**THE CENTRAL AMERICAN CUSTOMS UNION:**
**CHALLENGES FOR PROGRESSING TOWARD ECONOMIC INTEGRATION**

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**ABSTRACT:**
In recent years Central America has consolidated its process of economic integration through a customs union, the implementation of free trade between its members and the establishment of a common external tariff of more than 95% of the tariff lines. These elements have promoted a steady growth of trade of goods and services, not just among the region, but also in external markets. Despite these advances, however, the region still faces major challenges to deepen economic integration, such as: adoption of trade facilitation measures, consolidation of free trade and movement of goods within the customs territory, completion of the common external tariff, designing a Central American joint tax collection mechanism, as well as strengthening the institutional and intraregional coordination mechanisms.

Keywords: Central America; customs union; economic integration.

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**RESUMEN:**
En los últimos años la región Centroamérica ha consolidado el proceso de integración económica a través de una unión aduanera, que mediante la aplicación del libre comercio entre sus miembros y el establecimiento de una arancel externo común aplicado a más del 95% del universo arancelario, ha promovido un crecimiento constante del comercio de bienes y servicios intra y extra regional. A pesar de estos avances, la región todavía tiene importantes retos que atender para profundizar esa integración económica, dentro de los que destacan la adopción de medidas de facilitación del comercio, la consolidación del libre comercio y la libre circulación de mercancías en el territorio aduanero, la conclusión del arancel externo común, el diseño de una política comercial conjunta centroamericana, y la definición mecanismo común de recaudación arancelaria y fiscal, así como consolidar la institucionalidad y los mecanismos de coordinación intrarregional.

Palabras clave: Centroamérica, unión aduanera, integración económica.

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Frame of reference

Central American economic integration accelerated when the Organization of Central American States (ODECA) was founded in 1951, which would become the foundation for the General Treaty for Economical Integration (TGIE)\(^1\) in 1960. Its principal objective is economic unification, as well as promoting conjoint regional development, in order to improve the inhabitants’ living conditions. To do so, TGIE has established agreements between countries, specifically for a common market through a customs union. This customs union would be able to eliminate exchange trade barriers through a common external tariff. Articles 1 and 2 of TGIE elucidate:

**Article 1:**

The Contracting States agree to establish among themselves a common market which shall be brought into full operation within a period of not more than five years from the date on which the present Treaty enters into force. *They further agree to create a customs union in respect of their territories* (italics added for emphasis).

**Article 2:**

For the purposes of the previous article the Contracting Parties undertake to bring a Central American free-trade area into full operation within a period of five years *and to adopt a standard Central American tariff* (italics added for emphasis) as provided for in the Central American Agreement on the Equalization of Import Duties and Charges.

The participating countries defined the free trade regime as all products originating in their respective territories, with the only limitations delineated in Annex A\(^2\).

The goods that are exempt from importation and exportation duties include consular duties; as well as all other taxes and surcharges on imports and exports.

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\(^1\) TGIE came into effect June 4th, 1961, for Guatemala, El Salvador, and Nicaragua. Honduras joined April 27th, 1962, and Costa Rica September 23rd, 1963. Later, Panama adhered to the Central American economic integration process in June of 2013, adopting a series of commitments to gradually assume the rights and obligations of the System of IEC.

\(^2\) Free trade for original products are exempt from payment of customs duties to Customs Duties on Imports (DAI); exports; consular rights; and other taxes, surcharges, and contributions related to importation or exportation.
or consequential charges, be they national, municipal, etc. Likewise, national treatment applies to all goods from their country of origin, which are exempt from any restriction or measure; excepting control measures that are legally enforceable for health, safety, or political reasons.

Under TGIE, Central American commerce has continued to increase, despite the regional military and economic crisis in the 1980s and the international circumstances that affected the region.

![Figure 1. Central America: Intrarregional Commerce 1960-2014. Source: SIECA.](image)

**NOTE:** The graphic shows the constant increase of Central American exports. It does not include data on assembly plants nor information about Panama. Were these included, the figure would reach 9,000,000 USD.

Nonetheless, changing commercial needs have evolved since the 1980s, and the legal instruments for integration recently underwent a major renovation to suit modern requirements. To respond to these needs, the Protocol of Tegucigalpa was signed on December 13th, 1991, for the formation of the Central American Integration System (SICA) and the reformation of ODECA's Charter. This Protocol dedicated Central America's new vision to be one of peace, liberty, democracy, and development. It also modified the institutional regional structure, establishing the following bodies: The President’s Summit, the head of the organization; the Executive Committee, which is comprised of one representative of each member state; and also the Secretariat General, which is appointed by the President’s Summit.
Additionally, the Guatemala Protocol was signed on October 29th, 1993, modifying a new reference point for the regulation of Central American economic integration under TGIE. This treaty reiterates the countries’ commitment to voluntarily, gradually, complementarily and progressively develop the Central American Economic Union. Consequently, TGIE set up the Secretariat for Central American Economic Integration (SIECA).

This modification to TGIE puts in context its original aspiration to have configured a customs union within a period of five years, recognizing the particularities and difficulties of such a process, and introducing one of its foundations as the “economic integration defined as a gradual, complementary, and flexible process of converging wills and policies.”

Article 5 of the Guatemala Protocol establishes the beginnings of the system of Central American economic integration, suggesting that this process would adjust to the principles of legality, consensus, gradualness, flexibility, transparency, reciprocity, solidarity, totality, simultaneousness, and complementarity. This new vision, nearer to the reality of the development, establishes distinct stages for advancement: first through an area of free commerce, and then later through the consolidation of a customs union.

Years later, the integration agenda gained new momentum with the contribution of a new agent: the Framework Agreement for the Establishment of the Customs Union (also referred to as the Framework Agreement). This founded the groundwork necessary to advance the agenda. Here it was agreed that the agenda would be founded in the objectives and principles of regional integration instruments in force and that it would conform to the regulations in Article XXIV of the GATT. They reiterated that the customs union would be gradually and progressively implemented, and that its establishment would be the result of the development of the three following stages:

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3 The Framework Agreement for the Establishment of a Central American Customs Union was signed by Guatemala December 12th, 2007.
4 One of GATT’s fundamental elements is the principle of the treaty of the Most Favored Nation (MFN), which establishes and “any advantage, favor, privilege, or immunity granted by a member to a product origination in another country or destined to it, will be immediately and unconditionally granted to all similar products originating in the territories of all other Contracting or intended Parties.” Despite this provision, Article XXIV of GATT establishes an exception application to three types of regional agreements: 1) customs unions; 2) free trade zones; and 3) the necessary interim arrangements for the establishment of a customs union for a free trade zone.
1. Promotion of the free circulation of goods and facilitation of trade of trade;

2. Modernization and convergence of regulations; and

3. Institutional development.

The region subsequently further strengthened economic integration, at the same time that it began actively participating in extra-regional integration processes in order to maximize a commercial platform and attain a greater international economic presence.

On June 2015, through The Declaration of Placencia in Belize, the presidents gave a new impetus to “[i]nstruct the reliable-competent secretaries to draw a roadmap that considers times, deadlines, and responsibilities conducive to the establishment of the Central American Customs Union under the Framework Agreement for the Establishment of the Central American Customs Union.” In order to complete this mandate, the region formed the blueprints for the Advancement in the Customs Union 2015-2024, designing a series of tasks towards achieving this objective, and referring to the three aforementioned established stages in the Framework Agreement. This roadmap will be evaluated every two years by the Cabinet for Economic Integration (COMIECO) and will last ten years. It additionally constitutes the principal guide for the development and future advancement of the agenda.

**Economic environment**

As aforementioned in Graph 1, intraregional commerce has systematically increased since the creation of a blueprint for Central American integration, despite some setbacks in the first few stages of development. According to the 2015 Regional Economic Outlook (REO) as prepared by the Directorate of Economic Intelligence of SIECA, during the year of 2014 total Central American merchandise exportation increased 1.5% more than the previous year and reaching a sum of 30,247,800 USD. Nearly 30% of this was directed towards the intraregional market, with an amount of over 9,000 million USD.

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5 The 2015 Regional Economic Outlook was published September 2015 in Guatemala City, Guatemala. It is the result of SIECA’s efforts to promote academic discussions in Central America and collaborate with the facilitation of strategic inputs that support decision-making at the level of economic integration, as well as the formulation and design of public policies in favor of development.
In addition, the data show that sales between Central American countries presented an annual percentage of 5.6%, evidencing a greater dynamism than in foreign markets.

The slow restoration of external demand and the lowering of international prices of raw goods explains a good part of the modest increase of Central American exports. The United States is the principal recipient of exports, with 32% of total exports from all seven countries directing towards it. 13% of exports, meanwhile, are delivered to Europe. With the recent signing of the Free Trade Treaty between Costa Rica and China, exports towards the Asian market are also beginning to appear.

As for imports since 2011, there appears to be a process of deceleration. The data from 2014 reveal numbers near 71 million USD, a 1.5% increase from last year. Of that amount, 13.8% corresponded to markets in the same intraregional market, a small increase of 1.9% in relation to 2013.

In the services sector, the region has been increasing at a greater rate, although in 2014 the global economy negatively impacted it. The annual value increase of exports was 6.8%, the most noticeable of which belonged to services related
to tourism and travels, as well as transportation associated with activity around the Panama Canal. Panama’s exports led the region with 40.5% of total exports, followed by Costa Rica with 25.9%, Guatemala with 10.3%, Honduras with 9.8%, El Salvador with 8.4%, and Nicaragua with 5.2%.

The 2014 annual percentage of importations of services was smaller, as shown in Graph 3. Panama stood out with the highest percentage of around 34% of total participation, followed by Guatemala with 21.4%, and Costa Rica with less than 15%.

![Figure 3. Central American Commercial Services: Annual Percentage (%). Source: Directorate OF ECONOMIC INTELLIGENCE (SIECA). Taken from the 2015 Regional Economic Outlook.](image)

This dynamism of commercial Central American goods and services has been invigorated by the outline of regional integration, which has continuously been used during distinct international crises to maintain continuous economic flows to stimulate the economy. However, despite advances in this area, there are still challenges that the region must confront in the upcoming years to consolidate the customs union and facilitate commercial exchange.
Current situation of the Central American customs union

On June 29th, 2012, Panama signed the Protocol of Incorporation to the Subsystem of Economic Integration of the Central American Integration System, the most critical event to the region in the past few years. This protocol clearly and strongly demonstrates the continuous effort to deepen regional economic ties. In addition, it defines the terms, conditions, and modalities for the incorporation of Panama into the Central American integration agenda.6

Thanks to this major advance, today Central America can successfully implement concrete actions to progress towards a more advanced customs union. These steps can substitute two or more territories as one, eliminating the majority of customs duties for products. Its members can then apply common tariffs and restrictions common to third party countries.7

The adoption of a common external tariff and free circulation of merchandise—including goods from external countries of origin—allows for the same products to enter the customs union territory through a peripheral control center. It also completes the customs requirements and formalities of those of non-tariff nature, upon which they would be able to freely circulate through the Central American countries; since after their passage through customs they are released for free circulation and automatically become merchandise belonging to the customs union. In the same way, all of the goods whose countries of origin adhere to the national treaty’s requirements are exempt from all restrictions of measurements of quantitative character; with the exception of control measures that are legally applicable for health, security, or political reasons.

The free Central American commerce regimen for all original products is only limited by a list of specific goods that are included in Annex A of the General Treaty for Economical Integration. They are comprised mainly of sugar and green coffee, which, due to their sensitivity, have been maintained as exceptions to the rule.8

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6 The Panama Congress approved the Protocol of Incorporation through Law 26 on April 17th, 2013. It and the Protocol of Guatemala’s ratification instruments were realized May 6th, 2013 by the Secretary General of Central American Integration (SG-SICA). Since then Panama is a full member of the Central American Economic Integration Subsystem.

7 Balassa, B., *The Theory of Economic Integration*, Illinois, Richard D. Irwin, INC.

8 The process of developing Central American integration has eliminated products in Annex A, gradually incorporating free regional trade. Nonetheless, since June 2006, there have been no advances, especially since the things that are included have high political and social sensitivity.
One serious concern that must be amended pertains to the common external tariff, as there are myriad regional tariffs that are not harmonized. Thus the circulation of goods requiring a series of controls is obstructed, and trade is consequently hindered. The situation becomes further complicated with countries signing a large number of free trade agreements that have tariff reduction programs negotiated bilaterally or at the sub-regional level. They hinder not only a conjoint regional treaty, but also the possibility of the free circulation of all Central American products.

In the mid-nineties the common parameters were established for the regional tariff policy pertaining to third party countries, and it was agreed upon to implement the following levels to the tariff duties for imports:

- 0% for capital and raw materials not produced in the sub-region;
- 5% for raw goods generated in Central America;
- 10% for intermediate goods created in Central America; and
- 15% for consumer goods.

Based on these parameters, the region initiated a process of harmonizing tariff duties against third party countries. Today, out of a total of 6,389 tariff products, 95.7% are harmonized, implying that only 4.3% of the total is pending. This percentage is comprised mainly of products in the metal, petroleum, farming, and medical fields.\(^9\)

It is important to point out that the majority of the customs union processes presented are in reality exceptions, not only in granting free trade for some intraregional products, but also in what is referred to as the harmonization of common external duties for third party countries. The selfsame definition in Article XXIV of GATT states that the requirement to be considered a customs union is the elimination of barriers “essential” to trade, making it clear that since the conception of the organization it has never been considered necessary to achieve 100% harmonization and free trade for the regional goods. It especially demonstrates the exceptions and difficulties of configuring a perfect customs union.\(^10\)

\(^9\) There are more than 180 products that are not harmonized within the agricultural goods field due to its sensitivity, including cattle, pigs, poultry, dairy products, corn, rice, products of the milling industry, sugar, and offal certain wines and spirits.

\(^10\) The WTO jurisprudence has discussed on several occasions the scope of “essential trade,” though there is no specified date if agreement corresponds by 80% or 90%, according to the agreement.
Main challenges

The need for further progress in deepening Central American economic integration imposes the need to analyze the main challenges that the member countries must confront in upcoming years. They must do so by reaching a conjoint consensus and obtaining the highest engagement and political support in the region.

There is a series of elements that constitute the fundamental challenges that must be attended to in the next few years to realize a fully achieved customs union. These elements are:

Promotion of free circulation of merchandise and facilitation of trade

Although the Framework Agreement establishes the free circulation of merchandise and facilitation of trade as the primary stage of the customs union, it has been difficult in recent years to continue progressing in that direction. Diverse factors hinder such advances, and structural problems still exist. For example, it is extremely difficult to eliminate Annex A or to reach complete harmonization of products excluded from the common external tariff. At the same time, there are current issues related to the infrastructure, logistics, and red tape that affect regional competitiveness and the possibility of taking advantage of trade opportunities and product chains.

Additionally, there is another factor that hinders the free circulation of goods. Because of certain characteristics and dimensions of the Central American market, for years there has been a need to complement the regional process with a strategy for connecting to the international economy, not only in order to reach stronger markets, but also to attract foreign investments. This process has been stimulated by trade agreement negotiations. While necessary, it has actuated a series of challenges and complications that must be addressed comprehensively to develop a fully formed customs union. The additional subscription and vigorous implementation of bilaterally or sub-regionally agreed upon free trade treaties with reduced tariff reduction programs will require renegotiating such agreements in order to achieve harmonization. The situation is especially complicated when taking into consideration that not every country is part of the same treaty. While paying attention to each individual one is not realistic, it is difficult to administer free circulation to all products in the Central American market.

\[\text{any case, the WTO clearly defines and allows for exceptions in customs unions for both the common external tariff and the free trade regime.}\]
region. Mechanisms to address these exceptions must necessarily be implemented, yet each individual administration has its own peculiar challenges.

As a response to the aforementioned problems, the Central American region has aimed to reform the ambiguity of trade facilitation measures. The region’s Presidents delegated this task to the Ministers in charge of economic integration in the June 2014 Declaration of Punta Cana. In order to move countries to compliance, they adopted and implemented the Central American Trade Facilitation Strategy and Competitiveness with emphasis on Coordinated Border Management. Its two components include: 1) the implementation of five short term trade facilitation measures, and 2) a medium and long term plan for the execution of the Coordinated Border Management in Central America with measurement and evaluation indicators. These actions are complemented by each of the countries’ efforts to carry out the WTO’s Agreement on Trade Facilitation; this Agreement on Trade Facilitation seeks to support the development of concrete actions for comprehensive risk management, advance rulings, authorized economic operators, rapid shipping of perishable products, urgent alert systems, and improvement of procedures in ports and border checkpoints, among others.

Moreover, as countries facilitate regional trade, the tariff reduction programs agreed upon by Central America in treaties with primary business partners (the United States and Europe) will continue to decrease until it reaches zero. In that moment, the situation will further progress the common external tariff, considering how many products are currently not harmonized and would otherwise be at the moment trading freely with main markets.

**Promotion of free circulation of merchandise and facilitation of trade**

Although the Framework Convention aims for the free circulation of merchandise and the facilitation of trade, it has become difficult in the last few years. Multiple factors have hindered advancements, with structural problems such as the difficulty of annulling Annex A or achieving full harmonization of the excluded areas of the common external tariff. To reiterate, problems with infrastructure, logistics, and red tape still exist and obstruct both the region’s competitiveness and the ability to take advantage of commercial opportunities and product chains.

In addition, considering the characteristics and dimensions of the Central American markets, for several years the countries have needed to complement the
regional process with an international economic strategy. This would not only strengthen markets, but it would also attract foreign investments. While necessary, the resulting agreements have imposed a series of challenges and complications that must be comprehensively addressed in order to reach a fully formed customs union. It would require signing and enforcing a significant number of free trade treaties with programs for reduced tariffs that would be bilaterally or sub-regionally negotiated, as well as a renegotiation of these terms for harmonization. However, the challenge that the Central American region would then face is the disjointedness of countries’ belonging to different treaties. Until this is attended to, it remains difficult to apply free circulation to all Central American products. Thus it is necessary to implement control mechanisms that address these exceptions, despite the further challenges that implementing them will create.

In order to resolve the aforementioned problems, the immediate necessary path is the implementation of specific trade facilitation measures. The June 2014 Declaration of Punta Cana, to reiterate, has addressed this need, and has been greatly aided by the countries’ compliance with the WTO’s agreements of facilitation of trade. The present tariff elimination programs’ reduction with the United States and Europe must also reach zero in order to work out contemporary issues. At that point, the situation can facilitate progress of the common external tariff and solve the problem of today’s products being disharmonized. Free trade with the main markets would also flourish at a much lower cost for harmonization.

**Common trade polices and harmonization regulations**

Another central element for UA’s consolidation is the establishment a shared market policy. It would then be easier to delineate regional statuses and avoid a gap in regulations from businesses and individual positions in different forums.

First, a strategy for the harmonization of already existing trade agreements must be developed, as well as regionalization of current bilateral agreements. The latter includes those made in the WTO’s multilateral framework. Under this approach, countries would have bargaining power as a bloc with third parties and would limit individual arrangements.

Additionally, the region must collaborate for the complete harmonization or equivalence thereof with commercial technical regulations so as to adhere to stated regulations. It must also ensure the harmonization or uniformity of criteria and business procedures that regulate safeguarding impositions,
anti-dumping policies, subsidies, preferential and non-preferential rules of origin, special regimes (including export processing zones and returning rights), intellectual property rights, rights of retaliation of trade disputes, and of the uniformity of sanity and phytosanitary measures. Because of the absence of such consistency, there is a high risk of less rigorously regulated merchandise within one region circulating the rest of the territory and evading more restrictive provisions.

**Common tariff mechanism and tax collection**

Fiscally, the customs union’s consolidation agenda imposes a series of concrete classifications to address the importation of certain peripheral customs to address merchandise destined for one country that has been altered from the original good that entered it. In an environment in which merchandise freely circulates throughout Central America, it is necessary to define an institutional and highly coordinated system to implement a collection, administration, and distribution system for tariff revenues. For example, one good or service that enters through one peripheral custom in County A but is consumed in County B could potentially pay tax burdens in the Customers Office upon entry. To resolve this discrepancy, there must be a procedure allowing for the distribution or assignment of these resources.

It has been brought up in the past, as there have been different trends that are influenced by the level of consumption. Some member countries favor equal distribution of the charges between countries, arguing that it would encourage integration. On the other hand, some believe that raw materials or altered resources ought to remain in the country of production, independent of where it is consumed. The majority, however, holds that it should be assigned to the country in which the good is consumed, since the consumers of that country that should settle the corresponding taxes.

**Institutionalization and mechanisms for regional coordination**

As aforementioned, upon signing of the Framework Agreement, the participating countries agreed to commit to the third stage of the process: the establishment of a necessary institution for functionality, administration, and consolidation of the Customs Union. Despite the efforts by the Secretariat of Economic Integration, some claim that a reconsideration and renovation is necessary to adjust to future needs.
Executing a shared external trade policy within a framework of inter-governmental cooperation will present a great difficulty and enormous cost if it is to implement regional institutional foundations. Due to this, an institutional framework capable of adequately managing the process’ challenges and granting faculties is imperative. Advancing in this direction presents a challenge that must be recognized in countries where the conditions have not been addressed. This commitment would be the final stage of the process. It is clear that in many cases the current institutional framework has been delimited from some countries, in which national institutions are reluctant to yield and share these capabilities and finance them at the regional level.

**Conclusion**

Since the initiation of efforts towards Central American economic integration, exchange between countries has steadily and systematically increased, reaching an amount of over 9 million USD in 2015. This dynamic has benefited a plethora of goods; initiated intraregional exportations; and has matured the characteristics vital for planting other markets outside of the isthmus, generating exportation revenue more than 30 million USD in 2015. Additionally, trade services have increased significantly in the last five years, proving that, despite international crises, integration has continued to stimulate Central American trade. It also shows that it has and must continue to implement actions to consolidate and adapt to today’s current needs.

To continue this advancement, on December 12th, 2007, Guatemala signed the Framework Agreement for the Establishment of a Central American Customs Union, conforming to the rules and regulations of the Guatemalan Protocol. In this agreement, the countries agreed upon the objectives and principles of regional integration, also agreeing to conform to the arrangements of Article XXIV in GATT. They reiterated that UA would be gradually and progressively implemented in the following three stages: 1) promotion of the free circulation of goods and facility of trade, 2) modernization and convergence of regulations; and 3) institutional development.

This instrument solidified the countries’ commitment to the region and to continue to seek alternatives to strengthen ties for economic integration. It also acknowledged the need for solidarity and the importance of the Framework Agreement as a reference for the continuous growth of trade of goods and services, both within and outside the region.
Despite these continuous advances, however, the completion of a trade union still demands a strong political commitment and continuous work on the revision and actualization of the regulations. It has also not realized periodic efforts to streamline and coordinate the customs controls and sanitary, migratory, security, and internal tax customs in daily trade operations.

The consolidation of the Central American customs union requires a strategy with a long term vision that takes advantage of the opportunities derived from integration, and that also addresses the challenges that these initiatives present. As an immediate step, the region must rigorously implement specific trade facilitation measures that absolve, or at least reduce, the difficulties of the red tape and logistics affecting the region.

The countries must especially collaborate by implementing a model of coordinated border management that avoids the duplicity of controls and also facilitates regional circulation; outlining and executing policies that more effectively promote the development of Central American values chains, especially those that encourage the participation of small and medium countries (PYMES); working for the harmonization of procedures, administrative systems, shared norms and guidelines applicable to customs, migratory, etc. customs; and, finally, developing a digital trade platform for the transmission of trade documents and data in the region, which would operate external trade processes integrally with the information systems of customs administrations, PSCs, and national and regional sanitary, migratory, fiscal, etc. controls, that intervene in this process.

This step is in no way easy, and there are many challenges. Nonetheless, this route is clear and the political will aligns with this objective. This is the time to take advantage of the *momentum*.
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