

CENTRAL AMERICA INTEGRATION

WHAT'S NEXT?

THE INTEGRATION PROCESS
IN CENTRAL AMERICA

AND

THE ROLE OF THE EUROPEAN
UNION

1. Introduction

« Foreword », Christopher Patten, Commissioner for External Relations, European Commission

« Central America: integrating into the future » Rolando A. Guevara Alvarado, Ambassador of Panama and Pro-Tempore President GRUCA-Brussels

« Why this publication? », Francisco da Câmara, Director for Latin America, European Commission

2. EU-Central America Relations

« EU-Central America – Political, economic and cooperation relations », Elena Karadjova, Peter Versteeg, Federico Zorzan, European Commission

“The European Union’s regional co-operation strategy in Central America”
Philippe Combescot, Charge d’affaires, EC Delegation, Guatemala

3. Central American Integration : Institutional Reform, Economic Integration and Civil Society Participation

« The reform of the institutional framework: lessons and challenges », Oscar Santamaría, Secretary General of SICA-Central American Integration System

« Towards the Central American community », Augusto Vela Mena, President of the Central American Parliament

« Central American economic integration and institutional reform », Rafael Chamorro Mora, President of the Central American Court of Justice

« Economic integration: content, effectiveness and policy », Paolo Cecchini

« The challenge of the Central American customs union », Pedro Caldentey del Pozo, Executive Representative, ETEA Foundation for Development and Cooperation

« The problems and opportunities of the Central American customs union », Laura Quinteros de Aguilera, Director General of Integration and Trade of the Permanent Secretariat of the General Treaty on Central American Integration (SIECA)

« Prospects for the Central American customs union », Ricardo Zapata Marti, International Trade Unit, CEPAL

« The state of Central American integration – negative and positive aspects », Alfredo Trinidad, Assistant Professor, Faculty of Political Science, Rafael Landivar University

« Integration from the workers’ point of view », Carlos Eduardo Molina, Executive Secretary CCT-Central American Confederation of Workers, Director ICAES-Central American Institute of Social Studies

“Central American regional integration: recent progress and future challenges”, Ennio Rodriguez, Inter-American Development Bank, Peter Versteeg, European Commission

Annexes :

-Tables of statistic information on Central America

Acknowledgement

This publication has resulted from a European Commission sponsored Conference on “Central American Regional Integration and Institutional Reform” that was held in Brussels on 3 March 2003. It was attended by senior officials from the main Central American and European Union integration institutions, academia, civil society, international organisations and the diplomatic community. The European Commission wishes to acknowledge the contribution of all the speakers, moderators and participants in the conference, whose interventions have contributed greatly to this publication. Where relevant, additional information has been included, in particular concerning the EU-Central America cooperation strategy and programme, the responsibility for the content of each article belongs to the individual authors. I would like to express my gratitude to the following persons, Elena Karadjova, Sandra Valle, Denis Daniilidis, Federico Zorzan and Peter Versteeg in the Mexico and Central America Unit of the Directorate General for External Relations of the Commission for their efforts in organising the conference and preparing this publication.

Victor Andres Maldonado
Head of Unit Central America and Mexico
European Commission

1. INTRODUCTION

Foreword

The European Union's engagement with Central America spans almost two decades of political and economic relationship in the context of the San Jose Dialogue process. This ministerial-level dialogue was launched on 28 September 1984 in Costa Rica and is without doubt one of the most successful examples of EU relations with any sub-region in the world. The San Jose Dialogue process has been accompanied by substantial co-operation programmes in a broad range of sectors including debt relief in affected countries as well as preferential access to the EU's markets through the Generalised System of Preferences (GSP) Drugs Regime.

The fundamental aim of the San Jose Dialogue process was to build on the work of the Contadora Group to extend peace, democracy, security and economic and social development throughout the Central American region. In this context, its contribution to the peace process in the sub-region brought about a refocusing of the dialogue in Florence in 1996 and in Madrid in 2002 to concentrate on issues of sustainable development and regional integration. The region's success in bringing about this stability and security has set the stage for allowing social cohesion, boosting economic growth and opening the door to a stronger regional participation in global markets.

A parallel can be drawn with the process of integration in the EU, where the starting point was the principle of preserving peace through co-operation and collective security and where the process of economic integration has been the main driving force behind the extension of political and legal authority across national borders.

The EU is conscious of the changing nature of its partnership with the Central American region and its stated intention is to expand this relationship along the lines of the agreements it has signed and is negotiating with other countries and sub-regions in Latin America. In this context, the Second EU-Latin America and Caribbean Summit held in Madrid in May 2002 opened the door to a new Political Dialogue and Cooperation Agreement with Central America. This new Agreement, coupled with strengthened EU cooperation and deeper integration in the sub-region will pave the way for a more comprehensive relationship in the future.

Finally, although economic integration may be considered the motor for successful regional integration and indeed, backed up efficient regional institutions, remains the best option for Central America, we must not forget that the vulnerability of the sub-region to natural disasters, external shocks and social conflict rooted in poverty could result in the gains from integration being washed away in an instant. In this regard our co-operation with Central America for the coming few years will focus on the two key issues of regional integration and vulnerability to natural disasters with particular emphasis on building up the capacity of regional institutions, supporting the implementation of the Central American Customs Union and promoting the participation of civil society in the process of regional integration.

Christopher Patten
Commissioner for External Relations
European Commission

Central America: integrating into the future

Rolando A. Guevara Alvarado
Ambassador and Pro-Tempore President
GRUCA – Brussels

Attempts at achieving Central American integration go back to 1824, not long after political independence had been achieved in the region, with the Constitution of the Federal Central American Republic, until it was dissolved in 1848. In the modern era, the Central American region was a pioneer in terms of integration as it established the Central American Common Market in the sixties.

In the eighties, the integration process suffered a setback and the region was immersed in internal conflicts, which, added to the international crisis, made that era “the lost decade”, not only for Central America, but for all of Latin America. However, this situation was a determining factor in causing the European Union to fix its attention on Central America in the nineties, and also in the establishment, in 1984, of a mechanism for political and economic coordination and cooperation between both parties. This mechanism, known as the San José Dialogue, is now considered to be one of the most successful acts of European foreign policy.

This sustained dialogue contributed, in the nineties, to the peace and democratisation processes, allowing the development of a new phase in the process of development and integration of the region through the consolidation of peace, the establishment of the rule of law and the opening up of the economy, looking to develop outwards. These actions were complemented by specific cooperation programmes in the political, economic, social and cultural fields, as well as by humanitarian programmes to deal with the natural disasters that afflict the region.

On both a theoretical and practical level, this close collaboration between the two regions has enriched the subject of integration and enabled lessons to be learned from the two regions’ respective integration schemes. One of these lessons is that it is a process that certainly has similarities with other processes, but which also has its own dynamics, and that therefore there are differences – both in terms of time and structure – in the creation and operation of some of its components and institutions.

Another lesson is that we should treat diversity – in its various forms – as an asset that should be made the most of, and not as a problem that needs to be solved. It is precisely this diversity that encourages debate and which, when seeking to achieve a balance, generates proposals and options, although at times these are seen as symptoms of the weakness of a process or as a lack of will among those involved.

Taking into account the different aspects that make up integration and how they are intrinsically linked, currently the most obvious progress is being made in economic integration. This is as a result of the implementation of the Central American Economic Action Plan (PAECA), the strategic objective of which is establishing the Central American Customs Union, through tariff harmonisation, establishing the Common Customs Code and the rules governing it, common customs procedures, as

well as the mutual recognition of health records, a Pilot Plan for peripheral customs, and the removal of obstacles to trade, among other things.

Along with the Customs Union there have been other considerable achievements such as the signing of the Central American Treaty on Investment and Trade in Services, the entry into force of the Settlement of Commercial Disputes Mechanism and the agreements reached for coordinating common policies, such as agricultural policy and fisheries policy. It is also worth highlighting the progress in financial integration, with measures to modernise and coordinate legislation on banks and financial institutions and the establishment of a regional stock market and another one for government stock.

With regard to opening Central America up to the outside, it must be pointed out that economic freedoms are being strongly promoted, as recorded in the Free Trade Agreements that the countries in the region have signed with other countries such as Chile, Mexico and the Dominican Republic and those that are being negotiated with Canada and the United States of America.

Politically, one of the cornerstones of Central American integration is the Framework Treaty on Democratic Security and the work of the Central American Security Commission and the Security, Defence and Legal Subcommittees, the aim of which is to develop a model for democratic security in the region, through the adoption of common strategies and regional action plans for dealing with the serious threats to the security of Central American citizens. Along with the current programmes such as the Regional Anti-Drugs Action Plan and the Central American Plan for Integral Cooperation to Prevent and Counteract Terrorism, there are now other more recently adopted initiatives, the Regional Plan against Organised Crime and the Regional Coordination Mechanism of Mutual Assistance in Natural Disasters.

The region has also achieved considerable progress in the integration of other sectors. In tourism, there is the adoption of a joint tourist promotion system for the region through the Central American Tourism Mark. In social matters there is the adoption of common goals through the “Plan for joint guidelines for policies and strategies for development and social integration for 2000-2020”. In education and culture, there is the adoption of a whole series of joint measures to coordinate standards for primary and secondary education, improve the quality of education in the region and strengthen cultural identity through initiatives such as the Central American Popular Cultures series. In terms of the environment, there is the launch of the Environmental Plan for the Central American Region (PARCA), which harmonises policies and common environmental management systems and adopts regional positions regarding the environment.

Another event of the utmost importance in this evolutionary process of Central American integration is that in July 2003, Belize will, for the first time, take on the Pro Tempore Presidency of the Central American Integration System (SICA), using the opportunity not only to increase sub-regional integration, but also to move forward in proposing the SICA – CARICOM Action Plan.

The future of Central America can now be visualised based on an overall vision that enables countries to integrate themselves objectively into the world situation and gain the best advantage, both at regional and intra-regional level, in a competitive and

interdependent world. The Agenda for Modernisation and Transformation for the 21st Century - an agenda drawn up in consensus with regional interest groups, along with the Puebla-Panamá Plan, are two comprehensive plans setting out the path to take in order to improve political and socio-economic conditions for the Central American people, increase their standard of living and build a model of a modern society.

Support for regional integration is now the central focus of cooperation relations between the European Union and Central America, within the framework of the Memorandum of Understanding signed between the two regions and the Regional Strategy for 2002-2006, which establish indicative financial commitments of 75 million euros and the following cooperation priorities: *a)* support for the regional integration process, the implementation of common policies and the consolidation of the institutional structure, *b)* promoting the role of civil society in the integration process and *c)* reducing vulnerability and environmental improvements. Under this cooperation framework, the European Union is supporting the formation of the Central American Customs Union, through an 8 million euro project to help in the formulation and management of the common tariffs policy.

The recent XIXth Ministerial Conference of the San José Dialogue, held in Panama City on 12 May 2003, confirmed once again the priority support of the European Union for the process of Central American regional integration and the region's agenda for the future. The meeting also reaffirmed the political will and priority attached by both parties to the Political Dialogue and Cooperation Agreement, which is in the process of being negotiated. This new framework instrument will help to increase political dialogue and cooperation, mainly commercial, economic and investment cooperation, with the aim of establishing the conditions within the region and between the two regions so that an Association Agreement can subsequently be signed, including a Free Trade Agreement.

Therefore, as well as seeking to expand and deepen its relations with the European Union, Central America is also playing a crucial role in the new strategic association between the European Union, Latin America and the Caribbean, a bi-regional association which is currently being established, the results of which will become clear at the next Summit of Heads of State or Government of the European Union and Central America to be held in Mexico in 2004.

Among these countless activities aimed at better integration, moving relations between Central American and the European Union towards an association agreement will undoubtedly be the optimum way of helping to increase and guarantee the benefits of Central American integration, which is now well on the way to being consolidated.

Why This Publication?

Francisco da Câmara Gomes
Director for Latin América
European Commission

The policy orientation for the European Union's co-operation with Central America is set out in the framework of both the special regional partnership with Latin America and the Caribbean and in particular that of the San Jose Dialogue. The legal framework for this co-operation consists of the 1993 Framework Co-operation Agreement between the European Community and the six Spanish-speaking Central American Republics. As a result of the decision taken at the Second EU-Latin America and Caribbean Summit in Madrid in May 2002, the San Jose Dialogue and the Framework Co-operation Agreement are currently being transformed into a new Political Dialogue and Co-operation Agreement. This new Agreement broadens the fields of co-operation and paves the way for a future Association Agreement including a Free Trade Agreement between the EU and Central America. Such an Association Agreement is, however, conditional upon the achievement of deeper integration in the Central American sub-region and should build on the outcome of the Doha Development Agenda.

In this context, the Commission has fostered a variety of initiatives to increase exchanges of views on and assess the progress of regional integration in Central America. The subject of regional integration has become a regular feature in the annual Joint Committee and San Jose Dialogue meetings. A series of seminars on regional integration, presenting the EU experience, were held in the Central American sub-region under the guidance of the Commission's Delegation in Managua. On March 3rd 2003, a one-day conference on Central American Integration and Institutional Reform was organised by the Directorate General for External Relations of the European Commission in Brussels and co-hosted by the Panamanian pro-tempore Presidency of SICA. This conference was attended by senior officials from the main Central American integration organisations including the Secretariat-General of the Central American Integration System (SG-SICA), the Central American Parliament (Parlacen), the Central American Court of Justice (CCJ) and the Secretariat for Central American Economic Integration (SIECA) as well as the from the key European institutions such as the European Commission, the Council Secretariat, the European Parliament and the European Economic and Social Committee. In addition, a broad range of representatives from academia, civil society, international organisations and the diplomatic community participated.

The main aim of the conference was to encourage an open discussion of the state of Central American integration, progress achieved and remaining challenges, with a particular focus on economic integration and regional institutions. Chapter Two of this publication gives a general overview of the EU's political, economic and cooperation relations with Central America, whereas Chapter Three contains the presentations that were made at the conference as well as related analysis of the process of integration.

Some underlying themes that emerged from the conference include: the consensus that regional integration remains the best option for ensuring the sustainable development of the region and strengthening its global position; although economic integration constitutes a key ingredient or catalyst for the process of regional integration, this process is more than just an economic process and critical issues such as social justice and equity as well as other aspects of vulnerability must be addressed; civil society must play a growing role in the process of regional integration; and the process of integration must be backed up by a long-term vision and effective decision-making and national and regional institutional machinery.

This contribution to the debate on Central American regional integration is the starting point of a process of analysis and exchange that will effectively determine the future course of the EU's relationship with Central America.

2. EU-CENTRAL AMERICA RELATIONS

EU-Central America – Political, economic and and cooperation relations

Elena Karadjova, Peter Versteeg,
Federico Zorzan
European Commission

1. Introduction

The European Union and Central America enjoy a comprehensive relationship that encompasses political dialogue, a favourable trade regime and a broad co-operation framework. This relationship has evolved over the past two decades and continues to do so taking into account developments in the region such as the pacification and return to democracy in the region in the 1990s and international economic trends.

1.1 Political dialogue

The **San José Dialogue** process forms the cornerstone of EU-Central American relations. It was initiated at a ministerial meeting in Costa Rica in 1984. Essentially a forum for political discussion, the original purpose of the dialogue was to support conflict resolution, democratisation and development in Central America. Since its inception, ministerial meetings of the San José Group have taken place on an annual basis and the forum has been extended to other fields of political co-operation.

Given its contribution to fostering the peace accords (in El Salvador and Guatemala) and promoting respect for human rights throughout the region, the San Jose Dialogue can claim a notable historical success in that it was the key instrument in bringing about peace and re-establishing democracy in the region in the early 1990s. This success has gained the EU a high degree of political credibility and has also enabled the dialogue to focus on the important related areas of regional integration and economic and social development. Apart from its political dimensions the Dialogue has allowed considerable Community co-operation engagement at both regional and bilateral level. The continuity of this co-operation is essential to complementing the efforts of the region to consolidate peace, democracy and economic and social development.

The process, which was renewed in Florence in 1996, has laid down the following general objectives for future co-operation with the countries and the region: to promote sustainable and equitable economic and social development; to step up the fight against insecurity and crime; to promote the consolidation and modernisation of the rule of law; to strengthen social policies.

In addition to the San Jose Dialogue, the EU also maintains a political dialogue with Central America within the broader context of the Rio Group and the EU-LAC Dialogue. The **Rio Group** process (at present, the forum unites the countries from Central America, Andean Community, Mercosur, Mexico, Chile, Guyana and the Dominican republic) was launched in 1986 through the 'Rio de Janeiro declaration', which lays down the firm commitment to establish a permanent mechanism for political consultation within the context of a growing Latin American format. The

Rio deals with international matters of particular interest for the member states and promotes co-ordination among Latin American co-operation and integration structures.

The **EU-Latin America and Caribbean (EU-LAC)** dialogue began with its first Summit at Heads of State and Government level held in Rio de Janeiro on the 28 and 29 June 1999. The objective of the Summit was to foster political, economic and cultural understanding between the two regions in order to develop a strategic partnership establishing a set of priorities for future joint action in the political and economic fields. The Summit took important political decisions among which to reinforce the institutional dialogue between the two regions; preserve democracy and promote and protect human rights and fundamental freedom; work together to address the threats to international peace and security. During the forum a new bi-regional approach was introduced, which added value to the EU relations with the sub-regions and individual countries.

A second EU-LAC Summit was held in Madrid on 17-18 May 2002. This summit assessed progress made in the framework of the strategic partnership established at Rio, emphasising progress in the three main pillars of the relationship: political dialogue, economic and financial relations including trade and capital, and co-operation in a number of areas. Preparations are currently underway for the next EU-LAC Summit, which will be held in Mexico during the course of 2004.

1.2. Trade

The EU is the second most important trade (12% of total trade) and investment partner for the Central American sub-region after the United States (46% of total trade). Trade (exports and imports) between the sub-region and the EU represents some 0.4 % of total EU external trade, with exports from Central America being mainly agricultural goods and imports from the EU predominantly industrialised goods. EU direct foreign investment in the Central American sub-region has grown from some €140 million in 1994 to €540 million in 1999.

Commercial relations between the EU and the Central American sub-region are dominated by the 'drugs regime' of the Generalised System of Preferences (GSP) considered as one of the pillars of EU-CA economic relations. This special arrangement aims to support the sub-region's efforts to combat drug production and trafficking. It provides duty-free access to EU markets for around 90% of the exports from Central America and the Andean Community (all industrial products as well as some agricultural products) thus enabling the region to increase exports gradually and to attract European investment. The GSP arrangement was extended in 2001 for a three-year period, from 2002 to 2004. The Commission has agreed in principle that regional cumulation between the Central American and Andean countries should apply.

Since the late 1990s Central American countries have called upon the Commission to upgrade economic and particularly trade relations with the EU from a unilateral preference system to one of reciprocal trade liberalisation. In 2001, the EU and Central America agreed to establish a Joint Working Group on Economic and Commercial relations. The mandate of this Group which met on a number of occasions was to exchange information and examine the current state and prospects of

economic cooperation and trade relations between the two regions with a view to achieving greater stability and predictability in these relations. The position expressed by the Commission in this group was that the EU had declared a standstill on pursuing new agreements in 1999 and opted for paying greater attention to improving the operation of the multilateral trading rules. The decision taken at the Madrid EU-LAC Summit in May 2002 confirms this position by underlining that a future Association Agreement (including a free trade agreement) between the EU and Central America must be 'DOHA-plus' and based on the achievement of deeper integration in Central America. However, the uncertainty surrounding the continuation of the GSP drugs regime will no doubt lead to increasing pressure for a more secure trading arrangement.

1.3. Co-operation

The EU is the world's first provider of co-operation to Latin America and the Caribbean contributing some sixty per cent of total development assistance received by that region. The Central American sub-region has traditionally received the largest share in both absolute and per capita terms of EC co-operation. An average of €145 million per annum has been granted by the EC to Central America over the past seven years. Historically, this co-operation has focused on human rights and democracy, integrated rural development, disaster prevention and reconstruction, social development and regional integration.

The agreements the EU has concluded with Latin American countries and regional partners have evolved substantially over time to include a broader range of political and economic co-operation. These agreements include a democratic clause, enshrining co-operation and mutual respect for democratic principles and human rights. In addition, they include new perspectives for economic, industrial, scientific, technical and environmental co-operation, as well as the fight against drugs. Likewise, decentralised co-operation has become more significant over the last ten years. This trend has been coupled by an increasingly important role for civil society in the implementation of EU initiatives. The overriding aims of this cooperation (including the achievement of more equal access to social services and wealth distribution), reinforcement of the rule of law and democracy and environmental protection.

Currently, the legal framework for co-operation with Central America consists of the 1993 Framework Co-operation Agreement, the Regional Strategy Paper 2002-2006 and the national Country Strategy Papers 2002-2006 as well as the Memoranda of Understanding signed between the EC and the six Central American countries. In line with these documents the co-operation priority areas include: support for the regional integration process, implementation of common policies and consolidation of the institutional structure, strengthening the role of the civil society in the integration process, reduction of vulnerability and environmental improvement.

In 2001, a series of Memoranda of Understanding were signed between the European Commission and the six Central American countries establishing a five-year national and regional programme of co-operation with an indicative allocation of €655 million. This funding includes €75 million for sub-regional programmes aimed at supporting the process of regional integration, including the incorporation of civil society therein and reduction of vulnerability to natural disasters. At country level, indicative

allocations range from €24 million for Panama to €192.5 million for Nicaragua. The principal focal areas at national level include strengthening justice and the rule of law, poverty reduction and social development, decentralisation and local development, education and economic competitiveness.

The Strategies are based on each country's own development agenda, the Commission's cooperation principles and the Memorandum of Understanding signed with the country. For the period 2002–2006, the Commission's cooperation programmes with CA countries will focus primarily on the following priorities: consolidation/democratisation of the State and human right promotion, decentralisation and local development; support to the productive sector. The resources allocated will be complemented by projects funded from specific budget lines and programmes financed under the Central American and Latin American regional programmes. In addition to economic, financial and technical co-operation and in response to the various challenges faced by the region, other major initiatives have included the Central American Programme for Reconstruction and Rehabilitation (€250 million for the period 1999-2006) following Hurricane Mitch plus €25 million for reconstruction in El Salvador, a programme of support for the BCIE for the development of small and medium-sized enterprises and poverty reduction measures (€120 million) plus considerable support for human rights and democracy, environmental conservation and food security, all of which are funded from specific budget lines. Since 1998, the EU has also provided some €58 million through ECHO in humanitarian aid to Central America (mainly Nicaragua, Guatemala, Honduras and El Salvador) in response to catastrophes such as Hurricane Mitch, the earthquakes in El Salvador and the drought.

2. Future Prospects

The May 2002 Madrid EU-LAC Summit marks a further step forward in the EU's relations with Central America. The Political Declaration of the Summit formalised the decision to conclude a Political Dialogue and Co-operation Agreement between the EU and Central America. A similar Agreement is under preparation for the Andean Community. The main objectives of the Agreement will be to: a) strengthen EU-Central American relations by developing political dialogue and reinforcing co-operation, and b) create the conditions under which, building on the outcome of the Doha Work Programme, a feasible and mutually beneficial Association Agreement, including a free trade agreement, could be negotiated between the parties.

The Political Dialogue Title will formalise and strengthen the San Jose Dialogue process. The Co-operation Title will be based on current co-operation and will broaden coverage to include new areas of co-operation such as human rights, migration and counter-terrorism. Special emphasis will be placed on co-operation in support of the process of regional integration in Central America. The Agreement will build upon and replace the existing 1993 Framework Co-operation Agreement between the two regions. The Negotiating Directives for this Agreement were approved by the Council on 18 March 2003. The first round of negotiations was held from 13-15 May 2003 in Panama following the XIX San Jose Dialogue Ministerial meeting. It is expected that negotiations will be completed by the end of 2003.

The European Union's regional co-operation strategy in Central America

Philippe Combescot
Charge d'affaires
EC Delegation in Guatemala

1. Introduction

The process of Central American integration has been on the agenda for decades. Leaving aside the attempts made during the 19th century, we can say that this has been on the agenda of the countries in the region since the beginning of the fifties (with the examples being the Organisation of Central American States-ODECA 1951 and 1962, the Central American Common Market in 1960, the creation of SICA in 1991, the creation of SIECA in 1993, and so on).

The process started at practically the same time as the process of European integration, although it has struggled to advance.

However, Central America has taken a step which could give a decisive boost to the integration process with the commitment, initially of Guatemala and El Salvador and then of Honduras and Nicaragua, to establish a customs union. Costa Rica which was previously reticent has now recently joined in this.

The EU is firmly supporting this process.

2. Importance of the Central American integration process

The EU experience is a clear example of the benefits of integration combining a massive market, the harmonisation of standards and regulations, solidarity through structural and cohesion policies and an institutional framework. We are convinced of the advantages that such a process will bring to the sustainable development of Central America.

According to SIECA and Eurostat data, the GDP of the Central American Common Market was around 60 billion euro in 1999, just 0.75% of the EU's GDP in the same year which was around 8 trillion euro. Its exports were around 12 billion euro, 1.5% of EU exports at 760 billion euro.

These data show that the integration of the region, given its size, is necessary in order to allow it to cope with the growing globalisation. We also believe that integration will allow common problems to be tackled more effectively.

We know that our partners in Central America have a long way to go if they wish to achieve an integration similar to ours, as this has been a long process for the EU. For years we have been utilising our experience to the benefit of the region by providing, as one of the priorities of our cooperation in the area, support for the regional integration process.

3. Political framework

With regard to the political framework, the European Union has accompanied firstly the peace processes and then the democratisation and development processes in Central America, particularly since the beginning of the San José Dialogue in 1984. In this respect, the EU has made major efforts to cooperate with the region, one of the most important being the cooperation aimed at deepening the regional integration process.

The EU-Latin America and Caribbean Summit of Heads of State and Government which was held in Madrid in May 2002 confirmed regional integration as one of the priorities on the common agenda.

Furthermore, at the last meeting of the San José Dialogue which took place within the above Summit, it was agreed that a Political Dialogue and Cooperation Agreement would be negotiated with the 6 Central American countries:

The first round of negotiations on this agreement will take place in Panama on 13-15 May. This agreement will frame the EU-CA political dialogue and will extend the areas in which cooperation may be developed, with the following priority objectives of this cooperation being established: the promotion of democracy and human rights, the reduction of poverty and the extension of the Central American integration process.

This represents an important step in EU-CA relations which could lead, in the medium term, to the signature of an Association Agreement incorporating a Free Trade Agreement, provided that the Doha Round is complete and the process of Central American integration is extended.

4. Regional cooperation strategy for Central America

In line with what I have just mentioned, the EU's Regional Support Strategy 2000-2006 for Central America has the objectives of consolidating the peace and democratisation processes and supporting the efforts made towards economic and social development, by promoting regional integration and reducing vulnerability.

This strategy has the following priorities:

a. Support the regional integration process, implement common policies and reinforce the institutions.

- The main project is the one which has as its objective the creation of a Central American Customs Union.

It is hoped that this customs union will be the cornerstone of the integration process, creating a larger market encouraging foreign investment, introducing more competition and thereby improving the competitiveness of undertakings, allowing economies of scale and affording greater negotiating power on the international scene.

On the other hand, a customs union or having access to new markets are not in themselves enough unless internal policies establishing a suitable framework in order to benefit from these are implemented.

As an example, measures are needed to help local undertakings, particularly SMEs which are the main job creators, to be in a position to benefit from these advantages.

Furthermore, foreign investment does not automatically flood in unless there is a stable institutional framework, an appropriate legal framework and a trained workforce.

Finally, a social policy is required which is able to appropriately redistribute the benefits of this integration both among the various countries and among their regions or social groups.

In this respect, the EU, in both the regional strategy context and with regard to the bilateral cooperation actions with the Central American countries, is seeking to support these measures which will help the economic operators to draw the maximum benefit from this integration. It is promoting economic cooperation programmes, such as that which is about to start in Guatemala, which mainly seek to: help improve the competitiveness of undertakings, particularly micro-undertakings, in the regional and international markets, help attract investment and the transfer of know-how, promote European investment in sectors of common interest and promote technology transfers.

- With regard to institution building, the EU is seeking to consolidate the technical and administrative capability of the Central American integration institutions so that they can play their corresponding role.

The second priority of the strategy is to:

b. Reinforce the role of civil society in the integration process

One of the main weaknesses of integration processes is usually the problem of ensuring that the national societies adapt to the process and understand and share in this. The lack of information, the lack of appropriate participation mechanisms and the fact that the benefits are not sufficiently visible to most of the population are some of the causes of this weakness. The political impetus needed to relaunch the regional integration process in Central America requires awareness-raising among civil society with regard to the social, economic and sustainable development advantages which integration can offer.

In this respect, the strategy seeks to encourage information, training and awareness-raising processes among the Central American societies together with channels for participating in the preparation of common policies.

It will also try to promote, within universities, the analysis and discussion of various aspects of integration.

Finally, the process of integration requires significant technical capability. Therefore, training programmes for students and professionals will be promoted to ensure the existence of qualified staff in both the public and private sectors.

The third priority is to:

c. Reduce the vulnerability to natural disasters

The vulnerability of the region has been evident time and again. It is intended to improve prevention by promoting the implementation of common regional initiatives to improve the natural disaster prevention network and a common legal framework in this respect.

To implement this strategy, a budget of 74.5 million euro has been earmarked.

The coherence of these actions with other EU actions, such as the Democratisation and Human Rights Programme in Central America, the ECHO natural disaster prevention programmes and the activities carried out within the fight against drugs trafficking, and also the actions carried out within the bilateral cooperation strategies with the Central American countries, should also be highlighted.

Finally, there are other Community policies which have an impact on the relations of the EU with the Regional Integration System in Central America, such as the Common Agricultural Policy or the Trade Policy with the application of the GSP providing preferential access to the European market for a variety of Central American products.

5. Conclusion

We therefore believe that regional economic integration accompanied by appropriate internal structural policies is a good strategy for Central America in an increasingly globalised world. The EU is firmly supporting this in its political, economic and cooperation relations with the region.

**3. CENTRAL AMERICA INTEGRATION : INSTITUTIONAL
REFORM, ECONOMIC INTEGRATION AND CIVIL SOCIETY
PARTICIPATION**

The reform of the institutional framework: lessons and challenges

Oscar Santamaría
Secretary General of SICA-
Central American Integration
System

Introduction

I am pleased to be able to stand before you today and announce that this is one of the most promising times for Central American integration.

Following the post-1995 impasse in the process and while the region was facing the magnitude of the damage caused by Hurricane Mitch and the earthquakes in El Salvador, a series of events took place that generated a broad and rich debate in our Central American countries.

Out of all these events I should highlight the meetings of the Consultative Groups held in Stockholm in 1999 and Madrid in 2001. These two meetings demonstrated the importance and value of combining the efforts of the governments of Central America, their civil societies and international cooperation. Out of the Consultative Group in Madrid in 2001 came a strategy for transforming and modernising the area and a catalogue of projects, drawn up by all the agents in the region, which also showed the added value provided by a regional vision for solving our problems.

Large-scale studies such as that known as Central America 2020, co-sponsored by the European Union, had also created a climate of regional discussion of the obstacles to Central America's development. This Secretariat General is now promoting, with the support of international bodies, more major studies to help give fresh impetus to the process.

Looking back at the well-known European experience of the costs of non-integration and with the invaluable help of Mr Paolo Cecchini, the SG-SICA and ECLA have been behind a study into the benefits and costs of the process for several months.

However, very significant progress is also currently being made in the process. In recent months the negotiations to establish customs union have made considerable progress. All the indications are that soon we will be able to see the Central American Customs Union permanently established.

The European Union has been involved in this and has established a support programme for customs union that is a significant collaboration at this important stage in the process of Central American regional integration.

The results of recent years in terms of economic relations between the countries in the region have been really positive. Despite a complex and changing climate, Central American integration has enabled, for example, radical progress in intra-regional trade, which has already exceeded US\$ 3000 million of exports between the regional partners.

This greater inter-connection between the economies of the region is palpable in what is known in the region as informal integration. Some Central American business sectors are making faster progress in integrating their businesses and activities than the institutions are. A good example of this is the financial system, the energy sector, the food and agriculture sector, the transport sector, tourism and commercial distribution, along with many others.

In these sectors it is now understood to be a fact that integration is not only necessary but inevitable and they are working on that basis. This is an indicator of the growing strength of regional integration and, at the same time, an incentive to keep going with the development of the agreements.

The negotiations to establish customs union will create a favourable environment for greater development of intra-regional trade. An example of this is the full incorporation of Costa Rica into these negotiations and the significant progress in implementing the Economic Action Plan of March 2002, which includes the final schedule for liberalising intra-regional trade, defining common Central American tariffs and removing border posts by 1 January 2004, thus complying with the prime objective of the Guatemalan Protocol to the General Treaty on Central American Economic Integration.

Also, the network of trade agreements with third countries and regions is gradually being completed. Following the agreements with Mexico, Dominican Republic, Panama and Chile, the region is making progress on setting up joint agreements with Canada, has fixed dates for finalising a free trade agreement with the United States and is expecting to begin negotiations for a new, broader association agreement with the European Union which would also include a free trade agreement.

However, along with the progress towards fully establishing customs union, other considerable progress has been made in all aspects of Central American integration. We will shortly give a brief summary of the most notable advances, but I would now like to review some essential ideas on Central American integration today.

Lessons

1. THE INSTITUTIONAL FRAMEWORK FOR INTEGRATION IN THE NINETIES: THE TEGUCIGALPA PROTOCOL

As you know, the Contadora and Esquipulas processes, and in particular the San José Dialogue for cooperation between Central America and the European Union established in 1984, enabled the Central American countries to overcome the conflicts that had affected their experience of regional integration in the sixties and seventies, which began with the ODECA (Organisation of Central American States) Charter in 1951, when the European Union was also taking its first steps following the creation of the European Coal and Steel Community in the same year.

The presidential summits during the first five years of the nineties gave rise to a new political and legal framework for regional integration governed by the Tegucigalpa Protocol of 1991 creating the political framework for the rest of our core treaties and the institutional framework is being developed: the Guatemala Protocol of 1993, the

Social Integration Treaty of 1995 and the Framework Treaty on Democratic Security of 1995.

This series of agreements enabled the Central Americans to establish a set of principles, standards and objectives, centred on peace, development, freedom and democracy.

The new phase of integration in the nineties aimed to respond to the challenges of Central American development by promoting a regional context for the growth and modernisation of our societies, which at the same time would improve the conditions for our integration into the world economy and the institutions and agreements governing it. The region opted for a model of dual growth; inward growth with the ultimate aim of achieving economic union and outward growth with regional policies favouring the development of exports to third countries or groups of countries, through free trade agreements.

The purpose of the series of institutions in the process is to drive the development of the various dimensions (political, economic, social, environmental and cultural) of the process, by quickly establishing a customs union that would progress towards the single market and the development of common policies and measures in all areas of the process. The main new institutions generated by the Tegucigalpa Protocol compared with the original integration were the Secretariat General, the Central American Court of Justice and the Consultative Committee on Central American Integration.

In the Central American institutional structure the decisions are made by the highest level body which is the Presidents' meeting. The Central American Court of Justice has to ensure that the Central American agreements are complied with and draw up the legal framework for the process and also any disputes arising around it.

The Central American Parliament was an essential element in the recovery of the process in the eighties. In assessing its current functions, its importance as a forum for dialogue, having been created in a region in the throes of conflict in 1987 (years before the Tegucigalpa Protocol was adopted) is often forgotten.

The Vice-Presidents' meeting and the Councils of Ministers are the next bodies in the institutional structure and cover a wide range of sectors and policies in the region. The role of the Council of Ministers for Foreign Relations as the guiding head of the process and the leading role played by the Council of Ministers for the Economy should be highlighted.

The Consultative Committee is another of the new elements of the institutional framework. In recent years many people from the region have been involved in it. Its role in the process is of the utmost importance, even though it is of a consultative nature. Currently, the SG-SICA is trying to encourage its involvement in the debates regarding the presidential agenda and to increase its capacity for giving its opinion. The connection of civil society with the regional agenda and its perception of the process are essential in order for it to make progress.

Along with these bodies, the Secretariat General of SICA heads the network of Secretariats, Directorates and Institutions in the system. The coordination of these

secretariats and institutions is a determining factor in the success of the integration efforts.

The design of this institutional framework, like the actual principles of the integration model, is highly influenced by the European model. This is why the European Union's experiences are a constant reference point for us in the debates regarding both institutional reform and any other aspect of the process. The fruitful relationship between Central American integration and the European Union through the political and cooperation dialogue of the San José forum is undoubtedly one of the strengths of our process. European cooperation has been constantly evident, from its support for the peace agreements and the creation of the Central American Parliament to its current support for the establishment of customs union. I must express our thanks on this occasion for that support.

2. POSITIVE AND NEGATIVE ASPECTS OF THE INSTITUTIONAL FRAMEWORK CREATED BY THE TEGUCIGALPA PROTOCOL

Going back to the institutional framework created by the new treaties, we could summarise its positive and negative aspects as follows.

With regard to the positive aspects it can be said that:

- The agreements and treaties in the Central American integration system are based on restoring regional peace and their fundamental objective is to consolidate an area of regional understanding to prevent future conflicts. As the Tegucigalpa Protocol states, the fundamental objective is “to achieve the integration of Central America, to establish it as a region of peace, freedom, democracy and development”.
- The agreements and treaties in the Central American integration system resolve the one-dimensional nature of the previous phase of the process and establish an integration model with political, economic, environmental and cultural dimensions.
- The new regional integration agreements in Central America are a suitable framework and make a valid contribution to regional development. For example, they incorporate some of the main consensus on development reached during the nineties by the International Community. Concepts such as sustainable development, integration with openness, human development and human safety make up a substantial proportion of the Central American treaties and agreements.
- The existence of agreements and treaties in the social and environmental dimensions of the process is an appropriate response to the needs of the countries of the region. The social integration treaty places human development at the heart of integration. The Alliance for Sustainable Development (ALIDES) places the principle of sustainable development at the heart of integration.
- The new agreements also resolved two significant shortcomings in Central American integration with the creation of the Central American Court of Justice, PARLACEN and the Consultative Committee on Central American Integration. It adds enormous value to the institutional framework.

With regard to the negative aspects it can be said that:

- There is a degree of confusion in the legal and political framework of the process owing to the difficulty of working within a framework in which the agreements have not been signed or ratified by all the Member States of SICA and in which there is a clear absence of mechanisms to establish norms for ratifying the agreements;
- At times there are unilateral decisions that are contrary to the Central American agreements and a failure to comply with the agreements adopted.
- The regional institutional structure needs a reform to deal with problems such as the dispersal of institutions and the need to rationalise them and a review of the powers and procedures of some of its institutions in order to improve their operation and capacity.
- The dispersal of institutions represents a lack of effectiveness and efficiency in the institutional framework that needs to be corrected with appropriate coordination mechanisms between all the institutions.
- The institutional structure does not have an automatic source or mechanism for funding.

In general, it can be said that Central American integration is halfway between an intergovernmental and a community structure. This characteristic of the process is particularly visible in the institutional framework of the process, and will determine the results of the reforms to be carried out.

3. THE REFORM OF THE INSTITUTIONAL FRAMEWORK: IDB-ECLA PROPOSAL AND THE PANAMA AND COMALAPA PRESIDENTIAL SUMMITS.

The need to correct the negative aspects of the process inspired the regional governments to consider some institutional reform measures. ECLA and the IDB coordinated the support programme for strengthening and rationalising the institutional framework for Central American integration, according to a mandate from the XVIth Presidents' Summit held on 30 March 1995 in San Salvador. The results of this programme gave rise to a series of proposals on rationalising and reinforcing the Community institutions, which were discussed and adopted not long afterwards at the XIXth Presidents' Meeting which took place on 11 and 12 July 1997 in Panama.

The presidents decided to approach the institutional reform of SICA with rationalisation as the main objective. Their main decisions were:

- To review the numbers and the powers of elected representatives of PARLACEN.
- To revoke the power for internal intervention of the Central American Court of Justice and to reduce the number of judges to one per country.

- Unification of the Secretariats in the system.
- Replacing the Executive Committee with the Link Committee.

Also, the Central American governments decided to begin work on combining the regional agreements into a single treaty.

On 4 February 1998 the Central American presidents held an extraordinary meeting at Comalapa Airport (San Salvador) especially to discuss the progress in the process of discussion and reform of the institutional framework. A few important decisions arose from that summit. The main ones were as follows:

- To reduce the number of representatives in PARLACEN from the current 20 to 10 or 15 per country.
- To reduce the number of judges in the Central American Court of Justice from two to one per country and modify their working relationship with the Court, so that they are paid by sittings or sessions and not by monthly salaries.
- To unify the regional institutions into a single Secretariat in San Salvador under the coordination of the Secretariat General of SICA.
- To appoint a specialist as President of the Central American Economic Integration Bank, halting the custom of rotating the presidency between the different countries; and modifying the Bank's statutes to enable partners from outside the region to join.

The reforms are of great interest from the point of view of rationalising the system but they generated a considerable amount of discussion within the institutions.

4. ADVANCES IN INSTITUTIONAL REFORM FROM 1997 TO DATE: THE DEBATE ON THE REFORMS.

Some of the proposals are indeed debatable, and perhaps the focus of the project is affected by a negative perception of the regional institutions. In any case, the presidential documents and decisions include proposals that are of great value for the process which deserve a second chance.

The presidential reform decisions have only been partly dealt with. There has only been some progress on the unification of the Secretariats in San Salvador. The Executive Secretariat of the Central American Committee for the Environment and Development, OPESCA, the Secretariat for Tourism Integration and the Secretariat for Social Integration have moved to El Salvador.

The reforms of the Central American Parliament and the Central American Court of Justice have not begun. Both Parliament and the Court have argued strongly against the reforms proposed and no firm decisions have been taken. Some governments were recently proposing that the mechanism of election by universal suffrage to determine the representatives should be suspended, to be replaced by appointment from among the national representatives.

Although presidential decisions should be valued, it is important to point out that often results are demanded of the Central American institutions in a short amount of time when they do not have many powers to achieve them. Once again the European

case should inspire us to give integration and its institutions time to demonstrate their effectiveness in the medium term.

Beyond the proposals, we need to review the role of institutions such as PARLACEN, the Central American Court of Justice and the Consultative Committee in order to improve and strengthen that role.

This Secretariat General has an inter-institutional coordination bureau with PARLACEN and the Central American Court in order to enable them to participate fully in the Central American agenda and to coordinate the work of the three institutions.

Recently there has been a reform of the Tegucigalpa and Guatemala Protocols in order to make the Council of Ministers responsible for economic integration into a body for resolving trade disputes through an arbitration mechanism.

5. THE FALSE MYTH OF INEFFICIENT INSTITUTIONAL STRUCTURE: SOME POSITIVE CASES THAT DEMONSTRATE THE EFFICIENCY OF THE REGIONAL INSTITUTIONS

There is sometimes a negative myth regarding the Central American institutions that should be counteracted. There are many examples of the progress that is taking place in the process and it is easy to establish a causal relationship with the institutions that support it with the capacity to organise and to make proposals. In other words, there are as many or more positive examples as negative ones to demonstrate the efficiency of the system.

As well as the progress already mentioned with regard to customs union and trade negotiations, there has been other progress in which the institutions have played a leading role. For example, we can cite the following:

In the convergence of monetary and financial policies within the Central American Monetary Council. The Secretariat of the Central American Monetary Council, the head offices of banks in the region and the CABEI have made progress in analysing the legislation in force in terms of financial supervision in the countries in the area, with the aim of modernising it, coordinating it and adapting it to the Basilea principles. The structure of the securities markets in the area is also being analysed, and the CAMC has already agreed specific recommendations aimed at forming the 'regional securities market', which will begin with the establishment of a regional securities market for government stock.

- The tourism sector is making very rapid progress. The Central American Certification System for sustainable tourism has been adopted and the action plan for implementing it has been approved.

The region is taking part jointly in international events that highlight Central America as a unique tourist destination, including, among others, the Fitur 2002 fair in Madrid (Spain), the ITB in Berlin (Germany), and the World Travel Market (WTM), in London.

At a recent meeting of the Council of Ministers for Tourism, the Central American countries decided to launch the new Central American Tourism Promotion Agency (CATA) in Madrid the aim of which is to jointly promote Central America as a tourist destination and to work under the new common brand "Central America, so small, ... so big".

- There is also some progress being made in the agricultural sector. In October 2001, the Central American Agricultural Council – CAC, adopted a regional agenda, in order to outline a medium-term vision of the activities to be carried out as part of the integration of the agricultural sector and rural environment in the region.
- With regard to the economic sphere, this year (2003) an electrical interconnection project has begun in Central America, which was decided upon before the Madrid Consultative Group, reinforced in the regional strategy resulting from the Madrid process and is now being carried out as part of the Puebla-Panama Plan that has taken up some of the projects in the regional list again.

From a social point of view, the following are examples of good institutional performance:

- The Council of Ministers for Social Affairs adopted the proposal for “guidelines for policies and strategies for social development and integration” for 2000 – 2020, establishing goals for the first decade. Also continuing with the efforts made in the Madrid process, it approved a regional portfolio of social development projects, derived from the previous guidelines. It has also been used as a basis for the social proposal as part of the Puebla-Panama Plan.
- The Councils of Ministers for social affairs are also carrying out cross border measures in health and food and nutritional safety, as part of promoting an integral development policy for border towns. Among these are the initiatives in the Gulf of Fonseca and in Trifinio.

With regard to the environment, the following are examples of progress:

- The Environmental Plan for the Central American Region (PARCA) was drawn up for environmental integration. From its portfolio of projects the following have already been launched: the Mesoamerican Barrier Reef System project; The Regional Environmental Plan for Central America (PROARCA) which is seeking to ensure improved environmental management of the Mesoamerican biological corridor; and the Programme for the Modernisation of Environmental Management in Central America (PROSIGA), with the harmonisation of environmental regulatory frameworks in the Central American region.
- In terms of disaster prevention and mitigation, the Xth Meeting of Central American Presidents held in Guatemala in October 1999 adopted a regional model for reducing vulnerabilities and the impact of disasters for the 2000 to 2004 period. Within this framework there are various activities such as: action plan for the Lempa river basin; the satellite data acquisition system (SDAS) is being put into practice; the early warning project for the agricultural sector on the Central American isthmus is being implemented by CORECA, CRRH (Regional Committee on Water Resources) and the SG-SICA; the cooperation project with FINIDA (Finland) is being implemented by CRRH and the SG-SICA; the mareographic network for the Central American isthmus is being implemented by the CRRH and the SG-SICA;

And finally, in the political sphere, there has been the following progress:

- In terms of security, the region has made tangible achievements through the work done by the Central American Security Commission, and by its security, defence and legal subcommittees. Within this framework a democratic security model is being developed, mainly involving the adoption of the Regional Coordination Mechanism of Mutual Assistance in Disasters and the Regional Plan against Organised Crime.

- The Central American Permanent Commission for the Eradication of the Illicit Production, Trafficking, Consumption and Use of Narcotic Drugs and Psychotropic Substances (CCP), has taken strong steps towards establishing a Regional Action Plan (PAR) for reducing supply and demand for drugs and psychotropic substances in the region.
- It is also important to highlight the creation of the Central American Plan of Integral Cooperation to Prevent and Counteract Terrorism and Related Activities, which was adopted by a resolution of the Central American Security Commission on 25 October 2001.

CHALLENGES

1. THE POTENTIAL OF THE CENTRAL AMERICAN INSTITUTIONAL STRUCTURE: WHY ARE THE REGIONAL INSTITUTIONS ESSENTIAL?

Perhaps the best example of the slow but gradual consolidation of the SICA has been the capacity demonstrated by the regional institutions and governments to draw up the “Regional strategy for transformation and modernisation of Central America for the 21st Century” and to present it to the meeting of the Consultative Group in Madrid in March 2001. The difficult context in which this strategy was drawn up is a demonstration of the difficulties facing the integration process. However, despite this, the region was able to draw up a regional strategy for jointly dealing with the obstacles to Central American development.

The Madrid process brought together governments, civil society and international cooperation, coordinated by the regional institutions, in order to draw up a strategy for transforming and modernising Central America and a list of 31 projects that responded to the critical factors for development.

The Madrid process demonstrated the potential of the SICA mechanisms to coordinate governments and regional institutions if they can operate under the broad scope established in the agreements and the framework of regional integration.

As governments and institutions we are now working on implementing some of these projects, which depend on coordinating the efforts that we are making in the region and the support commitments that supporting countries and organisations are making based on them.

I would like to stress the value that the SG-SICA attaches to the “Regional strategy for transformation and modernisation of Central America for the 21st Century” as the central content of Central American integration.

There has therefore been a great deal of progress made in the integration process, enabling us to say that 2002 has been a good year for regional integration. The governments have raised their expectations regarding joint action and the outlook for 2003 is also promising given what I have already mentioned.

We can therefore begin to be moderately optimistic. We just need to limit that optimism because of matters such as the seriousness of the coffee crisis or the effects that the probable war in Iraq could have on oil prices, or because of the continuance of some of the more serious problems in the region.

This moderate optimism could be encouraged by one of the major achievements, which I would particularly like to highlight. In the middle of the year the SG-SICA conducted research into public opinion in Central America. The research was important because it confirmed that our people perceive integration as being necessary and appropriate for our countries. 66% of Central Americans think that the countries should present themselves to the rest of the world as a block of sister nations

and 60%, on average, think that integration benefits the people in the region either to some extent or a great deal. The results of this survey help us to determine the real feeling that Central American citizens have about regional integration and how much it has taken root. This undoubtedly gives us hope for the future.

Citizens also demonstrated that they had greater knowledge than was thought of the institutional framework for Central American integration and a greater confidence in it than is generally thought.

The people's expectations and the positive progress of the process represent a big responsibility for the institutions for integration that I have the honour to represent.

Removing the obstacles that reduce the efficiency of the institutional structure: moving to a community structure. The institutional budget.

Our institutions are limited because the process of regional integration is in transit between an intergovernmental structure and a community structure. The treaties construct a community-type structure, with institutions that are given the capacity to make decisions and implement them. However, in practice our integration is still markedly intergovernmental. The institutions, aside from their limitations, are forced to work in an environment that lacks definition, with the fairly far-reaching objectives established in the treaties but with limited powers due to the intergovernmental nature of the processes.

Central American integration and its institutions need a stage of transit towards a community structure and to build up their powers and gradually clarify their functions. During this phase, the governments should be increasing their confidence in the institutions, in their capacity to make proposals that will have a positive effect for general interests and to implement them appropriately.

In order to do this we need to correct something that is constantly limiting the capacity of the institutions: the budget. On the one hand, we need automatic funding mechanisms for the institutional budgets in order to reduce dependency on discretionary decisions. On the other hand, we need to give the institutions the resources to carry out their functions. This also requires selecting institutions with sufficient financial and human resources.

Once customs union has been established, we need to decide upon the possibility of the institutional budgets coming from the customs revenue generated by the common external duty. The European case is again a valuable reference point.

2. THE PRO TEMPORE PRESIDENCY AS AN ESSENTIAL ELEMENT FOR DRIVING THE INTEGRATION AGENDA. THE TROIKA.

Coordination is a basic principle when considering the challenges of institutional reform. As you know, the presidential summits play a very determining role in the Central American agenda. It is therefore essential that they continue as an essential mechanism for ensuring that the regional agreements make the proper progress. The pro tempore presidency is being taken on by the Central American countries with an increasing level of interest, which demonstrates their increased confidence in and dedication to integration.

The impetus that the presiding country can give to the presidential agenda during its six-month tenure is becoming a very positive element for the process. The recent Costa Rican presidency, the current Panamanian presidency and the interest with which Belize is preparing the next one demonstrate the importance of this mechanism. The Central American governments are now looking at the proposal that we made at the XXIst Summit in Granada (Nicaragua), on the advisability of establishing a

Troika system in Central America, involving the country that held the pro tempore presidency during the previous period, the country that currently holds it and the country that will hold the next presidency.

As you have experienced to a great extent in the EU, this would enable the country taking on the role to benefit from the experience of the previous presidency, and at the same time, the next presidency to follow the process and therefore take it on fully aware of what has been done and what needs to be done. After the first round, this scheme could be replaced by a Troika in which the previous presidency could be replaced by the Secretariat General, leaving only the current presidency and the incoming one along with the Secretariat General.

Mechanisms such as the Troika and the pro tempore presidency are now essential for ensuring a smooth continuation of the presidential agenda.

3. THE ROLE OF THE SECRETARIAT GENERAL OF SICA IN COORDINATING, DRIVING AND FOLLOWING UP THE CENTRAL AMERICAN AGENDA

The proposal for a single SG in the reform was based on the fact that the dispersal of the institutions takes away some of the technical and political capacity that the secretariat could hold. The different specialised secretariats in the system have had difficulty coordinating their work and have not been able to combine what efforts they have been able to make. The figure of a Secretary General of the system, surrounded by a small team of specialised secretaries working towards common aims means that we can contemplate having a regional representation with the clout to ensure that the agreements are fulfilled and make progress along with the Court and the Central American Parliament.

It is equally important to have an institutional structure coordinated by the SG-SICA that can prepare and follow up the summits. The model of integration defined in the treaties for the new phase of integration is not feasible without an institutional framework similar to the current one, following the necessary reforms. The multi-dimensional nature of the process owing to its political, economic, social and cultural aspects provides content for the institutions. The Secretariat General of SICA and the other technical and specialised secretariats not only have the function of intergovernmental secretariat for the Councils of Ministers. In practice they are already the beginnings of community institutions with a degree of management capacity and a considerable capacity for making proposals.

The Central American institutional framework has an important role to play in this process. Fully defining the institutional structure and providing it with the necessary resources is essential for the growth of integration. The central position of the SG-SICA for driving initiatives and proposals to the Central American governments and as a focus for following up the presidential agenda would ensure institutional efficiency.

Conclusion

So the Central American integration process is moving forward, having started in the 1960s with five countries: Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua and now with the addition of Panama and Belize as full members and the Dominican Republic as an observer, shortly to be incorporated at an equal level with the other countries.

It faces serious and complex challenges, but they are not insurmountable in the context of multinational action in which the countries are united in their interests and objectives. The challenges have been tackled gradually, and those that remain will be tackled gradually but determinedly, and for this Central American needs the continued support, guidance and advice that the European Union has been providing since the beginning, which the region sees as critical to the success of its integration process.

Towards the Central American community

Augusto Vela Mena
President of the Central
American Parliament

The fundamental aim of any integration process, whatever stage it may be at, is to provide the Member States with mutual benefits and greater advantages, with regard to third countries or groups of countries, than those which they could obtain if they continued to act alone as independent and isolated countries. This applies not only to processes of economic integration but also to those of political, social and cultural integration and to those seeking both types of integration.

In the Central American case, the idea of promoting or achieving integration – both economic and political – not only has historical geopolitical roots but also derives from the current situation of international political and economic relations which require countries to be highly competitive, both fundamentally in terms of world trade, finances, technology and production and also in other areas closely related to the development process of the world economy, namely globalisation.

The many regional identity factors which have bound the Central American countries since pre-Hispanic and colonial times, and which remain today, are important elements in an integration idea which has been shaped over the last two centuries through various attempted unions, both political and economic.

In addition to the identity factors specific to countries forming a geographical region and to the background of the *Capitanía General* or Kingdom of Guatemala and the United Provinces of Central America, there is a series of economic and political ties which, as a whole, form geopolitical and geostrategic factors which cannot be ignored in identifying with a regional integration project.

In effect, the geophysical position of Central America makes it an unavoidable link between the two main international and oceanic routes on the planet and also the point of natural union between the northern and southern parts of the continent. These factors, given how the world economy is currently developing, are essential in order to consolidate any process of strategic alliance, whether political or economic, regional or hemispheric, such as the Puebla Panamá Plan, the Free Trade Agreement between the Central American States and the United States of America and the FTAA.

Furthermore, the levels of economic development of the countries in the region are very similar and their trade relations do not change much, except for a few indicators.

Therefore, despite some differences in the level of economic growth, the similarities between our countries are enormous, our resources are similar and our economies are supported on the same traditional and non-traditional export products.

It must also be recognised that, on the international scene, a subregional identity of a small economic bloc has been developing which, although not particularly important

in terms of the volume of world trade, is achieving acknowledged production levels in some of its non-traditional export products and is maintaining excellent trade relations with the most important market places in the world. Its economies are in an expansion phase and are opening up to the globalisation process. This is confirmed by the special and differentiated customs treatment granted by some blocs – such as the European Union – to the region.

In terms of national legislation, it must be borne in mind that the majority of the Constitutions place special emphasis on the Political and Economic Union of Central America, i.e. the search for formulas to help us achieve this objective is a constitutional mandate.

The above are only some of the most important points of the arguments in favour of regional integration. Clearly, from the political perspective, the weight which the region would have if it acted as a single bloc front to the large world interests or as a single bloc in dealings with the International Community must be considered. This, without doubt, would bring many benefits to all the people in the region.

The Legal and Institutional Framework of the Central American Integration System (SICA)

The 1991 Tegucigalpa Protocol, amending the Charter of the Organisation of Central American States (ODECA) signed in San Salvador in 1951, included within its principles: “... To establish a Central American financial system and economic union ...” “... To strengthen the region as an economic bloc ...” and “... To promote, in a harmonious and balanced manner, the economic, social, cultural and political development of Central America”. However, more than twelve years after this Protocol was signed, the regional process has not been strengthened and Central America has not managed to consolidate itself as a bloc ready for the dynamic process of globalisation.

Perhaps the main limiting factor of SICA is that, although, with the change in the institutional structure of Central America, previously regulated as ODECA, **the integration bodies and institutions have kept their functional autonomy, thus ensuring efficient monitoring of the decisions of the Meetings of Presidents, intergovernmental cooperation has been maintained** without deepening the integration.

All the bodies of SICA still coordinate their work with each other, within the framework of an intergovernmental cooperation system, but without any vertical lines of action allowing the regional community to develop.

The Tegucigalpa Protocol therefore simply includes, as part of this, the following bodies:

- The Meeting of Vice-Presidents and Designates to the Presidency of the Republic
- The Central American Parliament
- The Central American Court of Justice
- The Consultative Committee

This means that, due to the way the system currently works, the regional community aspect is limited to PARLACEN (Central American Parliament) and the Central American Court of Justice which are incorporated within a rigid presidential and intergovernmental cooperation system which reinforces that the supreme body of the new system is the Meeting of Presidents.

The system proposed by the Plan in the Constitutive Treaty of PARLACEN would have been more effective than the plan proposed by the Tegucigalpa Protocol as the PARLACEN Institutional Plan, in which the political weight of the Meeting of Presidents in decision-making was still significant, increased the fluidity of communications between these regional authorities. It established appropriate levels of responsibility in accordance with the main themes of integration and regional development and it also assigned defined responsibilities to each of these authorities.

“The PARLACEN Plan also introduces a counterbalance to the political pre-eminence of the Meeting of Presidents with regard to the role of the Integration Institutions as, in accordance with Article 5(c) of the Constitutive Treaty, the Central American Parliament is given the power to “Elect, appoint or remove, as appropriate, in accordance with the Rules of Procedure, the most senior executive official of the existing or future bodies of Central American integration created by the Member States of this Treaty”. This power, ratified by the ruling of the Central American Court of Justice, would be complemented by another provision in this same Article which states that the authorities or bodies governing these institutions (normally the Ministers responsible for the area involved) should submit to the Central American Parliament a shortlist of three candidates for these posts. If this proposal is not made, Parliament shall elect or appoint the respective person.

In this way, adequate representation in the higher-level institutional positions of the integration bodies and a functioning more in line with community interests was guaranteed, unlike what happened previously or what is happening now that SICA is in force. The current situation is that the officials of the integration bodies are chosen by the respective Council of Ministers (Intergovernmental Body). For example, in the case of the Secretary-General of SIECA (Secretariat for Central American Economic Integration), the latter is appointed (in accordance with the Guatemala Protocol) by the Council of Ministers of Economic Integration on a proposal from a private Central American Institution. In this way, an eminently community function assigned to PARLACEN in its Constitutive Treaty and which guarantees a higher level of democracy and legitimacy in the conduct of the Central American integration bodies has been restricted.

The institutional plan contained in the PARLACEN Constitutive Treaty is also incomplete as it lacks a Judicial Body with respective control of the whole system and a Community Executive Body responsible for developing the programmes and projects of the global integration process. The latter has not been established with the entry into force of the Tegucigalpa Protocol or with the application of the Guatemala Protocol and the Social Integration Treaty which create their respective Sub-Systems. This is because these are only an extension of SICA **and do not clearly resolve the delicate issue of assigning responsibilities and functions to community and intergovernmental bodies whose decisions may be binding and which could effectively promote integration** or the Economic Union as proposed in the Tegucigalpa Protocol. They even less so establish a new democratic political concept

which, based on the combined exercise of the sovereignty of each of the States in the region, would result in the establishment of a Central America united as a single nation.

This analysis is made using the premise that the Tegucigalpa Protocol must be regarded, in accordance with the Consultative Opinion issued by the Central American Court of Justice, as the framework of Central American integration. It is therefore the highest ranking document and forms the fundamental basis of any other Central American legislation, whether this involves Treaties, Conventions, Protocols, Agreements or any other binding legal acts prior or subsequent to the entry into force of the Tegucigalpa Protocol. As a result, in view of said Opinion, the other Legal Instruments of the Economic and Social Sub-Systems and of the other Authorities forming part of the Central System must be regarded as derivative or complementary, whatever their legal nature and their applicable provisions: "... provided that these are not contrary to the present instrument and do not prevent the achievement of its aims and objectives." (Article 35 of the Tegucigalpa Protocol)".

The lack of a logical order in the assignment of responsibilities and powers to the bodies forming the system is well-known but, fundamentally, due to the emphasis placed on the main political decision-making body, the intergovernmental nature of its institutional structure prevails over the community nature of bodies such as PARLACEN and the Central American Court of Justice. One essential component must be added to the above analysis: SICA, as the basic structure of Central American integration, does not provide an operative or executive element to represent the regional interest in the face of the intergovernmental interest. **In other words, it lacks a Regional Executive Body which, together with PARLACEN and the Central American Court of Justice, could establish the balance required in a Community System in which the hegemony of the president is reduced.**

From this viewpoint, it can be seen that SICA does not provide a complete institutional structure and that its base instrument (the Tegucigalpa Protocol), instead of encouraging the community action which would make its nature, aims, principles and goals of achieving Central American integration effective, has in fact limited the actions aimed at establishing this economic and political community proclaimed by Article 1. Bearing in mind the above assessments and if we examine the organisational structure of SICA, we can see that the main bodies of its institutional structure (Meeting of Central American Presidents – Central American Parliament – Central American Court of Justice) seem to be set far apart, as if they lack an appropriate functional link allowing them to act side by side. There are no bridges or links between them and no reciprocal interaction mechanisms making the whole into a functional system.

We can therefore say that the current integration process is more a case of intergovernmental cooperation than a community-style integrationist plan. This is because efforts were concentrated on adapting this legal and institutional framework, rather than on creating a new plan. This is why this initiative could not completely escape the limitations of the past. A clear example of this is that the General Treaty on Economic Integration is still in force and other instruments in the process are being amended without a new model of integration being established, based on harmonious and coherent instruments or, why not say it, supported by a new Framework Treaty in the political and technical sense of the word.

As a result, it is in the context of this vision of political and economic realism that Central America must establish itself in the international arena at the beginning of the third millennium, in order to advance into the 21st century in the optimum condition to achieve the development and wellbeing which its population demands.

In terms of this philosophy, it is interesting to note that the Central American Integration System suffers from faults in its structure, due to the proliferation of instruments governing its development and an insufficient overall political vision which is making the governments react to the current situations, without planning for the medium and long term.

Strengthening Central American integration by creating a new model.

It can be seen that the legal and institutional framework established by the Tegucigalpa Protocol has not been the best option for allowing or facilitating the Central American process to advance towards a system of community authorities. Its structure has simply resulted in a consolidation of the intergovernmental mechanisms of regional cooperation without any possibility of encouraging what the protocol itself proclaims: "*Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama are an economic and political community aspiring to the integration of Central America ...*". This statement was ratified by the presidents of the Central American countries at the XIX and XX Summits held in Panama and Managua on 12 July and 2 September 1997 respectively.

It is easy to see that the Central American governments still have as their objective the establishment of the Union of Central America. Even though they state that this must occur gradually and progressively, they have underlined the ideal of regional unity and are planning for this Central American integrationist culture to be in place within the third millennium.

Based on these commitments, a process was started in 1997 to find alternative ways of reforming SICA, by rationalising and strengthening Central American institutionality, with the backing of ECLAC and the IDB.

Among various proposals is the need to stress to governments the enormous difference between having an intergovernmental system of horizontal cooperation and a vertical regional Integration System with bodies which are assigned community-style functions and responsibilities.

As things stand, regional integration is facing one of its greatest challenges as, in addition to the structural problems mentioned above, new scenarios are emerging such as the globalisation process, multilateral trade agreements and extra-regional development programmes, for example: the Free Trade Agreement being negotiated between the United States of America and the Central American states; the Free Trade Area of the Americas; the Puebla Panama Plan, and the negotiation of the association agreement between the European Union and Central America. The democratic fragility of our countries must also be noted as another challenge of integration.

Furthermore, in the trade sphere, the legal instruments of the regional economic integration process have been damaged as a result of the trade agreements negotiated

with third countries which have included the granting of greater trade preferences than those which we grant intra-regionally.

It should be mentioned that the Central American Parliament, as a body for analysing and making recommendations on issues of regional integration, has been strengthened by the incorporation of new players. However, full advantage has not been taken of this potential, despite the discussion of the challenges currently facing Central America having been promoted with the aim of achieving integration in the face of the globalisation processes, but always protecting the achievements and advances made within this integration.

We understand that the proposal at the Meeting of Central American Presidents, at Panama II and Managua II, constitutes a **Declaration of Principles** which, in due time, must result in a better assignment of functions and responsibilities among the intergovernmental bodies and community bodies with a supranational nature.

This will only occur through comprehensive and substantial reforms of the legal and institutional integration framework. This would require the preparation of a new draft framework treaty for the **REGIONAL COMMUNITY SYSTEM OF CENTRAL AMERICA** in order to build a true economic, political, social and cultural union. This treaty would completely differentiate between the functions and responsibilities of the intergovernmental bodies and the community bodies with a supranational nature.

The future of our economies, development and progress is intimately linked to the process of globalisation but, in order to achieve this, we must firstly complete our regional integration as regionalisation is increasingly becoming an important element in the new world economic order, as is happening in the countries in the European Union, the Asian Bloc and the African Union in which their integration commitments are increasing based on a complete process of economic and monetary union.

It was in this context that PARLACEN, as a regional community-style institution, proposed at the end of the 1990s to study the costs of non-integration, with a First International Seminar being held on this issue, involving European and American experts. At this they discussed the advantages and disadvantages which integration or non-integration would have for Central American society and its Member States, as the then European Economic Community did at the time through “The Cost of non-Europe” report prepared by Professor Paolo Cecchini. We can see results of this in the new model of the European Union.

Due to the above and in order to achieve the objective of building ourselves a community system, the Central American Parliament must immediately be converted into a Forum steering the proposals which must be put to the governments, aimed at creating a new legal and institutional framework for integration. The agenda of this Forum must include changes in the mechanics and handling of issues, so that efforts are not duplicated or discussions repeated, and it must focus on defining the outlines of the community policy needed by the region.

In this respect, the Central American Parliament proposes:

That the governments of the Member States of SICA be invited to a **Central American Commission of Legal Experts** on Integration which will be coordinated

by PARLACEN, with the support of the European Union institutions, particularly the Parliament and Commission. This joint forum involving experts in the field will cooperate with PARLACEN in preparing the project for the new legal and institutional framework for Central American integration.

Only by adapting and perfecting the legal instruments and institutions of the regional integration process can Central America establish itself efficiently and effectively within the new world political and economic model.

Central American economic integration and institutional reform

Rafael Chamorro Mora
President of the Central
American Court of Justice

The Central American region has for many years been trying to achieve union. The five provinces gained their independence from Spain and the Federal Republic of Central America was born with the 1823 Constitution.

In 1838 the Federation broke apart with successive attempts to re-establish the union being made subsequently, such as the signature of conditions for union in 1842 and the Permanent Pact of the Central American Confederation and the Pact of the Union, right up to the signature and ratification of the Tegucigalpa Protocol, the framework constitutive treaty of the Central American Integration System.

Our integration process has basically been characterised, in its recent stages, by the creation of free trade areas, a customs union and a common market. These certainly encourage “trade” but do not include the possibility of maximising our real possibilities of development within the region and thereby lead to individual productive processes of little or only relative benefit. Another characteristic has been the failure to adopt a coordinated approach in our foreign policies, with the aim being to improve our international integration and increase our negotiating power with third countries or international organisations.

We now need to make progress towards true integration in order to become stronger, to coordinate various policies on subjects as varied as labour, industry, trade, defence and security, etc., and to thus ensure the communal wellbeing of the Central American community.

Faced with the uncertain future of the Central American community within the globalisation process, the only certainty is integration. However, this must be supported by an institutional and legal framework in which a regional court guarantees legal certainty and the uniform application of Central American Community Law and resolves, both through the court system and by arbitration, the disputes arising within the Central American Integration System. This court is the Central American Court of Justice. This has been given wide powers which it has used to the full in its eight years of operation, having heard twenty consultative cases and forty-one disputes and delivered over one hundred decisions among which we can highlight, due to their importance, those delivered in the cases of the action by the State of Nicaragua against the State of Honduras due to the ratification of the Ramírez López Treaty and the action by the State of Honduras against the State of Nicaragua due to the application of the law requiring the payment of a 35% tax on goods and services originating from Honduras and Colombia. Both States have failed to comply with these decisions.

In the second case, the breach of community regulations was established and the order was made to suspend the application of this law. In the first case, the suspension of the procedures to ratify the Treaty was ordered and the breach of the community

regulations and the international responsibility of the State of Honduras, due to not having adopted measures leading to the suspension of the entry into force of the Treaty, were established. This is why Honduras was required, as a legal consequence of the judgment and in accordance with this established international responsibility, to adopt measures allowing everything to be returned to the situation which would have existed if acts to implement the Ramírez López Treaty had not been implemented.

One of the tasks of the Central American Court of Justice is to ensure respect for and observance of the decisions delivered by this Court so as to defend the aims and ensure compliance with the fundamental principles of the Central American Integration System and legal certainty of the Central American Community.

Another of its tasks is to keep defending the institutionality of the Central American Integration System faced with renewed attempts to weaken this and the legal certainty of the System.

A Protocol of Amendment to Article 35 of the Tegucigalpa Protocol was recently signed, relating to the resolution of disputes, in order to deprive the Court of its jurisdiction in commercial matters. This amendment establishes that: “disputes arising in the economic integration subsystem as a result of the intra-regional trade relations shall be subject to the dispute resolution mechanism established by the Council of Ministers of Economic Integration which shall include an alternative method of resolving trade disputes, including arbitration, whose decisions shall be binding on the Member States involved in the respective dispute. Failure to comply with the arbitral award shall give rise to the suspension of benefits of equivalent effect to those not received, as decided by the respective award.”

This amendment threatens the legal certainty of the integration process and attacks the institutionality of the Central American Integration System by aiming to deprive the Court of its jurisdiction in commercial matters. This is because the Court did not decide how the Ministers of Economic Affairs wanted, as indicated in the third and fourth recitals of said amendment which state: “Whereas, during 2000 and 2001, steps were taken to add alternative methods to the dispute resolution mechanism, established in the Legal Instruments of Central American Integration, which were unsuccessful due to the decision delivered by the Central American Court of Justice on 12 November 2001 at ten in the morning, in response to the request for an opinion submitted by the Council of Ministers of Foreign Affairs and Ministers of Economic Integration, through the Secretary-General of the Central American Integration System. Whereas the Intersectoral Council of Ministers indicated in the above recital, both in its meeting of 27 September 2000 and in that of 24 May 2001, agreed to leave reasonable time for the response from the Court and, in the absence of this or if the response was negative, to amend the Tegucigalpa Protocol to incorporate the use of alternative methods for resolving the disputes occurring in trade exchanges in the Central American Common Market.”

Furthermore, Article 14 of the Tegucigalpa Protocol establishes that the decisions of the Meeting of Presidents, the supreme body of the Central American Integration System, will be adopted by consensus. However, the Protocol of Amendment does not appear to be signed by Panama or Belize, which are members of the System, but,

despite this, the entry into force of the amendment is still being promoted although the established rules have not been observed.

All the tasks are included within the integration process which, throughout its history, has taken steps forwards and backwards, has had its good and bad moments and is still doing so. Everyone is well aware of the number of agreements signed, the amount of decisions taken and the few complied with. This must make us think long and hard about what we want, why we want it and how we want it. Therefore the Court has proposed that an Intergovernmental Conference should be held, with the participation of the Member States of the System, the bodies and organisations of this System and civil society and with the cooperation of experts in this respect, with the aim of analysing in depth and taking the decision as to whether or not we want integration, if the first question is positive then why we want it and how we want it.

To reinforce the integration process, it is absolutely essential that the Member States which have not already done so complete the process of ratifying the community instruments, especially the Constitutive Treaty of the Central American Parliament and the Agreement on the Statute of the Central American Court of Justice, in order to consolidate the institutionality of the System. There can be no integration without a legal system and there can be no efficient legal system without a Supranational Court of Justice guaranteeing legal certainty and the uniformity of Community Law. This is why the political will of the governments to comply with the community regulations and abide by the decisions of the Central American Court of Justice is of such vital importance.

The Central American Court of Justice is the institution whose members have remained longest in their positions compared with the main bodies of the Central American Integration System. This allows them to appreciate the development and the various stages passed through in the process and to draw the following general conclusions:

1.- Since 1995, with the change in five Presidents of Member States, a change in mentality has occurred at the highest level of Central American integration. This really became apparent in the Declaration of Panama II of July 1997 which concerned the removal of powers and permanence both from the Central American Parliament and the Central American Court of Justice, aiming to reduce them to figurehead bodies without any real meaning in the process. In other words, this was a reactionary process in which it was even suggested that integration would be promoted by increasing the intergovernmental cooperation relations. This is of course the exact opposite to a real integration process.

2.- In the same way, the fact that the Presidents of the Member States have asked for an assessment from bodies outside the system, to the detriment of the powers which both the Central American Parliament and the Executive Committee have for this purpose, although the latter is not formally established despite having to represent the Central American Community like the European Commission represents the European Communities, reaffirms to us that there is no clear idea of how to achieve Central American integration. There is also no clearly defined and explicit political will to drive the process as conceived in the Tegucigalpa Protocol, the Framework Treaty of the Central American Integration System and other constitutive treaties.

3.- We are at a crucial point in the process of Central American integration, at a time when disputes have arisen between the Member States of the Central American Integration System (SICA).

The way to tackle these problems is to reinforce the regional agenda and institutions of SICA in order to preserve, strengthen, enrich and extend the community patrimony and accelerate the rate of the Central American integration process. The focal point of this must be a Conference in which the Member States, the Fundamental Bodies of Central American Integration and the Consultative Committee within SICA are represented in order to determine: Where do we want to take integration? What features should it have? To what degree? and To what depth? In this, we must take as the reference and example, where applicable, the successful experience of the European Communities and European Union, asking them for their cooperation and assistance to prepare and hold this Conference.

We consider this to be of singular importance and urgency as the march towards globalisation has already started and is not stopping. It is up to us alone, as Central Americans, to successfully join the movement or we will be left without any chances of survival as countries.

Economic integration: content, effectiveness and policy

Paolo Cecchini
Author of the Cecchini Report
on the “Cost of non-Europe”

I) THE CONCEPT OF ECONOMIC INTEGRATION

As the result of a seminar on revitalising relations between all the nations within Mercosur and on the relationship established with Europe, it is to be assumed that the present conference cannot fail to take account of the European experience. However, this must not be regarded as the only model given that this corresponds specifically to the European situation. Furthermore, this does not mean giving a theoretical presentation but rather putting forward a methodical list of points relating to the possibilities and limits of economic integration between sovereign States.

Conceptually the term “integration”, properly applied to international relations, lacks clarity. Dictionaries in various languages all give this term the meaning of “formation of a whole from separate elements”. It is apparent from this that, in order to be transformed into a whole, the previously separate elements will necessarily have to undergo structural modifications. The use of the term “integration” in international relations requires us to clarify its scope by classifying the content. This means distinguishing between:

- “trade” integration in which the structural modifications, although sometimes extensive in sectoral terms, have little overall impact, given that the main preoccupation of the contracting parties is focussed on the protection of national sovereignty in its highest degree;
- “economic” integration in which the economic interactions have a global nature which necessarily result in major modifications in the economic structures of the participants. These modifications require the joint management of certain elements of national sovereignty;
- “political” integration in which the structural modifications do not only affect the rules applicable to the economy but also call into question parts of the very Constitutions of the participating States.

Personally, I have always found it very difficult intellectually to use the term “integration” for the free trade agreements frequently concluded in recent years in various parts of the world. These agreements protect the freedom of the contracting parties with regard to their trade policies, impose minimal requirements for joint management and provide relatively modest commercial advantages in relation to the increasing liberalisation of exchanges at multilateral level. This assessment is confirmed by personal experience in the negotiations and subsequent management of the free trade agreements signed in 1972 between the European Community and certain Member States of the European Free Trade Agreement in which neutrality prevented the elements of sovereignty from being jointly managed. On the other hand, when it has been wanted to extend these agreements in order to adapt them to the

legislative activities of the EC single market, with the creation of the European Economic Area, the problem of the joint management of the elements of sovereignty, unacceptable to the EC outside the institutional legal framework properly speaking, has been decisive in the failure of the initiative. This has been seen, on the one hand, in Switzerland's refusal to participate and, on the other, in the accession to the European Union of Austria, Finland and Sweden.

II) CONTENT OF ECONOMIC INTEGRATION

The objective of economic integration requires, as a starting point, the formation of a customs union between the participants. The formal definition of the customs union, established since 1947 in Article XXIV of GATT, is the replacement of the customs territories of the participating States by a single territory specific to the Union. This entails, firstly, the joint management of trade policy (import rules and tariffs) with regard to the countries not participating in the union and, secondly, an inevitable approximation of elements of the legal and administrative framework of economic activity.

This second element in the construction of the customs union is needed as, once a differentiation is made with regard to the countries outside the union, on the one hand, major distortions in the conditions of production of goods and services on the inside must be avoided. On the other hand, in the interests of economic and social development, the best possible use of the production factors in the economic area corresponding to the unified customs territory must be encouraged.

For this purpose, the proposed objective is to ensure the free movement of the factors of production formed by goods, services and people and, where possible, to ensure the existence of common rules for the following: the customs treatment of imported goods (nomenclature, origin of products, charging rules, etc.), the technical regulations in the public interest (health, safety, protection of the environment), the transport activity and the indirect taxation of goods and services. This even extends to the exchange rates as the devaluation and revaluation of the national currencies may alter the framework of the comparative advantages resulting from the elimination of the obstacles to free movement.

Having defined these approximately common rules, the problem unfailingly appears of administering the economic area of free movement in terms of the more general policies. Apart from the previously mentioned aspect of trade policy, this also affects the macroeconomic policy, in particular the orientation of industrial policy, as the benefits expected by undertakings must not be frustrated either by attempts to encourage monopolies or by an excessive injection of public funds in favour of public or private undertakings which are in competition.

The set of rules and political practices which both precede and result from economic integration end up requiring the structural changes to be established in a body of legal rules. These rules may certainly be established on a case-by-case basis when the real need arises. However, the development of the integration processes and their consequences at the legal level will unfailingly lead to a general focus on both the rules properly speaking and on the preparation and management of these.

In other words, the customs union understood conceptually as the creation of a whole starting from separate elements constitutes not the point of arrival of economic integration but its starting point.

III) CONDITIONS FOR SUCCESS (NECESSARY BUT NOT ALWAYS SUFFICIENT)

Economic integration firstly requires the motivations of the participants to be close enough. This requirement is less difficult to meet if the participants are not too numerous, at least in an initial stage and even at a more advanced stage, to establish an effective operating *praxis*. A second important asset is formed by the closeness of the countries which aids the development of interdependence and solidarity due to the ease of communication. Thirdly, the linguistic community represents a positive factor which must not be underestimated.

In more general terms, it must be remembered that the new economic integration initiatives, such as Mercosur, are being developed in a constantly changing international framework following the fall of the Berlin wall and the end of the Cold War. Prominent within this international framework are the International Monetary Fund, dominated to date by the interests of the United States of America and even subject to these, and the World Trade Organisation in which a political balance has been developing between the two big trading powers, the United States of America and the European Union. When the latter manages to successfully create its single currency, a similar political balance could be established officially or unofficially, even in the international monetary system. In this context, and looking long term towards China, Russia and new regional or subregional economic organisations being present on the international economic scene, the issue will have to be tackled of delimiting globalisation, as it is termed, given the deficient structure of the world organisations. The ideas of Adam Smith about the risks of social imbalance which are run if market forces are allowed unlimited freedom cannot be ignored as some schools of economic thought, which are closer to a theological type of focus than to a global analysis of society, would like us to do.

As regards the more technical aspects of the conditions for success of economic integration, in first place is efficiency in its operation which depends directly on the legal stability of the commitments adopted. This efficiency is related to the form of the base agreements which must be binding on the participating States as such. This aspect is essential to ensure the correct application of the agreements. Legal stability also requires a system for resolving possible disputes: legal certainty forms *de facto* an essential requirement in order to mobilise the interest of economic operators in expanding their activity within the single customs area.

Another factor in ensuring legal stability is the method adopted for fulfilling, at the technical level, the commitments contained in the base agreements according to the requirements imposed by the development of the economy and society. Purely administrative solutions bring with them the risk of instability which can be avoided by implementing instruments capable of producing permanent results.

In political terms, the stability of the integration process largely depends on the balance between the advantages and disadvantages deriving from the integration for each of the participants. There must necessarily be a dynamic balance given that it is

impossible to immediately create a balance in each action as, on every occasion, some participants will have to make concessions without immediate compensations on a case-by-case basis. As a result, the participants need the wisdom to ensure that the advantages and disadvantages do not always go in different directions. The response to this challenge lies in two different but necessarily parallel elements: on the one hand, the larger the field of action of the integration, the easier it is to recover the possibility of balance; on the other hand, the time factor must be taken into account as a dimension which, in a context of legal stability, may mean that the participants trust in the necessary balance being achieved. In this respect, we note that the Community took 35 years, from 1957 to 1992, to achieve its single market at legislative level and that this is still not totally operational.

However, this same time dimension is also not risk-free: we note the rush with which very often senior political figures try to achieve tangible results, often useable for electoral purposes. As evidence of this attitude we can cite, on the one hand, the prospects of rapidly expanding the European Union to the recovered democracies of Central and Eastern Europe and, on the other, the timetable included in the Treaty of Asunción establishing Mercosur. At this point, it is not inappropriate to mention two people who have illustrated European integration through their work: Raymond Barre who reminded anyone rushing that “the Community needs a lot of patience” and Jacques Delors who, in an even more explicit manner, declared that “there are no easy shortcuts in historical processes”. These are in fact the stages which must be passed through in order to overcome, within the political class, in public administration, among the economic operators and, last but not least, in public opinion, the psychological and factual obstacles opposing real integration.

These obstacles include the need to manage the structural adjustments of the economy caused by the opening of the market. These are not minor problems as can be seen, for example, from an important survey on the possible consequences of achieving the single European market in which the majority of business leaders agreed in predicting losses of sales in the national market, compensated by the increase in sales in the markets of other participating States.

In order to avoid the social repercussions of this anticipated economic restructuring, the national public authorities will have to use the existing financial mechanisms or create new ones. Bearing in the mind the European experience and the important differences existing between the Member States with regard to economic capacity, national intervention has been reinforced with the assistance of Community instruments, in a relatively complex institutional context.

As regards economic integration, ambitious objectives are proposed which may be difficult to achieve with the traditional method of intergovernmental organisations as these are also governed by the principle of decision-making by unanimous consent. In order to be effective, it is necessary to formally delegate a wide range of elements of sovereignty to common institutions using methods which, to a varying extent, may provide for decisions by majority, create an independent legal system with legal guarantees which are also independent, have an independent budget with a stable income, establish specific parliamentary control and assign the tasks of preparing the decisions to an independent common body.

IV) CREATION OF A POLITICAL CONSENSUS

In driving and developing economic integration, two aspects can be easily distinguished: the first relates to the diplomatic procedure of bringing the participating States together to define common objectives: this is an essential element although technical in nature. The second aspect relates to the organisation and maintenance of a political consensus on integration within each participating State.

The objective of national political consensus is the acceptance by public opinion of the joint management at international level of public issues such as stability and the development of the economy, social balance, protection of the population in health matters, protection from risks deriving from technology, international representation in economic matters and so on. The difficulties arising in the European Union with regard to the ratification of the Maastricht Treaty seem to demonstrate that the more integration seeps into the conscience of the people, the greater the effort which must be made to convince the people.

It is therefore necessary, above all, to make the integration process a public issue and not the exclusive territory of the people responsible for the work. This is why the relationship between politics and diplomacy, on the one hand, and the media on the other is essential. Also, the communication function must not be underestimated. This can be assumed, in a virtually permanent public debate, by the organisations elected to achieve the political consensus, from the Parliament to the local and regional organisations. The participation of the professional representatives of undertakings, the liberal professions and workers, depending on the integration problems, must occur at the same level.

The publicity given to the integration process has, in these circumstances, a dual political function: on the one hand, it informs the people about the scope and methods of operation; on the other, it provides the political authorities with the essential elements for defining the national interests to which priority must unavoidably be given in the process of the permanent negotiation characterising economic integration.

V) A BRIEF CONCLUSION

Please allow me to finish with two essential quotations from the two “fathers” of economic integration:

- Jean Monnet: “We cannot integrate States, only human beings”.
- Walter Hallstein: “We are not in business, we are in politics”.

To sum up this brief presentation, it can be concluded that economic integration bears witness to a hope as tenacity is needed to overcome the inevitable difficulties, the constant search for a political consensus among the people cannot be avoided and, finally, the permanence of the objectives and the capacity to take advantage of the fleeting moment of favourable circumstances must be ensured over time.

The challenge of the Central American customs union

Pedro Caldentey del Pozo
Executive Representative
ETEA Foundation for Development
and Cooperation

A. INTRODUCTION: 2003, A GOOD TIME FOR CENTRAL AMERICAN INTEGRATION

This is currently a particularly favourable time for the process of regional integration in Central America. In fact, we are actually at a similar point to that in the first years of the 1990s when the process was reinvigorated and restructured following the progressive resolution of the conflicts in the region. It is also true, if the exaggeration will be permitted, that Central American integration is at a kind of “now or never” point.

The negotiations on the permanent establishment of the customs union are undoubtedly the most important event in this period of progress. There are also other factors supporting this optimism about the development of the integration process:

- The recent regional studies having had a significant impact and interest (Central America 2020 and the Harvard-INCAE study).
- The Stockholm and Madrid Consultative Groups and the demonstration of what the region is capable of planning when it can agree to work around some basic points of consensus.
- The increasing, albeit slow, involvement of civil society in the process.
- The increase in intra-regional trade since the beginning of the 1990s and the decision of the Central American business world to work regionally without waiting for the governments to reach agreement.
- The proposals of the United States of America and the European Union to negotiate free trade agreements with the region.
- The decision of Costa Rica to join the negotiations on the permanent establishment of the customs union through the incentive of negotiating on NAFTA.
- The incorporation of Belize into the process and its growing interest in increasing its participation which will surely be clearly appreciated when it assumes the rotating presidency of the system in the second half of 2003.

Clearly there are also still some factors acting as a brake on this optimism:

- The territorial conflicts and some trade tensions between the Central American countries.
- The pending institutional reform which is limiting the capacity of the process to advance and which is hindering its legitimisation with regard to the Central American people.
- The concern about whether it is the offer of NAFTA which is the only reason for establishing the customs union.

- The lack of a joint negotiating and consultancy team within NAFTA to take advantage of the benefits of the customs union, which could be a starting point for the regional negotiating machinery.
- The will of the governments seems firmer than ever but is unable to rule out episodes of unilateral non-compliance (such as the reduction in the tariff ceiling by El Salvador in 1997, the subsequent unilateral amendment of the previously corrected Nicaraguan tariff or the lack of observance by Honduras and Nicaragua of the opinions of the Central American Court of Justice).
- The failure to follow up the projects developed within the Madrid and Stockholm Consultative Groups despite the expectations generated.

Despite the good timing, the Central American people still view the regional integration process with a certain scepticism and some distrust. What factors determine this perception?

The answer can be summed up by what we could call, rather theatrically, the *dilemma of Central American integration*.

Central American integration, its agreements and its institutions have defined a community-inspired legal and institutional framework. However, it actually works within a clearly intergovernmental framework, in a contradiction which has had many and frequent manifestations in recent years.

This contradiction is based on the dilemma of the Central American governments as to whether or not it is appropriate to gamble on regional integration as a framework for their development strategies. Weighty arguments¹ justify the dilemma but this lack of confidence in the agreements signed prevents the integration process from showing that its potential can be effectively developed.

¹ For example: the intra-regional trade figures compared to the region's exports to the United States of America; the distrust of agreements based on cooperation with partners affected by economic and political instabilities; the lack of conviction about the dynamic benefits of the integration agreements; the doubts about the benefits of joint action compared with bilateral actions in terms of attracting foreign investment or international cooperation; etc.

B. THE DILEMMA OF CENTRAL AMERICAN INTEGRATION

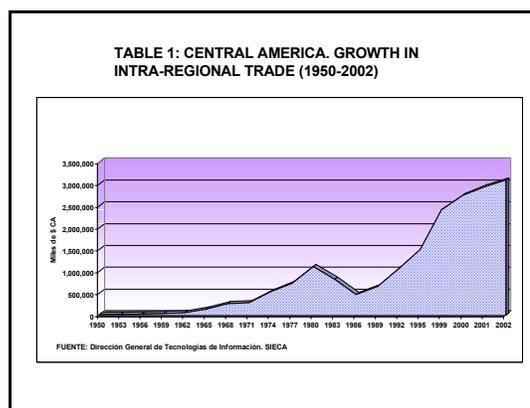
How does this dilemma manifest itself in the strictly economic sense? It has, for example, the following three manifestations:

Dilemma No 1: Intra-regional trade is not sufficient to justify the advantages of regional agreements but non-compliance with these prevents its growth.

In a quick summary, the intra-regional trade figures indicate the following:

1. The growth in Central American intra-regional trade must be noted in particular (See Table 1). In 2002 this exceeded the historic figure of 3 thousand million dollars². This growth reveals the vigour of intra-regional trade which, in recent years, has been developing faster than extra-regional trade.

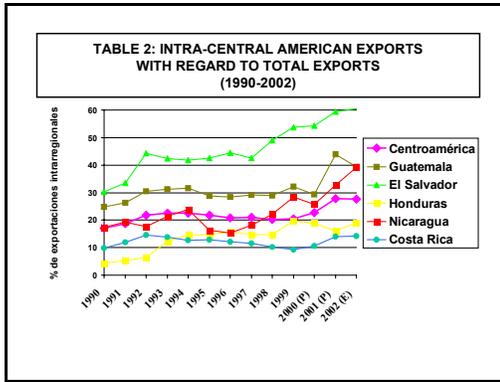
Behind these figures is also the phenomenon of “informal business integration”. It can be said that there is a group of business sectors which have decided not to wait for the customs union agreements and which is already working within a Central American market, avoiding the obstacles which still persist. Also, in terms of micro-enterprises and SMEs, increased dedication to the Central American market is being seen.



Source: SIECA. www.sieca.org.gt

2. The total amount of intra-regional exports is exceeding by far the maximum of 1980, having reached a figure of nearly 28% (see Table 2). The figures for countries such as El Salvador or Guatemala indicate the importance that intra-regional trade continues to have for the Central American economies. The percentage exceeds 40% in the case of El Salvador (according to data from SIECA) and 25-30% in the case of Guatemala, which means that both countries are particularly interested in the regional agreements. The percentage is lower than the regional average for Nicaragua, Honduras and Costa Rica.

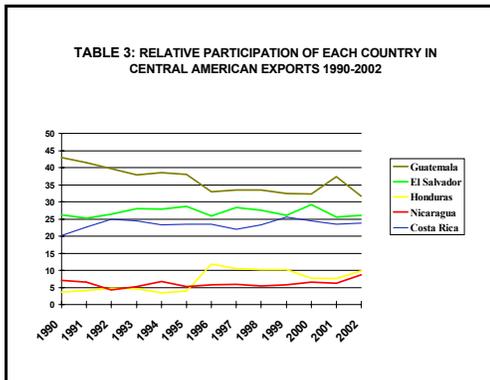
² However, it should be noted that the figures in the graphs in this report come from SIECA. Its statistics do not include the production of *maquila* (apparel) as exports. This therefore overvalues the intra-regional exports.



Source: SIECA (2003). www.sieca.org.gt

3. The total percentage of intra-regional imports has varied between 10% and 15% over the decade. Nicaragua is less interested in the integrationist trade agreements as we can see that it has a higher percentage, always exceeding 20%. El Salvador's percentage is around 15% and Costa Rica is the country with the lowest percentage at just over 5%.

4. Guatemala and El Salvador together account for over 60% of intra-regional exports with approximately 35% and 25% respectively. Honduras and Nicaragua represent only just over 15% (see Table 3).



Source: SIECA (2003). www.sieca.org.gt

5. Guatemala and Costa Rica are the only countries with a positive balance in the intra-regional trade relations over the decade. El Salvador is close to zero and Nicaragua and Honduras have a constant and increasing negative balance.

From all this data it can firstly be seen that El Salvador and Guatemala are the countries with the greatest interest in the progress of the Central American agreements but that Costa Rica could achieve significant trade results for some of its production sectors if it gambled more on regional integration. There is also a recurring and fundamental problem in Central American integration. This concerns the unbalanced development in certain sectors and countries of the region, revealing the limited participation and clearly negative balance of the poorest countries in the region, Honduras and Nicaragua.

The analysis of the intra-regional trade flows and their comparison with the extra-regional flows is a source of important information on which certain institutions in the region, such as ECLAC for example, are working. The exhaustive analysis of these flows is one of the tasks pending for the institutions, research centres and universities

in the region. The results of this will surely provide clear arguments for solving some of the dilemmas of integration.

Dilemma No 2: The intervention of the FTAA blocked the advance of the Central American integration agreements which have given way to the FTAA negotiations.

The hemispheric free trade offer by the USA to the Latin American countries at the Miami Summit in December 1994 reversed the progress of the Central American process. It should be realised that the Central American countries concentrate their trade relations on the American continent, and particularly on the US market. If we analyse the main destinations of the region's exports, the figures clearly show the importance of Central America's trade relations with the United States of America and this explains the influence of any proposed trade negotiations originating from the latter. And even if these trade relations did not have the relative importance which we have indicated, we could use, as an explanation, the political or cultural factors or the thousands of Central Americans who live in the USA.

However, there is no need to highlight the clear risks which Central America faces in its integration into the FTAA or in the agreement with the USA.

It is now time not only to negotiate but also to lament not having had the customs union ready for this moment. Integration could have had positive effects in this respect for two reasons. Firstly, it could have reduced to some extent the dependency on the US market and it could have diversified the trade options of the region. And secondly it would have encouraged the formation of more solid negotiating teams, particularly because a united Central American market is more attractive in any possible trade negotiation.

Fortunately, the negotiations with the USA (and this is more down to the USA than to the actual members of SICA) are occurring on a joint basis. Down the years we have seen both coordinated and independent negotiations which have caused significant confusion about the "common foreign tariff".

Customs union *requires the abandonment of unilateral trade negotiation strategies* where these are incompatible with the multilateral negotiations or with the Central American agreements. The indecision of some Central American governments as regards integration has resulted in unilateral negotiations which have caused non-compliances with the agreements and, in particular, a loss of legitimacy in the mind of regional and international public opinion.

Dilemma No 3: The region has opted for a development strategy which does not coincide with the underlying model in the integration agreements of the nineties.

What is the development strategy chosen by the region? What does the integration model contribute to this strategy?

The integration models in the Central American plan and in NAFTA have different theoretical foundations. The development strategy promoted by NAFTA or the FTAA does not recognise the benefits which may be generated by a customs union. It considers preferential treatment between regional partners as an obstacle to free trade and it is opposed both to creating regional institutional frameworks and to establishing common policies. It promotes the total openness of the economy above approaches which introduce gradualness and selectivity in the process.

Regional integration in Central America is an instrument of development which could have considerable potential in the structural transformation of the economies and

societies in the region. The historical and recent development of Central American integration is based on concepts closer to the European model or the period of the MCCA (Central American Common Market). NAFTA and the FTAA tend to reinforce a strategy of economic development based on the traditional exporting model which, if you look at Central American history in the 20th century, has done little to solve the structural problems of the Central American economies.

The dilemma as to which model to choose is the reason for the constant indecision about regional integration in the nineties and the failure to define the process. The policies which would have resulted from applying the Treaties signed at the beginning of the decade are not all compatible with the priorities of current economic policy. This is the main dilemma for regional integration in Central America.

In view of this conflict of goals, it should be considered whether the advances made in the process in the early nineties were the result of agreement between governments and society or whether the process advanced only until the neoliberal strategy was compatible with the integrationist effort, or whether the integration agreements have had the basic aim of facilitating trade liberalisation in the area in order to eliminate obstacles and make progress in the FTAA negotiations or those now ongoing within the WTO.

No one can ignore the difficulty of choosing between these. It is inappropriate to make a glib speech about regional integration or to sing the praises once again of the benefits of the process. It is true that opting for regional integration probably offers less spectacular results in the short term but may be more effective in eliminating the obstacles preventing the region's development and limiting progress in the fight against poverty.

If this objective is made the focal point of the regional development strategy, the integration mechanisms can offer viable answers by, for example, defining common infrastructure development, social integration or agricultural policies.

Furthermore, the possibilities of jointly developing regional cohesion policies are not exclusively limited to international cooperation. The presence and current position of the Central American Bank for Economic Integration (CABEI) allows a regional cohesion policy to be considered in the process which would solve, among other issues, the problem of the poor distribution of the potential benefits of integration.

**TWO THEORETICAL PARADIGMS FOR THE EUROPEAN UNION
AND THE NORTH AMERICAN FREE TRADE AGREEMENT**

	EUROPEAN UNION	NAFTA
Scope	Global	Trade
Institutional framework	Community	Intergovernmental
Aim	Customs union, single market, monetary union	Free Trade Area
Common policies	Yes	No

AND IN THE CENTRAL AMERICAN CASE?

	SICA	NAFTA
Scope	Global	Trade
Institutional framework	Community	Intergovernmental
Aim	Customs union	Free Trade Area
Common policies	Yes	No

From an analysis of the Central American Treaties of the nineties, there is no doubt that the integration conceived is closer to the European model than to the free trade model. This means that it has aspirations of a global scope, with a fully developed and community-style institutional framework and the old aim of achieving a customs union but with positive steps towards creating a common market.

C. CUSTOMS UNION AND ITS OPPORTUNITIES

In order to determine the opportunities offered by the customs union, we must look at two scenarios, which are far apart in terms of time, in order to highlight the possibilities which the customs union offers Central America:

- a) the experience of the MCCA in the sixties
- b) the recent experience of the Stockholm and Madrid Consultative Groups

The experience of the MCCA

Usually nothing good is said about this period in Central America but historical distance and the fortunate elimination of ideologies from the debate on these issues now allows some important ideas to be gathered.

Together with the traditional criticisms about excessive intervention and protectionism and the inefficiency of the industrial sectors promoted, the process had important positive effects on the region. These can be summarised as follows:

1. There are specific areas in which the regional action was very effective. The most obvious and most successful case is the construction in the region of a significant network of communications and telecommunications infrastructures, now quite dilapidated. This is an issue very much now in the limelight.
2. The MCCA had a positive effect on the expansion of production in the region. Its influence undoubtedly increased the positive results from an international context which was also favourable to the Central American countries. The MCCA had positive effects on regional wellbeing and gave rise to the greatest absolute and relative growth in industrial activity in the history of Central America.
3. The process also encouraged the greatest degree of economic interrelations between the Central American countries in their history. The framework generated by the integration agreements encouraged internal investment and attracted foreign funds into the region.
4. The process of integration and industrialisation caused certain structural changes in the region's economies although these did not go as far as desired. It was at this point that the modern sector of the economy appeared in the region which at least helped to diversify production. Despite its limitations, the MCCA led to a significant effort to modernise the Central American economies.
5. The MCCA also generated a network of regional institutions which have formed an asset in all joint actions, in particular the regional peace process and the reinvention of integration in the nineties.

Despite everything, the experience of integration in this period now provides us with valuable lessons, such as: the virtues of the regional action mechanisms if these are correctly used and defined; the need to create an institutional framework which is flexible and allows the effective defence of regional interests, and certain instruments which are very appropriate to the needs of the region. It is essential to recall once again the key regional construction effort which underlined the regional economic integration process. It can probably be said that this was the main *endogenous* effort

ever made to reform and modernise the Central American states. The Latin American component in the driving proposal of ECLAC and the actual participation of Central American governments in the initial design – and their subsequent departure – also form unusual elements in Central American history.

Aside from discussing the assessment of these years, the impact of an endogenous effort as the main asset in the first stage of Central American integration is what makes it relevant to refer to this in this document.

The Consultative Group

The differences are apparent and clear from many sides and viewpoints, but the meeting of the *Regional Consultative Group for the Transformation and Modernisation of Central America* in March 2001 in Madrid is another example of a regional effort which, combined with international support, may result in a catalogue of regional actions and strategies to tackle the fundamental problems of the region which natural disasters have highlighted.

Mitch mobilised the Central American countries and the international community, firstly to tackle its damage and then to transform the conditions which make the region so tragically vulnerable to the natural disasters which inevitably form part of its condition. The international community was prompted by the impact which the hurricane had on world public opinion and in particular by the feeling that decades of effort and support through international cooperation in the region had not reduced the vulnerability.

The meeting of the *Consultative Group for the Transformation and Reconstruction of Central America* took place in the city of Stockholm from 25 to 28 May 1999. At this meeting, the Central American governments and the international community decided to share responsibility for reconstructing and transforming the countries affected, forming a long-term association guided by the priorities defined by the former and based on the following principles and objectives:

- to reduce the ecological and social vulnerability of the region;
- to reconstruct and transform Central America based on an integrated approach of transparency and governability;
- to consolidate democracy and governability, reinforcing the decentralisation of power with the active participation of civil society;
- to promote respect for human rights as a permanent objective;
- to coordinate the efforts of donors, guided by the priorities established by the beneficiary countries;
- to intensify the efforts to reduce the burden of foreign debt on the region's countries.

Following Stockholm, the meeting of the *Consultative Group for the Transformation and Modernisation of Central America* was held in Madrid on 8 and 9 March 2001. As a result of this, a coordinated process of discussion and consultation was started in the region by the General Secretariat of SICA which formed a Coordinating Committee and established a Madrid Unit to prepare the necessary proposals.

Subsequently, a consultation body was formed, composed of ministers appointed by the governments for this purpose, which was named the Madrid Meeting of Ministers. A Coordinating Committee was also formed, composed of ECLAC, INCAE, SIECA

and the Secretariat General of SICA (SG-SICA), together with an Inter-institutional Committee formed of the regional institutions of SICA.

Finally, the Secretariat General of SICA held consultations on the same issue with the regionally organised civil society – through its Consultative Committee (CC-SICA) – and also with private enterprise which formed the *Commission for the New Central America* and other organisations.

The meeting of the Madrid Regional Consultative Group was the focal point of an intense debate focussing on the region as a unit and on the regional integration process as the most appropriate framework for regional development. The expectations generated by the discussions and by the valiant effort to achieve a consensus and jointly prepare a catalogue of projects to be undertaken among the region's countries, the international cooperation and the document on the Transformation and Modernisation Strategy for Central America in the 21st Century should be highlighted.

The results, however, did not live up to the expectations generated in the months prior to the Madrid Consultative Group. The projects have not been implemented as hoped and the responsibilities for this are probably shared.

Despite this, the meeting of the Consultative Group revealed the extent of the benefits of combined effort, the use of the technical capability of the regional institutions and the existence of “lubricated” mechanisms for cooperation between governments and institutions, between governments and civil society and between the region and international cooperation. The almost unwonted failure to follow up the process also shows the enormous difficulties facing integration.

What is the point of the new Central American integration? Benefits and costs of integration for the developing countries

The 1990s were marked by the paradigm of globalisation with all its complex manifestations. The new integration proposals constitute a Central American response to the globalisation within which the size of economies is undoubtedly a decisive factor. Now more than ever before there is a feeling of unquestionable doubt about the viability of the Central American economies as separate entities.

However, this is not the only argument. The general aim of any integration process is to increase the wellbeing of a country or a number of countries forming the integrated group by, firstly, improving economic efficiency by expanding the markets and increasing competition with the sectors and businesses of the integrated countries and, secondly, by taking advantage of the greater negotiating strength afforded by the bloc nature of a group of countries on the international stage.

There is a wealth of literature on the effects of economic integration, particularly with regard to the static effects, but also, although with a lesser degree of consensus, on its dynamic effects. The static effects of the customs union are evaluated according to the concepts of trade creation and trade deviation. Both effects, based on static efficiency, i.e. on the distribution of resources with other factors remaining constant, have been studied in depth since their formulation in the work by Viner³.

³ The trade creation effect improves the efficiency and wellbeing of the national economy, encouraging specialisation and the development of comparative advantages, and favours third countries indirectly due to the likely increase in imports deriving from the improvement in wellbeing. Trade deviation reduces the wellbeing of the international economy by harming the more efficient external producers to the benefit of the less efficient producers in the customs union. The effect of trade deviation in the economies of the member countries may be positive or negative if we take into account that the reallocation of resources has an impact on the demand side

The analysis by J. Viner of the two combined effects demonstrated, using the special case of the second-best⁴ theory, that a customs union could have positive consequences on the member countries, thereby counteracting the neoclassical tendency to regard free trade as the best possible option. This means that, given the restrictions on international trade, a customs union could be more beneficial than a strategy of generalising free trade if the necessary factors are present so that trade creation prevails over trade deviation⁵.

If we focus on these static effects as the criterion for determining the appropriateness of establishing a customs union between developing countries, we will probably conclude that the trade deviation is greater than the trade creation between them. The reasons for this phenomenon are clear. Developing countries are characterised by their limited industrial development and the concentration of production and exports on a very small number of agricultural or mineral raw materials or products involving virtually no processing. Their level of intra-regional trade is usually also limited. Finally, their markets are of an average size and purchasing power which hinders the specialisation of production.

From the neoclassical viewpoint, this analysis would mean rejecting the decision to establish a customs union. However, the analyses of the many experiences of integration in underdeveloped environments seem to negate this presumed evidence. The static effects of regional integration lack relevance when this occurs between underdeveloped countries as the predominance of trade deviation and the continuation, therefore, of significant inefficiencies in the allocation of resources is due to the economic and trade structure of these countries. And it is precisely on these structural factors that the integration must act⁶.

To conclude, the difference lies in conceiving the integration, not as an instrument of liberalisation, but as an instrument for economic development which, in underdeveloped countries, involves the transformation of certain structural conditions preventing this.

Using this argument, the assessment of the effects of a free trade area between underdeveloped countries tends to be negative due to their limited contribution to transforming the traditional structures of underdevelopment.

(prices rise due to the increased cost of the union's products) and on the supply side (sales by producers in the union increase).

⁴ Initially put forward by J.E. Meade in "The Theory of Customs Unions" (1955) and developed and universalised by R.G. Lipsey and K. Lancaster in their work "The General Theory of the Second-Best". This maintains that, if all the conditions of the Paretian best are not met, there may be a set of second options which, although not meeting a majority of these conditions, represent the maximum wellbeing achievable.

⁵ However, the analysis of the effects of integration, particularly at its initial stage, i.e. the customs union, has been focussed in recent years on its dynamic aspects. Experience has altered the perspectives on this issue. According to various authors, although there are evident difficulties in measuring these, the dynamic effects of the customs union are greater than the static effects on the wellbeing generated. The analysis of the dynamic effects of integration is not as uniform as that of the static effects but the majority of authors cite the following: the improvement in economic efficiency caused by the increase in competition; the appearance of economies of scale facilitated by the expansion of the markets; the increase in both internal and external investment given the opportunities generated by a wider market; the stimulation of technological development, etc.

⁶ In addition there are dynamic effects which are difficult to quantify and some political aspects which may alter the conclusions of the analysis. In developing countries, a customs union currently has a dual meaning: on one hand it facilitates the liberalisation of trade, but, on the other, it would allow selective protection mechanisms to be established with regard to imports of products originating from advanced countries. This trade deviation would therefore be an effect sought with the aim of discriminating in favour of national products or, in any case, in favour of products originating from other developing countries. Clearly, the level of discrimination must be reduced and must be temporary so that effects contrary to those sought do not result.

To conclude, the fundamental contributions of an integration process between developing countries are therefore in starting the structural transformations which attack the condition of underdevelopment, in modernising the economic systems and, finally, in linking the sectors of the economies of the underdeveloped countries and gradually bringing them within the world economy.

D. CONCLUSIONS

Returning to the dilemmas on which the process to be achieved depends, this moment in time which is full of opportunity must be seized in order to give integration a chance. It is essential to take advantage of the moment in order to rule out the dilemma between integration and free trade in favour of institutional development and regional policies. It is necessary to work towards a certain degree of community structure within the Central American integration.

The role of the European Union in this process is particularly important. The support for Central American integration being given by the EU presents an excellent opportunity for the European experience to act as an incentive to Central American progress. It has been said many times before that the regional institutions are weak and have few basic mechanisms for dealing with the pressure from national interests. The collaboration between these institutions, civil society and international cooperation could constitute an element of balance and solidity in the process⁷.

The European experience and what we could call its keys to success⁸ provide us with some simple ideas with which to conclude these reflections on the challenge of the customs union:

1. The economic dimension of the process is decisive in ensuring that integration offers tangible results to its members.
2. Central American integration must be developed through its treaties and institutions which is why institutional reform must be progressed and mechanisms defined to ensure compliance with the agreements and the definition of the responsibilities of the institutions.
3. Central American integration involves more challenges than possibilities and the integration agenda is too broad. A more pragmatic approach involving compromises is required.

⁷ In the absence of what, in the EU, ensures the balance of responsibilities between the Member States and the regional institutions (the triangle of the European Commission, Parliament and Court of Justice).

⁸ On some occasions in recent years, we have had the opportunity to present, in the region, a work entitled "las claves de éxito de la integración regional" [the keys to the success of regional integration]. In this work, prepared by a group of colleagues from the ETEA Foundation for Development and Cooperation, we have tried to summarise what could be useful from the European experience for Central America. See Caldentey, Romero and Ortega (2000), *Siete claves para comprender el proceso de construcción europea* [Seven keys to understanding the process of European construction]. Cuadernos socioeconómicos [Socioeconomic journals] of the Central American Bank for Economic Integration (CABEI), n° 26, December 2000. Published by the Planning and Budget Department of CABEI. Tegucigalpa (Honduras).

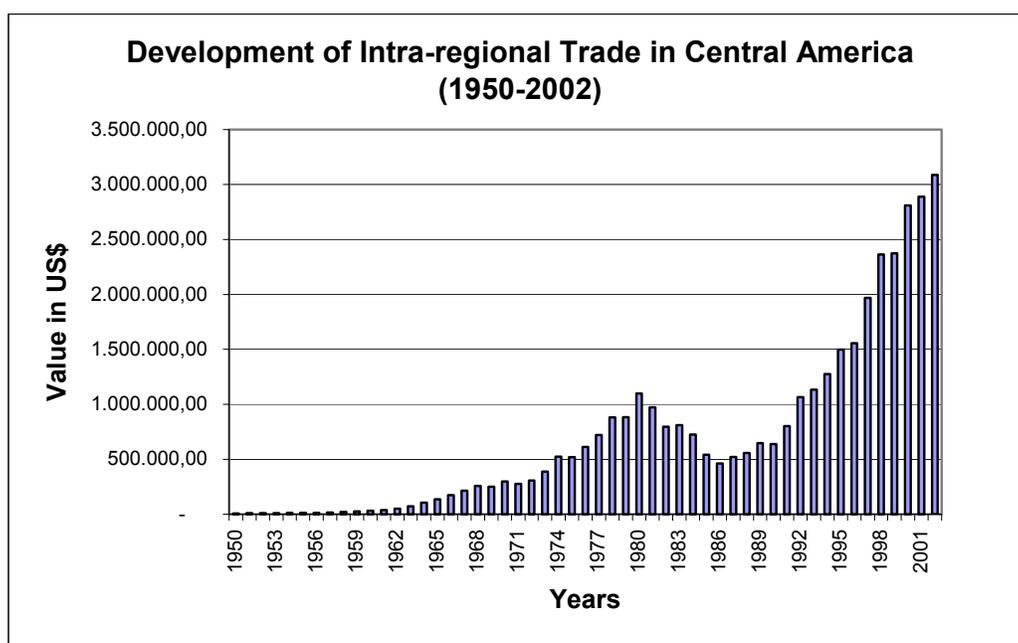
4. The Central American agreements must lead to the definition of community policies. Priority must be given to the most urgent.
5. The balanced development of the region is a decisive factor in the success of the process. As in the European process, it is a source of benefits for all.
6. Integration is a medium and long-term challenge. Central America requires leaders with the long-term vision to support this.

The problems and opportunities of the Central American customs union

Laura Quinteros de Aguilera
Director General of Integration and Trade of the Permanent Secretariat of the General Treaty on Central American Integration (SIECA).

Before presenting the situation of Central American Economic Integration, allow me to analyse the figures available for trade over the last 42 years, which are shown in the following graph.

GRAPH



As you can see, in 1950, trade between the five countries in the region reached a total of 8 million dollars, which, as the integration process moved forward through the determined political will of the governments of the region to support the process, reached US\$ 1200 million in 1981 (the highest level achieved in the first stage). Owing to the problems in the region during the 70s and early 80s, the figure dropped to levels similar to those in 1974. However, it can be seen that from 1990, when the Esquipulas agreements (peace and democratisation) were implemented and the presidents decided to re-launch Central American economic integration, again there was an improvement in intra-regional trade, which reached US\$ 3 087 million in 2002.

If we look at the total trade in the region last year, we can see that, in terms of both imports and exports, Central America is the second largest market for the countries

concerned and represents 28% of total exports and 14% of total imports, which means that trade interdependence between the countries has been increasing.

The largest traders in the region are Guatemala with 37%, El Salvador with 26% and Costa Rica with 24%. Although the other countries have increased trade with their neighbours, they have not managed to increase their share in terms of percentages.

In recent years fundamental changes have taken place in economic integration, especially since 24 March 2002, when the presidents established an Action Plan, with pre-established dates for achieving the various commitments.⁹

First of all there is the signing and entry into force from 19 March of this year of a Settlement of Commercial Disputes Mechanism, based on arbitration, which will solve problems arising in intra-regional trade. In terms of regulations, a Treaty on Investment and Trade in Services has been signed and is pending approval by the legislative assemblies of the countries concerned.

The Council of Ministers for Economic Integration (COMIECO) has also adopted and brought into force the Central American Standard Customs Code (CAUCA) and its Regulations (RECAUCA), which updated the instrument, which provides harmonised regulations for the different customs systems in the five countries, to fit in with the new trade requirements.

Another important element in the process is removing obstacles to trade. When the Action Plan to remove trade restrictions was signed, 60 obstacles were identified, 44 of which have been removed by the countries, with only 16 remaining, which should be removed as quickly as possible as the deadline was 31 December 2002.

The Plan also included the liberalisation of products that are still in Annex A of the General Treaty on Central American Economic Integration. This was achieved within the established deadline (31 December 2002) for wheat flour between those countries that still had restrictions on it, and for ethyl alcohol between El Salvador and Nicaragua from 1 January 2003 and between Guatemala and El Salvador from 1 January 2004. Roasted coffee was also liberalised between Guatemala and Nicaragua and between El Salvador and Nicaragua, in both cases from 1 January 2003.

The other important matter included in the Presidents' Plan is the formation of Customs Union between the territories of the countries, which is understood as the creation of a common customs area between the countries, which means that there would be free movement of goods, irrespective of their origin, and of the services associated with trade, i.e. a single market within which goods can move freely once they have entered the customs area through one of the countries and the corresponding duty has been paid. This decision by the presidents is a qualitative leap forward in the process and represents a move up to a higher level of integration.

Although the process was begun between Guatemala and El Salvador in 1996, in August 2000 Honduras and Nicaragua were incorporated, and, more recently (June 2002), Costa Rica joined.

⁹ See Presidents' Action Plan, 24 March 2002

The main features of the Customs Union to be established in the Central American Region are, as well as free movement of goods and services irrespective of their origin, the adoption of common external tariffs, the development of a common external policy and the harmonisation of customs, tax and intellectual property legislation.

The main areas of work are therefore as follows:

- Common tariffs
- Free trade
- Common Customs Administration
- Tax Harmonisation
- Common External Trade Policy

In order to move forward in establishing Customs Union, COMIECO was given the task of coordinating the work to be done, which is grouped either by sectors or across sectors, with Ministers with different portfolios depending on the subject to be dealt with, for example Agriculture, Health, Treasury or Finance, Government. The Vice-Ministers for the Economy and Trade are responsible for coordinating the different technical working groups, made up of the Integration Directors, Internal Revenue Directors and Customs Directors, who can also meet by sectors or across sectors. These groups have formed different technical subgroups to deal with more specific matters, as indicated later.

The main progress made on Customs Union.

The main progress made includes the agreements on harmonisation of tariffs. To date 78% of tariffs have been harmonised, with 22% remaining. Among the products still to be harmonised are agricultural, fiscal and other products. There are also around 813 types of textiles, clothing and shoes that have fixed tariff goals that are being applied by two of the countries, while the other three are applying their corresponding tax relief programme in order to achieve those goals by 31 December 2003. Discounting these items, it can be said that harmonisation is at 90%, without considering the new agreements to be reached during the rest of the year.

For product registration, four technical sub-groups have been formed: food and drink, medication and associated products, agricultural supplies and hydrocarbons.

As a result of the work of these subgroups, to date there has been mutual recognition of the health registration by the countries in the region for their own food and drink products, for which purpose the technical specifications and criteria for the registration of food products were harmonised. This means that a regional producer has only to register his product in one of the countries, and the registration is recognised in the other countries in the region.

Mutual recognition has also been established for health registers for medication, for own products, with the exceptions established in the corresponding COMIECO resolution. Progress has also been made in the harmonisation of stability criteria for medication.

For agricultural supplies, although there are no agreements in force, as there are for foods and medication, progress has been made in harmonising technical instruments for evaluating the quality, efficacy and safety of chemical pesticides and lists have been harmonised of agricultural and fishing supplies that are prohibited within the territory of the Customs Union.

In the case of hydrocarbons, as the region does not produce these products, the subgroup has made progress on harmonising the administrative requirements for expanding the registration of importers and exporters of oil and its derivatives, and on harmonising the technical quality specifications for producing and distributing oil products and their derivatives.

The Standardisation Measures Subgroup is making progress on harmonising technical regulations for various labels and specifications for food products, pharmaceuticals and hydrocarbons, and the Subgroup for Health and Phytosanitary Measures is working to establish harmonised health and phytosanitary requirements so that there can be free movement of non-processed foods, and to harmonise the evaluation and monitoring of agricultural protection systems.

The greatest achievements have been made in the Meetings of the Director Generals of Customs as part of Customs Union, with 11 meetings of the directors and around 25 meetings of the technical committees.

As well as completing the work of CAUCA and RECAUCA that has already been mentioned, the Single Manual for Customs Procedure was completed, which is being applied as a Pilot Plan in the integrated and peripheral customs between Guatemala and El Salvador. Once its effectiveness has been proven, it will be put into operation in the other countries in the region.

The other subject that has been dealt with by the Customs Directors and the technicians on the Technical Committee for Transit and Information Technology is transit. In order to monitor transit across the region, a system is being designed for communicating between the customs services, with the aim of exchanging information, firstly on the start, transfer and completion of transit within the region. This system for monitoring movement is being applied between Guatemala and El Salvador, through single information capture at the customs of departure and validation at the customs of entry of the country of destination.

Also, in order to remove border customs, the Customs Directors have put into operation Integrated Customs which consist of administrative services responsible for applying the common legislation and customs procedures for two or more countries sharing the same administrative office for clearing goods. Moreover, there is the arrangement that there is only one customs process at the posts in the country where the goods enter, so that a lorry going from Guatemala or any other country to El Salvador, for example, only stops once on the El Salvador side, where the customs officials from Guatemala and El Salvador carry out the procedures for the corresponding system, in accordance with the customs declaration. This has reduced the stopping time for transport units at border posts.

Also, where it is not possible to transfer customs officials from one of the countries to the other, Juxtaposed Customs are in operation, which means that the services are

carried out by the customs officials from each country in their respective offices and they carry out the complementary procedures via electronic communication between the customs services of the two countries.

These pilot customs posts, both integrated and juxtaposed, have enabled technical staff to harmonise, simplify and automate customs procedures, so that when the intra-regional customs posts disappear and the work takes place at the peripheral posts, the latter will have perfected their operational procedures and will be working with systems that will make their operations more transparent. The other important aspect is the exchange of experiences and knowledge between the customs officials of the different countries so that they learn to trust each other and coordinate highly efficiently with the work done by officials from the other countries.

Peripheral customs posts are also in operation as a pilot scheme at the entry ports in Guatemala, El Salvador and Honduras, with officials being transferred from the customs services that are going to work with those from the country where the port is actually located, so that the customs procedures of the country of entry and the country of destination are applied in one go. For example, El Salvador has peripheral customs posts at the land post in Tecún Umán, and the ports of Quetzal, Santo Tomás de Castilla and Puerto Barrios in Guatemala and in Puerto Cortés in Honduras.

Therefore for an import to El Salvador, through the port of Quetzal, the Guatemalan customs official takes the information and passes the documentation on to the El Salvador official, who verifies the import information, so that when it arrives in El Salvador the information is already recorded and if it was prepaid and if green was selected, it can be taken away immediately on arrival at the Central Customs, Fiscal Warehouse or customs site in the country of destination. The same process is used if it enters via Puerto Cortés bound for El Salvador.

As indicated, these customs posts are operating as a pilot scheme, as once Customs Union is established, the customs official of the country where the goods enter the customs area will apply the agreed procedures, without officials needing to be transferred from other countries, with the information being transmitted electronically.

The Technical Group for Risk Analysis and Taxation has also been formed, and they are working on drawing up uniform standards for risk criteria to be applied in the different customs systems and operations, in order to minimise failures to apply standards and procedures.

The Committee on Customs Legislation, made up of lawyers specialising in customs from each of the customs services of the different countries, has drawn up a draft Central American Law for Penalising Smuggling and Customs Fraud, with the aim of harmonising controls and having standard penalties in the countries of the region cases classified as smuggling or customs fraud. This is in response to the request from the region's presidents, who indicated in the Action Plan adopted in March 2002 that combating smuggling and tax evasion are essential requirements for the operation of the Customs Union.

The other subject that the Customs Directors have been examining is Customs Evaluation. The Central American Valuation Committee, made up of specialists in

this area from each country, drew up a draft regulation or piece of Central American legislation on customs valuation which will govern Article 7 of GATT in a harmonised way, which is to be submitted to COMIECO for its consideration and approval. On the same subject, a database is being put together of the value of goods at regional level, and updating mechanisms for products that are usually imported to the region.

With regard to the harmonisation of taxation when Customs Union enters into force, from the work carried out in 1992-1995 the Taxation Technical Group (TTG) decided that the taxes that should be harmonised are Value Added Tax (VAT), Specific or Selective Consumer Taxes, and import duties, which have already been mentioned.

For this purpose it was requested that two studies be prepared by consultants on the legal structures, organisations and operational procedures of the tax administrations of the countries. The TTG also has the following draft agreements at technical level for consideration by the Internal Taxation Directors:

- Agreements on the principles underlying taxation policy within Customs Union.
- Exchange of information and taxation cooperation agreement, with its respective explanatory statement.
- Regional agreement on the taxpayer information consultation system.

These agreements will enable greater flexibility in recording, monitoring, surveillance and taxation of taxpayers associated with the flows of trade that will be boosted by the operation of the Customs Union.

In this context there are subjects still to be considered by the countries that are in the presidents' Action Plan such as designing a Common Customs Administration, designing a collection mechanism, the administration and distribution of income from imports, defining a common trade policy and establishing a mechanism for on-line communication between the customs and taxation authorities.

These activities are among the components of the funding agreement that the Secretariat for Central American Economic Integration has signed with the European Community which will be able to be implemented very soon, to complement the work done in Central America and enable Central American Customs Union to become a reality.

Prospects for the Central American customs union

Ricardo Zapata Marti¹⁰
International Trade Unit
CEPAL

*“A strong Central American homeland can only be a united one. Attraction of foreign capital is one of the main and most urgent tasks for the region” **Rufino Barrios**, President of Guatemala, end of 19th century.*

A project for Central American integration

I would first of all like to say a few words about a specific programme we are implementing through a partnership between CEPAL and SICA, a programme called “Integration: costs and benefits”. It is an attempt to identify all previous achievements, setbacks, obstacles in the integration process in the region and in each one of the countries involved. On the basis of this analysis, the programme aims at developing tools for the benefit of national governments and civil society. These tools focus on strengthening awareness of the challenges of regional integration and facilitating the adoption of necessary decisions. This approach is particularly relevant and timely against a background of increased demand for international trade liberalisation, the negotiation of a Central American-US free trade agreement and a new Political Dialogue and Cooperation Agreement with the EU.

What are the first results of this work? Not surprisingly we have observed that the integration process was accompanied by different forces some strongly in favour of it, others opposing it. Each driving or obstructing force has influenced the process and managed to dominate specific periods. It seems however that there is currently a window of opportunity for deeper integration. There is increased awareness that there is a need to strengthen regional companies as international players together with a need for converging regional rules of the game in order to preserve stability, predictability, good governance and competition. If we are to prioritise required fields of action, we would say that the most urgent one relates to the creation of a regional Customs Union. In this respect, it is paramount to make sure the process is irreversible, gradual and is based on the principle of “shared sovereignty”. The acknowledgement of the latter is considered a pre-requisite for the successful integration course.

On the other hand, we have embarked on a detailed set of sector-specific analyses studying potential costs and benefits of integration using different scenarios (econometric models). Particular emphasis is placed on the so-called sensitive sectors such as agriculture or transport and services.

To address the challenges of the coming years, a step-by-step approach is recommended taking into account the timetable for the next few years: completion of the customs union and the Central American-US Free Trade negotiations (expected for the end of 2003), the Free Trade Area of the Americas (FTAA) (planned for 2005), negotiation of a new Agreement with the EU (launched in May 2003).

¹⁰ The opinions expressed in this presentation are done personally and so do not compromise the CEPAL

Central American integration: an on-going process

The origins of Central American integration are found in several declarations of politicians and academics at the end of 19th and beginning of the 20th centuries. At the time of independence of the countries from Spain, there has even been an attempt to draft a constitution for a federal Central American Republic. Following that, there have been attempts to create regional organisations, such as the Organisation of CA states (ODECA) and ultimately the well known CA Common Market (MCCA) born in 1960 under the strong impulse of CEPAL. The latter and in particular its Executive Secretary Dr. Raul Prebisch then launched the concept of “**import substitution**” as an engine towards modernisation and industrialisation of the countries in the region. The creation and development of a regional market with adequate external protection and the co-ordination of internal policies in order to channel investment to certain industries and countries were the key ideas behind regional integration. Thus, MCCA was born with the “**inward integration**” model.

MCCA broad objectives (1960)

- *To Converge towards a common external customs duty within a period of 5 years with a view to establishing a common market;*
- *To Promote and co-ordinate industrial development;*
- *To Co-operate in monetary and financial areas;*
- *To Develop integrated infrastructure and*
- *To Facilitate inter regional investment.*

The first measures taken in order to achieve these objectives have been (a) the immediate elimination of **intra-regional customs duties** for certain products and MFN treatment for all other products and services, (b) the establishment of an **external customs duty** for a wide range of products.

Although implementation of the integration agenda has been slow and troublesome at times, the region managed to achieve sustained growth roughly for two decades and the share of intra-regional trade soared three-fold to 25% from a weak 7.5%.

The 1980's have been described by many as the lost decade for Latin America. In Central America it has also been the decade of armed conflicts and strife in three countries (Guatemala, El Salvador and Nicaragua) whereas all the region was badly affected. As a result, priorities in these countries switched away from integration to peace seeking. Meanwhile, **CEPAL's approach to integration** evolved into a more **open, market-oriented** model involving structural adjustment, privatisation, opening of markets and liberalisation of the economy.

This **outbound integration model**, which was also sponsored by the international community and which complemented the peace process in the region, encompassed measures promoting export promotion and diversification and market liberalisation coupled with measures to increase domestic competition.

Key dates in CA integration

1971 – establishment of a MCCA standard commission with the exception of Honduras. This Commission agreed to admit the regular functioning of the meetings of the Ministers and vice ministers of economy as transitional bodies of MCCA assuming the functions of the Council of Ministers.

1975 – Establishment of an inter-institutional commission with the aim of identifying proposals for the implementation of different resolutions related to the integration process (trade policy, external financing, industrial policy, regional development of energy resources, etc.)

1980 – The Central American countries express their political will to restructure the integration process entrusting their powers to the meetings of Ministers and Vice ministers who thus become responsible for economic integration.

1983 – Establishment within the Latin America Economic System (SELA) of a Committee of Support to Central American Development (CADESCA) aiming to reinforce the integration process and the Contadora Group.

1984 – The ministers responsible for integration adopt a resolution for re-establishing the Economic Council and the Executive Council, entrusting the latter with the readjustment of the integration process. Honduras joins this initiative.

1987 – The ministers responsible for integration and regional development adopt a Plan for reactivation of the integration process. Signature of the Constitutive Treaty of the Central American Parliament, whose promotion and establishment were strongly supported by the European Union.

1988 – Adoption of a Plan for Urgent Action (PAI) consisting of a short-term plan of urgent actions and proposals for mainstreaming the integration process. The General Assembly of the United Nations adopts a Special Co-operation plan for the region.

Tegucigalpa and Guatemala protocols – agreements on the institutional reform and commitment to peace, democracy and development. Paving the way towards enlarging the scope of the regional process and going beyond the Central American Area.

Available comparative data show that the process has been partly successful. It is clear that intra-regional customs duties have fallen dramatically from more than 50% on average in 1980 to less than 9% in 2002. Apart from a series of products such as sugar, milk or coffee (where intra-regional trade is still subject to duties, sometimes considerable) intra-regional trade flows are not subject to duties. Moreover substantial efforts have been deployed in converging the economies of the Central American countries.

However, it is not a secret that integration efforts did not reach all expected results:

- Integration did not lead to the expected **industrialisation**;
- **Trade liberalisation and export promotion** strategies have not contributed to the expected degree in boosting growth of the economies in question.

- Inter-regional **disparities** in some cases have deepened; as a result, regional and border tensions were fuelled between the Central American countries; effective obstacles to integration remain at large.

Challenges ahead: disparities

This last point presents a major challenge in the region; the acknowledgement of the existing **deep intra regional disparities** as key risk factor for the integration. While there is no doubt that regional processes generate winners and losers, it is also essential to put in place the proper mechanisms for equal distribution of benefits of integration in favour of all interested parties.

In view of achieving a balanced and sustainable development of the regionalism, it is necessary to establish **adequate compensation mechanisms**, whose functional norm will become a criterion for equity.

There are objective obstacles in the development of Central American exports.

In multilateral plan:

- The elimination of quotas on **textile products** envisaged in the Textiles Agreement (GATT 1994);
- The gradual elimination by 2005 of subsidies to special **exports promotion** regimes;
- **China's** accession to the World Trade Organisation (WTO);
- Continued **dependence of exports on unilateral concession schemes** (CBI, GSP), which do not contribute to predictability and do not promote long-term investment.

Finding solutions to these challenges could further promote the co-operation among the Central American countries on regional policies that will provide them with greater competitiveness.

What are the challenges and the prospects for future integration?

Even though the regional integration process started some 40 years ago it is still considered to be partial and incomplete and its various aspects have been progressing at different speeds. The inward integration has not achieved its objective, namely industrialisation, while the outbound integration has found itself in a vicious circle:

- Export growth can only be achieved through selling goods with higher added value. However, in order to acquire such added value it is necessary to import.
- In order to promote exports, choices had to be made: priority was given to low capital investment and cheap labour initiatives, the major “industries” developed being maquila (apparel industry) and migration (!).

In addition to this, it has to be noted that a proper legal and institutional framework in most of the countries and in the region seems to be lacking.

What remains on the agenda?

1. Macroeconomic co-ordination

- Trade interdependence accompanied by limited economic and productive interdependence;
- Instability and macroeconomic differentiation among the countries;
- Lack of consensus on exchange rate regimes;
- Lack of consensus on fiscal regimes and on the relative weight of the direct and indirect trade-related contributions.

2. Integration in the labour environment

3. Competition policy

- Enlargement of the market;
- Regulations to reduce transaction costs;
- Regulations on restrictive commercial practices;
- Transparent anti-dumping and investment policies.

4. Protection mechanisms

- In the area of *environment*: national legislation and implementation of the international agreements and promotion of 'green' activities and environmental sustainability through economic instruments;
- In the area of *investment*: non-discrimination, avoiding unfair competition among the sectors and the countries;
- In the area of *intellectual property*: national legislation in line with the international practices;
- Mechanisms for **dispute settlement**.

The state of Central American integration - negative and positive aspects

Alfredo Trinidad
Vice Minister of External
Relations of Guatemala

The aim is to pool experiences with different individuals in society in order to build the foundations for a **genuine regional community**.

Negative aspects

At present Central America has no clear vision of where it is going in the near future.

Since 1997 it has done little more than respond to its own national or regional circumstances but in such a way that gives little impetus to the integration process.

Natural disasters, such as earthquakes and hurricanes, or proposals like the Puebla Panama Plan or negotiations for Free Trade Agreements are the result of incidental acts which find the region not only unprepared but also disunited, ill-informed, uncoordinated and with a poor response capacity.

Many experts have made it quite clear that rather than fulsome political declarations, what Central American Integration needs are **practical measures** that actually help to transform these societies and turn them into a coherent unit capable of basic survival.

Several publications have stated that Central American Integration has become all talk and no action. These findings are borne out by the 4% implementation rate of the major decisions reached at the Meeting of Presidents. This has further undermined the credibility of an integration process, which despite the best intentions, often takes one step forward and two steps back.

Since 1991, the fundamental integration agreements and some of the Presidential Meetings' declarations seem to have been drafted by specialists in distorting ideas, altering the meaning of words and changing the definitions of the integration process rather than by professional integration experts who specialise in advising Governments. Or perhaps they have simply been subsumed in the negotiations by a set of politicians who lack the political know-how needed for an integration process?

According to the agreements so far concluded, Central America is an Economic and Political Community and according to the Presidential declarations we have already embarked on the gradual and progressive establishment of the Central American Union. In actual fact, in more than forty years we have never got beyond the stage of inter-governmental cooperation - and that has already been exhausted.

The one exception is the economic sub-system which, 43 years after the conclusion of the General Treaty on Central American Economic Integration, offers the first promise of real economic integration, fulfilling the mandate of the March 2001 Meeting of Presidents.

Some regional institutions call themselves Community Organs although this stage of integration has not been reached.

All there really is, is a precarious patchwork of inter-governmental institutions. The only exception is the Central American Parliament which is an embryonic form of representation in the regional process and which, eleven years down the line, still has to cope with the inability of all but two of the 38 political parties of the member countries to tackle the whole integration question.

The Central American Parliament and the Central American Court of Justice require binding powers, possibly to give impetus to a Community process. However, if these efforts are to succeed, they should focus on the shift from public international law to integration law throughout the integration process, in the same way as the economic sub-system is doing.

As the regional institutional framework stands at present, it would appear that Central America suffers from institutional paralysis, with a closed decision-making system at odds with the region's democratic progress. Clearly it is not very democratic, if not bordering on the anti-democratic.

It is also clear that to date there has been no organised form of political leadership. There is no Government or institution that is leading the way. There is no capacity for initiative that can turn viable technical proposals into political decisions.

POSITIVE ASPECTS

Integration exists and it is on a solid footing despite the delays in official integration.

There are two aspects of integration that are widely debated among the region's academic circles. The first is that integration is vital for facing up to globalisation with any chance of success.

The feeling is that the integration system, faced by the reality of globalisation, needs economic, political and social foundations to support a solid framework that can withstand the process of economic opening up and cope with the structural delays that hamper development.

The second aspect is that real integration is making headway in areas such as Central American investments in Central America - Guatemalans have invested in Nicaragua, Salvadorians in Guatemala, Hondurans in El Salvador and Nicaragua - financial companies are merging, basic grains are being traded, SMEs are linking up and so on.

So far, all of this has nothing to do with the official integration process. This means that Central America faces the challenge of injecting new life into the integration process. For example, in the light of the results achieved to date, there is a pressing need for a comprehensive overhaul of the Central American *Integration System*.

The new integration needs to bolster a **sense of regional identity** that takes account of different situations and different forces.

The **ability to make proposals** at political level needs to be improved and backed up by the necessary technical input. These proposals should be discussed at regional political level and by the regional bodies that specialise in different sectors and issues.

In the current situation, however, we must not expect any immediate or comprehensive results from these "coordination meetings" of the regional bodies and institutions. It is part of an ongoing process of construction.

It involves pooling experiences. It involves systematically dealing with something that has been neglected for years. It means making the difficult **transition from the purely inter-governmental to the truly community phase**. And all this before globalisation distorts the objectives of the integration programme.

As the integration process stands at present - fragile and hierarchically subordinate to the executive bodies and supported only by the Presidents of Central American - it will always have a limited scope and an uncertain future. It is up to those same Presidents to change things and map out a new course of action. The Presidents must take the fundamental decisions to establish a real System that produces results and to begin the transition from an inter-governmental to a community approach.

The decision for change is ultimately a political decision, backed up by technical elements and with sufficient popular support.

Integration from the workers' point of view

Carlos Eduardo Molina
Executive Secretary CCT
Director ICAES

1.- CLARIFYING CERTAIN CONCEPTS

Integration and free trade agreements are two quite different concepts that tend to be treated as synonyms. It is important to draw the distinction between them from the outset.

The aim of any integration process is to improve the welfare of a country or the countries that make up the integrated group - improving welfare being understood as economic, social, cultural and political development. The integration process must be seen as an over-arching process, i.e. with a comprehensive and not just a commercial scope, a community institutional framework and common policies in the integrated countries.

In the case of Central America, and in accordance with Article 3 of the Tegucigalpa Protocol, the fundamental aim of the Central American Integration System (SICA) is to build up the region into an area of peace, freedom, democracy and development. To this end it is proposed to consolidate democracies, agree a new model of regional security, encourage a broad system of freedom, achieve a regional system of welfare and economic and social justice, establish an economic union, strengthen the region as an economic bloc, reaffirm and consolidate Central America's self-determination, and to promote sustained economic, social, cultural and political development in a harmonious and balanced way. It is clear from the above that the language of the Tegucigalpa Protocol is general, institutional and of a community nature, and goes well beyond purely commercial considerations.

The Free Trade Agreements, on the other hand, respond to a structural adjustment and trade liberalisation strategy, typical of the neo-liberal approach.

Trade liberalisation and structural adjustment models have been widely applied throughout the region since the 1980s, under the aegis of institutions such as the World Bank and IMF. Applying structural adjustment and economic stabilisation programmes became the prerequisite for obtaining funding from international organisations and governments.

The Free Trade Agreements respond to the neo-liberal strategy of what is incorrectly called economic integration, which follows similar principles to the adjustment and liberalisation plans. The neo-liberal approach to integration is confined to establishing free trade areas designed to reduce protectionism or create customs unions.

This neo-liberal strategy is shaped by the pro-free trade campaign launched by the US Government at various junctures. The chain of proposals and programmes designed to create a continental free-trade area in the medium-term can be traced back to the Caribbean Basin Initiative in 1983 and 1989, the entry into force of NAFTA in 1994

between Mexico, Canada and the USA and the proposal to create the Free Trade Area of the Americas (FTAA) put forward at the Summit of the Americas, convened by President Clinton in December 1994 in Miami.

Free trade agreement such as NAFTA and the FTAA cannot therefore be classified as integration processes but simply as trade liberalisation projects since all they set out to do is create a free trade area. They are not necessarily seeking real, comprehensive integration that fosters our nations' development.

As workers, we do not believe that it is possible to think in terms of democratising or humanising these free trade processes, since by their very nature they seek to enrich the most developed countries and therefore the hemisphere's political hegemony.

2.- HOW THE WORKERS VIEW CENTRAL AMERICAN INTEGRATION

Workers' views on integration can be summed up as follows:

A) The integration process is the best way of achieving active inclusion and maintaining our own identity and determination within a process of globalising interdependence, while aiming at a different world order, not only freer and more democratic but also fairer and more responsible.

B) The integration process must be community-based in nature and scope, and it must not become bogged down in tariff dismantling or trade agreements that favour privileged economic sectors. It must be a process designed to build a community of nations united by geographical and historical ties and capable of taking a firm stand in the economic, social, political, cultural and ethical fields.

C) It must be a process that is fully consistent with our nations' development and regional integration strategy, rather than the interests of transnational corporations or existing economic and political power blocs.

D) As members of the Central American Confederation of Workers, our political brief includes an integration project that goes beyond the Central American integration process to embrace the integration processes of the rest of Latin America, with the aim of building the "Gran Patria Latinoamericana".

E) This project offers our states and nations the opportunity not only to preserve their unique leading role, their identity, sovereignty, their social and popular cohesion and their cultural roots, but also to enrich and expand them.

F) It must be a process that contributes to reactivating our economies, focusing on capital and productive labour and not on speculative economies, thereby boosting employment and improving living and working conditions.

G) It must be a form of integration that does not subjugate our educational and cultural processes and that does not undermine our sovereignty and that encourages the full participation of unionised workers and other social organisations in all negotiations and agreements.

3.- ASSESSMENT OF CENTRAL AMERICAN INTEGRATION

Assessing the Central American integration process is somewhat complex because of the wide range of issues at stake. Our aim is to examine some of the social aspects of the process.

In the light of what has been said above, there is concern among unionised workers about the current direction and pace of the Central American integration process. These concerns can be summed up as follows:

A) The Tegucigalpa Protocol sets out and defines the fundamental underlying principles of the integration process and the functions of SICA. These include: protecting, respecting and promoting human rights; peace, democracy, development and freedom; the Central American identity; solidarity between the countries of the region; the gradual, specific and progressive nature of economic integration; the globality of the integration process and democratic participation in it by all the social sectors.

Clearly the spirit in which the Central American integration process was devised and set up envisaged a better future for the region.

B) Following the Tegucigalpa Protocol, other summits or Presidential Meetings have been held. Of particular note was the Meeting of Presidents held in October 1994, also in Tegucigalpa, when an integrated sustainable development strategy - the Alliance for Sustainable Development - was adopted for the region. It underscores the importance of the social aspects of integration.

C) In the Tegucigalpa Protocol, the Alliance for Social Development (ALIDES) and the Social Integration Treaty, social and cultural aspects form an integral and essential part of the measures adopted, on a par with political and economic aspects.

This means that, as it has been devised, Central American integration is not just a commercial or economic phenomenon, but an integrated process that seeks to establish a Central American community for Central Americans and open to the Latin American community.

D) Since 13 December 1991, a number of Presidential meetings have been held at which - at least on paper - many good ideas have been put forward as to the type of integration we want, i.e. a global form of integration that accommodates social, political and economic aspects. What we should now be asking ourselves is: Are these guiding principles of integration still valid, not only in legal and formal terms but also in terms of political will? Is there the political will on the part of our Governments to build a global Central American Integration process with a human face? Or is the intention simply to reduce the process to Free Trade Agreements between the countries of the region?

It is very worrying that the guiding principles of the Integration Process offered some hope for a more human Central America and yet its sights are firmly set on trade agreements.

E) According to our assessment the current pace of the Integration Process fails to guarantee three things:

- Compliance with the guiding principles that from the outset framed the Integration Process and hence promotion of these principles.
- Responsible, ordered, systematic and serious participation by civil society's regional organisations (Consultative Committee of SICA) in the central issues of the process.
- The construction of an Integration Process with a global and human dimension.

F) But even more worrying are the negotiations that the Governments of 5 Central American countries have begun with the USA with a view to a Free Trade Agreement. The burning question is how to negotiate from a good position without being integrated. In the labour organisations we therefore feel that it is imperative to reactivate the integration project established in the Tegucigalpa Protocol and make progress on the political, economic and social fronts towards real Central American integration.

4.- ORGANISED AND REPRESENTATIVE CIVIL SOCIETY IN THE INTEGRATION PROCESS

Article 12 of the Tegucigalpa Protocol sets up the Consultative Committee, which groups together representatives from the business, labour and academic sectors, as well as other actors in Central America who represent economic, social and cultural sectors that are also committed to the subregional integration efforts. This Consultative Committee was not set up until 2 November 1995, almost 4 years after the Tegucigalpa Protocol was signed.

This delay was due to the reluctance on the part of the Central American Governments to give civil society powers of decision in the Integration Process. Their presence was tolerated but only as an advisory, not a decision-making, body.

The idea behind setting up the Consultative Committee, promoted by organisations that had the backing of their regional counterparts, including the Central American Confederation of Workers, was to ensure the active participation of the different sectors of civil society and thus ensure that the process was not dominated by Governments.

And yet, civil society's participation in the region's decision-making process, via the Consultative Committee, is still insufficient. This sounds pessimistic but really there is little room for optimism.

There is absolutely no denying that, at present, civil society does not play a leading role in constructing the Central American integration process. Some of the main reasons for this are:

- Some sectors of civil society attach little importance to the Integration Process.
- Some Central American Governments set little store by civil society's participation in either national or regional issues.

- The Consultative Committee has no proper operational structure, which prevents it from playing an effective and relevant role in the Integration Process.
- The Consultative Committee does not have a proactive agenda.

It would be a very pessimistic prognosis if we just left it at that. After all, despite everything, civil society organisations remain determined to strengthen this instrument. The different sectors of civil society need to work on three fronts to: (i) strengthen our grassroots structures in order to increase our representativity, (ii) step up coordination between the grassroots at national level, (iii) step up coordination at regional level, so that we have an effective and proactive impact on the process.

The Central American Confederation of Workers is determined to contribute to strengthening civil society and it will do so via the Central American Committee of Intersectoral Coordination (CACI) and the Consultative Committee, so that the integration process benefits from the input of all sectors of society and all Central American nations.

As part of civil society's participation in Central American integration, the workers must also play an effective and active part in the process. In the CCT we believe in the need to form a pluralist and democratic labour instrument. It must belong to the workers, include the workers and benefit the workers in their capacity as protagonists and leaders of this project and as a subregional instrument that allows workers to have an impact on the Central American integration process.

5.- FINAL COMMENTS

A) We see Central American integration as an aspiration and the construction of its institutions as a step forward in the quest for an equitable society. We view integration as a vital relationship between neighbouring States that are weak but have great potential, which must harness their efforts on a basis of solidarity to attain the objectives of human development.

B) Ten years after the signing of social, cultural, political and economic agreements, we in the CCT are concerned that the sort of problems in Central America that in the past led to war, have still not been resolved. According to the World Bank and the IMF poverty is on the increase despite positive macroeconomic results.

According to CEPAL estimates, poverty affects over 20 million Central Americans (68% of the total population), of these over 14 million are in a situation of dire poverty, accounting for 46% of the total population.

In many countries of the region the level of under-employment is currently 50% of the labour force. Purchasing power has declined because of the fall in real wages.

C) There is a mass of presidential mandates, agreements, resolutions, coordination systems and lines of action. However, the institutional capacities of the integration structures have proved inadequate not only in operational terms but also fundamentally in terms of political will on the part of governments. In the long run this undermines the image and credibility of the process.

D) We are aware of the importance of the integration process but we also realise that there are serious problems with the current direction and pace of the process despite the existence of the Tegucigalpa Protocol and ALIDES, which put forward excellent principles and proposals. We consider that there is still no clearly defined Central American integration project but instead an alliance of Central American capitals that are seeking access to new markets, without seeing the riches available on the regional market.

E) We are of the view that the integration process has been shaped more by external pressures and ideological arguments than by a clear strategy of social, cultural and economic development.

F) It is urgent and essential that we make headway on Central American integration and that we establish links with Mercosur and the Andean Community of Nations with a view to the integration of the whole of Latin America.

Central American regional integration: recent progress and future challenges

Ennio Rodriguez, Inter-American
Development Bank,
Peter Versteeg, European Commission

In recent years, especially during 2002, Central American integration has made significant progress in the following four areas, among others: i) growth of intra-regional trade; ii) trade-related institutional developments (including the decision to form a customs union); iii) increase of intra-regional investment flows; and iv) greater civil society involvement on a regional scale. The aim of this article is to present a snapshot of the state of Central American integration, as at the end of February 2003, with particular emphasis on economic integration and the regional institutional set-up. Both of these are considered vital elements of a successful regional integration process and represent key challenges for the Central American region in the short to medium term future.

1. Economic Integration

1.1 Growth of Intra-regional Trade.

In 2002 for the first time intra-regional trade exceeded US\$3 billion (a six-fold increase since 1987). In the same year reciprocal Central American trade amounted to 28% of total exports. This share of intra-regional trade is the largest ever recorded by any integration agreement in Latin America and the Caribbean. However, it is still low when compared for example with reciprocal EU trade. This helps explain why in Central America there is great interest in trading partners outside the integration agreement. Notably, the European Union, which is Central America's third largest export market (13% of total exports).

Reciprocal trade in Central America is highly concentrated in the manufacturing sector, which is characterised by greater value added than in the primary exports sector. In contrast, primary commodities dominate exports to third markets. Intra-regional trade has shielded Central America from adverse movements in the terms of trade of its primary commodity exports, and has therefore played a counter-cyclical role. Central American exports to the US have also diversified in the context of the Caribbean Basin Initiative.

1.2 Trade-related Institutional Developments.

A number of important achievements that have been made including legal instruments and other measures deepening sub-regional trade include: a) a dispute settlement mechanism (starting 10 March, 2003); b) a treaty on investment and services (awaiting ratification by congresses); c) increased trade facilitation by eliminating 41 trade obstacles of a total of 60 identified at the beginning of 2002; c) progress in customs and border crossing modernisation (an IDB funded project under the Plan Puebla-Panama is currently under execution and an EU financed customs union support project will be initiated this year); d) a reduction in the list of exceptions (only five products remain: coffee, sugar, petroleum derivatives, ethyl alcohol and distilled alcohol beverages).

Guatemala and El Salvador initiated the process of formation of a customs union in 1996. In 2000 Nicaragua and Honduras joined in, and in June 2002 Costa Rica also

joined the process. The target for the completion of the customs union is January 2004. The definition of customs union includes: i) free movement of goods and services regardless of origin within the five countries; ii) common external tariff and common collection of import duties; and iii) progressive harmonisation of legislation on customs, tax and trade.

There has been concrete progress in customs integration in three ways: i) integrated border crossings where procedures take place only once (not as the current two step approach –one per country--); ii) one building for housing customs and immigration officials from two countries (but requiring the two steps); and iii) peripheral customs where one country establishes an office in the territory of another country (e.g., in a port) and merchandise is cleared all the way to the country of destination.

These customs measures represent movement towards trade facilitation but are not directed to a customs union, which would include a removal of border crossing controls altogether. One of the difficult issues to tackle is tax collection in ports of entry to the customs union and revenue distribution. First, common collection assumes a common external tariff (otherwise an importer can choose the lowest tariff country as its stated destination). Second, governments currently also collect sales and consumption taxes at the ports of entry. Such taxes are not harmonised, but differ significantly. Reform towards harmonisation, including possibly the introduction of value added taxes, is desirable, but its implementation difficult. Third, there is the issue of control. The intensity of smuggling activities varies by country. In a customs union this could have undesirable fiscal effects for the countries exercising greater control.

Advances towards a common external tariff are currently hindered by free trade agreements entered into by individual countries (or subgroups of countries), such as with Mexico, Canada, Chile, Panama and Dominican Republic. Harmonisation could only be to the lowest tariff. For example, the agreement Costa Rica-Mexico has reached the final stages of tariff reduction, while for Guatemala, El Salvador, Honduras/Mexico it is just beginning. If the countries decided to wait for the current tariff reduction schedules, harmonisation would be attempted only after 2012.

Significant progress has been achieved in customs nomenclature and valuation harmonisation. Sanitary and phytosanitary measures for unprocessed food products have been harmonised. Further work to harmonise regulations on labelling and registry of products is under way. Although there has been significant progress towards the formation of a customs union, it is highly unlikely that it will be complete by the target date.

1.3 Intra-regional Investment Flows.

There is ample anecdotal evidence of increasing intra-regional investments in sectors such as: financial services, particularly in banking; hotels and restaurants; retail chains and shopping malls; airline; and the food and beverage sector, among others. The number of financial groups planning investments regionally has increased, and according to them, this is to prepare for incursions into third markets (such as Mexico, Panama and Dominican Republic); to serve as a defensive response from increased competition in the domestic markets; and to facilitate exports. There is no quantitative evidence of this process; however, there seems to be an increasing trend

for intra-regional investments, which create another layer of integration not necessarily reflected in trade statistics.

1.4 Civil Society Participation.

A couple of decades ago nearly the only organised group with regional organisations and activities was the private sector. A significant change in the last decade has been the emergence of many sector organisations and NGOs having a regional focus, ranging from the environment and human rights, to the arts, higher education and municipal governments, to name a few. The regional civil society organisations and networks demand their own political space in their dealings with regional institutions, government authorities and international donors. The agenda for regional cooperation is now multidimensional with many social ramifications and many of the issues cannot be satisfactorily and credibly addressed without the active involvement of civil society. The role of the civil society umbrella institution, the Consultative Committee of SICA is dealt with in Section 2.5 below.

2. The Institutional Framework

The institutional framework for Central American integration comprises a number of treaties, protocols, agreements and presidential declarations that establish and orient the competencies and operation of the Central American Integration System (SICA). SICA formally came into existence in 1993 as a result of the 1991 Tegucigalpa Protocol, which effectively constitutes the foundation stone of the system. Members of the system include Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama as well as Belize, which joined in December 2000. The principal organs of SICA include the Secretariat-General (SG-SICA), the Central American Parliament (Parlacen) and the Central American Court of Justice (CCJ). In addition, the system encompasses other technical secretariats, permanent specialised institutions and inter-governmental forums. The driving force in setting the agenda for the process of regional integration is the meeting of Central American Presidents.

Based on a mandate given by the Central American Presidents in 1995, the IDB and ECLAC, together with country representatives, carried out an evaluation of the institutional framework for Central American integration in order to contribute to the process of rationalisation and strengthening of the regional integration institutions. The resulting study served as a basis for a set of guidelines for the strengthening and rationalisation of the regional institutional framework prepared by a team of delegates nominated by the Central American Presidents. These guidelines form an integral part of the Central American Presidential Declaration of Panama II, of 12 July 1997, adopting measures to reform the regional institutional framework. Aside from reasserting the supremacy of the Presidential meetings and the co-ordinating role of Council of Ministers of Foreign Affairs, the basic thrust of the proposed reforms is to improve coordination between all parties, unify the different secretariats in a single Secretariat-General, work towards a single legal instrument (reviewing and rationalising the statutes, cost and functioning of the Parlacen and CCJ in the process) and adopt an automatic financing mechanism as well as a single budget.

Since the adoption of the Panama II Declaration, the process of regional integration has moved ahead rapidly with more frequent meetings at Presidential and other levels coupled with the launching and/or furthering of a series of initiatives that have required concerted regional action. These initiatives range from the political, economic, commercial, social and environmental to questions of security. Of note

are: the response to Hurricane Mitch (Regional Consultative Group of Stockholm 1999); the 'Madrid Proposal' for the transformation and modernisation of Central America (Regional Consultative Group of Madrid 2001); the Plan Puebla-Panama (PPP) launched in 2001; the Action Plan for Central American Integration approved in March 2002 setting a calendar for the completion of the Central American Customs Union; and the launching of negotiations for a Free Trade Agreement with the USA (CAFTA) in January 2003. This period has also seen the incorporation of Belize into SICA and the integration of Honduras and Nicaragua (in 2000) and Costa Rica (in 2002) into the process of forming a customs union.

This progress has, however, not been backed up by similar progress in implementing the institutional reforms adopted in Panama in 1997 or advancing in this issue. The absence of such reform is acting as a brake on the implementation of regional initiatives and the achievement of regional integration objectives agreed at the highest level. In this regard, a number of critical issues require attention. These include:

2.1 Coordination:

The Tegucigalpa Protocol establishes the Council of Ministers of Foreign Affairs as the principal organ for coordination. It also foresees the creation of an Executive Committee made up of presidential nominees to ensure the efficient execution (via the Secretariat-General) of decisions adopted at presidential level. The latter was not brought into existence and the Panama II reform proposed replacing this Committee by a Liaison Committee (also under the auspices of Ministers of Foreign Affairs) that would represent country interests, liaise, follow-up and facilitate implementation of decisions. The latter has also not been established. Thus, the serious problems of coordination, follow-up, execution and evaluation of presidential and ministerial decisions, identified in the Panama II Reform Guidelines, persist.

2.2 Legal Base:

The Panama II Declaration proposed the establishment of a single legal instrument as well as the modification of the statutes of the CCJ and Parlacen in order to rationalise their cost and operation. This has not been implemented. It is necessary for the system to have a clearly defined legal base outlining the competencies and mandates of each instance in such a way that roles may not be misinterpreted. A certain continuity should also be ensured. The recent transfer of the dispute settlement competencies in trade matters from the CCJ to the Council of Ministers responsible for Economic Integration (COMIECO) is illustrative in this regard. It is also essential to ensure that the competencies/mandates of regional institutions are focused primarily on matters of a regional nature.

2.3 Financing:

The Panama II Declaration announced the decision to establish an automatic financing mechanism for the regional institutions to be defined by the Ministers of Finance as well as the creation of an audit or financial control mechanism. The guidelines to the Declaration also propose the introduction of a single budget drawn up by the General Secretariat. The issue of financing regional integration has not been resolved and there remain imbalances in the funding of the various institutions.

2.4 Administration:

The Panama II Declaration proposed the unification of the sectoral integration secretariats in a single Secretariat-General with its headquarters in El Salvador. To date, modest progress has been made in this regard with only the environment and development (CCAD), social integration (SISCA) and tourism (SITCA) fields having been incorporated. The key economic secretariats or fields including economic integration (SIECA), agriculture (SCAC) as well as hydrocarbons, electricity, transport have not been integrated. The transfer of secretariats such as SIECA from Guatemala, among others, does not appear feasible. Alternative arrangements could be envisaged. However, what is vital for the effective functioning of technical secretariats is a clear mandate together with adequate financial and human resources. A number of secretariats do not have the necessary resources to carry out their mandates.

2.5 Participation:

The strength of regional integration is also determined to an important extent by achieving the broadest possible participation of member countries in the regional institutions as well as the effective participation of the key actors (governments, civil society and regional entities) in the process. In this regard, it is underlined that Costa Rica, Guatemala and Panama are not members of the CCJ and Costa Rica is not a member of the Parlacen. Panama is examining possible participation in the Central American Customs Union, whereas Belize does not participate because it belongs to CARICOM. In terms of the government/regional institution/civil society interface, there is consensus in the region that efforts must be made to promote greater awareness and understanding of the respective roles and responsibilities and facilitate this process. Formalised civil society is a recognised party to the process of regional integration through the decision (Tegucigalpa Protocol) to establish a Consultative Committee (CC-SICA). CC-SICA has been brought into existence, but is not currently funded under SICA. This situation has limited CC-SICA's capacity to operate as a full partner in the process of regional integration. It is noted that SG-SICA is currently preparing a proposal to resolve this situation.

Finally, institutional reform can best be conceived and implemented in the context of a consensual and clear medium to long-term vision for the region's integration agenda. This vision should be developed on the understanding that acquiring and strengthening community or supranational competencies must be based on the existence of a solid inter-governmental basis. Such a vision or regional agenda can also facilitate the smooth adjustment of the institutional framework.

3. Conclusion

In conclusion, it can be argued that recent progress in the Central American economic integration agenda, namely the decision to forge ahead in the formation of a customs union and the related legislative instruments, has provided a significant boost to the process of regional integration. This has been backed up by strong political will as well as advances in regional policy making in other areas including environment, security and tourism. The growing awareness of the role that civil society should play in the process of integration has led to greater dialogue in this field. Some of the key challenges that lie ahead include the need: to develop a consensual and clear medium to long-term vision for the region's integration agenda; to complete the Central American customs union; and to ensure that the regional institutional framework is effectively tailored to achieve maximum efficiency in following up and implementing

decisions taken by the region as a whole. Regional integration is an excellent vehicle for promoting sustainable development in Central America and defending the interests of the region and should continue to be backed by international co-operation programmes.

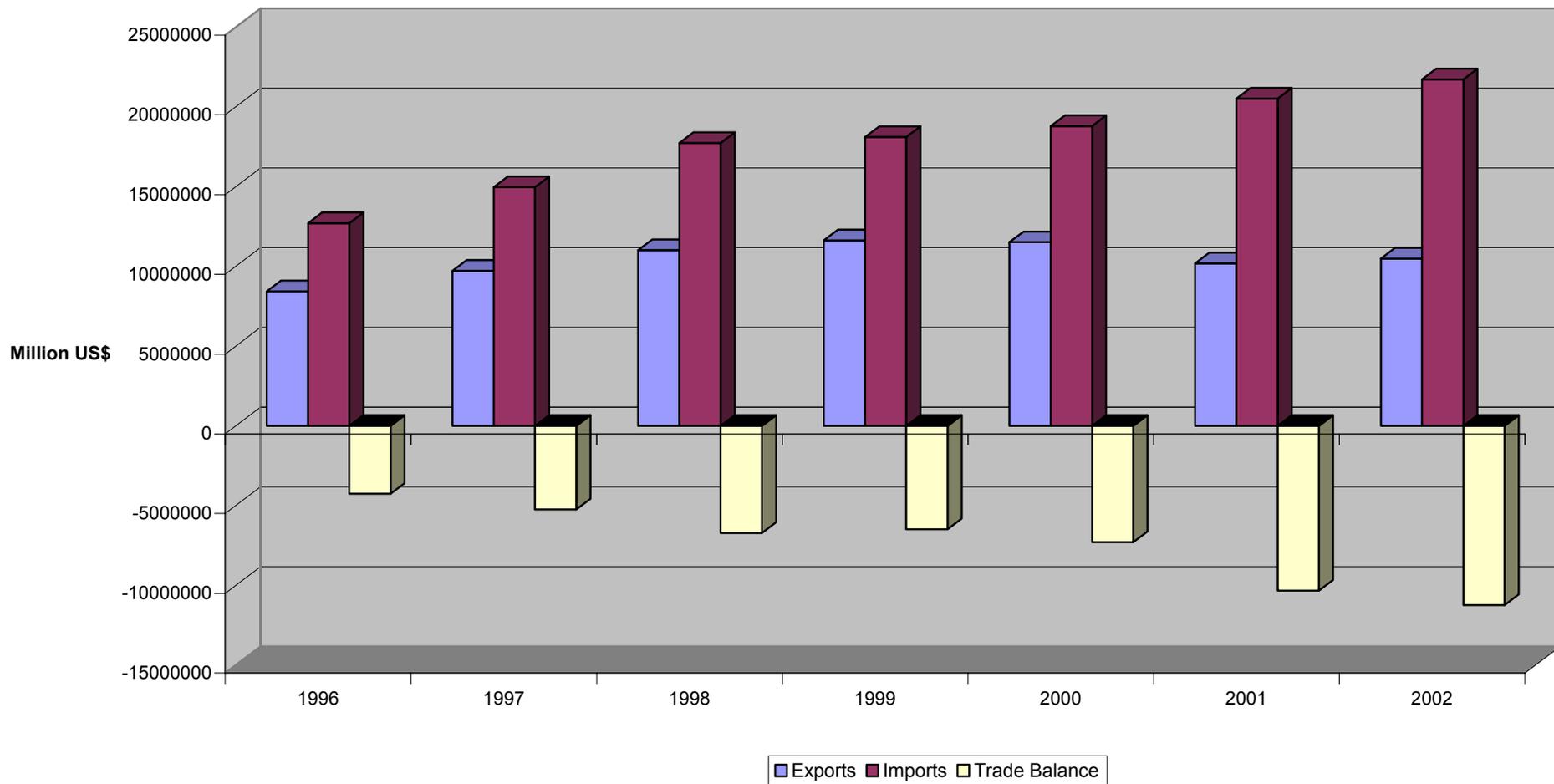
ANNEXES

TABLES OF STATISTIC INFORMATION
ON CENTRAL AMERICA

CENTRAL AMERICA: MAIN DEMOGRAPHIC AND ECONOMIC INDICATORS, 2002

DATOS GENERALES	GUATEMALA	EL SALVADOR	HONDURAS	NICARAGUA	COSTA RICA	CENTROAMERICA
DEMOGRAFICOS						
Tamaño (Km2)	108.890	21.040	112.090	129.494	51.100	422.614
Capital	Guatemala	San Salvador	Tegucigalpa	Managua	San José	-----
Idioma	Español	Español	Español	Español	Español	Español
Población (millones)	11.9	6.5	6.8	5.3	4.2	34.7
Crecimiento población	2.7%	1.9%	2.5%	2.7%	1.8%	2.4%
Analfabetismo	33.4%	22.9%	29.4%	36.6%	5.0%	25.5%
Densidad de población	110	314	61	41	82	122
ECONOMICOS						
PIB(miles de millones US\$)	23.2	14.2	5.8	2.5	16.9	62.6
PIB per capita, US\$	1.941	2.190	950	480	4.026	1.917
Crecimiento PIB	2.0%	2.5%	2.0%	1.0%	2.8%	2.1%
Inflación	6.3%	2.79%	7.82%	3.99%	9.29%	6.04%
Moneda (tipo de cambio promedio)	Quetzal 1\$=7.81	Colon 1\$=8.75	Lempira 1\$=16.61	Córdoba 1\$=14.31	Colon 1\$=359.39	-----
Exportaciones (millones US\$)	2,310.7	1,241.9	1,507.9	641.0	4,791.8	10,493.3
Importaciones (millones US\$)	6,003.9	3,943.4	3,092.6	1,803.9	6,881.4	21,725.2
Balanza comercial (millones US\$)	(3,693.2)	(2,701.5)	(1,584.7)	(1,162.9)	(2,089.6)	(11,231.9)
Exportaciones/ha bitantes	194.2	191.1	221.8	120.9	1140.9	302.4
Importaciones/ha bitantes	504.5	606.7	454.8	340.4	1638.4	626.1
Apertura comercial: Export +Imp/PIB	35.8	36.5	79.3	97.8	69.1	51.5

FUENTE: SIECA, Dirección General de Tecnologías de Información



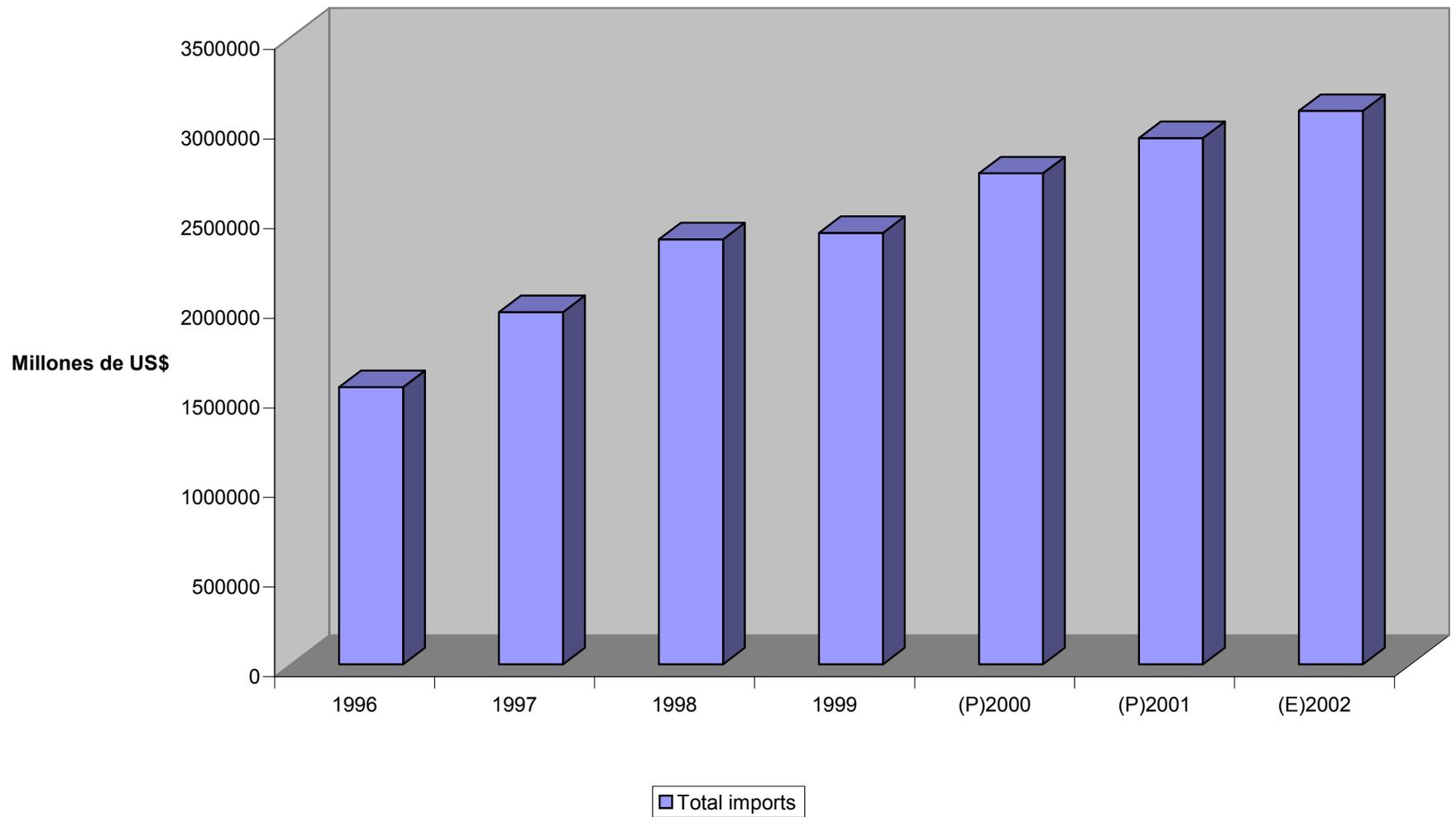
CENTRAL AMERICA
INTRAREGIONAL TRADE BALANCE, 1996-2002
US\$ (1,000)

PAISES	1996	1997	1998	1999	(P)2000	(P)2001	(P)2002
EXPORTACIONES							
Total exportaciones	1 684 159	1 991 522	2 316 352	2 449 513	2 616 798	2 829 179	2 883 872
Guatemala	577 981	683 345	748 547	789 944	815 348	1 059 595	910 914
El Salvador	455 070	578 823	617 875	638 737	737 028	722 479	751 945
Honduras	138 755	159 471	305 254	298 966	310 679	211 088	285 750
Nicaragua	101 191	121 274	122 495	145 061	164 214	174 522	251 724
Costa Rica 1/	411 163	448 609	522 181	576 806	589 528	661 496	683 539
IMPORTACIONES							
Total importaciones	1 546 429	1 965 087	2 370 838	2 406 800	2 739 479	2 935 744	3 087 527
Guatemala	242 977	411 427	607 931	485 674	615 735	777 256	688 367
El Salvador	505 871	582 257	602 707	652 982	811 055	822 690	816 448
Honduras	287 079	340 956	429 133	449 673	534 527	561 859	792 767
Nicaragua	259 977	331 475	418 156	519 222	490 689	467 307	454 530
Costa Rica 2/	250 525	298 972	312 911	299 248	287 473	306 631	335 415

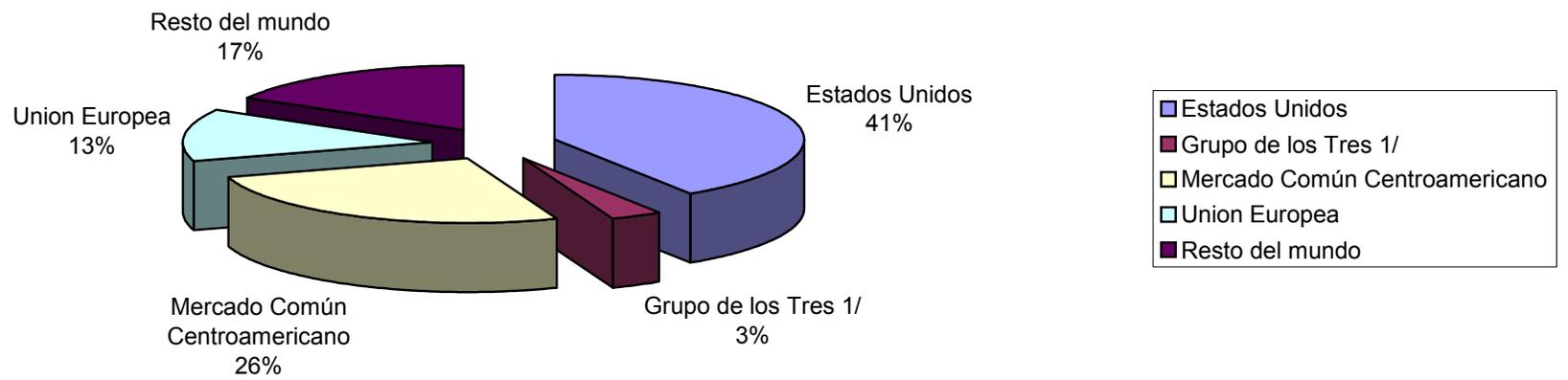
(P) Preliminares

FUENTE: SIECA, Dirección General de Tecnologías de Información

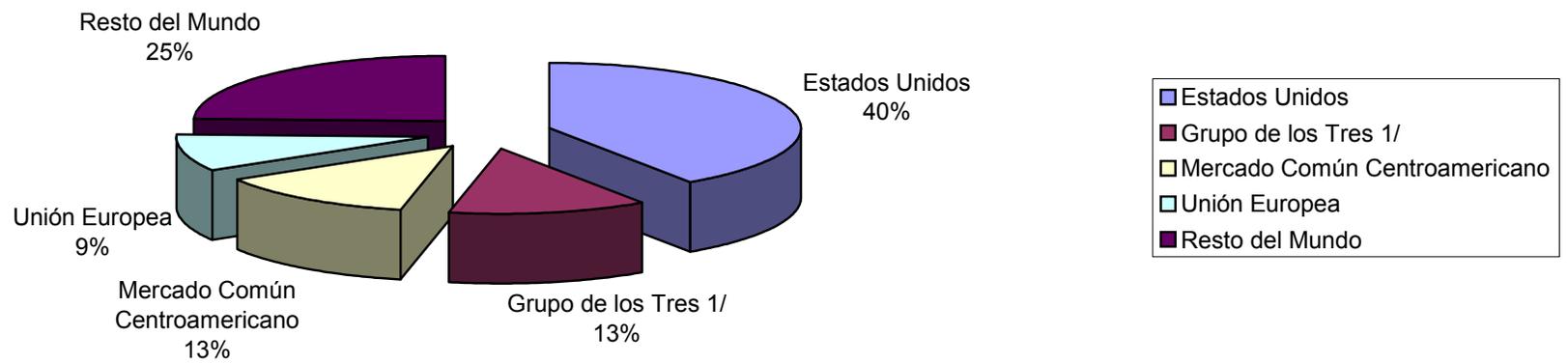
CENTRAL AMERICA: EVOLUTION OF INTRAREGIONAL TRADE 1996-2002



CENTRAL AMERICA STRUCTURE OF THE ORIGIN OF EXPORTS, 2002



CENTRAL AMERICA STRUCTURE OF THE DESTINATION OF IMPORTS, 2002

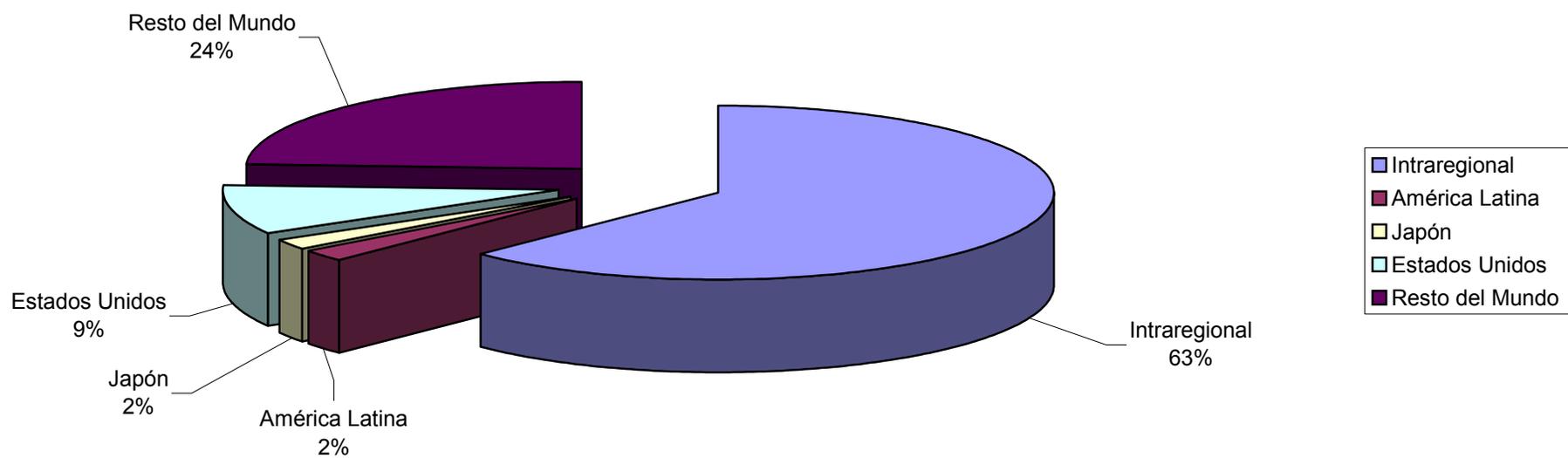


CENTRAL AMERICA
BALANCE OF TRADE WITH THE EUROPEAN UNION
US\$ (1,000)

PAISES	1996	1997	1998	1999	2000	2001
EXPORTACIONES DE CENTROAMERICA CON DESTINO A LA UNION EUROPEA						
Total Exportaciones	1,967,892	2,006,109	2,090,635	2,104,726	1,928,627	1,486,187
Costa Rica	870,143	868,073	1,171,574	1,402,591	1,184,369	831,203
El Salvador	285,461	404,046	231,109	166,370	151,983	79,873
Guatemala	271,520	307,978	314,845	290,362	289,618	289,618
Honduras	329,607	244,359	223,636	128,806	174,401	201,397
Nicaragua	211,161	181,653	149,471	116,597	128,256	84,096
IMPORTACIONES DE CENTROAMERICA PROVENIENTES DE LA UNION EUROPEA						
Total Importaciones	1,235,814	1,322,624	1,580,198	1,499,783	1,556,934	1,769,248
Costa Rica	387,911	455,241	577,909	566,152	553,615	655,567
El Salvador	256,682	264,079	292,207	247,706	337,559	335,186
Guatemala	337,232	365,195	429,762	408,347	411,619	475,797
Honduras	142,996	113,623	175,213	192,921	162,471	196,598
Nicaragua	110,993	124,486	105,107	84,657	91,670	106,100
SALDO EN LA BALANZA COMERCIAL DE CENTROAMERICA CON LA UNION EUROPEA						
Saldo Balanza	732,078	683,485	510,437	604,943	371,693	(283,061)
Costa Rica	482,232	412,832	593,665	836,439	630,754	175,636
El Salvador	28,779	139,967	(61,098)	(81,336)	(185,576)	(255,313)
Guatemala	(65,712)	(57,217)	(114,917)	(117,985)	(122,001)	(186,179)
Honduras	186,611	130,736	48,423	(64,115)	11,930	4,799
Nicaragua	100,168	57,167	44,364	31,940	36,586	(22,004)

FUENTE: SIECA, Dirección General de Tecnologías de Información

EUROPEAN UNION STRUCTURE OF EXPORTS, 2001



EUROPEAN UNION STRUCTURE OF IMPORTS, 2001

