CENTRAL AMERICA: Economic integration shows progress

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Abstract

Central American integration process makes progress.

The application of an Association Agreement (AA) between the EU and Panama and the five members of the Central American Common Market (CACM) -- Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica -- in the second half of 2013 is having a direct impact on the regional integration process. The agreement was negotiated 'region-to-region', with Central America undertaking obligations as a bloc. Its implementation involves a commitment to establish a free-trade area not only with the EU, but also on an intra-regional basis (within CACM, and with non-member Panama). These commitments will test an integration economic scheme subject to important limitations.

Full Text

SUBJECT:Central American integration process makes progress.

SIGNIFICANCE:The application of an Association Agreement (AA) between the EU and Panama and the five members of the Central American Common Market (CACM) -- Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica -- in the second half of 2013 is having a direct impact on the regional integration process. The agreement was negotiated 'region-to-region', with Central America undertaking obligations as a bloc. Its implementation involves a commitment to establish a free-trade area not only with the EU, but also on an intra-regional basis (within CACM, and with non-member Panama). These commitments will test an integration economic scheme subject to important limitations.

ANALYSIS: Impacts.

With a weak regional institutional framework, the attainment of common objectives remains difficult.

Economic integration will be carried out at various speeds and without the existence of a clear 'leading group' of countries.

Erosion of the CET will continue until the tariff reduction periods under the FTAs are completed.

Non-tariff barriers will condition the expansion of intra-regional trade.

Limited liberalisation of intra-regional trade in services will not encourage Panama, an economy based on the services sector, to join CACM.

Compared with other Latin American integration schemes -- such as the Andean Community, the Common Market of the South and the Pacific Alliance -- the CACM has been relatively successful. Its focus has been on the construction of a regional customs union, and it has been capable of signing free-trade agreements (FTAs) with the United States and EU, Latin America's two major trading partners. Despite these achievements, the CACM faces numerous challenges.

Common market achievements.

CACM has scored a number of achievements:

Intra-regional trade. Except in 2009 -- when the international financial crisis erupted -- intra-CACM trade has experienced significant and steady growth. Such growth has been of better quality than its extra-regional trade, characterised by larger content of manufactured and agro-industrial products.

Intra-regional investments. CACM has helped attract new foreign direct investment (FDI) inflows, particularly of intra-regional origin. A growing number of domestic firms from CACM member states operate with a regional vision, taking the region as a starting-point for their production and marketing strategies (see CENTRAL AMERICA: Family businesses keep policy sway - July 24, 2013). This regionalisation of business groups within Central America is part of a real integration that is taking place outside the formal integration promoted by governments.

Regional infrastructure. To promote trade integration, CACM takes part in the so-called Mesoamerica Project. This regional initiative, launched in 2008, includes countries outside CACM (Belize, Colombia, Mexico, Panama and the Dominican Republic), and its two strategic axes are the development of these countries' physical interconnection and cooperation in promoting social progress. The project is facilitating the development of three basic areas of regional trade-related infrastructure: transport, energy and telecommunications. Financing from multilateral development banks -- especially from the Inter-American Development Bank and the Central American Bank for Economic Integration -- has become the main financial driver allowing CACM to take part in these infrastructure projects.

External dimension. CACM has managed to sign free-trade agreements with its two main extra-regional trade partners. These FTAs provide a more stable legal framework, and promote higher international standards for behind-the-border issues, all of which reinforces the region's ability to attract US and European investors. In the case of Costa Rica and Panama, the attractiveness has been broadened by the FTA signed with the European Free Trade Association (EFTA) in June 2013.

Non-economic achievements. The institutional framework of regional integration has contributed to the political rapprochement of the region's countries and to democratic consolidation. Likewise, it has been able to promote a regional security strategy to fight organised crime and drug trafficking (see CENTRAL AMERICA: Regional drug responses fall short - April 26, 2012).

Unresolved challenges.

However, continuing the integration process for Central America faces a number of challenges:

Fragility of political commitment. CACM member states lack a strong, sustained political commitment in favour of regional integration. Without this basic precondition, economic integration is unlikely to proceed rapidly.

Legal and institutional weaknesses. Since CACM adopted the principle of 'variable geometry', whereby member states can advance at different speeds and without commitments to ratify all the signed agreements, the bloc has faced a significant degree of legal incoherence. Likewise, decision-making is excessively concentrated on the Summit of Central American Presidents: an intergovernmental, rather than supranational, approach to institution-building.

Predominance of extra-regional trade. Despite growth in intra-regional trade, its share of CACM's total trade remains low (around 26%). This explains why Central American governments tend to prioritise extra-regional economic relations over the interests of the Central American integration scheme.

Distribution of costs and benefits. The relatively more developed members (Costa Rica, El Salvador and Guatemala) are in much better position to enjoy the benefits generated by CACM. There is no a suitable mechanism to alleviate intra-regional asymmetries (see CENTRAL AMERICA: Institutions challenge reform schemes - December 28, 2012).

Absence of a common trade policy. In accordance with the principle of variable geometry, Central American governments have tended to negotiate free trade agreements individually with their extra-regional partners. With the exception of the FTA signed with the United States (the CAFTA-DR) and the trade pillar of the AA signed with the EU, all the other FTAs have been bilateral. Even in the case of CAFTA-DR, negotiation of its essential components -- especially, the lists of tariff concessions -- took place country by country. A recent example is the FTA negotiated with EFTA, which was signed only by Costa Rica and Panama. El Salvador and Nicaragua did not take part in the talks, and Guatemala and Honduras suspended their participation owing to discrepancies over agricultural issues. The absence of a common trade policy has prevented CACM member states from taking advantage of regional bargaining power; this has also paralysed progress in the harmonisation of the common external tariff.

Lack of common customs administration.

Finally, progress in setting up a common customs administration has been minimal, especially as regards its fiscal implications (collection, administration and distribution of the government revenues coming from the CET). Progress in the enactment of regional customs legislation, on the other hand, has been significant, although homogeneous application in all Central American countries has not gone in parallel.

CONCLUSION: Future developments in the integration process will be compatible with the existence of an imperfect customs union, in which additional members will not participate. As of 2015, the establishment of electronic customs should facilitate intra-regional trade. As regards the common external tariff (CET), different tariffs will still be applied to the same imported product, depending on extra-regional origin. Multiple tariff collection for the same product in different countries will also persist. However, the agreement compels Central American governments to renounce multiple collection for all EU-originated products.

Details

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