area of regulation, led the banks to be more conservative in offering new credits. Simultaneously, unfavorable expectations of growth limited demand for loans. Hence the level of loans remained flat even though real interest rates had fallen, a circumstances that was consistent with the prevailing recession

Macroeconomic austerity, together with lower export dynamism, explains the Central American countries' lower economic growth. The lower growth also negatively affected the labor market. Under- and unemployment rose, largely because of trends in exports, especially coffee. In some countries there was a rise in the minimum wage or public sector salaries, but the available information suggest that there was a general fall in average real wages.

The slow recovery of international coffee prices and the lack of (or delay in implementing) support policies aggravated the problems of the subregion's coffee sector. The most vulnerable social sectors were worst affected, since unemployment in the coffee sector rose to critical levels and wages fell. Most coffee producers have smallholdings, live in remote rural areas, and largely depend on their crop and income from the seasonal harvesting of the beans. In general, this crisis prompted a decline in economic activity in the countryside, increased migration to urban areas, and heightened social tensions in some areas. Its impact is also reflected in the macroeconomy in the form of lower fiscal revenues, the loss of export income (with effects on the trade account), and an increase in the general need for external financing. In some countries the coffee sector's debt and debt arrears damaged the financial system, constraining banking activity and financing for other sectors.

In 2002 the regional deficit in the current account reached 4.8% of subregional GDP. With the exception of Honduras and Nicaragua, the Central American countries experienced a significant increase in the goods and services trade deficit. Autonomous financial flows fell by 3.8% as a result of operations undertaken by the international banking center in Panama and the substantial decline in two of the five Central American countries (Guatemala and Nicaragua). Foreign direct investment (FDI), the most important component of capital inflows, fell by 25%. The fall in FDI stemmed mainly from contextual factors such as the weak recovery of the international economy, the uncertainty attendant on the elections in some countries of the subregion, and political and social problems in others. The more limited flow of official and private capital was insufficient to finance the current account deficit, and hence the subregion experienced a small loss of international reserves. Worth noting is the growing impact of remittances from Central Americans abroad, an issue examined below.

Estimates for 2001 indicate that about 51% of Central America's population was living in poverty in that year, and 23% was in extreme poverty (PNUD [2003a], Chapter 2). There are two reasons to assume that the share of the population living in poverty and extreme poverty increased in 2002. First, economic growth declined. Per capita GDP rates for 2002 were negative in Guatemala, Honduras and Nicaragua, where almost 75% of the isthmus's poor were concentrated in 2002 (*ibid*). Second, the coffee crisis and the drought (2001) that affected several countries of the region tended to strike the lower-income sectors hardest, as has been shown in the particular case of Guatemala (PNUD [2003b], Chapter 1).

CHAPTER II. FEATURES OF CENTRAL AMERICA'S EXTERNAL INSERTION

Contents

A. Stability of the External Accounts

Between 2000 and 2002, new trends remained evident in the Central American countries. Those trends had arisen in the preceding decade and entailed profound changes in the countries' means of insertion into the world economy. Many of these changes are more apparent in the area of services, remittances and investment than in the realm of goods exports (with the exception of *maquila*), and they have occurred against the background of a positive net transfer of resources for the Central American countries as a whole in the 1995-2002 period, albeit with the exception of Costa Rica in 1998-2001 and El Salvador in 2001-2002 (CEPAL [2003a], Table A-12).

Public and private capital inflows peeked in 2000 and then fell slightly in the following two years. Costa Rica tended to receive higher levels of FDI than the other countries, although privatization processes in El Salvador and Guatemala attracted higher amounts in some years (*ibid* [2003a] p. 34). With the exception of Nicaragua, as well as of El Salvador between 2000 and 2002, capital inflows enabled the countries of the subregion to cover the current account deficit in the 1995-2002 period. Despite the vulnerability attendant on current account deficits above 5% of GDP for some countries in several years (especially in Nicaragua and Guatemala), none of the Central American countries suffered a balance of payments crisis in this period. As mentioned earlier, remittances from Central American migrants abroad has a growing influence in this area.

B. Services Exports and Remittances

Between 1995 and 2002, the value of goods exports from the five countries as a whole increased by about 50%,[2] more so in Costa Rica and El Salvador than in the other countries, but services exports expanded by almost 100% in the same period. This stemmed largely from the higher growth of tourism (more than 120% overall), which was common to all the countries of the subregion.

In general, the rise in goods exports has not been enough to offset the increase in goods imports. The subregion's imports grew faster than exports in all years of the 1995-2002 period. That circumstance has spurred an increase in the trade and current account deficits for Central America as a whole. The growth was also affected by the rise in the trade imbalances of Costa Rica and Guatemala; their trade deficits were above 5% of GDP in 2002, a level that could not be offset by the modest decline of deficits in Honduras and Nicaragua. This situation is in contrast to the services balance for the subregion as a whole, which was transformed from a negative balance in 1995-1999 to positive thereafter, largely because of the growth of tourism and the consequent positive services balances in Costa Rica and Guatemala (CEPAL [2003b] Table 13, p. 32).

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[2] If the data are adjusted, including *maquila* exports as part of Central America's total exports, the growth of goods exports was higher. Calculated on the basis of data from the US Commerce Department, exports rose by 63% between 1995 and 2001.

TABLE 2
TOURISM (JOURNEYS)
(US$ millions and %)

	1995		2002		2002/1995
	Value	%	Value	%	% growth
Costa Rica	681	62.7	1,190	49.1	74.6
El Salvador	86	7.9	245	10.1	186.8
Guatemala	212	19.6	582	24.0	174.0
Honduras	57	5.2	291	12.0	410.7
Nicaragua	50	4.6	113	4.7	128.5
Total	1,086	100.0	2,421	100.0	123.0

Source: ECLAC.

Hence, in 2002, tourism accounted for more than half of the services exported by all countries except El Salvador (where the sector also grew strongly). In 1995 that was true only for Costa Rica. This new feature of the Central American countries as a whole, which brings them closer to the growth pattern evident in the Caribbean countries, is supplemented by the growth of remittances from Central American migrants abroad, mainly in the United States.

Between 1995 and 2002, these remittances (measured by the value of current transfers) also increased by more than 100% for Central America as a whole. The growth was especially marked in Nicaragua and Honduras, although El Salvador and Guatemala (which account for about half and a quarter of the total, respectively) remain the two countries that received the highest levels of remittances in 2002.

TABLE 3
REMITTANCES (CURRENT TRANSFERS)
(US$ millions and %)

	1995		2002		2002/1995
	Value	%	Value	%	% growth
Costa Rica	165	6.7	266	5.3	60.9
El Salvador	1,390	56.4	2,080	41.8	49.7
Guatemala	570	23.1	1,300	26.1	128.1
Honduras	265	10.8	959	19.2	261.4
Nicaragua	75	3.0	377	7.6	402.0
Total	2,465	100.0	4,980	100.0	102.0
Sub-4	2,300	93.3	4,715	94.7	105.0

Source: ECLAC.

One indicator of the importance of remittances is that in 2002 they were worth more than total services exports for the subregion as a whole, and for all countries except Costa Rica. In sum, remittances and services, especially tourism, have been the most dynamic elements of Central America's insertion into the world economy in recent years, in contrast to the bulk of goods trade.

C. Trade in Goods

The maquila boom

The lower dynamism of goods exports partly reflects the decline in the value of traditional exports such as bananas and coffee, especially because of the coffee crisis of 2000 and the withdrawal of the crop in many areas. That circumstance has been offset partially by the growth of non-traditional exports, mainly sales of garments (*maquila*). According to data from the US Commerce Department, the value of garment exports more than doubled between 1995 and 2002. The only exception was Costa Rica, which experienced even higher growth in exports of electronic components. Honduras consolidated its position as the leading Central American exporter of clothing to the United States between 1995 and 2002. In the latter year the country accounted for over a third (35.7%) of the subregion's export supply.

TABLE 4
TEXTILES EXPORTS TO THE UNITED STATES
(US$ millions and %)

	1995		2002		2002/1995
	Value	%	Value	%	% growth
Costa Rica	755	24.9	745	10.4	-1.3
El Salvador	583	19.3	1,712	23.9	193.8
Guatemala	684	22.6	1,709	23.8	150.0
Honduras	932	30.8	2,556	35.7	174.2
Nicaragua	74	2.4	446	6.2	502.7
Total	3,027	100.0	7,168	100.0	136.8

Source: ECLAC, 2003.

The growth of imports from within Central America

The foregoing conditions have arisen in a context of open regionalism and increasing trade openness. That context entails an erosion of the tariff preference on intra-Central American trade, because free trade persisted within the subregion but protection against third countries has fallen gradually since 1980. Nonetheless, the share of intra-subregional imports in total Central American imports increased slightly, from 12.4% in 1995 to 13.3% in 2002, in a context of the sharp increases in consumption and imports attendant on the economic opening, capital inflows, and exchange rate appreciation of the 1990s. This points to the incipient but growing competitiveness of Central American exports to the subregional market.

At the same time, the share of imports from within Central America varied among the countries: in 2002 the lowest shares were taken by Costa Rica (4.8%) and Guatemala (10.8%), while the share in the other three countries was above 20%. The relatively low share of imports from within the subregion suggests that now there is virtually no potential cost of trade diversion arising from the intra-Central American preference established in the 1960s.

Finally, in the same period the sources of the subregion's exports became more diversified. The United States was the main supplier but its share (over 40% of the total) declined slightly between 1995 and 2002, as did the substantially lower share of imports from the EU. By contrast, there was an increase in imports from the rest of the world (Mexico included).

TABLE 5
CENTRAL AMERICA: GEOGRAPHIC ORIGIN OF GOODS IMPORTS
(%)

	1995	2002
Central America	12.4	13.3
United States	42.7	40.2
Mexico	6.2	7.1
European Union	11.1	9.4
Rest of the world	27.6	30.2
Total	100.0	100.0

Source: SIECA, on the basis of official figures.

Costa Rica was an exception to the foregoing trends. Its share of imports from within Central America fell from 7.3% in 1995 to 4.8% in 2002 and it was the only country in which the United States increased its market share in that period. The US share of Costa Rican imports rose from 45% of the total in 1995 to 51.8% in 2002. The diversification of suppliers therefore narrowed, since the share of purchases from the rest of the world fell. This is mainly ascribable to the higher level of business integration arising from the establishment of INTEL in Costa Rica, which led to a sharp rise in both imports and exports of electronic goods.

The highly important effect of the increase in imports from the United States also neutralized, in relative terms, the growth of purchases from Mexico. Its market share grew in the other countries, probably driven by the FTAs they signed with Mexico in the 1990s.

New patterns of specialization in exports to Central America

- The dynamism of intra-Central American exports -

The Central American countries' exports to their subregional neighbors grew by more than 60% between 1995 and 2002. They did not attain the dynamism of *maquila* exports to the United States, but they grew faster than most goods exports. Within total intra-Central American exports, Guatemala remained the leading exporter. It was followed by El Salvador, whose share of the total grew between 1995 and 2002. Costa Rica's share fell and the country ranked a distant third. Significantly, Nicaragua (from a small base) experienced the highest increase in intra-Central American exports in percentage terms, while the Honduran share fell slightly. The fact that Honduras and Costa Rica were the countries whose exports to the United States increased most suggests that a growing share of resources are devoted to the production of electronic goods or garments for the US market, rather than to producing other goods for the Central American market.

TABLE 6
INTRA-CENTRAL AMERICAN EXPORTS
(US$ millions and %)

	1995		2002		
	Value	%	Value	%	% growth
Costa Rica	428	24.5	615	21.7	43.7
El Salvador	442	25.3	766	27.1	73.3
Guatemala	602	34.4	969	34.2	61.0
Honduras	183	10.5	260	9.2	42.1
Nicaragua	93	5.3	221	7.8	137.6
Total	1,748	100.0	2,831	100.0	62.0

Source: SIECA.

When the data are adjusted to take account of Central American *maquila* exports to the United States (which appear neither in the SIECA statistics nor in the national accounts as goods exports), it is apparent that intra-Central American exports increased as a share of the subregion's total exports from 14.6% in 1995 to 16.4% in 2002. The following table shows that the difference between the export values reported by SIECA and the US Commerce Department is similar to the value of Central American clothing exports to the United States.

Difference between the US and Central American Export Data and Clothing Exports, 2002 (US$ millions)

	Recorded Difference	Clothing Exports
Costa Rica	788.6	745.0
El Salvador	1,736.0	1,712.0
Guatemala	2,124.4	1,709.0
Honduras	2,815.7	2,556.0
Nicaragua	513.3	446.0
Total	7,978.0	7,168.0

Source: SIECA and USTR.

This happened in a context of gradual reductions in the tariff protection offered to the Central American market as a whole, which again suggests that the export supply devoted to meeting subregional demand is increasingly competitive.

-The higher degree of intra-industrial specialization -

Traditionally, intra-Central American exports have been significantly more diversified than sales to the rest of the world. One indication of this is the index of intra-industrial trade, which measures the extent to which trade among countries is in products from the same sector, in contrast to trade in goods from different sectors. Measurements of this index in 2002 clearly show that the degree of intra-industrial specialization, corresponding to trade within the same sectors, is greater for intra-Central American trade than for the Central American countries' trade with the United States or the EU. This springs from the significance of the trade in industrial products within Central America, in contrast to trade with the rest of the world; the latter is less diversified and composed more of raw materials.[3]

TABLE 7
INDICES OF INTRA-INDUSTRIAL TRADE

	Central America	United States	EU
Costa Rica	0.43	0.44	0.61
El Salvador	0.18	0.78	0.98
Guatemala	0.18	0.78	0.94
Honduras	0.51	0.72	0.91
Nicaragua	0.74	0.92	0.91
Central America	0.04	0.57	0.64

Source: Monge [2003] Table 20. The weighted index is used. The higher the level of intra-industrial trade, the closer the index is to 0.

Nonetheless, in two cases there is some divergence from this average. One is Costa Rica, where the intra-industrial index of trade with the United States is virtually the same as that for trade with the Central American countries. This is because of high levels of recent US investment in the production of electronic components, as well as in other sectors such as medical implements. These appear as Costa Rican exports to the United States that are produced with imported US components from the same sector.

The other case is Nicaragua, whose intra-industrial index for trade with the other Central American countries is far greater than that of the others. This is because Nicaraguan exports are less diversified and, in particular, because of the significance of agricultural goods in sales to the rest of the subregion.

- The growing importance of intra-Central American agricultural exports -

For intra-Central American exports as a whole, in 2002 the highest shares were accounted for by products from the chemicals (19.6%), foodstuffs (19.4%) and metals (10%) industries. This structure coincides with the composition of intra-Central American exports from Guatemala, Honduras, El Salvador and Costa Rica, with some variations: Salvadorean exports are more diversified, while certain sectors are more significant in some countries (plastics in Costa Rica, textiles in El Salvador). Nicaragua's intra-industrial trade index reveals a less diversified pattern of specialization, as reflected in the very substantial importance of live animals, essentially cattle (40.1% of the country's total intra-Central American exports in 2002).

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[3] Unfortunately the data on which Table 7's indices are based do not seem to include *maquila* exports, which would probably bring the intra-industrial trade indices of all the Central American countries with the United States closer to the level of the Costa Rican index with the United States.

A comparison of 1995 and 2002 reveals the mounting significance of food products in all the countries' intra-Central American exports, most particularly in Honduras. That circumstance probably stems from a pattern of specialization based more on the resources and raw materials available in each country. This contrasts with the "final touch" industrialization pattern of specialization, marked by a high level of imported inputs, that was evident in the 1960s and 1970s.

The foregoing is related to the increasing importance of agricultural trade within Central America, which rose from a quarter of total intra-subregional commerce in 1995 to a third in 2002. The growing importance of agricultural products in intra-Central American trade has been evident in all the countries of the region, but is especially marked in Honduras and Nicaragua. It highlights their lower level of industrialization, especially in the industrial sector geared to the domestic and Central American markets. This might be regarded as a sign of the end of that stage of Central American integration geared to promoting industrialization in the subregion. The higher level of agricultural trade also reflects the fact that the Central American market no longer offers preferential benefits to the old industries that emerged under the shelter of the import-substitution process; rather, that market is increasingly the destination of the subregion's export supply. The higher level of agricultural trade also shows that small producers have a growing share of intra-Central American commerce, since in many cases the goods traded consist of vegetables, fruits and livestock that are not produced by the large companies, which traditionally specialize in exporting to developed country markets.

These circumstances are in contrast to trade with the United States, which is marked by a growing share of *maquila* exports (clothing or electronic components) or with the EU (whose imports from Central America are dominated by raw materials). It seems that the existence of the Central American market as an export target continues to facilitate the diversification of each country's export supply (without the latter being confined to the traditional industrial sector) to a greater degree than trade with other regions. This might be crucial for the economic growth prospects of the Central American countries in the future.

TABLE 8
INTRA-CENTRAL AMERICAN AGRICULTURAL EXPORTS AS A PERCENTAGE OF THE TOTAL EXPORTS OF EACH COUNTRY AND OF CENTRAL AMERICA AS A WHOLE
(US$ millions)

	1995			2002		
Country	Agricultural exports to CA	Total exports to CA	%	Agricultural exports to CA	Total exports to CA	%
Guatemala	134.9	565.3	23.9	242.5	873.7	27.8
El Salvador	85.5	427.3	20.0	174.9	739.1	23.7
Honduras	19.7	117.9	16.7	103.4	240.5	43.0
Nicaragua	53.2	83	64.1	185	269.6	68.6
Costa Rica	94.1	349.3	26.9	215.1	686.4	31.3
Central America	387.4	1,542.8	25.1	920.9	2,809.3	32.8

Source: Author's calculations on the basis of SIECA data.

CHAPTER III. THE DETERMINANTS OF ECONOMIC INTEGRATION IN CENTRAL AMERICA

Contents

A. The Prevailing Integration Instruments

Market access

By 2002, very few products failed to benefit from intra-Central American free trade. Table 9 shows that only unroasted coffee and sugar are excluded, for all the countries. Additionally, Costa Rica and Honduras impose restrictions on imports of roasted coffee and ethyl alcohol, and Honduras limits imports of petroleum by-products and alcoholic beverages.

According to SIECA, there has been a significant decline in the number of measures that hamper trade, including special technical or phytosanitary regulations, illicit levies and administrative actions. The subregion's economy ministries agreed to identify such measures, and SIECA was entrusted with the follow-up. This has spurred negotiations that reduced these measures from about 60 in 2000 to about 35 in 2002, and to 13 in late-2003.

It is plain that there are now few barriers to intra-Central American trade. The fact that some restrictions seem to be more important as barriers to agricultural goods trade has possibly had some effect on the greater preponderance of such products in intra-Central American commerce. Nonetheless, there has been only a very small number of excluded products or measures subject to trade disputes, and thus their selective effect on intra-Central American trade has been almost insignificant.

TABLE 9

Roasted coffee	Costa Rica with all countries Honduras with all countries
Petroleum by-products	Honduras with all countries
Ethyl alcohol	Costa Rica with all countries Honduras with Nicaragua, El Salvador and Costa Rica
Distilled alcoholic beverages	Honduras with all countries
Unroasted coffee	All
Sugar	All

Source: SIECA.

The common external tariff: from myth to reality

Following a gradual reduction in tariffs (in a process undertaken at the national and subregional levels since the early-1980s) by 2001 the average tariff, weighted in line with the preponderance of imports, applied by each Central American country had reached low levels. Honduras has the highest level, with weighted tariff protection equivalent to 8.7%. Costa Rica had the lowest rate, at 4.2%. The other countries are in an intermediate position of about 6%: Nicaragua (6.2%), El Salvador (6.1%) and Guatemala (6%).[5]

Formally, progress has been made on harmonizing each country's tariffs towards third countries at the subregional level, and thus there are common tariffs for most products. By 2002, only 472 tariff lines were not harmonized, and more than 85% of tariff lines had been harmonized. Of these, 31% were agricultural goods, 12% were metals, another 12% were petroleum by-products, 8% were medicines, and the rest were miscellaneous products.

Bilateral trade agreements, however, and the tariff commitments (maximum applicable rates) assumed by each country as part of its accession to the GATT/WTO, have given rise to different tariffs towards specific trade partners. In particular, bilateral free trade agreements, starting with that between Costa Rica and Mexico in 1995, have yielded other tariff commitments and thereby eroded the commonality of the tariff protection originally ensured by the CET. The Central American countries do not have the same bilateral trade accords (see the table below). Note Costa Rica in particular, which negotiated tariffs bilaterally with Mexico, Chile and Canada. By 2002 the other countries of the subregion still had not concluded negotiations with Chile and Canada, although they had done so with Mexico. In practice, this means that Costa Rica applies the CET to fewer trade partners than do the other Central American countries.

Agreements in Force	Date
Central American Common Market El Salvador, Guatemala, Honduras and Nicaragua Costa Rica	 1960 1963
Mexico-Costa Rica free trade agreement	1995
Mexico-Nicaragua free trade agreement	1998
Mexico-Guatemala, El Salvador, Honduras free trade agreement	2001
Panama-El Salvador free trade agreement	2002
Panama-Honduras free trade agreement	2002
Dominican Republic-Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica free trade agreement	2001 and 2002
Chile-El Salvador free trade agreement	2002
Chile-Costa Rica free trade agreement	2002
Canada-Costa Rica free trade agreement	2002

Even when the Central American countries have negotiated jointly, as they first did with the Dominican Republic and, in 2003, with the United States, the outcome has generally been an accord in which norms are harmonized but tariff concessions are negotiated bilaterally in light of each country's peculiarities and sensitive products. Still to be assessed is the exact degree of divergence in tariff lines that the Central American countries have not harmonized towards

5 Data provided by SIECA.

partners with which they have concluded free trade agreements. Since a growing share of Central American trade with the rest of the world is governed by free trade agreements, and especially in light of the conclusion of free trade negotiations with the United States (the source of about 40% of Central America's total imports), these exceptions could be even more important than the non-harmonized tariff lines of the CET.

In sum, the lessening of protection stemming from the gradual decline in the CET rates indicates a gradual reduction in the degree of preference granted to intra-subregional trade. In the 1990s, moreover, this preference was eroded further as a result of the bilateral trade agreements that the Central American countries concluded with third countries. The foregoing circumstance means that extra-subregional goods gain ground in Central American demand to the extent that the decline in protection is not offset by greater competitiveness in subregional supply. To the extent that this has been matched by higher export volumes, it could indicate that the subregion's export supply has become more competitive.

Customs administration

In recent years, Central America's customs services have been modernized, a process reflected in better means of controlling goods, as well as in the streamlining of procedures and the movement of goods between countries. In addition to such advances at the national and bilateral levels, other progress on customs administration is reflected in joint customs projects that could be replicated later, and the drive for a draft Single Manual on Customs Procedures. Moreover, the Central American Uniform Customs Code (CAUCA) has been expanded, and some of the systems of its implementing regulation (RECAUCA) have been broadened. National legislation governing special customs regimes have been standardized. Improvements have also been made to the procedures governing the movement of cargo transport, the operation of duty-free shops, baggage handling, and the admission and departure of tourists.

There are now four models of customs administration. These are designed to address different ways of managing the subregion's trade and are geared towards the gradual establishment of a customs union in which all goods consumed (not just produced) in Central America move freely throughout the subregion. Efforts are being made to bring about a convergence in levels of tariff protection. The following models of customs administration have been set up: (i) integrated; (ii) juxtaposed; (iii) trinational; and (iv) peripheral.

Integrated customs comprise two countries that form part of the same customs territory, sharing a single office for customs procedures. Juxtaposed customs are similar, but in this case there are different offices for each sovereign jurisdiction. They coordinate their activities and apply complementary customs procedures, preferably using electronic means of communication. By 2003 the main customs between Guatemala and El Salvador were integrated or juxtaposed. This provides significant impetus to the movement of goods and people, since the two countries are important players in the integration process.

In trinational customs, the services of three countries converge in a single building. Procedures for handling goods entering or leaving the territory of one of the countries are uniform, coordinated and continuous. An example of this kind is the Peñas Blancas customs service on the Nicaragua-Costa Rica border, where Honduran, Salvadorean and Guatemalan delegates are present.

None of these customs "models" is the kind required for a true customs union, one that would allow the free movement of goods consumed in Central America. The peripheral model, by contrast, concerns administrative services located on the edge of the common customs territory. Uniform customs regulations and procedures are applied here. Once the goods have been processed they can move freely in the common customs territory of the countries in the customs union. This kind of customs is what is required, strictly speaking, to set up a customs union. Such customs have not yet been established, although a start has been made in setting up peripheral customs in various Guatemalan customs offices. Salvadorean and Honduran delegates are present to monitor or pre-check imports destined for El Salvador or Honduras.

Regulations on trade norms

The most recent stage of economic integration since the 1990s has gradually spawned a series of norms applicable to trade in goods and services, as well as to intra-subregional investment. These norms take the form of the following regulations, which have been approved by the Central American governments:

(i) origin of goods;

(ii) safeguard measures;

(iii) unfair trade practices;

(iv) international terrestrial customs transit regime;

(v) standardization measures, metrology and authorization procedures; and

(vi) sanitary and phytosanitary measures and procedures.

In general these regulations, approved by the Central America economy ministers, have helped focus attention on norms as determinants of intra-Central American trade. These norms have become a general framework that guides the harmonization of regulations or their interpretation according to agreed criteria. In general they are not the kind of norms that serve to appraise specific situations. An example of this is the regulation on rules of origin, which does not feature specific norms on trade in textiles. Nonetheless, Central American working groups have made gradual progress on harmonizing some technical norms, using those regulations as a frame of reference.

Infrastructure

Studies on degrees of readiness to tackle globalization offer benchmarks for assessing the subregion in this regard. The methodology recommended by ECLAC in this field uses the following variables to estimate the conditions of infrastructure:

- number of telephone lines per 1,000 inhabitants;
- kilometers of paved road per million inhabitants;
- consumption of residential electricity (kw/hour) per inhabitant.

The studies in this area[6] reveal substantial progress on infrastructure, especially relative to readiness in other areas. It should be noted that most of the countries undertook significant economic reforms in the 1990s, entailing privatization and foreign investment-attraction. It can be supposed that this led to better resource-allocation in important areas of infrastructure, such as telecommunications, and highway and electricity concessions.

In this field, taking 100 as an optimal performance, the trends in the indicators for each of the Central American countries are as follows:

TABLE 10

Costa Rica		El Salvador		Guatemala		Honduras		Nicaragua	
1999	**2001**	**1999**	**2001**	**1999**	**2001**	**1999**	**2001**	**1999**	**2001**
80	93	20	60	20	40	20	40	40	27

These indicators reveal substantial progress in El Salvador, Guatemala and Honduras since 1999, when circumstances were highly adverse. Conditions in Costa Rica also improved, while the infrastructure situation in Nicaragua declined somewhat.

The Plan Puebla-Panama, launched by the Central American presidents in San Salvador in June 2001, has also moved forward. The Plan is regarded as a mechanism for coordinating the implementation of joint projects in an adaptable and flexible institutional framework. More strategically, the PPP was conceived as a forum for various institutions to build consensus in matters of crucial importance for the subregion.

To that end, various initiatives were devised in areas that will enhance the subregion's insertion into a globalized world. The areas are as follows:

- energy interconnection;
- transport integration;
- telecommunications initiative;
- facilitating trade and boosting competitiveness;
- human development;
- sustainable development;
- prevention and mitigation of natural disasters; and
- tourism.

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[6] According to the 1999 and 2000 Human Development Reports presented in the report on the State of the Region (1999) each Central American country undertook such studies, which were analyzed with greater regional detail in the latter report.

The PPP is based on the existing trade accords, and on others now under negotiation. The strategy centers on the need to foster the infrastructure of the large subregional projects that Central America requires if it is to tackle globalization and promote the competitiveness of the subregion's economies. The Central American cooperation agenda also includes human development, sustainable development, and the prevention and mitigation of natural disasters (*http://www.iadb.org/ppp*).

One of the PPP's most ambitious initiatives concerns transport. A basic subregional institutional structure has already been set up in this field, the thematic cores of which are the regulations to be applied and coordination among the relevant ministries so as to ensure the continuity of the planned corridors (Pacific and Atlantic), as well as the complementary branches and connections. Financing has already been approved and other funding is being negotiated, mainly with the Inter-American Development Bank. Phases I and II of the various sections in the Pacific and Atlantic corridors are expected to be approved in 2004 and 2005.

In the area of highways alone, the cost estimate (according to different work programs of the officials working on the Plan) is US$4,321. More than 60% of the investment is now assured, and the Pacific corridor is wholly financed. One of the most novel tasks of the Central American Transport Initiative consists of securing not only the pending financing but also of attracting private investment for road-building. To a large extent this is related to the modernization of ports and airports, border crossings, and security-related regulations and preventative activities in the area of cargo transport. The Plan also covers trade facilitation initiatives and enhancing competitiveness. It is linked to, and coordinated with, the Secretariat for Central American Economic Integration (SIECA), the International Regional Organization for Plant and Animal Health (OIRSA) and the Central American Institute of Business Administration (INCAE)

As regards the Mesoamerican American Energy Initiative, the Plan Puebla-Panama brings together and seeks to strengthen the institutional and infrastructure-related achievements of SIEPAC, mainly by fostering electrical interconnection between Mexico and Guatemala, as well as by creating a regional institutional apparatus featuring a regional regulatory body, a regional operating agency, and the company that owns the network.

In the area of tourism, progress has been made on strengthening airport security, drawing up the Mundo Maya project, and preparing the Caribbean Route tourism initiative. The challenges here are in the field of ethnotourism, as well as the certification of tourism sustainability.

Finally, as regards sustainable development, the main projects planned are as follows:

- Trifinio Project, with a planned investment of US21.8 million;
- environmental protection in the Gulf of Fonseca, with a planned investment of US$16 million;
- environmental protection in the Gulf of Honduras, with a planned investment of US$19.1 million;
- sustainable development project in the binational Sixaola Basin, with a planned investment of US$9 million; and
- a project in the San Juan River Basin, which thus far lacks an overall cost estimate.

To date, the achievements in the area of sustainable development comprise the signing of the initiative's Memorandum of Understanding, as well as a Memorandum of Understanding on Rural Development. Hence the future challenges consist of fostering the initiative's various projects. In the field of human development there are memoranda of understanding on education, health and human development, as well as a project on the prevention of HIV/AIDS in migrant populations, and another on the prevention of contagious diseases.

The regional institutional framework[7]

Formally, Central America has an institutional integration system that was reformed following the Esquipulas II Agreement in 1987. It consists of the following:

- the Central American Parliament (PARLACEN) was created in 1986 and inaugurated in 1991, when its first plenary assembly was held;
- the Central American Integration System (SICA) was created in 1991, as explained below;
- the Alliance for Sustainable Development (ALIDES) was signed in 1994 to guide overall development, taking account of the environmental dimension;
- presidential summits have become the political engine of the integration process, despite the fact that their operation and implementation have not been in full accord with the speed and intention of the resolutions adopted; and
- the participation of new countries, including Panama, Belize and the Dominican Republic, in presidential fora or other bodies such as the PARLACEN, and the presence of other countries (as well as Mexico, Argentina, Taiwan and Spain) in the provision of capital and decision-making in the Central American Bank of Economic Integration (BCIE).

The activity of the presidential summits has been especially noteworthy. The table below shows the range of issues considered in the summits and the variety of matters entrusted to the integration institutions, jointly with the institutions of the Central American countries.

The following bodies were set up as part of the Central American Integration System, which is entrusted with carrying out the tasks of integration:

- Meetings of Presidents, known as summits;
- Council of Ministers;
- Executive Committee and General Secretariat; and
- technical secretariats (grouped into three basic subsystems: economic, environmental and social).

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[7] This study is based on Chapter 4, Desafíos de la Acción Regional, in the Segundo Informe sobre Desarrollo Humano en Centroamérica y Panamá, PNUD [2003a].

TABLE 11
CENTRAL AMERICA: PRESIDENTIAL SUMMITS AND ISSUES ADDRESSED, 1998-2002 [(a)]

Summit (place and date)	Issues addressed
Granada, Nicaragua (June 20, 2002)	Migration, Central American customs union.
San Salvador, El Salvador (March 24, 2002)	Democratic governability, free trade with the United States, the Argentine crisis, terrorist attacks in Peru and Colombia
Managua, Nicaragua (February 27, 2002)	Amendments to the Tegucigalpa Protocol, amendment to the Guatemala Protocol
Copán, Honduras (January 27, 2002)	Relaunching the integration process, FTA with the United States, economic development linked to the Plan Puebla-Panama
Zamorano, Honduras (September 19, 2001)	Terrorism, security, support to the United States following the September 11 attacks
Guatemala City, Guatemala (August 31, 2001)	Oil price increase, Plan Puebla-Panama, peace process
Pochomil, Nicaragua (March 30, 2001)	Security, peace, situation in the Gulf of Fonseca
Guatemala City, Guatemala (October 19, 1999)	Natural disasters, education and culture, consultation mechanism
Tegucigalpa, Honduras (February 4, 1999)	Strategy with the United States for post-Mitch reconstruction
Comalapa, El Salvador (November 9, 1998)	Hurricane Mitch and reconstruction
San Salvador, El Salvador (February 4, 1998)	Central American integration issues and reform

Note: (a) Agreements include declarations, joint communiqués, aides memoire, amendments and protocols.
Source: SICA, 2002.

The three basic subsystems consist of SIECA, founded in 1960; the Central American Commission on the Environment and Development (CCAD), founded in 1989; and the Secretariat of Central American Social Integration (SISCA), founded in 1995.

These subsystems also bring together a complex array of bodies, especially those related to ministries, specific committees and agencies that cover a wide range of activities in the areas of infrastructure, economic policies and social issues. This is the case of the Council of Health Ministers (COMISCA), the Central American Educational and Cultural Coordinating Body (CECC), the council of Transport Ministers (COCATRAM), and bodies such as the Central American Monetary Council (CMCA). The latter brings together the subregion's central banks and its main goal is to obviate macroeconomic disequilibria that hamper integration.

The progress made by these bodies has depended on the dynamism of their members and on the pressures exerted by the economic environment, as well as on the mandates conferred by the Central American presidents. The three secretariats mentioned above had a certain momentum in a particular period, even when their activities were still largely subordinate to the individual decisions of Central America's executive bodies. The foregoing is exemplified by a case such as SIECA's role in bilateral and multilateral trade negotiations, whereby it became a support agency to the relevant ministry and served as a locus of regional financial cooperation.

In the period considered here, SISCA and CCAD have lost momentum and leadership in the area. They have become bodies that organize technical meetings and drive forward regional consultancy projects, rather than policy- and decision-making agencies in the areas under their aegis.

B. National Economic Policies as Determinants of Economic Interdependence

The context of austere macroeconomic policies in each of the Central American countries (see the first part of this report), with restrictive monetary policies, has obviated the risk that excess aggregate demand in one country would spur a sudden rise in imports, including those from within Central America. Hence significant increases in trade deficits have been avoided, even though some countries have posted wide trade gaps. In these circumstances, intra-regional trade has been determined essentially by the rise in income and, to a lesser extent, by shifts in relative prices arising from changes to exchange rate policy, as well as geographic proximity and the trade preference stemming from the integration agreements.

Several studies have shown how intra-Central American trade depends on these factors. A first determinant arises from the relationship between the countries' real exchange rates. Since most goods traded in Central America are industrial products with a high elasticity of demand relative to price, these changes in relative prices have a substantial effect on trade. According to the estimates of the Secretariat of the Central American Monetary Council for recent years, variations in the real exchange rates between the Central American countries partly explain some of the variations in Central American trade.[8]

Although national exchange rate policies have varied in recent years, however, they have not had any great differential impact. In January 2001, El Salvador enacted the Monetary Integration Law, allowing both the colón and the dollar to circulate, but in practice the law meant the complete dollarization of transactions and official accounts in US dollars. Costa Rica and Nicaragua have applied very similar systems of pre-announced mini devaluations, while Guatemala has had a flexible system with limited participation in the market. In Honduras, currency has been sold publicly at auction within a band of more or less 7%. This is modified by the central bank every five auctions, taking into account the difference between internal and inflation and that of the country's main trading partners, as well as the trend in those countries' exchange rates relative to the dollar.

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[8] According to the General Secretariat of the Central American Monetary Council, evidence of a linear link prompt the conclusion that exchange rate policies have not constrained the volume of intra-subregional trade, since the signs of the linear relationship between the variations in the exchange rate and trade are positive in all cases. In other words (and without this being a sufficient explanation of trade in the years studied), the greater the devaluation, the more trade grows The results of the Central America Monetary Council can be summarized as follows:

(a) In Costa Rica the linear association is significant with an R^2 of 82%.

(b) En El Salvador there is no significant association between the exchange rate and exports.

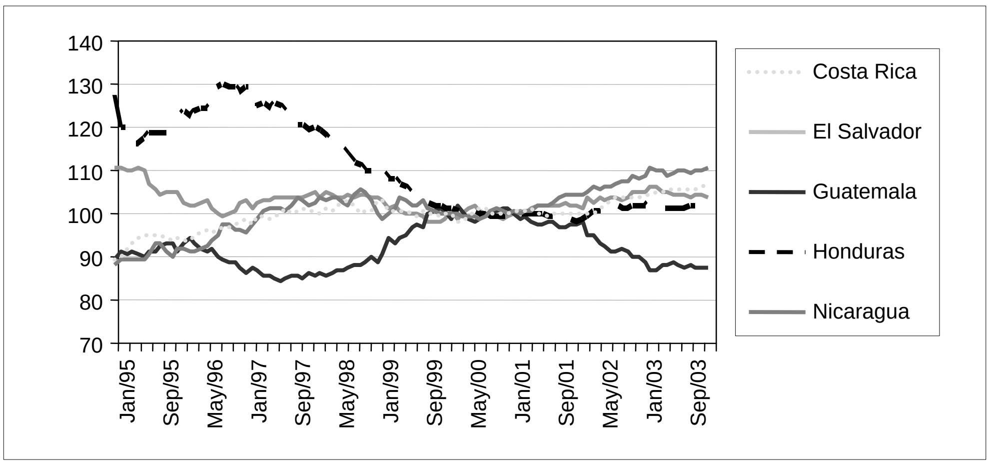
(c) In Guatemala the association is significant with an R^2 of 82%.

(d) In Honduras it is significant with an R^2 of 71%; and

(e) Nicaragua has a significant association with an R^2 of 90%.

As a result, Costa Rica's real exchange rate has tended to depreciate slightly. Guatemala's has tended to appreciate, but to do so in cycles, partly the result of the system of controlled free floatation. Honduras's exchange rate depreciated at the beginning and tended to stabilize after May 1999, while Nicaragua's has tended to depreciate over time. El Salvador's exchange rate has been fixed since 1994, but inflation has been controlled and is in line with rates in developed countries. This has allowed El Salvador to maintain a real rate that has been essentially static in recent years. These circumstances have mainly favored exports from those countries with a greater tendency to real currency appreciation, although the absence of any great differences has meant that the impact of these policies has not been particularly important.

FIGURE 4
CENTRAL AMERICA: THE SUBREGION'S REAL EFFECTIVE EXCHANGE RATE INDEX



Source: Secretariat of the Central American Monetary Council.

Traditionally, additional determinants of intra-Central American trade have been variations in income, reflected in variations in GDP, as well as geographic proximity (measured by the distance between the capital cities, for example) and the trade preference conferred by the commitment to allow Central American products to move freely in the subregion.[9] The most recent evidence confirms the importance of these factors, but also suggests that the regional preference is ever less significant. This is consistent with the decline in protection offered by the CET, and the fact that other countries (Mexico, the Dominican Republic and, soon, the United States) have been granted free trade treatment equivalent to that in force among the Central American countries.

The above suggests that intra-Central American trade and the subregion's general economic interdependence (reflected in other flows of direct investment, financial capital and labor) are ever less dependent on integration instruments designed to ensure a preference by protecting the subregional market. It also suggest the need for alternative integration instruments that help raise the international competitiveness of the subregion as a whole.

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[9] "Gravity" models tend to confirm the importance of these factors in Central America. See CEPAL [1995] and CEFSA [2003].

D. Investment and Integration

The growth of Central American investment in the subregion, and in other countries in the vicinity, provides more evidence of the increasing diversification and consolidation of the Central America-based production of goods and services. When the Central American Common Market (CACM) was set up in 1960 there was a surge in the establishment of transnational companies in the subregion but, initially, national firms with a regional focus (or with investments in the other countries) emerged only slowly. There were some cases of Central American firms that adopted a regional outlook from the outset, but it was only from the 1980s onwards that their productive presence increased significantly in Central America and other countries, with substantial levels of intra- and extra-subregional exports.[4]

In other cases, national firms have gradually extended their activities to other countries of the region, first with exports and later with investment. In many cases these activities have been fostered by the growing presence of foreign firms that also export to and invest in the subregion, a consequence of the economic opening that the countries embarked on in the mid-1980s. Examples of this are textiles, pharmaceutical products and white goods, and the same phenomenon is becoming apparent in the carbonated beverage and beer sector.

In addition, some transnational enterprises have consolidated their production and distribution, including large firms that concentrated their administrative services for the whole of the Americas in Costa Rica. The agricultural sector, which in the past was not one of those with any great role in Central American integration, has also undergone increasing internationalization, most evident in investments by Guatemalan firms in sugar production and refining in the rest of Central America.

Finally, and in keeping with the new features of Central America's external insertion as mentioned earlier, the regional expansion of investment in services has been particularly marked. This includes the establishment of supermarkets and household shops in all the countries of the subregion by firms from Guatemala and, to a lesser extent, El Salvador and Costa Rica, with a tendency to form conglomerates of Central American capital. In the financial sector, too, there has been an upswing in the regional and extra-regional presence of Nicaraguan, Salvadorean and Guatemalan financial groups, and there is fierce competition for the subregion's main corporate clients, despite distinct national laws in this field.

In the tourist sector, an airline originally financed with Salvadorean capital was consolidated as a single company as a result of a merger between pre-existing national firms. Its activities now cover the whole of the Americas. There has also been the spread of hotels, shopping centers and restaurants, some of them with investments in other countries, and there is the incipient but growing development of professional services related to insurance counseling, advertising and legal services. In another area, but still related to services exports, there has been very substantial migration from Nicaragua to Costa Rica. This amounts to another form of economic interdependence, one that prompts significant flows of remittances from Costa Rica to Nicaragua.

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4 Aitkenhead [2003] reviews and classifies various cases of foreign investment in Central America. This section is based on information in that source.

CHAPTER IV. THE POLITICAL, ENVIRONMENTAL AND SOCIAL DIMENSIONS OF INTEGRATION

Contents

A. The Presidential Summits

As mentioned earlier, the presidential summits are supreme in the institutional hierarchy of joint decision-making in Central America. Nonetheless, the diversity of issues and undertakings stands in contrast to the degree of concrete action in those same areas, especially as regards problems as varied as the subregion's vulnerability, the customs union, terrorism and regional security, the Plan Puebla-Panama, and free trade with the United States.

As the following table shows, between 1991 and 2002 there were 31 presidential summits.

TABLE 12
NUMBER OF PRESIDENTIAL SUMMITS, PARTICIPANTS AND OUTCOMES (1991-2002)

Year	Meetings	Declarations	Legal instruments	Number of participating countries
1991	2	3	1	6 (1)
1992	2	11	4	6
1993	1	2	5	6
1994	4	10	4	8 (2)
1955	2	9	4	7
1996	1	3	4	7
1997	2	6	4	8
1998	4	4	1	8
1999	3	7	1	8
2000	2	2	0	9 (3)
2001	4	3	0	8
2002 (4)	4	8	2	8
Total	31	68	30	

Notes: (1) Including Panama; (2) including Belize, Panama and the Dominican Republic; (3) including Mexico in the framework of the Tuxtla Dialogue; and (4) to July 2002.

Source : SICA, 2002.

Note the large number of declarations, as well as the different legal instruments to be ratified in each country and transposed into domestic regulations in various spheres of economic, social and political life. The following table summarizes and classifies the issues addressed and their relation to each of the summits.

Prominent are issues directly related to current conditions in Central America, such as democratic governability, terrorism and security, and natural disasters (like Hurricane Mitch), as well as famine and social vulnerability. The latter issues gained prominence following the famine among people in marginal areas affected by external shocks (natural disasters and the coffee crisis), in conjunction with the longstanding process of environmental damage and the gradual deterioration of their various productive patterns.

TABLE 13
CENTRAL AMERICAN PRESIDENTIAL SUMMITS AND THE ISSUES ADDRESSED (1998-2002)

Issues addressed	Summit (place and date)	Number of agreements (1)
Migration, Central American customs union	Granada, Nicaragua (June 20, 2002)	2
Democratic governability, free trade with the United States, the Argentine crisis, terrorist attacks in Peru and Colombia	San Salvador, El Salvador (March 24, 2002)	4
Amendments to the Tegucigalpa Protocol, amendment to the Guatemala Protocol	Managua, Nicaragua (February 27, 2002)	3
Relaunching the integration process, FTA with the United States, economic development linked to the Plan Puebla-Panama	Copán, Honduras (January 27, 2002)	1
Terrorism, security, support to the United States following the September 11 attacks	Zamorano, Honduras (September 19, 2001)	1
Oil price increase, Plan Puebla-Panama, peace process	Guatemala City, Guatemala (August 27, 2001)	1 (press release)
Security, peace, situation in the Gulf of Fonseca	Pochomil, Nicaragua (March 30, 2001)	1
Natural disasters, education and culture, consultation mechanism	Guatemala City, Guatemala (October 19, 1999)	4
Strategy with the United States for post-Mitch reconstruction	Tegucigalpa, Honduras (February 4, 1999)	1 (aide memoire)
Hurricane Mitch and reconstruction	Comalapa, El Salvador (November 9, 1998)	1
Central American integration issues and reform	San Salvador, El Salvador (February 4, 1998)	1
Famine, social, political and nutritional vulnerability,	San José, Costa Rica (December 2002)	Various mandates to SISCA and the agriculture ministers

Note: (1) Agreements includes the following: declarations, joint communiqués, aides memoire, amendments and protocols.
Source : SICA, 2002.

The problems involved in follow-up, and in putting the declarations into effect, stem from the weakness of the subregion's institutional apparatus, among other factors. In this respect it seems that one of the main obstacles has been the difficulty of linking the jurisdictions and responsibilities of regional-level bodies with the individual decisions of the Central American governments. This matter is reflected in SIECA's logistical and informative role in the most important free trade and multilateral negotiations, especially those with the United States, although SIECA has do direct involvement in the most significant decisions. This circumstance has prompted discontinuities that have complicated basic consensus-building at the regional level and have given greater primacy to national positions and policies, without creating channels and opportunities to make further progress on the kind of convergence that gives rise to joint positions.

In economic matters the summits' agenda has centered on the customs union. Some progress was made in this area in 2002, although it is still not clear if the countries will be able to comply with the medium-term work program because of the obvious priority accorded to the free trade negotiations with the United States. In March 2001 the presidents approved an action plan that made provision for further progress on trade regulations (dispute settlement, Central American agreement on services and investment), tariff harmonization and free trade, as well as various trade negotiations (the FTAA, negotiations with the United States, the WTO), trade facilitation and the customs union. In practice, albeit not necessarily in the presidential declarations, in 2003 the free trade negotiations with the United States took time, energy and political capital that was detrimental to the customs union.

The most recent presidential declarations evince concern for social matters, especially the San José Summit (December 2002), which referred to the famine, social vulnerability and the need for a new policy on nutrition. In that summit the presidents approved the "Strategic Framework to Address Food and Nutritional Insecurity Attendant on Drought and Climate Change". The framework was drawn up by the Social Integration Council (CISCA), whose activities were revived after several years in which its profile had been low.

That same year the presidents approved a Tourism Action Plan, whereby the various agencies responsible for this field in each country have been asked to draw up a list of concrete projects covering activities that link tourism potential and cultural interest in the subregion. Also approved was an Agricultural Action Plan to address climate change. This is an area in which the countries have been working separately, with a view to devising work programs related to the Kyoto Protocol. This Action Plan was drawn up by the Central American Agricultural Council.

Other medium- and long-term issues concern the approval of a regional agenda for seven priority areas:

- regional conglomerates and competitiveness;
- trade policies and international negotiations;
- agricultural health and food safety;
- management of technological innovation;
- agricultural environmental management;
- reducing vulnerability; and
- rural development.

B. Proposals and Activities in the Social Arena

Since 1997, the Social Integration Subsystem (SISCA) has featured a Social Integration Agreement. The technical secretariat responsible for putting it into effect, however, has had problems in consolidating itself. A first attempt was made to institutionalize the social integration system in the first half of the 1990s, when the Social Integration Agreement was approved. Moreover, efforts were made to institutionalize technical and ministerial meetings under the coordination of the regional social cabinets, as well as the various meetings held and commitments undertaken by the subregion's first ladies.

In recent years, on the basis of the summits mentioned, and with the proliferation of initiatives on the part of consultative groups, sectoral ministerial meetings and the Plan Puebla-Panama, the social subsystem assumed new commitments such as that related to food and nutritional security. In the social arena, recent summits have displayed renewed concern to offset the effects of economic adjustment in the wake of the liberalization of the subregion's economies. More recently, they have focused on the future impact of the free trade agreement with the United States on different sectors and localities.

In line with this kind of strategic thinking, the San José Declaration addresses SISCA's new responsibilities on the basis of the following guidelines:

- sustainable development strategies are reconsidered and targeted on culture and tourism;
- attention is paid to the effects of economic recessions, economic and commercial phenomena, and climatic vulnerability; concern in this area centers on the loss of sources of job-creation and on Central Americans' quality of life;
- culture is viewed as a core element of the Central American Integration System;
- tourism and culture are conjoined under the notion of sustainability and the protection of cultural display;
- a commitment to comply with the principles and protection of cultural displays;
- a commitment to comply with the principles enshrined in the United Nations Convention on the Rights of the Child, as well as its legal frameworks, programs and services;
- the relevant authorities are instructed to devise a strategy to promote the subregion as a multi-destination center of tourism and culture, by systematizing and integrating a "Central American tourism and cultural corridor" that includes tourist and culture-related itineraries, tours and maps;
- the agencies responsible for issues related to children and youth in the subregion are instructed, on the basis of the Convention on the Rights of the Child, to implement the UN proposal as advanced at the Child Summit and the Ibero-American Agenda agreed upon in Bávaro, Dominican Republic;
- instructions have been given to adopt the "Strategic Framework to Address Food and Nutritional Insecurity Attendant on Drought and Climate Change", as drawn up by the Social Integration

Council. That framework includes the Agricultural Action Plan to deal with the effects of climate change, drawn up by the Central American Agricultural Council (CAC).

In addition to the obligations that the countries assumed to meet the targets set by the Millennium Summit, the institutional structure of social integration (SICA, 2001) established a set of goals in the area of social development in the subregion. Some of those goals coincide with those of the Millennium Summit, although the date for meeting them is 2010 rather than 2015. The most important targets in this respect are:

- reduce extreme poverty by 50%;
- reduce illiteracy to 10%, and increase the rate of primary schooling to 95% and secondary schooling to 75%;
- attain 100% coverage in basic healthcare;
- reduce child and maternal mortality to less than 50% of the figures recorded in 2000;
- keep the subregion free of polio and eradicate measles;
- 100% rural coverage of safe water services and basic sewerage;
- cover the vegetative growth of demand through annual construction of social housing;
- devise plans to order and regularize land tenure in the subregion’s 10 most populated municipalities;
- enable all families to acquire healthy, and safe food at reasonable prices;
- strengthen foodstuffs with vitamin A, iodine, fluoride and iron; and
- comply with international agreements on gender, children, labor, population, migrants and indigenous peoples.

C. The Environment and Integration

With the advent of peace in Central America, in 1994 the subregion’s presidents agreed on the Alliance for Sustainable Development (ALIDES). This is an ambitious effort at economic and social development that has made only modest progress towards attaining its goals. ALIDES consists of a series of commitments in the area of social development and employment, as well as obligations in the field of the environment, including the rational use of renewable energy sources, support for research into and the development of clean technologies, a drive for environmental quality in export products, and the use of sustainable production processes.

The environmental goals of ALIDES have been included slowly in each country’s environmental agenda. They are as follows:

- harmonize and update environmental parameters, legislation and the national institutions responsible for this issue;
- reduce the levels of air, water and soil pollution that affect quality of life;
- safeguard, understand and use the subregion's biodiversity, promoting (among other things) the development of biological corridors and protected areas, biodiversity centers and biological gardens;
- enhance capacity to regulate, supervise and apply environmental norms, as well as to classify environmental crimes;
- foster awareness among society, as well as its participation, by including environmental matters in formal and informal education systems;
- consistently reduce the pace of deforestation, and at the same time promote reforestation and productive forestry activity at the subregional level;
- properly manage hydrographic basins to guarantee the various uses of water resources in quality and quantity;
- encourage subregional discussion of common policies on new and environmentally-friendly products, eco-labeling and environmental impact studies;
- foster sustainable development projects in border areas.

The ministers of the environment have held a series of meetings in the ALIDES framework. The most significant progress has been the institutionalization of their decisions and a modest start to the process of harmonizing environmental management policies and systems. International organizations such as UNIDO and UNEP have supported efforts to coordinate with chambers of commerce, with a view to raising awareness of clean technologies. The Central American secretariat entrusted with this task (CCAD) has worked to strengthen the technical committees and has promoted projects such as the Central American biological corridor, the Mesoamerican Reef System, and management of the Gulf of Fonseca.

CCAD's activities have expanded with the start of operations under the Plan Puebla-Panama, and the ministers of the environment have asked that terms of reference be drawn up for environmental impact studies. These will govern the formulation and implementation of regional projects under the framework of the Plan. The BCIE and the IDB have provided final support for projects geared to the environmental management of shared hydrographic basins in border municipalities.

As with social investment, the interaction between economic, social and environmental policies necessarily involves a marked effort on the fiscal side. This has not been made with the coherence required, and nor has it been accorded the proper priority. ALIDES makes provision for a Central American Environmental and Development Fund, but the environmental subsystem has not moved forward in establishing the Fund, since doubts persist about how it will work in the absence of counterpart financing.

CHAPTER V. NEGOTIATION OF THE FTA WITH THE UNITED STATES

Contents

A. Background: Towards Full Reciprocity

In 1964 the first United Nations Conference on Trade and Development, which was institutionalized as a high-level forum with its own secretariat, acknowledged the need for developing countries to benefit from "special and differential" treatment in view of the asymmetries of international trade relations. This treatment was included in the GATT - forerunner to the World Trade Organization - in Article XXXVI of Part IV, which recognizes that when developing countries participate in trade negotiations they should not have the obligation to make concession to developed countries. A concrete manifestation of this principle was the Generalized System of Preferences (GSP), through which the developed countries granted non-reciprocal tariff concessions to the developing countries.

As a result of the agreement, the United States unilaterally gave the Central American countries tariff concessions that form part of the GSP. This had limited product coverage but confined its eligibility requirement mainly to demands that Central American products comply with certain rules of origin. Acknowledging the geostrategic significance of Central America and the Caribbean, however, in 1983 the US government approved the Caribbean Basin Economic Recovery Act (CBERA). This initiative included not only a wider range of products that could benefit from preferences, but also incentives for US investment in the region. In parallel, a special system was set up to facilitate trade in textiles and *maquila* goods in general. These arrangements were consolidated in 2001 with the approval of the broader and more secure Caribbean Basin Trade Partnership Act (CBTP).

In parallel to the expansion of concessions under the CBERA and the CBTP, however, the eligibility conditions to benefit from these concessions or facilities were also widened, so as to entail, indirectly, greater reciprocity. These conditions included, in particular, meeting certain norms on the expropriation of US property, complying with regulations on labor, intellectual property and government procurement, and combating drugs trafficking. This trend was strengthened with the negotiation of the North American Free trade Agreement (NAFTA). The Mexican government set a precedent when it became the first developing country to agree to negotiate on the basis of strict reciprocity with developed countries.

These circumstances set the stage in 1997 for the Central American president to make the first moves towards the negotiation of a free trade agreement with the United States. Once the idea of full reciprocity was accepted, the US executive secured approval of Trade Promotion Authority, whereby the US Congress agreed simply to vote for or against the legislation (that is, without amending it) needed for free trade accords like the one proposed by Central America, which are negotiated by the executive, to enter into force.

B. Aims of the FTA

The US executive had three aims in pursuing an FTA with Central America: to promote US exports, to support democracy and economic reform in Central America, and to foster progress towards the completion of the Free Trade Area of the Americas (FTAA).[10] This was part of a policy towards the Western Hemisphere, one designed help strengthen democracy, promote the market economy, combat terrorism, ensure growth, and foster the economic, social and political stability of the countries of the Americas. In Central America, the aim was to eliminate specific barriers hampering US exports or investment, promote respect for labor norms and the rule of law, and set a precedent for the negotiation of the FTAA, especially in the areas of agriculture and intellectual property.

In the declaration issued at their San José Summit in 2002, the Central America presidents saw the FTA as an opportunity to export and attract investment while consolidating democracy and strengthening the rule of law.[11] The Central American position was underpinned by a desire to promote growth by building open economies, with free trade and greater competition, ensuring improved and stable access to the US market with clear rules and without discretional measures.

C. Negotiation of the FTA

The negotiations for the FTA between Central America and the United States began in January 2003 and ended with an accord between the United States and El Salvador, Guatemala, Honduras and Nicaragua in December of that year. Costa Rica reached agreement on January 25, 2004 after withdrawing temporarily from the talks because of differences that were resolved some weeks later. There were nine rounds of negotiations, held in each Central American capital and in cities in the United States, as well as three extraordinary meetings to discuss certain matters before the more complicated or sensitive negotiating rounds. In March 2004 the Dominican Republic acceded to CAFTA (Central American Free Trade Agreement), which included a clause allowing the country to form part of the FTA.

The Central American countries agreed to the establishment of six negotiating tables on market access, services and investment, government procurement and intellectual property, the environment and labor, dispute settlement and institutional matters. A committee on cooperation for trade capacity-building was also set up within the framework of the negotiations.

The talks involved government officials, as well as representatives of social and business organizations in what is termed the "side room". This allowed for the exchange of information, as well as some advice and lobbying. Although there was consultation with various organizations (a process that varied by country in intensity and scope), the negotiating issues remained very largely in the hands of government officials and the texts were only made public when the negotiations had concluded. The most sensitive issues were in the areas of textiles, agriculture and labor, as well as telecommunications and insurance in the specific case of the US-Costa Rican negotiations.

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[10] See "President Announces Step to Expand Trade and Create Jobs", comments of the chairman of the World Affairs Council, Organization of American States, January 16, 2002; and letters from Robert B. Zoellick to the House of Representatives (August 22, 2002) and the Senate (November 1, 2002).

[11] See presidential resolution on the Central America-United States FTA, Costa Rica, September 26, 2002, and the San José Declaration by the Central American presidents, December 2002.

D. Substance of the FTA

The US-Central America FTA is very similar to those that the United States has concluded recently with Chile, Singapore and Mexico. As the table below shows, the issue coverage and the chapter structure are very similar, albeit with some exceptions and differences. The CAFTA does not include chapters on the temporary admittance of business people, nor policies on monopolies, competition and state enterprises. Three issues are new or are more developed.

First, the chapter that seems more developed than in the other FTAs is that on intellectual property rights. This demands accession to a series of international agreements in this field, and in some cases includes shorter timeframes for compliance than do agreements between the United States and other countries, such as Chile. In the field of patents there is agreement to extend the timeframe for protection when the registration of patents is delayed by more than five years. Hence patent protection can last for more than 20 years, as laid down in the WTO's Agreement on Trade-Related Intellectual Property Rights (TRIPS). Copyright is protected for 70 years. As to plants, the proposal is to favor the granting of patents, although this is not mandatory.

Second, the agreement promotes streamlining in customs procedures and explicitly alludes to fostering transparency and the elimination of bribery and corruption in international trade and investment. The chapter on transparency includes a section on corruption similar to that in the FTA with Singapore. Finally, the accord recognizes the need for efforts to consolidate Central American integration, with clauses designed to avoid hindering the process.

CAFTA explicitly acknowledges differences in the development levels and economic size of the Central American countries relative to the United States. This is mainly evident in longer timeframes to reduce and eliminate tariffs or to comply with other obligations. Tariff-reduction will be undertaken using eight baskets. The first is the immediate elimination of tariffs and the longest will last for 20 years, longer than the maximum periods agreed with Chile (12 years), Mexico (15 years) and Singapore (10 years).

The tariff-reduction baskets are applicable to each country in line with the particularities of its development and with inter-sectoral differences. For the Central American countries, the maximum tariff-reduction period for industrial goods is 10 years, and CBERA's access benefits in the US market are consolidated and expanded. For textiles, the rules of origin agreed are contained in a special annex and are more detailed than in other agreements, such as the FTA with Chile. The procedures are similar to those proposed by the United States in other accords. In a limited manner, originating goods are taken to be those inputs imported by the NAFTA members, which broadened the options somewhat beyond the United States, although there is always the potential cost of trade diversion. The prospect of securing inputs from the beneficiaries of the Africa Growth and Opportunity Act and the Andean countries seems to have an importance more symbolic than real at the moment.

The maximum tariff-reduction period for agricultural goods is 20 years. Some products, mainly agricultural goods, are subject to quotas. White corn for human consumption is excluded from tariff-reduction in El Salvador, Guatemala, Honduras and Nicaragua, while potatoes and onions are excluded for Costa Rica. The United States excluded sugar from tariff-reduction, although with tariff-free quotas and with a mechanism for the United States to manage stocks.

A special safeguard mechanism has been set up. This can be applied by any country when imports surpass a certain level, and it might be important for sensitive products such as bovine meat, pig meat, poultry, rice, dairy goods and oils. Two kinds of safeguards have been established. One is bilateral, with a special annex that explains (unlike other FTAs signed by the United States) in detail how it is to be administered. The other is multilateral (considered in the WTO framework) and can be applied during the agreement's early years to avert serious harm to certain branches of production.

Government procurement includes purchases by central and subnational governments, with special emphasis on openness and, especially, on transparency and combating corruption. A special section on the need to prevent bribery and corruption distinguishes this FTA from previous accords. It is of note that the benefits of CAFTA are denied to countries that do not have diplomatic relations with any of the members, which seems designed to ensure that investment from Cuba cannot exploit the opportunities offered by the agreement. The few sectors in which there are no commitments to open up to investment include fisheries, transport and fuels.

The section on investment differs little from agreements such as NAFTA and the US-Chile FTA. In the area of services there are significant differences in the case of Costa Rica. The country will gradually open its insurance services to competition (those that it does not have to, as well as those that it does), as well as some telecommunications services, and will enact a law to modernize the Costa Rican Electricity Institute (ICE).

As regards labor and environmental issues, the commitments are confined to applying national legislation in each case. As in the FTA with Chile, the parties have agreed to impose a fine, to be paid by the governments, in cases in which this obligation is not met, as well as possible trade sanctions in the event of repeated non-compliance.

Finally, and as in the other FTAs pursued by the United States, there is no technical secretariat or permanent organization responsible for follow-up or for monitoring the FTA. There was simply an agreement to set up different mechanisms to favor cooperation or follow-up in the areas of labor, the environment, customs and dispute settlement. The parties also agreed to an Agricultural Review Committee and a Farm Trade Committee to assess the operation of the FTA and to foster cooperation among the parties to it. A Committee on Trade Capacity-Building was also set up.

Apart from the importance of these commitments for Central America's and the Dominican Republic's relations with the United States, they might also come to be applied among all the Central American countries and the Dominican Republic. This is a complex matter, for several reasons. One view is that this should happen because the extent to which these disciplines are formalized, and the degree to which they are applied, would be greater than now since the United States (regarded as more demanding in this matters) would be one the partners. There is also the view that, in some areas, Central America's current commitments are greater than those assumed with the United States (such as the number of products subject to trade restrictions), and that if the procedures agreed with the United States were to be applied to intra-Central American trade they would lessen the scope of trade liberalization already achieved in the subregion. It is further argued that the FTA is the outcome of a negotiation that takes account of US and Central American priorities, not solely those of the Central American countries and the Dominican Republic.

TABLE 14
CHAPTERS OF FTAs SIGNED BY THE UNITED STATES

Chapter	CAFTA	NAFTA	Chile	Singapore
Aims of the agreement and general definitions.	I, II	I, II	I, II	I
National treatment and market access: includes measures and timing for opening up goods trade in the agreement (the periods for reducing tariffs on the baskets of goods are included in annexes to these chapters).	III	III	III	II
Rules of origin: makes provision for specific percentages of raw materials that can be used in the production of a good for it to be considered as national and part of the agreement. Also includes mechanisms for administering such rules.	IV	IV	IV	III
Customs procedures: defines mechanisms for streamlining, standardizing and automating customs procedures, as well as for ensuring transparency and cooperation.	V	V	V	IV
Energy and petrochemicals: This was considered a sensitive sector in Mexico's case, and hence was addressed in a separate chapter.		VI		
Agricultural sector: A case similar to the energy sector.		VII		
Sanitary and phytosanitary measures: makes provision for the administration of regulations on the health of agricultural goods for human consumption, and for the creation of bodies for coordination, cooperation and certification.	VI	VII	VI	
Clothing and textiles: a sensitive sector for Singapore, and thus addressed in greater detail.				V
Technical barriers to trade: application of regulations on testing, labeling requirements, provisions on packaging, rules on marketing, certification, safety and so on.	VII		VII	VI
Emergency measures (safeguards). makes provision for measures to be applied to certain products in the event of an abrupt rise in imports of one product, so as to avoid the collapse of an industry by means of measures to protect the sector.	VIII	VIII	VIII	VII
Standardization measures: chapter on standardization in the three NAFTA countries.		IX		
Government procurement: provide access to bidders in public sector tenders.	IX	X	IX	XIII
Investment: rules to reduce or eliminate barriers to foreign investment, and national treatment for investors.	X	XI	X	XV
Crossborder trade in services: setting rules on trade in services.	XI	XII	XI	VIII
Telecommunications: agreements on treatment in this sector.	XIII	XIII	XIII	IX
Financial services: mechanisms on the liberalization of financial services, transparency, consultation among bank superintendents.	XII	XIV	XII	X
Policies on monopolies, competition and state firms: establishes the obligation to retain or adopt measures that ban practices inconsistent with free competition, and cooperation mechanisms in this field.		XV	XVI	XII
Temporary admittance of business people: allows people to enter the country for business purposes, so as to make investment, as well as trade in goods and services, effective; and facilities in the respective procedures.		XVI	XIV	XI
Electronic commerce: facilitate trade in goods and services through the Internet; no tariffs or discriminatory practices.	XIV		XV	XIV
Intellectual property: makes provision for an extensive chapter on intellectual property rights - including provisions on brand names and trademarks, Internet domain names, geographical indicators, copyright and associated rights, protection of satellite signals for encrypted programs and so forth.	XV	XVII	XVII	XVI
Labor: compliance with own labor legislation on basic labor regulations. These are defined in the text and are as follows: freedom to organize, collective bargaining, forced and child labor, and acceptable working conditions in terms of minimum wages, working hours and occupational health. Posits compliance with and ratification of ILO conventions.	XVI	(*)	XVIII	XVI
Environment: mechanisms to protect the environment and to avoid weakening legislation as a means of attracting foreign investment.	XVII (*)	(*)	XIX	XVII
Transparency: each country has to publish its general regulations and administrative resolutions, notify the other country of any measure that might have a substantial effect on its interests or the agreement, and answer the other country's questions.	XVIII		XX	XVIII
Administration of the agreement: defines the institutional structure for administering the agreement.	XIX		XXI	XIX
Publication, notification and administration of laws.		XVIII		
Review and settlement of disputes (antidumping and countervailing quotas).	VIII	XIX	VIII	
Dispute settlement: seek to resolve, in an effective, fluid, impartial manner that is consistent with the law, those disputes that affect trade relations in the area of agreed disciplines.	XX	XX	XXII	XIX
Exceptions and final provisions.	XXI			
Annexes: contained in various chapters and including sensitive issues in the negotiation of the agreement.				

Note: (*) Cooperation agreements were negotiated in this area.

CHAPTER VI. TOWARDS AN AGENDA FOR INTEGRATION AND EXTERNAL INSERTION

Contents

A. Deepening the Central American Preference

The preference for Central America products traded within the subregion has been eroded, and it is possible that a market-creation process might lead intra-Central American trade to be replaced by imports from extra-subregional partners (such as Mexico and the United States) with which FTAs are in force. In that context, efforts might be made to avoid further erosion using non-protectionist measures that enhance the efficiency of the supply of Central American goods and services by lowering transaction costs in the subregion.

More immediately, trade could be made more transparent and fluid by applying a set of harmonized norms, reflected in the regulations currently applied to intra-Central American trade. The effectiveness and efficiency of these regulations is still to be determined. Currently, there is a greater prospect of their being respected if the formal dispute-settlement system agreed upon by the five Central American countries in 2003 is applied. In practice, that mechanism could be an important means of lowering transaction costs in the subregion, by reducing uncertainty and bringing about lower costs than those arising from international litigation.

Also pending is a precise determination of the degree to which other technical norms should be harmonized at the Central American level, or whether it would be better to adopt international standards. The countries have begun taking steps to reach agreement on this matter. In some areas of the FTA, such as technical barriers to trade or sanitary and phytosanitary measures, the countries adopt the rights and obligations stemming from the WTO agreements. In other areas, such as company registration, it seems easier to harmonize the requirements of each Central American country.

Other measures to lower transaction costs in Central America are related to infrastructure, an area in which the projects planned under the Plan Puebla-Panama should be kept in mind. Additional measures could be designed at the national level, especially in the field of institutions and local economic development, as mentioned below.

B. Making the Customs Union Compatible with the FTA

Part of the debate on norms is related to the prospect that the Central American countries apply, among themselves, the rules agreed as part of the FTA with the United States. As mentioned, this might have the advantage of providing a set of rules with which there is greater pressure to comply, as long as the US government is willing to do this. A possible disadvantage, however, is that this might excessively formalize trade procedures that do not justify such agreements. It might even expand the number of instruments used for protectionist purposes, such as countervailing duties, antidumping measures, and the application to intra-subregional trade of rules of origin agreed upon with the United States, especially on textiles.

This study has already mentioned the problems involved in seeking both a CET and, simultaneously, a series of bilateral FTAs that offer different kinds of tariff concessions. To gauge the scope of this problem precisely, it would be useful to assess the extent of the difference in tariff concessions granted by each FTA. In many cases there will be a certain consistency, inasmuch as the concessions eliminate the applicable tariffs. If the degree of divergence is significant, it might be more realistic to pursue a single market, with a growing simplification and harmonization of rules, in tandem with the gradual dismantling of customs restrictions.

In view of the problems of triangulation that might arise from different tariff rates on imports from different sources (because of differences in the FTAs), one possible solution is to create joint, "peripheral" customs services. SIECA has proposed this, and already there have been some, albeit limited, experiences. As part of this process it would be useful, in the meantime, to make progress on modernizing existing customs, creating more "integrated" and "juxtaposed" customs so as to lower costs and strengthen the capacity of other tax-collecting agencies in each country.[12] Later, the countries will have to define the mechanism needed to distribute the revenues collected by the "peripheral" customs facilities among the Central American countries.

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[12] An important issue, to which ECLAC has drawn attention, is that the customs also collect internal taxes that other collection agencies are less able to oversee. If the customs were to be eliminated there would be a danger that the internal tax take would fall unless the other collection agencies were strengthened beforehand.

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