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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

**Annual Report on the Implementation of Part IV of the EU-Central America
Association Agreement**

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Annual Report on the Implementation of Part IV of the EU-Central America Association Agreement

1. Introduction

The EU signed the Association Agreement (hereafter the Agreement) with Central America on 29 June 2012. Part IV of the Agreement, covering Trade, has been provisionally applied as from 1 August 2013 with Nicaragua, Honduras and Panama, 1 October 2013 with El Salvador and Costa Rica and finally as from 1 December 2013 with Guatemala¹.

The Commission regularly informs and updates the Parliament and the Council as regards the implementation of the Agreement. As a complement, in accordance with Regulation (EU) No 20/2013 of the European Parliament and of the Council of 15 January 2013 implementing the bilateral safeguard clause and the stabilisation mechanism for bananas of the Agreement² (the Regulation hereinafter) the Commission shall present an annual report to the European Parliament and the Council. This report responds to this requirement.

In line with Article 13 of the Regulation, the report contains three sections:

- A summary of the statistics and an overall assessment of trade flows (part 2);
- Information on the activities of various bodies responsible for monitoring the implementation of the Agreement (part 3), including on fulfilment of obligations under the Title on Trade and Sustainable Development (part 4);
- Information on the monitoring activities referred to in the Regulation (part 5).

2. OVERALL ASSESSMENT: EVOLUTION OF TRADE

2.1. Methodology

The limited availability of data that could be used for this first annual report prevents drawing firm conclusions on the impact of the Agreement. Changes in trade flows cannot be attributed solely to the implementation of the Agreement and many other factors also influence these figures, such as fluctuations in demand or global prices. It should also be recalled that, as the asymmetry in the level of development of the economies is reflected in their respective tariff schedules, the tariff dismantling period is longer for Central America than for the EU. As a result, during the first year of application, the tariff reduction is higher for EU imports from Central America than Central American imports from the EU.

¹ The Agreement is provisionally applied in the EU until all Member States have ratified it. The status of the ratification is posted on the Council's website: <http://www.consilium.europa.eu/policies/agreements/search-the-agreements-database?command=details&lang=en&aid=2012001&doclang=EN>

² See: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0020>

It should be noted that before the implementation of the Agreement, Central American countries benefited from a preferential access to the EU market, the General System of Preferences (GSP hereinafter) granting tariff concessions to developing countries. In application of this scheme, some key Central American products (such as coffee and fruits) already benefitted from duty-free treatment. However, the tariff concessions granted under the Agreement cover a broader range of products than under the GSP and make these concessions permanent. The Agreement is expected to help increasing the diversification of Central American exports but it will take time to take effect.

The following analysis of bilateral trade flows is based on a comparison of data for a 12 months period (October 2013 - September 2014) which is then compared to the same period of the previous year (October 2012 - September 2013). Hereinafter, the first year of implementation will refer to the 12-month period between 1 October 2013 and 30 September 2014. Except otherwise indicated, this report is based on EUROSTAT data.

It should be noted that EUROSTAT and Central American statistics show significant divergences as regards Panama (+255%) and Costa Rica (+46%). These divergences have been discussed in the Market Access subcommittee and it has been agreed to carry out a joint analysis in order to seek the reasons for this.

2.2. Evolution of overall trade flows with Central America (goods)

New data from the United Nations' Economic Commission for Latin America and the Caribbean show that Foreign Direct Investment in Central America remained relatively stable during the first semester of 2014 compared to 2013. Nonetheless, trade³ between Central American countries as well as between this region and the rest of the world contracted by 1%-2%. Similarly, global EU trade flows decreased by 3%.

Despite this overall decline in trade flows and while it is premature to draw final conclusions, there has been an upward trend in trade flows for certain countries and specific goods. EU trade flows with the region remained stable or even increased, except with Panama where trade suffered a significant contraction in comparison with 2012 (-11.9 %). This may, however, be linked to the overall reduction of EU exports to South America in which the Panama Free Trade Zone plays a key role as regional hub.

Due to the uncertainties concerning the date of provisional application in 2013, operators could have experienced difficulties to integrate the benefits under the Agreement into their decisions. Despite this, there are indicators that suggest that businesses in specific sectors are increasingly making use of the Agreement.

The value of EU imports of goods from Central America increased by 3.4% (EUR 6,629 million) whereas EU exports to Central America decreased by 6.3% (EUR 5,106 million). In 2014, the EU's trade balance therefore reached a deficit of EUR 1,528 million (the year before the deficit was EUR 962 million).

³ IMF data.

	Export		Import		Total trade flows	
Costa Rica	812	1.5%	4,096	-0.7%	4,908	-0.4%
El Salvador	574	13.9%	191	-6.0%	766	8.1%
Guatemala	829	7.7%	619	4.0%	1,448	6.1%
Honduras	421	15.3%	791	3.1%	1,213	7.0%
Nicaragua	165	0.0%	305	28.7%	470	16.9%
Panama	2,305	-19.0%	627	29.7%	2,932	-11.9%
Total	5,106	-6.3%	6,629	3.4%	11,736	-1.1%

**Trade flow between EU and Central America and its yearly evolution
(in m Euros – period 1/10/2013 to 30/9/2014)**

The main destination of **EU exports to Central America** was Panama (46%) followed by Guatemala and Costa Rica (16% each). The main exports according to CTCI categories were machinery and transport equipment (32.7%) followed by chemicals (17.5%). EU exports are quite diversified and the 15 products which are exported the most (in value) cover 28% of total exports. In total, 5 817 different products have been exported to Central America during the first year of implementation (+0.5% compared to the year before).

EU exports to Central America decreased by 6.3%. This reduction, which mainly concerned Panama (-19%) could be related to the overall negative trend with the South American region. EU exports to Central America show a significant variability (both positive and negative) for products such as heavy machinery, railway, planes and vessels which represents a large share of total exports and for which trade flows are linked to industrial or capital investment.

Penetrating a new market may take time and does not depend solely on the existence of an FTA but it should be noted that among the EU exports to Central America which increased the most in relative terms, 9 out of the 15 benefit from a preferential tariff treatment in application of the Agreement, such as:

- **Aircraft parts** increased from EUR 2.5 million to 39.5 million during the first year of implementation (+ 1431%),
- **Pictures and print** increased from EUR 0.4 million to 3.4 million (+644%),
- **Drinking glasses** increased from EUR 0.3 m to 1.6 m (+432%).

The main **EU imports from Central America** were equipment and machinery (42%) followed by food and live animals (39.4%). The main sources of EU imports from Central America are Costa Rica (62%) followed by Honduras and Panama (11% each). Equipment and machinery imports from Central America mainly originate from Costa Rica (86% of total machinery and equipment imported from Central America).

In total, 2 281 different products have been imported from Central America during the first year of implementation (+3% compared to the year before). Despite this positive evolution, the diversification of products imported from Central America remains limited: the 4 most imported products cover around 60% of total EU imports from Central America (electronic assemblies of data processing machine (IT motherboard) 32%, coffee 10%, banana 10% and pineapples 7%).

Overall, EU imports from Central America increased by 3.4% during the first year of implementation despite the fact that imports of the two most traded products decreased (assemblies for data processing machine and coffee were down by 7.2% and 17% respectively). These decreases are probably related to external factors: The data processing machine import reduction might be an early sign of ongoing reorganization of this industry as a consequence of the recent announcement of the major producer in Central America to relocate its facility from Costa Rica to South East Asia. The decrease in coffee imports is related to the severe drought and the coffee rust epidemic (so-called “roya” in Spanish).

Notable positive variations in newly liberalised Central American exports have been recorded in products such as:

- **Cane molasses** rose by 394% (from EUR 8 million to 41 million)
- **Frozen shrimp** imports rose by 63% (from EUR 0.1 million to EUR 0.16 million),
- **Rum in bottle** imports rose by 205% (from EUR 5.6 million to 17 million)
- **Manioc** imports rose by 39% (from EUR 10 million to 14 million),

2.5. Use of tariff rate quotas (TRQs)

The Agreement provides for several TRQs which consist of granting to the other party a preferential tariff treatment up to the quota’s quantitative threshold. Above this threshold, the MFN tariff applies.

Overall, the preliminary analysis of quota utilisation suggests that operators have made significant use of TRQs for products which were already traded before the provisional application of the Agreement, whereas there was an insignificant trade creation for those products not traded before the implementation of the Agreement.

The EU has agreed to provide **eight TRQs in favour of Central America** on products that did not have any preferential access to the EU market before the implementation of the Agreement. No use of these TRQs was made by Central American economic operators in 2013 except for the TRQs for sugar which were used at 95%.

In 2014, TRQs were only used for two categories (cane sugar and rum). Out of the allotted 166,860 tonnes for cane sugar, 143,791 were used (86%). In terms of value, EU imports of

products covered by the TRQ for sugar increased from EUR 47.5 million to EUR 84.7 million (+78%).

Origin	Products	Unit	TRQ volume	EU Import	Utilisation rate
Central America	Garlic	ton	550	0	0%
	Rice		21,000	0	0%
	Manioc		5,000	0	0%
	Bovine meat		10,450	0	0%
	Mushroom		275	0	0%
	Sweetcorn		1,560	0	0%
Central America except Panama	Sugar		154,500	135,243	88%
	Rum in container > 2 l	Litre Pure Alcohol	1,022	153	21%
Panama	Rum in container > 2 l		105	0	0%
	Sugar	ton	12,360	8,548	69%
Nicaragua	Bovine meat		550	0	0%

TRQs granted by the EU to Central America – Usage until 26 November 2014

In addition to TRQs, the EU also granted to Central America derogation to the rules of origin under specific quotas for 118 tariff lines. Essentially, these derogations consist in granting some flexibility to Central America as regards the origin of well identified products up to a quota's quantitative threshold. Beyond these thresholds, stricter rules of origin apply. These arrangements mainly concern textile products. However the use of these derogations is almost negligible and the amounts imported under these quotas remain very limited and only concern a small fraction of the trade flow that could be eligible for the preferential treatment. This latter finding confirms a general trend noted for recently implemented agreements that it takes time for operators to adapt their trading channels to the new environment.

Central America granted **TRQs to the EU on four specific products**. All EU exports covered by these TRQs increased as follows:

- **Cured ham:** The EU exports rose from EUR 1.2 million to EUR 1.5 million (+22%)
- **Milk powder:** EU export rose from EUR 2.9 million to EUR 5.7 million (+96%)
- **Cheese:** EU export rose from EUR 7.1 million to EUR 9.3 million (+32%)

- **Whey:** EU export rose from EUR 0.5 million to EUR 0.6 million (+17%)
- **Prepared pork meat:** EU export rose from EUR 9.1 million to EUR 10.6 million (+16%)

Overall, these TRQs served as a boost for products which were already traded before the implementation of the Agreement, although there is still some margin of growth since exports remain below the thresholds.

2.6. Services

Services trade data is produced with a considerable lag in time and is presented in aggregated terms, making it unrealistic at this stage to make an analysis comparable to the one for trade in goods. This aspect will thus be covered in the annual implementation report once sufficient data is available.

3. ACTIVITIES OF THE IMPLEMENTATION BODIES

The implementation bodies created by the Agreement are composed of an Association Council, which meets regularly at ministerial level, an Association Committee and six subcommittees which meet on an annual basis. The first meetings of these bodies took place in Honduras in May/June 2014 except the Board on Trade and Sustainable Development which met on 17-18 November in Nicaragua.

3.1. Sub-Committee on Technical Barriers to Trade

During the meeting held on 13 May 2014, Central America and the EU reviewed:

- The implementation of 4 technical regulations implemented by Central America (labelling of alcoholic drinks, cream (dairy), labelling of footwear),
- Two Costa Rican technical regulations (tyres and electrical installations)
- The commitments taken by the Central American region to further their economic integration by adopting technical regional regulations.

The EU recalled Central America's commitment to provide written replies to the EU's written comments submitted in the framework of the TBT WTO notification procedure. Central America took note of the request and committed to reply.

As part of its commitments related to the implementation of technical regulations in order to foster regional economic integration, Central America had agreed to introduce a single regional registration for products. This regulation had still not been implemented but Central America informed that this new legislation was about to enter into force.

3.2. Board on Trade and Sustainable Development

The EU and Central America launched the dialogue on Trade and Sustainable Development and shared their experiences on domestic mechanisms to promote the participation of civil

society and groups committed to the implementation of the Trade and Sustainable Development provisions of the Agreement (see part 4 below).

3.3. Sub-Committee on Intellectual Property

The first meeting of the Intellectual Property Sub-Committee held on 22 - 23 May 2014 aimed at:

- Agreeing with Central America the content of the Decision listing protected Geographical Indications;
- Exchanging the latest status on respective ongoing procedures for protection of EU and Central American Geographical Indications, in particular as regards on-going opposition procedures concerning some important EU Geographical Indications; and
- Initiating the dialogue on ways to simplify procedures for the registration of Geographical Indications in Central America.

The outcome of this subcommittee was positive as the Parties agreed on a list of protected Geographical Indications and agreed that there is room for simplifying and easing the registration procedures in Central America, with a view to fostering a harmonised approach at regional level.

3.4. Sub-Committee on Sanitary and Phytosanitary Matters

At the first meeting of the sub-committee held on 17-18 June the topics discussed included import requirements, verifications, measures linked to animal and plant health, equivalence, and technical assistance. The main objectives were:

- To further identify possible problems in the implementation of the Agreement, and to explore solutions;
- To address market access barriers and new import authorisation requests and find ways to facilitate or open trade;
- To get confirmation by all Central American countries on the interpretation and proper implementation of the articles on approval of listing of establishments and on verifications, that CA will bear the cost of inspections carried out in Europe by Central American competent authorities;
- To discuss the level of integration of Central America and on-going discussions in this regard within the region.

Overall, the outcome of the subcommittee was positive, with Central America showing commitment to reach the objectives of the Agreement.

3.5. Sub-Committee on Customs Procedures, Trade Facilitation, and Rules of Origin

During the first meeting of this sub-committee held on 28-29 April, the Parties discussed:

- The fulfilment by Central America of its regional integration commitments;
- Two explanatory notes in the area of rules of origin and how to solve minor practical problems encountered by the operators during the first months of preferential trade under coverage of the Agreement.

The EU also expressed its concerns as regards a tendency of Central American countries to introduce scanning equipment on their borders and to charge *ad valorem* fees which the EU considers could be contrary to the Agreement.

3.6. Sub-Committee on Market Access for Goods

The points on the agenda of the first meeting of this sub-committee held on 19 June were aimed at reviewing:

- The Costa Rican legislation which introduced a minimum export price for bananas;
- The fee to be charged by Nicaragua for scanning goods at each checkpoint borders;
- The administrative control introduced by the EU for certain Central American products covered by TRQs.

Regarding the legislation on a minimum export price for bananas, Costa Rica recognized that there is no provision in this Agreement that would explicitly allow Costa Rica to make use of this legislation. However, Costa Rica considered that, given the current market price for banana, the minimum export price does not constitute a barrier to trade. The EU noted that it would continue to follow this issue.

As regards the scanning fee applied by Nicaragua, the EU recalled that, as a consequence of the Agreement, fees charged should not exceed the cost of the services rendered. Nicaragua assured the EU that the legislation would respect its international commitments.

The Parties also exchanged information on possible future areas of work and agreed to collaborate on collecting common reliable statistics.

3.7. Association Committee

The Association Committee held on 25 June reviewed the work carried out in the different sub-committees and also discussed other trade related issues. Particular emphasis was given to the regional economic integration issues and the need to avoid Central American measures running against the free intra-regional flow of goods, as the main beneficiary from easier trade flows would in fact be Central America.

The Parties discussed Central America's request for compensations for Croatia's accession to the EU, recognised the current existing differences of approach and agreed to continue the dialogue on this point with a view to finding an agreement as soon as possible. The EU also raised its concerns regarding Panama's law on auxiliary maritime services which discriminates against foreign operators. The EU and Panama discussed whether the law

diminishes market access and Panama informed that the new Government would reply to the EU.

3.8. Association Council

The Association Council held on 27 June considered the work done by the Association Committee and endorsed the outcomes. The Association Council adopted five decisions including the rules of procedure of the Association Council and its various structures, the list of protected geographic indications and the rules of procedure for the dispute settlement mechanism.

Central American participants also reiterated the importance of the Agreement in terms of trade, regional integration and enhanced relations which they expect will have a positive impact on the economic and social development of Central America. Furthermore, Central American participants expressed their wish for a rapid ratification of the Agreement by the remaining 19 EU Member States to achieve the entry into force also of the political and cooperation pillars. The EU presented the state of play of the ratification process in Europe. Furthermore, the EU referred to the entry into force of the Political Dialogue and Cooperation Agreement in 2014.

4. FULFILLMENT OF OBLIGATIONS ON TRADE AND SUSTAINABLE DEVELOPMENT

Activities in the first year of implementation of the Agreement have focussed on establishing the institutional structures set out in Title VIII on Trade and Sustainable Development.

4.1 Institutional Aspects

The first meeting of the Government to Government Board on Trade and Sustainable Development was held in Managua, Nicaragua on 18 and 19 November 2014. A meeting of the Civil Society Dialogue Forum was held in parallel and followed by a joint session of the Board and Forum.

The Board meeting was held with participation on the Central American side of representatives from Ministries of Trade, Labour and Environment. The Civil Society Dialogue Forum was organised by the Nicaraguan civil society advisory group and a number of presentations were made on topics such as labour rights, climate change, fair trade and corporate social responsibility. It was attended by over 100 people.

The EU advisory group comprises representatives from the European Economic and Social Committee and from EU civil society organisations who expressed interest in participating in this group following a call for expressions of interest launched through DG Trade's civil society database. The Secretariat is provided by the EESC.

4.2 Implementation of International Labour Organization (ILO) Conventions

During the Board meeting the Parties reported on their implementation of ILO conventions, in particular fundamental ILO conventions. As regards the later, focus was put on measures to address child labour and to strengthen social dialogue. The parties discussed the importance

of social dialogue and of effective and dissuasive sanctions against anti-union discrimination and against violence, including violence against trade union leaders; and the necessity for these sanctions to be effectively enforced.

As regards child labour emphasis was placed on the importance of intensifying efforts to tackle child labour especially in the informal economy, to strengthen labour inspections, of efforts to increase the rate of school attendance as well as to strengthen social protection with a focus on protection of children.

The EU drew attention to recently adopted ILO Conventions and Protocols and their state of ratification by EU Member States in particular the Convention on Maritime Labour (MLC), the Convention on Domestic Workers (C189) and the new Protocol supplementing the Forced Labour Convention (C29).

In relation to capacity-building on these issues the EU highlighted in particular a programme that is being developed to support the decent work agenda in Honduras.

4.3. Implementation of multilateral environmental agreements

During the Board meeting the Parties reported on implementation of multilateral environmental agreements, focussing in particular on climate change, endangered species (CITES), hazardous chemical and waste shipments. The Central American countries reported that they had all now ratified the Rotterdam Convention (on trade in hazardous chemicals) as well as the Gaborone Amendment to CITES

The EU drew attention to recently concluded environmental agreements, namely the Minamata Agreement on Mercury and the Nagoya Protocol to the Convention on Biodiversity (CBD) and reported on developments to implement these agreements within the EU. The Central American countries emphasised the vulnerability of the region to climate change, which directly affects export crops such as coffee, and the need to work on adaptation. A number of them also outlined ambitious plans to increase the share of renewable energy in their energy supply.

4.4. Development of a positive agenda for trade and sustainable development

During both the Board meeting and Civil Society Dialogue Forum many examples were presented where production and trade had had positive environmental and social impacts. Government policies to promote such outcomes were described, as well as partnerships between businesses, labour representatives, environmental NGOs and communities. Common themes included corporate social responsibility, renewable energy, sustainable agricultural production, cleaner production processes and sustainable tourism.

The Board agreed that further discussions will take place to identify priorities for the medium term. Articulation with ongoing and planned development cooperation support to the region as well as engagement with civil society on both sides of the Atlantic will be important in this process.

5. IMPLEMENTATION OF REGULATION (EU) NO 20/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL IMPLEMENTING THE BILATERAL SAFEGUARD CLAUSE AND THE STABILISATION MECHANISM FOR BANANAS

The Regulation establishes the appropriate procedures to avoid serious harm to the EU banana sector if, as a result of the reduction of customs duties, bananas are imported in such increased quantities as to cause or threaten to cause serious injury to the EU industry.

Hence, in line with Articles 3 and 13 of the Regulation, the Commission has been monitoring the evolution of imports of bananas from Central American countries to assess if the conditions set out in the Regulation are met to initiate a safeguard investigation or introduce prior surveillance measures.

5.1. Evolution of Central American banana imports

During the first year of implementation of the Agreement, the Commission neither initiated nor received any requests to initiate a safeguard investigation or to introduce prior surveillance measures as the conditions set out in the Regulation to initiate a safeguard investigation or introduce prior surveillance measures were never reached.

	2013			2014*		
	Import	Trigger	Utilisation Rate	Import	Trigger	Utilisation Rate
Costa Rica	131,519	1,178,750	11%	856,007	1,230,000	70%
Panama	58,935	431,250	14%	203,737	450,000	45%
Honduras	1,749	57,500	3%	3,622	60,000	6%
Guatemala	21	57,500	0%	22,861	60,000	38%
Nicaragua	0	11,500	0%	0	12,000	0%
El Salvador	0	2,300	0%	0	2,400	0%

(*) till 10 December 2014

Import of bananas under the stabilisation mechanism

6. CONCLUSION

It is too early to make any conclusive assessment of the impact of the trade part of the Agreement.

Despite the negative global environment including the overall decrease in global demand in 2014, EU trade flows with Central America remained substantially stable and saw significant increases in specific sectors. EU trade flows with most Central American countries increased except with Panama. Moreover, the relatively low utilisation rate of the available TRQs points to the possibility to further increase bilateral trade flows between the two regions.

As regards bananas, imports from Central American countries remained overall stable and below the established trigger imports, so that it was unnecessary to consider initiating any suspension of preferential customs duties.

It has been agreed with Central America to carry out a technical review of the statistical methods and data on trade flows which should allow a more detailed analysis in the future.

The overall conclusion of the Commission after the first year of implementation is that it has brought about a rapid set-up and functioning of the institutional framework of the Agreement and that the process of implementation is overall positive. The formal process between the Parties for the implementation of the Agreement will continue in the context of the meetings of the various implementation bodies which are expected to take place by mid-2015.

The focus of the second year of application remains the proper implementation of the Agreement in order to allow economic operators from both regions to take full advantage of its opportunities. The Commission is engaged in actions aimed at increasing the awareness of the economic operators as regards the opportunities presented by the Agreement. These actions take place both in the EU and Central America including through cooperation projects in Central America.