Robert Schuman

Economic Relations between the European Union and Central America: Building a Bi-Regional Association

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Jean Monnet/Robert Schuman Paper Series
Vol. 9 No. 11
October 2009

ublished with the support of the EU Commission

The JeanMonnet/Robert Schuman Paper Series

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Economic Relations between the European Union and Central America: Building a Bi-Regional Association

Fernando Rueda-Junquera[*]

Introduction

Unlike the United States, the European Union (EU) did traditionally not have motivations to privilege its relations with Central America.[1] The economic, political and geostrategic interests in the region are modest, as compared with those existing in other groups of less developed countries (LDCs) such as the so-called African, Caribbean and Pacific countries (ACP countries) and the Southern and Oriental Mediterranean countries (MEDA countries). Nevertheless, the threat of an internationalization of the Central American conflict after the victory of the Sandinista Front in Nicaragua in 1979, was able to attract EU's attention towards the region and encourage a greater involvement in it. The EU took the initiative in institutionalizing a political dialogue –the San José Dialogue–,[2] which has facilitated the signing of three multilateral cooperation agreements between the two regions in 1985, 1993 and 2003.

The subscription of the last Political Dialogue and Cooperation Agreement in 2003 opened the possibility of strengthening the bi-regional relations, which had been losing dynamism since the end of the Central American conflict. The chosen way has been the negotiation of an Association Agreement (AA), including –in addition to political dialogue and cooperation – the establishment of a bi-regional free trade area. The results of this negotiation initiated in 2007, will condition the future of the relations between both regions.

This paper aims at assessing the bi-regional economic relations in the context of the aforementioned negotiation. With this purpose, the paper is divided into four sections. The first two ones present respectively, the state of the trade and financial relations. After that, the third section analyzes the background to the negotiation of the AA and the major negotiation issues. The fourth and last section provides the main conclusions drawn from that analysis.

Trade Relations

The three multilateral cooperation agreements signed by the EU with Central America have contained the reciprocal recognition of the most-favored-nation (MFN) clause. However, this has not implied the extension to the Central American countries of the tariff advantages granted by the EU to other LDCs more privileged by historical and geostrategic links, such as the ACP and MEDA countries. The MFN treatment involves the signatory countries' commitment to give to each other the most favorable tariff terms negotiated with any single trading partner, except when such terms are result of an agreement setting up a customs union or are given only to certain countries –as it has happened until recently, to the

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[1] Throughtout this paper Central America is regarded as the region comprising the five member countries of the Central American Common Market, i.e. Costa Rica, El Salvador, Guatemala, Honduras y Nicaragua.

[2] The San José Dialogue takes place between the EU and the six countries of the Central American isthmus (the five members of the Central American Common Market and Panama).

ACP and MEDA countries[3]– in compliance with the regulations established by the World Trade Organization (WTO).

The Central American countries have not had access to special trade preferences other than those offered by the EU to all LDCs under its Generalized System of Preferences (GSP).This trade arrangement comprises a general regime and several special regimes, being intended to facilitate access of LDC exports to the EU market. The general regime provides tariff preferences for exports of manufactured and semi-manufactured goods, while the special regimes broaden the product coverage for specific beneficiary countries. Central America enjoys the general regime since 1971 and one of the special regimes since January 1, 1992, specifically the one supporting the struggle against the production and trafficking of drugs (known as GSP-Drugs). This special regime allowed to incorporate into the GSP a group of agricultural products –most of them, non-traditional products– regarded as substitute crops replacing coca.

In the last 2005 GSP renewal, the EU has simplified its format for the decade 2006-2015 including only three regimes: the general one and two special ones –the incentive arrangement for sustainable development and good governance (known as GSP+) and the Everything But Arms (EBA) arrangement[4]–. The GSP+ came into force on July 1, 2005, whereas the rest of regimes did it on January 1, 2006.[5] The GSP+ has replaced the GSP-Drugs, maintaining its product coverage. The GSP+ beneficiary countries are bound to ratify and implement international conventions in the fields of human rights, core labor standards, environmental protection and good governance, as a demonstration of their firm commitment to these issues.

Bi-regional trade relations have taken place under the described framework. After doubling their value in 2000 with respect to the recorded one in the first half of the 1990s, these trade relations have tended to stagnate in the present decade. As Table 1 shows, EU imports from Central America increased from €1,845 million in 1995 to €4,312 million in 2000 and since then, they kept an average value of €4,337 million in the 2000-2007 period. Similarly, EU exports to Central America expanded from €1,742 million in 1995 to €3,721 million in 2000, maintaining an average value of €4,064 million in the 2000-2007 period.

The bi-regional trade balance was unfavorable to the EU in the aforementioned period, except in 2001 and 2007. Nevertheless, the average amount of the EU's trade deficit was very small, just €273 million. This slight deficit represents almost the half of the value of the EU's trade surplus in 2007 (€539 million).

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[3] The EU has established a degree of trade preferences with LDCs according to their historical and geostrategic links. This has given rise to a "hierarchy of preferences", in which the former colonies of some member states –the ACP countries – have been particularly favored. Nevertheless, this trade policy is being modified to adapt it to the WTO regulations emanated from the Uruguay Round. The EU has to reduce progressively the unilateral tariff advantages and replace them by free trade agreements with reciprocal tariff preferences.

[4] The EBA arrangement provides duty-free and quota-free access to the EU market for all products (except arms and armaments) from the 50 Least Developed Countries recognized by the United Nations. For more details on this arrangement and the EU's new GSP scheme, see: the website of the European Commission Directorate General for Trade, http://ec.europa.eu/trade/issues/global/gsp.

[5] The GSP+ entered into effect before January 1, 2006, to comply with the ruling of the WTO Appellate Body in relation to the challenge against the GSP-Drugs presented by India, claiming that this GSP special regime discriminated among LDCs and thus, was contrary to the WTO Enabling Clause.

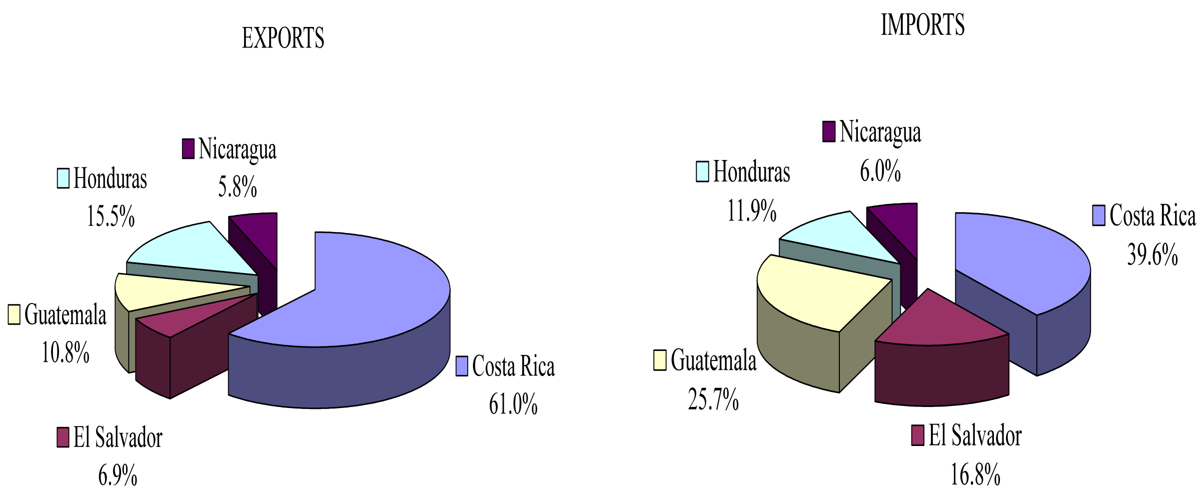
Table 1
EUROPEAN UNION: TRADE BALANCE WITH CENTRAL AMERICA,[a] 1995 AND 2000-2007
(in millions of euros and in percentages)

Year	*Exports*		*Imports*		*Balance*
	Value (€ million)	Share in total exports[b] (%)	Value (€ million)	Share in total imports[b] (%)	Value (€ million)
1995	1,742	0.3	1,845	0.4	-103
2000	3,721	0.4	4,312	0.4	-590
2001	3,511	0.4	3,414	0.3	97
2002	3,694	0.4	3,737	0.4	-42
2003	3,802	0.4	4,076	0.4	-274
2004	3,910	0.4	4,432	0.4	-522
2005	3,711	0.4	4,830	0.4	-1,119
2006	4,860	0.4	5,131	0.4	-271
2007	5,301	0.4	4,762	0.3	539
2000-2007 average	4,064	0.4	4,337	0.4	-273

Source: Derived from: COMEXT database, Eurostat, http://ec.europa.eu/eurostat/.
[a] Panama is included.
[b] Total exports (imports) exclude intra-European Union exports (imports).

What has not been altered is the limited relevance of Central America as EU's trade partner: it accounts for only 0.4 per cent of total extra-EU trade (see Table 1). Costa Rica is the EU's major Central American trade partner, constituting 61 per cent of total Central American exports to the EU in the 2000-2007 period and nearly 40 per cent of total Central American imports from the EU in the same period (see Figure 1).

Figure 1
CENTRAL AMERICA: GEOGRAPHIC BREAKDOWN OF TRADE[a] WITH THE EUROPEAN UNION, 2000-2007 AVERAGE
(in percentages of total)



Source: Derived from: SEC-SIECA (Sistema de Estadísticas de Comercio – Secretaría de Integración Económica Centroamericana) database, http://estadisticas.sieca.org.gt/.
[a] The value of assembly manufacture is excluded.

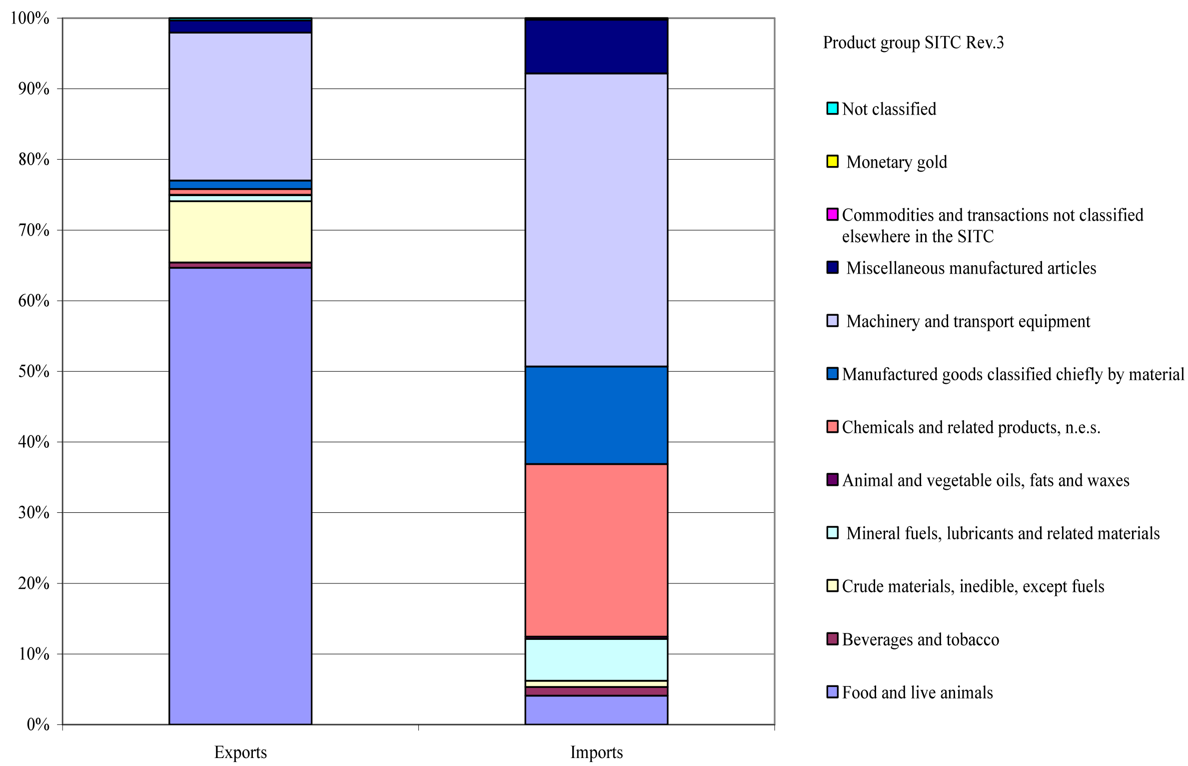
Table 2
CENTRAL AMERICA: MAIN TRADE PARTNERS, 2000-2007 AVERAGE
(in percentages of total)

Trade partner	*Exports*[a]	*Imports*[a]
United States	37.1	38.9
Mexico	2.8	7.3
Central American Common Market	26.8	13.1
Belize	0.4	0.1
Panama	2.5	2.9
South America	1.5	10.7
Caribbean	4.3	3.4
European Union	13.9	9.1
Asia	8.8	11.8
Rest of the world	1.9	2.7
Total	100.0	100.0

Source: Derived from: SEC-SIECA (Sistema de Estadísticas de Comercio – Secretaría de Integración Económica Centroamericana) database, http://estadisticas.sieca.org.gt/.
[a] The value of assembly manufacture is excluded.

From the Central American perspective, the relative importance of the EU market is much higher. After the United States and the Central American Common Market (CACM), the EU is the third trade partner of the region, absorbing almost 14 per cent of its exports and supplying a little over 9 per cent of its imports in the first eight years of the present decade (see Table 2). Nevertheless, its relative importance is much lower than that of the United States. Geographical proximity and trade agreements signed with this country –both preferential (the Caribbean Basin Initiative, CBI) and reciprocal (the United States-Dominican Republic-Central America Free Trade Agreement, DR-CAFTA)– have consolidated to the United States as the major trade partner of the region. This fact along with the recovery of intra-CACM trade have reduced EU's trade share since the beginning of the 1990s.

Figure 2
CENTRAL AMERICA: SECTORAL BREAKDOWN OF TRADE[a] WITH THE EUROPEAN UNION, 2000-2006 AVERAGE
(in percentages of total)



Source: Derived from: SIECA (Secretaría de Integración Económica Centroamericana), *Centroamérica: indicadores y estadísticas de comercio exterior, 2000-2006* (Guatemala: SIECA, 2007).
SITC Rev.3: Standard International Trade Classification Revision No. 3
[a] The value of assembly manufacture is excluded.

Table 3
CENTRAL AMERICA: MAIN PRODUCTS OF EXPORT AND IMPORT IN TRADE[a] WITH THE EUROPEAN UNION, 2007
(in millions of US dollars and in percentages of total)

Product and SAC Code	Value	%
EXPORTS		
1. Gold coffee (09011130)	778	31.0
2. Fresh bananas (08030011)	347	13.8
3. Tropical pineapples (08043000)	262	10.4
4. Parts and accessories for machines (84733000)	241	9.6
5. Tunas, stripe-bellied and bonitos (16041410)	81	3.2
6. Cultured shrimps (03061311)	68	2.7
7. Foliage, leaves and branches of plants (06049190)	60	2.4
8. Syringes, including with needle (90183990)	50	2.0
9. Melons, watermelons and papayas (08071900)	37	1.5
10. Absolute alcohol (22071010)	37	1.5
11. Zinc minerals (26080000)	35	1.4
12. Alive plants (06029090)	33	1.3
13. Preserves, jellies and marmalades (20079990)	31	1.2
14. Marine diesel (27101922)	22	0.9
15. Pineapple juice brix (20094100)	18	0.7
16. Burley tobacco (24012020)	17	0.7
17. Pineapple juice without fermenting (20094900)	15	0.6
18. Palm hearts (20089100)	15	0.6
19. Peanuts (12022090)	14	0.6
20. Parts and accessories of cameras (90079100)	13	0.5
Total of the 20 main exports	2,174	86.6
21. Rest of products	337	13.4
TOTAL EXPORTS	2,511	100.0
IMPORTS		
1. Other petrols (27101130)	220	6.2
2. Antimalarial medicaments (30049091)	187	5.3
3. Digital integrated circuits (85423120)	183	5.2
4. Metal oxide semiconductors (85422110)	68	1.9
5. Coiling and curling machines (84622900)	54	1.5
6. Current carrying telecommunication appliances	35	1.0
(85176110)	32	0.9
7. Appliances for receiving, converting and transmitting	31	0.9
data (85176200)	31	0.9
8. Automobiles (87032369)	31	0.9
9. Telephone parts (85177000)	30	0.8
10. Other transmitting appliances (85176129)	29	0.8
11. Laminated products (72083900)	29	0.8
12. Ammonium nitrate (31023000)	27	0.8

13.	Fuels type diesel for cars (27101921)	27	0.8
14.	Envelopes, cards and other articles for correspondence	27	0.8
	(49070020)	26	0.7
15.	Ceramic plates and slabs (69089000)	20	0.6
16.	Electricity-generating groups (85021300)	19	0.5
17.	Ammonium sulfate (31022100)	19	0.5
18.	Food preparations for breastfed babies (19011011)		
19.	Mineral based oil (27101991)	1,125	31.8
20.	Machines for filling, closing and labeling bottles		
	(84223090)	2,418	68.2
		3,543	100.0
	Total of the 20 main imports		
21.	Rest of products		
	TOTAL IMPORTS		

Source: Derived from: SEC-SIECA (Sistema de Estadísticas de Comercio – Secretaría de Integración Económica Centroamericana) database, http://estadisticas.sieca.org.gt/.
SAC: Sistema Arancelario Centroamericano (Central American Tariff System)
[a] The value of assembly manufacture is excluded.

The sectoral analysis of the bi-regional trade reveals a typical pattern of North-South trade. Central America exports primary products very vulnerable to international price fluctuations and imports higher added-value manufactured products. As Figure 2 illustrates, in the 2000-2006 period, 75.2 per cent of its exports to the EU corresponded to primary products, while 87.3 per cent of its imports from the EU were manufactured products.[6] Unlike other Latin America's regions exporting minerals and fuels to the EU, Central America concentrates its primary exports on agricultural products (64.7 per cent of its exports in the 2000-2006 period). The degree of agricultural export diversification is still weak. In 2007, nearly 45 per cent of Central American exports to the EU remained dominated by two traditional agricultural products, coffee and bananas (see Table 3).

There are supply and demand reasons to explain this sectoral structure of the Central American exports. In the supply side, the countries of the region –with the exception of Costa Rica– have not made big efforts to diversify exports to the EU. Costa Rica has been the most successful country at adapting its exporting supply to the European demand, managing to modify it towards non-traditional agricultural products and some manufactures. This region's behavior contrasts with the one observed in the United States market, for that the Central American exports have been able to diversify their composition, increasing the share of manufactures and incorporating new products, such as clothing *maquila* and in the case of Costa Rica, electronic products.

Central America has achieved some agricultural export diversification by taking advantage of the special GSP regime granted in 1992 (the GSP-Drugs). Until that moment, the European GSP had been of little relevance since Central American exports to the EU market were concentrated on agricultural products, whose coverage in the standard GSP had been minimal. Under the special regime, the non-traditional agricultural products –such as tropical fruits, fish, crustaceans, plants and vegetables– have increased their share in the region's export supply (see Table 3), but the diversification pace of that supply

[6] The following product groups of the Standard International Trade Classification (Revision No. 3) are regarded as primary products: food and live animals; beverages and tobacco; crude materials, inedible, except fuels; mineral fuels, lubricants and related materials; and animal and vegetable oils, fats and waxes. The manufactured products include the following groups: chemicals and related products, n.e.s.; manufactured goods classified chiefly by material; machinery and transport equipment; and miscellaneous manufactured articles.

has been growing slowly. In fact, the utilization rate of the GSP by the region is not very high. Only 50.1 per cent of the total value of the main Central American products exported to the EU benefited from the GSP in 2007, being Costa Rica the country that used it most with 65.8 per cent of the value of its main exports covered by these tariff preferences.[7]

In the demand side, the regulation of the EU market access is another explanatory factor of the current Central American export structure. The Common Agricultural Policy (CAP) and the special protocols for the ACP countries have restricted –through high tariff and non-tariff measures– the entry of traditional agricultural products exported by Central America, especially that of bananas, beef and sugar. Likewise, the EU's GSP has incorporated the constraints inherent to preferential trade schemes. Although it offers an opportunity for expanding and diversifying the Central American exports, it is granted temporarily, does not cover products of great interest for the region[8] and is subject to graduation mechanisms.[9] Furthermore, the special GPS regime includes a safeguard clause which permits the reintroduction of the normal customs duties when the preferential agricultural imports are detrimental to European producers or handicap the exports of the ACP countries.

In sum, trade 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. The future prospects of these bi-regional relations will depend on the results of two fundamental negotiations: that of the AA with the EU, which will include a bi-regional free trade area; and that of the Doha Round in the framework of the WTO, which will determine the international trade regulation.

Financial Relations

Foreign Direct Investment

Just as happens with the bi-regional trade exchange, Central America occupies a marginal position in the EU's total foreign direct investment (FDI). In the 2001-2006 period, only 2.4 per cent of total EU FDI flows and 6.3 per cent of total extra-EU FDI flows were channeled towards Central America, with El Salvador and Costa Rica being the main destinations. Although in the last years there has been a recovery of the EU FDI flows to Latin America, these flows have not altered their high geographical concentration, feature maintained since the 1990s when those flows registered an unprecedented expansion. European FDI remains concentrated in the Southern Cone countries and Mexico. Of the total stock of €219,927 million at the end of 2005, these countries accounted for 83 per cent (39 per cent in Brazil, 20 per cent in Mexico, 15 per cent in Argentina, 8 per cent in Chile and 1 per cent in Uruguay).[10]

By contrast, the European FDI has a higher relative importance for Central America, representing 20 per cent of total FDI inflows in the 2000-2005 period (see Figure 3). This percentage turns the EU into the region's second investor, followed closely by Latin America (17 per cent) and staying still very behind the first source of FDI, the United States (45 per cent). In the future, the RD-CAFTA's entry into

[7] SIECA (Secretaría de Integración Económica Centroamericana), *Trade Relations between Central America and the European Union* (Guatemala: SIECA, 2009), 19.

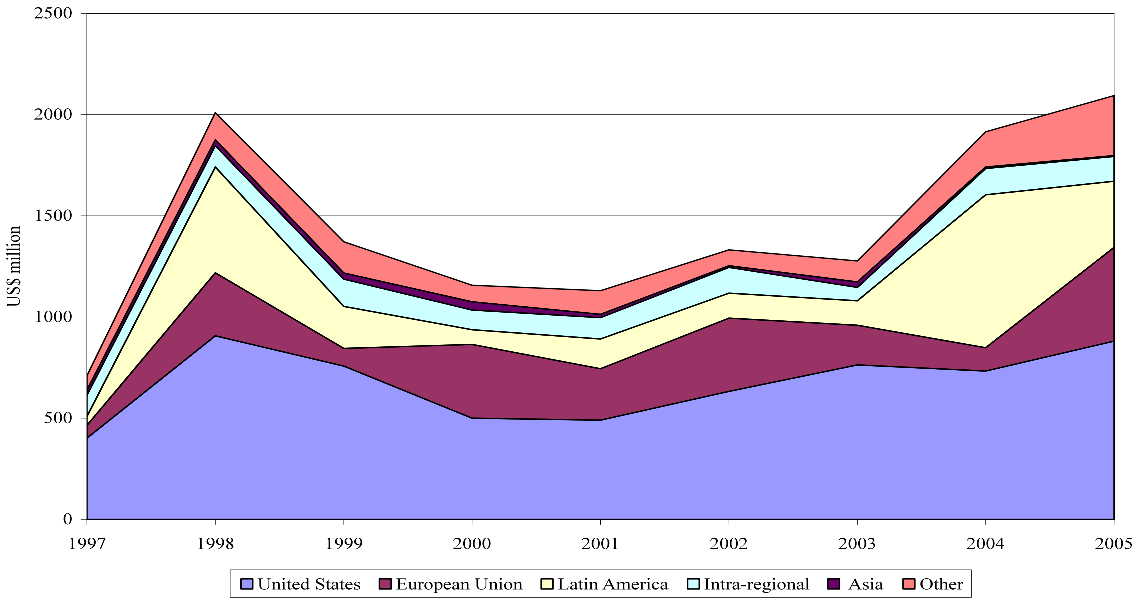
[8] The GSP scheme does not include agricultural products such as gold coffee, fresh bananas and some vegetables. In the case of manufactured products, textiles and apparel enjoy tariff preferences, but the exemption is only limited to 20 per cent of the Community customs tariff.

[9] The graduation mechanism is applied to beneficiary countries becoming competitive in one or more product groups exported to the EU market, and it involves the suspension of the GSP tariff advantages. Costa Rica was affected temporarily by this mechanism in 2003, when some of its export products (ornamental plants, ferns, pineapples, macadamias and melons) were "graduated" from the GSP scheme. Subsequently, the EU modified the graduation mechanism in such a way that it did not negatively affect small LDCs, as Costa Rica. The GSP scheme is offered to a great number of LDCs with very different levels of development, being the small LDCs at a disadvantage to compete on an equal basis in the EU market.

[10] All the percentages on European FDI flows and stocks refer to the EU with 25 member states. They were derived from: Eurostat database, http://ec.europa.eu/eurostat/.

force and the possible AA with the EU could encourage European FDI flows to the region and increase their share in total FDI inflows.

Figure 3
CENTRAL AMERICA: FOREIGN DIRECT INVESTMENT INFLOWS[a] BY REGION OF ORIGIN, 1997-2005
(in millions of US dollars)



Source: Derived from: INTAL (Instituto para la Integración de América Latina y el Caribe), *Informe centroamericano Nº. 3* (Buenos Aires: BID-INTAL, 2007), 122.
[a] Information on foreign direct investment inflows into Guatemala is excluded because of lack of data. The figures for the rest of the Central American countries include investment in assembly manufacture.

Official Development Assistance

Along with FDI flows, those of Official Development Assistance (ODA) are the other relevant financial flows in bi-regional relations. Central America has had access to these flows since 1976, when the EU's technical and financial assistance was extended to the Asian and Latin American countries. Although the region attracted an unusual attention from the EU in the 1980s, it was not able to maintain it after the ending of the Central American conflict. The EU member states' economic interests in the region are insignificant and in political and geostrategic terms, Central America is deemed as a region reserved primarily to the United States' sphere of influence. In other words, there are not essential reasons for privileging the cooperation with this region. This explains that Central America obtains a low volume of total EU aid. As Table 4 shows, in the 1997-2006 period the annual average of net disbursements of the EU's ODA to Central America was $120 million, what represented only 1.9 per cent of the EU's total ODA.

As has happened with the preferential trade schemes, the financial aid programs offered to the Central American countries have been less favorable than those available to other LDCs, such as the ACP and MEDA countries. Aid to the region has consisted mainly of grants financed by the EU general budget and long-term loans provided by the European Investment Bank (EIB). The Central American countries have not been entitled to other sources of aid outside the EU budget –such as the European Development Fund, financed by contributions from member states and destined for the ACP countries–, neither have they benefited from financial protocols and specific financial cooperation programs –such as those attached to the EU cooperation agreements signed with the MEDA countries–. Moreover, until 1993 the Central American countries were not able to request aid in the form of EIB loans, which had been exclusively at the disposal of the ACP and MEDA countries.

Table 4
CENTRAL AMERICA: NET DISBURSEMENTS OF OFFICIAL DEVELOPMENT ASSISTANCE BY MAIN DONORS, 1997-2006 AVERAGE
(in millions of US dollars and in percentages of total)

Donor	*Costa Rica*		*El Salvador*		*Guatemala*		*Honduras*		*Nicaragua*		*CENTRAL AMERICA*	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
European Commission	3	26.6	22	10.5	28	10.2	23	4.2	45	6.2	120	6.9
Member States of the EU	33	291.1	80	39.0	115	42.0	135	25.2	301	41.7	665	38.0
Multilateral	-2	-19.3	18	8.5	39	14.1	217	40.7	270	37.3	541	31.0
United States	-23	-204.1	59	28.5	53	19.5	93	17.4	72	10.0	253	14.5
Japan	-3	-29.7	40	19.2	43	15.7	66	12.4	43	6.0	189	10.8
Other donors	4	35.5	-12	-5.8	-4	-1.5	0	0.1	-8	-1.1	-20	-1.1
TOTAL	11	100.0	206	100.0	274	100.0	533	100.0	724	100.0	1,748	100.0
European Commission	3	-	22	-	28	-	23	-	45	-	120	-
% of the EC's total ODA	0.1	-	0.3	-	0.4	-	0.4	-	0.7	-	1.9	-

Source: Derived from: International Development Statistics Online database of the Organization for Economic Co-operation and Development's Development Assistance Committee, OECD-DAC, http://www.oecd.org/dac/stats/idsonline/.
EC: European Commission.
EU: European Union.
ODA: Official Development Assistance (net disbursements).

Despite all that, the European ODA –i.e. the EU's multilateral aid and the member states' bilateral aid– is the first source of foreign aid to Central America. Unlike the EU's trade policy which is a common policy exclusively exercised by the European Commission, the EU's development cooperation policy is a Community policy, that is, it coexists with the member states' respective bilateral aid policies. In the case of Central America, the EU and its member states taken as a whole are by far the leading donor to the region. Their aggregated contribution represented almost 45 per cent of total net disbursements of ODA received by the region in the 1997-2006 period (see Table 4).

Unlike that evidenced in the trade and FDI flows, the United States is not the region's main partner in the ODA flows. In the aforementioned 1997-2006 period, the United States provided 14.5 per cent of the total net ODA disbursed to Central America, becoming the third donor of the region, behind multilateral institutions (see Table 4). This lesser relative importance is the consequence of the United States policy initiated after the end of the Salvadoran civil war, consisting in reducing ODA and in turning FDI into the principal component of its financial flows to the region.

One of the peculiarities of the EU as donor is its support to the Central American integration process, especially after putting into practice its regional cooperation strategy for the 2002-2006 period. Previously, the EU cooperation had centered more on the backing of the peaceful solution to the region's armed conflicts and once these concluded, on the encouragement of mechanisms for consolidating and strengthening peace and democracy. Even then, there already existed precedents for the EU's direct and indirect support to the regional integration process. One of the first direct supports goes back to December 1990, when the EU financed the creation of the Central American Payments System as a part of the Central American Clearing House in a fruitless attempt to avoid its collapse. Likewise, since the 1980s the EU has been indirectly encouraging the integration process through subregional cooperation programs, involving at least two Central American countries.

In 2001 the European Commission signed the first regional Memorandum of Understanding with the General Secretariat of the Central American Integration System, in which a regional cooperation program was established for the period covering the EU's Financial Perspectives 2000-2006. This Memorandum was signed in a context of reform of the EU's aid management, which led to the adoption –among other measures– of the pluriannual strategy papers. Thus, the first Regional Strategy Paper for the EU's cooperation with Central America was approved for the 2002-2006 period, stating the EU commitment to the Central American integration process. This commitment responded not only to the European conviction that regional integration was able –as it had happened in the EU– to stimulate the Central American economic development, but also to the EU's need to consolidate Central America as a single regional interlocutor, with whom to negotiate the AA in bloc and from whom to demand the homogeneous application of the AA in the whole region.

The Regional Strategy 2002-2006 established three priority cooperation axes with a total budget of €74.5 million:[11] that of support to the regional integration process, the implementation of common policies and the consolidation of regional institutions (60 per cent of the budget); that of strengthening of the role of civil society in the integration process (10 per cent of the budget); and that of reduction of vulnerability and environmental improvement (30 per cent of the budget). The first two axes –with 70 per cent of the budget– have promoted the funding of programs with direct incidence on the regional integration process, such as that of Central American Customs Union (UAC), that of Support to the Central American Regional Integration (PAIRCA), that of Support to the Design and Application of Central American Common Policies (ADAPCCA) and that of Consolidation of the Central American Customs Union (CONSUAC).[12]

[11] The 2002-2006 Regional Strategy Paper for Central America can be consulted on line in: http://ec.europa.eu/external_relations/ca/.

[12] The meaning of the regional programs acronyms is the following: Central American Customs Union (*Unión Aduanera Centroamericana*, UAC), Support to the Central American Regional Integration (*Programa de Apoyo a la Integración Regional Centroamericana*, PAIRCA), Support to the Design and Application of Central American Common Policies (*Apoyo al Diseño y Aplicación de Políticas Comunes Centroamericanas*, ADAPCCA) and Consolidation of the Central American Customs Union (*Consolidación de la Unión Aduanera Centroamericana*, CONSUAC).

During the execution period of this Regional Strategy, the process of EU aid management reform was concluded. In 2005 the European Consensus on Development was approved with the purpose of improving aid policy coordination between the European Commission and the member states. As a result of this Consensus, a new financing instrument –the Development Cooperation Instrument (DCI)– was adopted, regrouping the different budgetary items. The DCI covers five geographical programs (one of them, that of Latin America) and five horizontal thematic programs. After its entry in force in 2007, it is expected that the development cooperation in Central America becomes more efficient and coherent.

Table 5
EUROPEAN COMMISSION COOPERATION WITH CENTRAL AMERICA: PRIORITY SECTORS FOR THE PERIOD 2007-2013

Strategies	*Indicative Programs* (in millions of euros)
Regional Strategy (€75 million)	
1. Strengthening the institutional system for regional integration (27%)	20
2. Consolidating the customs union and the related harmonized and common policies (63%)	47
3. Strengthening regional good governance and security matters (10%)	8
Country Strategies (€727 million)	
COSTA RICA (€34 million)	
1. Social cohesion (75%)	25.5
2. Regional integration (25%)	8.5
EL SALVADOR (€121 million)	
1. Social cohesion and human security (70%)	84.7
2. Economic growth, regional integration and trade (30%)	36.3
GUATEMALA (€135 million)	
1. Social cohesion (35%)	47.3
2. Economic growth and trade (65%)	87.7
HONDURAS (€223 million)	
1. Social cohesion (50%)	111
2. Natural resources (30%)	68
3. Justice and public security (20%)	44
NICARAGUA (€214 million)	
1. Institutional support for sector programs (5%)	10.7
2. Governance and democracy (17.5%)	37.5
3. Education (35.0%)	74.9
4. Economic and trade issues (42.5%)	90.9

Source: Derived from: the Regional Strategy Paper and the respective Country Strategy Papers, accessible on line in http://ec.europa.eu/external_relations/ca/.

In accordance with the DCI regulations for the 2007-2013 period,[13] the EU has begun to apply the pluriannual programming papers for each recipient region and country; that is, in the case of Central America, the Regional Strategy Paper and the respective Country Strategy Papers (see Table 5). Likewise, the EU has continued offering the regional programs set up for the whole of the region of Latin America,[14] to which the Central American countries also have access.

The new Regional Strategy 2007-2013 keeps the priority support to the regional integration process (90 per cent of the total budget),[15] although it does not incorporate a substantial injection of new financial resources (see Table 5). The total budget is practically the same as that one allocated for the previous period (€75 million). The three priority sectors of the Strategy aims at strengthening the institutional system for regional integration (27 per cent of the budget), consolidating the customs union and the related harmonized and common policies (63 per cent of the budget) and strengthening the regional good governance and security (10 per cent of the budget). The first two sectors are directly related to integration, giving continuity to the programs launched in 2002-2006. The support to integration is also reinforced by some Country Strategies –in particular, those ones of Costa Rica and El Salvador–, in which regional integration appears as one of the main intervention sectors.

The future prospects for the EU regional cooperation will depend to a great extent on the outcome of the AA negotiation. In principle, 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 thanks to the new DCI. However, if the AA negotiation concluded successfully, the volume of ODA might augment appreciably. The region will require a larger aid inflow to finance the accompanying policies necessary to take advantages of the opportunities offered by the AA, as well as to reduce the costs of an AA signed between asymmetrical partners with significant differences in the levels of development.

The Negotiation of the Association Agreement

The Background

The EU has formalized its relations with the countries of Latin America through successive "generations" of bilateral and multilateral cooperation agreements. While those of first generation had a limited scope, those of second, third and fourth generation have been framework cooperation agreements covering cooperation in an growing number of sectors until coming to include the creation of a free trade area in the fourth-generation agreements. The latter agreements have marked a turning point in the pattern of the EU's relations with Latin America, since until that moment these relations had presented strong limitations in trade issues.

The fourth-generation agreements have been included in the new EU policy of Strategic Association with Latin America, initiated in the mid-1990s. These agreements incorporate free trade, along with political dialogue and cooperation extended towards new sectors (such as intellectual property, science and technology, telecommunications and information technologies). This new Strategic

[13] The new cooperation policy was put into practice in the framework of the new Financial Perspectives 2007-2013, avoiding the previous gap between the strategies drawn up for the 2002-2006 period and the Financial Perspectives covering the 2000-2006 period.

[14] These regional programs are developed in the fields of the higher education (ALFA and Alban), the economic cooperation among small and medium enterprises (AL-INVEST), the information society (@LIS), the urban local development (URB-AL), the renewable electrical energies (Euro-Solar) and the social cohesion (Eurosocial). Detailed information on the contents of these programs can be found on line in: http://ec.europa.eu/europeaid/where/latin-america/regional-cooperation/index_en.htm.

[15] The 2007-2013 Regional Strategy Paper for Central America can be consulted on line in: http://ec.europa.eu/external_relations/ca/.

Association policy motivated the call for the first bi-regional Summit of Heads of State and Government held in Rio de Janeiro (1999) and has guided the subsequent four Summits of Madrid (2002), Guadalajara (2004), Vienna (2006) and Lima (2008).

The specific bi-regional relation between the EU and Central America has developed in this context. It is currently dominated by a third-generation agreement, the 2003 Political Dialogue and Cooperation Agreement, which gives continuity to the previous agreements of Luxembourg (1985) and San Salvador (1993). This means that 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.

In order to mitigate the aforementioned imbalance, the EU offered Central America the possibility of negotiating a fourth-generation agreement –that is, an AA– after the conclusion of the Guadalajara Summit in 2004. However, the EU made the AA signing conditional upon the fulfillment of two requirements: firstly, Central America should demonstrate a sufficient level of consolidation and advance in its regional integration process; and secondly, the Doha Round of multilateral trade negotiations should conclude successfully. The process conducting to the AA signing would begin with a first phase of joint evaluation of the Central American integration process and in due course, this would lead to a second phase in which the AA negotiation would take place.

Although the two requirements were not fulfilled, the EU decided to start the AA negotiation after the 2006 Vienna Summit. Three fundamental factors explain this decision. Firstly, the multilateral negotiations of trade liberalization under the WTO framework are increasingly slow and difficult to control. This has encouraged industrialized countries –as the EU and the United States– to support plurilateral processes of trade liberalization –such as the AA negotiation and the RD-CAFTA signing–.

Secondly, the EU has succeeded in promoting the aforesaid trade liberalization processes in Latin America at a bilateral level –the AA signed with Mexico and Chile–, but not at a subregional level. This fact questions one of the distinctive features of its foreign policy: the support to the economic integration processes. The delicate situation of subregional integration in South America and the problems caused by this situation in the AA negotiation with the Southern Common Market and the Andean Community, have substantially facilitated the EU decision of initiating the AA negotiation with Central America.

The third and last factor is linked to the potential strategic value that Central America might acquire as a trade axis among the United States, Asia and Europe. Although the EU's economic interests are reduced, the European countries do not want to be at a disadvantage in this axis with respect to the United States and Asia, particularly in a future scenario in which the free trade area among Asia-Pacific Economic Cooperation (APEC) members becomes a reality (in principle, for 2010). The region strategic value would increase significantly if the Central American countries ended up joining APEC or subscribing a free trade agreement (FTA) with some of its Asian members, as for example with China. The historical fact that Costa Rica has decided to move away from Taiwan and initiate the rapprochement with China –including the negotiation of a FTA– is an important strategic bet of the main FDI recipient country in Central America.

With regard to the Central American governments' motivations, they consider the potential signing of an AA incorporating a FTA with the EU, as a way of improving their insertion in the international economy. From the perspective of the mainstream policy paradigm, the Central American economies' former fears of taking part in a FTA between asymmetrical partners, are unjustified. It is argued that the 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.

The Issues of the Negotiation

The AA negotiation process started in October 2007 in San José, Costa Rica, with the commitment to complete it within a period of two years. If negotiations develop adequately, they might conclude in 2009 with a possible AA subscription in the first semester of 2010, coinciding with the Spanish presidency of the EU.[16] The process is getting complex, especially for the Central American party. In contrast to the EU's unity of interlocution, Central America clearly does not appear as a single negotiator representing the member states interests. The region discarded this latter option and decided to have a rotatory spokescountry for the negotiations. This has involved establishing a complicated coordination of three simultaneous negotiations: at the national level with the productive sectors and civil society of each country, at the regional level with the Central American counterparties and at the inter-regional level with the EU.[17]

Unlike the RD-CAFTA, the AA aspires to be a comprehensive agreement that includes not only trade commitments, but also political and cooperation commitments. However, the trade component of the AA will be the predominant in the negotiation, as the bi-regional relations in the other two components have been tightening since the beginning of the San José Dialogue.[18]

The negotiation issues of the political dialogue and cooperation components are very similar to those included in the Political Dialogue and Cooperation Agreement signed by both regions in 2003. This Agreement has been taken as the basis negotiating text with the aim of broadening its content and adapting it to current international context. In the political dialogue, the EU proposes the inclusion of three new priority issues: the non-proliferation of nuclear weapons of mass destruction, the fight against terrorism and the Central American countries joining the International Criminal Court. On its part, Central America emphasizes more the incorporation of issues such as the migration and the need for the region to have the financial facilities necessary to fulfill the AA commitments. In the cooperation component, both parties agree that the issues shaping the EU's future cooperation with Central America will have to encompass the negotiation results of the AA's other two components.

The political and cooperation issues are those ones demonstrating to have a higher proximity of the two regions' stances. However, these issues are not free from discrepancies either. One of the most important is that one raised by the EU's request for the Central American countries to join the International Criminal Court. El Salvador, Guatemala and Nicaragua have showed a deep reluctance to fulfill this request.[19] The three countries have not ratified the Rome Statute establishing and giving jurisdiction to the International Criminal Court to prosecute crimes against humanity anywhere in the world.

The negotiation of the AA's trade component aims at creating a free trade area between the EU and Central America. This negotiation is based on a "region-to-region" approach, in such a way that the commitments will be undertaken by Central America as a bloc. This means that the AA 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).

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[16] The evolution of the negotiations can be followed on line in: http://www.caue.sieca.org.gt/ and http://www.aacue.go.cr/ .

[17] The inter-regional negotiation is carried out between the EU and the CACM. At the present time, Panama only takes part as an observer. The full incorporation into the AA negotiation would require Panama to join the CACM and therefore, undertake the commitments adopted to establish the Central American customs union.

[18] For a more detailed analysis of the main issues delimiting the negotiation of the three components of the AA, see: CEPA (Comisión de Estudios Políticos Alternativos), *El sector agrícola centroamericano de cara al Acuerdo de Asociación con la Unión Europea: posibles escenarios* (San José: CEPA, 2007); Luis Rivera and Hugo Rojas-Romagosa, *Economic Implications of an Association Agreement between the European Union and Central America*, IIDE discussion paper 200708-01 (Rotterdam: Institute for International and Development Economics, 2007); Rómulo Caballeros, *Centroamérica: los retos del Acuerdo de Asociación con la Unión Europea* (México, D.F.: Comisión Económica de las Naciones Unidas para América Latina y el Caribe, 2008); Doris Osterlof, "Centroamérica: del Proceso de San José al Acuerdo de Asociación con la Unión Europea" in *América Latina y la Unión Europea: una integración esperanzadora pero esquiva*, ed. Doris Osterlof, 99-122 (San José: Facultad Latinoamericana de Ciencias Sociales, 2008); SIECA, *Trade Relations between Central America and the European Union*, *op. cit.*.

[19] The situation of the Salvadoran government is particularly delicate. It has a bilateral agreement signed with the United States, guaranteeing the American citizens in Salvadoran territory will not be put under the jurisdiction of the International Criminal Court. Another limitation for the ratification of the Rome Statute is that the Salvadoran Constitution does not contemplate life imprisonment.

The coverage of issues under the trade negotiation is very similar to that observed in the AA signed with Mexico and Chile. Not only trade issues are negotiated, but also issues indirectly related to trade (the so-called behind-the-border issues). The main negotiating issues include trade in goods and services, investment, intellectual property, government procurement, competition policy, labor regulation, environment and institutions to administer and implement the AA.[20] In addition, the Central American party asks for all these issues to be negotiated taking into account the existing asymmetries between the two regions.

The negotiation of trade liberalization in goods presents notable differences according to the type of good considered. In the case of manufactured goods, fewer problems in the tariff relief negotiation are expected, given the reduced presence of these goods in the Central American export supply. Nevertheless, there exist some manufactured products identified as sensitive in the GSP+, for which Central America aspires to improve its access to the EU market: among others, textiles and apparel, footwear, glass and articles thereof, and products of paper and cardboard. It is probable that these products will require a longer period of time to reach a consensus on the tariff relief schedule.

In the case of agricultural products, the discrepancies between both parties are much more significant. The trade liberalization of many non-traditional agricultural products –for example, those of tropical origin– presents fewer problems, since they are non-sensitive products covered by the GSP+. The opposite happens with the traditional agricultural products where serious disagreements are expected, particularly in products as bananas, beef and sugar. While Central America demands an improvement in the access of these products prevailing in its export supply, the EU systematically excludes them from the negotiations. Liberalizing these products would involve modifying the CAP and the special protocols granted to the ACP countries, something that at the present time, is not contemplated by the EU.

An EU commitment in the delicate issue of the CAP agricultural subsidies is not expected either. The EU has traditionally considered it as an issue to be solved within the framework of the Doha Round of multilateral trade negotiations. Aware of this stance, Central America is negotiating alternative options for attenuating the negative effects of the unfair competition from highly-subsidized European agricultural products (as for example, the dairy products and some vegetables).

In addition to the tariff issues, the negotiation of trade liberalization in goods encompasses various non-tariff issues. A first group of these issues refers to the rules of origin, the technical regulations and the sanitary and phytosanitary measures. In these issues it is likely that both parties negotiate their adaptation to the principles established by the WTO both at the national and regional level. Many Central American countries have already begun this adaptation, but it is still necessary to advance in the adoption of a homogeneous regulation at the regional level. The results of this negotiation will determine the standards demanded by the EU for the access of the Central American exports. The other group of non-tariff issues is centered on the trade defense mechanisms (antidumping, countervailing duties and safeguards). In this case, it is also negotiated their adaptation to the WTO regulations to avoid their indiscriminate use with protectionist purposes.

Along with the reciprocal goods trade liberalization, the AA negotiation embodies the liberalization of services trade and foreign investment. In these issues, the EU presses to achieve a higher degree of liberalization, especially in the services sector where it has significant competitive advantages. Talks are focused on the normative part, specifically on the EU's request for Central America to adopt a new legislation guaranteeing services sector liberalization, for example by assuming principles as that one of the service provider's non-obligation to reside in the service recipient country or that one of the non-discriminatory treatment for the signatory countries' service providers against national ones. In the same line, the EU demands the Central American Agreement on Investments and Services' full coming into force, since it still has not been ratified by all the Central American countries.

[20] Specifically, twelve negotiating trade issues have been agreed: market access, rules of origin, customs procedures, services, investments establishment, intellectual property, government procurement, trade defense, competition policy, dispute settlement, institutional arrangements and sustainable development.

As for the issue of intellectual property rights, the adoption of a homogeneous legislation at the regional level is negotiated. The EU asks Central American countries to subscribe the international agreements for intellectual property protection and to establish a regional mechanism to implement the commitments undertaken in those agreements. Some Central American governments are unwilling to endorse these commitments –as for example, that one of the geographical indications– because they argue that the EU uses them to restrict the region's agro-industry exports.

The trade negotiation also includes some of the so-called Singapore Issues, that is, issues which go beyond the commitments established under the WTO agreements. These are the cases of the liberalization of government procurement and the adoption of competition policy. In these areas there is no regional framework to regulate them, since they are subject to national laws. The EU is insisting on the need for Central America to establish regional regulations for both issues and to create a competent regional authority enforcing the competition rules.

Finally, other issues incorporated into the trade negotiation are the regulations on labor rights and environment, as well as the institutional arrangements. In the labor and environmental issues, no great difficulties in negotiation are expected, since there exists a commitment not to use them as hidden forms of protectionism. As regards the institutional part, it is necessary to design mechanisms to administer and implement the AA, including a system of dispute settlement. It is likely that the EU will actively promote this regional institutional structure to ensure a homogeneous application of the AA in all the countries of the region.

Conclusions

Although the EU has limited economic interests in Central America, it is an important partner for the region. The EU is substantially much more relevant to Central America than the opposite. It is its third trade partner, its second investor and its first donor (considering both the EU's multilateral aid and the member states' bilateral aid). The future of these economic relations will be conditioned by the result of the AA negotiation.

If the AA is not signed, the bi-regional relations will be based on the renewal of the 2003 Political Dialogue and Cooperation Agreement. Important limitations in the trade dimension of the bi-regional relations will go on existing. The GSP+ will be periodically extended until 2015 (that is, exhausting the decade 2006-1015) or only until 2010. The latter date is the one proposed by the European Parliament for the subscription of a Global Inter-regional AA with Latin America, which includes the creation of an Euro-Latin American free trade area. However, this possibility does not appear to be very feasible if the EU previously has not been able to sign AAs with the countries and subregions of Latin America.

In this scenario, it is very unlikely that the current pattern of economic relations between the EU and Central America will change. The contribution of these relations to the region's economic progress will be only perceptible in those countries achieving to diversify their exports to the EU market by taking advantage of the GSP+. Costa Rica will be the principal candidate for benefiting from these bi-regional relations, as it does at present.

If, on the contrary, the AA is signed, an important deepening of the bi-regional relations will take place, laying the foundations for a long-term alliance between both regions. These relations will be more balanced and comprehensive, putting an end to the traditional imbalance between the broad advances in the political and cooperation dimensions and the limited scope of the trade dimension. The AA will allow to replace the current system of unilateral trade preferences (the GSP+) by another one of reciprocal trade liberalization (the FTA).

This deepening of the bi-regional relations will strengthen the EU's visibility as an international actor in the region. Along with the success achieved in its foreign policy in favor of peace and democracy in the previous century's last decades, the EU will succeed in boosting the Central American integration process (as a result of the "region-to-region" approach followed in the AA negotiation). This last element will contribute to give more credibility to one of the distinctive features of its foreign policy: the support to the regional integration process among LDCs, on the conviction that it is an efficient instrument for economic development.

The new pattern of bilateral relations will also be able to have a positive impact on the region's own economic development process. It will depend particularly on the content scope of the trade component of the AA, as well as on the effective acknowledgement of the asymmetry principle in the AA negotiation.

If the AA includes the full trade liberalization in agricultural products considered as sensitive by the EU –for example, bananas and sugar–, Central America will obtain an important benefit in terms of trade creation. However, it is very improbable that this degree of agricultural liberalization will be reached in a context in which the Doha Round negotiations are stagnated and the EU budget devoted to the CAP is already allocated until 2013. In the short term, a significant trade creation is not foreseen, not only due to the aforementioned limitations in the market access liberalization for the traditional agricultural products, but also because an important part of the region's non-traditional export products already enjoys temporary preferential tariff in the EU market as part of the GSP+. In the medium and long term, it is more likely that there will be an increase in the trade flows as a result of the access of new products to the EU market.

The most foreseeable benefits will arise from the FDI attraction, which will encourage the economic growth of the region. The AA will provide a legal framework being more stable than that of the GSP+'s unilateral tariff reliefs and incorporating higher international standards for the behind-the border issues, which will reinforce the regions' ability to attract FDI. Nevertheless, it will not be an easy task or without risks, since the adoption of liberalizing measures in most of the behind-the-border issues will require internal legislative changes. It is possible that the Central American governments worry for the consequences of these legislative changes will augment, since they limit their national economic sovereignty and force them to homogenize their legislations with those of the EU countries.

The AA on its own will not suffice to generate economic growth in Central America, unless it is accompanied by economic policies that make possible to take advantage of the offered opportunities and to reduce the potential risks. These policies will have to shape an agenda to accompany the AA, being negotiated at the national and regional level. Policies concerned with attracting investment and improving competitiveness, as well as with facilitating the adjustment of the social groups adversely affected by the AA, will have to form part of such an agenda.

The Central American governments' ability to finance the accompanying agenda is severely restricted by the scarce fiscal resources available, which might turn more limited by the negative fiscal effect of the AA's tariff relief. To lessen this situation, it will be necessary to develop a comprehensive fiscal reform that increases government revenues –something that is not easy in Central America– and simultaneously, to resort to external loans and international cooperation. It would be advisable that the Central American governments have access to official financing on concessional terms and to aid inflows, avoiding further problems of external indebtedness. In this context, the EU cooperation could contribute to finance the accompanying agenda, incorporating some of its components as strategic axes of the future intervention in the region. It could be a way of reducing the asymmetry prevailing in the bi-regional economic relations.