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the European Union and Central America.

The Association Agreement and  
its Potential Impact on Central America.

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# 1 Introduction

In the course of the past few decades, globalization has changed the global economic and political order. The transformation towards a closer integration of the world economy and the vast increase in trade, foreign direct investments and portfolio investments are amongst the most important phenomena of this. Thereby, globalization describes a process that increasingly interlinks different economies and leads to a global economy, a global culture and global economic policymaking (Todaro / Smith 2009: 588). In this context, the multilateral trade negotiations have gained in importance since the signing of the GATT in 1947, up until the foundation of the WTO in 1995 and the subsequent years. This is a clear sign of the transforming processes of globalization. However, especially the scope of effects of the increase in international linkages are not clear as globalization brings benefits as well as costs and may increase inequality within and across countries. The impact of globalization processes on developing countries is especially relevant in this context, as they often do not have the economic and political power to mediate negative effects and implement policies to distribute gains more equally across their societies. Furthermore, the lack of international rules for the same, often lead to a reinforcement of already existing inequalities between countries.

Next to a closer integration of the world economy, indications of a shift away from unilateralism increased in recent years. Particularly in the economic sphere, the growth of economic powers challenging the hegemony of the United States suggests a transformation to a multipolar system. “[T]he current decline of the hegemon of the international system, together with a rise of new actors could create the conditions for a shifting to multi-polarity and great powers rivalry” (Varisco 2009). In this context, the European Union has managed to increase its power and become a global player that stands in close competition to the United States. Furthermore, the predominance of multilateral trade negotiations has been challenged in recent years due to a rise in bilateral agreements. The attempts of countries to increasingly compete on a global level have thereby partly undermined globalization processes. In particular, the European Union and the United States have used their economic power in the global trade system to further their own economic interests and to defend or establish themselves as global powers. They consequently negotiated increasingly more bilateral agreements in recent years, while being connected to each other through a competitive interdependence.



Moreover, increased globalization is not only changing the roles of international actors and the power hierarchies at the global level, it is also *“reshaping the role of the South, by diminishing the scope of action of the state to implement autonomous policies”* (Aguilar Castillo 2008: 17). A response to the increased challenges for individual states has been the rise in regional agreements that has taken place in the last decade. However, next to the economic and political position a country holds within the world order there are several other factors that determine its engagement in regional integration projects such as structural constraints of the world economy, negotiations and power struggles between civil society and the state and regulations and policies of other countries (Grugel / Hout 1999, in Aguilar Castillo 2008: 17). Regional integration thereby offers an opportunity for countries to integrate into the world economy and at the same time increase their economic and political power.

The Association Agreement between the European Union and Central America is in accordance with the described phenomena that have recently gained in importance. It is one of the very first true bi-regional agreements and institutionalizes the cooperation between two regions. An Association Agreement is generally a comprehensive trade agreement that the European Union negotiates with a partner country or region. Next to the trade part, it includes regulation on political dialogue and cooperation. Thereby, it is negotiated outside the multilateral trade system and includes a vast array of topics that go beyond WTO regulations. In this sense, it supports both regions to increase their competitiveness on the global level.

The role the European Union plays in this relation is particularly interesting as it positions itself as a global player and deliberately uses its trade strategy to increase its global power. The relationship between the two regions is quite asymmetrical due to the differences in political and economic power. Furthermore, in terms of trade volume the economic importance is much higher for Central America as the European Union is its second most important trade partner and investor and the main donor of bilateral and multilateral aid to the region. In contrast, for the European Union the economic relations with Central America are practically negligible. These arguments suggest that the interests and motives for involvement go beyond mere economic gains for the European Union in particular, but also for Central America. Thereby, it is of particular interest to analyze the impact of the Association Agreement on economic and social development in

Central America due to the previously described effects of globalization on development and inequality.

## **1.1 Motivation**

We currently live in a world where most countries are deeply integrated into the world economy and connected through complex interactions. Thereby, especially trade and foreign investments have immensely gained in importance over the last decades. It has always been of particular interest to the author of this paper to analyze and observe the connections between and effects of economic processes such as increased trade and investments at the global level and development at regional and local levels. She strongly believes that a throughout understanding of development requires a close look not only on the specific characteristics and circumstances of a region, but also of the larger context and global processes that influence and reshape them. Consequently, the author focused on issues of international development and economics throughout her studies and made an effort to develop a trans-disciplinary approach towards international and development economics. Thereby, the author became particularly interested in trade and its effects on developing countries. During her internship at the Trade and Investment Division of UNESCAP, she got inspired to analyze economic processes and trade at a regional level as regionalism is another phenomenon of globalization that has gained in importance in recent years. This gave her the idea of writing her thesis about one of the first true bi-regional trade agreements. Additionally, the comprehensiveness of the Association Agreement between Central America and the European Union and the inherent efforts to apply a holistic approach to the negotiations evoked her interest in the topic.

## **1.2 Research Question and Methodology**

The analysis of the Association Agreement between Central America and the European Union in this paper is based on a comparative study of multi-disciplinary literature in the hermeneutic tradition. Thereby, a literature and document analysis of primary and secondary sources is combined with a complementary data analysis. This is conducted under a trans-disciplinary approach and the joint use of several mainly economic and political studies and theories. It supports an in-depth understanding of the context in which the Association Agreement was negotiated and answers the research question to this paper: *What are possible outcomes of the Association Agreement in regard to*

*development and economic growth in Central America in the context of wider relations between the European Union and Central America?* The underlying hypothesis thereby is that processes of globalization and in particular trade can lead to unequal accumulation of wealth and development unless these are mitigated by trade policy. However, within the sphere of political economics and in the public discourse, it is often argued that trade policies are biased, which affects the distribution of export earnings as well as processes of development and growth.

Starting from this assumption, traditional and alternative (neoclassical and heterodox) economic models on trade are lined out based on a literature review. Additionally, the description of the political-economic context of trade in developing countries sets this in context with the specific challenges and chances that increased integration into the world economy can have for developing countries. The critical analysis of the Association Agreement between Central America and the European Union is established within the wider context of European Union trade policy. To better reflect the current realities and the initial conditions before the implementation of the agreement, a throughout description of economic, social and political processes in Central America and of the relations between the two regions in combination with a comprehensive data analysis is given. Finally, the Association Agreement is analyzed in relation to its likely effects on social and economic development in the region. This part is based on secondary sources of quantitative and qualitative in-depth analysis and simulations of a general and partial equilibrium model. It shall enable an overview of potential macroeconomic, socio-economic and political effects based on the discussed economic theory and global and regional political context of the Association Agreement.

### **1.3 Terminology**

Within this thesis, the term developing countries is used to describe countries in lower income groups and with low performance in social indicators such as education or health. Such a simplification can obviously not depict the high complexity of social, political and economic processes within a country. However, for the purpose of better readability and due to the lack of a more precise terminology, the term developing countries will be used throughout this study to describe countries at the lower ends of the income pyramid and the specific challenges and problems they face. This definition draws on the classification

by the World Bank that divides countries in low-income, middle-income and high-income economies whereby the first two country groups together are termed developing countries (The World Bank 2013b). It is very similar to the grouping by the UNDP that classifies all countries with low or medium levels of the human development index as developing countries (UNDP 2013a).

Furthermore, it is acknowledged that in the international academic and public discourse, there is much debate about the desirability and preferences for development processes. This philosophical discourse on development is extremely important. However, a throughout discursive analysis of these issues would go beyond the scope of this study. The understanding of development that is used here builds on a concept of development after Amartya Sen in which “[h]uman development is a process of enlarging people’s choices [...] [that] is achieved by expanding human capabilities and functionings” (The World Bank 2013b). Some of the most important capabilities include a long and healthy life, the access to knowledge, a decent standard of living, economic and social opportunities, creativity and productivity, self-respect, empowerment and community belonging (The World Bank 2013b). This is a very complex and comprising concept that aims at having a holistic approach towards human development.

Regionalism describes regional groupings of countries with close geographical proximity, often similar socio-economic circumstances and already existing links that seek to integrate into a region by setting up joint institutions and building a common identity. This closer cooperation between countries can be at the economic level, but also at the political level with different degrees of integration. Generally, “it is said to be an accompanying phenomenon to that of globalization, by either supporting it through the integration of regional blocs into the world economy; or by contradicting it with the creation of exclusive, isolated protectionist arrangements embedded in a complex context of regional cooperation” (Aguilar Castillo 2008: 13). Regionalism thereby describes the political endeavor of a coordinated integration of countries into a framework of regional institutions (Aguilar Castillo 2008: 14). This concept is of particular relevance for the analysis of the Association Agreement between the European Union and Central America as one of its aims is a deeper integration of the Central American region.

Inter-regionalism is a rather recent phenomena that defines formal relations between two regions that are linked. Thereby, at least one of the involved parts is a free trade area or

customs union (Aggarwal / Fogarty 2004: 4f.). Such relations between two regions can fulfil different functions such as balancing, institution building, rationalizing, agenda-setting and collective identity-building (Hänggi et al 2006, in Corley 2009: 8). For the European Union the main reasons in strengthening relations and in particular trade relations with other regions instead of individual countries are very diverse. According to Aggarwal and Fogarty, they are a result of competing interest groups and opposing European Union institutions, the aspiration for a joint European identity and the restrictions and chances that the global economic and political circumstances pose (2004: 6ff.). The Association Agreement between Central America and the European Union falls within the definition of inter-regionalism as it seeks to formalize the political and economic relations between the two regions.

#### **1.4 Research Outline**

In chapter 2, neoclassical and heterodox trade theories are lined out to give an overview over the state of the art research in this field. This is followed by a political-economic analysis of the effects of trade on developing countries. The different strategies between liberalization and restriction of trade and possible opportunities for developing countries to benefit from trade such as export diversification or regional integration are described.

In chapter 3, the multilateral trade regime and recent transformations of trade at the global level are characterized. Next, the role of the European Union within this global context and in relation to its largest counterpart the United States, its normative power as a global player and its strategies for competitiveness are described. Finally, the trade policy of the European Union is analyzed more closely in respect to recent changes and its policy towards developing countries.

In chapter 4, the political-economic context of regional integration in Central American is given. The regions socio-economic characteristics and in particular social and development indicators, macro-economic developments and the importance of external sources of finance are lined out. This is followed by an analysis of the regional integration processes that have taken place in Central America.

In chapter 5, the relations between the two regions, Central America and the European Union, are more closely depicted. Thereby, an overview of political relations and their

origins is given. The socio-economic relations, in specific the trade relations, the role of foreign direct investment and development cooperation, are described. An insight into the interests and motives for intensified cooperation between the regions is given. Accordingly, the influences of the European Union on regional integration in Central America and the perspectives of both regions are analyzed.

In chapter 6, the Association Agreement between Central America and the European Union and its context are more closely studied. The political context of the agreement is depicted with an overview of the opinions of civil society. This is followed by a summary of the regulations in the agreement and a comparison to previous relations between the regions and a free trade agreement between the United States and the Central American countries. The socio-economic prospects for Central America are predicted through the evaluation of a CGE model simulation and the projected macro-economic results. A more detailed and in-depth analysis of sectorial changes and combined outlook on expected socio-economic impacts concludes the chapter.

In chapter 7, the findings are summarized and conclusions are drawn.

## 2 Trade and Development

In the past few decades, globalization has strongly increased trade, foreign direct investments and portfolio investments (Todaro / Smith 2009: 588). *“The potential upside is perhaps [...] greatest for developing countries; globalization does present new possibilities for broad-based economic development. [...] The downside of globalization is also greater for poorer countries, if poor countries become locked into a pattern of dependence, if dualism in LDCs sharpens, or if some of the poor are entirely bypassed by globalization; the poor may end up in poverty traps that are all the harder to break out of without concerted public action”* (Todaro / Smith 2009: 589f). Thus, in order to understand the complex effects of globalization processes on development many factors need to be considered in more detail. This chapter will provide an overview of issues related to trade in developing countries and put these in context with neoclassical and alternative trade theories.

In the past, waves of globalization have been associated with colonialism and thus with a rapid increase of inequality and extremely uneven effects on different regions of the world (Todaro / Smith 2009: 590). This historic example obviously leads many critics of globalization to condemn it and brings up the question of what is different in today's form of globalization. If the recent wave of globalization is to have more evenly distributed effects on countries and people across the world, it needs effective global regulations for trade, investment, finance and development cooperation (Todaro / Smith 2009: 590). The World Trade Organization (WTO) that followed the General Agreement on Tariffs and Trade (GATT) in 1995 provides a framework for such a set of international rules. However, until now the rules *“have greatly benefited some countries but much less the very poor countries still trying to gain a foothold in growth and development through agriculture and facing barriers put up by the very countries most promoting the benefits of trade openness”* (Todaro / Smith 2009: 590). This implies that up to now even this wave of globalization has been characterized by unfair rules that lead to uneven processes of growth, benefitting few already privileged countries and leaving others out. The ways in which trade can affect countries and its development will be described more closely in this chapter. Firstly, an overview of economic trade theories will be given. Secondly, the political-economic context of trade with developing countries will be described more closely.

## **2.1 Theoretical Framework**

Globalization and in specific trade and investments can lead to an unequal accumulation of wealth and growth. The specific processes influencing a country's development can thereby take on various forms. This chapter gives an overview of the state of the art academic research on trade and of neoclassical and heterodox trade theories. It describes the effects trade and investments have on wealth accumulation and growth. Thus, it enables a better understanding of the circumstances, which are required for trade to be beneficial for developing countries. In specific, the importance of regulatory and other measures by governments to mediate unequal distribution resulting from capital accumulation and trade is lined out. Furthermore, the influence of multinational corporations on those very same processes and on local production patterns has important implications for developing countries.

### ***2.1.1 Economic Trade Theories***

The basic understanding of trade is that transactions between people exchanging goods are profitable. In order to fulfill their needs and requirements best it makes sense for them to specialize on producing a specific commodity and exchange their surplus products for other products that are useful to them (Todaro / Smith 2009: 599). As everyone has different abilities and resources - and thus a comparative advantage in certain activities - it is profitable to specialize on them as these activities can bring the highest possible profit for the individual. In essence, this applies to countries as well because of differences in relative costs and product prices. The classical theory of comparative advantage and free trade developed by David Ricardo and John Stuart Mill demonstrates the possible gains from specialization and free trade (Todaro / Smith 2009: 600). The important point to note is that in this model, a specialization on a specific product makes sense for a country when it is able to produce it relatively cheaper than another good, even if another country has an absolute advantage in its production cost. When trade occurs, the country thus can specialize on a product for which its abilities and resources are best suited for.

As this basic model of free trade requires rigid assumptions and simplifies processes of trade, Eli Hecksher and Bertil Ohlin have expanded it to better reflect reality (Todaro / Smith 2009: 601). Their neoclassical factor endowment trade theory outlines that



countries have different combinations of productive factors such as land, labor or capital. Thus, the prices for these factors differ based on their availability - resulting in each country's specialization on the production of goods that require use of their abundant e.g. cheap factor. Furthermore, products require different combinations of factors which are not only determined by their relative price, so primary products such as agricultural goods or cultivated raw materials will always be relatively more labor intensive. As many developing countries have plenty of cheap labor available, this theory results in the logical assumption that they will specialize on the production of labor and land intensive goods. This argumentation led to many developing countries largely specializing on the production and export of primary products (Todaro / Smith 2009: 602). Some of the most important conclusions of this model of free trade were that all countries can gain from trade, the overall production output is increased and specialization will only be partial. Furthermore, it predicts that the prices of factors will increasingly equalize across the countries engaged in trade. Reality has shown that the wage gap between workers in developing and developed countries has not been equalized but sometimes even increased (Todaro / Smith 2009: 605). In relation to the relative factor prices within a country, the model suggests a rise in the returns for the abundant factor through trade, which would result in a rise in equality of domestic income. Also, trade is said to foster economic growth and thus create more opportunities for countries and make efficient use of the production factors.

Despite the seemingly inherent logic of this model, it is based on a few assumptions that do not coincide with the reality of international economic relations. *"This theory therefore often leads to conclusions incompatible with both the historical and the contemporary trade experience of many developing nations"* (Todaro / Smith 2009: 606). For that reason, North-South models of trade reject some of the assumptions made in neo-classical trade theory and try to model trade in a more dynamic way. Change is inherent to international economic relations and especially productive factors that are important to development such as entrepreneurial skills, or the ability for scientific and technological research are constantly transforming. Trade and international specialization are thereby not a way towards increased equalization but rather reinforce and manifest unequal resource endowments and widen the distances between and across countries (Todaro / Smith 2009: 607f.). In this context, developing countries often specialize in the labor intensive production of primary goods with diminishing terms of trade and *"find*

*themselves locked into a stagnant situation that perpetuates their comparative advantage in unskilled, unproductive activities*” (Todaro / Smith 2009: 607). On the other hand, capital accumulation in developed countries in the North is a result of greater capital endowments, subsequent higher profit rates and monopoly power. This leads to a cumulating competitive advantage of the North, which increases even further when information on the different income elasticity of primary and manufactured goods and capital mobility are added to the model (Todaro / Smith 2009: 608). These models have shown (backed by developing countries’ experiences) that for a vast majority of developing countries, trade alone cannot bring the hoped-for structural changes and an equalization of incomes without accompanying development policies. Furthermore, the analysis of Porter’s model of trade supports the suggestion that instead of focusing on the production of primary goods and thus a comparative advantage, it makes sense for developing countries to foster advanced factors of production such as highly-skilled workers or knowledge resources (Todaro / Smith 2009: 608).

The vent-for surplus theory of international trade questions the assumption of full employment that is inherent to most trade models (Todaro / Smith 2009: 609). It describes how previously underemployed and unemployed land and labor can be utilized through an expansion of production for export. However, in the past the returns of this have mostly gone to colonial or foreign entrepreneurs. Furthermore, a focus on the production of primary goods to utilize such resources has often led to export enclaves and a reinforcement of unequal economic structures (Todaro / Smith 2009: 610).

Structuralist theory questions the assumption inherent to classical trade models that transformations of economic structure can easily be achieved (Todaro / Smith 2009: 611). As this theory lines out, it is often extremely difficult to reallocate resources from the production of one good to another one. This is the case especially in developing countries that have long focused on the production and export of primary products and that lack a diversified economy. For them, an adjustment to changes in the world economy is more difficult as they have often build up their economic structure around their production of primary products and have other factors that contribute to their structural inflexibility such as bad infrastructure, lack of skilled labor or lack of intermediate products (Todaro / Smith 2009: 611). Due to developing countries’ difficulties to adjust their production patterns, a change in world prices or an increase in trade does not consequently lead to a

change in production patterns. Despite the constraints developing countries face in these aspects there are still many tariff and non-tariff barriers active to prevent their cheap products from entering developed countries' markets (Todaro / Smith 2009: 611).

Another phenomenon that has altered trade relations and production patterns and challenged developing countries' exports is the increase of technological substitutes to traditional products. Products such as rubber, cotton, wool that were largely produced in developing countries have been subject to diminishing shares over the last decades as synthetic substitutes produced in developed countries are on the rise (Todaro / Smith 2009: 610). Nevertheless, technological change has also brought benefits to developing countries mostly in the form of knowledge transfers. By replicating products that were newly developed in another country, developing countries can benefit from their research and move towards high-tech production (Todaro / Smith 2009: 610). If they have enough skilled labor, developing countries can manufacture such goods more cheaply and thereby fill production gaps.

### ***2.1.2 The Role of National Governments***

Immanuel Wallerstein's World System Analysis offers a holistic approach to understanding the accumulation of capital in certain core regions in relation to peripheral regions (Eckhardt 2006: 95f.). Because of the existence of imperfect markets and most importantly the seeking of high profits by corporations many quasi-monopolies exist (Eckhardt 2006: 96). State support thereby helps to build up the respective industry through subventions, restrictions and more. Wallerstein describes such industries as core-production, whereby high profits emerge and capital is accumulated (Eckhardt 2006: 96). In contrast, peripheral production often serves the core and is much less profitable due to the more competitive nature. Due to the divergence of profitability in the core and periphery and the entering of new corporations and entrepreneurs into core-production, competition rises and profits decline. This leads to capital moving away from former core-production towards new more profitable quasi-monopolies where higher capital accumulation is possible (Eckhardt 2006: 96). In the occurrence of trade this difference in profitability and the role of the state puts core regions into a much stronger position with regards to the peripheral regions which in relation enables them to benefit more from trade. *"Quasi-monopolies depend on the protection of strong states [...]. And as they become more competitive, they usually, in a move to reduce the costs of production,*

*relocate to weaker states with cheaper labour and other factors of production. [...] This gradual disintegration of quasi-monopolies, and their replacement by new ones, creates the cyclical rhythm of the world-economy” (Eckhardt 2006: 96).*

When this process of capital accumulation takes place within a country, regulatory measures of a government can mediate the uneven effects of capital accumulation and distribute profits more equally throughout regions. *“But since there is no effective international government to play a comparable role across countries, the highly uneven gains from trade can easily become self-sustaining” (Todaro / Smith 2009: 613).* On top of that, countries have uneven power in the global economic and political sphere and are not equally able to enforce their own interests. Consequently, the interests of developing countries that generally have lesser power often get overlooked.

Even in other aspects the role of governments can be very important for trade (Todaro / Smith 2006: 613): First, industrial policy offers a highly effective tool to diversify an economy’s production structure and build up a comparative advantage in a new sector. Second, using policy instruments such as tariffs, quotas or subsidies can change a country’s trade position and modify its prices of goods. Especially in cases where developed countries use such measures (even for domestic policies) the effects on developing countries can be very distorting.

### ***2.1.3 The Role of Multinational Corporations***

Especially in developing countries that often have highly imperfect markets production patterns have been shaped by multinational corporations’ advertising that largely influences consumer preferences and demand (Todaro / Smith 2009: 610f.). This offers them a beneficial way to maximize their profits and in doing so increases the demand for imports from developed countries. Furthermore, neo-classical theories of trade do not take into account that some goods are subject to increasing returns of scale and thus bring the highest profit with large-scale production. However, such economies of scale shape global patterns of production and trade. In such cases large corporations often have the capacity to sell products at much lower prices than smaller or simply new corporations. Consequently they are able to hold monopolistic or oligopolistic market power and influence supply, demand and prices thereby undermining competition (Todaro / Smith 2009: 612). This obviously hinders developing countries that are trying to diversify their

economies, especially because mostly industrial or manufactured goods are subject to increasing returns. For them it *“means that the first nations to industrialize (the rich nations) are able to take advantage of these economies of scale and differentiated products to perpetuate their dominant position in world markets”* (Todaro / Smith 2009: 612). Additionally, such multinational corporations are often supported by their governments and have great power. Their role in connection with foreign direct investments is very important as multinational corporations not only exert great influence on developing countries but trade agreements increasingly include regulations to ease their access to markets.

When looking at indicators of economic growth and export earnings of developing countries, the role of multinational corporations needs to be closely analyzed. Due to their activities and the associated higher levels of foreign direct investment, a country might experience higher growth or export rates. However, it is not necessarily the case that profits from these developments actually go to nationals and different segments of society of the developing country in which the multinational corporation is active (Todaro / Smith 2009: 615). Rather, *“The major gains from trade may instead accrue to non-nationals, who often repatriate large portions of these earnings. [...] in reality, such trade may be conducted between rich nations and other nationals of rich nations operating in developing countries”* (Todaro / Smith 2009: 615). As these arguments show, growth from trade might not benefit the developing country that is experiencing but may mask the actual underlying structure of production and dependencies. This suggests that the activities of multinational corporations and foreign direct investments should be closely examined before drawing conclusions about their potential for the growth and development of a country. It may be that the actual beneficiaries are the owners of multinational corporations in developed countries and not the people in developing countries that are often said to profit from increased investments. As this surely varies depending on the individual case, the characteristics and effects of foreign direct investments are more closely outlined in this section.

Foreign Direct Investments are international capital transfers by corporations founding or enlarging a subsidiary or investing in a corporation in another country (Krugman / Obstfeld 2006: 218). This transfer of resources is usually accompanied with the control of the foreign corporation. According to the United States statistics, a 10% share in a

corporation's stock by a foreign corporation defines it as being under foreign control and in turn makes the holding corporation a multinational one (Krugman / Obstfeld 2006: 219). The European Union considers Foreign Direct Investment an important engine to growth and development. Thus, it enforces stricter rules for investment protection and other measures to create a good environment for investments via its trade policy (Rodriguez 2009: 9). However, in academic literature on Foreign Direct Investment the effects of such measures and of Foreign Direct Investment are subject to controversy.

Krugman and Obstfeld (2006: 219) argue that the international capital flows of multinational corporations should not be seen as an alternative to lending and borrowing of credit by a country as they use Foreign Direct Investment as a way to enlarge their control. In their view, there are several reasons to open subsidiaries in foreign countries. These arguments can be broadly classified in the theories explaining the location and the internalization of production within one corporation. The location of a corporation or subsidiary is often determined by available resources and transport costs and other tariff or non-tariff barriers to trade play a role too. Combining the different locations under one corporation can make sense because some transactions can be carried through cheaper within one corporation. Reasons underlining this argument are – amongst others – the difficulties arising with technology transfer and intellectual property rights which can be minimized if the production is done by a foreign subsidiary of the corporation instead of a buyer of the technology. Also, in a global production chain a number of difficulties such as price conflicts, problems of coordination and price volatility can arise. If several production steps are combined under one corporation these problems can be minimized, ensuring smooth production processes.

## 2.2 Influences on Trade in Developing Countries

In the last decades the pressure on developing countries to liberalize, build strong institutions and open their markets has been very high (Chang 2002). Trade thereby plays an important role as it is known to have the potential to spurn economic growth, to create better functioning markets and to support economic development. The main argument used to further liberalization was thereby the proclaimed necessity to undergo these reforms in order to achieve economic development, following the examples of today's rich countries. However, as Chang (2002) points out, *"Contrary to the conventional wisdom, the historical fact is that rich countries did not develop on the basis of the policies and the institutions that they now recommend to, and often force upon, the developing countries"*. Rather, they used a set of protectionist measures and subsidies to develop their industries while discriminating against foreign products. Furthermore, the arguments for trade liberalization are mostly true for trade between countries with similar levels of economic development that have each specialized in different sectors enabling them to benefit of the expansion of their markets (Rodriguez 2009: 13).

In terms of trade with developing countries, the benefits are not as obvious and might not come at all. This is due to a number of reasons that largely depend on the differences in the composition of the countries' economies and levels of economic development. *"[I]t is fair to claim that the principal benefits of world trade have accrued disproportionately to rich nations and, within poor nations, disproportionately to foreign residents and wealthy nationals"* (Todaro / Smith 2009: 616). This suggests that some of the regulations enforced on developing countries through the international trade system are not targeted at fostering their development but rather follow the interests of developed countries. Furthermore, as development economists have shown, parts of the trade policy discourse are not so much based on scientific theories and instead follow political ideologies. After all, constructs such as free trade, free markets and perfect competition that require various rigid assumptions do not reflect reality and thus should not be used as a basis for policy making.

Despite all the risks globalization brings, it still makes sense for developing countries to engage in trade instead of closing their economies to foreign influences. However, depending on the circumstances and characteristics of a country and its development

objectives, there are different strategies for involvement. In order to enable a better and more objective understanding of the potentials and risks of trade for developing countries and of the effects of trade policy of the European Union, this chapter will critically analyze the reality of developing countries' trade and development.

A majority of developing countries is more dependent on trade than developed countries and is largely exporting primary products. This higher dependency can be seen as a result of the relatively lower prices of other non-traded goods in developing countries and of a large share of trade being more expensive goods than primary products. However, this brings with it a number of difficulties (Todaro / Smith 2009: 591ff). First, the often large share of exports of primary goods in relation to the GDP of the developing country leads to a dependency on world markets. This leads to uncertainty as prices of primary products face volatility due to their low price elasticity. Second, the income elasticity of demand for primary products is low in contrast to manufactured goods and fuels that have a high income elasticity (Todaro / Smith 2009: 597). This means an increase in incomes in developing or developed countries will both result in relatively higher demand for manufactured goods or fuels than for primary products, resulting in a decline in relative prices of primary products. Third, the low income and price elasticity of primary products lead to developing countries facing an export earnings instability, meaning their rates of growth and potential for development from trade becomes lower, more volatile and less predictable (Todaro / Smith 2009: 597). Finally, prices of primary products in general have been following a downward trend. At the same time, however, prices of manufactured goods have often stalled or increased. The combination of these two aspects with the industrial development many developing countries have tried to foster and the rising demand for (largely imported) consumer goods, have led to long-lasting deficits on their current accounts and subsequently on their capital accounts.

*“In a number of LDCs, severe deficits on current and capital accounts have led to a depletion of their international monetary reserves, currency instability, and a slowdown in economic growth”* (Todaro / Smith 2009: 593). Also, this worsening of the terms of trade for most developing countries means their imports have in relation to the prices of their exports become more expensive. The Prebisch-Singer thesis describes this decline as long-term redistribution of income from developing to developed countries (Todaro / Smith 2009: 598). These arguments have led developing countries to foster the



diversification of their exports and increasingly export manufactured goods. However, the prices of manufactured goods have also diverged with basic goods that are more likely to be produced by developing countries experiencing a decline in prices.

### ***2.2.1 Protectionist Policies of Developed Countries***

The opportunities of trade for developing countries are seriously reduced by tariff and non-tariff barriers to trade that restrict their gains from exports to developed countries' markets. *"Although internal structural and economic reform may be essential to economic and social progress, an improvement in the competitive position of industries in which LDCs do have a dynamic comparative advantage will be of little benefit to them or the world as a whole so long as their access to major world markets is restricted by rich-country commercial policies"* (Todaro / Smith 2009: 646). Negative effects on developing countries' export can result from not only tariff and non-tariff barriers to trade from developed countries, but also from their internal policies involving unemployment benefits for workers that lose their jobs as competition from abroad rises and other economic policies such as subsidies (Todaro / Smith 2009: 646).

For a long time, tariff and non-tariff barriers by developed countries used to be the major hindrance in the expansion of developing countries' trade. Furthermore, it provided an obstacle for the development and diversification of developing countries' industries as these tariffs discriminated against higher processed products (Todaro / Smith 2009: 646).

Even though many of the tariff barriers to trade have been reduced in the past twenty years, especially developing countries are still subject to higher tariffs than most other countries. They face 10% higher tariffs than the global average (while LDCs face 30% higher tariffs) due to several reasons. In general, developing countries are much more affected by market entry barriers due to their higher share of agricultural exports which are still heavily restricted (Hoekman / Nicita 2011: 2071). Contrary to this, (higher income) countries that export mainly manufactured goods enjoy low barriers. This is a result of the remaining tariff and non-tariff barriers to trade in the agricultural sector and agricultural subsidies that especially developed countries have. *"While liberalization has been substantial in most countries, tariff reduction has centred more on manufacturing than agricultural products. Agricultural restrictiveness increased for some countries"* (Hoekman / Nicita 2011: 2070f.). Additionally to tariff barriers, non-tariff barriers to

trade and domestic trade costs also play an important role in restricting trade in agricultural goods.

These uneven barriers to trade that discriminate against developing countries' exports have unfortunately not been changed much in the trade rounds of the GATT and WTO (Todaro / Smith 2009: 647). In the Doha Development Round it was attempted to change that by putting developing countries' needs into the picture. However, until now the negotiations have been unsuccessful mostly because of the disagreement on agricultural subsidies and market access.

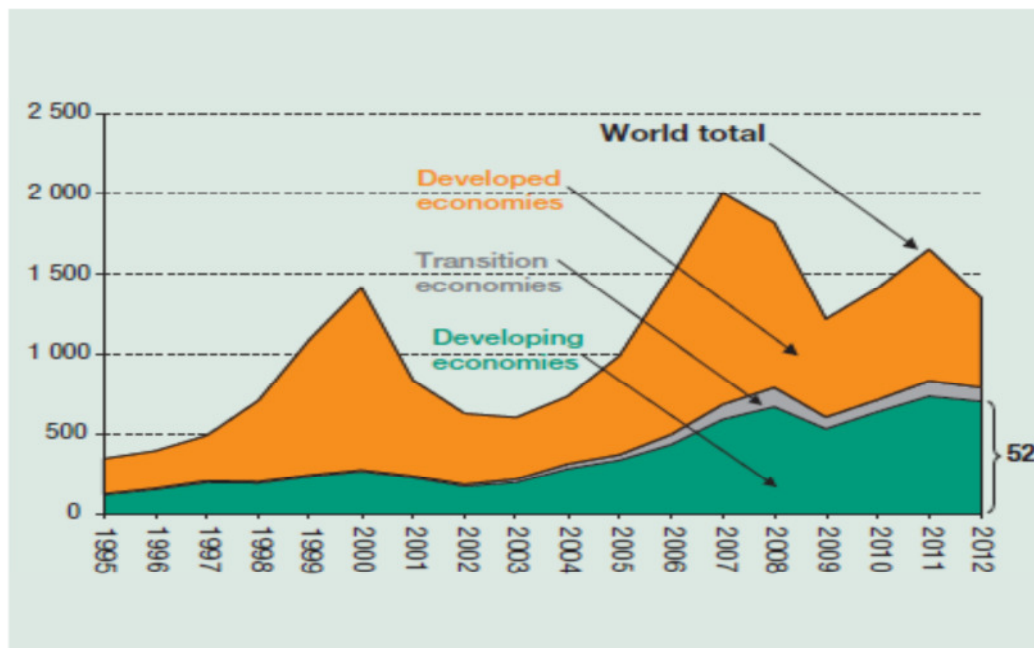
### ***2.2.2 Foreign Direct Investment***

Whether gains of trade will be distributed among the citizens of a developing country or go to foreign investors depend also on this country's ability to regulate the activities of multinational corporations. This point will be more closely described in the following section.

Flows of Foreign Direct Investment (FDI) to developing countries have rapidly grown over the last decades from 2.4 billion US \$ in 1962 to a pre-crisis record of about 1,300 billion US \$ in 2007 and 703 billion US \$ in 2012 (Smith / Todaro 2009: 715; UNCTAD 2013d: xiii). Those flows vary enormously across regions with about 58% of all FDI to developing countries going to Asia, about 35% going to Latin America and the Caribbean and only about 7% going to Africa (UNCTAD 2013d: xiii). The graph below shows that the volatility of these flows is very high over time. Most of the FDI is concentrated in a few countries that offer the highest returns and perceived safety. Even though FDI makes up for a majority of foreign funds flowing to developing countries, in comparison to domestic investments these numbers are very small (Smith / Todaro 2009: 716).

In reality, multinational corporations play an important role in international trade as many (one fourth to half of) international transactions are conducted as intra-corporation trade. However, as Krugman and Obstfeld (2006: 222) line out, multinational corporations are not the reason that labor (or capital) intensive production is being relocated to countries with a surplus in labor (or capital) but rather are facilitating and probably speeding up processes of globalization. Multinational corporations form a part of international economic integration (Krugman / Obstfeld 2006: 222).

Figure 1: FDI Inflows, in Billion US \$



(UNCTAD 2013d: 3)

The effects of FDIs on development are widely contested with only little empirical evidence to support either side. Looking at these arguments, Smith and Todaro (2009: 719ff.) line out that these differences in opinion are closely aligned with the different understandings of development. Arguments for Foreign Direct Investment often line out its importance to balance out or increase low levels of domestic savings, foreign exchange, government revenue and management skills and technological knowledge in developing countries and thus support the achievement of development. Especially the spillover of knowledge and skills could bring great long-term benefits for developing countries. However, empirical studies have so far only suggested that vertical spillovers might exist (Smith / Todaro 2009: 724). These arguments pro Foreign Direct Investment are closely connected to the traditional and new growth theory (Smith / Todaro 2009: 719). Its advocates are generally pro free markets and believe in the market mechanisms (Smith / Todaro 2009: 723).

On the other side, those arguments are countered with the dread that Foreign Direct Investment will widen the gaps (Smith / Todaro 2009: 721). Its arguments are concerned with dependency and power and they believe in national control of the economy and view multinational corporations as modern tools of colonialism (Smith / Todaro 2009: 723). It

is argued that multinational corporations might suppress competition through exclusive agreements with governments and their preference to import products from their own company instead of using local suppliers, fail to reinvestment in the country and often pay vastly decreased tax fees in their host countries. Furthermore, the spillover of knowledge and skills to local firms is said to be only of minor importance due to the dominance of the multinational corporation that often even hinders the growth of entrepreneurship. It is argued that in the long run foreign-exchange earnings might be reduced because of the vast amounts a multinational corporation imports and the profits it sends back to its country of origin.

Additionally to these arguments that might be softened with the implementation of targeted policies, developing countries brought up more fundamental issues against Foreign Direct Investment (Smith / Todaro 2009: 721). Investments and activities by multinational corporations often widen income inequalities, the imbalances between rural and urban areas and strengthen dualistic economic structures (Smith / Todaro 2009: 721). Furthermore, their products, advertisement, market power and production technologies are often considered inappropriate as they divert important resources and change consumption patterns (Smith / Todaro 2009: 721f.). This leads to *“local resources [...] to be allocated for socially undesirable projects [...] [which] tends to aggravate the already sizeable inequality between rich and poor and the serious imbalance between urban and rural economic opportunities”* (Smith / Todaro 2009: 722). Also, multinational corporations take advantage of favorable conditions given by many governments of developing countries such as protectoral measures, investment allowances, tax reductions and cheap locations and use practices such as transfer prices to further reduce their costs (Smith / Todaro 2009: 722). Due to their size and expertise, many multinational corporations are feared to suppress competition in the developing countries and ripe the benefits of their superior power. Similarly, it is feared that multinational corporations could use their power to influence political decisions and gain control over political processes (Smith / Todaro 2009: 722).

Concluding these arguments, it needs to be lined out that Foreign Direct Investment can be of great importance for growth and development only if the interests of the host countries and of the multinational corporations are the same (Smith / Todaro 2009: 724). In most cases the activities of multinational corporations are of oligopolistic or

monopolistic nature, where prices are bargained rather than set by demand and supply (Smith / Todaro 2009: 723). Thus, many analysts argue for stronger regulations of Foreign Direct Investments, the establishment of standards and requirements, greater domestic control and for an increase in bargaining power of the host governments (Smith / Todaro 2009: 724). *“[A] strengthening of the relative bargaining powers of host-country governments through their coordinated activities, while probably reducing the overall magnitude and growth of private foreign investment, might make that investment better fit in the long-run development needs and priorities of poor nations while still providing profitable opportunities for foreign investors”* (Smith / Todaro 2009: 724).

### **2.2.3 European Union Trade Restrictions**

As was outlined previously, developing countries' exports are relatively more restricted than exports by developed countries. A major factor thereby is that tariff and non-tariff barriers to trade as well as subsidies remain largely intact in the agricultural sector. The European Union is no exception in this and continues to exclude agricultural and other primary products from developing countries from its markets. Additionally, it often controls market access for agricultural products via sanitary and phyto-sanitary measures (SPS) (Woolcock 2007: 6). Even though it can be argued that such regulations are in the name of food safety and environmental standards, an inclusion in European Union Free Trade Agreements could make them an instrument that is being used to restrict trade. Rodriguez (2009: 8) lines out that *“[t]he FTAs that the EU is currently negotiating certainly have the potential to provide developing country partners with new trading opportunities [...] and be powerful tools for economic growth. Yet many of these issues, alongside having a great potential for development, may also be damaging. The challenge is finding the right balance between liberalisation and development and the right time to open up markets”*. Some of the European Union policies that potentially have damaging effects on developing countries are more closely described in the following paragraphs.

Agricultural subsidies from the European Union either go directly to farmers or to regions via the Common Agricultural Policy. As has been analyzed in a previous section, they have very distorting effects on the agricultural production of farmers especially in developing countries as not only the real costs of products are artificially being changed, but furthermore surplus products are sold on developing countries' markets for low costs.

This does not only inhibit competition within the European Union, but it also drives local farmers in developing countries out of the market and distorts the functioning of the market. *“The EU is, of course, not ready to contemplate inclusion of agricultural subsidies in an FTA”* (Woolcock 2007: 6). Thus, the opportunities for an increase of developing countries’ exports after the conclusion of such an agreement remain mostly limited to industrial products. However, as will be outlined in the following paragraphs, the European Union seeks to include several measures such as the Singapore Issues in its Free Trade Agreements as well as in negotiations on the multilateral level that bare additional risks for developing countries and may inhibit their potential to profit from trade with the European Union.

The Singapore Issues are four topics that have been brought into the multilateral trade agenda largely by the European Union and the United States. These countries have pressed for an inclusion of investment protection, competition policy, transparency in government procurement and trade facilitation into multilateral agreements (Rodriguez 2009: 5). Due to several reasons and the fear of developing countries that provisions on such issues will harm them more than they will be able to benefit, an agreement on the multilateral level has so far been blocked. However, the European Union is trying to reach a conclusion on the bilateral level by including regulations about the individual issues in its Free Trade Agreements. *“[A]ll the issues the EU wishes to include in its FTAs have important development implications for its partner countries. Liberalisation in these areas could, if managed properly, lead to economic growth, but it could also hamper it, reduce the policy space of poor countries and force them to accept measures that are not coherent with their development strategies”* (Rodriguez 2009: 11).

For the European Union competition policy plays an important role as it helps prohibit harmful anticompetitive practices. Especially when it comes to state subsidies, the European Union has included a prohibition in its Free Trade Agreements (Woolcock 2007: 9). However, the inclusion of such policies in trade agreements can be tricky due to the great differences in economic structure and development of the partner countries. A prohibition of state subsidies significantly reduces the policy space of developing countries and inhibits its possibilities for the support of infant industries or its development strategy more general. The differences in levels of development and economic structure have to be acknowledged in the design of the competition policy,

which should be asymmetrical and flexible in order not to harm corporations in developing countries and drive out competition (Rodriguez 2009: 10). If these differences are not thought of, competition policy might even restrict competition instead of fostering it.

Intellectual Property Rights play an important role in driving innovation and research. The European Union has largely used existing standards such as TRIPS in its Free Trade Agreements (Woolcock 2007: 9). However, in regard to development policies they have to be designed with great caution as they can restrict knowledge or technology usage and prohibit public access to intellectual property. Including Intellectual Property Rights in trade agreements, which the European Union is trying to do, is thus risky, as an optimal balance needs to be found in order not to restrict benefits of access to knowledge for development and growth (Rodriguez 2009: 10).

Another area the European Union emphasizes in its trade agreements is transparency and accountability in government procurement (Rodriguez 2009: 10). This is regarded as very important as it holds the promise of greater efficiency, improved public expenditure procedures and prohibited corruption. However, many developing countries fear that they will no longer be free to design an industrial policy in favor of their development (Rodriguez 2009: 10). Additionally, they see the superior power of foreign corporations as threat that might drive out local competition with the use of predatory pricing (Rodriguez 2009: 10). Finally, this instrument – while holding many chances to benefit for strong European corporations – is not likely to bring many gains to developing country corporations as their capacity might not be enough to enter the market of public services in Europe (Rodriguez 2009: 10).

Foreign Direct Investment is another important area for the European Union. However, it is still unclear whether Foreign Direct Investment will bring the benefits it is claimed to hold, especially within imperfect markets. Following the theoretical underpinnings, it seems as if the European Union is putting high importance on Foreign Direct Investment not so much to encourage development in its partner countries, but rather to further its own economic growth and opportunities for its large corporations. This line of argumentation has also been explored in relation to the European Union Central America Association Agreement. Corley (2009: 24f.) lined out that the value of Foreign Direct

Investment from the European Union in the region is much larger than the value of trade and thus forms a large motivation for the agreement.



## 2.3 Balancing Liberalization and Development

The importance of trade and especially of cheap quality imports for developing countries' growth and economic development cannot be neglected (Rodriguez 2009: 11). The access to developed countries' markets can be a stimulus for the use of available resources and earnings of foreign exchange offer a good opportunity to increase scarce financial resources (Todaro / Smith 2009: 315). In short, in today's globalized world it is essential for developing countries to reform and participate in trade in some form if they want to benefit from it and achieve development. “[W]here opportunities for profitable exchange arise, foreign trade can provide an important stimulus to aggregate economic growth” (Todaro / Smith 2009: 315). These positive effects of trade can also be seen in the historic examples of almost all of today's developed countries. Also, many developing countries are dependent on the import of goods and resources for their food production, as they do not have a sufficient market size and enough resources to be self-sufficient (Todaro / Smith 2009: 616). Additionally, they often favor trade as a source of technological knowledge and scarce capital (Todaro / Smith 2009: 616). Thus, developing countries are rather faced with decisions on specific regulations involving trade to find a way, which supports its own economy while balancing the interests of international actors.

Nonetheless, trade does not only hold benefits for the trading partners especially for the weaker part. It also poses threats to countries and its people and often widens the gaps between winners and losers across and within countries. As outlined above, increased earnings from trade and increased output of production do not necessarily go hand in hand with welfare gains and development as the distribution of benefits depends on the structure of the economy, the export sector and its relations to other sectors of the economy. A liberalization of developing countries industries thus has to be done with great caution and care to not threaten their very existence (Rodriguez 2009: 12). If liberalization is not accompanied with the right measures and done too fast, it will hurt developing countries much more than it will bring them gains. After all, “*no country has ever developed by just opening up; rather, ‘all of today's rich countries used protectionism and subsidies, while discriminating against foreign investors’*” (Chang 2007, in Rodriguez 2009: 12). Also, many developing countries do not have the capacity to compete on global markets and trade and finally, industrial policy is seen as an

important instrument to support infant industries and build up the domestic economy (Rodriguez 2009: 12).

A focus on agricultural exports with complemented imports of industrial products will result in developing countries being stuck in a situation with only little chances of long-term growth and development. Even economic theory shows that possible gains from trade are a result not only of specialization but also of economies of scale (Rodriguez 2009: 12). Thus, it is essential for developing countries to carefully assess when and how to open up their markets while building up their industries if they want to gain from trade in the long term and reduce poverty. As Rodriguez (2009: 12) points out, *“protection of infant industries in the first stages of industrialisation [...] may be necessary to promote a diversified economy and create jobs. [...] [L]iberalisation should take place only when these industries have grown to be sufficiently large to compete internationally”* (2009: 12). Developing countries should consider these aspects when negotiating with the European Union and recognize how a Free Trade Agreement could help them to encourage industrialization, restructuring, technological change and diversification (Rodriguez 2009: 12).

The trade concessions that developing countries can get from developed countries play an essential role in determining the potential outcomes of increased trade (Todaro / Smith 2009: 616). As was described more closely above, the effects of trade and the distribution of its benefits depends to a great extent on the ability of developing countries to push through regulations on the multilateral level that mediate uneven effects of capital accumulation and trade. The degree to which earnings from exports bring gains to the poor in developing countries also rest on the smart utilization of available resources and relations to other sectors of the economy. Depending on the sector in which export earnings are collected, its specific characteristics and the people benefitting from the increase export, these profits will create demand for different products. *“For example, small-farm agricultural export earnings will expand the demand for domestically produced simple household goods, whereas export earnings from capital-intensive manufacturing industries are more likely to find their way back to rich nations in payment for luxury imports”* (Todaro / Smith 2009: 616).

According to the United Nations Conference on Trade and Development (UNCTAD) (2007, in Rodriguez 2009: 8), Free Trade Agreements (FTAs) between developing

countries and developed countries (North-South FTAs) bare a lot of risks due to reasons such as the principle of reciprocity and national treatment which may lead to developing countries being flooded by imports while tariff elimination restricts the protection of infant industries through policies and leaves the country with less revenues. Also, agricultural subsidies that countries such as the United States or the European Union have reduce possible market gains for developing countries that have often specialized in the agricultural sector. Other restrictive rules such as technical barriers to trade (TBTs) or restrictive rules of origin can have similar effects for developing countries. Through the power imbalance in trade negotiations developing countries are furthermore limited in their decision making on policies for development as obligations that come with free trade agreements usually go way beyond trade issues.

### ***2.3.1 Evaluating Trade Strategies***

Generally, there are advocates of both sides of the trade discourse. First, the trade optimists that argue for liberalization of trade, a promotion of exports and development policies that are outward oriented (Todaro / Smith 2009: 635). They believe a strategy focused on these aspects will lead to increased exports and economic growth due to a number of benefits that free trade brings with it. Second, the trade pessimists argue for protectionist measures, the substitution of imports and development policies that are inward oriented (Todaro / Smith 2009: 635). In their understanding trade is not beneficial for developing countries because an increase in exports will lead to a transfer of income to developed countries, bring balance of payments and foreign exchange crisis and hinder the industrialization process. Furthermore, trade pessimists are skeptical when it comes to trade regulations and liberalization at the WTO as they argue that developing countries often lack the capacities and power to negotiate favorable deals for them.

However, as historical evidence has shown, advocates of neither one side have been completely right with their argumentation. Much more, the profitability of either strategy depends on the circumstances in the world economy. In periods of high growth, many of the trade optimist arguments are valid, while in periods of slow growth or stagnation, a more closed trade strategy seems to bring more favorable results to countries (Todaro / Smith 2009: 640). In general, the benefits of a more closed trade strategy or a more open trade strategy also vary amongst regions and depend on the level of development and many other political and economic circumstances within a country. In the case of low-

income developing countries, an export-oriented strategy has empirically shown to bring worse results even in times of high world growth rates (Todaro / Smith 2009: 640). “[T]he current consensus leans towards an eclectic view that attempts to fit the relevant arguments of the free-trade, protectionist, and strategic exporting models to the specific economic, institutional, and political realities of diverse nations at different stages of development” (Todaro / Smith 2009: 641). However, the strategy of either inward-looking or outward-looking trade policies does not seem to be the deciding factor for the development of a country. As Colin Bradford (in Todaro / Smith 2009: 641) lines out, an essential factor in determining the prospects of development for a country is rather its development strategy and especially how coherent it is and how closely the public and private sector work together to achieve their shared goals.

The European Union argues that its Free Trade Agreements are compatible with its commitments that development is a very important function of its trade policy (Rodriguez 2009: 11). They follow a certain understanding that is associated with a very optimistic view on free trade. It sees trade policy as essential to boost economic growth, create new opportunities and bring development (Rodriguez 2009: 11). Thus, it argues for liberalization of markets with the inclusion of accompanying measures such as the Singapore Issues. However, many developing countries and Non-Governmental Organizations line out the difficulties that can arise with trade agreements between two regions with vast differences in economic structure and development levels. “*Many developing countries simply lack the capacity to trade and are thus unable to take advantage of enhanced access to developed markets; even if they did, developed country subsidies and much more advanced production methods make it impossible for developing countries to compete with local products. Formal bilateral binding agreements would seriously reduce their policy space [...]*” (Rodriguez 2009: 11).

### **2.3.2 Diversification of Exports**

When looking at development processes (in terms of GDP growth) in relation to production patterns two phenomena can be observed (Imbs / Wacziarg 2003, in Todaro / Smith 2009: 613): First, there is a trend to move from initially high shares of agricultural production more towards industrial production and the service sector. Secondly, countries are often originally engaged in only a few activities but in the process of diversification spread out their activities across various sectors, before they start to specialize again. This

suggests “development is not driven by a simple process of gains from specialization” (Todaro / Smith 2009: 613). Rather, there are many factors that need to be taken into account to understand the effects of production patterns, sectorial distribution and trade on an economy.

Many developing economies have a very large agricultural sector and could thus profit from exporting agricultural goods, according to Ricardo’s theory of comparative advantages. This possible gain through trade liberalization is in the case of the European Union Central America Association Agreement limited by the European Union’s Common Agricultural Policy (CAP) which subsidizes agricultural goods leading to unfair competition through price distortion, but also floods markets in developing countries with its cheap surplus products (Rodriguez 2009: 8f). Thus, the chances for developing countries to profit from access to European Union’s markets in this sector may not outweigh the risks associated with opening up their own agricultural markets for as long as the CAP is in place. Furthermore, it poses a threat to farmers in developing countries and raises questions on the important issue of food security and sovereignty. Besides, as was outlined in more detail above, a focus on the export of primary products brings high uncertainty and in the long run a worsening of the terms of trade with it (Todaro / Smith 2009: 612). These arguments suggest that a strategy towards diversification of exports will in the long run be more beneficial to developing countries than a focus on few primary products where they have a competitive advantage given the highly imperfect markets and various protectionist measures in developed countries.

In the long run, liberalization of the industrial sector of developing countries may be of greater importance to achieve economic growth and development as the industrial sector brings increased returns with each additional input in contrast to the agricultural sector that has diminishing returns (Rodriguez 2009: 9). Thus, access to cheaper machinery and intermediate inputs from the European Union may help to expand and diversify the industrial sector in developing countries. This has to be done very carefully though as in many developing countries industries are still in their infancy state or non-existent and are not yet able to compete with its European counterparts (Rodriguez 2009: 9).

For the European Union services as the leading and fastest growing sector is of great importance and is integral to its competitiveness strategy (Rodriguez 2009: 9). It has increasingly been included in trade and plays a rising role. For developing countries

liberalization of trade in services brings chances as well as risks for development. On the one hand, foreign corporations can support a government with the provision of basic services and ensure higher quality while increasing opportunities for local firms (Rodriguez 2009: 9). On the other hand, liberalization of all services is not socially desirable and beneficial to the country. Rather, certain services have to be regulated in order to ensure quality provision of essential basic services for all citizens (Rodriguez 2009: 9). *“The quality and efficiency of a public administration are very important factors in order to make liberalisation of trade in services beneficial, and many developing countries do not have the adequate administrative and regulatory capacity”* (Rodriguez 2009: 10).

### **2.3.3 Regional Integration as an Alternative**

A profitable strategy for developing countries could also be a combination of trade in certain sectors with developed countries and regional trade agreements with other developing countries. Especially the movement towards regional integration is seen as a good strategy to benefit from larger markets with more resources and at the same time be more autonomous than in the case of free trade with developed countries (Todaro / Smith 2009: 616, 642). Regional trade agreements between developing countries can bring a number of benefits to its member countries such as the compensation of weak global demand or protectionist measures by developed countries (Todaro / Smith 2009: 641). Furthermore, in this way they hold larger bargaining power towards developing countries and can get better trade concessions from them. Economic integration of developing countries' economies can in the long term bring profits of economies of scale and a division of labor that the individual countries would be too small for (Todaro / Smith 2009: 342). Thus, they can by means of a coordinated industrial policy build up their industrial sector and further their industrialization process. Besides the wanted creation of trade through the elimination of internal barriers to trade, trade diversion through higher external tariffs can sometimes be an unwanted outcome of such an agreement. Yet, in the case of developing countries, trade diversion can play an important role as it might bring economies of scale, create jobs and keep income flows within the region (Todaro / Smith 2009: 643). In such a case, the shift of production from a country that is not part of the regional trade agreement to a country within the region may actually be beneficial in the long term even if the costs of production are higher in the short term. This is due to the

characteristics of some industries that need protection in their infancy state in order to reach a size of production in which they are able to profit from economies of scale (Todaro / Smith 2009: 643). Finally, there are many other potential benefits of regional integration such as increased chances for investment or reduced chances of war. As Vicard (2012: 67) lines out, the importance of regional integration for international security depends on the degree of integration between the countries.

Summing up, it can be concluded that regional trade agreements and regional integration can bring great benefits and internal growth to developing countries at similar stages of development and with comparable market sizes and close geographical proximity that are willing and eager to coordinate their development strategy and promote growth in the long term (Todaro / Smith 2009: 644; Vicard 2011: 189). It can furthermore inhibit some of the negative effects of globalization on small developing countries while at the same time bring positive effects of trade and specialization amongst the member countries. Central America as a region qualifies for these conditions.

Even though it is acknowledged that the importance of such regional agreements might often be overstated, it does provide developing countries with an alternative for a diversified and balanced development strategy while benefitting from trade with developed countries (Todaro / Smith 2009: 616). Developing countries, *“especially small ones, continue to experience the limitations of either development in isolation (autarky) or full participation in the highly unequal world economy, it is likely that interest will increase in the coming decades in the long-run benefits of some form of economic (and perhaps political) cooperation”* (Todaro / Smith 2009: 643). However, an ideal strategy of regional integration should target a balanced approach between a focus on the internal market and some degree of openness to the outside.

The next chapter 3 takes a closer look at the multilateral trade system, the role of the European Union as a global actor and the trade policy of the European Union.

### **3 The European Union within the Global Economic Sphere**

Globalization is a process that reshapes the international economic order. Over the past sixty years, a shift towards a closer integration of the global economy has been visible. The changes have simultaneously led to a transformation of the bi-polar world system towards one with multiple actors competing against each other. While also the level of international coordination and cooperation has risen over this time, in the recent decade, a rise in bilateral agreements and regional integration has taken place.

The European Union has evolved to become a major player within the global economy. It thereby follows a strategy of increasing its competitiveness on the global level through a number of policies. This chapter gives an overview of the role the European Union plays in the global economy. It starts with an introduction to developments at the multilateral trade regime from the General Agreement on Tariffs and Trade (GATT), to the trade rounds and the foundation of the World Trade Organization (WTO). Furthermore, it lines out the recent transformations towards an increase in bilateral trade agreements and regional trade agreements. Within this global context, the position of the European Union as a global player is analyzed, with a focus on its normative power, the influence of international systemic factors and its strategies to manage the pressures of globalization. Following, the specifics of the European Union's trade policy are described, together with its strategies to increase its competitiveness within the global economy. Lastly, an overview over the free trade agreements and the underlying motivations of the European Union is given and its preferential trade agreements for developing countries are analyzed.



### **3.1 The Multilateral Trade Regime**

The General Agreement on Tariffs and Trade (GATT) constituted of a simple trade agreement that worked as the central trade policy liberalization regime after the foundation of the International Trade Organization (ITO) failed (WTO 2013c). The central principles were liberalization of trade, non-discrimination, reciprocity and transparency. The existing multilateral trade regime and its principles were generally accepted due to the active furthering of/pushing for trade liberalization by the United States hegemonial power on the one hand. On the other hand the virtuous circle of economic growth, trade liberalization and modernization accompanied by welfare measures supported the catching-up process taking place in many western European countries in the post-war times and trade liberalization was thus seen as chance to solidify economic growth (Bieling 2010: 115f.). This phase of world trade policy is called embedded liberalism, as it shaped the circumstances under which the national welfare state could develop (Ruggie 1982, in Behrens 2011: 248). Despite the limitations of GATT, between 1950 to 1973 world trade grew at an annual average of 7,2 percent and tariffs on manufactured goods could be reduced to an average below 4 percent until 1993 (Bieling 2010: 114). Furthermore, the number of member states increased from 20 in 1947 to beyond 100 in 1993.

#### ***3.1.1 The GATT and WTO Trade Rounds***

In the 70s the hegemony of the United States and its position as strongest economic power was challenged due to the rapid economic growth in Japan and in specific its capitalization of comparative cost advantages that enabled it to sell mass products of increasingly higher value on the world market (Behrens 2011: 248). The western industrial countries reacted with non-tariff barriers to trade to protect their markets and in turn weakened the GATT. They even tried to put through selective import restrictions in the Tokyo Round to discriminate against Japanese products, which goes strictly against the GATT principle of non-discrimination (Bielings 2010: 119). Only when Japan - after pressure from the United States – agreed to appreciate its currency and open its markets to foreign suppliers, were these measures revised. This prepared the ground for further liberalizations through GATT rounds (Bieling 2010: 120).

With the Uruguay Round the complexity of multilateral trade negotiations increased drastically (WTO 2013d). The United States tried to put forward a liberalization of trade in agricultural products, trade in services, intellectual property rights and trade related investment measures (Bieling 2010: 120). Apart of agricultural liberalization, which the European Union strongly opposed, the United States, Japan and the European Union cooperated in the other three aspects (Bieling 2010: 121). Despite the complicated and enduring negotiations, an agreement could be reached in the end. This was amongst other factors also a result of the negotiating strategy of the United States which strategically used the possibility of market access for other countries as pressure to gain concessions from them. Furthermore, many developing countries had to inhere to the conditionalities of the IMF and the World Bank and liberalize their economies in order to get credits and be able to pay back their debt. Finally, the United States started regional integration projects to increase the pressure on the European Union. These reasons combined together with the plea of the European Union to support the suggestions of creating a new multilateral trade organization, led to the foundation of the World Trade Organization (WTO) (Bieling 2010: 121).

This turning point represents a shift in the multilateral trade system from a modern to a post-modern trade policy (Behrens 2011: 249). The WTO as an international organization with a much stronger institutional structure did bring many new opportunities to manage international trade. Additionally to the previous negative regulations, new positive regulations were implemented to include non-tariff barriers to trade in the new WTO trade regime (Behrens 2011: 249). Furthermore, the mechanisms for dispute settlement were strengthened and the Agreement on Trade-Related Intellectual Property Rights (TRIPS) was introduced (Behrens 2011: 249; Bieling 2010: 122). Together with the GATT that continues to regulate trade in goods, and the General Agreement on Trade in Services (GATS), they form the three pillars of the WTO (WTO 2013e). Additionally, there are about 30 sectorial agreements.

As this short historic overview of the international trade regime has shown, the developments leading from the GATT to the foundation of the WTO were disturbed by a phase of unilateralism that resulted from changes in the global economic order and led to the transformation of national competition states (Behrens 2011). The foundation of the WTO based on neoliberal values led to a wave of deregulation and privatization of former

public services in many countries in Europe (Behrens 2011: 249). Furthermore, the newly implemented regulations targeted only economic factors, leaving out ecological standards or consumer protection (Behrens 2011: 250). At this time also the so-called Singapore issues were discussed. While western countries wanted to introduce investment protection, competition policy, transparency in government procurement and trade facilitation many developing countries strongly opposed this (Behrens 2011: 249). Due to the strict regulations that would accompany the implementation of these measures, developing countries fear their reduced scope of action in economic and social policy making would significantly reduce chances for catch-up development.

From the end of the 90s onwards, a civil society movement against the multilateral trade regime came into being. Worker's unions and NGOs started protesting against some of the effects of international trade on domestic affairs (Behrens 2011: 250). Partly giving in to the increased pressure, some western countries tried to increasingly include standards that were not directly related to trade into the trade rounds. Even at the beginning of the Doha Development Round (DDR) such standards were up for discussion with the European Union trying to push through ecological and social norms (Behrens 2011: 250). However, they faced strong opposition from developing countries and the United States. Also, the agricultural subsidies of the European Union and the United States faced heavy criticism (Behrens 2011: 250). Until now, it has not been possible to reach a conclusion and close the Doha Round (WTO 2013b). Interpreting this optimistically, it can be traced back to diverging interests and the complexity of the negotiations that delay a closure of the round. From a more pessimistic point of view, the Doha Development Round (DDR) has failed due to the changed power relations in the negotiations between developing and developed countries. This is due to a number of reasons more closely outlined in Behrens (2011: 251f.): First, structural changes have weakened the hegemonial position of the United States and the European Union has become a strong actor in international politics with its trade value exceeding the one of the United States. Second, the economic growth in China will lead to a swift away from a bipolar economic system to a multipolar one. Third, the United States are no longer willing to make compromises in order to stabilize the international trade regime and the European Union does not accept to stand behind the United States anymore. This leads to them failing to negotiate a joint position vis-à-vis the developing countries. Fourth, the high number of member states in comparison to

earlier trade rounds and the one-state-one-vote principle of the WTO have immensely increased the complexity of negotiations and made it much harder to reach a conclusion.

Other explanations for the stalemate of the Doha Round focus on the relations between the European Union and the United States. Falke (2000, in Behrens 2011: 252) lines out that the European Union aims at the multilateral trade system to include a holistic Global Governance approach and thus has moved into a post-modern trade policy while the United States remains within modern trade policy norms. This reasoning is opposed with the argument that the strategy of the European Union is shaped by protectionist interests of corporations while in the United States a critical civil society influences and restricts political support for trade liberalization in recent years (Behrens 2011: 253). Interestingly, these explanations focus on the multilateral trade regime and often seem to leave out the rise in bilateral agreements in the last two decades.

The table below gives an overview over the GATT and WTO trade rounds and their achievements. As can be seen, the complexity has drastically risen from the first round in 1947 that included 23 countries and discussed mostly tariff reductions in industrial goods to the latest Doha Development Round that has been ongoing since 2001 with 159 countries negotiating a comprehensive set of measures that go way beyond tariff reductions. The next section will look more closely at this shift away from multilateralism to bilateral agreements and regionalism.

*Table 1: Subjects and Achievements of the GATT and WTO Trade Rounds*

Name	Start	Duration	Countries	Subjects	Achievements
Geneva	April 1947	7 months	23	Tariff reductions	- signing of GATT, - 45,000 tariff concessions
Annecy	April 1949	5 months	13	Tariff reductions	- 5,000 tariff concessions
Torquay	September 1950	8 months	38	Tariff reductions	- 8,700 tariff concessions
Geneva II	January 1956	5 months	26	Tariff reductions	- Tariff reductions worth \$2.5 billion

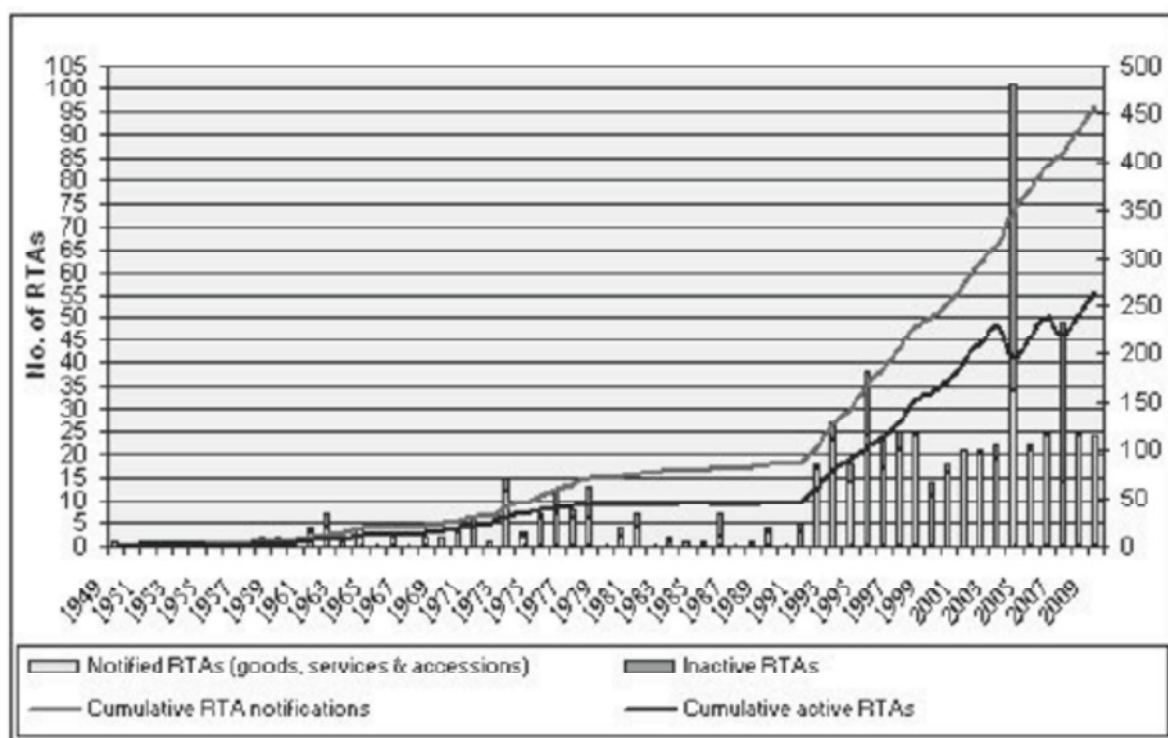
Dillon	September 1960	11 months	26	Tariff reductions	-	Tariff reductions worth \$4.9 billion
Kennedy	May 1964	37 months	62	Tariff reductions, Anti-dumping	-	Tariff reductions worth \$40 billion
Tokyo	September 1973	74 months	102	Tariff reductions, non-tariff measures, "framework" agreements	-	Tariff reductions worth more than \$300 billion
Uruguay	September 1986	87 months	123	Tariff reductions, non-tariff measures, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO	-	creation of WTO - extension of range of trade negotiations - reductions in tariffs (about 40%) and agricultural subsidies - full access for textiles and clothing from developing countries - extension of intellectual property rights
Doha	November 2001		159	Tariff reduction, non-tariff measures, agriculture, labor and environmental standards, competition policy, investment protection, transparency, intellectual property	-	not yet concluded

(WTO 2013c)

### 3.1.2 The Rise in Bilateral Agreements

Since the end of the 90s, a shift in the United States trade strategy has been visible. It resulted from domestic protests against further trade liberalizations, increased competition from the European Union and the economic growth in China (Behrens 2011: 253f.). In the international economic sphere, the multilateral trade systems seems to loose in importance while at the same time, bilateral trade agreements are rising (Behrens 2011: 253). The rise in bilateral agreements is clearly seen in the graph below picturing the notifications to the WTO.

Figure 2: The Number of Notified Regional Trade Agreements to the GATT / WTO



(WTO 2010, in Behrens 2011: 255)

Before this shift towards bilateralism, the United States almost exclusively refused bilateral negotiations and instead supported the multilateral trade system of the GATT / WTO. The European Union in contrast used its integration and expansion as a regional strategy of trade policy while supporting the multilateral trade system (Behrens 2011: 254). Especially the east expansion of the European Union threatened the economic and political power of the United States and led the United States to increasingly negotiate

trade deals on the bilateral level (Behrens 2011: 254). This in turn led the European Union to start negotiations for bilateral agreements and compete with the United States. Ever since, the European Union and the United States have been competing for market entry and increasingly negotiated free trade agreements with developing countries (Behrens 2011: 254). In these negotiations it is all too often obvious that strategic economic interests are dominant (Behrens 2011: 256). This shift away from the multilateral level towards bilateral or inter-regional agreements is often interpreted as the second-best strategy of trade liberalization after the stalemate of the Doha Development Round (Aggarwal / Fogarty 2004: 1).

### **3.1.3 New Forms of Regionalism**

Regionalism refers to *“the processes by which actors, public or private, engage in activities across state boundaries and develop conscious policies of integration with other states”* (Gamble / Payne 1996, in Grugel 2004: 604). It has been a fairly new phenomenon in recent decades that is said to be an accompanying process of globalization. Consequently, hand in hand with increased trade liberalization, came an increased level of integration in some regions. From the end of the 50s to the 70s the first wave of regional trade agreements led to the European integration process (Bhagwati 1993, in Thomassin and Mukhopadhyay 2010:23). It was characterized as closed regionalism with *“regional arrangements designed to protect the markets inside the regional structure from competition coming from countries that were not in the regional arrangement, or as a response to security issues, under the then current bipolar world order”* (Aguilar Castillo 2008: 14). At this time the world trade system was largely bipolar. It constituted of the United States and Europe trade blocs that were formed with countries in geographical proximity, former colonies in the case of Europe and cold-war partners in the case of the United States (Thomassin / Mukhopadhyay 2010:24).

At the end of the 80s and in the 90s a second wave of regionalism started and spread across Europe, North America, Latin America and Asia. In this period since the Cold War, the United States as the hegemon experienced declining power in the global economic and political sphere. This gave room for the creation of regional blocks of power that have since become an essential characteristic of the new world order (Aguilar Castillo 2008: 15f.). Regional integration in this context can be understood as *“an instrument towards a better integration in the global economy”* (Aguilar Castillo 2008:

14). The regional arrangements vastly differ depending on the region, but a few common characteristics can be observed that exemplify the emergence of a new form of open regionalism.

This new regionalism was a reaction of states to manage social and economic pressures that came from globalization (Grugel 2004: 604). *“For some states, it signifies the adoption of reflexive strategies to improve their global market position [...]; while for others, it reflects a defensive strategy aimed at securing or holding onto markets and investment in the face of greater global competition”* (Grugel 2004: 605). This new form of regionalism changed global politic-economic structures and relations between many countries and it is a form of regional governance. In contrast to previous protectionist models of regionalism, the new form of open regionalism is compatible with multilateralism and open to global markets as well as global norms (WTO 2013a). This can be seen in regional agreements that often incorporate more ambitious regulations than at the multilateral level and thus go beyond the arrangement at the WTO. Also, it provides countries with the opportunity to move forward with their trade liberalization despite the practical stalemate at the Doha Development Round. Furthermore, the new regionalism is a specific form of regionalism as it integrates countries that had not been formally linked, many of which are North-South relations (Grugel 2004: 604f.). The new regionalism brought strategies of liberalization and neo-liberal development and thus supported harmonization of relations between the North and the South. Many developing countries sought convergence with its partners in the North (Grugel 2004: 605). New regionalism can also be understood as an identity-creating process that builds new political-economic circumstances (Grugel 2004: 607). Models of new regionalism vary in their power structure, nature of North-South relations, institutional framework and policies, depending on the region (Grugel 2004: 606). As for this thesis it is most relevant to draw a comparison between the European and the American form of regionalism as *“Conceptualizing the EU and the US as operating interdependently helps explain why the attempt to manage globalization actually stimulates and nourishes it”* (Sbragia 2009: 17).

The European Union has long focused on regional integration and its form of new regionalism is thus closely linked to its history. As such, issues of economic growth, security and the global expansion of its norms and interests are essential characteristics (Grugel 2004: 607). However, increased liberalization, pressures of globalization and the



European Union's attempts to position itself as a global actor have led to a change in strategy. With the transformation to new regionalism, deeper integration and harmonization as well as a new language of partnership with its partners in the South came along (Grugel 2004: 607). Along these lines, the European Union has fostered the emergence of inter-regionalism between different regions that are equal partners. *"The new inter-regionalism attempts to go beyond economic governance to embrace political and institutional reform and social inclusion and, at the same time, seeks a discursive mediation of the power inequalities between Europe and the South"* (Grugel 2004: 608). It is characterized by its focus on issues such as good governance, dialogue, development, mutual agreements and negotiated policies (Grugel 2004: 608). Thus, it represents a vastly different model of governance and regionalism than that of the United States.

Since the early 90s the United States has tried to position itself within an institutionalized framework at the center of inter-American relations. In Latin America, the seeking of convergence together with difficult economic circumstances led to a transformation away from protectionist development strategies towards liberal economics. *"This paved the way for a softening of the tensions that had characterized relations within the Western hemisphere throughout the Cold War and for a subsequent realignment of US policy towards the South"* (Grugel 2004: 605). The main reasons for increased regionalism initially were to serve United States capital and to manage security issues such as migration, development or drugs (Grugel 2004: 606). The new regionalism in the United States was formed by its hegemony. In recent years, the regionalist agreements have diversified and increasingly include bilateral and sub-regional agreements, but in the Americas it is still mainly the United States that is driving such negotiations. Latin American countries on the other hand see it as a way to improve their economic power on global markets.

Comparing the two forms of regionalism, certain differences stand out. *"In contrast to the US, where the new regionalist agenda is essentially linked to the recreation of hegemony and the pursuit of multilateralism, the EU is attempting to establish new and deeper regional relationships in order to cope with and mitigate the impact of US power"* (Grugel 2004: 622). While both the United States and the European Union use new regionalism to regulate their relations with the South and to further liberalization, for the European Union it offers a space of differentiation to the United States, identity building

independently of the United States and positioning as global actor (Grugel 2004: 621f.). In this context, new regionalism means more than a reaction to global changes for the European Union. These differences can also help to explain the role of the European Union in the global sphere and especially its relation and competitive interdependence with the United States. Those aspects will be outlined more closely in the chapters 3.2 and 3.3.

### **3.2 The European Union as a Global Player**

In recent year the European Union has evolved to become a global player managing globalization. Even though the possibilities of influence vary depending on the field of foreign policy, various interactions are a strong force in shaping global relations and the world economy. Similarly to the United States, the European Union adapted its foreign policy strategy to global circumstances over time. The shift towards increased bilateralism marks a transformation from a national competition state towards a transnational competition state meaning it competes globally for access to foreign markets (Behrens 2011: 241). The next chapter will more closely describe strategies the European Union uses in competition with the United States to increase its geopolitical power in the global economic sphere.

Bieling (2010: 108) lists three main ways of interaction with the power to change global patterns that the European Union exercises. First, the transformative social forces that are inherent to trade, foreign direct investments as well as financial transactions that will change not only global production patterns but also the political organization of international relations. Second, the economic, political and institutional role model the European Union is perceived as works as orientation for other regions. Third, the flexible and dynamic ways in which the European Union approaches contradictions/objections and limits to globalization and Europeanization constantly result in new approaches. Trade policy is thereby an important area of contest and offers the European Union a chance of increasing its global influence. As the power relations and the global economic order changed over the last decades, so did the ways in which this influence was exercised. Despite the changes of power hierarchies on the global level and in the world economy, certain factors of influence the European Union exercised existed from its very beginning.

On the multilateral level, the European Union uses the powerful system of the WTO and formerly the GATT to bring forth its own agenda (Sbragia 2009: 3). Similarly, the United States has used the trading system to position itself within the international economic system and react to policies by the European Union and its enlargement rounds. Through the strengthening of the multilateral trade system, it also became a more powerful tool for

the European Union to manage globalization. Additionally, the European Union tries to increase support for its norms by expanding its territory of influence (Sbragia 2009: 3).

### ***3.2.1 Normative Power Europe***

The European Union hereby does not always actively seek to convince others of their norms. Rather, it acts as a 'normative power' whose norms are diffused through its credibility as a union of states with supranational institutions, intergovernmental elements and based on laws (Manners 2002, in Behrens 2011: 246). Due to its specific forms of governance as well as its position on the global sphere, the European Union is generally said to be a post-modern state. In contrast to a modern state like the United States its member states delegated sovereignty and other competencies to supranational institutions (Behrens 2011: 245). The European Union thereby mediates between its member states peaceful coexistence. Additionally, the European Union sees itself as a force for civil power that enforces its interests with economic and diplomatic instruments instead of military power and power games (Behrens 2011: 245). Based on Manners (2002, in Behrens 2011: 246), its normative power results from its core values of peace, freedom, democracy, rule of law and human rights. He points out that those norms are spread through official documents, legal proceedings, transfers and through the European Union's function as role model for regional integration processes (Manners 2002, in Behrens 2011: 246). However, there has also been criticism on the argument that the European Union represents a normative power. Generally it is supposed that a state wanting to support norms in foreign policy will use multilateral actions, while bilateral actions are often targeted at furthering the state's own interests (Behrens 2011: 247). Furthermore, the differentiation between norms and interests itself is highly debatable and the European Union's reaction to changing global circumstances could also be traced back to reasons such as changing power hierarchies or pressures from civil society instead (Behrens 2011: 247). However, while these arguments cannot be proven empirically, it can be said that the geostrategic race for access to foreign markets that the European Union competes in suggests the dominance of economic interests. The construct of a normative power Europe can in this context also be understood as a discourse for legitimacy and identity (Behrens 2011: 248). How the European Union exercises its power in the global economic system will be more closely outlined in the chapter 3.3.

### 3.2.2 International Systemic Factors

In order to understand the ways in which the European Union has tried to manage globalization it is necessary to look at the structure of competition between the United States and the European Union within the global trading system (Sbragia 2009: 3; Corley 2009: 39). *“The competitive interdependence which binds them [the EU and US] includes a dual logic. [...] Since each is a key player in international trade, the opportunity structure open to either is shaped by the structure which has been created by the other”* (Sbragia 2009: 4).

The European Union started its influence on trade policy at the multilateral level when the Treaty of Rome came into force in 1958. With the establishment of the European Economic Community and subsequently the European Commission, it was enabled to act as the unitary negotiator within the General Agreement on Tariffs and Trade (GATT) (Sbragia 2009: 4). The foundation of the European Union changed the global trading system. The GATT hereby played an important role in defining the existing options in trade as *“the GATT Rounds [...] represented a key mechanism by which the US and the EU could try to “manage” each other”* (Sbragia 2009: 8). The power of the European Union and subsequently the United States becomes visible in their influence on the trade rounds within the framework of GATT and WTO. As Sbragia (2009: 4) points out, *“The EU (along with the US) has played a key role in delaying, launching, and closing multilateral trade rounds”*. However, they are dependent on each other in this aspect as together they have the power to start a new trade round or direct the outcomes of the negotiations (Sbragia 2009: 5).

In the early years of the European Economic Community, its trade strategy was mainly defensive and concentrated on the interior (Rode 2000, in Bieling 2010: 110). Even though the share in world trade of the European Economic Community did increase in the decades post-war, the intra-regional trade rose much faster (Bieling 2010: 117). The role of the European Economic Community was partly a result of the institutional limits of the supranational competencies of the European Commission and partly of the fragile compromise on trade issues coming from internal conflicts of integration. This lack of support for the European Commission limited its power to shape the multilateral trade regime to a passive and reactionary role. In some cases though, the European Economic Community did take the initiative to negotiate trade agreements with countries in the

Mediterranean as well as with the African, Caribbean and Pacific states (ACP) as a way to stabilize the relations with former European colonies due to economic and geopolitical reasons. These preferential trade agreements secured the ACP states privileged access to the common market additionally to European Community funds to financially support the revenues of commodity exports (Bieling 2010: 118).

The United States strongly supported European integration even though it did not encourage its Common Agricultural Policy and was very dissatisfied by it (Sbragia 2009: 9). With the Dillon Round the United States brought its concerns about the Common Agricultural Policy and the consequences for its exporters to the common market of the European Union to the negotiating table (Sbragia 2009: 8). This was followed by US President Kennedy defining the European Common Market as one of the five reasons why the traditional trade policy of the United States was no longer valid (Sbragia 2009: 8). In the subsequent Kennedy Round the United States changed its strategy to adapt to the different circumstances. While at first the hope prevailed that United States exports would increase with trade liberalization in all sectors, agriculture proved to be a very difficult negotiating area and was later excluded from the Kennedy Round (Sbragia 2009: 8). The European Economic Community gave in to the liberalization pressures by the United States as it significantly reduced tariffs for industrial products, while at the same time refused to include agricultural products into the regulatory framework of GATT (Bieling 2010: 117). At the same time, the Kennedy Round proved to be the starting point of trade negotiations on the multilateral level where the United States and the European Union faced each other and of their relations shaping the international economic system (Sbragia 2009: 9).

In the 70s conflicts on the trade policy arena increased as the international competition became stronger. This was a result of the rise of intra-industrial trade in relation to inter-industrial trade, the general period of economic stagnation that took place in many countries and the entry/pushing of companies from Japan and the Newly Industrialized Countries (NICs) into the United States and European Union market (Bieling 2010: 118). This difficult economic situation in the world constituted a challenging negotiating background for trade policy. The United States and European Union increasingly used non-tariff measures to restrict trade and thus protect their markets (“new protectionism”) while at the same time at the multilateral level the United States pushed to decrease such

trade barriers (Bieling 2010: 118). With the start of a new trade discussion round, the United States followed its line of fostering increased trade liberalization as a way to face its trade balance deficit. The European Community acted at the same time very defensive as it had to deal with internal differences and even tried to partially bypass the GATT principle of non-discrimination with selective import restrictions (Bieling 2010: 119). Despite the difficulties however, the Tokyo Round managed to reduce tariffs on industrial products by 33% to 38% and came to an agreement to foster the cutback of non-tariff barriers to trade (Bieling 2010: 119).

In 1986, the Uruguay round could only be started after the European Union decided to support it. Later in this round, the European Union and the United States used their combined economic power and the threat of withdrawing countries the access to their markets to negotiate favorable terms for them and pressure all countries to join the WTO that was created with the closing of the round (Sbragia 2009: 5). In the following year, the European Union continued to heavily support the WTO and multilateralism more generally. It only very rarely negotiated on the bilateral level in order not to distort the multilateral negotiations (Sbragia 2009: 5). Furthermore, it fostered the start of the Millennium Round (that later failed) and the Doha round of negotiations.

Meanwhile, the United States tried to distort the territorial influence of the European Union and constrain it by bringing the preferential trade agreements it has with the ACP countries to the WTO (Sbragia 2009: 9f.). Due to its non-compliance with GATT and WTO rules and the strengthened dispute settlement mechanisms in the WTO, the European Union had to change the preferential relationships. They were followed by the Economic Partnership Agreements (EPAs) including trade liberalization and development assistance (Sbragia 2009: 10). In this attempt to create WTO compliant trade agreements mixed with development goals, the European Union faced vast criticism (Sbragia 2009: 10). Also, the negotiations that started in 2002 proved to be very difficult and enduring and are still not finished with all countries to date.

### ***3.2.3 Managing Globalization***

The increased pressure of globalization and the changing global world order lead the European Union and other actors to react in the attempt to mitigate negative effects and to position themselves in the global sphere. Thereby *“the US and the EU necessarily*

*compete, whether at the multilateral or regional level or both. [...] That same dynamic furthers globalization as well as the attempt to manage – and to profit from – that same globalization”* (Sbragia 2009: 16). Many of the agreements that the European Union negotiated in the 90s were aimed at balancing the United States strategy of enlargement of its economic influence and came as an answer to the North American Free Trade Agreement (NAFTA) and the proposed Free Trade Area of the Americas (FTAA). At the same time, the European Union deepened its integration. The creation of NAFTA as the largest regional trading block next to the European Union that included the United States, Canada and Mexico presented a great challenge to the European Union. For the United States it was an effective way of increasing its own influence. NAFTA is considered one of the most important economic developments and the positioning of the United States as a regional power (Sbragia 2009: 11f.). Furthermore the creation of NAFTA represented a clear shift in the policy of the United States from multilateralism as the only way to liberalize trade to regionalism as an alternative (Sbragia 2009: 12). This was also the starting of a new regionalism, which combined both developed and developing countries in a Free Trade Area that went beyond WTO regulations to include even sensitive topics such as intellectual property rights (Sbragia 2009: 12). Much as the creation of the European Union had challenged other countries and changed power relations in the international economic sphere, NAFTA presented a great transformation of the global trading system. *“Just as the EU’s birth as the post-war world’s first major example of economic regionalism presented new challenges to the United States, so too did the introduction of American regionalism into the global economy confront its European counterpart with new dilemmas”* (Sbragia 2009: 12).

Especially in the last two decades, the European Union has also expanded its territorial influence by the gradual integration process from an EU-6 to a EU-28. Sbragia (2009: 6) lists as benefits of this enlargement the greater market power and the export of the regulatory framework to the new member states. This in turn *“increased the EU’s geo-economic and geo-regulatory power”* (Damro 2006, in Sbragia 2009: 6). Even outside the European continent, the European Union managed to extend its influence with various instruments such as development aid, Association Agreements, Free Trade Agreements and political dialogue that are often tied to conditionality and thus affect policies. This in turn spurred the United States to suggest a Free Trade Area of the Americas, including 33 countries, that would challenge the European Union’s power and undermining its



important trade relations with Latin America (Sbragia 2009: 12f.). The European Union themselves responded to this challenge with the start of bilateral negotiations with countries in Latin America. In order to be able to compete on the Latin American and NAFTA markets, the European Union started negotiations for the European Union-Mexico Global Agreement in 1995 as well as for the Free Trade Agreement with Mercosur in 1999 and with Chile in 2000 (Sbragia 2009: 14). Despite the furtherance of these negotiations, the focus of the European Union was clearly laid on its enlargement. While the United States could not initiate negotiations for its proposed FTAA due to the lack of negotiating authority that was not given to the president's administration from the Congress, the European Union only managed to catch up with its negotiations in Latin America but did not actively pursue it for its own advantage (Sbragia 2009: 14f.). However, in 2001 after the elections in the United States lead to a change in administration coupled with the trade authority given from the Congress, the United States started a trade policy strategy of competitive liberalization (Sbragia 2009: 13). This meant the United States started negotiating a large number of bilateral trade agreements that went beyond WTO regulations with a number of countries in Latin America and Asia to increase its global sphere of influence (Sbragia 2009: 13). While the United States has been on the forefront of extending its influence in Latin America, the European Union has so far been more successful in negotiations in Asia (Sbragia 2009: 16). In Latin America, not all negotiations have been going smoothly. Especially with Mercosur, neither the United States nor the European Union has been able to successfully conclude an agreement due to Brazil's demands for agricultural liberalization that both regions could not agree on (Sbragia 2009: 15).

As Behrens (2011: 261) lines out, both the United States and the European Union have focused on a transnational foreign policy through bilateral agreements instead of their old strategy of increasing the attractiveness of their own countries for foreign investors. This movement away from a national competitive state to a transnational competitive state poses a threat to the world trade system and regional integration projects as well as negative political and economic effects for developing countries (Behrens 2011: 262). The ways in which the European Union furthers its competitiveness and its related use of trade policy will be more closely outlined in the following chapter 3.3.

### 3.3 European Union Trade Policy

In the 90s, the free trade agreements negotiated with European countries were mainly targeted at establishing economic and political stability after the cold war with similar concerns being at the core of the negotiations with countries in the western Balkan and the Association Agreements with the Mediterranean countries that should additionally form a backup zone to restrict migration to Europe (Woolcock 2007: 3). Development aims are at the core of the Economic Partnership Agreements that were negotiated with developing countries that have colonial ties to some European member states. These political motives can also be understood as part of the larger strategy of territorial expansion of the European Union's influence and norms and way to manage globalization/compete in the global economic sphere. Additionally, in negotiations with many developing countries the focus is on building markets by fostering regional integration and improving the business environment (Rodriguez 2009: 6).

At the Doha Development Round (DDR) at the beginning of the 21<sup>st</sup> century, the European Union has pointed out its commitment to a successful conclusion of the round (Rodriguez 2009: 3). The Doha Development Round aims to find a solution to reduce agricultural subsidies and tariff escalation, increase assistance for trade and extend the principle of free access of products from Least Developed Countries (LDCs) to global markets (Rodriguez 2009: 4). Negotiations are still on-going and it is not clear whether the round will be completed. As Rodriguez (2009: 4) points out, if the DDR fails, developing countries would *“lose the opportunity of increased market access to both developed countries and to the fast-growing markets of big emerging economies”*. Furthermore this most likely will lead to an increase in bilateral negotiations as it has already been happening in recent years. The negotiating power of small economies and most developing countries is far smaller than on the multilateral level there, because they cannot build coalitions to strengthen their influence in bilateral agreements. In multilateral negotiations it has been shown that emerging economies like Brazil or India as well as groupings of developing countries can vastly influence the outcomes which mostly benefits other developing countries as well (Rodriguez 2009: 4). Especially Least Developed Countries (LDCs) can profit from multilateral agreements with little required commitment from their side, but vast benefits. Bilateral negotiations on the other hand

generally involve trade liberalization on both sides, which can harm the weaker part (Rodriguez 2009: 4).

### ***3.3.1 Changing Strategies for Competitiveness***

With the document ‘Global Europe’, the European Union changed its trade strategy in 2006 towards an approach focused more on bilateral Free Trade Agreements. Before the strategy change that came along with ‘Global Europe’, the European Union argued that its negotiated trade agreements were targeted at supporting regional integration projects while it tried to diffuse its norms through regulations that went far beyond trade such as social or ecological standards (Behrens 2011: 257). However, it can be seen that the degree of influence the European Union was able to exercise correlates with the development levels, economic power and dependency on the European market of the partner countries (Maur 2005, in Behrens 2011: 257). Furthermore, ecological and social standards that the European Union includes in its negotiations are – in contrast to economic norms - not binding as they are not an integral part of the agreements itself, but rather a supplement to it (Behrens 2011: 258). This suggests that the European Union strategically uses its power to pressure weaker partners for the benefit of its own interests.

As Rodriguez (2009: 5) points out, the new strategy ‘Global Europe’ that led to free trade agreement negotiations with emerging economies in Asia was vastly different to the previous one where Free Trade Agreements had been negotiated with countries in the Mediterranean, on the Balkan and in Eastern Europe to ensure security and stability on the one hand and preferential arrangements for former colonies of European countries on the other hand. This shift resulted from changes in the economic world order such as the emergence of large economic powers in combination with the competition of the United States and to a lesser extend of Japan – both countries that were actively negotiating on the bilateral level – and the stalling of the Doha Development Round as well as the exclusion of some important issues for the European Union from the negotiations such as the Singapore issues (Rodriguez 2009: 5). The new trade strategy is part of a larger plan to increase European competitiveness. Additionally to internal policies, it includes opening foreign markets and creating more transparent rules for trade. Even though the official argument of the European Union is that it wants to achieve that through multilateral negotiations it becomes clear that this is not possible at this point in time as many of the key issues to achieve this competitiveness (e.g. the Singapore issues) are

excluded from multilateral negotiations at the WTO and can thus only be achieved through bilateral negotiations (Rodriguez 2009: 5). Those include services, non-tariff barriers, access to resources, intellectual property rights, investment, government procurement, anticompetitive practices and others.

As Behrens (2011: 260) points out, the European Union (as well as the United States) enjoys a number of advantages when negotiating bilateral trade agreements. Due to the asymmetric interdependencies between it and its partner countries, it can enforce its interests more easily than in multilateral negotiations. Additionally, bilateral trade agreements and the inclusion of the Singapore issues help the European Union to get market access for its corporations and to minimize risks. Thereby, ecological and social standards offer a useful protection of domestic markets from foreign imports that could threaten domestic industries. Finally, the inclusion of such standards satisfies domestic non-governmental organizations (NGOs) while at the same time bilateral negotiations help reduce the pressure from a critical civil society as trade negotiations become less transparent and thus move away from the public attention.

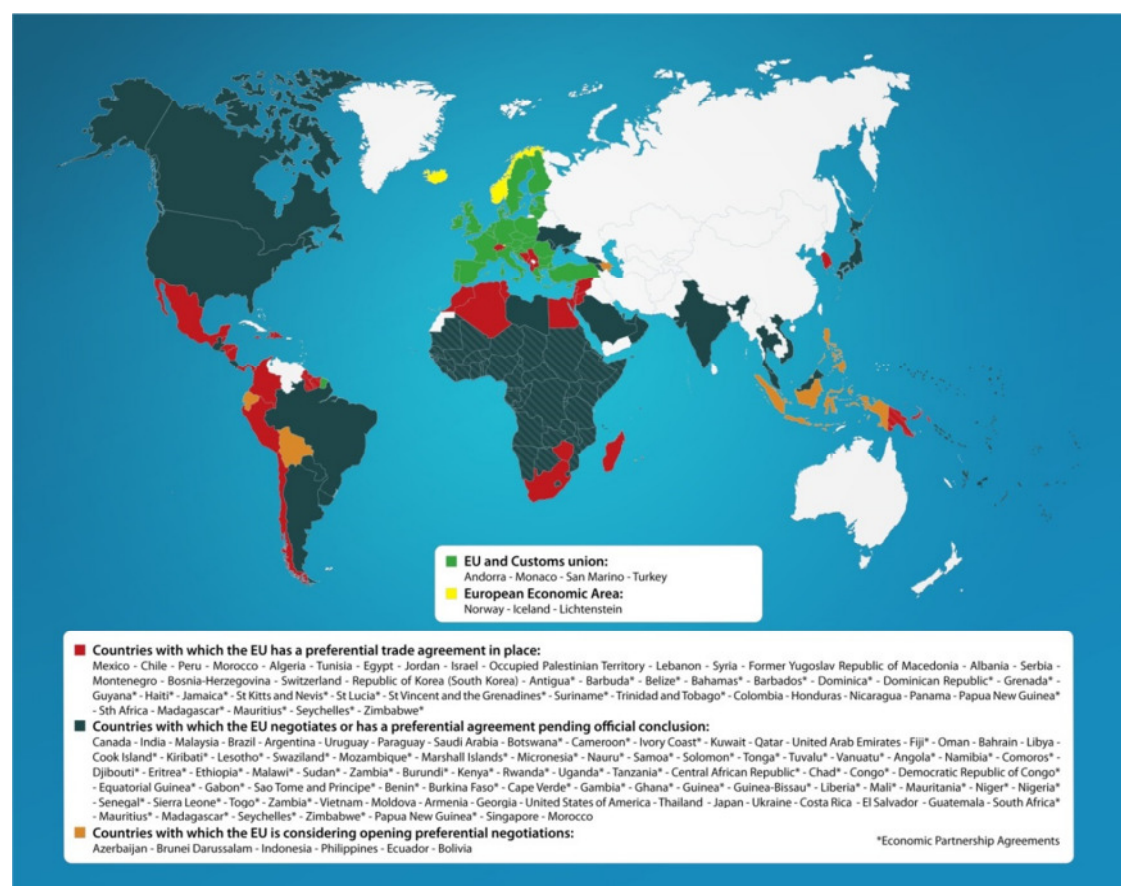
### ***3.3.2 Free Trade Agreements***

All free trade agreements the European Union negotiates are different and there is no model free trade agreement which allows for adaption to the different circumstances and motivating factors. Also, there are numerous motives that generally fall in the category of political and security interests, economic motivations or promotion of regional integration (Woolcock 2007: 3f.). The free trade agreements the European Union negotiated in the past can be broadly classified into four categories (Woolcock 2007: 2):

- 1.) Association Agreements (AA) with countries in the western Balkans and in North Africa are targeted at fostering economic development and establishing a stable political climate in geographical proximity to the European Union.
- 2.) Economic Partnership Agreements (EPA) with countries in Africa, the Caribbean and the Pacific (ACP) are centered on development objectives.
- 3.) Bilateral Free Trade Agreements and region-to-region negotiations such as the Trade, Development and Cooperation Agreement with South Africa are focused mainly on commercial benefits.
- 4.) Other cooperation agreements

An overview of the trade agreements that the European Union has with various partner countries is given in the graph below. It shows the different stages of negotiations and differentiates between Free Trade Agreements, Economic Partnership Agreements, the European Union Customs Union and the European Economic Area. As can be seen, a large majority of countries either already had preferential trade deals with the European Union in 2012 or was in the process of negotiating an agreement. A more comprehensive and up-to-date list of European Union trade deals will be given further below.

*Figure 2: An Overview of European Union Free Trade Deals in 2012*



(European Commission 2012a)

One economic reason for the European Union to pursue a free trade agreement is of competitive nature, to avoid a decline in trade after the conclusion of a free trade agreement between third countries (generally the United States and sometimes Japan as main partner). This played a major role in the European Union-Mexico free trade agreement and to some extent in the negotiations for the European Union-Central America Association Agreement (Woolcock 2007: 3f.). As more closely outlined in

chapter 3.2 of this dissertation, the European Union's trade strategy can be understood best within its global context and in specific its competitive interdependence with the United States. Additionally, the European Union seeks to strategically cooperate with emerging nations that are expected to experience rapid economic growth in the coming years and thus strengthen links with important future markets (Woolcock 2007: 3f.). This is exemplary of most free trade agreement that the European Union negotiated in Asia such as the one with India. Finally, the European Union aims to bring forth topics on the bilateral level that are difficult to implement or approve multilaterally, such as intellectual property rights and thus strengthen and expand international trade rules (Woolcock 2007: 4).

Depending on the level of economic development of the European Union partner countries in trade negotiations, certain measures come with Free Trade Agreements. Generally, the European Union insists on regional integration, trade liberalization within a maximum of 15 years, the adoption of highly developed rules and arrangements on all key issues (Rodriguez 2009: 7). This already suggests that all Free Trade Agreements negotiated by the European Union go beyond commitments at the WTO which can be controversial as the European Union sometimes pushes for issues to be included that have been blocked at the multilateral level. Trade agreements are usually in the form of Free Trade Agreements when economic considerations are central or Association Agreements when broader cooperation between the European Union and a partner country or region is envisaged.

In the table below a comprehensive and up-to-date list of the Preferential Trade Agreements of the European Union is given. As can be seen, the type of agreement varies greatly based on the partner country and the motives behind the cooperation. In 2013, there are about 33 agreements in place additionally to the ones with African, Caribbean and Pacific (ACP) countries. Negotiations are concluded for 10 agreements and in 11 more cases the negotiations are still on-going. The Association Agreement with Central America is in force in Costa Rica, El Salvador, Honduras, Guatemala, Nicaragua and Panama since the end of 2013.

Table 2: EU Trade Deals in 2013

<b>On-going negotiations</b>			
United States of America	Transatlantic Trade and Investment Partnership (TTIP)	First Round in 2013	
Japan	Free Trade Agreement	First Round in 2013	
Singapore	Free Trade Agreement	Concluded in 2012	
Malaysia	Free Trade Agreement		
Vietnam	Free Trade Agreement		
Thailand	Free Trade Agreement	First Round in 2013	
Morocco	Deep and Comprehensive Free Trade Agreement (DCFTA)		
Canada	EU-Canada Comprehensive Economic and Trade Agreement (CETA)	First Round in 2009	
India		First Round in 2007	
Mercosur			
African, Caribbean and Pacific countries (ACP)	Economic Partnership Agreements (EPA)	First Round in 2002, partly on-going	
<b>Concluded, not yet applied</b>			
Moldova	Deep and Comprehensive Free Trade Area (DCFTA)	To be initialed in 2013	
Armenia	Deep and Comprehensive Free Trade Area (DCFTA)	To be initialed in 2013	
Georgia	Deep and Comprehensive Free Trade Area (DCFTA)	To be initialed in 2013	
Ukraine	Deep and Comprehensive Free Trade Agreement (DCFTA)	To be ratified	
Singapore	Free Trade Agreement (FTA)	To be ratified	
Cote d'Ivoire	Economic Partnership Agreement (EPA)	To be initialed	
Cameroon	Economic Partnership Agreement (EPA)	To be initialed	
Southern African Development Community	Economic Partnership Agreement (EPA)	To be initialed	
Ghana	Economic Partnership	To be initialed	

		Agreement (EPA)		
Eastern African Development Community		Economic Partnership Agreement (EPA)		To be initialed
<b>Agreements in place</b>				
Colombia and Peru		Free Trade Agreement (FTA)		In force since 2013
Central America (Honduras, Guatemala, Nicaragua, Panama, Costa Rica, El Salvador)		Association Agreement (AA)		In force since 2013
South Korea		Free Trade Agreement (FTA)		In force since 2011
Mexico		Economic Partnership, Political Coordination and Cooperation Agreement		In force since 2000
South Africa		Trade, Development and Co-operation Agreement		In force since 2000
Chile		Association Agreement (AA)		In force since 2003
CARIFORUM		Economic Partnership Agreement (EPA)		In force
Papua New Guinea		Economic Partnership Agreement (EPA)		In force
Zimbabwe		Economic Partnership Agreement (EPA)		In force
Mauritius		Economic Partnership Agreement (EPA)		In force
Madagascar		Economic Partnership Agreement (EPA)		In force
The Seychelles		Economic Partnership Agreement (EPA)		In force
Andorra		Customs Union		In force
San Marino		Customs Union		In force
Turkey		Customs Union		In force
Faroe Islands		Free Trade Agreement		In force
Norway		European Economic Area (EEA)		In force
Iceland		European Economic Area (EEA)		In force
Switzerland		Free Trade Agreement		In force
The former Yugoslav Republic of Macedonia		Stabilization and Association Agreement		In force



Republic of Macedonia	Association (SAA)	Agreement	
Albania	Stabilization Association (SAA)	and Agreement	In force
Montenegro	Stabilization Association (SAA)	and Agreement	In force
Bosnia and Herzegovina	Stabilization Association (SAA)	and Agreement	In force
Serbia	Stabilization Association (SAA)	and Agreement	In force
Algeria	Association (AA)	Agreement	In force
Egypt	Association (AA)	Agreement	In force
Israel	Association (AA)	Agreement	In force
Jordan	Association (AA)	Agreement	In force
Lebanon	Association (AA)	Agreement	In force
Morocco	Association (AA)	Agreement	In force
Palestinian Authority	Association (AA)	Agreement	In force
Syria	Co-operation	Agreement	Not applied
Tunisia	Association (AA)	Agreement	In force
ACP countries	Free Trade	Agreement	In force

(European Commission 2013e: 1-5; European Commission 2013c; European Commission 2012b)

### ***3.3.3 Trade Negotiations with Developing Countries***

The bilateral Free Trade Agreements the European Union has been negotiating with developing countries in recent years “*have been widely criticised on the grounds that they might actually undermine the development of poor countries, as they go far beyond WTO*

*obligations and, if handled wrongly, can be very damaging, given the vastly different levels of economic development of the parts” (Rodriguez 2009: 5).*

In the view of the European Union, trade and regional integration are important ways to reduce poverty and increase welfare (Rodriguez 2009: 3). Thus, it provides special trade-related assistance and differential treatment to developing countries. The Generalized Scheme of Preferences (GSP) is its widest arrangement providing developing countries with tariff reductions or full removal of tariffs (EC 2013a). It is currently divided into three categories: the GSP provides market access with partial or full elimination of tariffs on about two thirds of products to developing countries, the GSP+ provides full elimination of tariffs on about two thirds of products to developing countries compliant to international conventions on topics such as human rights, good governance and others, and finally the Everything but Arms (EBA) Scheme provides full elimination of tariffs on all products except for arms to Least Developed Countries (LDCs) (European Commission 2013d).

As the world’s largest trading block in trade in goods and services, in such negotiations the European Union is in a much stronger position and has used its power to influence domestic policies of its partner countries (Rodriguez 2009: 7). Incentives for developing countries to gain access to the European single market are much higher than vice versa. This often results in developing countries adopting measures and policies that are not in their interest (Rodriguez 2009: 7). The African, Caribbean and Pacific (ACP) states argued that the European Union *“tried to push through the EPAs issues that the ACP had expressly rejected at the multilateral level in the WTO, and did not give enough attention to the potential damaging effects that comprehensive EPAs could entail for development”* (Rodriguez 2009: 8).

The following chapter 4 analyzes the social, political and economic circumstances of Central America in more detail and describes the regional integration processes.

## 4 The Context of Central American Integration

Central America, as used in this thesis, is an isthmus comprised of the countries Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama. All six countries combined, about 41 million people live in Central America. Central America geographically belongs to North America and builds the connection to South America. Sometimes it is even considered a subcontinent. Central America is in the North bordered by Mexico and Belize (sometimes considered part of Central America) and in the South by Columbia. In the Northeast of the region the Caribbean Sea is located and in the Southwest lays the Pacific Ocean.

*Figure 3: The Countries of Central America*



(European Commission 2013b)

Due to a number of reasons such as the shared history, common language, the benefits of a larger market and the wish for a louder voice in the political and economic world order, the countries of Central America have started a process of regional integration. As Corley (2009: 26) lines out, “[t]here has [...] been a long history of attempts at political unification in the isthmus since independence, and this tradition was one key factor in the resumption of the integrationist project”. Regional integration has so far mostly been focused on the creation of a common market and economic integration. Meanwhile

political integration and a greater coherence of the countries' social and economic indicators has not taken place to the same extent. The following chapter will describe the political, economic, social and historical circumstances of this regional integration process and line out the different motives involved.

## 4.1 Socio-Economic Characteristics

In the last twenty years, the Central American economies have undergone a throughout transformation from largely agrarian societies with partly autocratic systems to urban societies with democratic systems (Beteta 2012: 2). Furthermore, structural reforms in the 90s and a shift in the development policy of Central American countries towards increased trade, growth and the attraction of investments has led to economic liberalization and attempts of diversification of production (Beteta 2012: 2). At the same time, the demographic structure of the societies has drastically changed. Nowadays, Central America still faces a number of political, economic and social challenges. Even though some progress has been made in recent years – in particular in the area of democracy and governance – inequality and social exclusion is still high (European Commission 2010: 4f.). There are a number of factors such as weak institutions, the lack of transparency and corruption that deter economic and social progress. As will be outlined later in this section, poverty rates have been reduced in recent years, but remain high. Meanwhile, human development and income growth has been slow in most countries of the region. Finally, it has to be noted that there are large differences within Central America and social and economic indicators accordingly vary across countries.

Central America has also been affected by the financial and economic crisis in 2007 and 2008 and in particular by rising prices of food and oil (European Commission 2010: 4). As the European Commission (2010: 4) has pointed out, “[t]he crisis is affecting economic growth and GDP, and is increasing poverty and food insecurity”. Many people, especially so low income groups of the population, have been adversely influenced by increasing living costs and an insufficient number of jobs.

The region is known for its biodiversity and its rich natural habitat. It does not have many natural resources (Rivera / Rojas-Romagosa 2007: 5). Also, it is also very vulnerable to effects of climate change and environmental degradation (European Commission 2010: 5). This has led to numerous natural disasters in the region that often affect the most vulnerable population groups. Furthermore, institutions and policies are often not strong enough to provide adequate support.

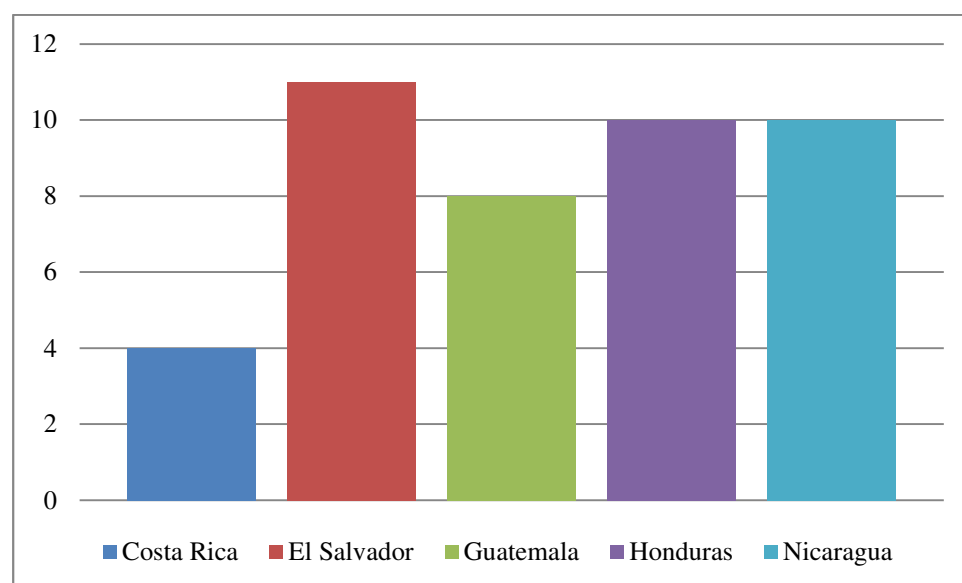
#### **4.1.1 Social and Development Indicators**

Central America is faced by numerous problems such as high levels of poverty and inequality. Apart of Costa Rica and Panama, it has low levels of human capital as will be more closely analyzed in this section. This, together with the fact that there is much underutilization of labor in the region suggests that its abundant factor of production is low skilled and unskilled labor. In particular, Central America is challenged by low quality of education and, especially in Nicaragua, by the population's limited access to education that serves as one of the main causes of poverty and income inequality (Rivera / Rojas-Romagosa 2010: 19). However, as Rivera and Rojas-Romagosa line out, there is a strong connection between economic growth, development and education (2010: 7). Education has the potential to spur development and bring a rise in incomes. *"Recent estimations indicate that a worker in Nicaragua earns 10% more for each additional year of schooling received. [...] It is estimated that workers require at least 11 years of education to achieve an income level above the poverty line"* (World Bank 2008, in Rivera / Rojas-Romagosa 2010: 19). This suggests that education has a high importance for development, which can also be seen when drawing a comparison to other countries in Central America. In contrast to Nicaragua, Costa Rica has managed to significantly improve its education system in the last years and is now ahead of the Latin American and Central American standards (Rivera / Rojas-Romagosa 2010: 20). Also, its labor force is more skilled. In the past twenty years, the diversification of its productive structure and increased demand for qualified labor by multinational corporations and exporting firms has led to rising incomes for highly skilled workers (Rivera / Rojas-Romagosa 2010: 20). Meanwhile, there has been no significant change in the incomes of low skilled workers, which has led to the rising levels of inequality. In sum, it can be said that education has definitely been an important factor not only in Costa Rica's development, but also in its ability to attract and profit from rising foreign direct investment inflows and opportunities for increased trade.

In Central America, crime and insecurity have been on the rise. Political violence has decreased; meanwhile organized crime and drug trafficking still stand at very high levels. *"[This] is in part the result of external influences: the massive repatriation of illegal emigrants from the US is proving fertile soil for the Maras (young gangs repatriated from the US), and the Mexican war on drugs is apparently pushing organised crime activities*

[...] from Mexico and Colombia to CA” (European Commission 2010: 4f.). Additional factors that contribute to the high levels of crime and insecurity are that the rule of law is not very strong, inequality is relatively high and rising, there are not enough opportunities for the many young people and the access to weapons is easy. Women are especially affected by widespread domestic violence (European Commission 2010: 5). Next to the social and emotional consequences of high insecurity and crime, they are also known to have negative effects on economic growth and development efforts (Beteta 2012: 9). Based on a Study by the National Council for Public Security, crime in Central America in 2006 resulted in an average of 8 percent of the Gross Domestic Product being lost every year (Beteta 2012: 9). As can be seen in the graph below, violence and crime cost 11 percent of GDP in El Salvador, 10 percent in Nicaragua and Honduras, 8 percent in Guatemala and 4 percent in Costa Rica. The costs thereby included the stolen goods, effects of insecurity, reduced investments and productivity.

*Figure 4: The Cost of Crime as percentage of GDP in 2006*



(CNSP 2008, in Beteta 2012: 9; own illustration)

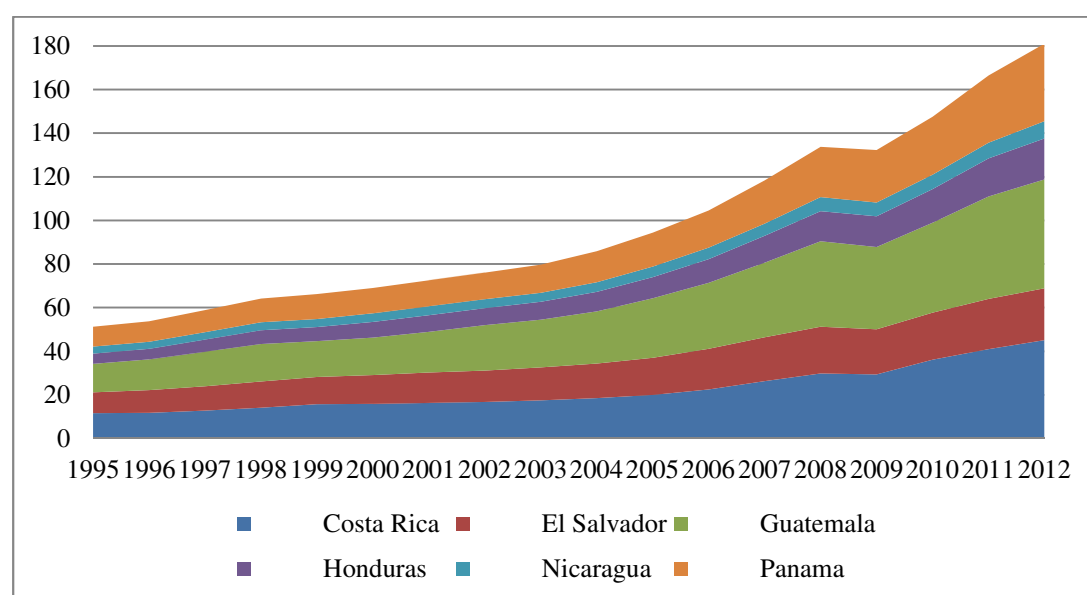
The countries in Central America vastly differ in a number of economic and social indicators. Also the disparities within the countries in Central America are quite high. To measure national income or the economic activities in a country, the most commonly used concepts are the Gross Domestic Product (GDP) and the Gross National Income (GNI). The GDP thereby represents the monetary value of all finished goods and services that

were produced within the borders of the country and year indicated, irrespective of the nationality of the person to whom this income is attributable. In contrast, the GNI measures the monetary value of all finished goods and services that were produced by nationals of the country in the indicated year. It thus adds the net income of employees and investment accrued abroad. The GDP is more frequently used as an indicator to describe the economic activities in a country. However, for the purpose of getting a better understanding of the actual income of the nationals of a country it can be very useful to analyze the GNI as it also accounts for the debt a country has abroad or the income that is generated by foreign investments.

For the past two decades, the Gross Domestic Product of Central America has been rising, with the exception of 2009 where it experienced a small recession due to the financial and economic crisis. However, it has recovered since and experienced substantial growth in the past few years. In 1995 it had a total value of \$ 51 billion and reached \$ 69 billion in 2000 and \$ 94 billion in 2005. Consequently, it had almost doubled within ten years. Until 2008 it had rapidly climbed to \$ 134 billion. After falling to \$ 132 billion in 2009, it experienced growth again and stood at \$ 147 billion in 2010. In 2012 it had reached \$ 181 billion, which is more than double the value of ten years before and more than three times the value it had 15 years before. As can be seen in the graph below, Guatemala, Costa Rica and Panama are responsible for large proportions of the regional GDP. This is partly due to the size of the economy in the case of Guatemala, but also due to the economic strength in the cases of Costa Rica and Panama. To better understand the actual incomes of the population, in the following part the Gross National Income per capita will be analyzed.



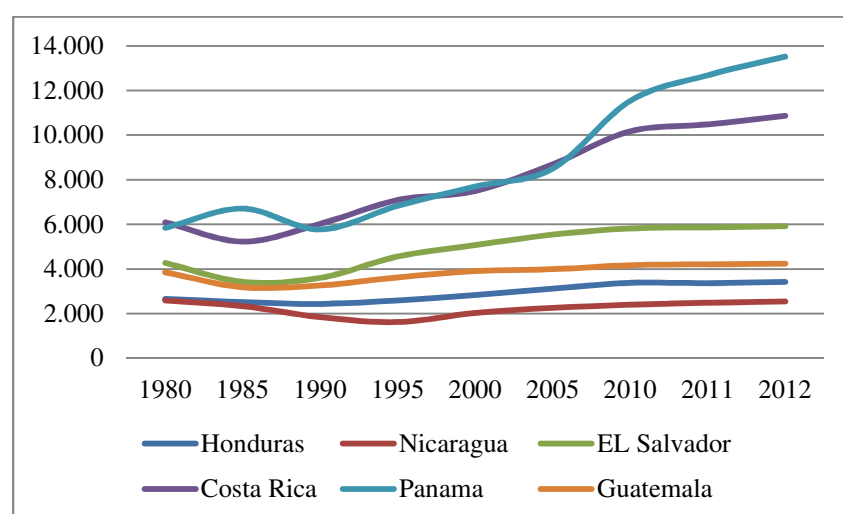
Figure 5: GDP, in current \$ billion



(UNCTAD 2013c; own illustration)

As can be seen in the graph below, the Gross National Income per capita (measured in 2005 PPP \$) of the Central American countries has actually diverged over the past few years. This stands in contrast to the expectations that were set in the reviving of the Central American Common Market (CACM). Panama and Costa Rica have managed to sustain substantial income growth over the last thirty years. Their GNI per capita grew respectively with 131 and 78 percent since 1980. El Salvador and Honduras have experienced moderate growth too with a total of 38 and respectively 29 percent GNI per capita growth in the same time period. However, Guatemala has not been able to increase its GNI per capita significantly with only 10 percent for the time period. Nicaragua has even experienced a two percent decline since 1980 despite its relative recovery since the end of the 90s. Additionally to the dissimilar growth rates of the countries in Central America, their starting levels significantly differed. This combination led to diverging levels of GNI per capita in the region.

Figure 6: GNI per capita, in 2005 PPP \$



(UNDP 2013b; own illustration)

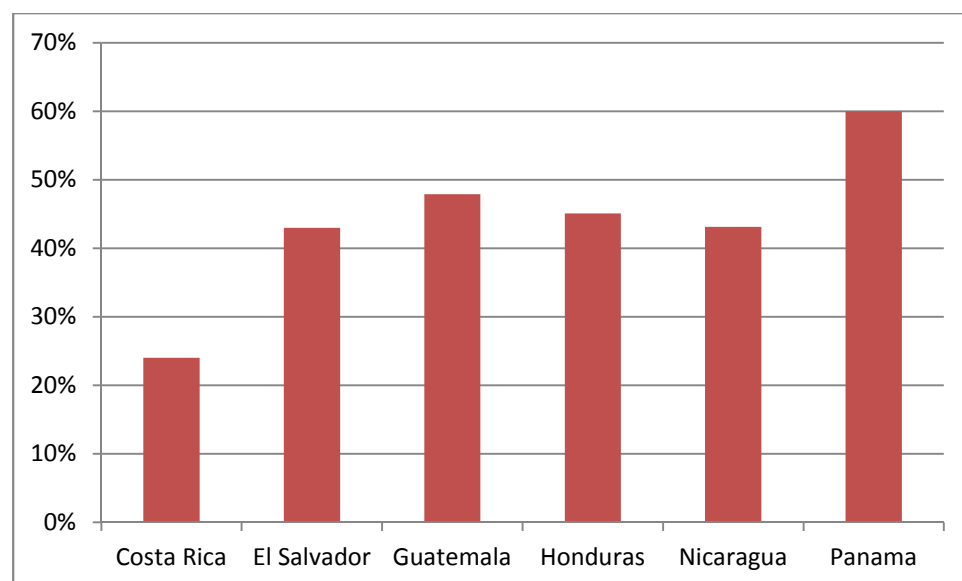
Panama has become part of the countries in the high-income group and thus is not classified as a developing country anymore, based on the World Bank classification. However, as will be outlined throughout this chapter, not all social and economic indicators of Panama reflect this categorization. While Costa Rica, El Salvador and Guatemala fall into the category of upper middle-income countries, Honduras and Nicaragua are considered lower middle income countries (The World Bank 2013b). However, as has been pointed out, the measure of income levels is not sufficient to understand the actual situation of human development in a country or region. Thus, a closer analysis of different indicators is required to understand the wealth of a country and its population.

As official data on an economy is usually calculated without estimates on the informal economy, it does not give an exact picture of the situation. This is especially so in developing countries where the informal economy generally accounts for a relatively high share of the Gross Domestic Product. The informal economy thereby includes all legal production of goods and services on the market that are on purpose hidden from authorities (Schneider / Buehn / Montenegro 2010: 444). Some of the characteristics of the official sector contribute to a larger informal economy such as the burdens of tax and social security payments or intensive regulations that reduce the freedom of choice (Schneider / Buehn / Montenegro 2010: 445). Furthermore, the attractiveness of

employment in the official sector depends to a large extent on the economic circumstances, the availability of good jobs and possibilities to earn an income. Consequently, estimations on the size of the informal economy not only depict a more accurate picture of actual economic activities, but also support the understanding of perceived and real economic opportunities in a country. Furthermore, it shows the relatively high under-employment in the region.

The graph below gives an overview of the estimated size of the informal economy as a percentage of the Gross Domestic Product in 2007. Due to the unavailability of data for 2007, the estimated figure for Panama is based on data for 2006. As can be seen, the shares of the informal economy are quite high for all countries in Central America, with the exception of Costa Rica. Panama has the highest share of informal economy with about 60 percent. El Salvador, Guatemala, Honduras and Nicaragua have respective values between 43 and 48 percent of GDP. Costa Rica has by far the lowest share of informal economic activity with 23 percent of GDP. This indicates that all countries in Central America, with the exception of Costa Rica, have very large levels of underutilized labor. In the case of increased exports and production caused by free trade agreements, these workers could be integrated in the formal sector as more employment opportunities arise.

*Figure 7: The Informal Economy as Estimated Percentage of the GDP in 2007*



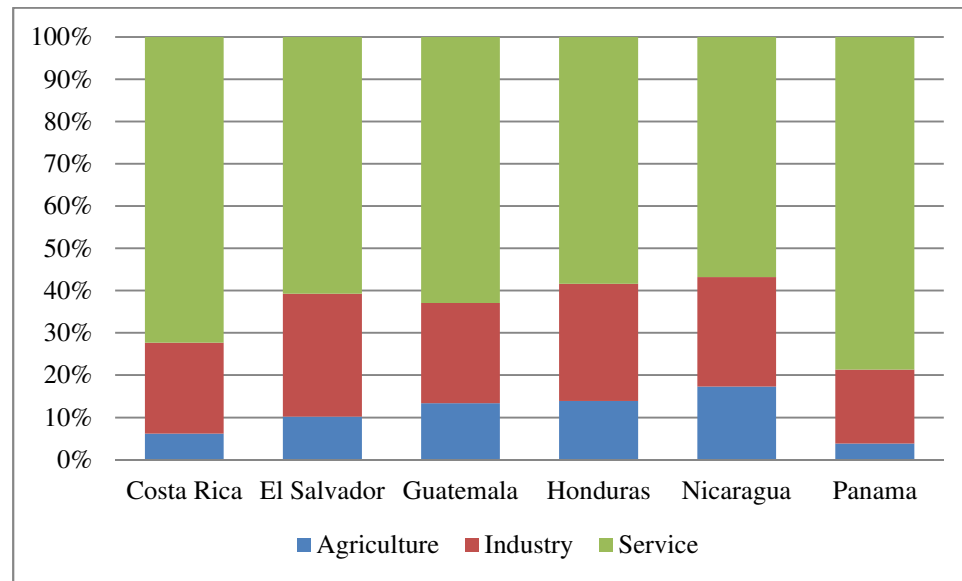
(Schneider / Buehn / Montenegro 2010: 454ff.)

The composition of the Gross Domestic Product in the graph below shows the share each sector contributed to national income in the Central American countries in 2012 (excluding the informal economy). It is an indication of the diversification of the economy within a country that was more closely described in chapter 2 and is often used to illustrate the level of industrial development. Thereby, a low share of the agricultural sector, a medium share of the industrial sector and a high share of the service sector is seen as preferable.

As can be seen, in all countries the share of the tertiary sector accounted for more than half of the generated income. The highest percentages of services were in Panama with 78.7 percent of GDP and in Costa Rica with 72.4 percent. El Salvador, Guatemala, Honduras and Nicaragua had respective values between 57 percent and 63 percent of GDP. The secondary sector or industrial activity was highest in El Salvador with 29.1 percent and in Honduras with 27.7 percent. In Nicaragua it accounted for 25.9 percent and in Guatemala for 23.7 percent of GDP. The lowest percentages were in Panama with 17.5 percent and in Costa Rica with 21.5 percent. Consequently, the agricultural or primary sector accounted for the lowest shares. Thereby Costa Rica and Panama showed very low shares of 6.2 percent and 3.8 percent of GDP respectively. El Salvador, Guatemala and Honduras accounted for 10.2 percent, 13.4 percent and 13.9 percent respectively. Nicaragua accrues 17.3 percent of its GDP in the agricultural sector.

Generally, Central America has specialized on non-traditional agricultural products and become competitive in products such as coffee, bananas and sugar (Rivera / Rojas-Romagosa 2007: 5). Additionally, it has started to foster maquila production of textiles for the export to other regions in the past few years (Rivera / Rojas-Romagosa 2007: 5). In the case of Costa Rica, the structural change that started in the 90s was enabled by the growth of Foreign Direct Investment (Monge-González et al. 2009, in Rivera / Rojas-Romagosa 2010: 13). It has since managed to diversify its production structure towards increased medium and high technology intensive goods. Nicaragua on the other hand produces a much larger share of agricultural or primary products. In comparison to Costa Rica, it is a much less diversified and dynamic economy and has low literacy rate and expenditure for education (Rivera / Rojas-Romagosa 2010: 14). This can help understand some of the differences in labor productivity and suggests that trade will have different effects on trade and poverty in these two countries.

*Figure 8: Composition of GDP by Sector in 2012, in percent of total*



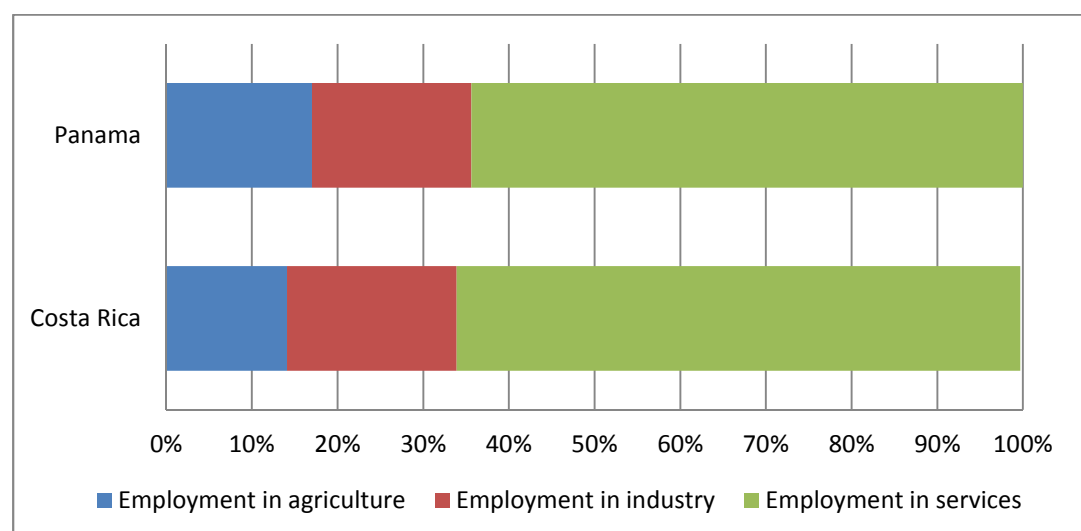
(CIA World Factbook 2012; own illustration)

Even though the distribution of the Gross Domestic Product by sector already gives a good understanding of the economy's composition, this does not necessarily mean that the labor force is evenly distributed across those sectors in relation to their respective shares. Thus, the following graph illustrates the structural composition of the labor force in 2011 for Panama and Costa Rica. Data for the other Central American Countries is not available. Despite the different years used as basis, the data can be put in relation due to the practically insignificantly low changes in the structural composition of GDP and labor force over the period of one year.

The graph below depicts the structural distribution of the labor force in Panama and Costa Rica. Due to the unavailability of data for the other countries in Central America, the below indicated percentages will be used as an approximate average of the region. However, as especially Costa Rica, and to a lesser extent Panama, is known to have a more diversified economy than the other countries in the region, it can be assumed that employment in agriculture is on average higher while employment in the industrial and service sectors is lower. As can be seen, in both countries the agricultural sector and production of primary products employs about 14 to 17 percent of the total labor force. Employment in the industrial sector and manufacturing is around 18 to 19 percent. The service sector employs around 64 to 66 percent of the total workforce in Costa Rica and

Panama. In comparison, in the European Union only 3 percent of the labor force work in the agricultural sector, while 24 percent work in industrial production and 72 percent in the services sector (World Bank Data).

*Figure 9: Structural Distribution of Labor Force in 2011, in percent of total*



(The World Bank 2013a; own illustration)

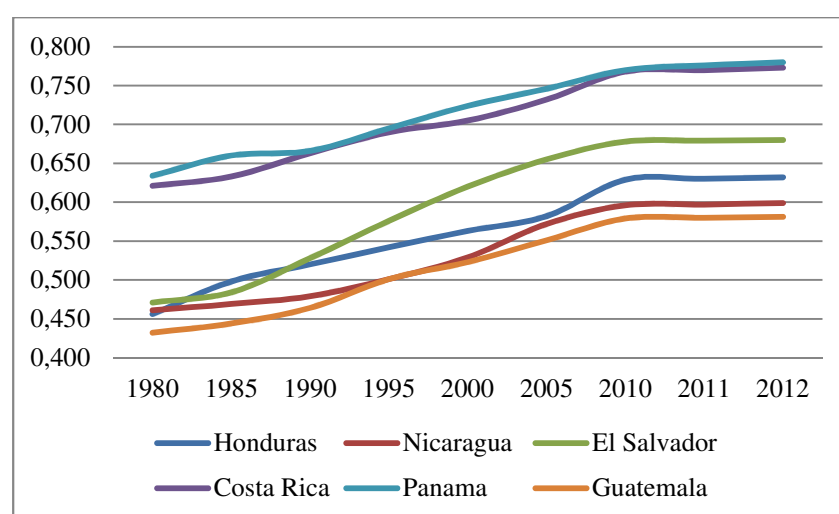
In relation to the accrued GDP in Panama about 17 percent of the total labor force is employed in the agricultural sector, while it only accounts for 3.8 percent of its GDP. In the industrial sector, 18.6 percent of the labor force contributes 17.5 percent of the GDP and in the service sector 64.4 percent of the labor force create 78.7 percent of GDP. This suggests that in Panama, employees in the agricultural sector earn relatively less than in the other sectors, while work in the service sector is the most productive. In Costa Rica, the 14.1 percent of the total labor force that works in agriculture accounts for 6.2 of its GDP. The 19.8 percent of the total labor force employed in the industrial sector contributes 21.5 percent of the GDP. In the service sector, 65.8 percent of the labor force creates 72.4 percent of GDP. This depicts a similar structural composition and relative productivity of the sectors as in the case of Panama. While labor is the most productive in the service sector, it gets the lowest incomes in the agricultural sector of the economy.

Following, several indicators measuring human development, inequality and poverty will be given to enable an insight into the social and economic realities of the population in Central America. Even though a throughout understanding of well-being and

development in a country or region does require a very detailed analysis of social and economic data, here the focus will be more of giving an overview. In this context, comprehensive indices and measures will be discussed to enable a more realistic view of the situation in the countries in Central America.

The Human Development Index (HDI) thereby is the most commonly used index to measure the average well-being of people in a country. It is “*a summary measure for assessing long-term progress in three basic dimensions of human development: a long and healthy life, access to knowledge and a decent standard of living*” (UNDP 2013b). Because the HDI is calculated as an average, it does not adequately show the inequality within a country and thus reflects a biased view in many countries. Therefore, the Inequality Adjusted HDI (IHDI) was developed to correct for uneven distributions and to give a true reflection of human development in a country (UNDP 2013c). To account for gender inequalities, the Gender Inequality Index (GII) calculates empowerment, reproductive health and economic activity and maps out “*the loss in human development due to inequality between female and male achievements in the three GII dimensions*” (UNDP 2013b). Due to the measurement of inequality and in contrast to the HDI and IHDI calculations, higher values stand for worse performance of a country in this case. The graph below gives an overview of the levels of human development measured by the human development index for the countries in Central America.

Figure 10: Human Development Index



(UNDP 2013b, own illustration)

Similarly to the differences in GDI per capita and the structural composition of the economy, even with regard to the HDI levels, Panama and Costa Rica show significantly higher values of human development. With 0.78 for Panama and 0.77 for Costa Rica, both are part of the group of countries with high human development and even exceed the average of 0.76 (UNDP 2013b). Both countries started in 1980 at already higher HDI levels than the current ones for Honduras, Nicaragua and Guatemala. However, the adjusted IHDI is only above the average of the high human development country group (0.60) in the case of Costa Rica that has a level of 0.61. The same is true for its GI index value of 0.35 that is not only below the group average of 0.38, but also by far the lowest (and best) level amongst all countries in Central America. Panama on the other hand lies with 0.59 for its IHDI below the average of 0.60. The difference between Panama's HDI and IHDI are a clear indication of relatively high inequality within the country. Despite its higher levels of income and human development, Panama's GII level shows the second worst level for the whole region, which is at 0.50 much above the group average of 0.38.

El Salvador, Honduras, Nicaragua and Guatemala fall into the group of countries with medium human development levels. The HDI level of El Salvador is with 0.68 above the group average of 0.64. Honduras, Nicaragua and Guatemala are all below the average of countries with medium human development levels with 0.63, 0.60 and 0.58 respectively. A closer analysis of IHDI values shows a similar picture. El Salvador is slightly above the average of 0.49 with a IHDI level of 0.50, while Honduras with 0.46, Nicaragua with 0.43 and Guatemala with 0.39 are below. The relatively high difference between the countries' HDI levels and respective IHDI levels indicate high inequality. The GII average for the countries with medium human development levels is at 0.46, which is right in between the values of the four countries in Central America. El Salvador fares better than the average with 0.44, while Nicaragua lies right at the average with 0.46. Both, Honduras and Guatemala have worse GII levels than the average, with 0.48 and 0.54 respectively.



*Table 3: Levels of Human Development in Central America*

	Panama	Costa Rica	El Salvador	Honduras	Nicaragua	Guatemala
Human Development Index	0.780	0.773	0.680	0.632	0.599	0.581
Inequality-Adjusted Human Development Index	0.588	0.606	0.499	0.458	0.434	0.389
Gender Inequality Index	0.503	0.346	0.441	0.483	0.461	0.539

(UNDP 2013b)

Generally, it can be said that not only income levels, but also levels of human development and gender equality vary quite drastically across the countries in Central America. Panama, even categorized as high income country, also has far better values in its human development indices than other Central American countries with the exception of Costa Rica. Interestingly, when accounted for inequality, Costa Rica shows the highest values of human development. This is a clear sign for higher equality in comparison to Panama. Also, its level of gender inequality is the best in the entire region. On the other side of the spectrum, Guatemala has the worst levels of human development and gender inequality even though it is classified as an upper middle-income country.

Another aspect that is highly relevant in relation to development is poverty. It is especially relevant to Central America's progress, as inequality and poverty are known to hinder economic and social development (Beteta 2012: 12). Poverty could be reduced in all countries in the region. Meanwhile, inequality declined in all countries but Costa Rica (Beteta 2012: 13). The Gini coefficient measures inequality and assigns a value of zero to a situation in which all people within a country or region have equal income. A value of one on the other hand stands for a situation in which one person gets all the income of a country while everyone else has nothing. The average Gini coefficient across the countries in Central America was at 0.49 in 2009 (Beteta 2012: 13, based on ECLAC Data). Despite the improvement in comparison to twenty years ago, this indicates quite a high level of inequality.

Due to the complexity of poverty and the many different ways to calculate it, there are several different indicators presented in this section. Multidimensional poverty thereby measures deprivations not only in income, but also in the aspects health, education and living standards (UNDP 2013b). Deprivations in each dimension thereby influence the overall level of poverty. It thus allows for a much more encompassing analysis of poverty than the wide-spread poverty line by the World Bank that is set at PPP \$1.25 a day and solely measures income poverty. Severe poverty is calculated as a deprivation score of more than 50 percent and vulnerability to poverty by a deprivation score between 20 and 30 percent (UNDP 2013b).

Unfortunately, the unavailability of data prevents a comparison across all countries in Central America. However, data from UNDP surveys on multidimensional poverty in Guatemala (in 2003), Honduras (in 2005/2006) and Nicaragua (in 2006/2007) is more closely depicted in the table below. The data on the share of population living below the income poverty line is retrieved from the World Development Indicators 2013 and available for all Central America countries. As can be seen in the table, the method of measurement of poverty strongly influences the share of people that are considered poor in a country. Income poverty measured by the poverty line of PPP \$1.25 a day thereby drastically underestimates the share of actually deprived people. Interestingly, the values for people living in severe poverty closely correspond to the percentages that fall below the income poverty line, with the exception of Honduras.

*Table 4: Levels of Poverty in Central America*

Country	Share of Population			
	multidimensional poverty	vulnerable to poverty	in severe poverty	below \$1.25 PPP a day
Guatemala	25.9%	9.8%	14.5%	13.5%
Nicaragua	28.0%	17.4%	11.2%	11.9%
Honduras	32.5%	22%	11.3%	17.9%
El Salvador				9.0%
Panama				6.6%
Costa Rica				3.1%

(UNDP 2013b; The World Bank 2013c)

In Guatemala, the share of people with multidimensional poverty is with 25.9 percent almost twice as large as for income poverty. The percentage of the population living with multidimensional poverty is also for Nicaragua much higher at 28 percent than with the measurement of income poverty. In Honduras, 32.5 percent of the population are considered poor under consideration of multidimensional poverty. The differences between the percentages of people experiencing multidimensional poverty and income poverty imply that even people that live above the income poverty line are likely to be deprived in the three measured dimensions of education, health and living standards. Taking into account the share of population that is vulnerable to poverty, the percentage of deprived people within the three countries is remarkably high. This suggests that a lot still needs to be done to foster development processes and achieve growth that are equally distributed across the population. Regional integration is, as was in more detail described in chapter 2.3.3 of this thesis, often seen as a way to foster coherence across countries and support development. The next section 4.2 will therefore take a closer look at efforts of regional integration in Central America.

#### **4.1.2 Macroeconomic Indicators**

The negotiations for an Association Agreement with the European Union are preceded by active attempts of attracting foreign capital, increasing their global market position and expanding production and exports. This economic strategy is targeted at bringing economic growth and should consequently reduce poverty, bring development and uplift the wellbeing of the Central American population. Thereby, the already high openness of the Central American countries has to be pointed out (Tondl 2008: 19). This is a result of *“[t]rade policy reforms [that] have included the unilateral reduction of tariffs, an increase in intra-regional trade [...] and the negotiation of free trade agreements (FTAs)”* in the past twenty years (Rivera / Rojas-Romagosa 2007: 5). In general, the average tariffs are very low - with the exception of few sensitive products such as agro-industrial goods, processed rice, sugar, dairy products and poultry - and non-tariff barriers to trade were also significantly reduced (Rivera / Rojas-Romagosa 2007: 7).

Exports rates vary across the six economies with Panama reaching a record-high of exports at 81 percent of GDP. Guatemala and El Salvador are the least open economies in the region. Furthermore, all countries in Central America have a trade deficit, meaning they import more from abroad than they export. These percentages are exceptionally high

for Honduras with 21 percent, and Nicaragua and El Salvador, both with 19 percent of GDP. Inflows of Foreign Direct Investment in percentage of GDP are very high in some of the Central American countries with 12 percent for Panama, 10 percent for Nicaragua, six percent for Honduras and 5 percent for Costa Rica. Guatemala and El Salvador have lower values with one percent and two percent respectively.

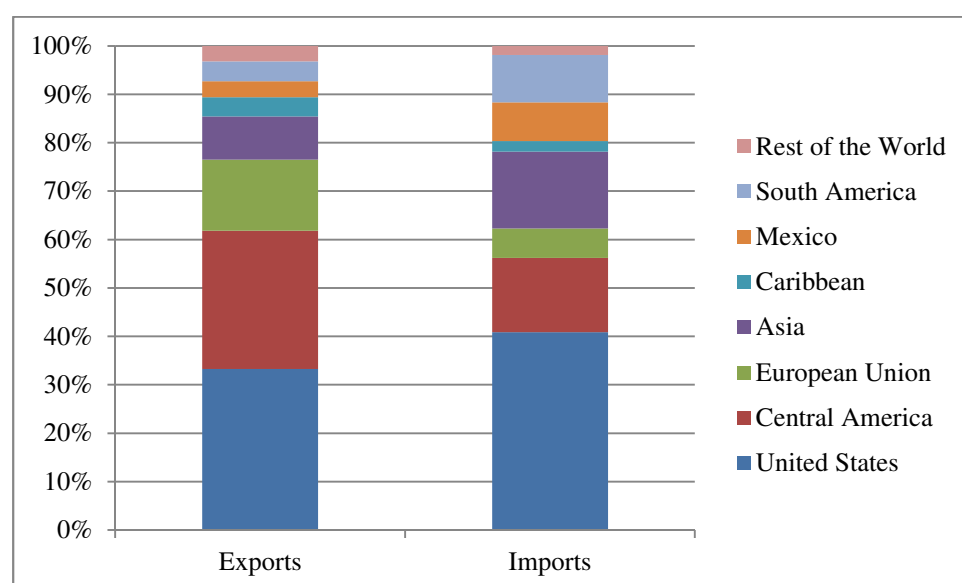
*Table 5: The Importance of Trade and Investment in 2011, in percent of GDP*

	Exports	Trade Balance	Foreign Direct Investment
Costa Rica	37	-5	5
El Salvador	28	-19	1
Guatemala	27	-11	2
Honduras	48	-21	6
Nicaragua	41	-19	10
Panama	81	-3	12

(The World Bank 2013c; own calculations)

Central America's main trade partners are listed in the graph below, with relation to their share of trade. The data does not include assembly manufacture and uses as a basis the Central American Common Market, exclusive of Panama. As can be seen, the United States are by far the largest trade partner, accounting for 40.9 percent of all imports and 33.3 percent of exports. Intra-regional trade is following with almost 28.5 percent for exports and 15.3 percent of imports. The different percentage of exports and imports thereby comes from the region's trade deficit. The European Union is the third most important trading partner for Central America to which it exports 14.7 percent of its total exports and from which it imports 6.1 percent of its imports. Interestingly, it is the only significant trade partner with whom Central America has a trade surplus.

Figure 11: Main Trade Partners in 2012, in percent of total



(SIECA 2013; own illustration)

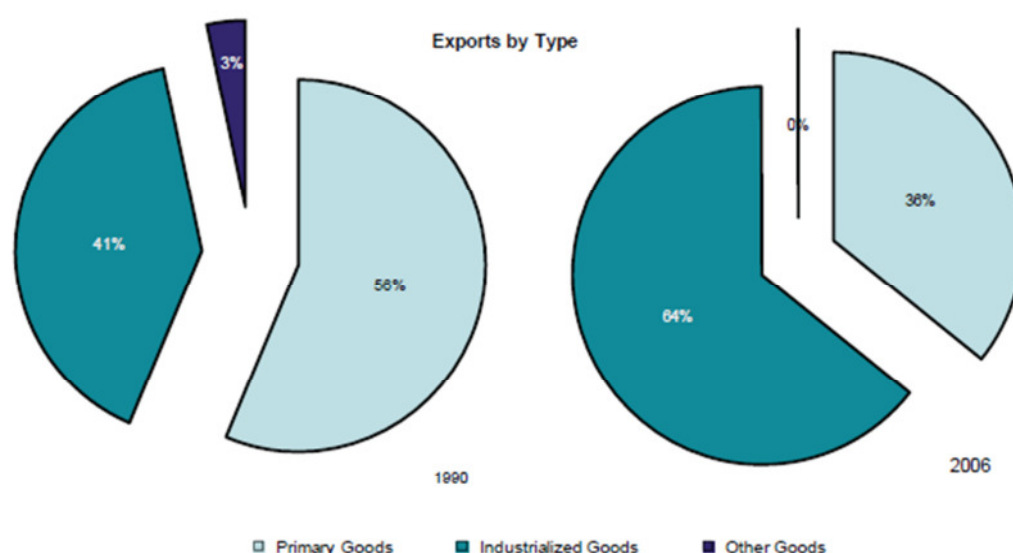
There are large differences in the export structure of the countries in Central America, which are not reflected in these total numbers. In particular, El Salvador and Guatemala export more than 30 percent to other countries in the region, while Nicaragua exports much to the United States (Beteta 2012: 6f.). In total, trade in 2012 amounted to \$ 86.6 billion (SIECA 2013). Central America's imports valued \$ 57 billion while exports came to \$ 29.6 billion, leaving the region with a significant trade deficit of \$ 27.3 billion. Despite stability of prices and a very low public deficit over the past two decades, Central America has increasing foreign debt. This is a result of the high volume of imports that have resulted in persistent trade deficits. Additionally, "*low domestic demand, heavy dependence on US consumers, and reliance on imported food and energy*" lead to the high dependency of Central American economies on foreign capital and make them extremely vulnerable to economic shocks (Beteta 2012: 14).

Despite rising shares of the European Union, Asia and South America, Central America has not been too successful in diversifying its trade partners and consequently mitigating the dominance of the United States since the 90s (Beteta 2012: 6). However, it did manage to change its production structure and subsequently the composition of its exports as can be seen in the graph below. At the beginning of the 90s 56 percent of Central America's exports consisted of primary products and agricultural goods, reflecting a

typical pattern of trade between developing and developed countries. However, “*the subregion has successfully overcome the agro-export model of the past and has made the transition to an export structure dominated by manufactured goods*” (Beteta 2012: 7). This is also reflected in the ten most exported products to the United States that included seven manufactured goods in 2007, which stands in stark contrast to the two industrial products that were in this list in 1990 (Beteta 2012: 6). In 2006, 64 percent of exports were industrial goods and the share of agricultural exports had declined to 36 percent. However, the structure of exports varies greatly across the Central American countries. Costa Rica’s trade structure is characterized by “*a higher level of technological sophistication*” that was introduced through structural changes in production resulting from increased Foreign Direct Investment inflows in the 90s (Rivera / Rojas-Romagosa 2010: 13). In contrast, especially Nicaragua exports mainly primary goods and goods based on natural resources. Nicaragua has not experienced significant changes in its trade structure in the past twenty years which is still characterized by low technology intensive goods (Rivera / Rojas-Romagosa 2010: 13f.).

A more detailed composition of the Central American export structure with the European Union will be analyzed at a later point in this thesis.

*Figure 12: Change in Export Structure, in percent of total*



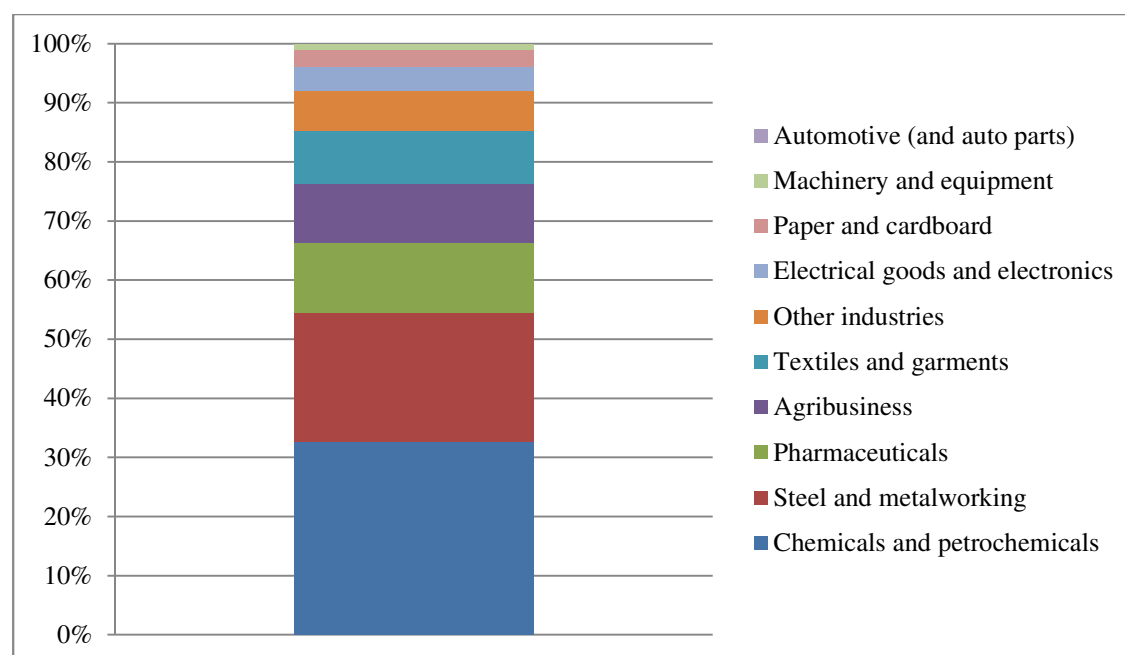
(ECLAC 2008, in Beteta 2012: 7)

An overview of the region's position in global value chains helps to better understand the role production networks play in regard to exports from Central America. Especially Costa Rica is strongly involved in the production network for the United States. Of its exports in intermediate goods to the United States from 2010 to 2011, about 98 percent could be attributed to only seven industries that are all part of a value chain (ECLAC 2013b: 17). Out of these industries electrical goods, medical equipment and chemicals represented the largest share. In these industries, the high relevance of intra-industry trade and their potential for indirect and direct job creation has to be lined out (ECLAC 2013b: 18). In Costa Rica, Honduras and Salvador the textile spinning and garment production for North America is part of a production network. *“This trade relationship provides these countries with a source of foreign exchange and jobs but creates little value added and leaves them greatly dependent on imported inputs from the United States”* (ECLAC 2013b: 18). The Asian and North American multinational corporations that are involved in these value chains generally outsource the production for the North American markets to Central America due to its low labor costs and close geographical proximity. Generally, it can be said that Central American countries *“are full and active participants in various value chains focused on the United States, both in goods (in the automotive, electronics and garment sectors, among others) and in services (call centres, information and communications technologies and other cross-border services)”* (ECLAC 2013b: 19).

In the Central American Common Market, Costa Rica, El Salvador, Honduras and Guatemala participate in regional value chains and production networks. Nicaragua in contrast has mostly inter-industry trade relations with the other countries in Central America (ECLAC 2013b: 18). The graph below provides an overview of the main industries in intra-regional trade. Intra-regional trade patterns can support a throughout understanding of the opportunities of increased regional integration and as well help to explain its effects. The most important industries in the regional value chains are thereby chemicals and petrochemicals with 33 percent of intra-regional trade and steel and metalworking with 22 percent of intra-regional trade. These two industries support several regional sectors such as plastics in the first case and aluminum products in the second (ECLAC 2013b: 18). Of the produced intermediate products many are used for end-use sectors. Consequently, the products made in the two regional production networks are *“linked to infrastructure and housing projects, which in turn create jobs and*

*act as a driving force in the economy*” (ECLAC 2013b: 18). In total, chemicals and petrochemicals and steel and metalworking account for 55 percent of all intra-regional trade in intermediate products. Pharmaceuticals such as medicinal products or serums make up 12 percent of intra-regional trade and Agribusiness accounts for 10 percent. Interestingly, the percentages of intra-regional trade in electrical goods and in machinery and equipment are very low even though they are important in inter-regional trade.

*Figure 13: Central American Common Market Industries, in percent*



(ECLAC 2013b: 19; own illustration)

### ***4.1.3 External Sources of Finance***

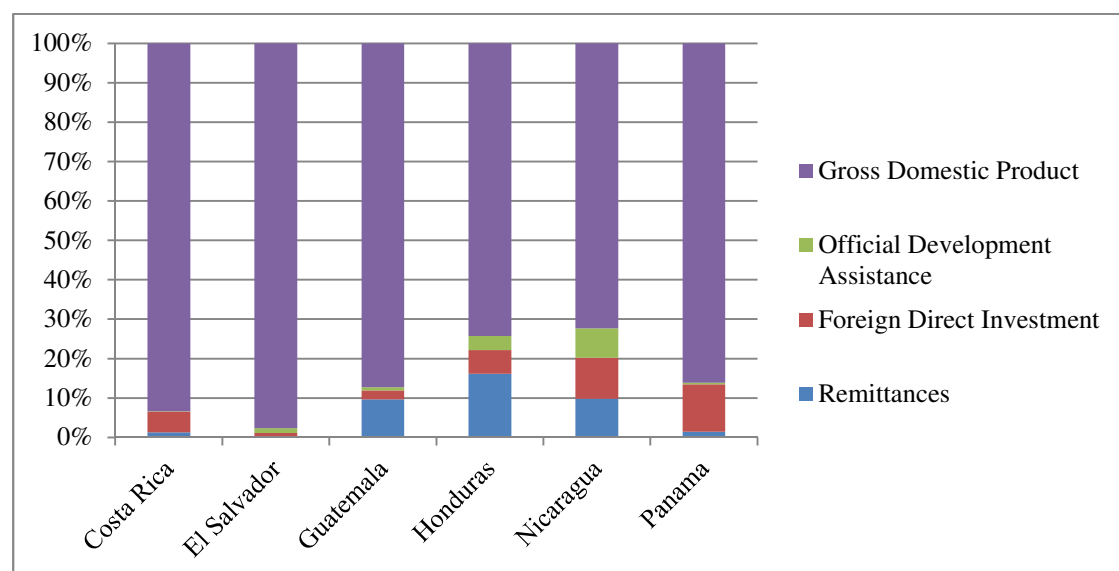
In Central America, the reliance on external sources of finance is generally very high while savings are low (Beteta 2012: 10). Domestic savings reached their peak in 2006 at almost 18 percent of GDP, but experienced decline due to the financial and economic crisis (Beteta 2012: 10). In 2010, the savings rate was just above 14 percent of GDP (Beteta 2012: 10). In contrast to this, investment has on average been at much higher levels. As Beteta (2012: 10) lines out, “[g]iven the gap between investment and savings, which has averaged around 5 percent of GDP over the past two decades, it is clear that Central America relies heavily on foreign investment to finance economic growth”. Consequently, Central America is very vulnerable to global economic influences. On the



other hand, in particular foreign direct investment can finance the diversification of production and support an increase in exports, as was the case in Costa Rica and Panama (Beteta 2012: 11). Due to its proclaimed high potential to further economic growth, Central American governments have created tax incentives to attract foreign capital. However, in some cases these incentives have outweighed the benefits of the investments it attracted. Foreign direct investments and its specific characteristics in the Central American context will be analyzed later in this chapter.

The graph below shows the percentages of remittances, official development assistance and foreign direct investment in 2011 in relation to the Gross Domestic Product of the respective country. Within Central America, especially Honduras, Guatemala and Nicaragua receive quite substantial proportions of their respective Gross Domestic Product as remittances from migrants abroad. Net inflows of official development assistance are mostly relevant for Nicaragua and Honduras; meanwhile the importance of Foreign Direct Investment is particularly relevant for Panama, Nicaragua, Costa Rica and Honduras. It becomes obvious that especially Nicaragua and Honduras are highly dependent on external sources of finance as both have net financial inflows of foreign capital that exceed 25 percent.

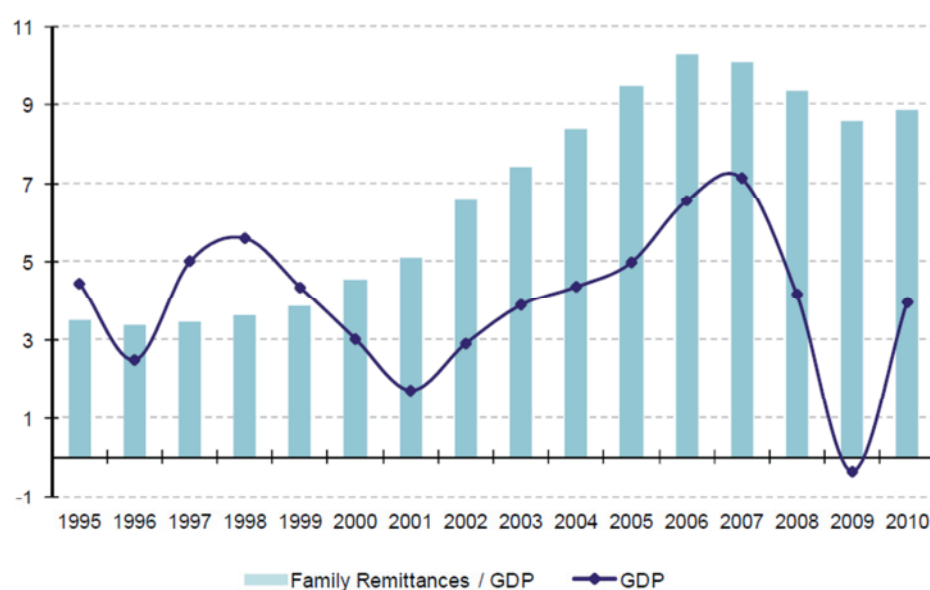
*Figure 14: Net Financial Inflows in percent of GDP in 2011*



(The World Bank 2013c; own illustration)

Furthermore, the region remains highly dependent on remittances of migrants in the United States (European Commission 2010: 4). As can be seen in the graph below that shows remittance flows to Central America and GDP growth, this source of finance is particularly vulnerable to economic circumstances. The data sample includes the Dominican Republic. Despite their importance and potential to spurn economic growth, remittances are usually unevenly distributed across a society. Consequently, they often have only limited potential to bring even economic growth and development in a country. In Central America, the remittance levels and their relative importance in percentage of GDP have drastically increased since 2000. In 2006, inflows of remittances to the Central American countries reached a peak of over 10 percent of GDP. After declining and falling below 9 percent due to the financial and economic crisis and its aftereffects, it has slowly recovered since 2009.

*Figure 15: Remittances as percentage of GDP and GDP Growth*



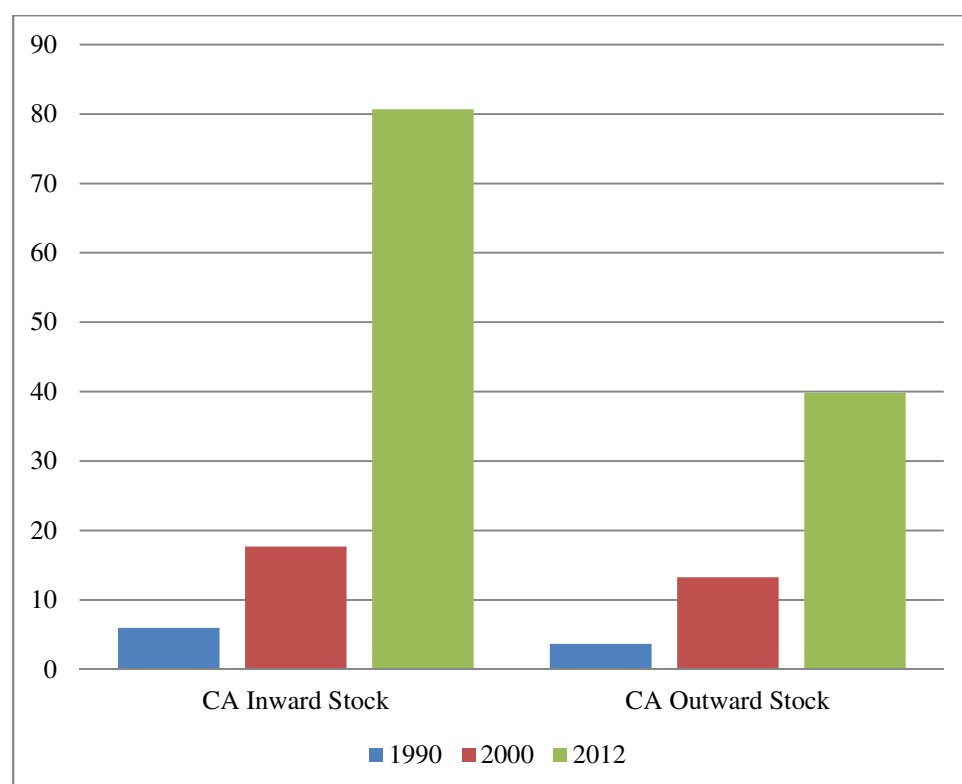
(ECLAC Data, in Beteta 2012: 17)

Next to remittances, another important source of foreign capital that has vastly gained in importance is foreign direct investment. The graph below shows the strong growth that stocks of foreign direct investment have experienced over the past two decades. While the inward stock, meaning direct investments in Central America from foreign investors has risen from \$ 5.98 billion in 1990 to \$ 17.68 billion in 2000, it has reached a record high of \$ 80.66 billion in 2012. In the same time period, the outward stock of foreign direct

investment has grown considerably too. It has risen from a value of \$ 3.69 billion in 1990 to \$ 13.26 billion in 2000 and to \$ 39.84 billion in 2012. This data includes Belize.

In the past twenty years, there was *“not only a wave of FDI inflows but also a considerable increase in the number of investment treaties at bilateral level as well as at regional level”* (Grazzi / Mori 2008: 271). In the Central American Common Market, it was agreed upon a Treaty on Investment and Services that would be based on the investment regulation in the Free Trade Agreement CAFTA-DR with the United States (Grazzi / Mori 2008: 287). Thereby, the rise in Foreign Direct Investment inflows over the past twenty years was largely a result of a strategy of diversification and export promotion. Central American countries have implemented trade reforms and *“have been actively attracting Foreign Direct Investment (FDI) and pursuing competitiveness reforms to strengthen their integration with global markets”* in order to tackle some of its problems by fostering economic growth, reducing poverty and increasing the living standards of its population (Rivera / Rojas-Romagosa 2010: 7).

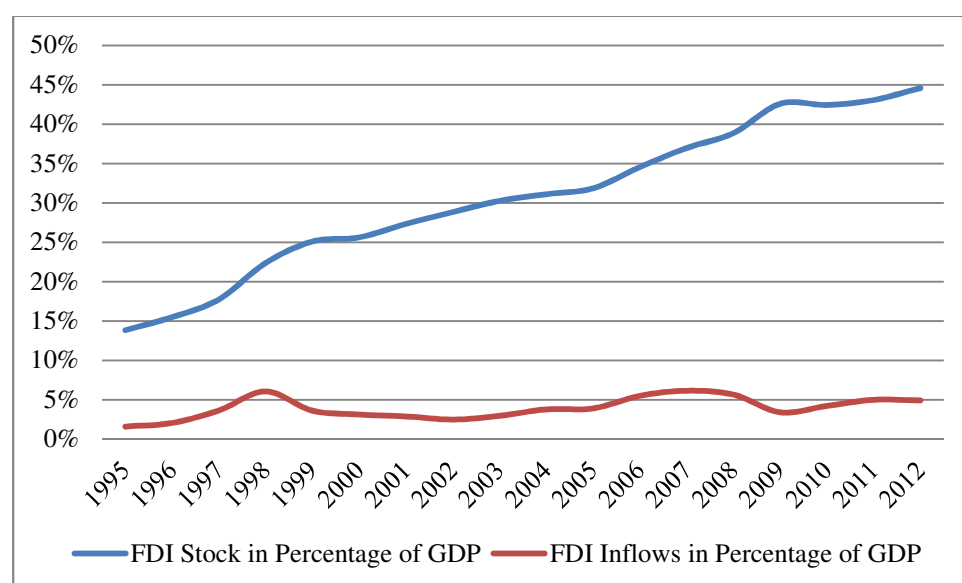
*Figure 16: The Growth of FDI Stocks, in \$ billion*



(UNCTAD 2013d: 219; own calculation and illustration)

Figure 17 shows the growth in the stock of foreign direct investment in percent of GDP. While it accounted for 14 percent of GDP in 1995, by the year 2000 it had risen to 26 percent and by 2005 to 32 percent. After the financial crisis it has seen a minimal relative decline after 2009, but started to recover since. In 2012, the stock of foreign direct investment in Central America has reached a record high of 45 percent of GDP. The inflow of foreign direct investment has been fairly constant at 2 to 4 percent of GDP until 2006, with the exception of 1998 where it reached a share of 6 percent of GDP. From 2006 until the financial and economic crisis, the inflows of foreign direct investment reached 6 percent of the GDP. In 2009, the inflow slowed down and has started recovering again since. For the past three years it has been around 5 percent of GDP. This is particularly interesting as the GDP in the region rose from an initial value of about \$ 132 billion in 2009 to a \$ 181 billion in 2012. The share of foreign direct investments of the GDP thus corresponds to actual rising inflows. This will be illustrated in more detail in the following graph.

*Figure 17: Inflows and Stock of FDI in percent of GDP*

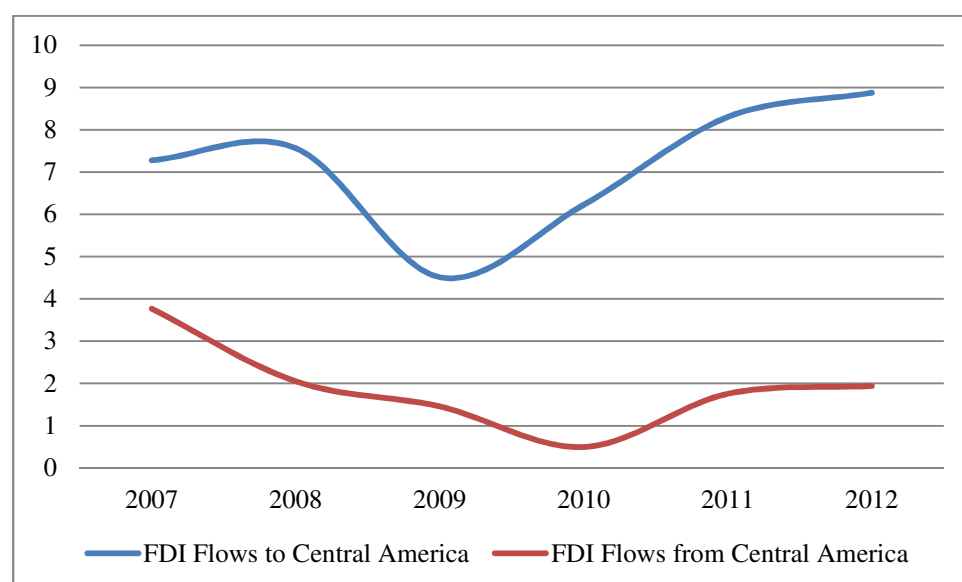


(UNCTAD 2013a, UNCTAD 2013b; own illustration)

Reflecting the growing stock of foreign direct investment in Central America, the inward flows have been positive as illustrated in the graph below for the past few years. Due to the economic and financial crisis, the inflow of foreign direct investment to Central America has slowed down in 2009, but since that started to recover again. The value for

2012 with \$ 8.88 billion of investments is a record high. The outflows of foreign direct investment are at a much lower level than the inflows and were at \$ 1.94 billion in 2012. Similarly to the inflows, the outflows have slowed down in recent years and only began recovering after reaching a negative value of minus \$ 498 million in 2010.

*Figure 18: Total FDI Flows in Central America, in \$ billion*



(UNCTAD 2013d: 215; own calculation and illustration)

Below, the composition of inflows of foreign direct investment in Central America by the ten most important countries and regions of origin is given. Similarly to trade partners, the United States represents the most important investor in the region. In 2011 about 33 percent of all foreign direct investment flows to Central America came from there. The European Union takes the second position with 21 percent of total inflows into the region. Latin America, excluding the Central American countries, invested 15 percent of all inflows out of which Mexico accounts for 8 percent and Colombia for 4 percent. Foreign direct investments by countries within the region were responsible for 9 percent of total inflows. The Caribbean Islands, Asia and Switzerland played minor roles with respectively 7 percent, 6 percent and 5 percent of total foreign direct investment inflows. Finally, Canada accounted for only 2 percent of total inflows to the region. Data for Nicaragua was not available and the country is thus not included in the calculation.

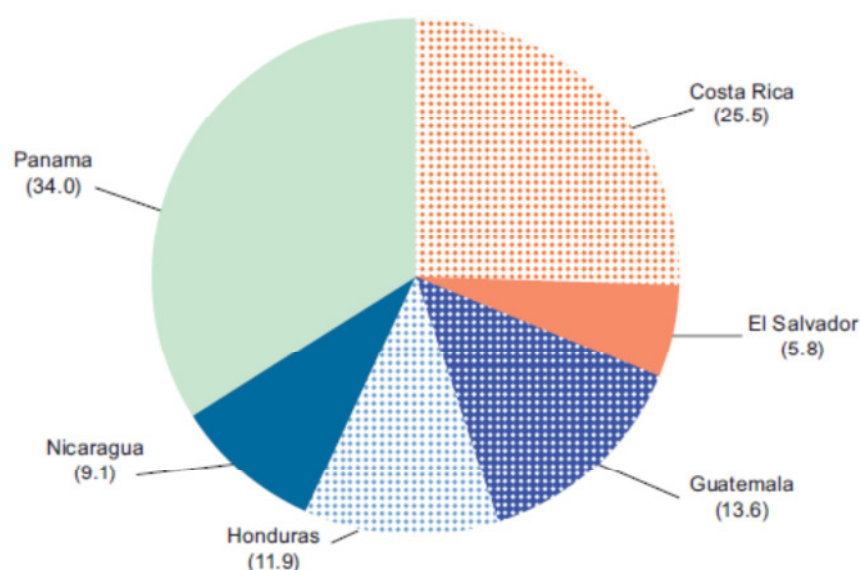
*Table 6: FDI Inward Stock in percentage of total stock in 2011*

	in percentage of total stock
United States	33%
European Union	21%
Intra-Regional	9%
Mexico	8%
Caribbean Islands	7%
Asia	6%
Switzerland	5%
Colombia	4%
Rest of South America	3%
Canada	2%

(IMF 2013; own calculation)

The inflows of foreign direct investment in 2012 went to a large extent to Panama and Costa Rica with 34 percent and 25.5 percent respectively. This reflects the relatively higher attractiveness for investments of these two countries in relation to the other Central American countries, which can in part be explained by the more diversified production structure and more profitable business opportunities available there. Guatemala has received 13.6 percent of foreign direct investment inflows, while Honduras and Nicaragua got 11.9 percent and 9.1 percent respectively. El Salvador received the lowest share of foreign direct investment inflows in 2012 with 5.8 percent.

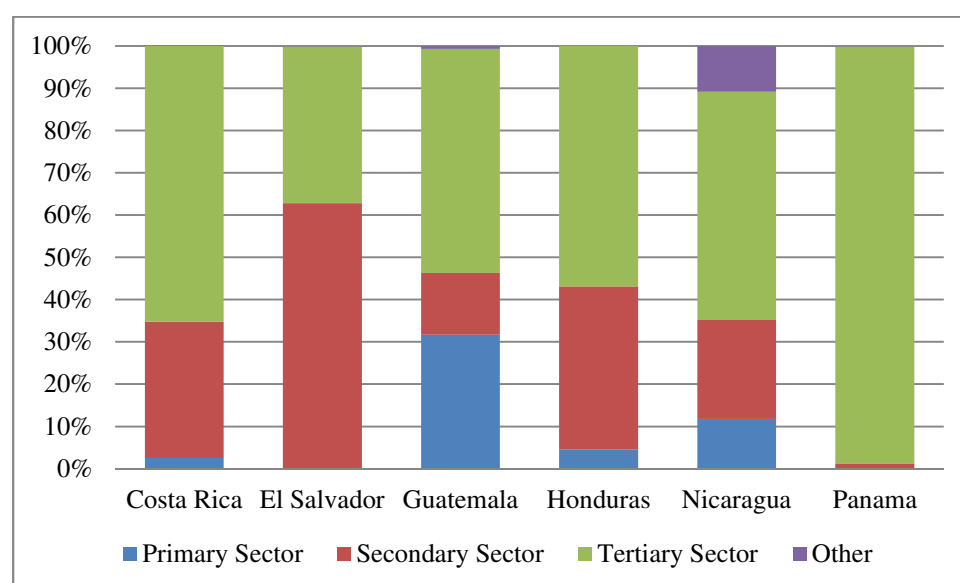
*Figure 19: Distribution of FDI Inflows by Recipient Country in 2012*



(ECLAC 2013a: 32)

Below, the distribution of foreign direct investment inflows by sector in percent for the Central American countries is outlined. It gives an approximate indication for the perceived attractiveness and profitability of business in the different sectors by international investors. As can be seen, with the exception of El Salvador, the majority of investments were made in the tertiary or service sector. While in Costa Rica and Honduras below than 5 percent of foreign direct investments were made in the agricultural or primary sector, about 30 percent in Costa Rica and 40 percent in Honduras went to the industrial or secondary sector and the remaining 65 percent and respectively 55 percent constituted of investments in the tertiary sector. El Salvador received more than 60 percent of its foreign direct investments in the industrial sector and the remaining proportion to its service sector. In Guatemala a large share of about 30 percent of investments was used in the primary or agricultural sector, and about 10 percent in the secondary and 50 percent in the tertiary sector respectively. Nicaragua received more than 10 percent of its inflows of foreign direct investment in the primary sector, about 20 percent in the secondary sector and more than 50 percent in its tertiary sector. Additionally, about 10 percent of its foreign direct investment inflows went to other businesses outside these sectors. In the case of Panama, foreign direct investments went almost exclusively into the service sector.

Figure 20: Distribution of FDI Inflows by Sector in 2011

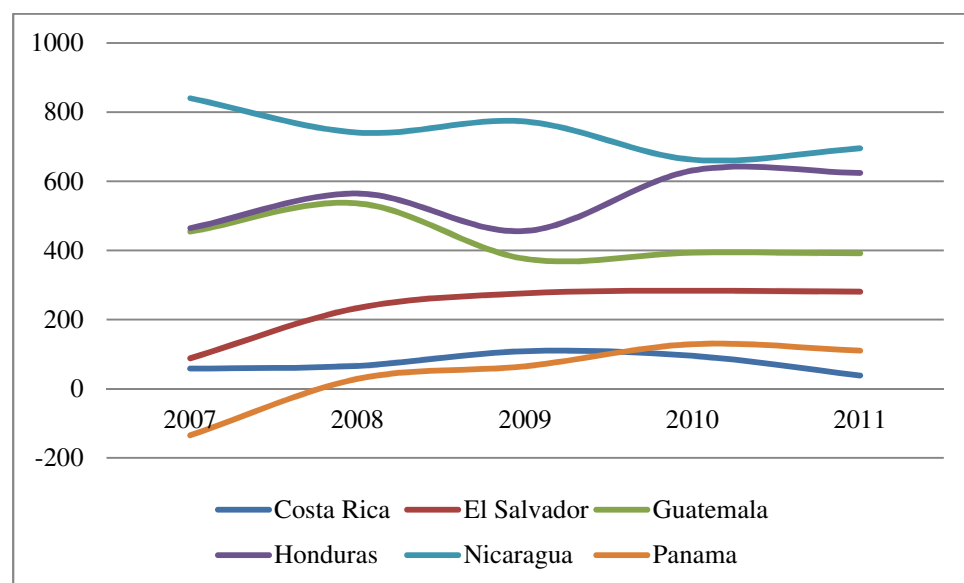


(ECLAC 2012: 51f.; own illustration)

The Central American countries received a total of \$ 2.14 billion of official development assistance in 2011. Partly corresponding to its levels of economic development, Nicaragua and Honduras thereby received the largest share, with \$ 695 million and \$ 624 million respectively. In the same year, Guatemala received a total amount of \$ 391 million of foreign aid and El Salvador \$ 281 million. As the two wealthiest countries in the region, Panama and Costa Rica received much less with \$ 110 million and \$ 38 million correspondingly. As can be seen in the graph below, the flows of official development assistance have grown for Honduras, El Salvador and Panama since 2007. In the case of Panama the negative values in 2007 can be explained due to loan repayments. Nicaragua and Guatemala have experienced falling inflows of aid in the same time period. Meanwhile, the official development assistance to Costa Rica has experienced a slight decline too, but was already at very low levels in 2007. In total, ODA to Central America amounted to \$ 1.7 billion in 2007 and rose to \$ 2.5 billion in 2008. In 2009, probably caused by the effects of the economic and financial crisis, the aid flow to the region declined to \$ 2.1 billion. Since then it has slightly recovered and remained at around \$ 2.2 billion.



*Figure 21: Official Development Assistance by Recipient, in \$ millions*



(OECD 2013; own illustration)

## 4.2 Regional Integration Processes

Central America had been a united colony, named the Kingdom of Guatemala, during the Spanish colonial rule (Abrahamson 2008: 3). After independence in 1821, the conservative leaders of Guatemala (Central America) sought annexation to Mexico. Less than two years later liberal leaders came to power in Mexico. With the foundation of a republic in Mexico came the acknowledgement of sovereignty for Central America. This led to the foundation of the Federation of Central America as an independent and free nation (Abrahamson 2008: 4). It included Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica and from the 1830s on Los Altos (parts of today's Guatemala and Mexico). Liberal politicians in the region had high aspirations for the republic and hoped it would become a modern, democratic state with flourishing trade after the model of the United States of America. However, in 1838 a civil war broke out and the Federation of Central America broke up, giving rise to conservative political elites continuing to dominate the region (Abrahamson 2008: 4). In the course of the 19th century, several more attempts at regional integration were unsuccessful and lasted for a maximum of two years.

In the 20th century, regional integration in Central America was in line with the global waves of regionalism. Within the first wave of closed regionalism, it was *“striving to create a customs union that would not only promote the development of the region, but also help industrialize it, by protecting key sectors from external competition, eventually generating an increase in intra-regional trade and the creation of an industrial base in the region”* (Aguilar Castillo 2008: 15). The second wave of open regionalism in Central America was characterized by regional integration accompanied by integration into the world economy. The understanding of regional integration thereby is that *“at the same time [...] regional cooperation in the political and security arenas would help with its [Central America's] pacification and democratization”* (Aguilar Castillo 2008: 15). The specific projects of integration that came along with these waves will be more closely described in the following paragraphs.

In 1960, another attempt at regional integration was the foundation of the Central American Common Market (CACM) by the countries El Salvador, Guatemala, Honduras, Nicaragua and Costa Rica that joined two years later (Abrahamson 2008: 4). The signing

of the General Treaty on Central American Integration provided the basis for the establishment of a customs union and a common market and thus for increased integration in the region. Even though the Central American Common Market was an economic success, regional integration stopped in the 70s and 80s due to the ‘football war’ between Honduras and El Salvador and civil conflicts in the region (Abrahamson 2008: 4). It was only in the 90s that attempts at regional integration were reintroduced.

Despite the several previous unsuccessful attempts of economic and political integration in the region, in the 90s it took on new forms. The signing of the Tegucigalpa Protocol by Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama in 1991 (Belize joined in 2000) led to the creation of the Central American Integration System (SICA) (Corley 2009: 27). In the process of this, the General Treaty on Central American Economic Integration was amended into the Guantánamo Protocol that was signed by all SICA members in 1993 (Abrahamson 2008: 4). As Tondl (2008: 22) points out, trade was liberalized in all sectors with the exception of sugar cane, coffee, alcohol and petroleum. With the attempts at reviving economic integration came a form of open regionalism with a focus on export-led growth, trade liberalization, reduction of internal barriers and improvement of investment conditions/opening up to Foreign Direct Investment Flows. Regional integration was mostly focused on deepening the free trade zone and setting up a customs union (Beteta 2012: 5). Additionally to the processes of increased economic integration, in the last decades several important regional institutions were founded such as the Central American Parliament, the Central American Information System, the Secretariat for Central American Social Integration and the re-activation of the Central American Court of Justice that was initially founded at the beginning of the 20<sup>th</sup> century (Abrahamson 2008: 4).

Even though attempts at regional integration have vastly increased in the last twenty years and inter-regional trade levels have slowly raised, the results of these processes are mixed. Aguilar-Castillo (2008: 19) points out that “*[regional integration in Central America] has never fully accomplished all the goals proposed, and the countries have always had difficulties agreeing on the institutions and sectors that should be included in a regional framework, or the procedures and the pace at which regionalism should be implemented*”. This has led to several problems and in part explains the outcomes of regional integration in Central America in the past. Additionally to disagreements about

the envisioned model of integration in the region and the complexity of this process, there is no common identity as of now. Consequently, the integration has proceeded very slowly; meanwhile diverging interests have provided for more obstacles.

Another important hindrance for deepened integration is posed by the vast differences in socio-economic characteristics. As was outlined in more detail in the previous chapter 4.1.1, Costa Rica and Panama have higher levels of human development and their social and economic indicators in general share fewer similarities with the other countries in the region. As a consequence of this, Costa Rica has been hesitant to proceed too fast with regional integration and has refused to integrate more deeply (Aguilar Castillo 2009: 21). Due to its economic structure and its relatively higher strength in exporting, it could benefit more from market access to developed countries than from increased regional integration. On the other hand, Guatemala, El Salvador, Honduras and Nicaragua favor deeper regional integration. This became obvious in the formation of the Centroamérica-4 (CA-4) group that aims for deep integration at the political, social and economic level (Aguilar Castillo 2009: 21). There are several agreements on issues such as on economic development, tourism or the free movement of people in place.

The slow proceeding of regional integration in Central America is partly also being attributed to the low levels of intra-regional trade. In the early years of the CACM, intra-regional exports actually reduced and only after some time started rising again (Coulibaly 2007: 8). However, this could also have been an effect of the political tensions between some member countries in the 60s. Trade with other regions of the world and in particular exports to countries that are not members of CACM are estimated to have decreased due to the common market (Coulibaly 2007: 8). Furthermore, insufficient macroeconomic coordination such as the lack of a common trade policy or of customs administration contribute to the slow progress and the lack of compensatory policies to balance negative effects of regional integration. As Rueda-Junquera (2007, in Abrahamson 2008: 5) points out, in the case of Central American integration, *“the lack of these [compensatory] policies in the CACM has accounted for most of its limitations”*. Also, it has likely led to the relatively deliberate macroeconomic convergence of the economies that are members of the Common Market (Abrahamson 2008: 6).

Nowadays, there are still numerous challenges for regional integration posed by limitations of the Central American Integration System (SICA) As Rueda-Junquera

(2007, in Abrahamson 2008: 6) points out, “*the prospect that the potentially positive effect for the new CACM materializes in practices is very grim. As for the compensatory policies, these are practically non-existent in the CACM despite the presence of important intraregional asymmetries*”. This is due to several reasons that limit the theoretical potential of regional integration: Firstly, the ratification of signed agreements is lack of compulsory deadlines. Secondly, the decision-making power with presidents of the member states is concentrated and institutional anchors are missing. Thirdly, the member countries are not able to effectively lead the regional integration process. Fourthly, the legitimacy in civil society has declined due to member countries failures to comply with commitments given at presidential summits. Lastly, the complexity of the regional institutions is said to be too high and representing overly motivated aims.

These ambiguous effects of the CACM bring up the question as to why regional integration in this form is sought for by Central America. In general, the Central American integration process is likely to bring mixed results even in the future. Analyzing interest groups in Central America and international systemic factors can give a better explanation of motives and reasons for regional integration. Aguilar-Castillo (2009: 20) argues that the main interests groups in Central America that influence regional integration processes are historically powerful elites, newly emerged rich entrepreneurs and groups linked to the military. Those groups have gained respectable economic power and are consequently able to pressure governments and influence them in their interest. “[T]hese elite groups have ties with each other along the region, both in and out of national state boundaries, forming strategic alliances not only among themselves, but with important transnational capital present in the region” (Aguilar-Castillo 2009: 20, based on Segovia 2007). As such, they foster regional integration in Central America to serve their interests of economic expansion that is achieved much more easily within a larger common market.

However, another perspective on regional integration leaves aside the power hierarchies and subsequent interests within Central America and focuses on the political and economic role the region plays in the global world order. In this context Corley (2009: 28) describes the latest integration project in Central America as a reaction to globalization pressures that led the region to implement policies increasing the competitiveness and flexibility to act in the world economy. “*The wish to strengthen its*

*own political identity, to define its own strategy independently of the political ambitions of [...] the US [...] and international institutions”* (Tondl 2008: 21f.) serves as key motivation for increased regional integration.

The next chapter 5 describes the economic and political relations between Central America and the European Union, together with the macro-economic context of trade and investments between the two regions.

## 5 European Union and Central American Inter-Regionalism

Inter-regionalism is a rather new phenomenon that describes strategic relations between two regions instead of individual countries. The agreement between the European Union and Central America is the first inter-regional agreement to date and takes on a form which lies somewhere between a pure interregional agreement linking two customs unions or free trade areas and a hybrid interregional agreement with only one part being a customs union or free trade area (Aggarwal / Fogarty 2004: 5). In the Association Agreement the European Union is a customs union with joint institutions that was negotiating as one regional block while Central America spoke with one voice too while including most countries that are part of the customs union SICA. Thereby, *“the bi-regional relation presents a fundamental imbalance. Whereas the advance in the political dialogue and cooperation areas has been considerable, the progress in the trade field has been more limited”* (Rueda-Junquera 2009: 14). The Association Agreement between the two regions is targeted at changing this and creating an encompassing cooperation between the European Union and Central America.

The European Union and Central American Inter-Regionalism can be best understood within the context of broader international relations (Corley 2009: 38). As described in the previous chapter, the competitive interdependence between the European Union and the United States vastly influences both their strategies in the global economic sphere. In regard to Central America, the policy of the European Union in the last twenty years has similarly often been said to be a reaction to actions of the United States. Next to economic and political considerations, this can be understood as a major reason for the Association Agreement between the two regions. For Central America, intensified relations with the European Union and the Association Agreement are expected to bring economic opportunities. They have an interest in accessing the European Union market and in the possibility of increasing trade with them (Corley 2009: 49). Furthermore, the agreement provides them with a way to react to globalization pressures by integrating into the global economy. Lastly, the relations with the European Union can help to avoid a too heavy dependence on the United States that has long been the major international influence in the region (Corley 2009: 49). As can be seen, Central American motivations in deeper cooperation with the European Union equally serve a number of different reasons that are mostly of economic and political nature.

The following chapter will take a closer look at the relations between Central America and the European Union and in particular the Association Agreement that was signed in 2012. Following, inter-regional characteristics and the developments leading to the negotiations for the Association Agreement will be discussed. This will foster a deeper understanding of the circumstances under which the Association Agreement will be implemented and serve to conceptualize possible outcomes.

## 5.1 Political Relations

Recent relations between Central America and the European Union are generally said to have started during the armed conflicts in the 80s with the San José Dialogue. Considered often as one of the most successful foreign policy interventions, this institutionalized process of political dialogue provided European support and facilitation to Central America and finally led to a peaceful resolution of the conflict (Corley 2009: 15). According to Smith (1995, in Corley 2009: 12), the intentions of the European Union involvement with Central America from the 70s on were initially centred around limiting the possible negative outcomes of the Nicaraguan' revolution and thus working against a de-escalation of the cold war.

In this context, the European Union managed to establish itself as a visible actor in the international sphere which increased the credibility of the European Union. In the late 80s and early 90s after the tensions of the cold war eased and the conflicts in Nicaragua and El Salvador were resolved, the relations between the two regions weakened (Sotillo 1998, in Corley 2009: 13). This led to a declining intensity of the relations between the two regions as they turned their focus towards internal matters and political issues in Central America lost its significance for the European Union (Corley 2009: 13). Since the end of the 90s a shift towards economic motives for interregional cooperation has been visible.

The San José Dialogue was no longer at the core of the relations between the two regions when in the 90s economic reasons gained in importance and the thematic focus shifted towards democracy, human rights and the Central American integration (Corley 2009: 16f). In 1993, a Political Dialogue and Cooperation Agreement (PDCA) was signed by the two regions, which was followed by a new and updated agreement in 2003. *“To begin with this dialogue [the San José dialogue process] was focused on extending peace, democracy, security, economic and political development throughout Central America,*



but was in 1996 and 2002 refocused on issues of sustainable development and regional integration” (Abrahamson 2008: 6). The gradual increase of economic reasons and lesser importance of a political dialogue are clearly reflected in the PDCA of 2003. In comparison to the first agreement of 1993 it not only included more aspects of cooperation, but also political dialogue and thus institutionalized the San José dialogue (Abrahamson 2009: 7). Corley (2009: 18f) rightly calls the shortcoming to tackle significant challenges such as the (remaining) social inequality which was at the heart of the conflict in the region and many other unresolved political issues a missed opportunity. On the other hand, certain issues that had gained in importance since the first agreement were incorporated such as counter-terrorism, immigration, natural disasters or conflict prevention (Abrahamson 2009: 7). As Aguilar Castillo (2009: 28) lines out: *“The objectives of the Dialogue have gone beyond the promotion of democracy, peace, security and social and economic development, and now include equitable development, intensification of the fight against insecurity and delinquency, the consolidation of the rule of law, and the reinforcement of social policies”*. Additionally, aspects such as gender, civil society or indigenous populations were explicitly mentioned (Abrahamson 2009: 7). In the agreement also changed circumstances and new economic structures are thought of. This is shown in the explicit mentioning of services, small-and medium sized enterprise development and competition policy (Abrahamson 2009: 7). Furthermore, the support of the European Union for regional integration and cooperation is clearly visible in the agreement by special reference to it. Finally, the previously described role the European Union takes on as a normative power becomes evident in the mentioning of human rights and respect for democracy.

Much of the trade between the two regions was so far regulated through the General Scheme of Preferences (GSP) that allows developing countries to export to the European Union while paying lower or no tariffs altogether (European Commission 2013d). The standard GSP reduced or eliminated tariffs on about two thirds of products, but was of little importance to Central America. Due to its concentration of exports in the agricultural sector, which remained largely out of this scheme, the Central American countries could not profit much from it. However, in 1992 the European Union granted the Central American countries a special General Scheme of Preferences, the ‘Drug Arrangements’, to combat drug production and trafficking in the region (Rueda 2009: 7). Next to the full removal of tariffs on all products included in the standard GSP, it

included free market access for certain non-traditional agricultural products that were previously not covered. This included products such as tropical fruits, fish, plants and vegetables and enabled the Central American countries to slightly diversify their structure of agricultural exports (Rueda 2009: 7). The special GSP granted to the Central American countries was replaced by the GSP+, which covers similar categories as the standard GSP and allows free market access for these goods from beneficiary countries (European Commission 2013d). The condition for this is the implementation of international regulations on issues such as human rights, labor rights, environment and good governance (European Commission 2013d). While these preferential trade schemes did encourage increased trade to some extent and thus provided the Central American countries with an opportunity to diversify its exports, it also has several constraints. Most importantly, it is only granted on a temporary basis, is dependent on the level of national income and it excluded many products that would have been of interest to Central American producers such as gold coffee, fresh bananas and certain vegetables and restricted tariff preferences of textiles to twenty percent of the Community customs tariff (Rueda 2009: 8). Furthermore, it included graduation mechanisms and a safeguard clause that both allowed the European Union to temporarily suspend the tariff preferences on certain goods if the imported products became too competitive on the European Union markets (Rueda 2009: 8). Thus, the tariff preferences granted to the Central American countries under the different forms of the General Scheme of Preferences were not very predictable and barred only limited potential for the diversification and expansion of exports.

## 5.2 Socio-Economic Relations

There are several asymmetries in terms of interregional trade, some of which are visible in the graphs below (Corley 2009: 24): While trade between the two regions is important for Central America, the amount of Foreign Direct Investment is significantly higher than the respective ones for trade. Second, in the past few years, European Union exports to Central America have increased much more than Central American exports to the European Union. Third, a vast majority of Central American exports to the European Union come from mainly Costa Rica and Panama. Last, the European Union mostly exports manufactured goods to Central America, while the reverse trade flows consist mainly of agricultural goods and raw materials. These trade patterns and the underlying variances in the economic structure suggest different implications of the European Union – Central America Association Agreement for the two regions. Some of those aspects will be analyzed more closely in this section.

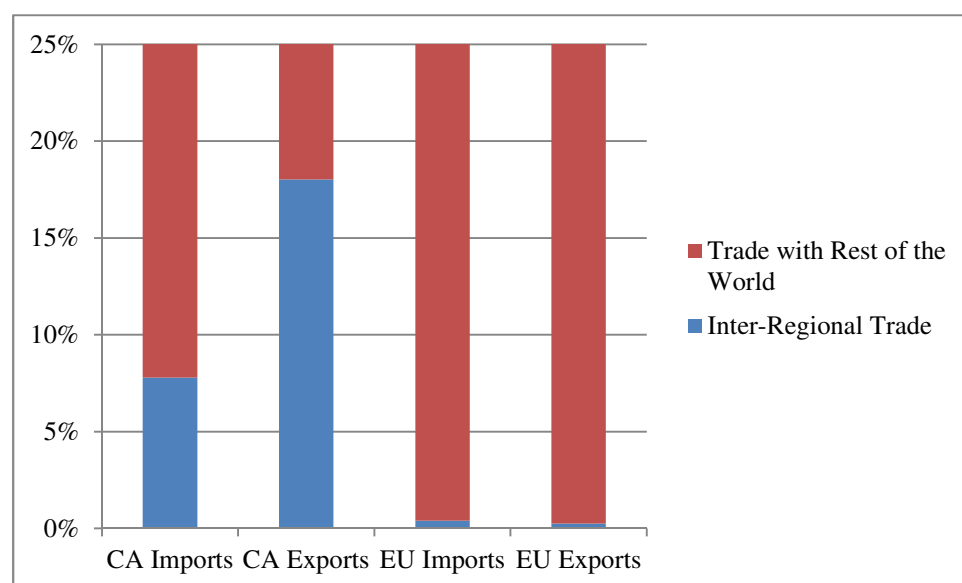
Note: This section is strongly built on Eurostat and OECD Data, in contrast to the previous chapter in which primarily the databases of ECLAC, IMF, UNCTAD, UNDP, The World Bank and SEC-SIECA were used. Due to different methods in the collection and analysis of data and varying definitions of certain indicators as well as different currencies, the presented figures in this chapter cannot be compared to the absolute values in the previous chapter (Eurostat 2013d). However, it is still possible to draw conclusions on the presented figures by looking at their relative values.

### 5.2.1 Trade Relations

Inter-regional trade with Central America is practically insignificant for the European Union; as can be seen in the graph below. It accounted for only 0.4 percent of its imports and 0.2 percent of its exports in 2010 (Eurostat 2013c). In contrast, the European Union is the second most important trading partner for Central America (intra-regional trade excluded) to which it exported 22 percent of its total exports and from which it imported 8.4 percent of its total imports in the same time period (SIECA 2013). However, the importance of the United States as the main trade partner of Central America prevails also due to the close geographical proximity and the recently signed preferential and reciprocal trade agreements (Rueda-Junquera 2009: 5). This has led to a relative decline of the importance of trade with the European Union over the past two decades.

Note: The data for Central America from the SEC-SIECA Database does not include imports to and exports from Panama. However, it can still provide a good overview of the differences in the relative importance of inter-regional trade for both Central America and the European Union. Furthermore, values of intra-regional trade in both European Union and CACM were excluded from this calculation.

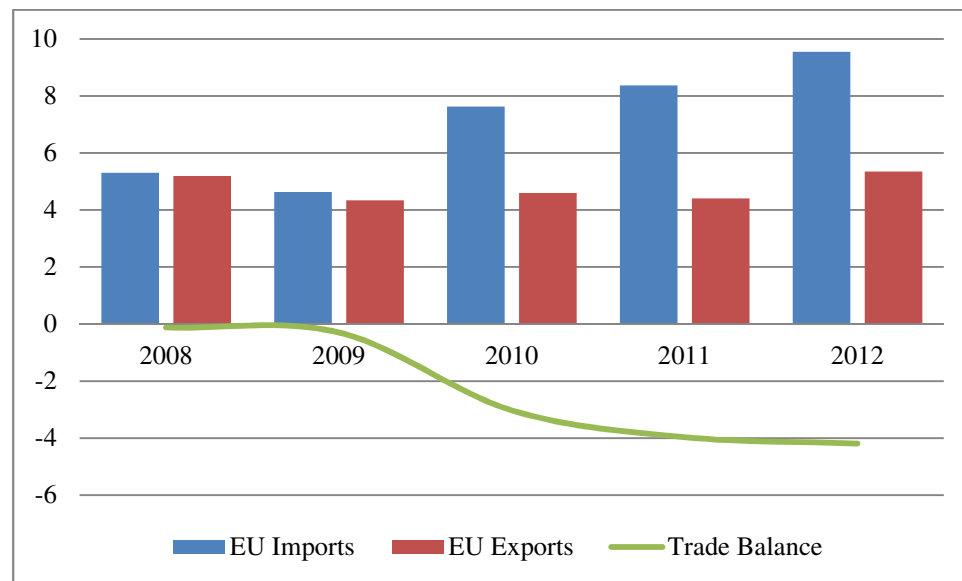
*Figure 21: Central America and EU Inter-Regional Trade in 2010*



(Eurostat 2013c; SIECA 2013; own illustration)

The graph below illustrates the rising exports from Central America since 2009. Exports from the European Union have more than doubled in the second half of the 90s from € 1.7 billion in 1995 to 3.7 billion in 2000 (Rueda-Junquera 2009: 2f.). In the following years until 2005 it remained fairly stable at that value. Ever since, it has fluctuated between € 4.3 and € 5.3 billion. In 2012, European Union exports to Central America have reached a record high of € 5.4 billion. Since 1995, the value of imports from Central America to the European Union increased from € 1.8 billion to € 4.3 in 2000 and reached a record level of € 9.5 billion in 2012 (Rueda-Junquera 2009: 2f.). The trade deficit of the European Union has thereby been strongly increasing. While it was fairly low in the 90s, it has reached its highest value in 2012 with € 4.2 billion.

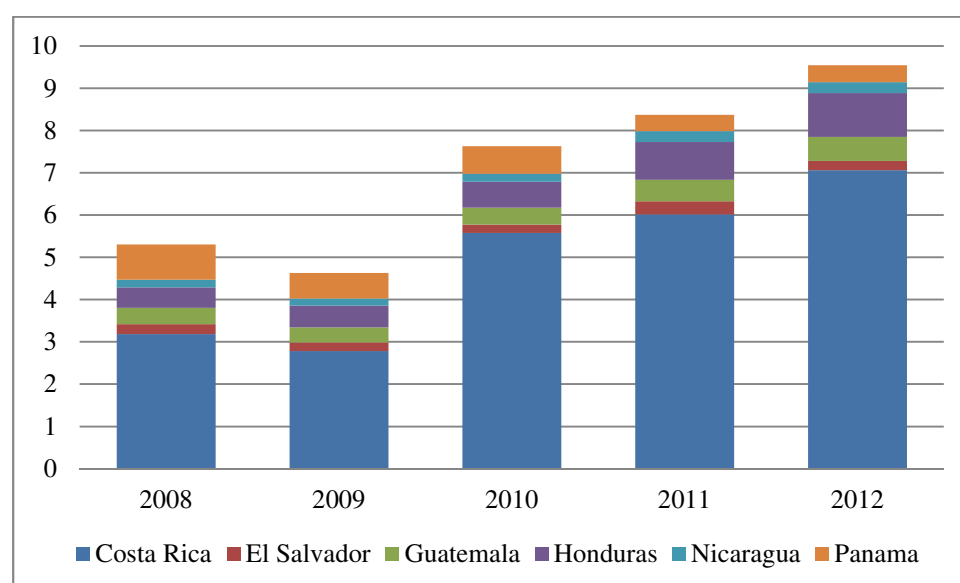
Figure 22: Trade Volume between the EU and Central America, in € billion



(Eurostat 2013c; own illustration)

The imports to the European Union from Central America have in the last three years come with an overwhelming majority of over 70 percent from Costa Rica. As can be seen in the graph below that depicts the value of imports of the Central American trade partners, the rise in imports from Central America is largely due to the rising exports from Costa Rica to the European Union. In 2012 Costa Rica's exports to the European Union amounted to € 7.1 billion. Also the export volume of Honduras has grown significantly in this five-year period. It has more than doubled to a value of over € 1 billion. Guatemala and Nicaragua saw respectable growth in this period too and reached an export value of more than half a billion € and € 0.3 respectively. Panama and El Salvador reduced their exports to the European Union within this time period. While the exports of El Salvador to the European Union have mostly been stagnating in the past few years, Panama's exports actually declined by half of its value of 2008 and are now below half a billion Euro.

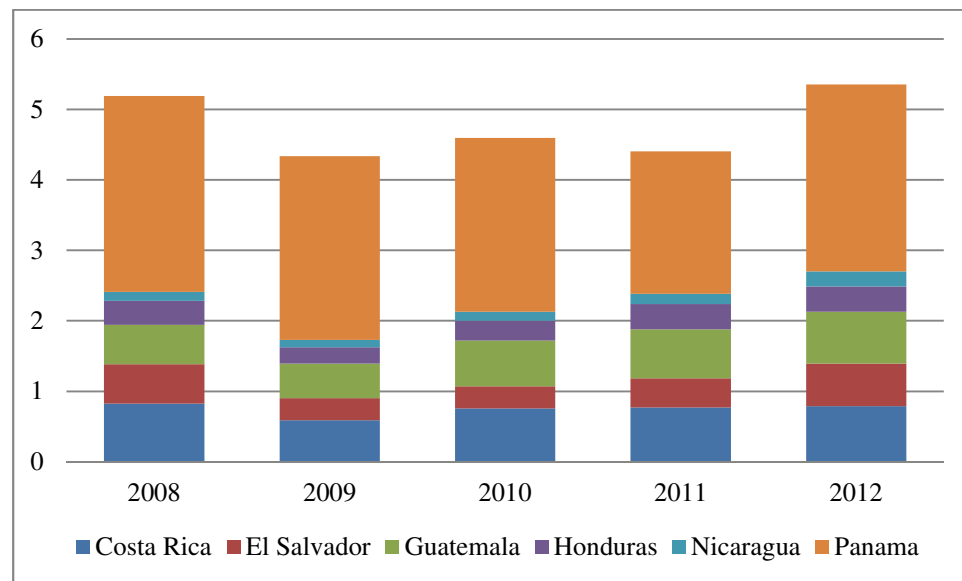
Figure 23: EU Imports from Central America, in € billion



(Eurostat 2013c; own illustration)

In comparison, the imports of Central America from the European Union go to a large extend to Panama. They had their peak in 2008 with a value of € 2.8 billion and have recovered in 2012 to a level of € 2.7 billion. The second biggest destination of European Union exports in the region is Costa Rica. Its level of imports from the European Union has remained fairly stable just below € 0.8 billion, with the exception of 2009 in which it dropped to € 0.6 billion. Guatemala has slightly increased its imports from the European Union from below € 0.5 billion in 2009 to € 0.7 billion in 2012. El Salvador has experienced rising imports from the European Union too, after a drop in value in 2009 and 2010. Its imports from the European Union reached a value of € 0.6 billion in 2012. Honduras and Nicaragua have the lowest imports from the European Union in the region with € 0.4 and € 0.2 billion respectively.

Figure 24: EU Exports to Central America, in € billion



(Eurostat 2013c; own illustration)

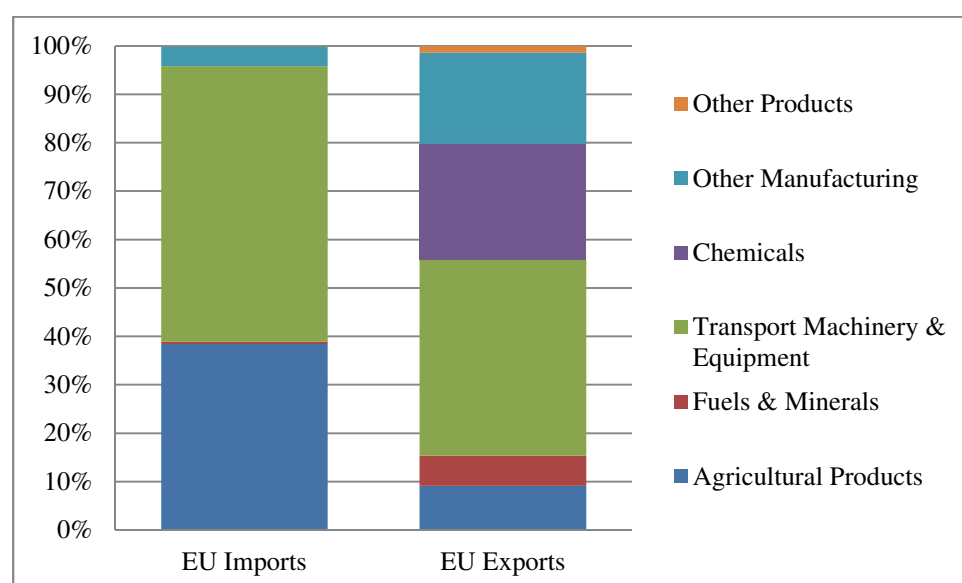
*“[T]rade relations between the EU and Central America are characterized by their scarce dynamism and their asymmetries in the relative importance of the mutual trade and in the sectoral composition of the same one”* (Rueda-Junquera 2009: 8). As can be seen below, in the sectorial analysis of trade between the two regions it becomes obvious that Central America relies in relation to the European Union to a much larger extent on the export of primary or agricultural products. In 2011, they made up for almost 40 percent of exports from the region, while the respective share for the European Union was only at 9 percent. However, this already reflects a drastic change to the period between 2000 and 2006, when 75 percent of all exports from Central America to the European Union were primary products and 65 percent agricultural products. This resulted in Rueda-Junquera to line out the *“typical pattern of North-South trade”* (2009: 7) and the resulting high vulnerability to international fluctuations in prices and negative effects on the terms of trade. Even in 2007 about 55 percent of exports from Central America to the European Union were typical agricultural products, namely coffee, bananas and pineapples (Rueda-Junquera 2009: 6f.). Thereby, the export of coffee to the European Union accounted for the largest shares in export for El Salvador, Guatemala, Honduras and Nicaragua (Rivera / Rojas-Romagosa 2007: 8).

Due to the high share of exports from Costa Rica, the structural composition of the region's exports is largely shaped by it. It exports almost all of the transport machinery and equipment that accounts for a share of 67 percent. Since 2008, the value of these exports has tripled – in specific office equipment and telecommunications - which explains some of the overall growth of exports from Central America to the European Union. In 2011, 41 percent of agricultural exports to the European Union originated in Costa Rica and 25 percent in Honduras (Inter-American Development Bank 2012).

The strong dominance of Costa Rica in the manufacturing sector compared to the other countries of the region can be explained by the active attempts of it to diversify its exports to the European Union. It has focused on exporting non-traditional agricultural products and manufactured goods and thus managed to better meet the European demands (Rueda-Junquera 2009: 7). In relation to agricultural products, the region has been able to diversify its exports through the special GSP regime from 1992 onwards that allowed them to export goods such as tropical fruits, fish and vegetables. However, Central America did only utilize this preferential treatment for about 50 percent of its exports up until 2007 (Rueda-Junquera 2009: 8). This can in part be explained by the design of the GSP scheme in which products that would have great exporting potential in the region such as coffee and bananas were made an exemption and which was subject to graduation mechanisms and a safeguard clause (Rueda-Junquera 2009: 8). Additionally, agricultural exports to the European Union have been restricted due to its Common Agricultural Policy and its preferential trade agreements with African, Caribbean and Pacific countries (ACP). This is especially relevant for traditional agricultural export products of Central America such as beef, bananas or sugar (Rueda-Junquera 2009: 8).



Figure 25: Structural Composition of Trade with Central America in 2011



(Inter-American Development Bank 2012; own illustration)

Exports from the European Union to Central America consist of 82 percent manufactured products. About 40 percent of that is machinery and transport equipment and 19 percent is other manufacturing. Chemicals account for the remaining 24 percent. Agricultural products are 9 percent of total exports and fuels and minerals account for 6 percent.

As illustrated in Table 7 exporters in inter-regional trade face a list of tariffs. As can be seen, Central America has higher tariffs for manufactured goods and agro-industrial products, while the European Union mostly protects certain agricultural sectors. The low tariffs and zero tariffs that Central American exporters face in many sectors are due to the preferential trade scheme GSP+ that was granted by the European Union. However, as can be seen in the list below, the most important agricultural exports of the region to the European Union and the one with the greatest potential for export growth all face relatively high tariffs. The first category corresponds to veg\_fruits and includes agricultural goods such as bananas, pineapples or melons. These products faced 44.9 percent of tariffs, while bananas from the region faced additional quota restrictions (Rivera / Rojas-Romagosa 2007: 10). The second refers to sugar – a product that did not account for a large share of exports to the European Union even though it is widely produced in the region. Rivera and Rojas-Romagosa line out that *“this is a direct consequence of the high tariffs faced by this product: 177%. This is the most protected*

*sector in the European Union, and in addition, its production is also highly subsidized within the EU”* (2007: 10). A possible reduction of tariffs in this category is estimated to bring a substantial increase in production and exports from Central America (Rivera / Rojas-Romagosa 2007: 10). Next to these two categories, also paddy\_rice, sugar\_cane, meat and dairy products face relatively high tariff barriers of 52.9 percent, 14.3 percent, 29.1 percent and 23.2 percent respectively. Out of these products, in the first two categories there is practically no trade between the two regions. The export of meat and dairy products is not expected to increase substantially, as Central American producers are not considered competitive, even if tariffs were to be removed (Rivera / Rojas-Romagosa 2007: 10). Other important export products include coffee, which is included in the category foodprod\_nec, and other agricultural goods such as plants, foliage that are included in the category crops\_nec. Both these sectors faced very low tariffs in the European Union.

Table 7: Tariffs faced by Exporters in Inter-Regional Trade, in percent

	EU to CA	CA to EU
1 Paddy_rice	14,0	52,9
2 Wheat	0,0	0,0
3 Other_cereal	5,3	0,0
4 Veg_fruits	26,6	<b>44,9</b>
5 Oil_seeds	0,8	0,3
6 Sugar_cane	0,0	14,3
7 Plant_fibers	4,4	0,0
8 Crops_nec	2,1	0,2
9 Cattle	6,5	0,0
10 Animprod_nec	2,2	0,3
11 Raw_milk	0,0	0,0
12 Wool	0,0	0,0
13 Forestry	2,8	0,0
14 Fishing	0,1	0,1
15 Coal	1,3	0,0
16 Oil	0,0	0,0
17 Gas	0,9	0,0
18 Minerals_nec	2,2	0,9
19 Meat	8,3	29,1
20 Meatprod_nec	18,2	2,7
21 Veg_oils	10,0	1,1
22 Dairy	15,9	23,2
23 Proc_rice	32,2	0,0
24 Sugar	28,7	<b>177,0</b>
25 Foodprod_nec	10,5	2,8
26 Bev_tobacco	23,8	1,2
27 Textiles	12,2	0,2
28 Apparel	12,9	0,2
29 Leather	11,6	0,2
30 Wood_prod	12,2	0,0
31 Paper_prod	2,7	0,1
32 Petrol_coal	4,9	0,0
33 Chemical_pla	3,6	0,1
34 Minprod_nec	10,0	0,1
35 Ferrous_met	4,3	0,0
36 Metals_Nec	0,8	0,2
37 Metal_prods	5,4	0,1
38 Motor_veh	7,8	0,0
39 Trans_eq_nec	5,3	2,3
40 Electronic	2,2	0,0
41 Machine_nec	1,9	0,1
42 Manufact_nec	10,2	0,1
43 Services	0,0	0,0

(GTAP 6 Database, in Rivera / Rojas-Romagosa 2007: 9)

Next to tariffs on trade, also subsidies in the European Union can reduce the exports of Central American producers and their competitiveness. Thus, below an overview of selected agricultural subsidies of the European Union's Common Agricultural Policy is

given. The total values were calculated to represent the subsidies as trade barriers faced by importers to the European Union. As can be seen, additionally to the tariffs on imports, certain sectors face high levels of subsidies. *“The high subsidies granted by the EU to bovine meat, dairy products and sugar, can affect negatively Central American producers”* (Rivera / Rojas-Romagosa 2007: 10). These sectors face 77.7 percent, 30 percent and 58.2 percent of trade barriers, caused by subsidies by the European Union.

*Table 8: Selected EU Agricultural Subsidies as Trade Barriers, in percent*

Sector	EU Subsidies
2 Wheat	2.4
3 Other_cereal	33.3
4 Veg_fruits	2.2
10 Animprod_nec	0.7
11 Raw_milk	0.1
19 Meat	77.7
20 Meatprod_nec	5.4
22 Dairy	30.0
23 Proc_rice	42.0
24 Sugar	58.2
25 Foodprod_nec	3.2
26 Bev_tobacco	0.9

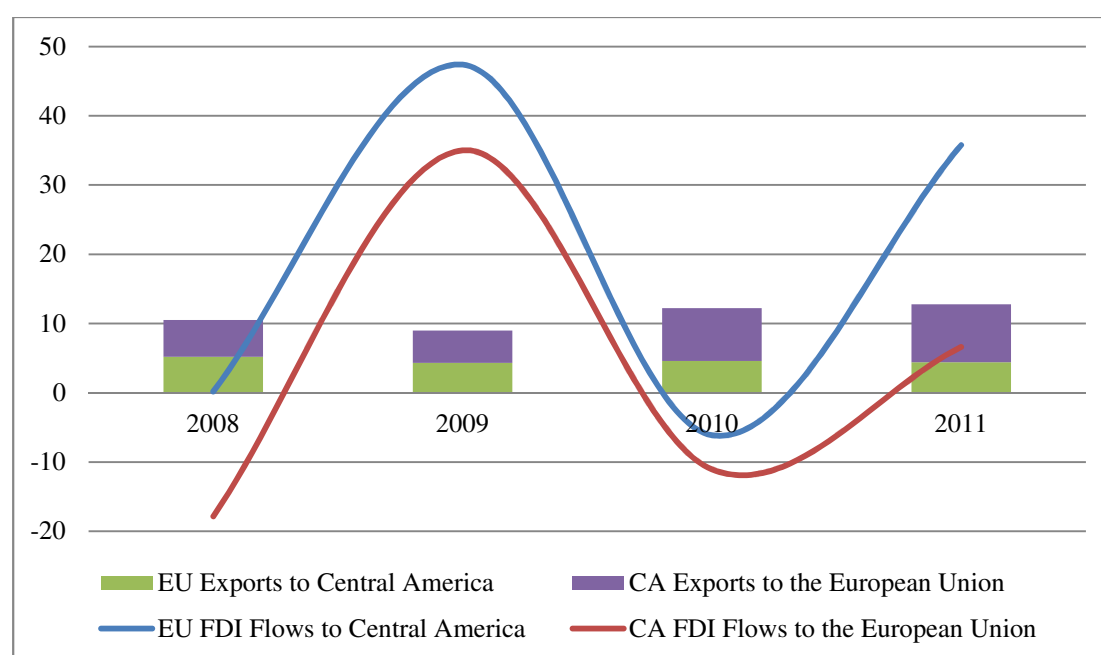
(GTAP 6 Database, in Rivera / Rojas-Romagosa 2007: 11; own illustration)

### **5.2.2 Foreign Direct Investment**

The importance of foreign direct investment for Central America has drastically risen in the past ten years. In the past few years Central America seems to attract increasingly more European investors in absolute terms as well as in relation to Latin America in general (Corley 2009: 23). As was outlined in the previous chapter, the European Union net inflows of foreign direct investment into the region represented about 21 percent of total inflows in 2011. According to the European Union the FDI flows to Central America accounted for 9.8 percent of extra-European Union outflows of foreign direct investment in 2011 while outflows of foreign direct investment from Central America to the European Union amounted to 2.8 percent of all inflows into the European Union (Eurostat 2013a; including Belize).

Consequently, investments play quite an important role in the inter-regional relations and they are expected to continue to rise in the coming years. In comparison to total trade flows between the two regions that reached € 12.7 billion in 2011, the European Union net foreign direct investment flows to Central America alone were at € 29.2 billion, composed of inward foreign direct investment flows of € 35.8 billion in Central America and correspondingly € 6.6 billion of outgoing foreign direct investments from Central America to the European Union. The graph below indicates the proportions and shows the development of these two indicators for the past four years. As can be seen, the flows of foreign direct investment generally experience high volatility and are vulnerable to external economic crisis.

*Figure 26: Inter-Regional Trade and Foreign Direct Investment Flows, in €billions*



(Eurostat 2013a; Eurostat 2013c; own illustration)

Almost half of the net foreign direct investment from the European Union to the region has been going to Panama in 2011. For the country these inflows represented a share of 24 percent of total inflows. Costa Rica and Panama have also received substantial amounts of net foreign direct investment inflows that correspond to 17.48 percent and 24 percent respectively of the total inflows into these two countries. Inflows of net foreign direct investment to Guatemala and El Salvador received 16.02 percent and 9.54 percent of its total net inflows of foreign direct investment from the European Union. The

regional average consequently amounts to 20.84 percent of total net inflows. Nicaragua is excluded due to the unavailability of data.

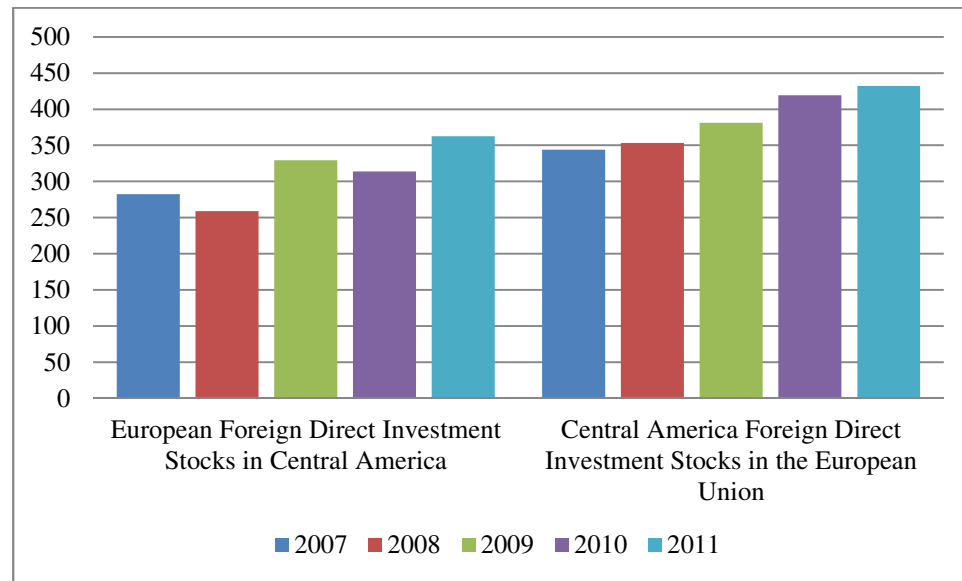
*Table 9: EU FDI Flows to Central America in 2011*

	in percentage of all Central American FDI inflows	in percentage of all European Union FDI outflows
Costa Rica	17.48%	0.02%
El Salvador	9.54%	0.01%
Guatemala	16.02%	0.01%
Honduras	34.77%	0.02%
Panama	24.00%	0.05%
Central America	20.84%	0.11%

(IMF 2013; own calculation)

As can be seen in the graph below, the stocks of foreign direct investment have increased in the past few years and reached a level of € 362 billion in 2011. Interestingly, it can be observed that the outward stock from Central America to the European Union has been higher for the past few years than the foreign direct investments to Central America from the European Union. The inward stocks in the European Union have reached a high of € 432 billion in 2011.

Figure 27: Inter-Regional FDI Stocks, in € billion



(Eurostat 2013b; own calculation and illustration)

From the beginning of the 90s onwards, large European companies have shifted away from investments in the agricultural and industrial sectors and towards large investments in the services sector “such as financial and insurance services, telecommunications, transport and public utilities” (Corley 2009: 23). This explains also why trade in services with Central America is of high importance to the European Union. As Corley (2009: 25) points out, there are several analogies between interests of private European investors and the European Union (investment) policy towards Central America. Considering the high levels of European Foreign Direct Investments in the region and the official rhetoric of the European Union on its trade and foreign policy, it seems likely that the improvement of favorable investment conditions to European investors in Central America was one of the motives behind the fostering of the European Union-Central America Association Agreement.

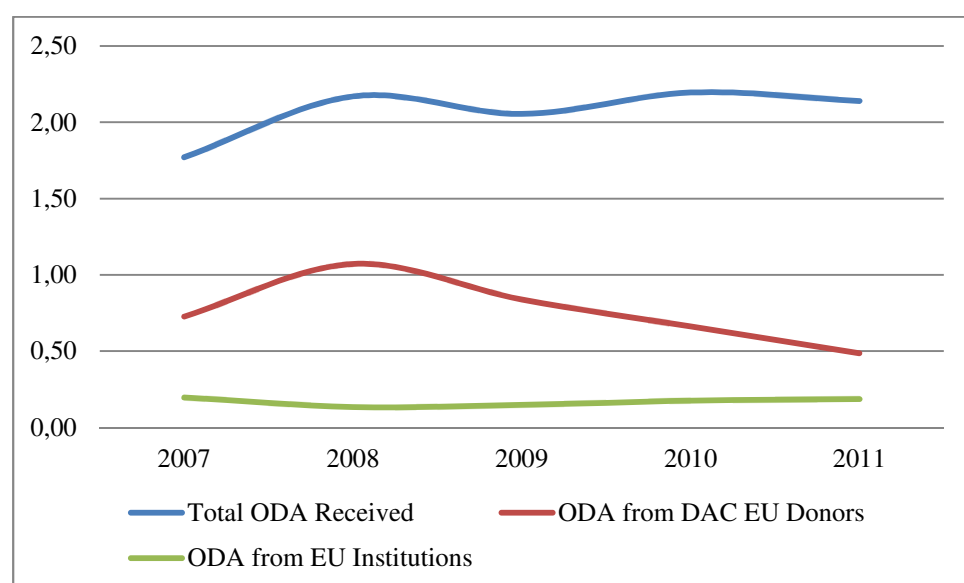
### 5.2.3 Development Cooperation

Since 1976, the European Union has been a donor of official development assistance to Central America (Rueda-Junquera 2009: 9). With the exception of the 80s the flows of aid from the European Union were generally of small value in both relative and absolute aid from the European Union. The official development assistance to Central America represents only a small amount of total aid from the European Union (OECD 2013).

*“Central America is likely to remain as a marginal destination for the EU’s ODA and given the budgetary restraints of the EU, it is unlikely to receive substantial increases in aid. Likewise, it is reasonable to expect ODA to be used more efficiently”* (Rueda-Junquera 2009: 13). However, in contrast to the trade policy that is solely in the responsibility of the European Commission, the development policy of the European Union exists next to the individual member countries’ development policies (Rueda-Junquera 2009: 11). When combined, the European Union member states bilateral and the European Union’s multilateral official development assistance accounted for a long time for by far the largest share of foreign aid for Central America (Rueda-Junquera 2009: 10f.). Despite the declining levels of official development assistance from the European Union to Central America, in 2011 these flows still accounted for about 30 percent of total ODA disbursements to the region as can be seen in the graph below. In comparison to the previous years, this relative decline in importance of aid flows from the European Union is quite drastic. In 2007, bilateral and multilateral ODA from the European Union to Central America still amounted to 52 percent of total aid to the region and in 2008 it was at 56 percent. Since then it had been falling to 48 percent in 2009, to 38 percent in 2010 and 31 percent in 2011 respectively. This overall decline was mostly a result of reductions in bilateral aid of European Union member countries to the region, as ODA from European Union institutions in comparison remained at fairly low levels between \$ 135 million and \$ 196 million in the same time period. Aid from European Union member countries amounted to \$ 727 million in 2007 and rose to \$ 1.1 milliard in the following year. Since then it has experienced a drastic decline to \$ 838 million in 2009, to \$ 662 million in 2010 and to \$ 487 million in 2011.



*Figure 28: Official Development Assistance in Central America, in \$ billion*



(OECD 2013)

At the center of development cooperation between the two regions has for a while been the process of regional integration as had been outlined previously and will be described more closely in the next section.

### 5.3 Interests and Motives

After analyzing the political and socio-economic relations between Central America and the European Union, the question remains what the reasons for intensified cooperation are. Corley (2009: 8) points out that for both the European Union and Central America, the main functions of inter-regionalism are balancing and rationalizing, with collective identity building playing a minor role too. Central America thereby expects economic gains such as an increase in exports and higher foreign direct investment inflows. Additionally, closer cooperation with the European Union provides it with an opportunity to balance the dominance of the United States in the region. For the European Union, closer cooperation with the countries in Central America offers a number of opportunities. The *“region is rich in biodiversity, does have a great potential for investment in infrastructure; following the structural adjustment era, privatization of key services such as water, construction, energy, minerals, or oil, has opened the services market; [...] the geographical position of the region, [sic!] makes it a key geostrategic region”* (Aguilar Castillo 2009: 24). However, as will be elaborated more closely in this chapter, many of the economic opportunities depend to a large extent on the functioning as well as the size of the Central American market. Thus, the European Union has long been a supporter of regional integration in Central America. However, this is also due to the benefits for economic growth and development that the European Union sees in deeper regional integration and a number of other factors. Those will be more closely described in the next section, followed by the respective interests of European Union’ and Central American’ actors and their motives for closer collaboration between the regions.

#### 5.3.1 Influences of the European Union on Regional Integration

The issue of regional integration has long shaped the relations between Central America and the European Union. In the last decade, one of the key objectives of the relations between the two regions has been the proceeding of regional integration in Central America (Corley 2009: 29). The European Union has been a major force in fostering and increasingly pushing for regional integration in Central America. The intensified focus on regional integration especially in the last decade clearly shows the European Union’s interest in the topic. This is also reflected in the European Union-Central America Political Dialogue and Co-operation Agreement signed in 2003 that puts clear emphasis on economic issues and technical provisions for regional integration. In the Regional

Strategy Paper for 2007 to 2013 support for regional integration became the one main objective. As the European Commission (2007: 21f.) lines out in its Regional Strategy Paper for 2007 to 2013, “*Regional integration is seen as a long-standing objective for cooperation between the EU and Central America in order to promote political stability and sustainable socio-economic development in the region and reduce vulnerability. [...] a more efficient institutional system and deeper integration will also be a means to contribute to tackling other challenges which the region faces such as: strengthen democracy; decrease the economic vulnerability and dependence of the region*”. In this context several measures were planned to support regional integration in Central America and to prepare for the Association Agreement between the regions (Abrahamson 2008: 9): Firstly, the reform of institutions for regional integration were to be reinforced. Secondly, intra-regional trade and the establishment of a customs union were supported to prepare the way for a future common market. Lastly, regional governance was strengthened to enable mitigating measures to be taken.

The increasing spending for regional integration can also see the importance the European Union puts on the process of regional integration in Central America. The share of funding for regional integration increased from an average of 5% before 2000 to more than 50% between 2002 and 2006 (Abrahamson 2008: 8). Also, being a region itself, the European Union preferably negotiates with other regions instead of individual countries. Before the negotiations on the Association Agreement started, the European Union clearly communicated that the creation of a common market in Central America was a precondition to negotiations and they would only negotiate with the region as a whole and not with individual countries (European Commission 2007: 15).

However, it is not very clear as to why the European Union emphasizes regional integration in Central America by such an extent. Corley (2009: 58) thereby points out that “[t]he EU [...] is driving forward the process of Central American integration much more so than Central American political leaders or societal groups themselves. In this way the EU is also controlling the [sic!] both the pace and content of the process, ensuring that the type of regional integration that emerges is potentially one which favours European business rather than the needs of Central American society”. A similar argument was brought forward by Arroyo Picard, Castañeda Bustamante and Rodríguez who line out the focus on the creation of a customs union and a common market in

Central America together with strong trade agreements linking the two regions (2009: 13). This and the fostering of export production and integration into the world markets serves the interests of European firms as it enables them to invest more easily in the region and expand their business by a better access to larger markets and a better investment climate. Consequently, it supports the positioning of the European Union as a transnational competition state and ensures its competitiveness on the global political and economic sphere.

Additionally, it has to be pointed out that the focus on regional integration and encompassing agreements that link the different aspects of foreign policy and in particular political dialogue, development cooperation and economic relations have given the European Union a positive image. Some - especially critical civil society groups - argue that despite its positive rhetoric, the European Union is almost exclusively interested in economic gains it hopes to achieve through inclusive trade agreements (A comprehensive discussion of such arguments is given in Arroyo Picard, Castañeda Bustamante and Rodríguez 2009). Meanwhile, there are also strong proponents of the trade agreements the European Union negotiates, particularly because of their inclusion of cooperation and political dialogue. Furthermore, the historic experience of the European Union may influence its preference for regional integration as Aguilar Castillo (2009: 23) points out: *“regional integration was not only the best way to prevent conflict among the major European powers, but is [sic!] was also an attempt to find a more comfortable, advantageous situation in the world economy, and a response to the increased level of globalization, which forces national economies to interact with each other, and with other actors”*. In sum, it can be said that both sides use a valid argumentation. While it is definitely true that the European Union supports a specific model of regional integration in Central America that is geared towards a deeper economic integration and an easier access for European businesses, this argument should not be seen as the sole interest of the European Union in the region. Furthermore, it has to be acknowledged that the European Union has for a long time been the main donor of official development assistance in the region and has also been involved in the pacification process in the 80s as was outlined in the chapter 5.1. In this context, the European Union argues that deeper regional integration is a way to achieve stability and development and to strengthen the economic and political position of Central America.

To disregard these political interests and the efforts of the European Union to position itself in differentiation to the United States on the global political stage would be oversimplified and not accurate. This is especially so as economic relations with Central America are in relation much more important for Central America than for the European Union. Finally, while the power asymmetries between the two regions should not be discredited, this does not mean that Central America is a powerless victim of European Union interests. Rather, the relations between the two regions can be understood within the broader framework of external influences and interdependent interests of various actors within Central America and the European Union. Those interests and motives for intensified cooperation between the two regions will be more closely analyzed in the following two sections.

### ***5.3.2 The Perspective of the European Union***

In its policy towards Latin America, the European Union shows mostly strategic and economic interests. In the past, the objectives of the European Union were quite different and mostly political in nature, which can be seen by the two previous agreements between the regions that centered on the promotion of development and security concerns, next to the increasing support for regional integration. However, in the last decade economic reasons were at the core of the intensified relations between the European Union and Central America (Corley 2009: 16). Thereby, it is important to understand the policies of the European Union as a contested space between different actors and interests involved such as the farmers in the European Union that are a strong force behind the Common Agricultural Policy and agricultural subsidies or European Union multinational corporations that are interested in expanding their business by gaining access to markets and profits in favorable investment climates.

Some of the main reasons that led the European Union to negotiate a comprehensive Association Agreement with Central America include the possibility it gives them to move forward with trade liberalization at the bilateral level, while negotiations at the multilateral level at the WTO are blocked. However, the initial precondition for negotiations set by the European Union was a successful conclusion of the Doha Development Round (Rueda-Junquera 2009: 14). It was only after the stalemate at the multilateral negotiations that the negotiations were started anyway. Furthermore, the Association Agreement enabled the European Union to include issues that are considered

sensitive at the multilateral level, such as provisions on government procurement, investment or competition policy, which are likely to benefit European corporations (Aguilar Castillo 2008: 23). Additionally, the European Union has relatively more power on the bilateral level due to its economic strength and its size.

Also, the negotiation of the Association Agreement has leveled the playing field with the United States, as *“EU interests are not disadvantaged by preferences granted to the US or Canada”* in the region (European Parliament 2012: 5). This is especially relevant due to the geostrategic importance of the region. As a strategic area between South America and North America and the additional possibility of transport to the East and the West due to the Panama canal, Central America is of great interest to the European Union (Aguilar Castillo 2009: 34). Additionally, the region has recently concluded important Free Trade Agreements with some of those regions, which opens up these markets for European corporations operating in Central America. In this context, the possibility of Central America being included in Free Trade Agreements that are targeted at increased trade between the United States and Asia provides another incentive for the European Union to invest in the region (Rueda-Junquera 2009: 14). Cheap labor and production costs and the favorable geographical location make Central America interesting for European multinational corporations that are looking to produce for larger markets in North and South America. Aguilar Castillo lines out that the region is very attractive for potential investors if greater political stability is achieved and transport is made easier (2009: 34). A common market will in this context reduce the costs of business activities and of transport in the region. Consequently, it further increases the geostrategic importance of Central America for the European Union.

The main economic interests include easier access to a common Central American market for corporations from the European Union and consequently increased opportunities for profits in sectors where they have comparative advantages, such the service sector. Furthermore, the potential for profitable investments especially in infrastructure and for involvement in government procurement and in service sectors such as water supply, construction or energy production is very high in the region (Aguilar Castillo 2009: 24). Even though the relative shares of trade and investment in Central America of the European Union’s total values is very small, economic interests in the region still have some importance. An indication for that is that the trade pillar of the Association

Agreement is the only new aspect of inter-regional cooperation between the European Union and Central America and it is by far the most encompassing one.

For the European Union the main functions of inter-regionalism with Central America are balancing and rationalizing that were in more detail described in chapter 2.3.3 (Corley 2009: 43). The European Union trade strategy should be analyzed within its international context to better understand its functions. International systemic factors such as *“constraints and opportunities provided by wider international economic, political and security systems within which individual EU interregional relations are nested”* can best explain why the European Union is fostering interregional cooperation in its external policies, next to its aspiration to create a common European identity (Corley 2009: 9f.). The European Union’s involvement in Central America helps to balance the influence the United States hold in the region. To counter initiatives of the United States targeted at increasing their influence, the European Union has brought up the suggestion of the establishment of a strategic partnership with Latin America at the Rio EU-LAC summit in 1999 (Corley 2009: 40). The Association Agreement between Central America and the European Union can be understood as being nested within this context. Some analysts even go further and argue that European Union negotiations of Free Trade Agreements in Latin America are an effort to set up a free trade area between the two regions as a whole (Grain 2008, in Corley 2009: 40f.; Aguilar Castillo 2009: 36). This could be described as the rationalizing function that is strategically using its trade policy within the context of the larger international sphere to achieve its goals and actively manage globalization.

Another function of the relations for the European Union – even if only of secondary importance - is collective identity building (Corley 2009: 44). As was described in more detail in chapter 3.2.1, the trade strategy of the European Union might serve the creation of common values and shared interests and raise awareness of a European identity within its member countries. *“The perception of these common interests and shared values contributes to an overall sense of common identity among EU citizens. The emergence of such an identity [...] is a necessary condition for the creation of a coherent Common Foreign and Security Policy (CFSP), which has long been an elusive goal of European integration”* (Aggarwal / Fogarty 2004, in Corley 2009: 45). The role the European Union has played in its relationship with Central America supports the argument that it functioned to foster its identity seeking as well as its positioning on the international

sphere. The emphasis put on regional integration, political stability and economic development in Central America can partly be understood as being intended to build a common European identity.

Other factors that serve to explain trade policies of the European Union are often centred around competing interest groups and opposing interests of free-trade versus more protectionist policies in European Union institutions (Corley 2009: 46). In the case of European Union and Central American inter-regionalism this does not seem to be all too relevant as the trade volumes between the two regions are, at least for the European Union, not high enough to pose a large threat to European businesses and agricultural producers. Aside of critical voices from civil society that oppose globalization and processes of liberalization, debates between competing interests groups have not been prominent in the case of the intensified relations between the European Union and Central America.

### ***5.3.3 The Perspective of the Central American Countries***

From the perspective of Central America, economic and political reasons are at the core of intensified relations between the two regions. While economic interests are a much stronger drive for inter-regionalism similarly to the European Union, the concerns vary depending on the country (Corley 2009: 48). Generally it can be said that access to the European market and accompanying possibilities for an increase in exports and expansion of production served as an important factor for the negotiation of the Association Agreement. *“[T]he access to a larger export market through a FTA has the potential to be relatively more beneficial to the smaller economies than to the bigger ones, since the limited size of their market prevents them from relying on national demand to boost and maintain the supply of goods and services. In addition, this national market enlargement allows small economies to be more capable of attracting FDI inflows, necessary to compensate for the national savings deficit in the investment financing”* (Rueda-Junquera 2009: 14). The Association Agreement with the European Union provides incentives for Central America by lowering trade barriers for some of its key products and the manifestation of already existing but temporary preferential trade regulations that were granted under the GSP+ program (Aguilar Castillo 2009: 26f.).



Furthermore, intensified economic relations with the European Union, including possibilities for the expansion of exports and increased inflows of investments, can bring many chances for the Central American economies. Already now, the European Union is the second most important trade partner behind the United States (intra-regional trade in Central America excluded), accounting for 15 percent of all exports and 6 percent of all imports in 2012. This also makes it the only major region with which Central America has a trade surplus. Additionally, it is the second most important foreign investor behind the United States, accounting for about 21 percent of the total FDI stock in 2011 in the region. Finally, it has long been the major donor of the region and accounted for more than half of the total ODA flows. In 2011, bilateral and multilateral aid from the European Union still accounted for 31 percent of the total aid to Central America. These numbers clearly show the importance of the European Union as a partner region for Central America and are an indication of the economic possibilities that might arise due to intensified cooperation between the regions. The Association Agreement thereby provides Central America an opportunity to not only intensify the relations with the European Union, but also to institutionalize the future cooperation (Aguilar Castillo 2009: 27). It is likely to bring increased economic activity as well as political dialogue and probably even higher flows of official development assistance at the multilateral level from the European institutions.

Additionally, the inter-regionalism forms a strategy of managing globalization pressures for Central America by partially opening up its markets and establishing itself as an investor friendly region in the global economy (Corley 2009: 49f.). Regional integration provides Central America with many opportunities in this context as it can position itself as a competition state while keeping the benefits of partial integration into the global economy. In these context-intensified relations with the European Union foster increased cooperation within the region, as was more closely outlined in the section 5.3.1. The support of the European Union for regional integration might be of great interest to Central America and lead to increased inter-regionalism due to a number of reasons (Corley 2009: 51): First, an intensification of relations between the two regions will likely foster regional integration in Central America. Secondly, the regional institutions in Central America become more visible on the international sphere. Thirdly, the requirement by the European Union to negotiate only with Central America as a region leads to increased coordination and joint actions. Fourthly, these processes will likely lead

to greater cohesiveness of economic policy. Lastly, Central America holds more power and has a louder voice in the international economic sphere if appearing as one region instead of several individual countries. Thus, with the negotiations for the Association Agreement and the signing of the same, Central America has agreed to “*a fast-paced and deeper regional integration, with a strong institutional base*” (Aguilar Castillo 2009: 27). The European Union on the other hand has through its development cooperation provided financing for regional integration processes and promised to keep up this support (Aguilar Castillo 2009: 40).

Furthermore, the inter-regionalism with the European Union offers Central America the opportunity to balance its relations with the United States (Corley 2009: 50). Thus, increased relations with the European Union can support Central America to overcome its high dependency on trade with the United States and the influence it has on the region. It is not only an expansion of international relations for Central America, but the European Union might also be seen as a more neutral partner than the United States (Corley 2009: 50). As can be seen, for Central America the inter-regionalism seems to fulfill similar functions as for the European Union, namely balancing and rationalizing (Corley 2009: 48).

The next chapter will provide a closer analysis of the Association Agreement between the European Union and Central America and will critically analyze its prospects.

## 6 The Association Agreement between the European Union and Central America

In 2010, the European Union and the Central American countries Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama signed an association agreement. It is one of the first inter-regional agreements and is targeted at strengthening the relationship between the two regions. The European Union – Central America Association Agreement is built around the three pillars of Political Dialogue, Cooperation and Trade (Corley 2009: 34). It forms the most comprehensive and institutionalised bilateral relationship the European Union can have with another country or region at the moment.

As it was only implemented in 2013, it is not yet clear, which implications and outcomes the agreement will have on Central America. Rivera and Rojas-Romagosa line out that *“[t]he main feature of FTAs is the change in relative prices of final goods and factors, associated with the reduction or elimination of tariffs and other trade barriers. [...] The final outcome of an FTA depends on the general equilibrium adjustments and resource reallocations resulting from relative price changes. As well as the dynamic effects created by FDI inflows, increased productivity and innovation derived from higher exposure to international markets and ideas”* (2010:7). This chapter looks at some of these effects and analyzes simulations that were done to estimate the outcome of the agreement for the two regions. Furthermore, the political context and the regulations within the agreement is examined.

## 6.1 The Political Context and Regulations

Negotiations for the Association Agreement between the European Union and Central America started in 2007 (Abrahamson 2008: 6). The ground for this was prepared during the European Union - Latin American and Caribbean (EU-LAC) summits that took place since 1999 in different cities in the European Union and in Central America. *“These summits were initiated with a view to creating a new strategic relationship between the two regions”* (Corley 2009: 34). At these summits European Union and Central American leaders first expressed their interest in an Association Agreement and a Free Trade Agreement (Abrahamson 2008: 6). The joint objective was to intensify and expand the already existing cooperation and establish a strategic relationship. In seven negotiation rounds and informal meetings a comprehensive agreement was set up.

The Association Agreement was built on the previous Political Dialogue and Cooperation Agreement that was signed in 2003 (Corley 2009: 33). The trade pillar replaces the previous trade concessions the European Union granted the Central American countries under the GSP+ scheme with a more stable and predictable set of reciprocal trade benefits (European Parliament 2012: 3). The Association Agreement was implemented in the European Union, Honduras, Nicaragua and Panama in August 2013 and in Costa Rica and El Salvador in October 2013. As of December 2013, it became operational in all countries with Guatemala being the last country to implement it. The following chapter will take a closer look at views of civil society and the main regulations of the agreement.

### 6.1.1 Public Voices

The Association Agreement between the European Union and Central America has led to several debates on its effects, both in the European Union and in Central America. While advocates of the agreement have generally lined out the positive effects on economic growth, investments and development, opponents have criticized its focus on market access for European companies on the one hand and protectionist measures of the European Union on the other hand (Corley 2009: 35). The European Union argues that the Association Agreement will bring Central America economic growth and well-being, increased job opportunities, lead to reduced poverty and support exporters in the region to diversify their production and move up in the value chain (European Commission 2012c: 3).

In the European Union and in Central America, civil society groups have expressed great concerns regarding the implementation of the Association Agreement. Many NGOs, trade unions or other organizations of civil society view it as a Free Trade Agreement that merely benefits European businesses, while Central America will lose out (Abrahamson 2008: 12; Corley 2009: 36). However, Abrahamson rightly argues that the importance of the political and cooperation pillar of the Association Agreement cannot be neglected and trade liberalization does not equate to neo-liberalism and negative effects (2008: 12f.). The regularly used comparison to the Free Trade Agreement between Central America and the US (CAFTA-DR) does not only lack credibility due to the content-related differences in the agreements, but also because the contexts are very different (Abrahamson 2008: 13). While the United States is the major trading partner of Central America and has long exercised their influence in the region, the liberalization of trade does not bring the European Union similar gains. *“Rather, to the extend neo-colonialism is at play in this context it is in the form of Europe trying to export its political and institutional model to CA [Central America]”* (Abrahamson 2008: 14). Thus, it can be assumed that the European Union has other important interests in the agreement next to economic ones such as geopolitical considerations and its position as a global player as was more closely described in the previous chapter.

### **6.1.2 Summary of Regulations**

In total, about 95 percent of all tariffs between the two regions will be eliminated by the end of the phase-out periods (European Parliament 2012: 19). Through the GSP+, the Central American countries have already had duty-free market access to the European Union for a majority of their industrial and many agricultural exports. However, as can be seen in the table below, about 2 percent to 20 percent of all Central American exports faced import duties in the European Union between 2008 and 2010. While the number of non-duty-free products was highest in Costa Rica with 63, the percentage of them was at 13 percent of total exports to the European Union. In Guatemala 45 products making up for about 7 percent of exports faced duties, while in Panama it was 44 products that accounted for 19 percent of exports. Honduras exported 26 product categories to the European Union that amounted to 10 percent of all exports to the region. Nicaragua exported 16 non-duty-free items to the European Union that accounted for a total of about 20 percent of its exports, which is the highest percentage in the region. In El Salvador, on

the contrary, only 2 percent of its exports to the European Union faced duties, which translates to 15 different products.

*Table 10: EU Imports of Non-Duty-Free Products under GSP+ from Central America, 2008 to 2010 average*

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama
Total Items	63	15	45	26	16	44
Percentage	13%	2%	7%	10%	20%	19%

(European Parliament 2012: 25)

Most tariffs on agricultural goods for Central American importers to the European Union will be eliminated, but a number of products in this sector have been excluded from complete tariff elimination or been regulated under Tariff Rate Quotas as they are considered sensitive products (European Parliament 2012: 11). Those quotas currently include the already traded volume and most will be further increased every year (European Commission 2012c: 2). For the European Union these sensitive products include “*various meat products; powdered-milk, yoghurt, butter; fresh tomatoes, grapes, apricots, nectarines, plums; cereals; rice; grain sorghum; some sugars; and certain animal feed*” (European Parliament 2012: 12). Quotas remained on “*bananas, garlic, manioc starch, sweet corn, mushrooms, beef, sugar and bulk rum*” (European Parliament 2012: 12). Thereby, special provisions have been made on the import of bananas. The detailed annual quotas for Central American imports to the European Union can be seen in the table below. The yearly quotas are increased at an annual level for certain products such as sweet corn, beef, sugar and bulk rum. While most quotas are applicable to the whole region, Panama has separate quotas for the products sugar and bulk rum and its exports to the European Union are thus not included in the regional quota for the two products. Nicaragua is allowed to export an additional quantity of beef to the European Union, next to the regional quota. For the products garlic, manioc starch, beef, some sugars, rice and bulk rum, the duties for quantities exceeding the duty free quota in any year will be at the base rate. Duties for sweet corn, mushrooms and some sugars for products imported to the European Union from Central America that are above the agreed quota in a given year the ad valorem duties will be eliminated, but specific duties remain in place at the base rate.

The import of bananas from Central America to the European Union has been regulated under a special treatment that foresees preferential customs duties for a certain quantity. These duties are annually reduced by seven € per ton from the base rate of 2010 and will reach a total value of 75 € per ton in 2020. The quantity to which this preferential customs duty is applicable is divided at a country level with 68 percent accruing to Costa Rica, 25 percent to Panama and the remaining seven percent are divided between the other four Central American countries. These import volumes will be increased by about three percent per year. If the traded quantities exceed the agreed quota for preferential customs duties, the European Union can temporarily suspend the preferential access of bananas to its market for a maximum of three months and apply duties at the base rate in this period. In contrast, African, Caribbean and Pacific countries that have signed an Economic Partnership Agreement with the European Union enjoy duty free and quota free access for their banana exports to the European Union (European Commission 2013a).

*Table 11: Annual Quotas for Sensitive Products for Central American Imports to the EU*

	Duty Free Quota	Annual Rise	Above Quota
Garlic	550 t		Duties Remain at Base Rate
Manioc Starch	5,000t		Duties Remain at Base Rate
Sweet Corn	1,440t	120t	Ad Valorem Duties Eliminated, Specific Duties Remain at Base Rate
Mushrooms	275t		Ad Valorem Duties Eliminated, Specific Duties Remain at Base Rate
Beef	9,500t Nicaragua: +500t	475t +25t	Duties Remain at Base Rate
Sugar (92 % of white sugar)	150,000t Panama: 12,000t	4,500t 360t	Duties Remain at Base Rate OR Ad Valorem Duties Eliminated, Specific Duties Remain at Base Rate (dependent on product)
Rice	20,000t	1,000t	Duties Remain at Base Rate
Bulk Rum (pure alcohol equivalent)	7,000hl Panama: 1,000hl	300hl 50hl	Duties Remain at Base Rate
Bananas (Preferential	1,738,800t (68% Costa Rica	~3%	Temporary Suspension of Preferential Customs Duty, max.

Customs Duty, 25% Panama)	3 months
annual reduction of 7 €, to 75 € per t in 2020)	

(Section A, Appendix 2 and Appendix 3 of Annex 1 of the EU-Central America Association Agreement 2012)

The table below gives an overview of selected export products from the Central American countries to the European Union that previously faced duties under the GSP+ and the new regulation under the Association Agreement. As can be seen, market access is improved particularly for cane molasses, frozen shrimps and rum. Thus, in these product categories there is potential for expansion of exports to the European Union. Sugar will have duty-free access to the European Union within the agreed quota. Consequently, there are gains to be expected, but the expansion of exports will only proceed slowly as the remaining tariffs for imports to the European Union above the agreed quota continue to be quite high. The import of Bananas is regulated under a special treatment that foresees a reduction of tariffs to half the base rate of 2010 by 2020 for products within the agreed quota. This can potentially bring Central America significant gains as bananas are an important export product of the region. However, they also encounter strong competition from ACP countries that do not face duties or quotas in its market access for bananas.

*Table 12: An Overview of Selected European Union Imports of Non-Duty-Free Goods under GSP+ from Central America, 2008 to 2010 average*

	Product	Share of Exports	Duty under GSP+	Regulation under Association Agreement
Costa Rica	Bananas	12.6%	143€ per ton	Special Treatment
El Salvador	Cane Molasses	0.9%	3.5€ per ton	Duty-Free
	Cane Sugar	0.7%	419€ per ton	Duty-Free under TRQ
Guatemala	Frozen Shrimps	2.5%	3.6	Duty-Free
	Cane Molasses	1.4%	3.5€ per ton	Duty-Free
	Bananas	1%	143€ per ton	Special Treatment
	Rum	1%	0.6€ / %vol per hl + 3.2€ per hl	Duty-Free by 01.01.2015
	Frozen Shrimps	0.7%	3.6	Duty-Free
Honduras	Frozen Shrimps	6.1%	3.6	Duty-Free
	Bananas	1.9%	143€ per ton	Special Treatment



	Cane Molasses	1.2%	3.5€ per ton	Duty-Free
Nicaragua	Frozen Shrimps	18.7%	3.6	Duty-Free
Panama	Bananas	16.5%	143€ per ton	Special Treatment
	Frozen Shrimps	2.1%	3.6	Duty-Free

(European Parliament 2012: 55-58)

Central America, similarly, has kept quotas for certain agricultural goods or excluded them from tariff elimination. This is valid for “*beef, pork, prep. meat; sugar; rice; some vegetables and dairy products*” that remain excluded from the tariff elimination (European Parliament 2012: 12). Central America will retain quotas on “*cured hams and bacon, powdered milk, whey, and cheese*” (European Parliament 2012: 12). While Central America will eliminate most tariffs on agricultural goods within ten years, the European Union grants Central American exporters immediately free access to its markets with the exception of few products that will be phased out within seven years (European Parliament 2012: 12). In Central America, products such as wine will enjoy free market access immediately, while whisky is to be liberalized with six years and fish products within seven years respectively (European Parliament 2012: 12).

Even for manufactured goods, the tariff phase-out has differing durations in the two regions. The European Union thereby will offer immediate free market access for all manufactured goods (European Parliament 2012: 12). The Central American countries in contrast will phase out a majority of tariffs of 96 percent of manufactured goods within ten years and almost all within 15 years (European Parliament 2012: 12). About 66 percent of manufactured products will enjoy immediate free entry to the Central American markets upon implementation of the agreement (European Parliament 2012: 12).

In the service sector, Central America granted the European Union wide access with the exception of “*services supplied in the exercise of governmental authority; [...] which is supplied neither on a commercial basis, nor in competition with one or more service suppliers*” (European Parliament 2012: 27). The commitments in this sector go beyond the GATS regulations at the multilateral level of the WTO (European Parliament 2012: 13). According to the European Parliament, “[t]he major difference in market access between the status quo and upon EIF [entry into force] of the Agreement will in fact be in the services sector, since the GSP+ does not include services and CA [Central American]

*commitments under the GATS Agreement were modest and more than 16 years ago*” (2012: 26). However, there are specific provisions for regulation in financial services and the exclusion of landownership in some Central American countries (European Parliament 2012: 13). Furthermore, it is explicitly noted that this liberalization of the service sector does not mean any privatization of services that are in the responsibility of the government need to be done (European Parliament 2012: 26). Also, there is the option to introduce new regulations in this sector to provide for national policy objectives (European Parliament 2012: 26).

Furthermore, in contrast to regulations at the multilateral level of the WTO, the Association Agreement includes the four controversial Singapore issues. Firstly, in transparency in government procurement, framework rules similar to the plurilateral Agreement on Government Procurement in the WTO were set up (European Parliament 2012: 13). The entity coverage thereby is largest in Costa Rica and Panama. The European Union liberalized this sector with immediate effects. Secondly, in regard to investments, provisions on current payment, capital movement and establishment with the exclusion of sensitive sectors were made while investment protection was not included in the agreement (European Parliament 2012: 13). Some member states of the European Union have kept exceptions on the ownership of land. Thirdly, competition policy will be strengthened through the setting up of a regional competition authority in Central America with support of the European Union (European Parliament 2012: 13). Thereby, *“[t]he Agreement does not prescribe the form of market organisation. It explicitly allows a party to maintain monopolies and state enterprises where this is in accordance with its domestic legislation”* (European Parliament 2012: 34). Also, it is allowed to use subsidies as long as they are general and not selective with the exception of some agricultural export subsidies that are restricted (European Parliament 2012: 34). Finally, the Association Agreement also includes trade facilitation tools and will foster the harmonization of standards and regulations. Central America thereby will establish regional customs regulations (European Commission 2012c: 5). The provisions on Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) both go beyond WTO requirements (European Commission 2012c: 4f.).

The rules of origin agreed upon are based on the Pan-Euro system and are planned to be harmonized in the region within 2 years (European Parliament 2012: 12). Thereby,

diagonal cumulation allows for the use of intermediate products and raw materials from other countries of the region, the Andean Community and Venezuela to be used in production for export under the agreement (European Commission 2012c: 4). They “*are the critical ‘small print’ that determine how far the tariff cuts set out [...] actually translate into greater export opportunities*” (European Parliament 2012: 35). The regulation on Intellectual Property Rights is based on the multilateral provision of TRIPS with the addition of many geographic indications such as champagne, parma ham or Scotch whisky (European Parliament 2012: 13). In terms of institutions, the Association Agreement will lead to the establishment of an Association Council with specialist sub-committees, an Association Parliamentary Committee and a combined Consultative Committee and Board on Trade and Sustainable Development (European Parliament 2012: 13). Included in the institutional provisions are amongst others dispute settlements, open hearings, sequencing and a mediation mechanism for non-tariff barriers to trade (European Parliament 2012: 13).

There is a specific section in the agreement on human rights and democratic principles (European Parliament 2012: 38). It foresees that all parties involved must not only make sure that the state circumvents any breach of human rights, but that such violations do not take place within their jurisdiction (European Parliament 2012: 43). “[I]t appears that human rights and democracy issues are to be discussed within the organs established by the Agreement, such as the Association Council, the Association Parliamentary Committee, which has recommendatory powers, and the Joint Consultative Committee, representing civil society and drawn from the European Economic and Social Committee (EESC) and pre-existing Central American consultative committees” (European Parliament 2012: 38). If a violation of the human rights clause takes place, the other party can implement any measure that is within international law, in proportion to the breach of the clause and that affects the implementation of the Agreement the least (European Parliament 2012: 38). However, there is no institution for the monitoring of human rights compliance.

Regulations on sustainable development in the Agreement include the obligation to comply with international conventions and provisions on labor standards and environmental protection that are based on peer review (European Parliament 2012: 13). Some of these are independent social provisions that are not connected to the economic

part of the agreement (European Parliament 2012: 37). In relation to sustainable development, certain aspects are particularly mentioned such as fair trade, organic products, corporate social responsibility and eco-tourism (European Parliament 2012: 39). Moreover, labor and environmental standards are lined out. Thereby, the established mechanism for this is a permanent political dialogue. This part will be monitored by a joint Trade and Sustainable Development Board and national advisory groups as well as a bi-regional Civil Society Dialogue Forum (European Parliament 2012: 40). In contrast to the human rights clause, the possible enforcement is very weak. However, there is a certain amount of overlap between the issues in these two categories, which means that many social issues can be tackled within the human rights provision.

### **6.1.3 Comparative Analysis**

When comparing the Association Agreement with the Political Dialogue and Cooperation Agreement, the biggest change is the inclusion of the trade pillar. In relation to the political dialogue and cooperation components, the included issues are very similar to the ones from the previous agreement. As Rueda-Junquera lines out, “[t]his [Political Dialogue and Cooperation] Agreement has been taken as the basis negotiating text with the aim of broadening its content and adapting it to current international context” (2009: 15). In terms of the political dialogue, the European Union brought the issues of nuclear weapons, the war against terrorism and the membership of the Central American countries to the International Criminal Court to the negotiating table, while Central America lined out the importance of issues such as migration and the financing of the implementation of the Agreement (Rueda-Junquera 2009: 15).

The trade pillar of the agreement is the largest addition to the previous agreement and is targeted at eliminating or reducing tariffs between the two regions. Its “*implementation will involve the commitment to establish an effective free trade area not only inter-regional (with the EU), but also intra-regional (within the CACM)*” (Rueda-Junquera 2009: 15). The Association Agreement provides the Central American countries with permanent and secure trade benefits and market access to the European Union. Because the Central American countries already profited from zero tariffs in many product categories under the special General System of Preferences (GSP) and the subsequent GSP+, there is not too much change in the trade structure between the two regions expected (European Parliament 2012: 5). With the exception of few products such as

bananas, shrimp and sugar cane, most sectors in the Central American countries are not likely to increase their profit due to the eliminated tariffs. *“For these products the Agreement offers an improvement in market access for bananas for Costa Rica; molasses and raw sugar for El Salvador; frozen shrimps, bananas and molasses for Honduras; frozen shrimps for Nicaragua; bananas and shrimps for Panama; and all of the aforementioned (except raw sugar) and rum for Guatemala”* (European Parliament 2012: 17). For the European Union, the lower tariffs in the export of automobiles to Central America are expected to bring economic benefits (European Parliament 2012: 5).

In contrast to the preferential market access that was granted to the Central American countries under the condition of their ratification and implementation of international conventions on issues such as human rights, labor rights and environmental protection, the trade concessions made within the Association Agreement cannot be withdrawn (European Parliament 2012: 17f.). However, the agreement includes a section on Trade and Sustainable Development that *“embodies a co-operative approach based on common values and interests, taking account of the differences in their level of development”* (Article 284:3, in European Parliament 2012: 17). Similarly to the conventions included in the GSP+, with the exception of conventions on drug trafficking and corrupt practices, this section refers to a comprehensive list of international conventions (European Parliament 2012: 17f.). Despite the explicitly mentioned requirement to ratify these international conventions on human and labor rights, environmental protection and good governance, a violation of the same cannot be brought before the dispute settlement or mediation mechanisms that are included in the agreement (European Parliament 2012: 18). Instead, measures, such as the referral to a group of experts that give recommendations and can present an action plan or the monitoring of the implementation of these suggested actions, can be taken (European Parliament 2012: 18).

In comparison to the Free Trade Agreement CAFTA-DR that the Central American countries (including the Dominican Republic) have with the United States, they both include a comprehensive set of aspects that go beyond the multilateral regulations at the WTO and that provide for a majority of tariff eliminations. However, several important differences stand out (European Parliament 2012: 11): Firstly, in contrast to the Association Agreement, the US CAFTA-DR is a framework agreement and has been negotiated on a bilateral level with every country individually. Secondly, the United

States allowed for longer phase-out periods of tariffs for agricultural products than the European Union. Also, it eliminated almost all import tariffs for agricultural goods with immediate effect, while the European Union protected more of its products that it considers sensitive. In turn, Central America has also kept more Tariff Rate Quotas active for agricultural products from the European Union in comparison to ones from the United States. Thirdly, the Association Agreement contains more clauses on SPS provisions that go beyond the WTO regulations. Fourthly, it also includes more public procurement than the agreement with the United States. In sum, it has to be outlined that there are important differences in the trade part of the Association Agreement and the CAFTA-DR. Additionally, the agreement between the United States and the Central American countries is merely a Free Trade Agreement and does not include as comprehensive commitments on political dialogue and development cooperation as the Association Agreement between Central America and the European Union (Rueda-Junquera 2009: 15). Thus, while there are certainly similarities between the agreements, they are likely to foster diverse processes in the region and lead to different outcomes.

## **6.2 Socio-Economic Prospects for Central America**

In general, Central America is expected to gain from the Association Agreement by up to € 2.6 billion, which is more than the gains the European Union can expect in relation (European Parliament 2012: 21). A majority of this is a result of the projected growth in the production and export of vegetables and fruits in which particularly Costa Rica and Panama have comparative advantages. Also the electronic sector and the textiles and clothing are likely to experience an increase in production and export. The effect on services is said to be positive but depends largely on the ability of the Central American countries to create a favorable investment climate to facilitate trade in services.

The Central American countries particularly profit from tariff reductions in products that did not enjoy duty-free access to the European Union market under the General Scheme of Preferences (GSP) plus. This includes products such as bananas, frozen shrimps and sugar. Also, Central America can expect growth in foreign direct investments and consequently a stimulation of its production for export in sectors such as textiles and clothing. The following sections examine the estimated effects of the tariff reductions on a number of indicators for Central America and take a closer look at sectorial changes and its implications for economic and social development.

### ***6.2.1 CGE Modeling and Macro-Economic Effects***

In order to assess possible outcomes of the Association Agreement on exports and production and consequently in economic growth and welfare gains in Central America, two econometric analyzes based on CGE modeling will be compared in this section. Firstly, an analysis done by Rivera and Rojas-Romagosa in 2007 and secondly, simulations for the Sustainability Impact Assessment done by ECORYS in 2009. As all the calculations inherent were done before the finalization of the agreement, they are based on assumptions of possible scenarios. In reality, 95 percent of all tariffs will be eliminated after the phase-out periods (European Parliament 2012: 19). Additionally, sensitive sectors in particular in agriculture have been excluded on both sides of the agreement and others face Tariff Rate Quotas. In regard to trade costs to service trade and trade facilitation, the concrete percentages of reductions in trade costs depend to a large extend on the implementation and can thus only be assumed as of now (European Parliament 2012: 21). However, a comparison of the scenarios that most closely represent

the actual outcome of the negotiations will help to understand the economic effects of trade liberalization under the Association Agreement.

The simulation of the CGE model is based on data from the GTAP Database – a comprehensive collection of data on tariffs and trade. In the GTAP Database, recent trade developments are generally reflected and consequently, effects of a particular trade agreement can be calculated based on the existing trade relations. It has to be noted that the aggregation of Central America in the GTAP Database includes Belize (Rivera / Rojas-Romagosa 2007: 13). Also, there are certain limitations to the CGE model (Rivera / Rojas-Romagosa 2007: 12): Firstly, these models generally do not include short-term readjustment costs such as restructuring of production or temporary unemployment. Secondly, mostly dynamic effects of trade such as increased FDI inflows, shifts in production, adjustments of labor supply and transfers of technology are not accounted for in the simulations. Thirdly, complementary policies within the countries affected by the trade agreement are not assessed. Consequently, CGE models cannot fully depict the great complexity of effects of trade agreements, but they can give a good estimation of static effects such as changes in production and trade patterns and shifts in wages and employment (Rivera / Rojas-Romagosa 2007: 11f.).

For their simulations Rivera and Rojas-Romagosa (2007) use the GTAP 6 Database with the base year 2001 and include the ATC protocol implementation and the expansion of the European Union as well as the DR-CAFTA. Thus, the effects of the Association Agreement between Central America and the European Union in their simulations are calculated while taking into account how other phenomena in the international context of trade influence the respective economies. Especially relevant in this context is the effect of the ATC protocol for Central America that “*experiences GDP and welfare losses from the increased Chinese competition in textiles and apparel*” (Rivera / Rojas-Romagosa 2007: 16). However, the DR-CAFTA and the Association Agreement with the European Union change this again.

Rivera and Rojas-Romagosa compare three scenarios, out of which two will be presented here: The first scenario (named scenario 1) assumes that the sectors veg\_fruits, sugar and bovine meat are sensitive sectors for the European Union and will thus be excluded from the tariff eliminations. For Central America other cereals, bovine meat, dairy products and processed sugar are considered sensitive and are consequently excluded. The second



simulation assumes that a full liberalization of tariffs takes place, which is described as scenario 2 in the table below. In comparison the actual Association Agreement lays somewhere in between these assumptions. Certain products from these sectors are exempt from the tariff eliminations such as tomatoes, grapes, apricots, nectarine and plums, some sugars and meat products for European Union imports and beef, sugar and some dairy products are excluded for Central American imports (European Parliament 2012: 12). Meanwhile, other products considered sensitive enjoy quotas that cover the currently traded amounts and that will be increased every year. The European Union kept such quotas amongst other on bananas, beef and sugar while the Central American countries kept them for products such as powdered milk or cheese (European Parliament 2012: 12). Thus, economic effects that lay between the two scenarios are likely to occur.

The Sustainability Impact Assessment by ECORYS (2009) used two separate scenarios that will be presented here. They are calculated based on the GTAP 7.5 Database with the base year 2004. Similarly to the previously described simulation by Rivera and Rojas-Romagosa (2007), it tries to depict the reality of world trade as close as possible. It thus takes into account the effects of the new General Scheme of Preferences of the European Union and its effects. Also, the simulation accounts for a deeper integration of the Central American Common Market. Additionally, it assumes that the Doha Development Round will be concluded successfully and the agreed tariff lines will be implemented. The first scenario of ECORYS (named scenario 1 below) pictures a comprehensive trade agreement with 90 percent of tariff reductions, 25 percent of reductions in trade costs to service trade and trade facilitation of 1 percent of trade (European Parliament 2012: 21). The second (named scenario 2) in contrast assumes 97 percent of tariff reductions, 75 percent of reductions in trade costs to service trade and trade facilitation of 3 percent of trade (European Parliament 2012: 21). Similarly to the previously described cases, an outcome between the two scenarios seems most likely. The actual elimination of tariffs is at 95 percent, while the other two assumed percentages can only be assessed after implementation of the agreement. Regional averages are calculated with the data given in the Sustainability Impact Assessment. Certain indicators, in particular effects on wages and imports, for El Salvador and Honduras were not available and are thus not included in the regional average.

In the first scenario by Rivera and Rojas-Romagosa that is named GTAP 6 in the table below, the sectors `veg_fruits` and `sugar` are excluded from the tariff elimination for Central American exporters, while all others are reduced to zero. Vice versa Central America has kept tariffs on a number of sensible sectors in the scenario too. As can be seen in the graph below, Central America actually experiences a loss of welfare meaning a decline in production and consumption of 0.1 percent of its GDP and also GDP does not change. For the European Union the changes in GDP and welfare are not significant. Inter-regional trade rises by 11.6 percent and 12.4 percent respectively. *“These results remark that the static gains for CA [Central America] are closely related to the reduction of the EU agricultural protection”* (Rivera / Rojas-Romagosa 2007: 19). Due to the remaining tariff protection of the two sectors yielding the potentially highest gains of liberalization in this scenario, there are no significant changes in the production and export structure and only a small decrease in wages (Rivera / Rojas-Romagosa 2007: 19).

The second scenario shows significant welfare gains of 1.6 percent and GDP growth of 0.2 percent for Central America. This indicates the relatively high importance of the European Union as a trade partner for the region and outlines the potential gains for Central America in the case of full liberalization of tariffs (Rivera / Rojas-Romagosa 2007: 16). For the European Union, in contrast, no noteworthy changes in welfare or GDP are expected, due to the relatively small importance of Central America as a trade partner. Inter-regional trade is expected to grow by 45.3 percent and 45.6 percent respectively. This indicates a large potential for the expansion of exports for both regions, which is especially important for Central America.

This projected growth of trade is to a large extent a result of the competitiveness of the sugar industry in Central America and the high protection that the European Union has kept on imports of sugar (Rivera / Rojas-Romagosa 2007: 17). Interestingly, the largest barrier that Central American exporters face seems to be the tariffs by the European Union as the simulation results do not change when agricultural subsidies are eliminated in the model (Rivera / Rojas-Romagosa 2007: 17). With full liberalization, the production of processed sugar in the region would rise by 150 percent, while exports would reach three times their current value (Rivera / Rojas-Romagosa 2007: 17). Another sector that would highly profit from zero tariffs is the `veg_fruits` sector that would experience an increase of 60 percent in exports to the European Union (Rivera / Rojas-Romagosa 2007:

17). At the same time, the production and export of other agricultural goods, agro-industrial products and manufactured goods would decay similarly to “*the maquila-based textiles and apparel production, which is concentrated in urban areas and [will] bring output and export opportunities to rural areas*” (Rivera / Rojas-Romagosa 2007: 17). Due to the restructuring of production that follows this change and the different demand, the return on land would increase by 46 percent and wages would rise by 3 percent (Rivera / Rojas-Romagosa 2007: 17).

*Table 13: Estimated Static Effects of the Association Agreement, in percent*

	GTAP 6		GTAP 6		GTAP 7		GTAP 7	
	Scenario 1		Scenario 2		Scenario 1		Scenario 2	
	CA	EU	CA	EU	CA	EU	CA	EU
Gross Domestic Product	0.0	0.0	0.2	0.0	0.7	0.0	0.6	0.0
Welfare Gains (% of GDP)	-0.1	0.0	1.6	0.0				
Inter-Regional Trade	11.6	12.4	45.3	45.6				
Total Exports					5.0	0.0	7.6	0.0
Total Imports					4.7	0.0	8.0	0.1
Unskilled Wages					0.4	0.0	0.7	0.0
Skilled Wages					0.1	0.0	0.0	0.0

(Rivera / Rojas-Romagosa 2007; ECORYS 2009)

In the calculations done by ECORYS that are also depicted in the table above under the header GTAP 7, the results are quite different due to the differing baselines, the inherent assumptions and the calculated scenarios as well as the different indicators. It is important to note that the calculations are based on a static model and describe the short term outcomes only. As can be seen, there are substantial variations between the regional averages in the two scenarios. Furthermore, there are also substantial differences between the Central American countries. For the European Union the effects are negligible in all scenarios, in relation to its total GDP level, trade volume and wages. In Central America, changes in GDP are expected to be between 0.6 and 0.7 on average. The changes in national income or GDP are largest for Panama with 1.5 percent to 1.9 percent increase, shortly followed by Costa Rica that is projected to experience GDP growth between 1.3 percent and 1.6 percent. Honduras is projected to enjoy static gains between 0.6 percent and 1 percent of GDP growth due to the Association Agreement with the European Union, while Nicaragua will likely experience an increase of 0.5 percent and 0.8 percent

respectively. El Salvador is estimated to have a change in national income that is between 0.4 percent and 0.7 percent and Guatemala one between 0.1 percent and 0.2 percent.

For the European Union, the effects on its overall trade volume are practically negligible in both scenarios as the increase in trade with Central America in relation to its overall trade volume is very small. In contrast, for Central America in scenario 1 - that is an underestimation of the actual liberalizations agreed on in the Association Agreement - the total value of exports rises by 5 percent for Central America while its imports rise by 4.7 percent. In scenario 2, exports are predicted to rise by 7.6 percent and imports by 8 percent. In both scenarios, Panama and Costa Rica account for the largest increases in exports as well as imports. Both Guatemala and Honduras are predicted to have increases in trade volume that are significantly below the rise projected for Panama and Costa Rica but still above the lowest increases that are said to occur in El Salvador and Nicaragua respectively. The increases in exports in both scenarios result to a large extend from an expansion of exports in fruits and vegetables and electronics (ECORYS 2009: 74). A more detailed description of expected sectorial changes due to the Association Agreement will follow in the next section.

The estimated changes in wages based on shifts in production and demand of labor are positive in both scenarios in Central America. Sectorial shifts in labor thereby occur due to larger incentives in sectors in which production and exports are expected to increase (ECORYS 2009: 75). This excludes El Salvador and Honduras as in these countries data on labor wage changes is not available. The positive effect on wages indicates the generally higher production levels and increased demand for labor that will occur due to the Association Agreement. The effect is much more pronounced for unskilled labor that is expected to experience an increase in wages between 0.4 percent and 0.7 percent. Interestingly, skilled labor seems to gain more from scenario 1 with 0.1 percent rise in wages, while it is only projected to gain a negligible 0.02 percent in scenario 2. When looking at the country specific data, in scenario 1, unskilled wages rise only in Costa Rica, Nicaragua and slightly in Guatemala, while Panama will not experience significant changes. However, skilled labor will only experience a rise in wages in Nicaragua and to a lesser extend in Costa Rica. In Guatemala and in Panama wages for skilled workers are expected to reduce. In scenario 2, positive effects on wages occur in all countries for unskilled wages and in Nicaragua and Costa Rica for skilled wages. Nicaragua is

expected to have the highest rises in wages due to the agreement. Generally, the estimated gains in wages tend to be overestimated especially for unskilled labor (ECORYS 2009: 76). This is due to the high percentage of informal labor in all Central American countries that indicates a high number of hidden unemployment. Once more jobs are available, it is likely that more people that were formally active in the informal economy will enter the labor markets. Consequently, unskilled labor will not be scarce and wages will not rise in the amount indicated, but to a lesser extent.

The basic CGE modeling does only calculate static effects of trade due to the complexity of dynamic effects and thus, underestimates the actual changes of trade on production and economic growth. As Rivera and Rojas-Romagosa point out, “[t]hese include: international capital flows, and FDI, the availability of cheaper and higher quality intermediate inputs, the implementation of trade facilitation mechanisms, increased competition in the domestic markets, and possible technological transfers associated with a closer integration with international markets. These dynamic effects have the potential to generate much larger welfare and outcome benefits than the static gains” (2007: 21, based on Francois et al. 1996). In order to account for some of these effects, both studies that were analyzed previously also included some dynamic effects in their calculations.

Rivera and Rojas-Romagosa included a 2 percent reduction of iceberg costs in their scenario to account for an increase in trade facilitation mechanisms such as “the simplification of customs procedures, the harmonization of standards and regulations between regions, and in a more general view: customs automatization, better ports and transport infrastructure, and other means that reduce the effective price of imports” (2007: 22, based on Hertel et al. 2001). Additionally, they incorporated endogenous capital accumulation into their simulation to better reflect the expected increase of Foreign Direct Investment and its effects (Rivera / Rojas-Romagosa 2007: 23). The results of this simulation for both scenarios are seen in the table below.

As can be seen, the welfare gains, GDP growth and inter-regional trade are all above the projections made in the static model. The difference between the first scenario that reflects an exclusion of the sensitive sector and the second scenario that assumes full liberalization gets even more pronounced than before (Rivera / Rojas-Romagosa 2007: 22). However, when accounting for dynamic effects in scenario 1, welfare is rising. In scenario 2 about 75 percent of the change are due to an increase in the capital stock.

Meanwhile, in the scenario 1 both of the included dynamic effects account for about half of the change. As Rivera and Rojas-Romagosa point out, when accounting for these dynamic effects, the scenarios are “*an approximation of the full impact of EU-CAAA when both the expected static and dynamic effects are included. Moreover, it can be regarded as a lower-bound estimating, since not all the dynamic effects are estimated, such as an increased competition and productivity associated with higher trade volumes*” (2007: 24).

*Table 14: Estimated Dynamic Effects of the Association Agreement, in percent*

	GTAP 6 Scenario 1		GTAP 6 Scenario 2		GTAP 7.5 Scenario 1		GTAP 7.5 Scenario 2	
	CA	EU	CA	EU	CA	EU	CA	EU
Gross Domestic Product	0.7	0.0	2.0	0.0	0.7	0.0	1.6	0.0
Welfare Gains (% of GDP)	0.5	0.0	3.0	0.0				
Inter-Regional Trade	21.4	45.5	56.9	52.1				
Total Exports					5.3	0.0	8.7	0.1
Total Imports					5.1	0.0	9.2	0.1
Unskilled Wages					0.3	0.0	1.1	0.0
Skilled Wages					0.1	0.0	0.7	0.0

(Rivera / Rojas-Romagosa 2007; ECORYS 2009)

The simulations done by ECORYS that are depicted in the table above include dynamic and predict the long-term effects of the Association Agreement. The European Union – similarly to all previous simulations – only experiences very small growth in GDP, trade volumes and wages due to its relative small importance of trade with Central America. For Central America the simulation shows higher gains in all aspects apart of national income and wages in scenario 1 that on average rise by a similar percentage than in the short-term simulations that were described before. Scenario 2 predicts significantly higher growth of GDP and wages, while the rise in exports is only slightly higher than in the previous model analyzing static gains. In general, national income in Central America is expected to growth between 0.7 percent and 1.6 percent in the long term due to the Association Agreement. Interestingly, the highest rise is predicted for Costa Rica and Honduras, followed by El Salvador. The increase in national income for Panama is estimated to be only slightly above average. Nicaragua and Guatemala are estimated to have only very small percentage gains in national income due to the agreement. For

Central America, both exports and imports are expected to rise by less than 0.5 percent more in scenario 1 than in the short term simulation and by more than 1 percent more in scenario 2. The country specific variations are thereby very similar to the ones in the short term model. Again, scenario 2 is projected to bring a much larger percentage increase than scenario 2.

In scenario 1, unskilled wages are expected to slightly rise by 0.3 percent. At a country level, Panama is estimated to experience a slight decline, while Costa Rica is expected to achieve a gain and Nicaragua and Guatemala are expected to have slightly rising wages for unskilled labor too. Skilled labor will experience a small rise of 0.1 percent in the region. This is mostly due to a relatively strong decline in Panama that is partly offsetting the effects of the expected rise in wages for skilled labor in the other countries that is highest in Costa Rica. Scenario 2 shows higher gains for unskilled and skilled labor - both in relation to the short term model and scenario 1. Unskilled wages are expected to grow by 1.1 percent, with particularly high effects in Costa Rica. In contrast, Panama is projected to experience a slight decline in unskilled wages. A similar pattern can be observed for skilled labor that is estimated to grow by 0.7 percent, with by far the highest growth in Costa Rica and a relatively strong decline in Panama. This is due to Panama's *"dependency on some very strong sectors [that] negatively affect[...] the other sectors in the economy, in this case resulting in decreasing wage levels at a macro-economic level"* (ECORYS 2009: 76). As was described before, these effects have to be analyzed with caution due to the high relevance of informal labor in the region that is very likely to offset some of the effects of rising wages, particularly for unskilled labor.

In general, trade is expected to rise due to the agreement. Thereby, the structure of trade will change due to the shift in production initiated because of the Association Agreement (ECORYS 2009: 74). Caused by competitive advantages, the textiles and clothing sector will experience a relative shift from Panama and Costa Rica towards El Salvador, Honduras and Guatemala (ECORYS 2009: 74). The fruits and vegetables sector is expected to growth in overall terms in the region and especially so in Costa Rica and Panama (ECORYS 2009: 74). While the electronics sector and its exports will grow particularly in Costa Rica, the transport equipment sector is expected to decline (ECORYS 2009: 74). In Central America generally, trade within service sectors is likely to increase, which will in part be due to higher foreign direct investments that facilitate

trade in services (ECORYS 2009: 74). However, the effects of the Association Agreement on foreign direct investments will to a large part depend on the degree of improvement of the investment climate in the region. Thereby, *“[i]nvestment condition amelioration at a regional level in Central America is expected to have an overall beneficial effect, inducing increased EU investments, but also intra-regional investments and FDI from other parts of the world”* (ECORYS 2009: 73). Increased investment is not only projected to have positive growth effects on the national income, but on output and production as well. Furthermore, it shows the reinforcing effects that trade and investments have on each other (ECORYS 2009: 73). Finally, the positive effects of investments on people in Central America will be dependent on the targets and whether *“the investments not only flow to export-oriented large firms, but spread and disperse into the more domestically focused small producers”* (ECORYS 2009: 73).

The effects of the projected increase in trade, investments and production will also lead to changes in other social and economic indicators. In general, with the exception of Panama, wages are expected to rise slightly. The shifts of production that are being expected will thereby lead to a rising attractiveness of growing sectors for labor due to higher wages and more demand. This factor is predicted to occur in all of Central America with the exception of Panama and is going to be highest in Costa Rica (ECORYS 2009: 75). Thereby, some of the effect of rising wages will probably be offset by an increasing number of workers from the informal economy being integrated into formal labor markets. On the contrary, in Panama, a significant negative labor market displacement is likely to occur that is caused by declining wages (ECORYS 2009: 75). Across the region, certain sectors are expected to pull employment towards them, which is closely connected to the competitive advantage of sectors. In Costa Rica and Panama such effects will occur in the fruits and vegetables sector, in Costa Rica, Guatemala, El Salvador and Honduras in the electronics sectors and in Nicaragua, Guatemala, El Salvador and Honduras in the textiles sector (ECORYS 2009: 75). Due to the relatively high expansion of the fruits and vegetables sector in Panama and Costa Rica that also creates more demand for labor, migration of unskilled labor from the other countries in the region can be expected (ECORYS 2009: 76).

The rise in wages - especially for unskilled labor - has positive effects on poverty, while the lower prices particularly for primary products that will occur in all Central American



countries apart of Costa Rica and Panama can have similar effects. Also, increased demand for labor can lead to the formalization of workers in the informal sector and thus decrease hidden unemployment, which again has positive effects on poverty (ECORYS 2009: 76). When taking these factors together, the Association Agreement is projected to lead to a reduction of poverty by about 0.6 percent in Central America (ECORYS 2009: 78). The most significant reductions of poverty will thereby happen in El Salvador and Honduras and the smallest ones in Costa Rica (ECORYS 2009: 78). Panama is likely to experience a very small increase in poverty due to the worsening of the relation between consumer prices and income (ECORYS 2009: 78). In reality, the positive effects on poverty could be higher due to a number of factors that were not included here such as increased employment due to foreign investments.

Inequality is projected to decline within the Central American countries due to the relatively higher rise in wages of unskilled labor than of skilled labor (ECORYS 2009: 79). However, the growth of incomes in Costa Rica and Panama is going to be higher in comparison to the other countries in the region, which suggests that inequality between the countries will slightly increase (ECORYS 2009: 79). *“With respect to income inequality at sector level, there is the risk that increased specialisation patterns and an orientation to export within some sectors, such as the FVN [fruits, vegetables and nuts] sector, may be of benefit to firms which are already more efficient and relatively large, while SMEs and small-scale (subsistence) farms may not be able [to] benefit from the new opportunities and could even face a relative competitiveness erosion”* (ECORYS 2009: 79). Additionally to these effects, the Association Agreement could lead to more equality between men and women as the textiles and clothing sector that traditionally employs a majority of women is expected to increase employment and pay higher wages (ECORYS 2009: 79). This will in relation lead to more benefits accruing to female workers in Honduras, El Salvador and Guatemala (ECORYS 2009: 79). In Costa Rica and Panama the effect will to a small extent be reverse. However, these changes in gender equality will probably only be marginal.

### **6.2.2 Sectorial Analysis**

Due to specialization based on comparative advantage, sectorial shifts in production are expected to occur within Central America as well as with the European Union (ECORYS 2009: 72). Thereby, certain sectors are expected to grow due to the Association

Agreement, while others loose in relation. This will also lead to changes in prices and employment. In general, production and output are likely to expand in the region and lead to increased employment. The increase in trade will thereby play a major role. Both imports and exports in Central America are expected to rise considerably, with exports growing even more than imports (ECORYS 2009: 45). An analysis of this can further support the understanding of such changes on *“poverty and social impact analysis because they give information about the cost of living and can be combined with wage effects to see what happens with incomes in Central America”* (ECORYS 2009: 44). The shifts in production can be explained in part by the comparative advantages that Central America has in these sectors, by the trade structure with the European Union and by tariff reductions. In the table below, there is an overview of expected changes in output and production after the implementation of the agreement.

As can be seen in the table below, the sector fruits and vegetables is likely to experience an expansion by more than 10 percent on average and a particular increase in Panama and Costa Rica. This is also a result of the substantial increase of exports to the European Union in this sector (ECORYS 2009: 45). The sugar production is projected to increase slightly in Costa Rica, El Salvador and Honduras. However, this effect is only very small. In Panama and Costa Rica the prices of agricultural products are expected to increase considerably due to a rising scarcity of land (ECORYS 2009: 44). In Nicaragua and Guatemala this effect is much less pronounced. Due to the high output rise in the production of fruits and vegetables in Costa Rica and Panama, wages and employment will also experience an increase in this sector (ECORYS 2009: 45).

In industrial production, processed foods and beverages are expected to have an expanded production in all countries but Costa Rica and Panama, where they are going to decline. This will be substituted by increased imports in this category in the two countries as well as in Guatemala (ECORYS 2009: 46). The production of electronic equipment is likely to bring gains from increased output in Costa Rica, El Salvador and Honduras. Panama and Nicaragua will experience a decline in this sector as production shifts within the region occur. Exports are likely to shift from Panama and Nicaragua to both Guatemala and especially Costa Rica (ECORYS 2009: 45). This will also lead to increased employment in this sector in Costa Rica, Guatemala, El Salvador and Honduras (ECORYS 2009: 45). Transport equipment is projected to experience a decline in production that is highest in

Panama with a drop of 25 percent and lowest in Nicaragua with an expected drop of 1.8 percent. Subsequently, imports from the European Union will rise (ECORYS 2009: 45). This will also lead to reduced employment of up to 22.3 percent in this sector as well as in the sector producing motor vehicles and parts (ECORYS 2009: 45). This is another sector that is likely to shrink due to the Association Agreement, with the exception of Costa Rica. Similarly, the production of other manufactured goods is likely to decrease slightly apart of in Costa Rica. In Nicaragua, exports from the sector other machinery equipment will rise in Nicaragua, next to exports of chemicals (ECORYS 2009: 45). A shift towards the production of textiles and apparel will lead to increased employment in this sector in Nicaragua, Guatemala, El Salvador and Honduras (ECORYS 2009: 45). Prices for industrial goods and services are generally expected to decline for Guatemala, Nicaragua and Honduras - aside of prices for motor vehicles and parts in Guatemala and Nicaragua (ECORYS 2009: 45).

Public services are generally likely to experience an increase in all countries, while financial and insurance services are expected to shrink due to the increased competition from the European Union. However, this will also lead to lower prices for these services in all countries but Costa Rica and to a decline in employment in this sector (ECORYS 2009: 45f.). Trade in services in general is projected to experience an increase across Central America with the exception of Nicaragua (ECORYS 2009: 46). Imports will particularly increase in business services, construction, financial and insurance services (ECORYS 2009: 46). *“The extent of potential positive impacts on output and real income in the services sectors, including maritime transport services, depend to a large extent on the degree of successful regional integration, liberalization and NTM reduction in the Central American region, including logistic bottlenecks and regulatory divergence between the countries”* (ECORYS 2009: 72).

*Table 15: Estimated Sectorial Changes in Production by Country, in percent*

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama	Central America
<b>Agricultural Products</b>							
Vegetables, Fruits, Nuts	20-23%	+	+	+	+	58-65%	+10% increase
Sugar	+0.1%	+0.1%	/	+0.1%	/	/	increase

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**Industrial  
Products**

Processed Foods, Beverages, Tobacco	-	+	+	+	+	-	increase
Electronic Equipment	+	+	/	+	-	-	increase
Transport Equipment	-	-	-	-	-1.8%	-25%	decline
Motor Vehicles and Parts	+	-	-	-	-	-	decline
Other Manufactures	+	-	-	-	-	-	decline
<b>Services</b>							
Public Services	+	+	+	+	+	+	increase
Insurance Services	-	-	-	-	-	-	decline

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(ECORYS 2009: 44ff.; - indicates a decrease, + indicates an increase, / indicates no change)

*“Overall, like with output changes, Costa Rica and Panama see employment gains in electronic equipment and vegetables, fruits & nuts, Nicaragua and Guatemala see employment gains in textiles, machinery and chemicals, rubber & plastics, and El Salvador and Honduras – ‘in the middle’ – see gains in electronic equipment, vegetables, fruits & nuts and textiles”* (ECORYS 2009: 45). The sectors that experience the largest expansion of production are thereby fruits and vegetables as well as electronics. Following, a more detailed description of sector specific projections is given for sectors in which Central America has comparative advantages and which have great potential for expansion such as fruits and vegetables (including products like bananas or pineapples), sugar, textiles and clothing and electronics.

In Central America especially the agricultural production of fruits and vegetables is expected to rise. According to the Sustainability Impact Assessment, the expansion of output in this sector will be between 20 percent and 23 percent in Costa Rica, between 58

percent and 65 percent in Panama and smaller but still positive in the other countries of the region (ECORYS 2009: 60). Trade in this product category is expected to rise across all countries in the region (ECORYS 2009: 60). An additional specialization towards the production of fruits and vegetables where Central America has comparative advantages will take place which could lead particularly to an increase in the agricultural production of tropical fruits such as bananas or pineapples. Due to the high demand for organic fruits and vegetables in the European Union, this sector is likely to increase too (ECORYS 2009: 60). Furthermore, especially in Costa Rica and Panama the use of land for agricultural production of fruits and vegetables will rise by about 13 percent and about 40 percent respectively (ECORYS 2009: 61). The rise of output in fruits and vegetables will lead to increases in income and employment within this sector on the one hand and higher prices for fruits and vegetables on the other. Consequently, it will have overall positive effects, but mixed results for consumers. Due to the higher amount of employment opportunities that are expected in this sector as a result of the Association Agreement, poverty and income inequality are likely to be reduced (ECORYS 2009: 61). Also, workers that were previously active in the informal economy could be drawn in the formal sector. Furthermore, it could lead to migration flows of unskilled workers “*from Nicaragua, Honduras and El Salvador towards Costa Rica and Panama*” that are drawn towards regions with more and better employment opportunities in the fruits and vegetables sector (ECORYS 2009: 61). The effects of the increase in production will most probably not be evenly spread across all countries and regions in Central America. Consequently, there is the risk that gains from increased production will diverge between regions and between larger exporting companies, small and medium sized enterprises and subsistence farmers as not all of these groups will have the same opportunities to benefit from the increased opportunities that become available through the Association Agreement (ECORYS 2009: 60).

The production of sugar is another comparative advantage in the region, as Guatemala is the second biggest producer of sugar in Latin America (ECORYS 2009: 50). However, its exports to the European Union have been very limited due to the high tariffs sugar faced and the preferential treatment of the African, Caribbean and Pacific (ACP) countries. Based on the Sustainability Impact Assessment, due to the low or eliminated tariffs faced by the ACP and despite the high ability to compete, there are no significant gains to be expected from this sector (ECORYS 2009: 50). Costa Rica, El Salvador, Honduras and

Guatemala could experience small gains in production, a slight increase in trade and some welfare gains (ECORYS 2009: 50). However, the overall effects could be higher in the long term as the agreement will subsequently increase the quantity of duty free imports of some sugars to the European Union.

The Association Agreement will likely lead to an increase of the production of textiles and clothing in Honduras, El Salvador and Guatemala and a decrease of the sector in Costa Rica and Panama (ECORYS 2009: 63). However, the overall effect is positive even for these countries as prices are likely to decrease due to the increased output. Exports to the European Union are projected to rise and will to a small extent provide Central America with the opportunity to diversify their exports and mitigate the dependency on exports to the United States (ECORYS 2009: 63f.). Furthermore, an increase in investments from Asia and the United States in this sector is expected, as the production of textiles and clothing in Central America will enable them to export them to the European Union without paying any customs duties (ECORYS 2009: 63). To a lesser extent, investments from the European Union in this sector could rise as well. Consequently, increased employment in this sector – particularly of women – would reduce poverty and illegal immigration towards the United States (ECORYS 2009: 64). However, migration within the region is expected to rise as workers move to cities to work in maquilas there (ECORYS 2009: 64). Generally, it has to be said that much of the effects of the increase in production of textiles and clothing are determined by the involved companies and whether they are foreign owned and export oriented producers or smaller and domestically oriented.

The electronics sector and particularly its potential for expansion due to the Association Agreement are primarily relevant in Costa Rica (ECORYS 2009: 65). It is estimated to grow in production and export, which in turn leads to increased employment of mostly skilled labor (ECORYS 2009: 65). In Guatemala, El Salvador and Honduras the sector is expected to gain slightly, but due to the small size of it in these countries this does not have significant economy wide effects (ECORYS 2009: 65). In Nicaragua the electronics sector is projected to contract marginally (ECORYS 2009: 65). There is a relative shift from Panama and Nicaragua towards El Salvador, Costa Rica and Honduras (ECORYS 2009: 72). In all Central American countries, prices for electronics are predicted to rise, but this does not have a large effect on consumers due to the nature of this good

(ECORYS 2009: 65). The expanded trade in electronics and an increase in investments will continue to integrate *“the country (and region) in the global supply chain”* (ECORYS 2009: 65). The effects on employment will be particularly relevant for Costa Rica that will experience a rise in this sector and to a lesser extent for Guatemala, Honduras and El Salvador (ECORYS 2009: 65). Nicaragua and Panama in contrast could face a reduction of employment (ECORYS 2009: 65). Due to a majority of highly skilled labor as well as foreign corporations being active in the electronics sector, no significant impact on poverty and inequality is to be expected due to an expansion of this sector (ECORYS 2009: 65).

## 7 Conclusion

The Association Agreement is a permanent institutionalization of the relations between Central America and the European Union. It is of a very comprehensive scope and includes provisions on political dialogue, trade and development cooperation. Thereby, it substantially upgrades the previous relationship as temporary preferential trade concessions under the European Union's General Scheme of Preferences plus are exchanged with reciprocal trade liberalization. The relationship between the European Union and Central America is subsequently expected to deepen and gain in importance in the coming years.

For the European Union one of the main motives for increased cooperation and the negotiation of the Association Agreement seem to be its aim of establishing itself as a global power. Its support for regional integration in Central America can be understood in this context. Furthermore, it attempts to strengthen regional alliances and appear as a global actor in Latin America to increase the possibility of a future Euro-Latin American free trade area. Next to these strategic and political motives, it expects to benefit from increased investment opportunities in Central America that will enable European corporations to produce export goods in the region for larger markets in geographical proximity like the United States. Additionally, the liberalization of service trade is projected to bring many opportunities for European firms.

Central America, on the other hand, will potentially benefit from much higher economic gains in relation to its size. Furthermore, its strategic and political aims include the potential for mediating the hegemony of the United States in the region and diversifying its production and exports. Also, the support of the European Union for regional integration can further such processes in Central America, even though the establishment of regional institutions and mechanisms that is foreseen in the Association Agreement brings high costs.

It can be concluded that Central America will experience growth and development due to the implementation of the Association Agreement. Especially the sectors fruits and vegetables, electronics and textiles will profit from welfare gains of production and consumption increases with the largest growth expected in Costa Rica and to a lesser extent in Panama. Furthermore, poverty will be reduced (with the exception of Panama)



as the demand for labor rises; wages increase and workers from the informal sector are integrated into the formal economy. Inequality within the Central American countries will decline, but inequality between Costa Rica and Panama and the other countries of the regions will increase.

The expected rise in trade volume and welfare gains due to the Association Agreement will largely be a result of tariff eliminations for products that were previously excluded from the preferential trade concessions granted to the Central American countries under the General Scheme of Preferences plus. In specific, this includes agricultural products such as frozen shrimp or cane molasses that now enjoy duty-free access to the European Union market. Other products considered sensitive like cane sugar or bananas will be subject to zero tariffs or preferential customs duties for amounts traded below fixed tariff rate quotas. The phase-out periods thereby account for the asymmetry between the two regions.

In the long run, trade and production will also increase as new export products from Central America enter the markets of the European Union. The potential for increased exports to the European Union largely depend on the competitiveness of the Central American exporters. Their opportunities for export are limited by the preferential trade concessions granted to African, Caribbean and Pacific countries and by the agricultural subsidies granted under the Common Agricultural Policy of the European Union. To mediate some of the negative effects of the agricultural subsidies by the European Union, Central America kept tariff rate quotas on certain products and excluded others from tariff elimination such as dairy products and some vegetables.

Dynamic effects of the Association Agreement such as increased foreign direct investment have the potential to bring high welfare gains. However, this depends to a large extent on the ability of the Central American countries to improve its investment climate and attract foreign investors. Furthermore, the involvement of multinational corporations in the production and export of goods does not necessarily mean that Central America will benefit. Rather, the potential of foreign direct investment to foster growth and subsequent development in the region depend largely on whether such investments go to larger export-oriented and multinational corporations or smaller domestically oriented firms.

Generally, the countries within the region will further specialize on the production of goods where they have a comparative advantage. In the long term, this might lead to a specialization on the production of agricultural products such as bananas, pineapples or sugar, while industrial goods are increasingly imported. This reflects typical patterns of North-South trade and can lead to undesired results. The specialization on agricultural production yields few opportunities for growth due to unfavorable terms of trade, high volatility of prices and consequent uncertainty, the impossibility to upscale production and the diminishing returns of trade. So far, Costa Rica has been the only country in the region that managed to significantly diversify its production and export patterns by implementing policies to attract foreign investors and specializing on the production of high technology electronic goods. To a lesser extent, a specialization on textiles and clothing across Central America has attracted foreign investors producing for the export to markets such as the United States. This sector is expected to increase in Honduras, El Salvador, Guatemala and Nicaragua due to the Association Agreement. However, the production of textiles and clothing is not expected to bring significant welfare gains to the region as it is a very labor intensive production that is not subject to economies of scale and the competition from Asian producers is very high. Furthermore, the potential benefits depend largely on whether the production gains accrue to foreign export oriented corporations or to small domestic producers.

The potential welfare gains and development resulting from the Association Agreement will to a large extent be determined by accompanying policies and regional institutions. These should enable people in Central America to take advantage of the economic opportunities and simultaneously mediate negative effects and lead to a more equal distribution of benefits across all sectors of society. Furthermore, the ability of the Central American countries to finance a deeper integration within the Central American Common Market and the successful implementation of accompanying measures to the Association Agreement is severely restricted due to macroeconomic circumstances and the low tax base. Thus, support of the European Union through development cooperation and other means will be of crucial importance to the successful implementation of the Association Agreement. In this context, the profitability of certain trade strategies will also depend on the circumstances in the world economy and the policy measures at that time. In essence, a balance between liberalization and policies for development has to be found. Therefore, it is absolutely necessary for Central America to diversify its exports, support infant

industries and protect certain key sectors. At the same time, an increase in production and trade should be fostered and foreign investment channeled to productive sectors that can boost the economy while bringing welfare gains and development for the Central American people.

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## **Abstract - English**

The last decade witnessed a rise in bilateral trade agreements and regional integration. Both phenomena are often believed to be a reaction to globalization pressures by countries attempting to increase their competitiveness within the global economy thereby reinforcing the very same processes. In this context, trade and foreign investments can lead to an unequal accumulation of wealth and development unless mitigated by complementary trade policies, which poses a particular challenge for developing countries. This paper provides an in-depth analysis of economic and trade relations between the European Union and Central America in regard to these international systemic factors through a comparative study of multi-disciplinary literature in combination with a complementary data analysis. It examines endogenous and exogenous motivational factors and assesses the potential impact of the first bi-regional agreement with the European Union on Central America. The study finds that the expected gains from increased trade opportunities and investments are highest in the sector fruits and vegetables (mostly bananas) in Costa Rica and Panama, electronics in Costa Rica, El Salvador, Guatemala and Honduras and textiles in El Salvador, Guatemala, Honduras and Nicaragua. The effects are mixed in the service sector. Costa Rica is expected to have the greatest gains from the agreement, while poverty will be most significantly reduced in El Salvador and Honduras. These results suggest that the economic benefits will be larger for Central America, while being negligible for the European Union. This implies that political and social motives play an important role next to economic ones.

## **Abstract - German**

Im letzten Jahrzehnt ist die Anzahl bilateraler Handelsabkommen und regionaler Integrationsprozesse rapide angestiegen. Dies wird oftmals als Reaktion einzelner Länder auf den durch die Globalisierung ansteigenden Druck und als Möglichkeit ihre eigene Wettbewerbsfähigkeit in der Weltwirtschaft zu steigern, gesehen. Gleichzeitig fördert es Prozesse der Globalisierung und treibt diese voran. Handel und ausländische Direktinvestitionen spielen dabei eine besondere Rolle und können zu einer ungleichen Verteilung von Wohlstand und Entwicklung führen. Solange dem nicht durch ausgleichende Handelspolitiken entgegengesteuert wird, kann das eine besondere Herausforderung für Entwicklungsländer stellen. Diese Diplomarbeit analysiert die wirtschaftlichen Beziehungen zwischen der Europäischen Union und Zentralamerika im Kontext dieser internationalen systemischen Faktoren. Durch eine vergleichende, multidisziplinäre Literaturanalyse in Kombination einer Datenanalyse, werden endogene und exogene Gründe untersucht und die potentiellen Auswirkungen des ersten bi-regionalen Assoziationsabkommens zwischen der Europäischen Union und Zentralamerika eingeschätzt. Die Ergebnisse zeigen, dass die zu erwartenden Gewinne durch den Anstieg von Handel und Investments am Größten in den Sektoren Früchte und Gemüse (hauptsächlich Bananen) in Costa Rica und Panama, elektronische Güter in Costa Rica, El Salvador, Guatemala und Honduras und Textilien in El Salvador, Guatemala, Honduras und Nicaragua sind. Die Auswirkungen auf den Dienstleistungssektor sind gemischt. Zusammenfassend sind die erwarteten Gewinne durch das Abkommen für Costa Rica am Größten, während Armut am drastischsten in El Salvador und Honduras reduziert wird. Die erwarteten wirtschaftlichen Gewinne für Zentralamerika sind beachtlich, in der Europäischen Union jedoch werden die Auswirkungen vernachlässigbar gering sein. Dies ist ein Hinweis auf die hohe Bedeutung politischer und sozialer Motive, neben wirtschaftlichen Beweggründen.

# Curriculum Vitae

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## Ausbildung

Universität Wien Individuelles Diplomstudium Internationale Entwicklung	Wien
<ul style="list-style-type: none"><li>- Spezialisierungen Entwicklungsökonomie, soziale Ungleichheit, Gender</li><li>- Regionalschwerpunkte Südasien, Ostafrika, Zentralamerika</li></ul>	10/2008-01/2014
TATA Institute of Social Science Auslandssemester im Rahmen des M.A. Development und Women's Studies	Mumbai
<ul style="list-style-type: none"><li>- Spezialisierungen Entwicklungsökonomie, Gender und Entwicklung</li></ul>	06-10/2011
Wirtschaftsuniversität Wien Bachelorstudium der Wirtschafts- & Sozialwissenschaften, Volkswirtschaftslehre	Wien
<ul style="list-style-type: none"><li>- Spezialisierungen Internationale Wirtschaft und Entwicklung, Verteilungstheorie, Wirtschaftsgeographie</li><li>- Abschlussarbeit über ausgewählte sozio-ökonomische Aspekte von Haushalten in Kisumu, Kenya in Bezug zu ihrer Erwerbsfähigkeit, sowie der geschlechterspezifischen Arbeitsteilung; Beurteilung mit Sehr Gut</li></ul>	10/2006-9/2011

## Arbeitserfahrung

Österreichische Forschungsförderung für Internationale Entwicklung (ÖFSE) Bereich Wissenschaft und Forschung	Wien
<ul style="list-style-type: none"><li>- Verfassen zweier wissenschaftlicher Artikel (siehe Publikationen)</li><li>- Redaktionelle Mitarbeit an der Publikation Privatssektor und Entwicklung der Reihe Österreichische Entwicklungspolitik</li></ul>	03-04/2013
United Nations Economic & Social Commission for Asia and the Pacific Abteilung für Handel und Investment	Bangkok
<ul style="list-style-type: none"><li>- Forschungsassistenz im Bereich Privatssektor und Entwicklung</li><li>- Mitarbeit an einem Handbuch zur Entwicklung von Klein- und Mittelunternehmen für politische Entscheidungsträger in der Region</li></ul>	01-02/2012
Raiffeisen Zentralbank Österreich AG Abteilung für Corporate Responsibility	Wien
<ul style="list-style-type: none"><li>- Forschung zu dem Sozialsektor und Entwicklung in Zentral- und Osteuropa</li><li>- Mitarbeit an dem Nachhaltigkeitsbericht 2010 der RZB Group</li></ul>	11/2010-06/2011
KnowledgeYatra India	Wien / Delhi
<ul style="list-style-type: none"><li>- Gründung, Management und Administration des Tagesgeschäfts</li><li>- Konzeptualisierung und Organisation von interkulturellen Studienreisen</li><li>- Eventorganisation und -management</li></ul>	09/2009-12/2010

## Persönliches Engagement

Technische Universität Wien, in Kooperation mit Horizont3000 Forschungsprojekt Integrierte Regionalentwicklung in Kenia	Wien / Kisumu
<ul style="list-style-type: none"> <li>- Forschungsreise und Expedition nach Kisumu, Kenia</li> <li>- Forschungsschwerpunkt auf Einkommen- und Ausgabenstrukturen sowie Arbeitsteilung innerhalb von ausgewählten Haushalten</li> </ul>	09/2010-06/2011
AIESEC	Wien
<ul style="list-style-type: none"> <li>- Organisation der Konferenz "Future", 12-15.11.2009, 150 TeilnehmerInnen</li> <li>- Entwicklung und Durchführung des Projektes "Global Development"</li> <li>- Leitung zweier Teams über die Periode von einem Jahr</li> <li>- Teilnahme an zahlreichen Trainings und Konferenzen</li> <li>- Ausbildung und Erfahrung in Training und Facilitation</li> </ul>	03/2007–12/2009

## Publikationen

<ul style="list-style-type: none"> <li>- „The Idea of India“, in International Studies Society Belgrade (2013).</li> <li>- „Zuschüsse privater Organisationen“ mit Michael Obrovsky, in ÖFSE (2013): Österreichische Entwicklungspolitik (2013).</li> <li>- „Remittances aus Österreich: Überblick und Trends“ mit Michael Obrovsky, in ÖFSE (2013): Österreichische Entwicklungspolitik (2013).</li> <li>- „In my region we kill people with a weapon, here you kill refugees with a pen“ mit Judith Wiesinger, in International Studies Society Belgrade (2013), online unter <a href="http://dmsbeograd.org/2013/03/05/here-you-kill-refugees-with-a-pen/">http://dmsbeograd.org/2013/03/05/here-you-kill-refugees-with-a-pen/</a> (Zugriff am 29.04.2013).</li> <li>- „Sexing Economy - Die dualistische Weltansicht als Auslaufmodell“ mit Salome Quinhones-Hall, Eva Nicola Rinner und Angelika Schirgi, in Frauensolidarität (2012), 3.</li> </ul>
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## Sprachen und Fertigkeiten

Sprachen	
Deutsch	Muttersprache
Englisch	C2
Französisch	B1
Spanisch	A2 (Auslandsaufenthalt an der Universität Salamanca, 08/2007)
Trainings und Weiterbildungen	
NLP & NLPt Professional Practitioner, ÖTZ-NLP&NLPt,	03/2012-06/2013
Crisis Management & the EU as Global Actor, Europäisches Forum Alpbach,	16.08.-01.09.2012
Effectives NPO Management, Peter F. Drucker Workshop,	16.05.2011
Interkulturelles Training, Intercultural Perspectives,	31.10-01.11.2010
Entrepreneurship Training, START Europe,	26.-29.10.2010
Social Entrepreneurship Training, Social Business Tour,	12-13.06.2010
Destination Management Sochi, Summeruniversity Carinthia,	11-12.05.2010
Leadership Training, Dale Carnegie,	07/2009
Train the Trainer Seminar, AIESEC.	7-9.06.2009
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