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Prospects for the Central American Customs Union

- Fernando Rueda-Junquera

Jean Monnet/Robert Schuman Paper Series
Vol.5 No. 18
July 2005

This publication is sponsored by the EU Commission.

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Prospects for the Central American Customs Union

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July 2005

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Prospects for the Central American Customs Union

Introduction

The summit of Central American presidents held in Antigua, Guatemala, in June 1990 gave a strong impulse to the revitalisation of the Central American Common Market (CACM), regional integration scheme created in 1960 by Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. This renewed attempt at integration in the 1990s has not involved a return to the old scheme launched in the 1960s. While regional integration remains viewed as an instrument for accelerating the growth rates of the economies participating, its main goal has shifted. It is not sought to extend domestic import-substituting industrialisation (ISI) policies at the regional level, but to support an outward-oriented growth model based on the promotion of non-traditional exports. As part of this shift, the Central American governments have adopted commitments such as the liberalization of intraregional trade and the drastic reduction in the common external tariff (CET), commitments that have to materialize in the reestablishment of a customs union.

This article aims at assessing the progress of the new Central American economic integration scheme, identifying its principal potentials and weaknesses. With this purpose, the paper is structured into four sections. The first analyses the measures taken to restore the Central American customs union. The second and third sections examine respectively, the achievements and limitations of the new CACM. The fourth and last section provides the conclusions drawn from that assessment.

Reactivation of the Central American Common Market

From the statements of the presidential summits in the early 1990s as well as from the Guatemala Protocol signed in October 1993 to modify the 1960 General Treaty of Central American Economic Integration, it is followed that the Central American governments have wished to reactive the CACM under the approach of the *open regionalism* or *new regionalism*.[1] The governments have manifested their intention of supporting a new market-driven integration, compatible with an outward-looking economic development.[2]

[1] The theory and praxis of open regionalism in less developed countries are examined in: Jaime De Melo and Arvind Panagariya (eds.), *New Dimensions in Regional Integration* (Cambridge: Cambridge University Press, 1993); Vincent Cable and David Henderson (eds.), *Trade Blocs ?: The Future of Regional Integration* (London: The Royal Institute of International Affairs, 1994); CEPAL (Comisión Económica de las Naciones Unidas para América Latina y el Caribe), *El regionalismo abierto en América Latina y el Caribe: la integración económica al servicio de la transformación productiva con equidad* (Santiago: CEPAL, 1994); Sheila Page, *Regionalism among Developing Countries* (London: Macmillan, 2000); BID (Banco Interamericano de Desarrollo), *Más allá de las fronteras: el nuevo regionalismo en América Latina*, Informe 2002 sobre Progreso Económico y Social en América Latina (Washington D.C.: BID, 2002); World Bank, *Trade, Regionalism and Development*, Global Economic Prospects 2005 (Washington D.C.: The World Bank, 2005).

[2] On the new regionalism in Central America, see: Victor Bulmer-Thomas (ed.), *Integración regional en Centroamérica* (San José: Facultad Latinoamericana de Ciencias Sociales / Social Science Research Council, 1998); Fernando Rueda-Junquera, *La reactivación del Mercado Común Centroamericano* (Burgos: Servicio de Publicaciones, Universidad de Burgos, 1999); Klaus Bodemer and Eduardo Gamarra (eds.), *Centroamérica 2020: un nuevo modelo de desarrollo regional* (Caracas: Editorial Nueva Sociedad, 2002); SGSICA-CEPAL (Secretaría General del Sistema de la Integración Centroamericana – Comisión Económica de las Naciones Unidas para América Latina y el Caribe), *La integración centroamericana: beneficios y costos* (San Salvador and México: SGSICA-CEPAL, 2004).

The main initiatives of the new CACM have been directed at restoring the two essential instruments of a customs union: the free intraregional trade and the CET. The last adopted initiative dates back to June 2002 when in the 21st Summit of Central American Presidents celebrated in Granada, Nicaragua, the Action Plan for the Central American Economic Integration was approved. The general objective of this Action Plan is the consolidation of the economic integration process, emphasizing the establishment of a customs union for January 1, 2006.[3]

At present the benefit of free intraregional trade is granted to those goods originating in the CACM member countries, except to those included by pairs of countries in the Annexe A of the General Treaty of Central American Economic Integration. The number of products originated from Central America that do not benefit from free intraregional trade, is small. Only sugar and unroasted coffee are excluded for all the countries. To this, there is to add the restrictions imposed on the imports of ethylic alcohol by Costa Rica and Honduras, on those ones of roasted coffee by Costa Rica, and on those ones of petroleum by-products and distilled alcoholic beverages by Honduras.[4] For the full achievement of a free intraregional trade area, it is still necessary to eliminate the Annexe A and grant the same treatment to those goods not originated from the region, that is, that free trade extends to all the goods consumed –and not only produced– in the region, as well as to services (specially to those associated to the trade of goods).

In order to facilitate free intraregional trade, there has been adopted a group of regulations applicable to intraregional trade. The main regulations approved by the CACM governments have been the Central American Regulations on Unfair Trade Practices (1995), Safeguard Measures (1996), Rules of Origin (1998), Measures of Standardization, Metrology and Authorization Procedures (1999) and Sanitary and Phytosanitary Measures (1999). In addition to these regulations, there has been created a trade dispute settlement mechanism in 2002.

The aforementioned regulations provide a general framework to orientate the harmonization of norms, but it does not constitute a set of norms that serve to evaluate specific situations, what limits its effectiveness as a driving factor of intraregional trade. To amend this deficiency, proposals are been developed to advance in the harmonization of norms applying to specific situations.[5] In this context, it is debated on the degree in which it is necessary to harmonize the existing regulation at the Central American level or if alternatively, it turns out to be better to adopt international standards. Furthermore, this debate is conditioned by the possibility that the Central American countries apply among them the norms established as part of the United States – Central America Free Trade Agreement (CAFTA) signed in 2003. This could have the advantage of constituting a set of norms in which the pressure to fulfil them would be greater. However, it would not suppose an endogenous element of strengthening and deepening of the Central American customs union.

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[3] The foreseen date for entering into force the Central American customs union was January 1, 2004. As this deadline was not complied with, it was agreed to postpone it to January 1, 2006.

[4] SIECA (Secretaría de Integración Económica Centroamericana), *Unión aduanera centroamericana en cifras* (Guatemala: SIECA, 2005), 91.

[5] For example, working parties have been established for the harmonization of technical standards, sanitary and phytosanitary measures, registries (with four specific technical subgroups: food and beverages, medicines and related products, agricultural inputs, and oil products), rules of origin and regulation of intellectual property. For more details, see: SIECA (Secretaría de Integración Económica Centroamericana), *Estado de avance de la unión aduanera: agosto* (Guatemala: SIECA, 2004).

The implementation of harmonized norms will contribute to a greater transparency and fluidity in the intra-Central American trade. Likewise, the fact that there is a formal trade dispute settlement mechanism will facilitate the application of those harmonized norms. In practice, it is still necessary to verify if this mechanism is an effective means for reducing transactions costs within the region, being able to diminish uncertainty and lead to fewer costs than those ones stemmed from the international litigations initiated to settle intraregional trade disputes.

With regard to the CET, the member countries of the CACM have made substantial progress in the harmonization of tariffs applied by every country against third countries, in such a way that there is a harmonized CET for most of the products. At the beginning of 2005 there were 332 tariff lines remaining to be harmonized and 5,861 tariff lines already harmonized, which represent 94.6 percent of the total of tariff lines.[6]

Also progress has taken place in the areas of customs procedures and customs legislation.[7] In the last years there has been a process of modernization of the Central American customs, which has translated into better methods for goods controls, as well as into a speeding-up of the trading procedures between countries. Regarding regulations, important progress has been achieved such as the entry into force in the five CACM countries, of the Central American Uniform Customs Code and its corresponding regulation. Also there exists a Single Manual of Customs Procedures, which is applied by some customs in the region. Likewise, different projects of customs legislation are being drawn up (legislation for fighting against contraband and customs fraud, reform of the Regulation on International Customs Transit Regime, code of conduct for customs officials, etc.).

As for the establishment of a common customs, the CACM has four customs administration models.[8] These models have been designed to test out the different forms in which trade in the region might be managed in order to gradually advance towards a customs union. The customs models which have been put into practice, are the following: three of intraregional character – integrated, juxtaposed and trinational–, and one of peripheral character.

The integrated customs consists of sharing a single office for customs formalities by two countries, which are members of the same customs territory. The juxtaposed customs refers to the same previous case, but keeping different customs offices in every country, that coordinate their activities. In this case, the customs offices are committed to apply complementary customs formalities through the use of electronic communication mechanisms, which guarantee the effective control of intraregional transits from origin to destination. In this respect, it has begun to work on the implementation of an electronic interconnection system allowing the early electronic transmission of the Central American Uniform Customs Forms (*Formularios Aduaneros Uniformes Centroamericanos*, FAUCAs) and the International Transit Declarations (*Declaraciones de Tránsito Internacional*, DTIs), forms required to those goods originated from the CACM.

[6] SIECA, *Unión aduanera centroamericana en cifras*, *op. cit.*, 79-87. Motor vehicles have not been included in the total of 6,193 lines of the tariff universe because they have been classified by different tariff nomenclature in the Central American countries. Nevertheless, at present the harmonization of motor vehicles nomenclature has been already achieved and therefore, from now it will be possible to initiate negotiations for harmonizing its tariffs at the regional level.

[7] See: SIECA, Estado de avance de la unión aduanera: agosto, op. cit.

[8] INTAL (Instituto para la Integración de América Latina y el Caribe), *Informe centroamericano Nº 2* (Buenos Aires: BID-INTAL, 2004), 17-18.

Since 2003 major customs between Guatemala and El Salvador rely on a customs administration model either integrated or juxtaposed. These two countries are those ones that have made more progress in promoting customs and migratory facilitation in their binational frontiers.[9]

The trinational customs correspond to customs administration services provided by three countries which carry out their functions in a common building where they implement coordinated and uniform procedures. The Amatillo (Honduras) is an example of trinational customs shared by El Salvador, Guatemala and Honduras.

None of the three models of intraregional customs examined constitutes the type of customs that would benefit to a customs union in which free movement was allowed not only to those goods produced in the CACM, but also to those goods consumed in the region. The peripheral customs model can overcome this problem and is the one which is closest to the type characteristic of a customs union. This model consists of locating customs administration services in the exterior periphery of the common customs territory, applying the same procedures in the framework of an uniform customs legislation. In this case, those goods dispatched by the peripheral customs, could move freely within the common customs territory. Currently El Salvador, Guatemala, Honduras and Nicaragua have established a pilot programme with six border posts operating as peripheral customs: Puerto Quetzal, Santo Tomás de Castilla, Puerto Barrios and Tecún Umán (Guatemala), Puerto Cortés (Honduras) and Peñas Blancas (Nicaragua).

In sum, since the beginning of the 1990s the CACM reactivation has aimed at reestablishing a custom union. However, after almost three lustrums the new CACM remains an imperfect customs union.

Achievements of the Central American economic integration scheme

New regionalism is expected to provide mechanisms promoting decisively the economic development of the Central American countries. The reactivation of the CACM has been able to stimulate substantially intraregional trade, improve its quality and attract intraregional investments, thus contributing to economic growth in the region.

Since the beginning of the 1990s, intraregional trade in the CACM has experienced a steady expansion. The total value of intraregional exports and imports quintupled in the 1990-2004 period, passing respectively, from $671 and $638 million in 1990 to more than $3,300 million in 2004 (see Table 1 and Figure 1).

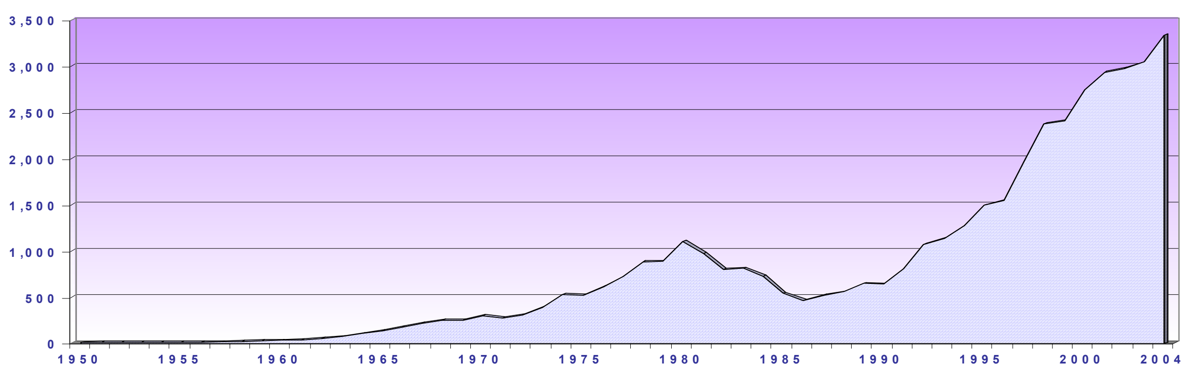
[9] In fact, since November 15, 2004 they have simplified substantially their procedures to facilitate goods and persons mobility. At present the customs procedure for loading traffic in the border posts between both countries has been reduced to only two stages: the haulage contractor presents the FAUCA in the integrated customs office and next, the customs official verifies the documentation and the corresponding payment. In migratory matters, when the overland route is used, travellers between Guatemala and El Salvador will only be required to enter to and leave for both countries, the submission of the migratory form in a mailbox installed in the border post. For the Salvadorans and Guatemalans using airway, their flight will be considered as domestic and so, they will only have to show the document identifying their nationality.

Table 1
CENTRAL AMERICAN COMMON MARKET: INTRAREGIONAL TRADE, 1985-2004 (SELECTED YEARS)
(in millions of US dollars and in percentages)

Year	*Intraregional exports*		*Intraregional imports*	
	Value (US$ million)	Share in total exports (%)	Value (US$ million)	Share in total imports (%)
1985	485.8	13.5	540.8	10.2
1990	671.2	17.1	638.1	9.9
1995	1,595.4	21.7	1,497.6	12.4
2000	2,616.8	22.7	2,739.3	14.6
2001[a]	2,829.4	27.8	2,933.6	14.3
2002[a]	2,871.7	28.2	2,949.1	13.4
2003[a]	3,076.6	27.3	3,042.1	12.8
2004[b]	3,439.7	27.6	3,312.7	12.4
2000-2004 average	2,966.9	26.7	2,995.4	13.5

Sources: For 1985, 1990 and 1995, derived from: SIECA (Secretaría de Integración Económica Centroamericana), *Series estadísticas seleccionadas de Centroamérica N.º 28* (Guatemala: SIECA, 1998); for 2000–2004 period, derived from: SIECA, *Boletín estadístico 13.1* (Guatemala: SIECA, 2005).
[a] Preliminary data.
[b] Estimated data.

Figure 1
CENTRAL AMERICAN COMMON MARKET: INTRAREGIONAL IMPORTS, 1950-2004
(in millions of US dollars)



Source: SIECA (Secretaría de Integración Económica Centroamericana), *Centroamérica en gráficas* (Guatemala: SIECA, 2005), Figure 5.

Not only the value of intraregional trade has improved since 1990, but also its quality. As it has been revealed by several studies,[10] intraregional trade has been of a greater quality than extraregional trade, characterizing by its larger contents of manufactured products and intraindustry trade.[11]

The sustained growth of intraregional trade is essential to increase economic interdependence among the CACM members and to reduce their external vulnerability. If intraregional trade has a growing share in the total trade flows of the Central American countries, their dependence on extraregional trade will be diminished and the impact of adverse external shocks on their economies will be reduced.

The greater quality of the intraregional trade in expansion is specially relevant for the economic development of Central America. The increasing presence of intraindustry trade in intraregional exchanges of manufactures helps to develop new comparative advantages alternative to the pattern of specialization in primary goods, since it improves industry productive efficiency and stimulates its diversification.

The growth of intraregional trade in manufactures in the new CACM also can be an important factor for achieving a customs union with net trade creating. The old CACM was bound to be net trade diverting because it commenced its existence with the imposition of a CET which raised average tariff levels in a region lacking of a significant industrial base. By contrast, the new CACM has adopted a CET much lower than its predecessor and at the same time, a minimal domestic manufacturing sector is now in place in each member country. In this context there is considerable scope for the new integration scheme to be net trade creating. The lower CET induces increase in extraregional imports and the full restoration of free trade area within the CACM enables expansion in intraregional imports.

If this potential trade creation comes accompanied by a high component of intraindustry trade, economic integration scheme will be facilitated. The productive structure adjustment linked to intraindustry trade is relatively costless and its effect on income distribution is less severe. In case of predominance of this trade, member countries have only to bear the cost of eliminating some firms from some industries, without having to abandon entirely those industries. By contrast, interindustry trade involves the whole elimination of some industries in some member countries due to their moving to other member countries where comparative costs for these industries are the lowest in the regional market.

[10] See: Pablo Rodas, "Comercio intra-industrial y ventajas comparativas reveladas en el comerco intra-centroamericano en manufacturas" in *Integración regional en Centroamérica*, ed. Victor Bulmer-Thomas, 79-98 (San José: Facultad Latinoamericana de Ciencias Sociales / Social Science Research Council, 1998); Rueda-Junquera, *La reactivación del Mercado Común Centroamericano*, *op. cit.*, Ch. III; BID, *Integración y comercio en América*, *op. cit.*; BID, *Más allá de las fronteras: el nuevo regionalismo en América Latina*, *op. cit.*; Roberto Monge, *El comercio de bienes y servicios entre los países centroamericanos en el contexto de la apertura externa*, Proyecto SGSICA-CEPAL "La integración centroamericana: beneficios y costos" (San Salvador and México: SGSICA-CEPAL, 2003).

[11] The main sectors involved in the expansion of intraindustry trade in manufactures in Central America produce final demand goods. These sectors at the four-digit level of International Standard Industry Classification (Revision No. 2) were identified by: Rueda-Junquera, *La reactivación del Mercado Común Centroamericano*, *op. cit.*, Ch. III. Specifically, these sectors are: 3121 (food products n.e.c.), 3211 (spinning, weaving and finishing textiles), 3220 (clothing), 3419 (pulp, paper and paperboard articles n.e.c.), 3522 (drugs and medicines), 3523 (cleaning and toilet preparations), 3551 (tyres and tubes), 3560 (plastic products, n.e.c.), 3620 (glass and glass products) and 3720 (non-ferrous metals).

In addition to enhancing intraregional trade flows in value and quality, the new CACM has become an attraction factor of new foreign direct investment (FDI) flows, particularly of intraregional origin. Although the relationship between regional integration and investment is not clear, prospects offered by an integrated regional market appear to turn this integrated market into an important destination for FDI. In the case of the CACM, the FDI inflow of extraregional origin has been chiefly induced by the privatization processes undertaken by the regional governments in the framework of their structural adjustment policies, rather than by the reestablishment of the regional market, whose economic size remains small compared with those of the Common Market of the South (*Mercado Común del Sur*, MERCOSUR) and the Andean Community.

The regional market seems to have contributed to a greater extent to encourage the FDI flows of Central American origin. There is not statistical information compiled systematically on regional capital movements, but available evidence suggests that intraregional investments have been growing since the reestablishment of the CACM.[12] Increasingly there is a greater presence of domestic firms of CACM member countries which operate with a regional vision, taking the CACM as a starting point at the moment of designing their production and marketing strategies. In fact, this type of managerial activities is part of what is called *real integration*, which takes place outside the *formal integration* promoted by the governments.[13] The process of real integration is constructed from the expansion and strengthening of the regional financial and trade activities developed by the major Central American economic groups and the transnational companies operating in this area.

[12] See: Richard Aitkenhead, Tendencias y características de las estrategias empresariales en el contexto del proceso de integración económica centroamericana, Proyecto SGSICA-CEPAL "La integración centroamericana: beneficios y costos" (San Salvador and México: SGSICA-CEPAL, 2003).

[13] Monge, *op. cit.*, 71-80.

Table 2
CENTRAL AMERICAN COMMON MARKET. MAIN INTRAREGIONAL INVESTMENTS BY COUNTRY OF ORIGIN, 2000

Country of origin	*Sector*	*Activity*	*Group or Company*	*Recipient country*
COSTA RICA				
	Industrial	Construction materials	Grupo Durman Esquivel	Central America
	Trade	Wholesale trade	Supermercados Más x Menos	Honduras, Nicaragua
	Services	Written press	Grupo La Nación	Guatemala
EL SALVADOR				
	Services	Airlines	Grupo Taca	Central America
	Services	Financial	Grupo Cuscatlán	Costa Rica, Guatemala
	Services	Financial	Agrícola Comercial	Guatemala
	Services	Hotels	Intercontinental Camino Real	Costa Rica, Honduras
	Construction	Property	Grupo Poma	Central America
	Trade	Department stores	Almacenes Simán	Guatemala
GUATEMALA				
	Farming	Poultry	Grupo Gutiérrez	El Salvador, Honduras
	Farming	Sugar industry	Ingenios Guatemaltecos	Costa Rica, Honduras, Nicaragua
	Trade	Supermarkets	Grupo Páiz	El Salvador, Honduras
	Industrial	Fizzy drinks	Grupo Mariposa	Honduras, Nicaragua
	Services	Hotels	Hoteles Princess	El Salvador, Honduras, Nicaragua
	Servicios	Fast food	Pollo Campero	Central America
	Trade	Goods vehicles	Camiones Hino	Honduras
HONDURAS				
	Industrial	Brewing industry	Cervecería Hondureña	Nicaragua
	Trade	Supermarkets	Despensa Don Juan	El Salvador
	Housing	Property	Inversiones Sogeval	Guatemala
	Industrial	Non-alcoholic beverages	Grupo Facusse	El Salvador, Guatemala
NICARAGUA				
	Services	Financial	Grupo Pellas	Central America
	Services	Financial	Grupo Pacific	Central America
	Services	Financial	Grupo Fogel	Guatemala

Source: INTAL (Instituto para la Integración de América Latina y el Caribe), *Central American Report Nº 1* (Buenos Aires: BID-INTAL, 2001), 38.

As Table 2 shows, the main intraregional investments tend to be concentrated in the services sector, specially in the financial, trade and tourist activities. This type of investments is consistent with the new growth pattern prevailing in the region, based on the dynamism of activities linked to the *maquila* industry and the services.

Weaknesses and challenges of the new regionalism in Central America

Despite the achievements examined, regional integration in Central America is still subject to numerous limitations, which have to be surmounted if expected positive effects on the economic development process are wished to become a reality. Among these limitations, the following can be highlighted: the great predominance of extraregional trade, the slow improvement in the quality of intraregional trade, the distributive problems of costs and benefits, the absence of a real common trade policy, the lack of a common customs administration, the limited coordination of macroeconomic policies and the weakness of regional institutions. Next these limitations are analyzed and some implications for institutional and economic policies are drawn for overcoming them.

Predominance of extraregional trade

Trade liberalization initiated in the 1990s has facilitated the rapid growth in intraregional trade, but part of this growth has only represented the recovery of trade lost as consequence of the economic crisis of the 1980s.[14] Intraregional trade remains limited within the total trade of the CACM. In the 2000-2004 period intraregional exports were not able to represent on average more than 26.7 percent of total exports, while intraregional imports did not exceeded 13.5 per cent of total imports (see Table1). These percentages are still far from those ones observed in the European Union (EU), where intraregional trade –measured by both the export and import side– accounts for more than 60 percent of total trade (see Table 3).

Table 3
EUROPEAN UNION (15 COUNTRIES): RELATIVE IMPORTANCE OF INTRAREGIONAL TRADE, 1992-2003 (SELECTED YEARS) (in percentages)

Year	*Intraregional exports* % of total exports value	*Intraregional imports* % of total imports value
1992	66.9	64.5
1995	64.0	64.1
1999	63.8	62.0
2000	62.4	59.1
2001	61.9	59.5
2002	61.8	60.4
2003	61.9	60.2
1999-2003 average	62.4	60.3

Source: Derived from: Eurostat, http://epp.eurostat.cec.eu.int.

[14] Another important part of the growth in intraregional trade has been possible thanks to the net inflow of capitals, which has facilitated the funding of imports and current account deficits.

The dominance of extraregional trade –between 73.3 percent and 86.5 percent of total trade– explains why the economic policy of Central American governments has given priority to extraregional economic relations and in moments of conflict, has not favoured the interests of the Central American integration scheme. If intraregional trade is wished to acquire more significance for the economic development of Central America, it is necessary to adopt measures favouring its expansion. Thus, measures such as the removal of the non-tariff barriers (NTBs) and the effective liberalization of intraregional trade in primary products and services can help to achieve this objective.

The use of NTBs has been one of the principal obstacles to the sustained expansion in intraregional trade. Although in the last years considerable progress has been made to reduce them, it is still necessary to attain their total elimination. For example, the Central American governments need to adopt a competition policy designed to suppress oligopolistic practices among suppliers and restrictive practices between producers and distributors.

The relevance of regional market can be enhanced not only by removing NTBs to intraregional trade in finished products, but also liberalizing intraregional trade in inputs, particularly in raw materials and in some services. A regional market in such inputs could generate important cost savings for the Central American firms. Many of the sectors better placed to face successfully international trade insertion are industries processing raw materials. A genuine liberalization of intraregional trade in raw materials would provide an opportunity for these firms to lower their costs by purchasing these inputs from the cheapest regional source. Likewise, the costs of other inputs could be reduced if they were traded freely within the regional market. This could be the case of services such as electricity, water, gas, financial services and some business services.

Although the proposed measures can help to increase the relevance of intraregional trade, it will be necessary –as it is shown next– to make additional efforts to enhance its quality and achieve a more equitable distribution of its potential benefits.

Slow improvement in the quality of intraregional trade

Intraregional trade with its greater contents of manufactured products and intraindustry trade, has showed a better quality than extraregional exchange. Nevertheless, the available empirical evidence does not appear to corroborate the idea that intraregional trade, as it is expected in the new regionalism, has contributed substantially to change the structure of extraregional exports and improve the trade insertion of Central America.[15] According to the theory of the new regionalism, the creation of a regional market has to enable member countries to attain learning economies, in such a way that later they gain access to extraregional market in competitive conditions.

There has certainly been a rise in the participation of manufactures in extraregional exports –in particular, those ones going to the United States market–, as well as a change in the structure of these extraregional exports, which have incorporated new products, such as clothing *maquila* and in the case of Costa Rica, electronic products. The evidence indicates that this new pattern of

[15] See: Rueda-Junquera, *La reactivación del Mercado Común Centroamericano*, *op. cit.*; Monge, *op. cit.*; Jorge Mario Martínez and Enrique Cortés, *Competitividad centroamericana*, Serie Estudios y Perspectivas de la CEPAL nº 21 (México: Sede subregional de la CEPAL, 2004).

extraregional trade insertion has not been boosted decisively by mechanisms generated by the new CACM, but by others linked to the national processes of trade opening-up and the preferential trade agreements, such as the Caribbean Basin Initiative and more recently, the signing of the CAFTA.[16] All this without forgetting the decisive role played in the 1990s by the intense and sustained economic recovery in the United States, major extraregional export market for the new Central American manufactures.

As for the presence of intraindustry trade in intraregional exchanges, this has expanded since the reestablishment of the CACM. However, it reflects mostly a recovery of the levels existing before the crisis of the 1980s. Besides, the current dimension of intraindustry trade in Central America is still very far from that one reached by the industrialized nations.

In short, the quality of intraregional trade in the CACM has improved since the early 1990s, but at a slow and insufficient pace and without substantial invigorating effects on the quality of the extraregional trade insertion. Intraregional trade liberalization by itself has not been enough to ensure a significant rise in its quality. Trade liberalization leads to a more efficient use of regional productive resources. Nevertheless, a better reallocation of these resources without the appropriate level of investment to upgrade the sources of industrial competitiveness, will not induce the expected revitalizing effect of intraregional trade. In the medium term, this revitalizing effect can become an essential factor for accomplishing a high-quality trade insertion, since the new exporting sectors of manufactures are demonstrating to have a limited capability for creating productive linkages and expanding productivity.

Distributive problems of costs and benefits

Most of the growth in intraregional trade and in its intraindustry component has been explained by the trade exchanges among the relatively more developed Central American countries, that is, Costa Rica, El Salvador and Guatemala. Several studies have revealed that intraindustry trade is a phenomenon appearing exclusively in the trade flows among these three countries.[17]

Nicaragua is the country that less takes part of the relative greater quality of intraregional trade. It is the CACM member which tends to have a lower intradustry trade index and a higher weight of the agricultural products in the total value of its intraregional exports.[18] As it is observed in Table 4, in 1995 agricultural exports accounted for 64.1 per cent of Nicaraguan intraregional exports, being this percentage the highest in the CACM. In 2002 this percentage has increased slightly to 68.6 percent and remains the highest one in the region. Nicaragua keeps a pattern of intraregional trade specialization with weak quality and very little diversification, focused principally on the cattle exports.

[16] On the special regime of trade preferences granted by European Union to Central America in the framework of the Generalized System of Preferences, see: Victor Bulmer-Thomas and Fernando Rueda-Junquera, “The Cooperation Agreement Between Central America and the European Union: A Case Study of the Special GSP Regime” *Bulletin of Latin American Research* 15, no. 3 (1996): 323-340.

[17] See: Rodas, op. cit.; Rueda-Junquera, La reactivación del Mercado Común Centroamericano, op. cit., Ch. III; Monge, op. cit..

[18] An empirical assessment of the effects of liberalizing intraregional trade in agricultural products, can be found in: Fernando Rueda-Junquera, “Regional Integration and Agricultural Trade in Central America” *World Development* 26, no. 2 (1998): 345-362.

Table 4
CENTRAL AMERICAN COMMON MARKET: INTRAREGIONAL EXPORTS OF AGRICULTURAL PRODUCTS, 1995 AND 2002
(in millions of US dollars and in percentages)

Country	1995			2002		
	Agricultural intra-CACM exports (1)	*Total intra-CACM exports* (2)	% (1):(2)	*Agricultural intra-CACM exports* (3)	*Total intra-CACM exports* (4)	% (3):(4)
Costa Rica	94.1	349.3	26.9	215.1	686.4	31.3
El Salvador	85.5	427.3	20.0	174.9	739.1	23.7
Guatemala	134.9	565.3	23.9	242.5	873.7	27.8
Honduras	19.7	117.9	16.7	103.4	240.5	43.0
Nicaragua	53.2	83.0	64.1	185.0	269.6	68.6
CACM	387.4	1,542.8	25.1	920.9	2.809.3	32.8

Source: INTAL (Instituto para la Integración de América Latina y el Caribe), *Informe centroamericano Nº 2* (Buenos Aires: BID-INTAL, 2004), 12.
CACM: Central American Common Market.

Besides the three relatively more developed Central American countries are responsible for most intraregional exports. Costa Rica, El Salvador and Guatemala have explained 84.3 percent of the average intraregional exports in the 2000–2004 period (see Table 5), being the bilateral exchange between El Salvador and Guatemala the most important.[19]

[19] The bilateral exchange between Guatemala and El Salvador represents around 30 per cent of the average intraregional trade in the same period. For more detailed quantitative information, see: SIECA (Secretaría de Integración Económica Centroamericana), *Boletín estadístico 13.1* (Guatemala: SIECA, 2005).

Table 5
CENTRAL AMERICAN COMMON MARKET: MEMBER COUNTRY'S PERCENTAGE SHARE IN TOTAL INTRAREGIONAL EXPORTS, 1990-2004 (SELECTED YEARS)
(in percentages)

Year	*Relatively more developed countries*				*Relatively less developed countries*		
	Costa Rica	El Salvador	Guatemala	TOTAL	Honduras	Nicaragua	TOTAL
1990	20.1	26.3	42.9	89.3	3.6	7.1	10.7
1995	21.9	26.8	34.8	83.5	11.3	5.2	16.5
2000	22.5	28.2	31.2	81.9	11.8	6.3	18.1
2001[a]	23.4	25.5	37.4	86.3	7.5	6.2	13.7
2002[a]	23.9	25.8	35.1	84.8	8.4	6.8	15.2
2003[a]	24.9	24.3	35.3	84.5	8.2	7.3	15.5
2004[b]	25.1	23.9	35.7	84.7	8.1	7.2	15.3
2000-2004 average	23.9	25.5	34.9	84.3	8.8	6.9	15.7

Sources: For 1990 and 1995, derived from: SIECA (Secretaría de Integración Económica Centroamericana), *Series estadísticas seleccionadas de Centroamérica N.º 28* (Guatemala: SIECA, 1998); for 2000–2004 period, derived from: SIECA, *Boletín estadístico 13.1* (Guatemala: SIECA, 2005).
[a] Preliminary data.
[b] Estimated data.

This empirical evidence points out that the members relatively more developed are in better conditions to enjoy the potential benefits from the consolidation of the new CACM. If this new regional integration scheme is to endure, it must not only result in a situation that improves allocative efficiency in the regional resources, but it must also be perceived to be equitable by all the member countries, especially by Honduras and Nicaragua. Without additional measures paying attention to specific needs of the relatively less developed countries, it is almost inevitable that these countries begin to question their participation in the new CACM.[20]

It would be appropriate to design mechanisms that enabled the potential winners of the customs union creation compensate the potential losers of the same. The European experience has shown that a way to carry out this compensation is through financial solidarity materialized in the Structural Funds and the Cohesion Fund. By these Funds, a part of the member states' contributions to the community budget is transferred to the less favoured social groups and regions. In the current Financial Perspective 2000–2006, the aforementioned Funds account for the third part of the community budget.

[20] The presence of intraregional asymmetries and the need to search for a mechanism facing them, have been a constant in the process of Central American integration from its inception in the 1960s. The lack of a suitable mechanism to tackle the specific problems of the relatively less developed countries, was one of the main factors that contributed to the slowing-down of the integration scheme in the 1970s and to the withdrawal of Honduras in 1971, as well as to the crisis of the 1980s. On the problem of the intraregional asymmetries in Central America, see: Jorge Nowalski, *Asimetrías económicas, laborales y sociales en Centroamérica: desafíos y oportunidades* (San José: Facultad Latinoamericana de Ciencias Sociales, 2002).

This experience is beginning to be taken into account in the Latin American integration schemes, as it has been confirmed during the last MERCOSUR Presidential Summit held in Ouro Preto, Brazil, in December 2004. The creation of a Structural Convergence Fund was approved during this summit with the purpose of supporting the most depressed sectors and areas in the MERCOSUR. The debate that took place within MERCOSUR revealed two different approaches to confront the problem of the asymmetries in intraregional trade, a problem that also is present in the CACM. As opposed to the Argentinean position that demanded the right to establish safeguard measures in intraregional trade to protect the national industries vulnerable to intraregional competition, the Brazilian position argued that the best way to correct trade imbalances was not by restricting free intraregional trade, but by creating a mechanism of intraregional financial solidarity to facilitate the competitive incorporation of the most depressed sectors and areas into the regional trade.

In the same way as it is happening in MERCOSUR, the European experience on intraregional solidarity could be adapted to the peculiarities of the Central American case, giving rise to some kind of structural and social cohesion instrument. In fact, the Central American presidents themselves have shown their formal interest in the creation of a Social Cohesion Fund. In the presidential summit held in Belize in December 2003, the Central American Bank for Economic Integration (CABEI) was instructed to submit "a financial mechanism to create a Social Cohesion Fund to mitigate possible impacts derived from the customs union and to promote its benefits " (Point 6 of the Declaration of Belize, on December 19, 2003). Although the CABEI proposed a project of a financial mechanism of intraregional solidarity, this one was not approved. For the present time, the interest of the Central American presidents in this type of mechanisms is more formal than real.

Absence of a real common trade policy

The creation of a customs union involves unavoidably the adoption of a common trade policy, since all the customs union members are bound to apply the same CET against third countries. Besides the existence of the CET compels that trade negotiations are carried out jointly, providing a potential benefit to the customs union members stemmed from the greater regional bargaining power.

In customs unions made up of developing countries, as it is the case of the CACM, the possibility of using the greater regional bargaining power is singularly important because it allows to take part in better conditions in international trade relations. However, the Central American countries have scarcely used this power. They have tended to negotiate bilaterally their free trade agreements, eroding the common dimension of the tariff protection guaranteed by the CET (see Table 6). Even when the Central American countries have negotiated free trade agreements en bloc –as it was done with the Dominican Republic and the United States–, harmonized joint agreements were only reached regarding procedures, while the tariff concessions were negotiated bilaterally, taking into consideration the peculiarities and the sensitive products of every country.

Table 6
CENTRAL AMERICAN COMMON MARKET: FREE TRADE AGREEMENTS INTO FORCE

Agreement	*Entry into force*
Mexico – Costa Rica	1995
Mexico – Nicaragua	1998
Mexico – Guatemala, El Salvador and Honduras	2001
Panama – El Salvador	2002
Panama – Honduras	2002
Dominican Republic – CACM	2001-2002
Chile – El Salvador	2002
Chile – Costa Rica	2002
Canada – Costa Rica	2002

Source: INTAL (Instituto para la Integración de América Latina y el Caribe), *Informe centroamericano Nº 2* (Buenos Aires: BID-INTAL, 2004), 16.
CACM: Central American Common Market.

The absence of a real common trade policy not only has prevented CACM members from taking advantage of the potential regional bargaining power, but also it can endanger progress made in the CET harmonization. The problem arises when simultaneously establishing a CET with a series of bilateral free trade agreements including different tariff concessions. The entry into force of the CAFTA will give clear proof of this problem, since it will not take place in a homogeneous way in all the Central American countries. Tariff concessions were negotiated bilaterally, which means that the schedule of tariff exemption in the CAFTA will be different in every country and therefore, the CET will not be applied in its entirety by all the countries during the period of tariff exemption. The fact that the United States is the principal trade partner of the CACM, providing around 40 per cent of its total imports,[21] converts to the CET exceptions originated by the CAFTA implementation, into a potential disturbing factor of the Central American customs union. The potentiality of this disturbance will become effective if governments do not come to an agreement to harmonize the differences in the CAFTA tariff concessions and to make them compatible with the establishment of the CET.

Likewise, the weakness of the common trade policy in the CACM can hinder the conclusion of the current process of CET harmonization. If the aforementioned problem on CAFTA coming into force is left aside, the current percentage of the tariff universe remaining to be harmonized is small (5.4 percent). Nonetheless, its harmonization can be complex because tariffed agricultural products are included. For this type of products, a renegotiation both in the list of products and in the tariff levels, as well as in the quotas, could be required within the framework of the World Trade Organization (WTO). In other words, it would be necessary to renegotiate commitments assumed by every country as part of its admission into the WTO, for what it would be advisable to rely on a regional bargaining power.

It is evident that the creation and consolidation of a customs union in Central America will need to adopt an authentic common external trade policy. This common policy will have to facilitate the harmonization of the different commitments undertaken by the CACM members as a

[21] SIECA, Unión aduanera centroamericana en cifras, op. cit., 26.

result of their participation in the WTO and/or of the bilateral free trade agreement signed. Likewise, it will have to contribute to create joint trade negotiation mechanisms.

Lack of a common customs administration

Along with the common trade policy, the common customs administration is another element inseparable from the formation and operation of a customs union. Not only the CET has to be applied against third countries in equal terms by all the CACM members, but also it has to be collected and administered jointly. The CET collection is a source of community revenues, which can be allocated to the financing of common policies consolidating and deepening the economic integration process.

At present there exist four models of customs administration –three of intraregional character and one of peripheral character– that are being tested in the CACM. For now, the advances in the setting up of a customs administration strictly common are limited, what can be conditioning the effective establishment of the customs union. Progresses are only perceived in the binational customs between Guatemala and El Salvador. Nevertheless, it is still necessary to eliminate all the intraregional customs, keeping only the peripheral customs model until becoming the type of customs which is typical of a customs union.

Given the budgetary restriction of the Central American governments, a significant issue is to delimit the use of the revenues collected in the peripheral customs, once intraregional customs are removed. These revenues include both the tariff incomes and the domestic taxes on imported goods collected at the customs. That is why it is important to find suitable mechanisms of tax harmonization as well as of collection and distribution of the CET revenues received by the peripheral customs. A coherent proposal would be that such revenues financed a community budget from which common policies could be developed. Nonetheless, for the time being the Central American governments are reluctant to this idea.

Moreover, a potential fiscal challenge arises in many countries due to the fact that the customs collect internal taxes that other tax agencies cannot due to their smaller overseeing ability (for example, the collection in the customs of taxes on the goods bound for the informal sector). In this context, the elimination of intraregional customs –element inseparable from the creation of a common customs administration– could lead to reduce this collection of internal taxes. To avoid this, it will be necessary to make previously progress towards the strengthening of other internal tax collecting agencies.

Limited coordination of macroeconomic policies

Macroeconomic stability is another requirement for laying down a customs union on a sound basis. A way of contributing to this stability is the coordination of the major macroeconomic policies of the countries participating in the customs union. Besides, this coordination is fundamental to avoid that the measures adopted by every member country to adjust to the international economy changes, end up affecting unfavourably on the rest of the partners.

Aware of the relevance of the macroeconomic coordination, the Central American Monetary Council (CAMC) has established a group of basic parameters of macroeconomic convergence as a starting point for that coordination. These parameters have been used only for monitoring the economic evolution of the region, without a political commitment having existed to fulfil them. The prevailing parameters of macroeconomic convergence are the following:[22]

a) The growth rate of Gross Domestic Product (GDP) must achieve or surpass 5 per cent. Nevertheless, due to the economic slowdown in the last years, growth rates exceeding 4 percent were regarded as satisfactory;
b) The rate of inflation must not go above 6 percent;
c) The index of real effective exchange rate with the United States has to be placed between 95 and 105;
d) The rate of real passive interest must not pass 5 percent;
e) The ratio of Central Bank´s net international reserves to monetary base has to be greater than or equal to 100;
f) Balance of payments' current account deficit does not have to surpass 3.5 percent of GDP;
g) Public sector deficit must not be above 2.5 percent of GDP;
h) Total public debt must not exceed 50 percent of GDP.

As Table 7 shows, the fulfilment degree of these macroeconomic convergence criteria in Central America has been modest. In the 1997–2004 period the average fulfilment degree did not exceed 34 per cent in Honduras and Nicaragua, was around 50 per cent in Costa Rica and Guatemala, and reached almost 66 per cent in El Salvador. Although all the CACM members have been applying similar macroeconomic stabilization and structural adjustment policies, the degrees and speeds of implementation of these policies have been different in each country, what explains the disparity in the macroeconomic convergence.

[22] The macroeconomic convergence parameters established by the CAMC have been changing throughout time, adapting to the conjunctural changes. The current version was established in November, 2002 in the 233rd CAMC Meeting. In this Meeting it was agreed to modify some of the parameters to reflect appropriately the recent evolution of the Central American economies and to take into account the Dominican Republic incorporation into the CAMC in that year. For more information, see: SECMCA (Secretaría Ejecutiva del Consejo Monetario Centroamericano), *Informe económico regional 2004* (San José: SECMCA, 2005).

Table 7
CENTRAL AMERICAN COMMON MARKET: FULFILMENT DEGREE OF MACROECONOMIC CONVERGENCE PARAMETERS, 1997-2004[a] (in percentages)

Year	*Costa Rica*	*El Salvador*	*Guatemala*	*Honduras*	*Nicaragua*
1997	50.0	63.0	50.0	37.7	50.0
1998	63.0	63.0	75.0	38.0	25.0
1999	38.0	63.0	25.0	13.0	50.0
2000	63.0	63.0	50.0	38.0	37.5
2001	50.0	63.0	63.0	25.0	25.0
2002	25.0	75.0	50.0	38.0	13.0
2003	50.0	74.0	50.0	38.0	13.0
2004[b]	38.0	63.0	38.0	38.0	38.0
1997-2004 average	47.1	65.9	50.1	33.2	31.4

Sources: Derived from: SECMCA (Secretaría Ejecutiva del Consejo Monetario Centroamericano), *Informe económico regional 2001* (San José: SECMCA, 2002), 20; SECMCA, *Informe económico regional 2002* (San José: SECMCA, 2003), 22; SECMCA, *Informe económico regional 2003* (San José: SECMCA, 2004), 21; SECMCA, *Informe económico regional 2004* (San José: SECMCA, 2005), 27.

[a] The macroeconomic convergence parameters are the eight ones established by the Executive Secretariat of the Central American Monetary Council; on this, see: SECMCA (Secretaría Ejecutiva del Consejo Monetario Centroamericano), *Informe económico regional 2004* (San José: SECMCA, 2005), 25–26. The fulfilment degree of these parameters takes values varying between 0 per cent (null fulfilment) and 100 per cent (full fulfilment).
[b] Preliminary percentages.

In sum, the empirical evidence confirms that macroeconomic policies coordination in the CACM is very limited. The real possibilities that this coordination will be extended and deepened, appear to be still very reduced, since regional commitments continue occupying a secondary position among governments' national priorities. In the medium term it is not predictable that a political commitment at the regional will be undertaken to coordinate macroeconomic policies and fulfil convergence criteria.

Weakness of regional institutions

The new institutional framework created by the 1991 Protocol of Tegucigalpa is characterized by its global and multidimensional aspects. It has established an institutional model –the Central American Integration System (CAIS) – based on four subsystems: political, economic, social and cultural. With this, it attempts to go beyond the strictly economic area and grant a global dimension to the new Central American integration, a feature that was lacking in the 1960s old scheme.[23]

[23] On the new institutional framework, see: PNUD (Programa de las Naciones Unidas para el Desarrollo), *Segundo informe sobre desarrollo humano en Centroamérica y Panamá* (San José: PNUD-Proyecto Estado de la Región, 2003), Ch. 4; SGSICA-CEPAL, *op. cit.*.

Likewise, the CAIS incorporates new institutions as the Central American Court of Justice and the Consultative Committee, which come to solve two fundamental insufficiencies of the previous phase. Firstly, the lack of institutional mechanisms guaranteeing the fulfilment of the agreements and the safeguard of the common interest (as the Central American Court of Justice). Secondly, the absence of an institutional mechanism allowing the active participation of the civil society (as the Consultative Committee).

In contrast to these advances, the new regional institutional scheme presents three major limitations reducing its effectiveness. Firstly, the institutional scheme develops immersed in a remarkable juridical disorder. There are no homogeneous and compulsory deadlines for the national ratification of the agreements signed, what causes delays in their entry into force or the partial entry into force for only some member countries. For example, Costa Rica has not ratified the 1986 Constitutive Treaty of the Central American Parliament. Likewise, Costa Rica, Guatemala and Panama have not ratified the 1992 Statute of the Central American Court of Justice.

Secondly, the essentially intergovernmental conception of the new institutional framework makes that the decision taking power is concentrated on the Summit of Central American Presidents, which is the CAIS highest ranking organization. The high political commitment level of the presidential summits is decisive in the first years of an integration process, but it can limit its deepening. The political consensus of the governments will be strongly conditioned by each member country's specific political situations, which can slow down and hinder the regional integration process.

If the consolidation and deepening of the new CACM is wished, facing an increasing number of conflicts in trade matters as well as in harmonization and production factors movement matters, will be inevitable. In this context, it will be necessary to provide the regional integration scheme with supranational institutional mechanisms having sufficient decision-making and financing capacity to remove rapidly obstacles arising on the path towards a greater integration.

The third limitation of the new regional institutional scheme lies in its excessive complexity and high number of institutions. This not only has conditioned its effectiveness, but also has ended up causing a serious funding problem.

The aforementioned limitations have brought about an important institutional weakness, which hampers the advance in the regional integration scheme. Aware of this, in the second half of the 1990s the Central American governments and the CAIS General Secretariat with the support of the Inter-American Development Bank (IADB) and the United Nations Economic Commission for Latin America and the Caribbean (ECLA), carried out a profound reflection on the rationalization and reinforcement of the Central American common institutions. The result was an institutional reform proposal contained in the report *Diagnosis of the Central American Regional Institutions*, published by IADB and ECLA in 1997. However, governments did not put into practice report's recommendations.

Recently, the Central American Presidents Summit held in June 2004 has taken up again the formal commitment to conduct a deep institutional reform by constituting an *ad hoc* Commission for the Comprehensive Reconsideration of the Regional Institutions. This Commission with the support of the the CAIS General Secretariat and the Central American Economic Integration Secretariat has to submit a consensual agreement on the different institutional reform proposals. If this formal commitment will actually materialize into a reality still remains to be verified.

Conclusions

After a profound deterioration in the 1980s, the interest in regional integration in Central America has been revived on a new basis. Now regional integration is perceived not only as an instrument for creating a regional market that extends the national demand, but also as an instrument for gaining international competitiveness, compatible with the promotion of non-traditional extraregional exports.

This new regional integration has achieved the revitalization intraregional trade, improving its quality and attracting intraregional investments, thus contributing to economic growth. Despite these achievements, the new CACM is subject to serious limitations such as the excessive dominance of extraregional trade, the slow improvement in the quality of intraregional trade, the unequitable distribution of benefits, the absence of a real common trade policy, the lack of a common customs administration, the limited coordination of macroeconomic policies and the weakness of regional institutions. If these limitations are not overcome by implementing suitable economic and institutional policies such as those ones suggested in the article, the new regional integration will not be able to contribute effectively to the Central American economic development process.

Faced with the current situation of the regional integration scheme, Central American governments can take up a passive or active stance. The adoption of a passive stance would imply that the regional integration scheme would limit itself to perfecting only the free trade area and at best, to completing the customs union. This passive stance would reduce drastically the bargaining power of the CACM, particularly if the Free Trade Area of the Americas was established. When tariffs were eliminated within the Americas, CACM's political decision power against the big multinational companies and world economic centres would diminish substantially.

Along with this passive stance, there is another alternative consisting of taking up an active stance in favour of regional integration. This alternative would aim at consolidating and deepening the economic integration scheme, by perfecting completely the customs union and going gradually and realistically towards the creation of a common market and an economic and monetary union. Only through this active stance the regional integration scheme will be able to support effectively the economic development of Central America. For that, it would be necessary that member countries renewed their political commitment, taking on the need to deepen the integration scheme and especially, observe and comply with the commitments undertaken.