



Brüssel, den 19. Mai 2016  
(OR. en)

16491/06  
ADD 1 DCL 1

WTO 260  
AMLAT 102

**FREIGABE<sup>1</sup>**

---

des Dokuments 16491/06 ADD 1 RESTREINT UE

vom 15. Dezember 2006

Neuer Status: Öffentlich zugänglich

---

Betr.: Recommendation from the Commission to the Council authorising the Commission to open negotiations for the conclusion of an Association Agreement between the European Community and its Member States and the Central American Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama

---

Die Delegationen erhalten in der Anlage die freigegebene Fassung des obengenannten Dokuments.

Der Wortlaut dieses Dokuments ist mit dem der vorherigen Fassung identisch.

---

<sup>1</sup> Dokument von der Europäischen Kommission am 19. Mai 2016 freigegeben.

# RESTREINT UE



RAT DER  
EUROPÄISCHEN UNION

Brüssel, den 15. Dezember 2006 (18.12)  
(OR. en)

16491/06  
ADD 1

RESTREINT UE

WTO 260  
AMLAT 102

## ÜBERMITTLUNGSVERMERK

---

Absender: Herr Jordi AYET PUIGARNAU, Direktor, im Auftrag des Generalsekretärs der Europäischen Kommission

Eingangsdatum: 8. Dezember 2006

Empfänger: der Generalsekretär/Hohe Vertreter, Herr Javier SOLANA

---

Betr.: Recommendation from the Commission to the Council authorising the Commission to open negotiations for the conclusion of an Association Agreement between the European Community and its Member States and the Central American Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama

---

Die Delegationen erhalten in der Anlage das Kommissionsdokument SEK(2006) 1597.

Anl.: SEK(2006) 1597



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 6.12.2006  
SEC(2006) 1597

RESTRICTED

**COMMISSION STAFF WORKING DOCUMENT**

**Accompanying document to the**

**Recommendation from the Commission to the Council authorising the Commission to open negotiations for the conclusion of an Association Agreement between the European Community and its Member States and the Central American Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama**

**Impact Assessment**

{SEC(2006) 1596 final}  
{SEC(2006) 1598}

DECLASSIFIED

## **INTRODUCTION**

The present impact assessment (IA) refers to the conclusions of the two latest summits between EU and Latin American countries (Guadalajara in 2004 and Vienna in 2006), in which both sides considered the negotiation of an Association Agreement between the EU and Central America as a joint strategic objective. The opening of negotiations towards a bi-regional Association Agreement (AA) was agreed upon during the last Vienna summit, particularly in view of the reaffirmed commitments taken by the Central American heads of state towards completing a customs union within an established timeframe.

The final content of the agreement is obviously contingent upon the negotiation process. Therefore - and pursuant to the principle of proportionality inherent in the IA methodology - the present IA can only outline the possible impact of the Association Agreement, and sketch out its main foreseeable implications. A more complete and accurate assessment will only be possible once the negotiations have started, notably in the light of the respective positions of the negotiating parties. This more detailed and comprehensive assessment will take the form of a Sustainability Impact Assessment (SIA), which will be launched during the preliminary stage of the negotiations.

The present report takes into account the Commission Communication on impact assessment, the Commission's internal guidelines on the IA procedure and the provisions of the Commission's 2006 work programme. In the economic and trade area, it also takes due account of the main conclusions of the Joint Assessment on the level of regional integration in Central America, which was carried out by the EU and CA countries during the course of 2005.

### **1. ISSUES THAT THE PROPOSAL IS EXPECTED TO TACKLE**

The issue at stake consists in developing further the potential of the EU-CA relationship in order to transform it in a robust and comprehensive bi-regional partnership, helping the CA region weather the challenges of its integration into a globalised economy, play a more assertive role as a region on the world scene and associate itself with the EU in support of common values.

#### **1.1. The present EU-CA relationship. General overview**

The relationship between the EU and Central America has gained momentum over the last two decades and is now both diversified and far-reaching. Overall political cooperation between the EU and the six republics of the Central American isthmus<sup>2</sup> has been shaped by the **San José Dialogue**, which was launched in 1984 and has remained the principal channel for political dialogue between the two regions ever since. This pioneering experience in terms of CFSP has proved particularly instrumental in supporting the peace process and the ensuing consolidation of democracy across the region by fostering, wherever possible, a dialogue-based approach to domestic and regional conflicts. Its coverage has been extended to include new issues such as sustainable and equitable economic and social development, the fight against insecurity and organised crime, the rule of law, and social policy.

---

<sup>2</sup> Guatemala, El Salvador, Honduras, Costa Rica, Nicaragua and Panama.

Substituting an earlier agreement signed in 85, the **Regional Development Cooperation Framework Agreement**, between the same six Central American countries and the Commission, signed in 1993, came into effect in 1999. This “third generation” agreement covers a broad range of sectors and provides for the establishment of a Joint Committee to oversee its implementation, as well as sub-committees dealing with specific sectors.

In **December 2003** a new **Political Dialogue and Cooperation Agreement** was signed by the EU and Central America, which, once ratified, will institutionalise the San José Dialogue and expand cooperation to include new areas such as migration and counter-terrorism. It also opens the door to a future Association Agreement, including a Free Trade Area.

At the **Guadalajara summit** (2004), the EU and CA decided that a future Free Trade Area between them should be built on the outcome of the Doha Development Agenda and would be predicated upon the attainment of a sufficient level of regional economic integration. To this effect, a joint EU-CA stock-taking exercise (“Joint Assessment”) was launched in January 2005, with a view to assessing the state of play of the regional integration. Its conclusions were released in early 2006, pointing out the positive developments registered over the last years in this endeavour.

In terms of **trade**, the vast majority of Central American exports to the EU are governed by the new **GSP +** regulation, which grants significant trade preferences (duty and quota free access to the EU markets) to developing countries that have ratified and implemented a number of international conventions related to sustainable development and good governance. Since January 2006, a new tariff-only system has been introduced for the banana exports.

Broadly speaking, the most salient features characterising the developments of the EU policy towards CA are:

- 1) The **long-term vision** of the EU strategy towards the region, which has been pursuing the same set of policy objectives over the last two decades in a consistent, albeit gradual, manner;
- 2) The steadfast policy followed by the EU in support of **regional integration**, by regarding Central American countries as a full-fledged regional partner rather than the mere addition of individual countries;
- 3) The high degree of **solidarity** displayed by the EU vis-à-vis Central America and its responsiveness to the numerous challenges of this region through a variety of instruments.
  - In the aftermath of the protracted civil conflicts, democratisation and peace-building have been addressed through the San José Dialogue. A strong support to democratic institutions and civil society has been provided to this effect;
  - Development and trade expansion have been addressed through the Development and Cooperation framework Agreement and the non-reciprocal trade preferences granted under the GSP scheme;
  - Post-disaster emergency relief and reconstruction (especially in the aftermath of hurricane Mitch) have been covered by the EU Humanitarian Office assistance programmes and the regional recovery programme PRRAC.

In view of the wealth and variety of the links between the two regions, both sides have come to the conclusion that the long-standing EU effort in support of the CA regional integration process could be further enhanced by way of a full-fledged bi-regional Association Agreement, serving as the corner stone for the whole EU-CA partnership.

## **1.2. The need for a strengthened bi-regional partnership**

Taken individually, none of the tiny CA countries seems able to overcome the economic, social and environmental challenges the region is confronted with. Perhaps more than anywhere else in the world, the need for a sound regional integration policy seems both necessary *and* realistic in CA, in view of the magnitude of the challenges but also of the commonality between the CA countries and the already significant integration *acquis*. There is, however, little doubt that this regional integration process would risk running out of steam if it were not spurred or bolstered by a consistent and reliable external partner region like the EU. In view of past experiences and the challenges of integration, the role of the EU is thus critical to support the regional momentum and help him gather pace. This regional consolidation will notably help CA integrate into the globalised economy, play a more assertive role as a region on the world scene and team up with the EU in support of common values. By its comprehensive and region-to-region nature, an Association Agreement would undoubtedly give a strong impetus to the regional integration process and signal a qualitative step in the bi-regional partnership.

## **2. MAIN OBJECTIVE THAT THE PROPOSAL IS EXPECTED TO REACH**

The opening of negotiations towards an Association Agreement will respond to a series of joint political statements expressed over recent years notably in the framework of the EU-Latin American summits. It is expected to serve a wide spectrum of general objectives, which can be broken down into more specific goals.

### **2.1. Political commitments**

At their **Guadalajara summit in 2004**, the heads of state of Latin America and the EU confirmed “the positive signal given by the Madrid Declaration (2002) in relation to the negotiation of Association Agreements, including Free Trade Agreements” between the EU and the Latin American sub-regions, among which Central America. In these conclusions, the parties agreed that such Association Agreements were their “common strategic objective”, recognised that “the prospect of an Association Agreements should give a new impetus for strengthening regional economic integration processes” and “welcomed the decision of the concerned parties to now open the process leading to such Agreements”. In its **December 2005 Communication** on “*A reinforced European Union-Latin America partnership*”, the Commission also restated its long-term aim of achieving a strategic partnership with the entire Latin American region while stressing the need for the EU to “support the sub-regional integration processes”, notably by opening negotiations towards an association and free-trade agreement with Central America.

Further to the findings of the Joint Assessment on the level of regional integration and in view of the subsequent commitments taken by Central America in this direction, the strategic objective of negotiating a bi-regional AA was reconfirmed and further qualified at the fourth **EU-Latin America summit** held in 2006. In Vienna, the EU and Central American countries welcomed the commitments taken by CA leaders towards completing the customs union by

the end of 2006. In consideration thereof, they declared that they shared “the objective of concluding a comprehensive Association Agreement” and looked forward “to a rapid process of negotiations, as well as an effective implementation of the future Association Agreement”.

The **European Parliament** has traditionally been very supportive of the regional integration process in CA and advocated a strengthening in the bi-regional relationship, particularly through the signature of an ambitious and comprehensive AA.

The proposal under consideration has consequently been inserted in the annual political priorities set for 2006 in the Work Programme of the Commission.

## **2.2 General objectives**

A renewed momentum in favour of regional integration has been building up over the last years, which has already materialised in concrete achievements. This has been particularly in the field of regional economic integration, as confirmed by the Joint Assessment performed on regional integration. This relatively buoyant regional context now provides a clear opportunity to make a further qualitative step in the bi-regional relationship, by concluding a wide-ranging Association Agreement (including a FTA). Such an Association Agreement should notably allow the two sides to:

- consolidate existing relations and develop their potential and mutual benefits by providing a comprehensive, forward-looking perspective for the whole of the EU-CA relationship,
- firmly root in the democratic achievements in CA by fostering further intra-regional links and enhancing bi-regional political dialogue and cooperation,
- develop both intra- and bi-regional trade exchanges in goods, services as well as investments, by improving legal security and competitiveness while enlarging the CA market size,
- provide a further impetus to the regional economic integration process, in order to help CA integrate in the world economy, harness globalisation in support of sustainable development and open up to new partnerships on the world stage,
- bolster the good-neighbourly relations and the principles of peaceful resolution of disputes between the CA states,
- develop a privileged political partnership with the region, in order to defend joint positions based on common values on the world stage, in support of human rights and democracy and as a contribution to the development of multilateralism,
- in a wider perspective, pave the way towards an EU-Latin American bi-regional partnership, as the ultimate objective of EU and Latin American countries

## **2.3. Specific objectives**

The Association Agreement with Central America is envisaged as a comprehensive agreement, embracing the whole array of the multifaceted EU-CA relations (political dialogue, cooperation, trade...) in one single contractual agreement, thus reflecting more visibly the depth and variety of the bi-regional links and developing them further.



Building upon the Political Dialogue and Cooperation agreement, the AA with CA should notably provide for:

### **2.3.1. Political and global issues**

- A firm commitment to upholding common values (notably democracy and the rule of law, sustainable development, respect for human rights and fundamental freedoms, including the rights of persons belonging to ethnic minorities, good governance, core labour standards and market-oriented economy);
- Enhanced cooperation in foreign and security policy, with a particular emphasis on regional issues, conflict prevention and disarmament as well as cooperation in international fora, with a view to developing convergent positions and addressing global issues through multilateralism;
- Sustainable development – including its environmental and social dimensions – should be considered as an overarching objective of the parties, including the respect of internationally recognised core labour standards and the protection of the environment.. The agreement should provide for an adequate monitoring of the implementation of commitments, through mechanisms based on participation by civil society, cooperation and dialogue. Social and environmental provisions should be in line with the policy dialogue undertaken on social cohesion (poverty reduction and social exclusion) and consistent with the commitments already taken by Central American countries to benefit from the GSP+ regime;
- Provisions on public security, law enforcement, justice and home affairs, with a view to addressing issues related to governance, regional insecurity, transnational crime and delinquency in a regional context.

### **2.3.2. Cooperation**

- The main policy goals of the EU cooperation policy towards CA will consist in supporting development, fighting against poverty, promoting social cohesion and fostering regional integration. This will notably be achieved through:
- Enhanced cooperation in the field of environment and sustainable management of natural resources;
- Enhanced cooperation in the field of Justice, Freedom and Security, covering rule of law and good governance, data protection, migration (including readmission), money laundering (including the financing of terrorism), illicit drugs, fight against organised crime, regional insecurity, counter-terrorism and the fight against transnational crime and delinquency;
- Enhanced cooperation in all other areas of mutual interest, such as public health, science and technology, education, culture, information society, employment and social affairs...;

### **2.3.3. Trade issues**

An ambitious and comprehensive free trade area FTA should be sought, going beyond the WTO basic rules (“WTO+” FTA) so as to maximise the mutual and long-term benefits of bi-



regional trade liberalisation. This FTA should make the best possible use of the conclusions of the Joint Assessment carried out by the EU and CA countries. Covering substantially all trade, it notably aim at improving market access for goods but also for services, include enhanced provisions on non-tariff barriers, such as trade facilitation, the protection and enforcement of intellectual property rights (IPRs), sanitary and phyto-sanitary measures (SPS), technical barriers to trade (TBT). As envisaged, the FTA should also include enhanced provisions about foreign investments, competition policy, trade defense instruments and public procurement, along with an operational dispute settlement mechanism.

Commitments by both sides in terms of the social and environmental aspects of trade and sustainable development should be included in the AA.

Taking into account the different level of development in the EU and in Central America, region-to-region asymmetries may be considered, where necessary, in all trade and trade-related areas discussed in the course of negotiations.

#### **2.3.4. Institutional mechanisms of the Association Agreement**

Building upon the structures already existing, strengthened institutional and joint monitoring mechanisms should also be foreseen, with a view to ensuring an efficient management of the AA and associating, as appropriate, the civil society.

### **3. MAIN POLICY OPTIONS AVAILABLE TO REACH THE OBJECTIVE**

#### **3.1. Main policy options**

As for any international agreement, the whole matter – and thus the range of options - remains ultimately subject to the process of negotiations. Bearing in mind the policy line set at the Vienna summit, three basic policy choices can be identified to achieve the goal of an AA:

##### **3.1.1. Overall balance and content of the Association Agreement**

The two options would be:

- Just complementing the existing contractual relations with an FTA. In practice this would boil down to adding an FTA to the Cooperation Agreement and the Political Dialogue and Cooperation agreement.
- Trying to upgrade the whole, three-pronged relationship altogether (i.e. political, trade, cooperation instruments) by extending/ enhancing the existing contractual links *and* negotiating an FTA.

##### **3.1.2. Scope of the trade component**

The two options would be:

- Settling for a mere WTO-compliant Free Trade Area, i.e. dealing with liberalisation “at the border” for substantially all trade;

- Seeking a more comprehensive and ambitious FTA, covering i.a. services, sanitary and phyto-sanitary measures, technical barriers to trade, intellectual property rights, trade defense instrument...(dubbed “WTO+”).

### **3.1.3. Negotiation process and format**

The three options would be:

- Accepting a two-track negotiation process (i.e. a region-to-region negotiation process with a hard-core of front-running countries + separate negotiations in parallel with individual countries if needed);
- While negotiating the bulk of the AA on a region-to-region basis, accepting to address some particular issues on an individual basis with specific CA countries (CAFTA approach);
- Insisting on the principle of a single, region-to-region agreement, implying a bi-regional negotiation process across the board, which includes all interested countries throughout the process.

Based on the above mentioned policy options, various scenarios can be envisioned, which would be consistent with the objective set, albeit to various degrees. By decreasing order of ambition, the possible formulae would range from the negotiation of a comprehensive AA, negotiated on a region-to-region basis and including a “WTO+” FTA, down to the mere insertion of a shallow FTA into the existing contractual relationship, with a number of common provisions for the whole region but leaving room for separate *ad hoc* negotiations with the less integration-prone countries.

## **3.2. Justification of the options taken**

The analysis of the context and possible implications of the available options has led to the following considerations:

### **3.2.1. Content and overall balance of the AA**

Given the existing institutional framework, the objective of concluding an AA could be reached by simply topping up the contractual relationship already in place with an FTA. This low key scenario should, however, be avoided, as it would clearly fall short of the political, social and developmental ambitions that the two regions have in common. Instead, a full-fledged Association Agreement, encompassing political, cooperation and trade components into an enhanced contractual relationship with the EU should be sought. Rather than simply adding an FTA to the existing relationship, the negotiation of the AA should thus be the occasion of revamping the whole bi-regional contractual links, by also updating and enriching to the largest possible extent the existing agreements on cooperation and political dialogue.

Although the bulk of the negotiation process will logically dwell on the trade-related aspects, this should not mean that the existing political and cooperation aspects should be left unattended. Beyond the normal updating process that these two components should go through (introduction of most recent standard clauses e.g.), they may also be enriched by including new areas/modalities of cooperation or political dialogue as well as an enhanced institutional framework. In itself, the very fact that the negotiations should take place on a bi-regional basis is not insignificant, as it underlines the political dimension that both sides

attach to their ambitions. Moreover, public opinions and civil society on either side harbour high expectations as to the outcome of the negotiations and are clearly looking forward to a comprehensive and balanced agreement, which clearly promotes political and economic integration of the region. Finally, in a package-deal logic, the enhanced trade opportunities that the AA would offer to CA may also increase the leverage at the disposal of the EU to insert new or more ambitious provisions in the cooperation or political chapters of the AA. A “trade-only” negotiation should thus be discarded.

### **3.2.2. Scope of the trade component (FTA)**

The possibility of settling for a shallow FTA dealing with trade “at the border” might always be envisaged in theory but should normally be dismissed in view of the following considerations:

- A mere WTO-compliant FTA providing for free trade in goods but with only limited ambitions as regards services or the regulatory framework would represent a departure from the current trade policy orientations of the EU (which clearly favour the negotiation of ambitious and comprehensive FTA - “WTO+” - that bring real added value to the multilateral framework).
- Due to the limited size of the CA market, the relatively low level of trade between the EU and CA, the high degree of trade liberalisation already achieved for goods on either side a low key FTA would finally bring very little added value in terms of trade expansion.
- The wide-ranging FTA already concluded by the US with the region (CAFTA) has brought about a new situation, in which the EU has to seek a level playing field with this major regional player, failing which its current position would be further weakened in the future.
- At least as much as commercial interests, the EU has potential interests in developing trade in services and its investments in the region (including through public procurement opportunities), hence the need for an agreement that also adequately covers the related matters.
- Moreover, the previous experiences of the FTA signed with both Chile and Mexico have validated the approach of negotiating comprehensive WTO+ FTAs.

### **3.2.3. Format and negotiation process**

Contrary to the (largely) country-based CAFTA negotiation process with the US, the AA should clearly aim at a bi-regional negotiation process, without individual or *ad hoc* negotiations with separate countries. Beyond practical concerns (such as the efficiency of the negotiation process) or economic considerations linked to the economic merits of regional harmonisation *per se* (market expansion, increased competitiveness etc), this position is essentially inspired by the steadfast policy of the EU to promote Central American endeavours towards regional integration. Indeed, in the long-standing relationship between the EU and CA, regional integration has traditionally been pursued as a powerful means of consolidating the democratic and economic developments in the region while bolstering good neighbourly relations and opening up Central America to the outside world by diversifying its partners. In every respect, the “regional dimension” is thus part and parcels to the EU policy vis-à-vis CA.

### 3.3. General assessment

In spite of their differences, all options would arguably have, at various degrees, some positive impact. However, in consideration of the already strong partnership between the two regions, the question is whether such impacts would be sufficient to warrant the pursuit of a negotiation process and match the expectations expressed on either side in terms of political, commercial and developmental advancement in their relationship. With this in mind, the proposal considers that the negotiation of a far reaching, balanced AA on a region-to-region basis and including a “WTO +” FTA would best match the historical nature of the relations between the two partners and correspond to their stated ambitions, by adding real value to the existing state of play. It is therefore this scenario that will be presented in most detail and upon which the negotiation directives should rest.

## 4. EXPECTED IMPACTS FROM THE SELECTED OPTION

### 4.1. Impact assessment methodology

According to the Commission Communication on impact assessment, the type of impact which a policy proposal has on particular groups sectors or regions should be expressed as far as possible in economic, social and environmental terms. As indicated, the proposal to be assessed does not consist in a full-fledged normative text, but in negotiating directives. It is therefore difficult to prejudge the level of commitments that will be undertaken by the parties.

The assessment is mostly based on qualitative methodology. It analyses the economic, social and environmental impact of the selected option, while also presenting the economic impact of the shallow FTA option. It also summarises the rationale for adopting the selected option. A further, more detailed and comprehensive impact assessment will be conducted later on as part of the Sustainability Impact Assessment (SIA).

### 4.2. Sources available for impact assessment

Available sources on the rationale or possible effects of an AA with CA are yet relatively scarce. A preliminary, internal economic analysis had been undertaken in 2004 by Commission services, but in a significantly different regional and international context (particularly as regards regional integration and multilateral trade negotiations). Meanwhile, the Joint Assessment carried out about the level of regional economic integration has proved a relevant and valuable stock-taking exercise, providing clear indications as to the achievements, challenges and shortcomings of the regional drive towards creating a customs union. Exploratory discussions have been held with the CA partners over the last three years, which have allowed both sides to circumscribe better the range and scope of a possible agreement, and gauge its potential implications. Little, if any, academic research has been yet undertaken on this very subject, except for some preliminary analytical work by civil society on the eve of the Vienna summit. The issue of a possible AA with CA has nonetheless attracted a lot of attention within the CA civil society, whose early reactions appear to be supportive in principle of the endeavour while revealing high expectations as to the involvement of civil society, the content of the AA and its follow-up mechanisms. The issue of the AA has already been broached quite extensively with representative organisations of the civil society on a number of occasions, most recently during the consultations surrounding the EU Regional Strategy Paper for CA, in the run up to the Vienna summit and during a conference organised under the auspices of the European Parliament. Further discussions

were held in September 2006 with a Brussels-based group of civil society organisations active in CA.

### **4.3. Results of the impact assessment**

#### ***4.3.1. Starting point – overall political and economic assessment of the present situation***

##### **4.3.1.1. Political**

In the late 1970s and early 1980s, Guatemala, El Salvador and Nicaragua were plagued by a series of internal conflicts, largely resulting from social inequalities and repressive political regimes, which were also fuelled by the policies pursued in the region by foreign powers. These conflicts also affected Costa Rica and Honduras. It is now widely recognised that the European involvement and political stewardship brought a significant contribution to the peaceful resolution of the conflicts.

The progress achieved in peace building and democratisation have greatly transformed the region, as evidenced by the replacement of a widespread authoritarian tradition by regular and democratic elections and the progress achieved in the promotion of civil liberties. However, the rule of law remains weak in most countries and progress towards establishing a really participatory democracy involving the civil society has been shaky and uneven. Moreover, political polarisation is an obstacle to the building of nationwide consensus. Public security is deteriorating due to the high levels of crime and impunity and a serious lack of confidence in the administration of justice remains. Although some countries have taken steps to combat the problem, the persistence of corruption, in both the public and private sectors, is a serious hindrance to development. The various forms of social exclusion undermine the basis of social coexistence. These deficiencies, in societies where the social and institutional fabric is still weak, reflect the vulnerability of the region.

##### **4.3.1.2. Economic and social**

Further to a decade of relative vigorous economic development during the 1990's, GDP growth in Central America has averaged some 4.2% over the 2003-2005 period. Central America's import and export of goods expanded in 2004/2005 as did the transfer of private capital to the region, primarily made up of remittances from migrants, which exceed foreign direct investments. The apparel assembly (maquiladora) sector is facing increasing competition from Asian producers in the US markets, in particular in the textiles sector. The growth rate of this sector dropped from 19.4% in 2003 to 4.4% in 2004.

The export sector has grown in recent years, especially in light of expansion of the maquila industry. The United States remains Central America's main trade partner (45% of total import and export in 2004), followed by the EU (9% in 2004). The Central American intra-regional trade in 2003 was 27% of the total export and 13% of the total import. 2003. Although there has been some degree of diversification in the region's exports, traditional products such as coffee, bananas and sugar still constitute a large proportion, particularly to Europe. All the countries of Central America are members of the World Trade Organisation (WTO).

General macroeconomic stability throughout Central America has been backed up by improved fiscal performance, in part assisted by debt reduction initiatives in Nicaragua and Honduras under the Heavily Indebted Poor Country (HIPC) initiative. Although macro-



economic fundamentals such as budget and current account deficits and inflation are now globally under control, the general weakness of the state in CA, paltry tax revenues and the lack of redistributive state policies have, with the notable exception of Costa Rica, impeded the development of social cohesion. Although the balance of trade and capital account deficits worsened in 2004, foreign direct investment increased by 2.6% to reach some \$2 billion.

Central America has seen an increase in trade with the EU between 1995 and 2003, based as much on export growth as on rising imports, but for both regions this increase tends to be outperformed by the growth of total trade with the world. As a result, the CA share of total EU imports passed from close to 0.4% in 2000 to 0.3% in 2005, and the CA share in total EU exports was 0.32% in 2005. The traditional commercial surplus posted by CA has progressively increased since 2001, and reached about 1 billion EUR in 2005. Central America's export performance in the EU can be attributed to the positive impact of preferential market access under the GSP scheme, and to the progress recently made in diversifying exports by promoting non-traditional goods. This diversification is clearly reflected in the composition of EU imports from CA. Between 1995 and 2003, the share of Primary products in total EU imports from CA declined from 91% to 51%, while the share of manufactured products (mainly machinery and mechanical appliances, electrical equipment) increased from 8% till 48%. Imports of machinery constituted the most dynamic component of EU imports from CA countries over the period.

However, Central America's trade with the EU is highly concentrated in a few countries. In 2005, Costa Rica accounted for over 64% of EU imports from CA. Indeed, between 1995 and 2002 while EU imports from Costa Rica increased rapidly, imports from other CA countries declined. Even the diversification of CA Europe-bound sales stems exclusively from the swift growth of Costa Rican sales of manufactured goods to the EU, notably thanks to an important EU investment in the semi-conductors sector. The other Central American countries remain highly dependent on exports of traditional products such as coffee, bananas and sugar, which account for over 60 percent of their sales to the EU. In general, EU exports to the CA Isthmus are less focused on a specific country; however Costa Rica and Panama absorbed together 55% of the total EU export in 2005.

Growth performance has not filtered down equitably across the CA countries' societies and income distribution exhibits strong national and regional discrepancies. Per capita income ranges from around \$1,000 in Nicaragua and Honduras to about \$2,000 in Guatemala and El Salvador and above \$3,500 in Costa Rica and Panama. With the exception of Costa Rica, income distribution is highly unequal with the poorest 40% of the population receiving between 10-14% of total income. Although human development indicators have increased in most CA countries over the last decade, serious educational problems persist in the region and life expectancy figures still exhibit noticeable contrasts among the Central American countries or social groups. Significant differences exist also in the degree of coverage of the health services and the HIV/AIDS epidemic is serious with the reported number of deaths reaching about 37,500 in the period from 1998 to 2003. According to the ILO, unemployment in the Central American region is around 1.5 million persons or 8% of the total labour force of some 18.8 million persons. Some 60% of workers are employed in the informal economy and in rural and indigenous productive activities. Likewise, food security remains a problem with rates of malnutrition ranging from 20% in El Salvador, 25% in Nicaragua, 30% in Honduras and 50% in Guatemala. The International Organisation for Migration (IOM) estimates that some 2 million Salvadorans and 1.2 million Guatemalans live in the USA, while almost 500,000 Nicaraguans live in Costa Rica. Central America is also host to migrants in transit from South to North America. Migration from Central America to the European Union is not



significant. Remittances have been steadily growing and now play an important part in the C A economic equilibrium.

Although Central America is not a major drug producer, it is an important transit region for South American drugs en route to the USA and Europe. This has had an impact on both drug consumption and drug-related crime in the region, which has seen an increase in money-laundering activities. The region continues to be affected by large-scale cocaine trafficking and abuse. In parallel, there has been a growing wave of violent crime committed by youth gangs (known as ‘*maras*’). So far their activities have concentrated in Honduras, El Salvador and Guatemala with some spill over into southern Mexico. Security has become one of the priorities for cooperation and dialogue at sub-regional level, as well as in relations to other countries affected directly or indirectly by these phenomena (the US, Colombia, etc.).

#### 4.3.1.3. Environmental and sustainability issues

Central America constitutes a biological, cultural and economic bridge. Due to its geographic diversity, CA offers a very rich ecological heritage, whose conservation is of worldwide interest. With 2% of the world’s territory, it has nearly 12% of the world’s biological diversity. However, the region is affected by increasing, and in some cases, irreversible environmental degradation, with the continuing erosion of arable land, deforestation and the depletion or pollution of water resources, which threatens both terrestrial and marine biodiversity.

Among the root causes of this situation are inadequate environmental policies and legislation, institutional weakness, destructive farming practices such as the burning of fields prior to sowing, as well as the effects of poverty and the persistence of polluting or harmful methods of production. Furthermore, rampant urbanisation and the persistence of poverty and social inequalities, apart from increasing the burden on already overstretched public services in urban areas, have led to an increase in crime and violence – including domestic violence – while destitution is increasing among broad sections of the rural population.

The most economically depressed populations in rural and urban areas are found in zones of high natural disaster risk. Natural disasters closely linked to climate variability have increased in frequency and intensity in past decades.

#### 4.3.1.4. Central American regional integration process

At present, the regional economic integration system in Central America (“SIECA”) encompasses five countries: Guatemala, El Salvador, Honduras and Nicaragua and Costa Rica. Panama, which is only part of the political integration system (called SICA), is increasingly pondering the possibility of integrating the regional economic integration sub-system, which would entail the possibility to fully participate in future bi-regional negotiations with the EU. To this aim, it has already embarked upon negotiating a series of FTA with its partners, as a first stage towards possible full membership of SIECA in the future. The main juridical instrument for Central American *economic* integration is the Guatemala Protocol (1993) which was subscribed to by the six countries but ratified only by five (all except Panama). It has been in force since 1997.

After years of ups and downs in regional integration, a strong political will was manifested over the last three years with a view to reinvigorating the regional integration process. To this effect, an objective was set to achieve a Customs Union by the end of 2006, which was

enshrined in a roadmap agreed upon by all regional heads of state during their Panama summit in March 2006. The EU has proved particularly instrumental in supporting this renewed momentum, notably by providing assistance to regional integration efforts and offering the perspective of a bi-regional AA.

Institutional framework: The **regional institutional set up** remains largely intergovernmental and is still in a process of consolidation. The regional Secretariat of economic integration (SIECA), which now exercises mainly technical and administrative competences, seems poised to receive more executive powers as regional integration intensifies. The regional ratification process is underway as regards both the Court of Justice and the Central American Parliament (PARLACEN), and will have to be completed if those two institutions are to assume a regional coverage and become full fledged regional bodies. This is particularly important in the case of the Court of Justice, given the need for a regional dispute settlement procedure that would not only be available to governments but also to private entities.

Customs union: In Central America the vast majority of originating products benefit from free trade, except for a few sensitive products (mainly sugar and coffee). An - incomplete - **Common External Tariff** (CET) comprises 94.6% of harmonised tariff lines, the consistency of which has nonetheless been recently affected by a series of bilateral trade agreements between CA countries and third countries, including the individual dismantling schedule negotiated with the US.

Regulatory environment: Central America has already put in place a common legislation on **customs procedures and customs regimes**, which still needs fine-tuning so as to eliminate remaining national exceptions. A limited number of harmonised norms, regulations and procedures exist in the **sanitary and phytosanitary** (SPS) area, in the field of **technical barriers to trade** – TBT (technical regulations, mutual recognition of registers, etc.), as well as regards **trade defence instruments** (TDIs). In the **services and investments** area, Central American countries have signed a regional Treaty, whose ratification process is underway<sup>3</sup>. In the meantime, the CAFTA should provide for common rules on principles such as market access and national treatment, as well as for substantial integration as regards **Intellectual Property Rights**, (but not **Geographical Indications**). While there is a rather large degree of convergence on the principles applied, at the moment there are no common laws at regional level as regards **government procurement and competition**.

#### 4.3.1.5. Principal obstacles and challenges to sustainable integration in Central America

The main medium-term development challenges that currently confront the Central American region can be summarised into four broad categories, which are closely inter-mingled:

- **Strengthening democracy**, by consolidating fundamental freedoms, empowering civil society, tackling impunity, increasing transparency in public sector management and improving the electoral system and political party structures;
- **Reducing economic vulnerability**, particularly the reliance on primary commodities, apparel assembly industries, remittances, imported energy sources and the tourism sector, which are all subject to high market volatility;

---

<sup>3</sup> It should also be noted that the annexes of the treaty containing the specific commitments undertaken by each country are yet to be discussed.

- **Stepping up social cohesion**, failing which the desperate quest for alternative options in migration or criminality would seriously endanger the social fabric;
- **Addressing environmental vulnerability**, especially as the hardest hit populations are also the worst off.

In such conditions, furthering the regional integration agenda is increasingly regarded as a new dimension that would help address these challenges. Progress along this path has hitherto been limited by a number of stumbling blocks, such as the institutional weakness of the integration machinery, the different visions and levels of interest regarding integration, intraregional economic disparities, lack of financing mechanisms to strengthen and develop the integration system, the non-binding nature of the regulations and resolution together with the weakness of enforcement mechanisms and the uneven social ownership of the integration process. Though not a panacea in itself, the AA is expected to set off a new dynamic and facilitate the response to such problems.

#### 4.3.2. Possible impact of an association agreement<sup>4</sup>

##### 4.3.2.1. Economic impact

Globally more open than the CA market, the EU should thus benefit from the increased trade liberalisation that the FTA should bring about. By traditional “FTA-eligibility standards”, the CA region remains, however, a relatively small economic area, with a cumulated GDP of just 74 billion € in 2004 and a relatively low GDP per capita of 1777 US\$. In 2005, CA represented 0.4% of total EU imports and 0.34% of its exports. In such conditions, the sheer economic or trade interest can not be the major determining factor when it comes to weighing the merits of an Association Agreement with CA (least of all if it only includes a shallow FTA).

##### *Trade impact of the FTA*

In all likelihood, the **impact of the elimination of CA tariffs** would be limited for the EU while the impact for CA countries would be generally larger and even quite significant in some specific sectors, largely due to increased trade liberalisation in the trade of primary products towards Europe.

Given the vast coverage of the current GSP system<sup>5</sup>, trade creation for CA exporters to the EU market would be probably limited to a small number of sectors not currently benefiting from GSP+ whose relevance is nonetheless significant in the total CA exports to the EU. Though not quantifiable, one of the main benefits of the association agreement for CA would be the replacement of the current unilateral and time-bound preferential trade regime granted by the EU (GSP+) with a permanent and contractual preferential access to the EU market, which would be more stable and more conducive to promoting long term investments. Moreover, in practice the GSP system was mainly used by larger companies while trade

<sup>4</sup> Possible social and environmental implications will be detailed as part of a thorough Sustainability Impact Assessment exercise, to be launched once the negotiations have started.

<sup>5</sup> In 2002, the GSP utility and utilisation rates were quite similar, ranging from 88% in Costa Rica to 39% in El Salvador, and were considerably above the Latin American average of 44%. More recent figures from SIECA, however, would suggest a clear decline in the utilisation of the FSP, with a 51% average rate in 2004 for CA countries.

liberalisation through an FTA would make it easier for SMEs to accede EU markets. Finally, the actual benefits derived from the preferential treatment granted under the GSP were running the risk of being eroded as a result of the proliferation of FTAs across the world.

Trade creation would be relevant for EU exports market in a few manufacturing and food sectors characterised by high tariff protection (vehicles e.g.), though its overall dimension would be likely to be constrained by the limited size of the CA market and the dissimilarity in EU and CA production structures. As a result of the FTA, EU exporters would now be able to compete with US, Mexican and Chilean exporters on the CA market on an equal footing as well as with the other countries that have already engaged in FTA negotiations with CA countries (Taiwan e.g.).

*Impact related to enhanced competition, the improvement of the business environment and the consolidation of regulatory framework*

Much more significant market access improvements and economic gains for both sides may potentially be obtained if the EU-CA FTA goes beyond the mere elimination of barriers at the border and makes substantial progress in removing non-tariff barriers (in particular regulatory ones), while pushing forward effective CA regional integration through the consolidation of a customs union.

For CA countries, the lack of formal market integration, the remaining non-tariff barriers and the incomplete CET still impose high transaction costs on regional operators, clearly hindering intra-CA trade flows and the development of the CA economies. A WTO + Free Trade Area would imply a bold extension and deepening of liberalisation and regulatory cooperation/convergence, notably in the area of services and investment, customs provisions, technical barriers to trade including product standards, testing and certification procedures, intellectual, industrial and commercial property rights, competition and public procurement. A more coherent regional integration process could thus develop intra-regional trade (at least in more traditional agricultural products, basic manufactured products and services) and economic integration. Increased intra-regional exports could stimulate the growth of CA exports to the world by providing CA producers with an enlarged initial market, thereby enabling them to profit from region-wide economies of scale and going through the learning process implied by external competition.

For CA the gains to be derived from increased competition and economies of scale could be potentially large, especially in some manufacturing sectors. On the other side, regional integration would have a larger impact in the agro-business sector and in services (commercial and financial). Though still limited in its size, a CA market comprising a fast-growing population of 40 million inhabitants would also become commercially more attractive for the EU.

Another benefit derived from the FTA would be the **increase of FDI in CA**, especially if the FTA brings about significant improvements in the domestic policy environment. Between 2000 and 2002 the annual average growth rate of the inward investment stock in CA (9%) was three times the world average (3%), mainly focused on Costa Rica and the relevance of FDI for capital formation appears quite significant for all CA countries, especially Nicaragua and Costa Rica. Concerning the EU, after declining in previous years, EU FDI outflows to CA and Caribbean countries passed from 3.8% of total EU FDI outflows in 1996 to 7.2% in 2002. Between 1996 and 2002 EU FDI stocks in the whole region increased from 29 billion € to 72 billion €. As regards the CA region itself, the balance of EU FDI stocks showed a surplus of



almost 25 billion EUR in 2004. This upward trend would probably be accelerated by the legal security and market size effect offered by an EU-CA FTA associated with an enhanced regional economic integration.

Given the strong EU position in **services**, the inclusion of liberalisation commitments in the area of services would clearly benefit EU services providers, especially in those countries which maintain public monopolies in the area of services (like Costa Rica in telecommunication, financial, assurance, energy).

For both partners, the impact also depends on each party's **on-going preferential trade liberalisation initiatives** (EPAs with ACP countries - including the Caribbean - for the EU, and FTAA negotiations and the implementation of the US-CAFTA agreement for CA). The fact that the far-reaching CAFTA agreement will already be up and running by the time the AA comes into play will certainly water down the structural impact of the latter on CA socio-economic structures. One may also assume that, faced with a more and more pervasive US influence in the regional economy, the diversification of CA international trade partners through an FTA with Europe could prove beneficial and alleviate its economic dependence vis-à-vis the US. This would allow the region to multiply its economic options and avoid "single-provider scenarios", so as to reap more dividends from the trade liberalisation efforts accepted under CAFTA. With the implementation of CAFTA, another positive impact of the AA for the EU economic operators could be to use the CA countries as a platform whence to access the US market in particularly favourable conditions.

The **incidence of tariff elimination on CA budget revenues** is likely to be modest. Globally, the tendency towards a reduction of the relative weight of import duties in overall budgetary resources has continued over recent years across the region, albeit to various degrees. Given the limited level of trade between the EU and CA and the asymmetrical process of tariff dismantling upon which AA generally rest, the further loss of import duties following an FTA with the EU should not affect the stability of overall government revenues, especially if it is offset by increased revenues derived from the fiscal benefits of trade liberalization<sup>6</sup>.

On balance, the positive impact of an FTA on both sides is certainly worth considering, especially as no major constraint on either side seems likely to counterbalance the expected benefits of the FTA. For the EU, the one possible exception could be the need to tackle adjustment in a few traditionally protected agricultural sectors. However, the final impact of the FTA on these sectors will largely depend on the ultimate results of the negotiations and on their current reform process.

In addition to the FTA-related impact, the Association Agreement will also provide for an enhanced economic cooperation between the two regions, which is likely to result in an improved economic performance and better development prospects for CA.

---

<sup>6</sup> As regards the impact of CAFTA on fiscal revenues, estimates about the loss incurred as a result of trade liberalization varied between 1.6% of budget revenues and 8% (depending on the studies and on the countries considered), Honduras being the hardest-hit country and Costa Rica the least affected. The impact of the AA on tax revenues would be significantly lower, due to the lesser importance of bilateral trade between CA and the EU.

#### 4.3.2.2. Social impact

Social impact for the EU can be expected to be minimal, if not insignificant, with the possible exception of a small number of agricultural products. In general terms, a positive social impact can be expected from the AA within the CA region.

- The privileged bi-regional partnership created by the AA would represent a qualitative leap in the bilateral relationship and would thus allow the EU to convey more forcefully its political message on **social cohesion** across the region, through a reinforced political dialogue.
- Likewise, building upon the social (and environmental) undertakings upon which the “GSP+” preferential trade regime is predicated, the association agreement should offer the opportunity to enshrine these important commitments on **core labour standards** into the new contractual relationship hereby created.
- Within the region, the enhanced intra-regional integration and cooperation resulting from the AA dynamics may lead CA countries to share - and emulate - **best social practices** amongst themselves.

**Social cohesion within CA:** Existing **regional discrepancies in terms of development** may, however, be exacerbated as a result of increased competition and trade liberalisation, especially in the absence of mechanism to mitigate the social adjustments and ensure a fair redistribution of the benefits derived from trade openness. Unless cohesion-enhancing measures are designed at regional level, such a situation might even create tensions in the CA own integration process, increase intra-regional migration flows (witness the issue of labour mobility between Nicaragua and Costa Rica) and generate differences in the countries’ perceptions of the benefits accruing from deeper integration. CA leaders seem however to be mindful of these risks. At the behest of Nicaragua, a reflection has already been undertaken in the region as to how to address further regional imbalances. This debate is expected to intensify as progress towards the customs union and the AA gathers pace, with the possible effect that *regional economic integration* could spill over to *regional social cohesion*. The use of the customs duties collected at the entry of the future CA customs union could be considered in this respect. In any event, the EU could also bring a seminal contribution to the emergence of **regional cohesion mechanisms** as part of the AA, both in terms of experience-sharing and financial cooperation with the region.

The risk of “**social dumping**” in the region seems, however, limited. Indeed, rather than comparing labour cost differences, EU FDI candidates are expected to gauge business climate levels in the respective countries before choosing where to invest (witness the success of Costa Rica in FDI).

**Employment:** Globally, the overall economic impact is likely to result into higher intra-regional and extra-regional trade and better development prospects, generating in turn higher **employment** levels within the region. Due to the relatively limited trade between the two regions -and to the composition thereof - the AA is unlikely to have any significant disruptive effect on the CA labour market. Unlike CAFTA, there seems to be little risk that the AA would result into an increase in EU agricultural exports of such a magnitude as to affect local farmers. On the contrary, the AA can be expected to have a beneficial social impact in the labour-intensive **banana sector**, especially in the CA countries where the share of small producers is significant (Costa Rica or Nicaragua e.g.). **Local staff requirements** applying to



foreign companies in some countries (Honduras and Nicaragua) may probably have to be revisited in the context of an FTA, but this is unlikely to have any significant social impact.

### Specific issues

The solution agreed as to how pharmaceutical products will be treated in terms of IPR protection may have a social impact, especially in consideration of the flexibilities recognised under the WTO TRIPs and health declaration and decision. The issue of **state monopolies** in the sector public services can be expected to strike a sensitive chord in Costa Rica, as their existence is generally seen as part and parcels of the domestic “social model”. However, the gradual approach generally taken by the EU on market access is not alien to the preservation of specific regulatory frameworks. In any event, the expected ratification of CAFTA should have led Costa Rica to revisit this issue before the AA comes into play. In the post-CAFTA context hereby created, the diversification of international trade partners resulting from an FTA with the EU would enlarge the gamut of economic options and may thus prove beneficial for Costa Rica. Notwithstanding recent progress in complying with environmental and social regulations, the **banana and sugar sectors** have remained under public scrutiny in both respects. The increased political and economic leverage offered by the AA should enable the EU to insist on proper compliance with social and environmental norms in these sectors (particularly collective bargaining rights, child labour).

On top of the reinforced social dialogue and cooperation, the social impact of **enhanced cooperation in sector policies** such as education, water & sanitation, drugs, consumer protection and health can be expected to be positive for the population at large and help the region attain the MDGs.

In a region where remittances account for an ever-increasing part of the GDP, the boost provided to domestic growth and job opportunities by the AA can be expected to reduce CA’s economic dependence on economic emigration, the intensification of which would be fraught with adverse social effects (family disintegration, human being trafficking, rural abandonment etc). The bulk of CA migration flows are directed to the US and the AA is not expected to result in any significant change as regards emigration to the EU.

In a wider (and longer term) perspective, the conclusion of the AA is expected to help usher in a more modern and “outward-looking” socio-political paradigm in CA societies, which have hitherto been characterised by their relative imperviousness to social changes. By instilling rule-based practices and higher transparency in the economy, diversifying the spectrum of international social models available to CA, fostering intra-regional comparisons or experience-sharing and promoting the role of civil society the AA can, up to a certain extent, favour the emergence of a new social deal in the region.

#### 4.3.2.3. Environmental impact

**General:** Overall the AA can be expected to have a mixed impact on the environment, with potential positive effects flowing from increased cooperation and enhanced political dialogue (albeit limited compared to the magnitude of the challenges the region is confronted with), and negative impacts likely to result from increased economic activity and trade. Negative effects should nonetheless be limited in scope and intensity due to the relatively small economic and commercial impact of the Association Agreement. As appropriate, enhancing and mitigating measures (both trade and non trade-related) may have to be designed to address such effects.

The Agreement may positively influence the environmental agenda through various means:

- The qualitative step that an AA would entail in bi-regional relations will allow the EU to promote its environmental values more forcefully in the political dialogue with its CA partners.
- Likewise, building upon the environmental undertakings upon which the “GSP+” preferential trade regime is predicated, the association agreement should offer the opportunity to enshrine these important environmental commitments into the new contractual relationship hereby created.
- At a time when environmental issues, the sustainable management of natural resources and the prevention of natural disasters pose region-wide collective challenges which ignore borders, the further impulse given to regional integration through the AA can usefully promote the vision of a collective, region-wide approach to common problems.
- As for social issues, the enhanced intra-regional integration and cooperation resulting from the AA dynamics may also lead CA countries to share - and emulate - best environmental practices amongst themselves.

**Environmental impact of increased trade and economic activities:** The overall impact of the AA on economic activities is expected to be limited and so should also its effect on pollution levels or environmental degradation.

- In terms of European investments, a further concentration of FDI on the most dynamic regions can be expected, which could sporadically result in higher urban concentration and additional pressures on the environment.
- Unlike CAFTA, the paucity of EU agriculture exports to CA make them unlikely to affect rural employment, land occupation patterns or the existence of traditional farming systems in CA. Likewise, the development of intra-regional trade and related transports infrastructures as a result of enhanced economic integration is expected to be very gradual, as most CA countries exhibit analogous economic patterns which limit the scope for intra-regional trade integration.
- The possible increase of EU investments in the fisheries sector (which is politically sensitive in some CA countries and where a number of EU operators are already present) may also have consequences in terms of sustainable development, which could justify a sector study as part of SIA.

**Cooperation:** Stronger cooperation in environmental issues would entail a positive impact in a number of fields, such as the transfer of environmentally sustainable and/or clean technologies; the regional monitoring of biodiversity; harmonisation of environmental legislation, the promotion of joint regional research programmes (e.g. on renewable energy); capacity building in negotiating and implementing multilateral environmental agreements etc

**Specific issues:** Illegal logging has become a critical issue in some of the CA countries, among which Honduras and Nicaragua. Illegal trade in wood products has been reported to take place over recent years, including towards EU markets. The leverage offered to the EU by enhanced trade opportunities and cooperation under the AA should also be used to make

progress on a number of environment-related trade issues in the field of forestry products, in order to promote best commercial practices in certification or eco-labeling. The AA can be expected to result in enhanced intra- extra-regional customs cooperation and intra-regional interconnection between customs services and law enforcement agencies, which would also have a positive impact in limiting illegal trade. Likewise, the AA could result in developing trade in non-timber forestry products, which is considered important for the sustainable management of natural resources. Small producers who are not necessarily familiar with the GSP procedures can be expected to benefit from the simplification of trade exchanges under a FTA.

In a wider perspective, both the consolidation of the customs union and the conclusion of an FTA with the EU should lead to the harmonisation of technical and SPS norms within the CA region and to further progress in their actual enforcement. In some cases, this harmonisation may result in the substitution of domestic norms with international standards, which would have a positive effect on the environment.

Due to its geographic diversity, CA offers a very rich ecological heritage, whose conservation is of worldwide interest and benefit. With 2% of the world's territory, it accounts for almost 12% of the world's biological diversity. Any improvement of the CA environment can be expected to exercise beneficial effects well beyond the region, including for the EU.

#### **4.3.3. Summary of the expected impact of the selected option**

The AA is expected to result in short term mutual benefits in terms of trade and economic developments, first and foremost for CA but also, to a lesser extent, for the EU economic position across the region.

As a powerful vector towards further regional integration, the AA between the EU and CA is expected to have long-term benefits for the region as a whole. Beyond the economic benefits generally associated with a higher degree of trade exchanges and regional economic integration, the AA should help “disentangle” the traditionally northward-looking CA countries, helping CA reach the critical size to really take shape as a full-fledged regional political actor. This would not only allow the CA region to play a beneficial role on the regional Latin American stage but also to act more assertively on the world stage - in conjunction with the EU - for the promotion of common values.

In a region where the consolidation of democratic institutions has traditionally outpaced real social progress, a closer partnership with the EU may also raise public awareness on the social dimension of economic development, contributing to the emergence of a “new social deal” within the region. Likewise, the AA will open a new, regional political space for the still rather disenfranchised CA civil society, helping it to network region-wide and make its voice heard in the public debate. The dynamics of the region-to-region negotiation process and the pro-integration impact of the AA should also help CA countries make a qualitative step in terms of institutional set-up, moving away from their traditional inter-governmental pattern towards a more supra-national one. This new institutional pattern could ease the transition towards structural policies and regional funds in the future, with a view to bridging social gaps at regional level.

For the EU, an AA with CA will demonstrate its capacity to harness in a consistent and forward-looking fashion the whole array of its policy instruments (cooperation, trade, political dialogue etc) in support of wider, overarching common foreign policy objectives linked to

regional peace-making, stabilisation, development and democratisation. It may also set a positive precedent for further region-to-region agreements between the EU and other regional groupings and thus contribute to the promotion of multilateralism in world affairs. The strong investment made by the EU in championing and sponsoring regional integration will benefit its image in the region, the EU being one of the few international actors that pursue a clear and consistent regional agenda in CA.

As regards the three basic criteria against which the impact is usually measured, we can observe that the impact of the AA can generally be considered positive, most notably for CA. As expected, this relative asymmetry in terms of benefits confirms the underlying development agenda that partly motivates this particular AA.

<b>Impact</b>	Economic	Social	Environmental
EU	++		+
CA	+++	++	++

+++ : *significantly positive*

++ : *positive*

+ : *marginally positive*

Although, in relative terms, the overall expected impact of an AA with CA may be regarded as moderate compared to other – or prospective – AA, especially EU-wise, it should be mentioned that this AA seems also free of any significant drawbacks for the EU, which somehow reinforces its merits.

By way of conclusion, the main positive aspects of the AA with CA may be summarized as follows:

- A strong impetus in favour of regional integration, helping CA face the challenges of development and trade integration in a context of globalisation, and mature into a self-standing regional actor able to match regional challenges with regional responses;
- A step forward in developing the – largely untapped – CA potential in terms of regional economic cooperation/ rationalisation, with positive economic and social consequences in the long run in terms of regional development policy at the CA level;
- A response to some of the shortcomings of the business climate in CA, which is likely to boost the current upward trend of European FDI in the region;
- A diversification in the spectrum of CA international partners, enabling the EU and CA to develop and pursue common agenda in multilateral fora in support of joint positions and common values;
- A – gradual – transformational effect on the socio-political fabric of the CA societies, through the development of a rule-based economic culture, the further empowerment of the civil society and a stronger exposure to European social and environmental values and experiences;

- A corner-stone upon which building the wider EU vision of its future bi-regional partnership with the whole Latin American continent;
- A positive precedent and an incentive for other potential candidates interested in forging a bi-regional partnership with the EU.

## 5. POSITION OF CENTRAL AMERICAN NON-STATE ACTORS WITH REGARD TO THE ASSOCIATION AGREEMENT

The traditional privileged partnership between the EU and CA civil society explains the keen interest raised by the AA among the community of non-state actors. Likewise, the sometimes shaky relationship between CA governments and civil society goes some way towards explaining the considerable expectations that CA non-state actors place in the AA, some of which may even exceed the scope of deliverables that can reasonably be expected from such an agreement.

Generally supportive of the AA, civil society organisations (CSO) have nonetheless come up with a series of recommendations and requests, as regards both its content and the manner in which it should be negotiated and, later on, monitored. For a number of CSOs, this relative assertiveness may be due to the sense of frustration and the feeling of being sidelined throughout the CAFTA negotiations. As a matter of fact, many disgruntled CSOs also tend to see the AA as an opportunity to regain, in a triangular relation with the EU, some leverage on domestic public policies. This seems particularly obvious in the case of labour organisations or trade unions, whose social claims have often gone unheeded at national level and which are generally critical of what has been agreed upon in terms of social provisions under the CAFTA agreement. As regards employers' unions, the initial reaction seems largely positive, although the AA tends at times to be equated with a mere FTA.

In some cases, more "philosophical" misgivings about trade liberalisation *per se* and the perceived risk of losing "national sovereignty" in the economic field pervade the NGO discourse on the AA. In this respect, it is feared that the AA would result in formally embedding what is already a very asymmetrical relationship between two incommensurate economic blocks. The compactness of the CA economic block to face the EU giant is often questioned, and it is argued that CA should first integrate more strongly before venturing into any further FTA negotiations. The AA is often perceived as an instrument that should mitigate the existing discrepancies between CA and the EU, through asymmetrical concessions and increased cooperation.

Partly due to a still very vivid historical legacy of social conflicts and foreign influence over domestic affairs, the behaviour of multinational firms is generally regarded with utmost suspicion, especially their compliance record concerning labour and environmental norms. Lamenting what they see as the unraveling of the Doha Development Round and the oblivion in which its development-related components have fallen in the course of the round, many CSOs are wary of the real intentions behind a comprehensive and ambitious ("WTO+") FTA, which they see as a maneuver to usher in the "Singapore issues" (public procurement, investments, competition policies etc) through the backdoor. In the views of many CSOs, the latter issues are as many means of curtailing what little leeway is still available to the State for promoting domestic social and development policies and should not thus be on the agenda.



As opposed to the trade-driven CAFTA, the three-pronged pattern of the AA (political, cooperation, trade) is viewed with favour, although CSOs express doubts about the real content and concrete incidence of the political and cooperation pillars within the new AA. There is a large consensus to insist that any AA should rest on these three equally important pillars, which is generally encapsulated in the motto that the AA ought to be “*mas que comercio*”. The fear that the future AA could actually boil down, in practice, to merely adding an FTA to the existing contractual links in cooperation and political dialogue seems quite present and, for many CSOs, any such occurrence would signal a regrettable shift in the traditional EU-CA relationship. Judging by international precedents, many CSOs consider that the political will of the EU to really “enforce” the provisions regarding labour rights, human rights and democracy can not be taken for granted, hence the call for “operational enforcement mechanisms”, a stricter definition of the “democratic clause” and a real monitoring of its implementation.

Many CSOs have already made it clear that, beyond the usual consultation phase, they expected to be given a say, if not a seat, in the negotiation process and the monitoring of the AA.

In a wider perspective, CSOs claim that the AA should also offer the opportunity to address issues such as regional (i.e. structural) funds in CA, debt alleviation schemes, EU agricultural subsidies..., which may arguably go beyond the remit of the negotiations.

The interest raised across civil society by the AA is certainly positive and should be welcome. Clearly, the initial reaction of many CSOs seems to foreshadow an assertive participation on their side in the consultations surrounding the AA. Building upon the climate of confidence that generally exist in the partnership between the EU and civil society in CA, it should however be possible in the period leading up to the negotiations to overcome some of the remaining misunderstandings (or dispel some misconceptions) that still exist at this early stage, while considering those recommendations that can fall within the remit of an AA. In view of the local context, the general lack of information and the magnitude of the expectations expressed by civil society, a special effort of communication seems, however, particularly necessary in order to set out and explain the nature but also the ambitions of the AA at stake.

As already mentioned, the EC and CA CSOs have already met on several occasions to exchange views on this issue, but this dialogue should be intensified as we draw closer to the opening of the negotiations and pursued later on through the Sustainability Impact Assessment exercise. Although most of the points raised by civil society are valid in their own right, one of the main difficulties will be to distinguish between what belongs to AA and what should be dealt with through other means.



## INDICATORS OF HUMAN DEVELOPMENT (2004)

	Life expectancy at birth	Illiteracy rate. (Adults)	Gross enrolment rate	GDP per capita	Index of life expectancy	Educational Index	GDP Index	IDH results 2003
Costa Rica	78,0	95,8	69,0	8.840	0,88	0,87	0,75	0,834
Panamá	74,6	92,3	73,0	6.170	0,83	0,86	0,69	0,791
El Salvador	70,6	79,7	66,0	4.890	0,76	0,75	0,65	0,720
Honduras	68,8	80,0	62,0	2.600	0,73	0,74	0,54	0,672
Nicaragua	69,4	76,7	65,0	2.470	0,74	0,73	0,54	0,667
Guatemala	65,7	69,9	56,0	4.080	0,68	0,65	0,62	0,649
Central America	71,2	82,4	65,2	4.842	0,77	0,77	0,63	0,722
Developing Countries	64,6	76,7	60	4.054	0,66	0,71	0,62	0,663
World	66,9	nd	64	7.804	0,70	0,76	0,73	0,729

## ECONOMIC INDICATORS

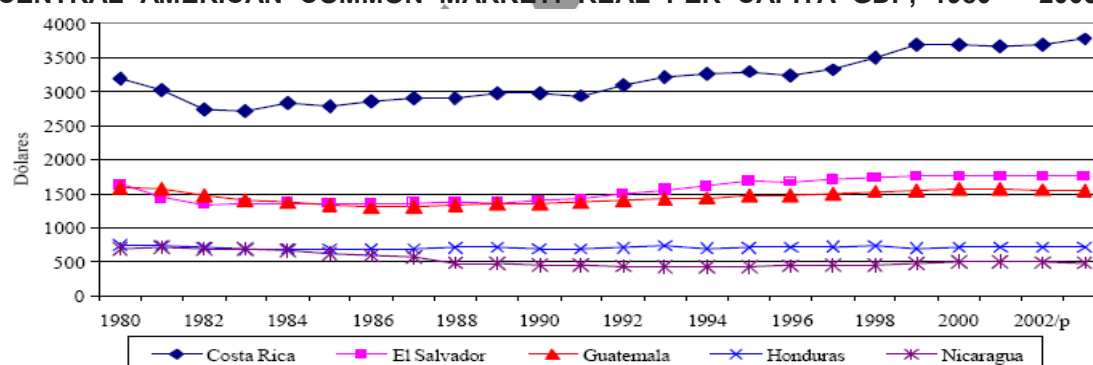
	2001	2002	2003	2004	2005	Average growth 2001-2005 (%)
<b>Euro/USD exchange rates (average annual)</b>	<b>0,90</b>	<b>0,95</b>	<b>1,13</b>	<b>1,24</b>	<b>1,24</b>	
<b>Population</b>					<b>40</b>	
<b>Area</b>					<b>489</b>	
<b>Gross domestic product</b>	<b>82</b>	<b>82</b>	<b>72</b>	<b>70</b>	<b>74</b>	<b>-2,4</b>
<b>GDP per capita</b>				<b>1.777</b>		
<b>Real GDP</b>		<b>2,8</b>	<b>6,3</b>	<b>4,2</b>	<b>4,1</b>	
<b>Current Account Balance</b>	<b>-4,6</b>	<b>-4,7</b>	<b>-5,2</b>	<b>-5,7</b>	<b>-4,9</b>	

## CENTRAL AMERICA: ECONOMIC GROWTH, 1998 – 2004

Indicator	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama
<b>Real Gross Domestic Product (annual rate of variation)</b>						
1998	8,3	3,8	5,1	3,3	3,5	7,4
1999	8,0	3,4	3,9	-1,5	7,0	4,1
2000	1,8	2,2	3,6	5,7	4,2	2,7
2001	1,0	1,7	2,3	2,6	3,0	0,6
2002	2,9	2,2	2,2	2,7	1,0	2,2
2003	6,4	2,0	2,0	3,5	2,3	4,7
2004*	4,1	1,8	2,6	4,3	4,0	6,0
<b>Real GDP per capita (annual rate of variation)</b>						
1998	5,6	1,6	2,4	0,5	0,7	5,3
1999	5,6	1,3	1,1	-4,1	4,2	2,1
2000	-0,6	0,2	0,9	3,0	1,4	0,8
2001	-1,0	-0,2	-0,2	0,0	0,3	-1,3
2002	0,9	0,3	-0,4	0,1	-1,6	0,4
2003	4,4	-0,1	-0,5	0,9	-0,3	2,2
2004*	2,2	0,0	0,1	1,8	1,9	4,1
<b>Internal gross investment [ gross Formation of fixed capital (% of GDP)</b>						
1998	21,7	17,9	18,5	29,0	23,7	24,6
1999	19,3	17,1	18,8	31,3	30,2	27,5
2000	18,9	17,5	18,9	27,4	26,6	29,5
2001	19,2	17,5	18,5	24,6	25,1	27,1
2002	20,0	17,6	17,0	22,6	24,9	19,8
2003	20,2	17,6	18,0	23,7	24,2	22,8
2004*	18,6	16,8	17,0	27,2	24,8	21,8

SOURCES: Data de CEPAL, \*Preliminary values

## CENTRAL AMERICAN COMMON MARKET: REAL PER CAPITA GDP, 1980 – 2003(\$ 1995)



Fuente: CEPAL con base en cifras oficiales.

**CENTRAL AMERICAN COMMON MARKET: PARTICIPATION OF SOME ECONOMIC SECTORS  
IN THE GIP, 1970-2003 (% GDP)**

	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-03
<b>Costa Rica</b>							
Primary	22,8	19,4	19,3	11,6	11,8	11,3	10,5
Agricultura	22,8	19,4	19,3	11,6	11,7	11,2	10,4
Secondary	24,3	27,6	26,4	25,4	25,1	25,9	26,3
Industry	19,5	21,8	21,7	21,1	21,1	22,2	22,4
Services	52,9	53,0	54,3	56,5	56,1	55,1	56,5
<b>El Salvador</b>							
Primary	18,4	17,1	19,2	17,9	16,1	13,5	12,1
Agricultura	18,1	16,9	18,9	17,6	15,7	13,1	11,7
Secondary	30,8	30,8	25,4	25,0	25,3	25,7	27,4
Industry	27,8	26,5	21,8	21,1	21,7	21,9	23,5
Services	50,8	52,0	55,4	57,1	55,7	54,7	54,7
<b>Guatemala</b>							
Primary	27,9	26,7	25,5	26,0	25,5	24,2	23,2
Agricultura	27,8	26,5	25,2	25,7	25,2	23,7	22,6
Secondary	17,5	18,8	19,0	17,6	16,8	16,0	14,8
Industry	15,8	15,9	16,0	15,6	14,7	13,7	12,9
Services	54,6	54,6	55,5	56,5	57,7	59,8	62,0
<b>Honduras</b>							
Primary	33,2	26,8	26,3	25,7	26,0	25,6	24,4
Agricultura	31,0	25,0	24,6	24,2	24,6	23,9	22,8
Secondary	17,1	18,4	18,0	17,9	18,4	17,8	18,4
Industry	12,8	13,6	12,9	13,6	13,6	14,1	15,0
Services	40,0	43,9	46,3	46,5	45,7	47,1	49,8
<b>Nicaragua</b>							
Primary	27,0	27,1	25,1	23,6	25,7	20,8	21,6
Agricultura	23,9	24,9	24,4	23,0	25,0	19,9	20,5
Secondary	25,5	26,8	28,2	28,2	25,6	21,6	21,9
Industry	21,2	22,3	25,5	24,8	22,5	17,2	17,6
Services	47,5	46,1	46,7	48,2	48,7	48,5	48,2

Source: CEPAL data.

DEC

## TRADE INDICATORS

### CENTRAL AMERICA MERCHANDISE TRADE WITH THE WORLD



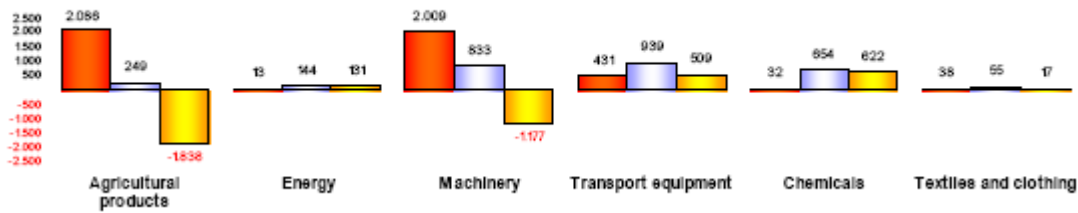
Source: IMF (Direction of Trade Statistics) \* excl intra EU Trade

### EU25 MERCHANDISE TRADE WITH CENTRAL AMERICA



Source: Eurostat, statistical regime 4

## EU25 MERCHANDISE TRADE WITH CENTRAL AMERICA BY PRODUCT (2005)

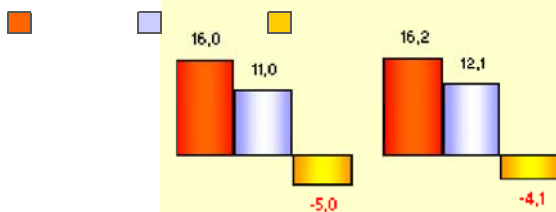


## EU25 TRADE IN SERVICES WITH CENTRAL AMERICA



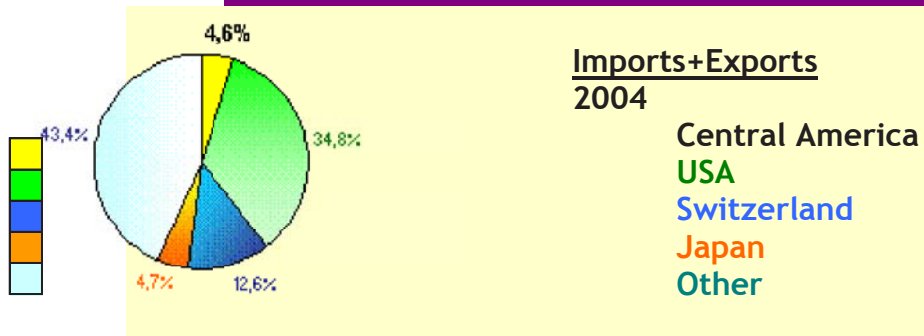
(Bn Euros)

Imports Exports Balance

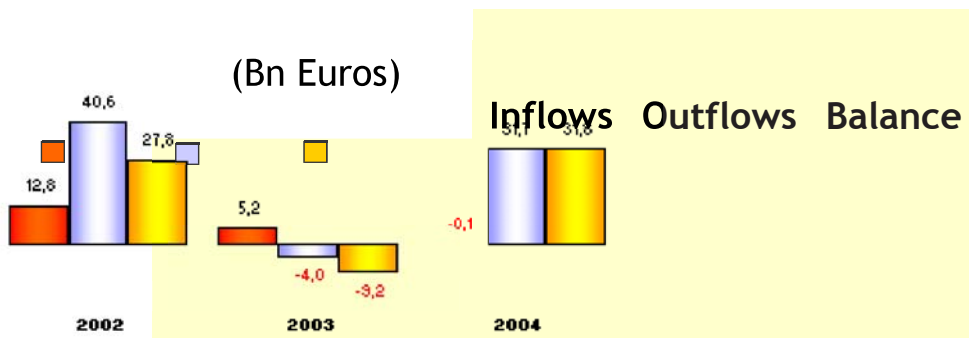


Source: Eurostat (excluding government services)

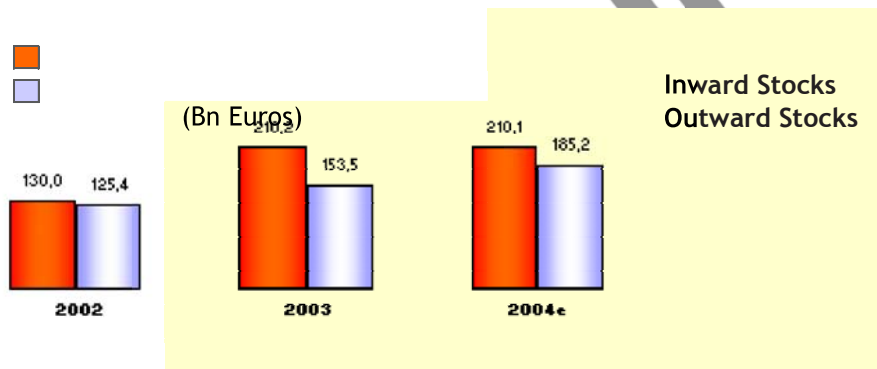
## CENTRAL AMERICA SHARE OF EU25 TRADE IN SERVICES



# EU25 FOREIGN DIRECT INVESTMENT WITH CENTRAL AMERICA



Source:  
Eurostat





CENTRAL AMERICA MERCHANDISE TRADE WITH THE WORLD					(millions of euros)	
	2001	2002	2003	2004	2005	2001-2005 (%)
Imports	28.548	27.935	25.113	27.106	44.769	+11,9
Exports	16.704	16.328	15.047	14.962	23.042	+8,4
Balance	-	-	-	-	-21.726	
	<b>11.844</b>	<b>11.607</b>	<b>10.066</b>	<b>12.144</b>		
EU25 MERCHANDISE TRADE WITH CENTRAL AMERICA					(millions of euros)	
	2001	2002	2003	2004	2005	2001-2005 (%)
Imports	3.656	4.285	4.053	4.409	4.727	+6,6
Exports	3.628	3.906	3.786	3.892	3.658	+0,2
Balance	-29	-379	-267	-517	-1.069	
% OF THE WORLD *					(millions of euros)	
	2001		2003		2005	2001-2005 (%)
Imports	0,50		0,60		0,81	+13,0
Exports	0,31		0,39		0,44	+9,3
% OF EU TOTAL					(millions of euros)	
	2001		2003		2005	2001-2005 (%)
Imports	0,37		0,43		0,40	+2,0
Exports	0,41		0,43		0,34	-4,0

EU25 MERCHANDISE TRADE WITH CENTRAL AMERICA BY PRODUCT (2005)					(millions of euros)	
	2001	2002	2003	2004	2005	2001-2005 (%)
<b>Agricultural products</b>						
Imports	2.005	1.960	1.905	2.003	2.086	+1,0
Exports	211	246	216	216	249	+4,2
Balance	-1.794	-1.714	-1.689	-1.787	-1.838	
<b>Energy</b>						
Imports	10	10	0	6	13	+6,8
Exports	107	127	136	147	144	+7,9
Balance	97	117	136	140	131	+8,0
<b>Machinery</b>						
Imports	297	1.772	1.644	2.001	2.009	+61,2
Exports	813	843	766	792	833	+0,6
Balance	516	-929	-878	-1.210	-1.177	
<b>Transport equipment</b>						
Imports	259	378	324	228	431	+13,6
Exports	855	1.138	1.286	1.342	939	+2,4
Balance	596	760	962	1.114	509	-3,9
<b>Chemicals</b>						
Imports	23	26	24	18	32	+8,6
Exports	786	704	638	659	654	-4,5
Balance	763	677	614	642	622	-5,0
<b>Textiles and clothing</b>						
Imports	41	41	42	45	38	-1,6
Exports	80	79	67	60	55	-8,7
Balance	39	38	25	15	17	-18,5

EU25 TRADE IN SERVICES WITH CENTRAL AMERICA	2003	2004
Imports	15.960	16.191
Exports	10.988	12.132
Balance	-4.972	-4.059

EU25 FOREIGN DIRECT INVESTMENT WITH CENTRAL AMERICA	2002	2003	2004
<b>FLOWS</b>			
Inflows	12.802	5.179	-72
Outflows	40.612	-3.972	31.746
Balance	27.810	-9.151	31.818
<b>STOCKS</b>			
Inward Stocks	130.036	210.207	210.135
Outward Stocks	125.422	153.499	185.245
Balance	-4.614	-56.708	-24.890

Source: Eurostat, IMF, World Bank

DECLASSIFIED