



# **Analysis of trade flows between SICA and the rest of Latin America and the Caribbean. Policy recommendations for their promotion, stabilization and diversification**

## **Intra-Regional Relations**

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**F O R E W O R D**

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*This study has been prepared in order to comply with Activity I.2.1 of the Work Programme of the Permanent Secretariat of SELA for 2014, "Analysis of the trade flows of goods and services between the countries of the CARICOM and Central America with the rest of countries of Latin America and the Caribbean. Elements and recommendations to promote and diversify these relations."*

*The document is organized as follows: The introduction presents the main goals and scope of the document; Section I explores the macroeconomic performance of SICA for the period 2000-2013; Section II examines the structure of the exports from SICA to the world and to the rest of Latin America and the Caribbean; Section III studies the evolution for the period 2000-2013 of the exports of goods from SICA to the rest of Latin America and the Caribbean, and the imports goods to SICA from Latin America and the Caribbean; Section IV reviews the trade agreements in effect between the member countries of SICA and Latin America and the Caribbean, with the purpose of identifying opportunities in this area; Section V evaluates the situation of SICA in terms of a series of factors that are fundamental for competitiveness in international trade and for economic growth; finally, Section VI presents the main policy recommendations derived from the issues examined in the study.*

*The Permanent Secretariat expresses its gratitude to Dr. Victor Olivo for his dedication in preparing this study.*



## EXECUTIVE SUMMARY

This document examines in detail the structure of the exports from the Central American Integration System (SICA) and the evolution of trade flows between SICA and the rest of Latin America and the Caribbean (RLAC) for the period 2000-2013. Based on the analysis of the data, the document proposes a series of national and regional policies aimed at promoting, stabilizing and diversifying the exchanges of goods and services between SICA and the RLAC.

The paper also assesses the macroeconomic performance of SICA, the current state of the trade agreements between SICA and the RLAC, and explores certain factors that are crucial to stimulate international trade and growth: the administrative process required for cross-border trade; the commercial and maritime connectivity in the region; the general environment for doing business; the coverage and quality of infrastructure, especially that which is more related to international trade; the capacity of the educational system to provide the necessary labour force in appropriate quantity and quality; and the progress made in the process of economic and commercial integration.

The research relies on data obtained from the statistics databases of the main multilateral institutions: the World Bank (WB), the United Nations Conference on Trade and Development (UNCTAD), the International Monetary Fund (IMF), the Economic Commission for Latin America and the Caribbean (ECLAC) and the World Economic Forum (WEF).

Based on the analyses contained in sections II and III, the following main elements characterizing trade flows between SICA and the RLAC are identified:

- Exports of goods from SICA, in general, and those exports directed to the RLAC in particular, show a relatively high level of diversification.
- Exports of goods from SICA to the RLAC are mainly manufactured goods.
- Exports of services account for a significant percentage of total exports in the cases of Belize, Dominican Republic, Panama and Costa Rica.
- Exports from SICA are highly concentrated towards the United States. Few countries of the RLAC appear among the five main destinations of exports from SICA.
- Exports of goods from SICA to the RLAC, in nominal terms, during the period 2001-2013, have expanded at a quite greater average rate than exports to the rest of the world.
- Exports of goods aimed at the RLAC significantly increased their share in total exports of goods and in the GDP, but still represent relatively small percentages with respect to both magnitudes.
- Exports of goods from SICA to the RLAC in nominal and real terms grew at very similar rates.
- Imports of goods to SICA from the RLAC, in nominal terms, for the period 2001-2003, expanded at an average rate slightly higher than imports of goods to SICA from the rest of the world.
- Imports of goods to SICA from the RLAC increased their share in total imports of goods and in the GDP, between 2001 and 2008, but after a sharp drop of both in 2009, their recovery has been relatively slow.
- Imports of goods to SICA from the RLAC in nominal terms grew at an average rate substantially higher than imports of goods in real terms.

From the above one can conclude that, even though there have been substantial improvements in trade flows between SICA and the RLAC, there is still much room for expanding exchanges between the two regions. In order to increase, stabilize and diversify trade flows between SICA and

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the RLAC, the study proposes, as a first option, the negotiation of trade agreements with the MERCOSUR countries and the transformation of existing agreements of preferential type into free trade and economic integration agreements. However, the main argument of the study is that SICA needs to design and implement a coherent set of reforms in different areas, which are essential to promote its exports of goods and services towards the RLAC and the rest of the world. Without such fundamental reforms, SICA will not be able to make the best use of the advantages granted by existing trade agreements and those that are negotiated in the future.

Based on the analysis of the data, the document raises the following policy recommendations:

- Correcting fiscal and macroeconomic imbalances.
- Improving and standardizing the administrative processes related to cross-border trade.
- Increasing shipping connectivity for transport of goods.
- Reinforcing the environment for doing business and entrepreneurship.
- Investing in infrastructure and its maintenance, with special emphasis on infrastructure directly related to international trade.
- Introduction of deep reforms in the education system.
- Deepening the integration process.
- Exploring opportunities in the areas of services and information and communication technologies.
- Reducing barriers to competition.
- Reinforcing the institutional structure to improve efficiency in the use of the financial and technical resources obtained through international cooperation.



## INTRODUCTION

This document examines in detail the structure of exports from the Central American Integration System (SICA)<sup>1</sup> and the evolution of trade flows between SICA and the rest of Latin America and the Caribbean (RLAC) for the period 2000-2013. Based on the analysis of the data, the document proposes a series of national and regional policies aimed at promoting, stabilizing and diversifying the exchanges of goods and services between SICA and the RLAC.

The paper also assesses the macroeconomic performance of SICA, the current state of the trade agreements between SICA and the RLAC, and explores certain factors that are crucial to stimulate international trade and growth: the administrative process required for cross-border trade; the commercial and maritime connectivity in the region; the general environment for doing business; the coverage and quality of infrastructure, especially that which is more related to international trade; the capacity of the educational system to provide the necessary labour force in appropriate quantity and quality; and the progress made in the process of economic and commercial integration.

The research relies on data obtained from the statistics databases of the main multilateral institutions: the World Bank (WB), the United Nations Conference on Trade and Development (UNCTAD), the International Monetary Fund (IMF), the Economic Commission for Latin America and the Caribbean (ECLAC) and the World Economic Forum (WEF).

The data analysed indicate that: a) Exports of goods from SICA, in general, and those exports directed to the RLAC in particular, show a relatively high level of diversification; b) Exports of services account for a significant percentage of total exports in the cases of Belize, Dominican Republic, Panama and Costa Rica; c) Few countries of the rest of Latin America and the Caribbean appear among the five main destinations of exports from SICA; d) Exports of goods from SICA to the RLAC, during the period 2001-2013, have expanded at a quite greater average rate than exports to the rest of the world; e) Imports of goods to SICA from the RLAC, in nominal terms, for the period 2001-2003, expanded at an average rate slightly higher than imports of goods to SICA from the rest of the world; and f) Exports of goods aimed at the RLAC significantly increased their share in total exports of goods and in the GDP, but still represent relatively small percentages with respect to both magnitudes.

From the above one can conclude that, even though there have been substantial improvements in trade flows between SICA and the RLAC, there is still much room for expanding exchanges between the two regions. However, to attain such expansion in trade relations, the economies of SICA need to adopt a well-coordinated set of policies, which are essential to promote their trade flows, and in general, they need to strengthen the exporting orientation of the members of the system.

The document is organized as follows: After this introduction, Section I explores the macroeconomic performance of SICA for the period 2000-2013; Section II examines the structure of the exports from SICA to the world and to the rest of Latin America and the Caribbean; Section III studies the evolution for the period 2000-2013 of the exports of goods from SICA to the rest of Latin America and the Caribbean, and the imports goods to SICA from Latin America and the Caribbean; Section IV reviews the trade agreements in effect between the member countries of

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<sup>1</sup> For the period under analysis, the full members of SICA are: Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama. Dominican Republic maintained a status of associate member since 2004 up to its incorporation into the bloc as a full member in 2013. However, in order to maintain uniformity of information, the aggregated data of SICA include Dominican Republic since 2000.

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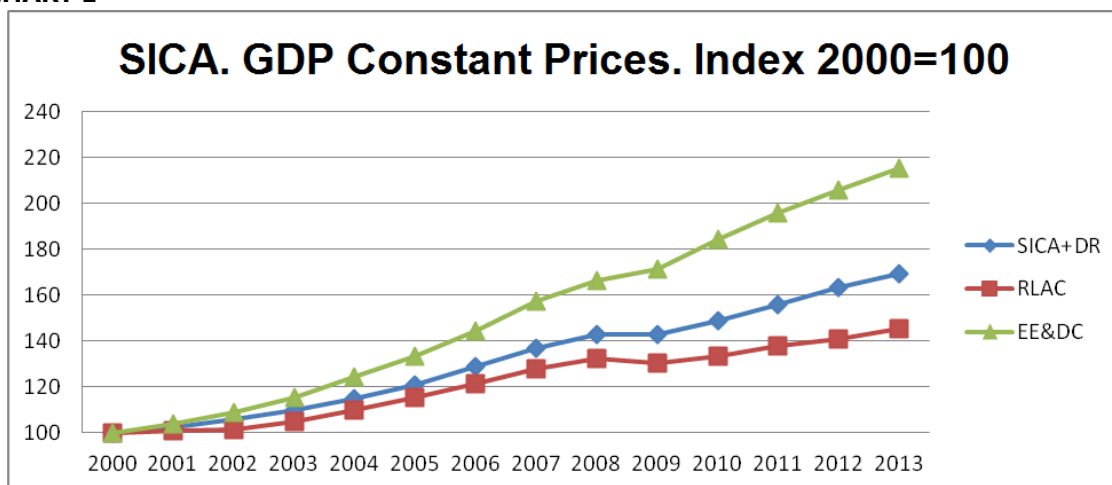
SICA and Latin America and the Caribbean, with the purpose of identifying opportunities in this area; Section V evaluates the situation of SICA in terms of a series of factors that are fundamental for competitiveness in international trade and for economic growth; finally, Section VI presents the main policy recommendations derived from the issues examined in the study.

## I. MACROECONOMIC PERFORMANCE IN SICA

This section analyses the macroeconomic performance of SICA countries for the period 2000-2013 in an aggregate manner, and compares it to that of the RLAC, emerging economies and developing countries (EE&DC).

For the period 2001-2013, the GDP at constant prices of SICA economies grew at an average rate of 4.13% (Chart 1), exceeding that of the RLAC, which stood at 2.91%, but lower than that posted by the EE&DC (6.08%).

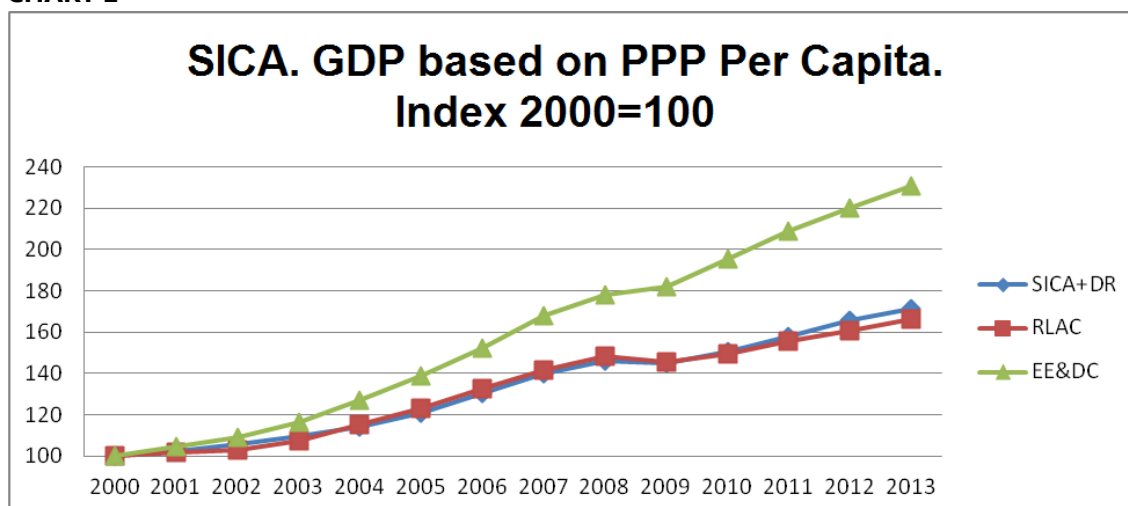
**CHART 1**



Source: IMF; calculations by the author.

Chart 2 shows that the GDP based on SICA's purchasing power parity (PPP) per capita has grown at an average rate of 4.02% during the period 2001-2013. This rate is very similar to that recorded by the RLAC (4.0%), but is below those reported for the EE&DC (6.67%).

**CHART 2**

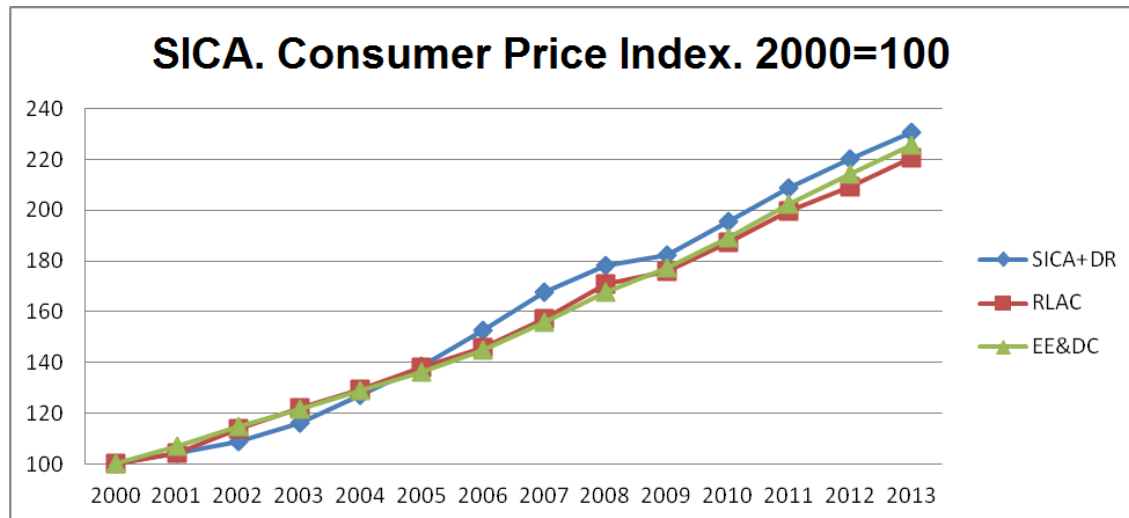


Source: IMF; calculations by the author.

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Chart 3 presents the evolution of the consumer price index (CPI). For the period under analysis (2001-2013), the annual average inflation of SICA was 6.64%, slightly higher than the one seen in the RLAC (6.27%) and in the EE&DC (6.47%).

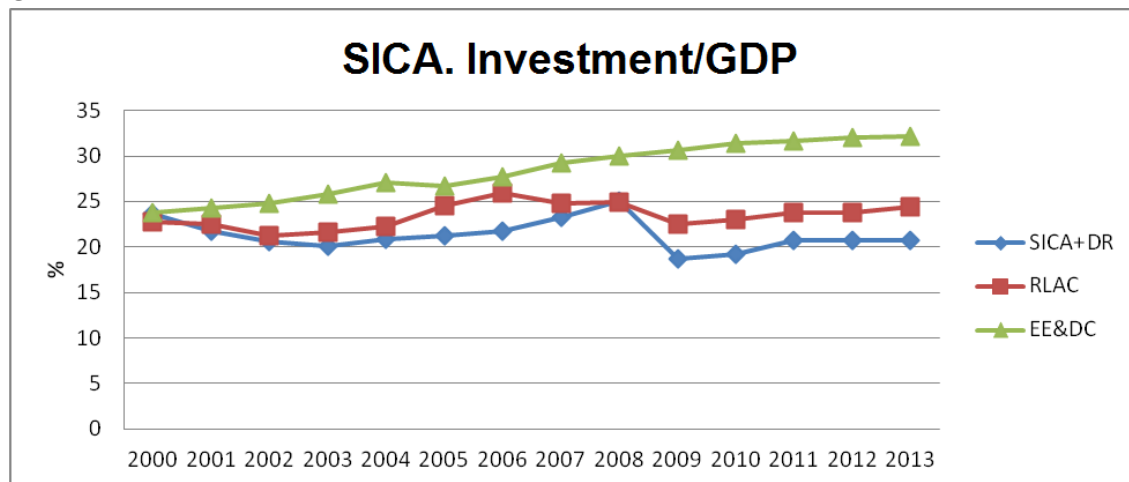
**CHART 3**



Source: IMF; calculations by the author.

The Investment/GDP ratio of SICA (Chart 4) reached an average of 21.3% during the period 2000-2013 vs 23.44% for the RLAC, and 28.38% for EE&DC.

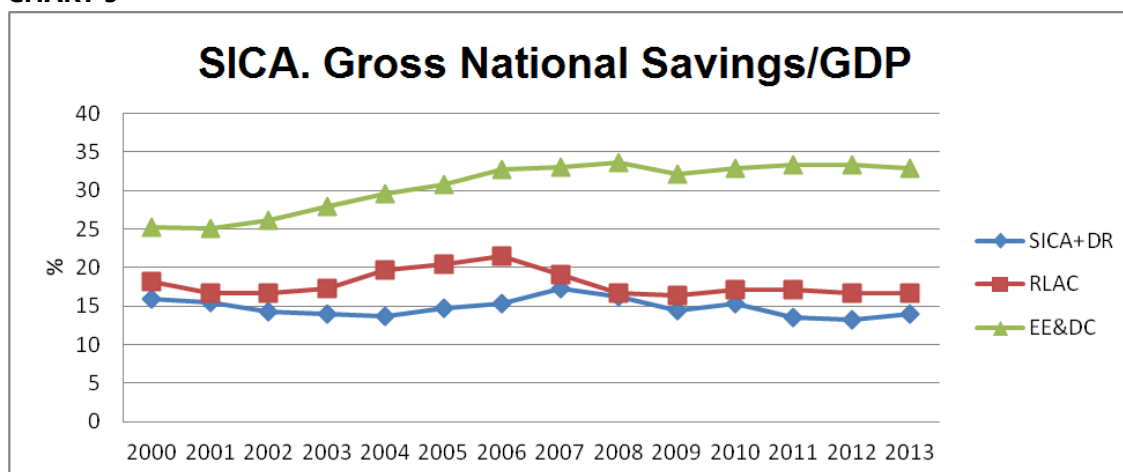
**CHART 4**



Source: IMF; calculations by the author.

The Gross National Savings/GDP ratio of SICA (Chart 5) stood at an average of 14.82% during the period 2000-2013, lower than the one reported for the RLAC (17.87%) and substantially lower than the average for the EE&DC (30,64%).

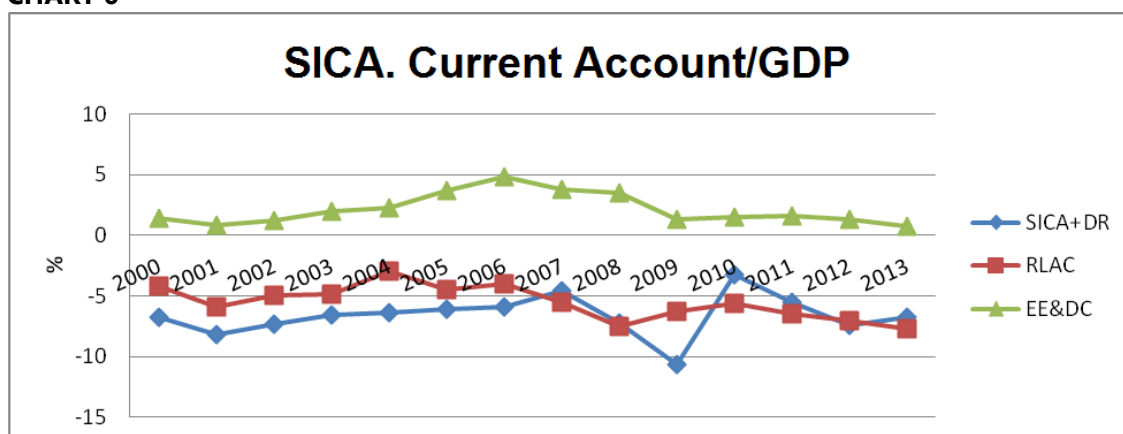
**CHART 5**



Source: IMF; calculations by the author.

Chart 6 shows the evolution of the Current Account/GDP ratio (2000-2013). The substantial gap between the Investment/GDP ratio and the Gross National Savings rate observed in SICA leads to a markedly negative Current Account/GDP ratio (-6.65% in average for the period 2000-2013). For the RLAC, the Current Account/GDP ratio also presents an average deficit of -5.53%, whereas the EE&DC recorded an average surplus of 2.15%.

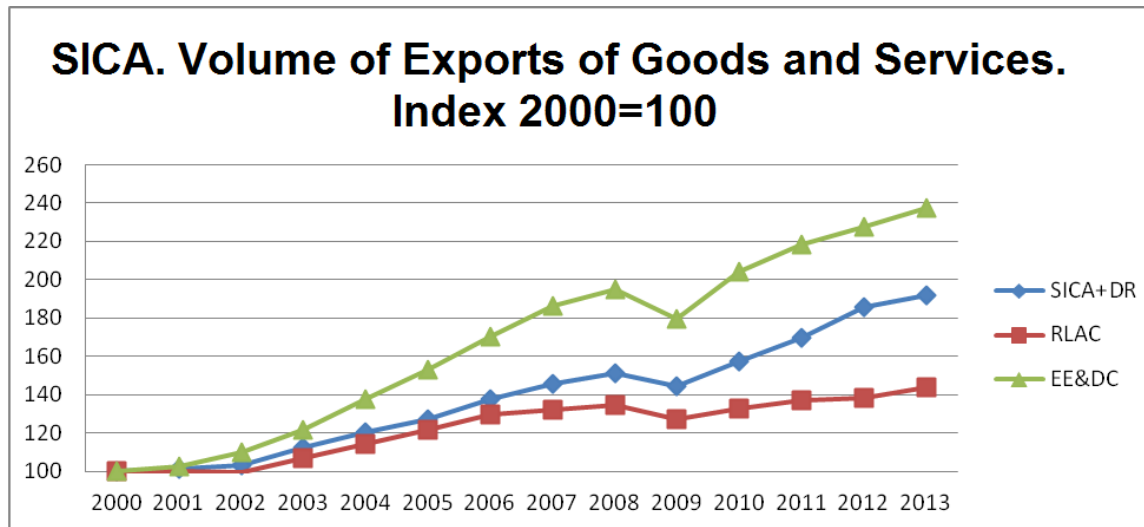
**CHART 6**



Source: IMF; calculations by the author.

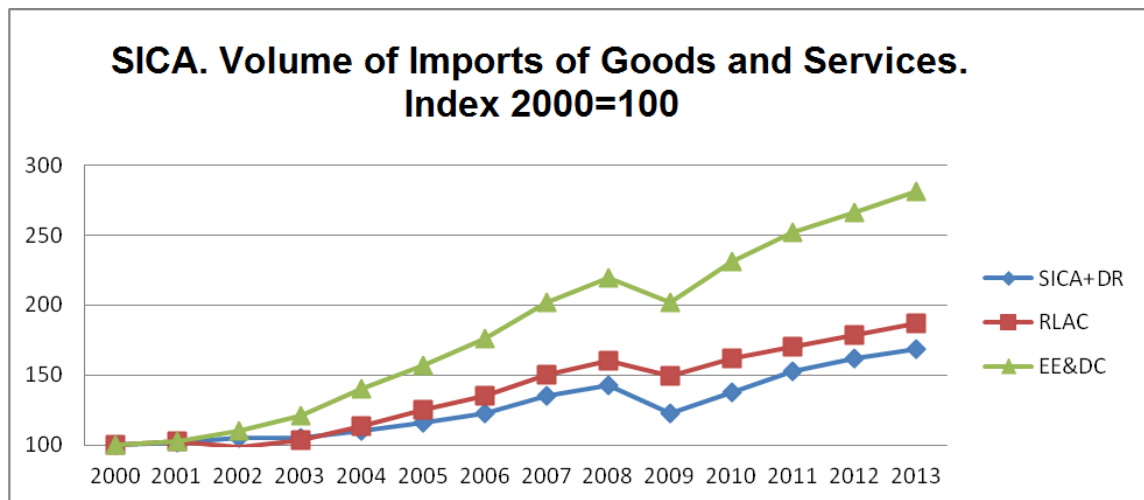
The volume of exports of goods and services from SICA increased at an average rate of 5.14% during the period 2001-2013 (Chart 7), notably higher than that of the RLAC (2.84%), but lower than the expansion seen in this index in the EE&DC (6.89%). In turn, the volume of imports of goods and services in SICA grew at an average rate of 4.1% for 2001-2013, compared to 4.91% in the RLAC and 8.28% in the EE&DC (Chart 8).

**CHART 7**



Source: IMF; calculations by the author.

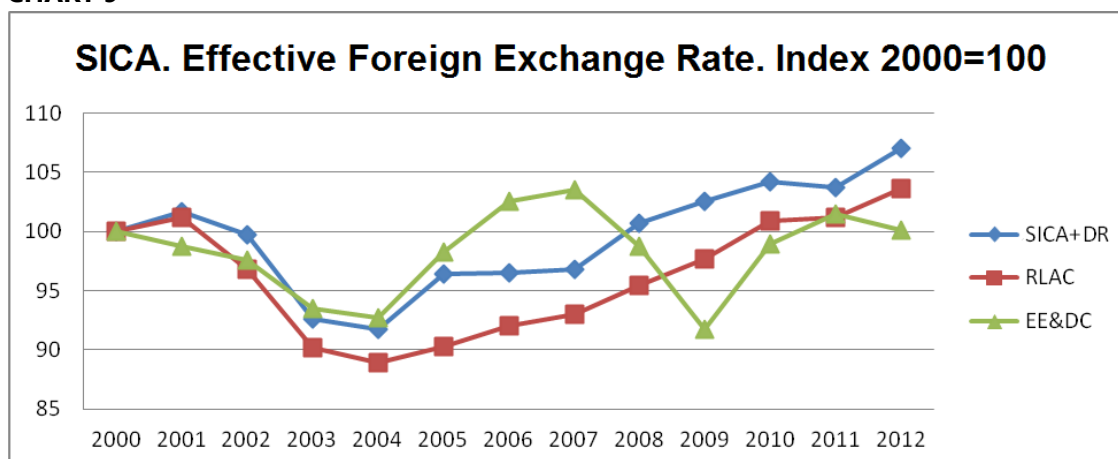
**CHART 8**



Source: IMF; calculations by the author.

The real and effective foreign exchange rate of SICA for the period 2001-2012 (Chart 9) has remained relatively stable, with a slight trend to depreciation since 2008.

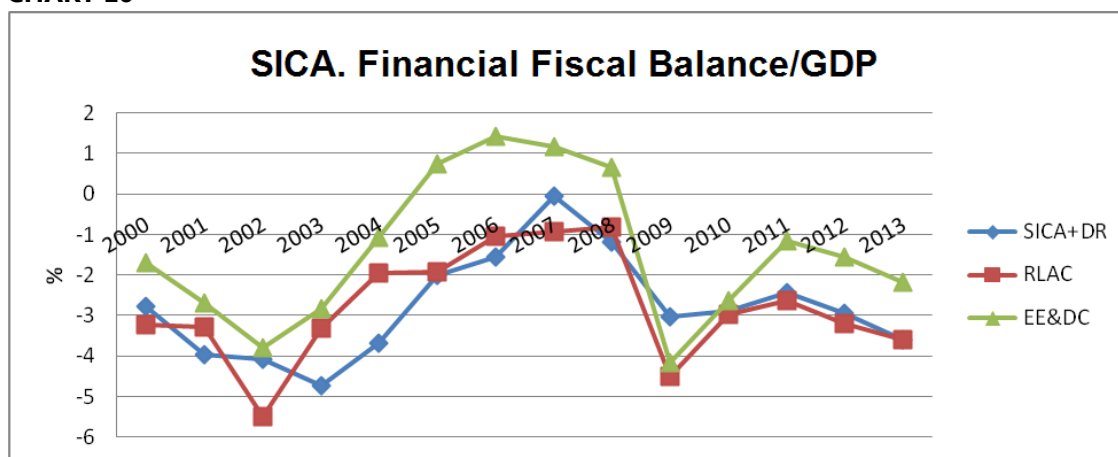
**CHART 9**



Source: UNCTAD; calculations by the author.

As regards fiscal policy, Chart 10 shows the performance of the financial fiscal balance as a percentage of GDP for the period 2000-2013. This indicator showed an average deficit of 2.78% during the period under analysis, very close to that reported for the RLAC (2.82%). In turn, the EE&DC showed an average financial deficit of 1.41%. Noteworthy, SICA has recorded a significant reduction in its financial deficit since 2004, to reach a balance close to zero in 2007. But from 2008 on, this indicator began to deteriorate again, with a significant drop between 2008 and 2009, and a more gradual decline from 2009 until 2013.

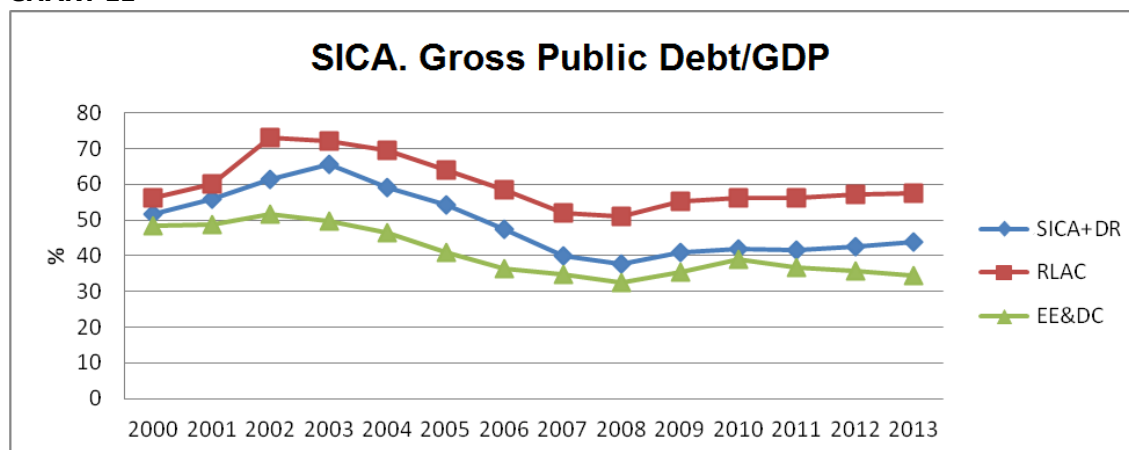
**CHART 10**



Source: IMF; calculations by the author.

The evolution of the Gross Debt/GDP ratio is presented in Chart 11. For SICA, this ratio reached 43.68% in 2013, compared with 57.53% in the RLAC and 34.47% in the EE&DC. In the case of SICA, the Gross Debt/GDP ratio has shown a continued reduction from 65.64% in 2003 down to 37.61% in 2008. From 2009 onwards, this indicator has posted a slight increase.

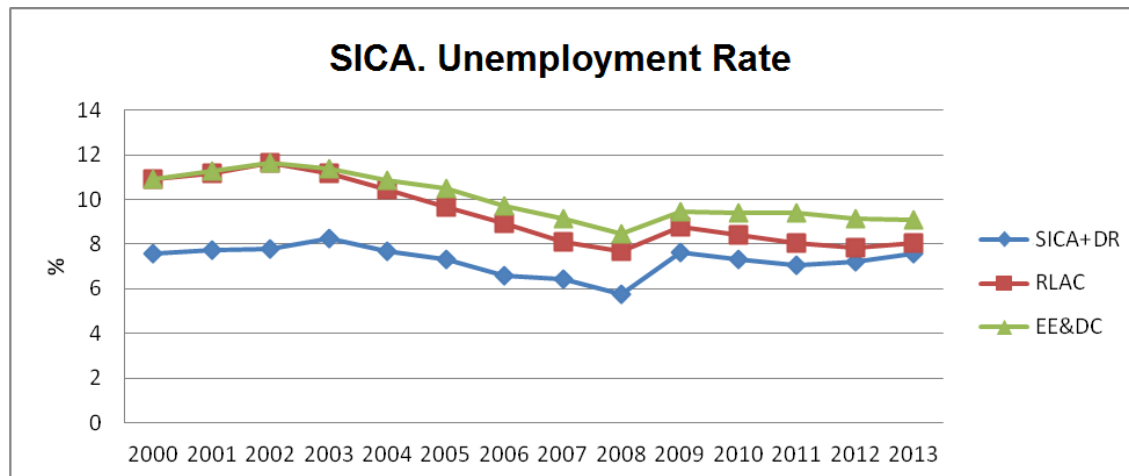
**CHART 11**



Source: IMF; calculations by the author.

In the area of labour, Chart 12 shows the evolution of the unemployment rate. In the case of SICA, the average unemployment rate stood at 7.27% during the period 2000-2013, which compares favourably with the rates reported for the RLAC (9.34%) and for the EE&DC (10.02%). In SICA, the unemployment rate declined gradually from a maximum of 8.23% in 2003 down to a minimum of 5.76% in 2008. However, as of 2009 it increased above 7%.

**CHART 12**



Source: IMF; calculations by the author.

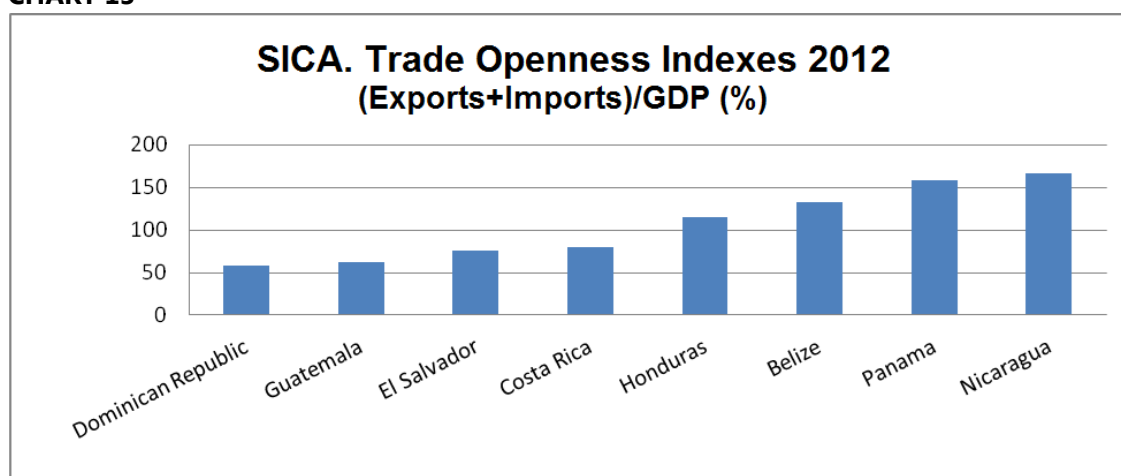
In general terms, SICA has had a satisfactory performance in most of its fundamental macroeconomic variables. However, the overall financial fiscal deficit has increased since 2007, and the gap between investment and savings has been significant during the period under analysis. The latter element is reflected in a marked deficit in the current account in relation to GDP. The other element that stands out in the macroeconomic performance of SICA is its low economic growth in comparison with the average seen in the EE&DC group. From a macroeconomic perspective, the moderate growth of SICA is linked to the low level of Investment/GDP and the slow expansion of the volume of exports of goods and services in comparison with that observed in the EE&DC group.



## II. STRUCTURE OF EXPORTS FROM SICA

In general, the economies that make up SICA are quite open to the rest of the world. Chart 13 shows the trade openness index – (exports+imports)/GDP – by 2012, as reported by UNCTAD. The median openness index for SICA is 97.26%, which is above the openness index values reported by UNCTAD for developing economies in Latin America (45.88%) and that of the emerging economies (84.25%). However, Chart 13 also reflects a high dispersion in the openness index among the economies that make up SICA. The member country of SICA which showed the highest level of openness to international trade in 2012 was Nicaragua, with a rate of 166.2%, followed by Panama (158.71%), Belize (132.68%) and Honduras (115.09%). The rest of the economies of SICA presented openness levels below 100%: Costa Rica (79.43%), El Salvador (75.14%), Guatemala (62.02%) and Dominican Republic (58.76%).

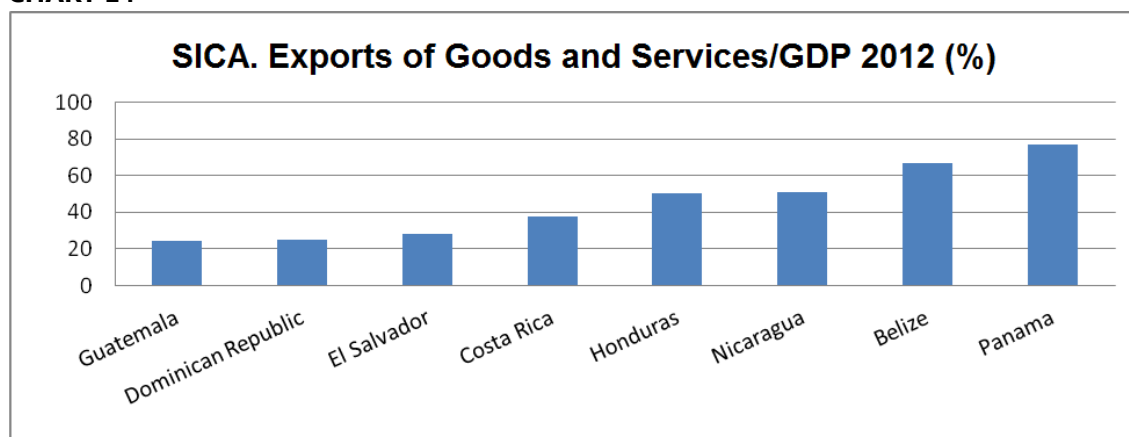
**CHART 13**



Source: UNCTAD.

Chart 14 shows the exports of goods and services/GDP ratio for the economies of SICA in 2012. Panama recorded the highest value of this index (76.66%), followed by Belize (66.6%), Nicaragua (50.82%) and Honduras (50.31%). Other members of SICA presented an index of exports of goods and services over GDP quite below 50%: Costa Rica (37.51%), El Salvador (28.35%), Dominican Republic (25.2%) and Guatemala (24.71%). The median of this indicator for SICA is 43.91%.

**CHART 14**

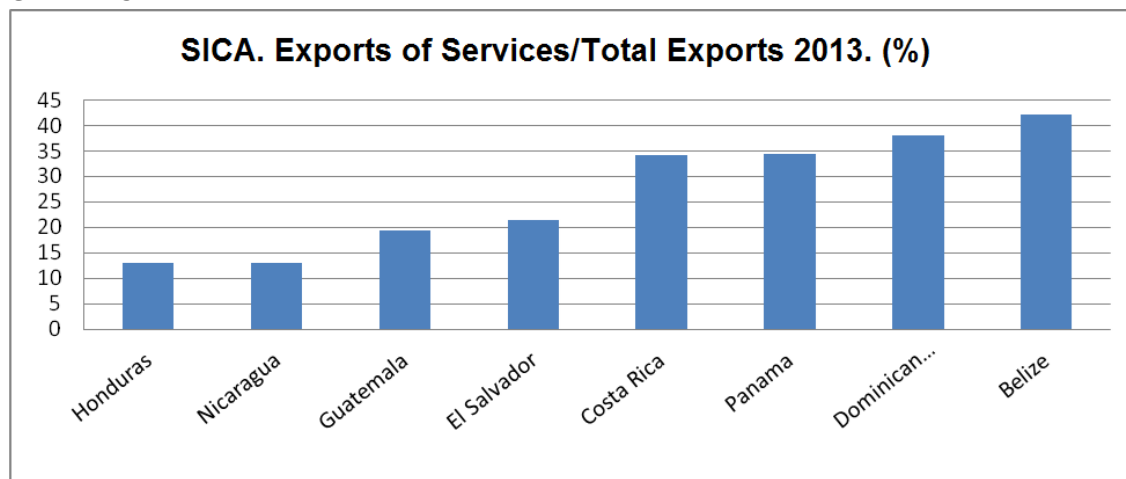


Source: UNCTAD.

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Chart 15 shows the weight of exports of services on total exports by 2013. The country of SICA that posted the greatest ratio of exports of services over total exports was Belize (42.1%); followed by Dominican Republic (38.12%), Panama (34.35%) and Costa Rica (34.18%). The rest of the economies that make up SICA have a lower weight of services exports on total exports: El Salvador (21.37%), Guatemala (19.42%), Nicaragua (13.01%) and Honduras (12.95%). The median of this indicator for SICA is 27.78%.

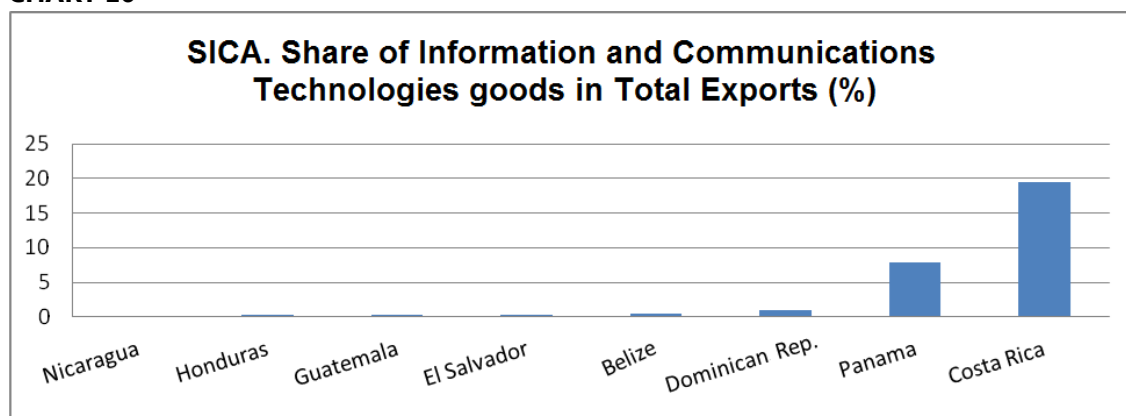
**CHART 15**



Source: UNCTAD; calculations by the author.

Chart 16 depicts the share of goods related to information and communication technologies (ICTs) in total exports in total exports by 2012.<sup>2</sup> The only countries of SICA that show relevant percentages of exports of ICT goods with respect to total exports are: Costa Rica (19.45%) and Panama (7.87%). The rest of the economies of SICA presented values for this indicator below one percent. The median of the exports of ICT goods / total exports ratio for SICA is 0.43%. Such value is higher than that of South America, which has a median of 0.09%, but lies well below the value corresponding to ASEAN-5 (16.04%).

**CHART 16**



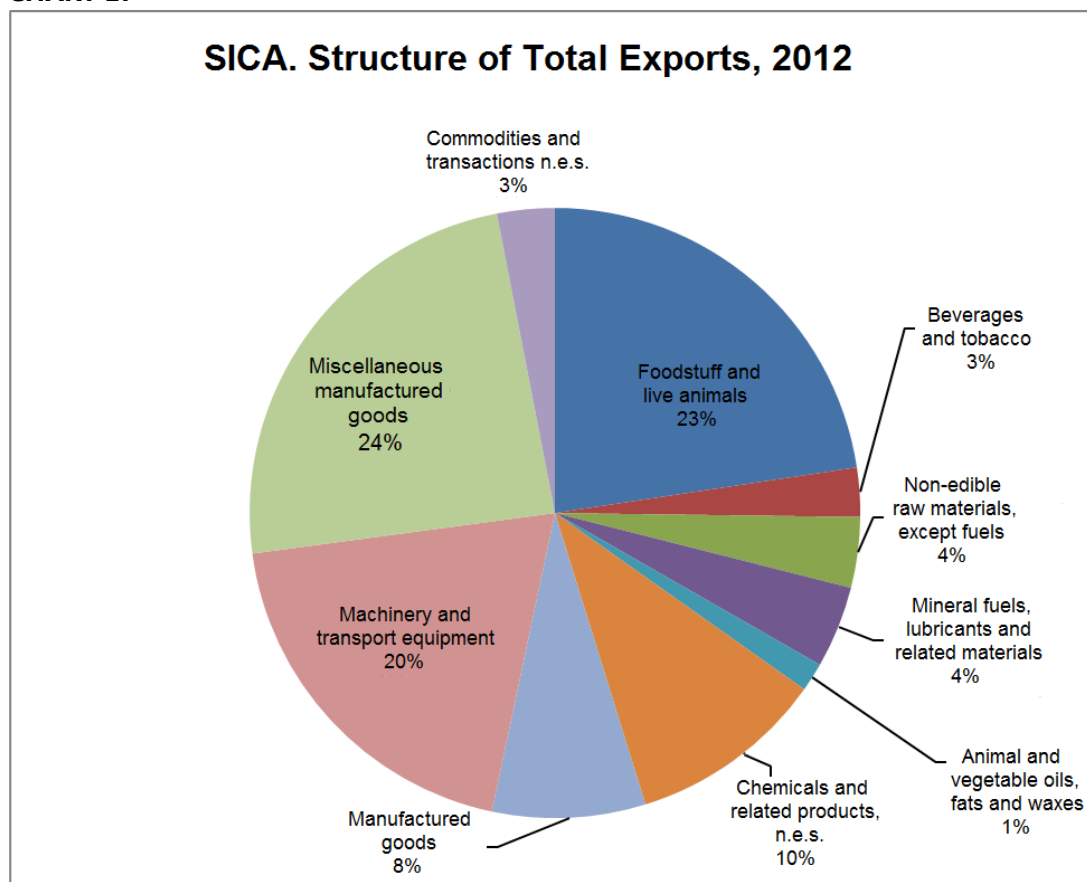
Source: World Bank.

Chart 17 shows the percentage share of total SICA exports in the ten top categories in which UNCTAD divides exports of goods for 2012. Three categories comprised 67% of the total exports

<sup>2</sup> Data on Belize and Panama correspond to 2011.

of SICA: Various Manufactured Items (24%), Foodstuff and Live Animals (23%) and Machinery and Transport Equipment (20%).

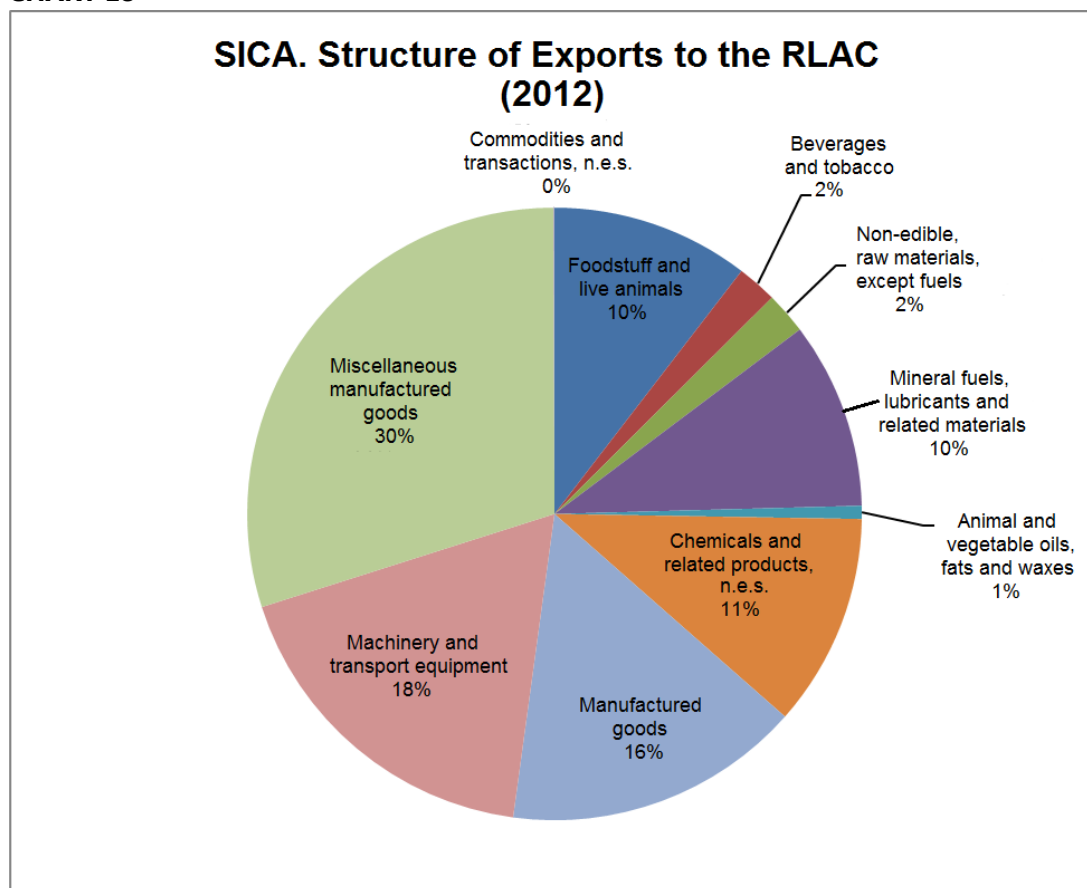
**CHART 17**



Source: UNCTAD; calculations by the author.

Chart 18 shows the percentage share of the ten broad categories in which UNCTAD classifies exports, in the exports aimed at the RLAC by 2012. The structure of exports from SICA to the RLAC differs from that reported for total exports. The three main categories of exports comprised 64% of the exports from SICA to the RLAC: Miscellaneous Manufactured Goods (30%); Machinery and Transport Equipment (18%); and Manufactured Goods (16%). Thus, exports of agricultural products have less weight in the exports of goods from SICA to the RLAC than in total exports.

**CHART 18**

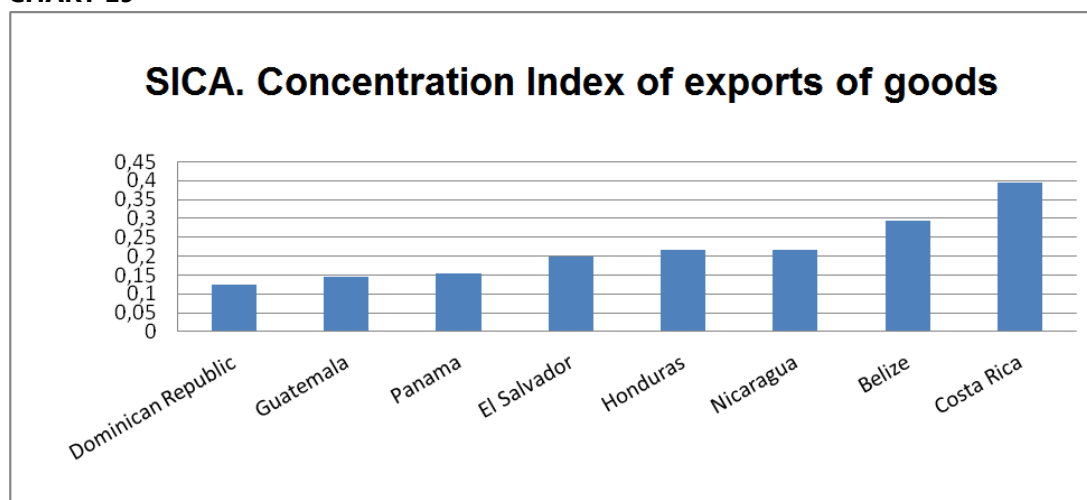


Source: UNCTAD; calculations by the author.

Chart 19 reports the rates of concentration of exports of goods from the economies that make up SICA, as calculated by UNCTAD for 2012. The concentration index of UNCTAD is based on the Herfindahl-Hirschmann index, which measures the degree of market concentration. UNCTAD normalizes the index so as to obtain values between 0 and 1 (maximum concentration).

The SICA country with the highest concentration of exports of goods is Costa Rica (0.394), followed by Belize (0.295). The country that shows the lowest concentration in SICA is Dominican Republic (0.124), followed by Guatemala (0.146) and Panama (0.154). El Salvador, Honduras, and Nicaragua are in a range between 0.198 and 0.217. The median of the concentration index for SICA stands at 0.207, which is markedly lower value than that recorded by the countries of South America (0.435), but higher than that corresponding to the ASEAN-5 (0.164).

**CHART 19**



Source: UNCTAD.

The table in Annex I, based on data of the Observatory of Economic Complexity, presents the five largest exports of goods and the five main destinations of exports of goods from SICA countries.

The table shows that for all SICA countries – except for Belize and Costa Rica – the five major exports represent altogether less than 50% of total exports of goods.

The table indicates that exports of goods by destination are highly concentrated. For all countries of SICA – with the exception of Belize – the United States is the main destination of exports of goods. For all SICA countries at least 25% of its exports of goods are destined to the United States.

Annex I reveals that few countries of the RLAC appear among the five main destinations of exports from SICA: Mexico for exports from Costa Rica, Guatemala, and Honduras; Venezuela for exports from Nicaragua; Ecuador, Venezuela and Peru for exports from Panama; and Haiti for exports from Dominican Republic.

The table also suggests that reciprocal trade in SICA is important: Costa Rica appears among the five main destinations of exports from Belize; Guatemala, Honduras, Nicaragua and Costa Rica are among the five main destinations of exports from El Salvador; El Salvador, Honduras and Costa Rica are among the main destinations for exports from Guatemala; El Salvador and Guatemala are among the main destinations of exports from Honduras; and El Salvador appears among the five main destinations of exports from Nicaragua.

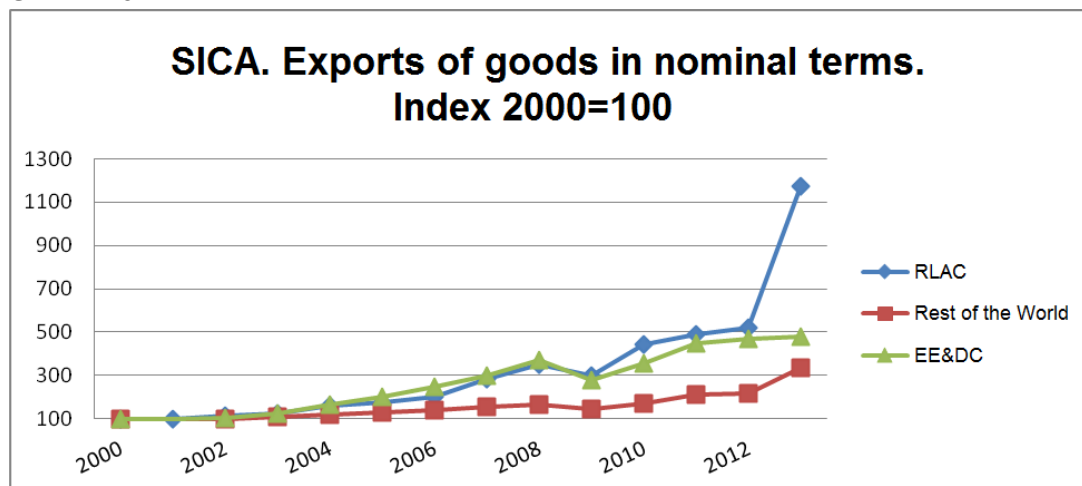
### **III. ANALYSIS OF TRADE FLOWS BETWEEN SICA AND THE REST OF LATIN AMERICA AND THE CARIBBEAN**

This section examines the evolution of exports of goods from SICA to the RLAC, and SICA's imports from the RLAC for the period 2001-2013. Exports and imports of goods are evaluated in nominal terms, as a percentage of total exports, as percentage of GDP, and in real terms. Trade flows between SICA and the RLAC are compared with the values corresponding to SICA with the rest of the world and with the EE&DC.

**1. Exports**

Chart 20 shows the performance of exports from SICA to the RLAC in nominal terms for the period 2001-2013. Nominal exports of goods from SICA to the RLAC grew at an annual average rate of 20.87% during the period under analysis, well above the exports from SICA to the rest of the world (9.7%) and above nominal exports to the EE&DC (12.77%). Noteworthy, in 2013, the database of the Direction of Trade of the IMF reports a huge expansion of 126.38% of nominal exports of goods from SICA to the RLAC. Exports from SICA to the rest of the world also expanded significantly in 2013, to 52.52%. However, even excluding data from 2013, which can be considered conservatively as outstanding values, nominal exports from SICA to the RLAC expanded on average by 14.71% between 2001 and 2012. Such value still exceeds the average growth of exports from SICA to the rest of the world (6.72%), and to a lesser extent, the increase of exports to the EE&DC (13.7%) for the same period.

**CHART 20**



Source: IMF; calculations by the author.

Chart 21 shows how the expansion of exports from SICA to the RLAC gradually increased its share in total exports from the bloc until 2012, and the greatest increased can be seen in 2013. Exports from SICA to the RLAC accounted for 3.28% of the total in 2000, whereas in 2012 they stood at 7.46%, and they jumped to 10.69% in 2013.

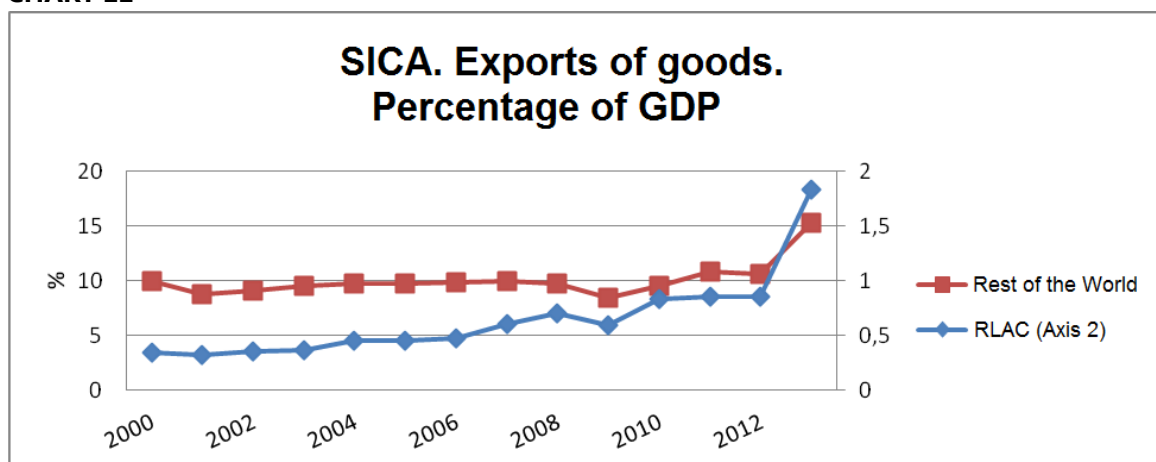
**CHART 21**



Source: IMF; calculations by the author.

Chart 22 presents the performance of exports from SICA as a percentage of GDP. In 2000, exports from SICA to the RLAC accounted for 0.34% of GDP (Axis 2 of the chart), while exports to the rest of the world stood at 9.96% (Axis 1 of the chart). The share SICA exports to the RLAC grew gradually until 2012, when they reached 0.85% of GDP, and rose sharply to 1.83% of GDP in 2013. Furthermore, exports from SICA to the rest of the world remained fairly stable within a range between 8% and 11% until 2012, and increased sharply in 2013 to reach 15.29% of GDP.

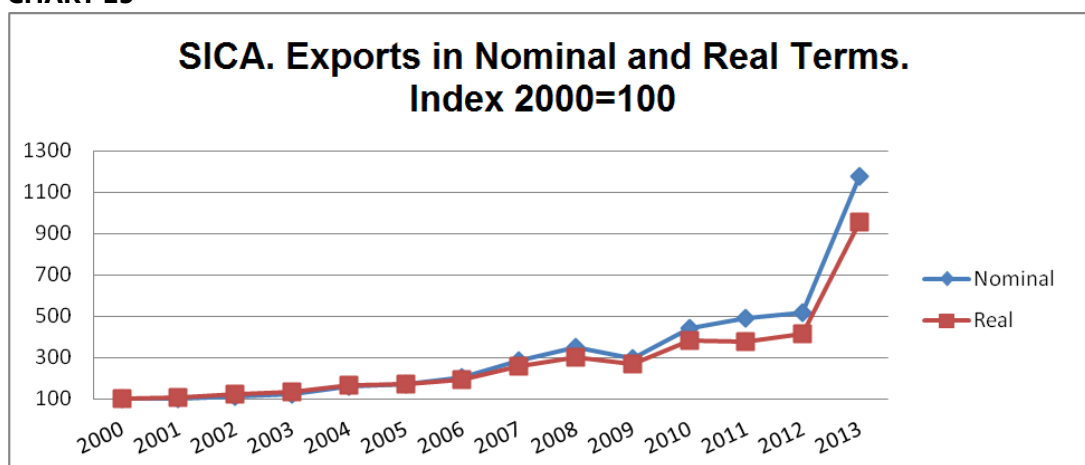
**CHART 22**



Source: IMF; calculations by the author.

Chart 23 compares the evolution of exports from SICA to the RLAC in nominal and real terms.<sup>3</sup> The chart reveals a very similar performance for exports measured in nominal and real terms, which shows that export prices have not changed substantially during the period under analysis. Nominal exports grew at an average rate of 20.87% (2001-2013), compared to 18.97% in real terms. Excluding the high values reported for the year 2013, nominal exports expanded at an average rate of 14.7% for the period 2001-2012, compared to 12.56% in real terms.

**CHART 23**



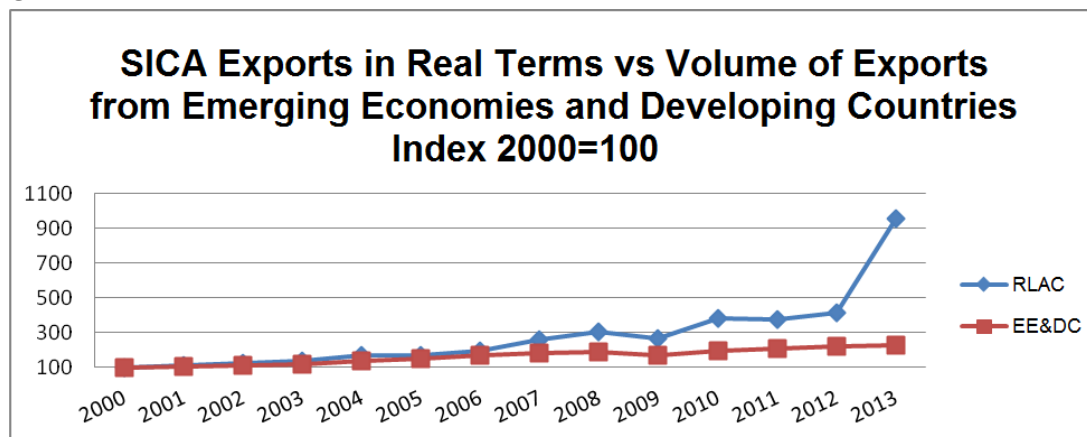
Source: IMF; calculations by the author.

<sup>3</sup> In order to deflate nominal exports, a deflator of exports from SICA was designed based on the deflators of exports reported by ECLAC for each one of the members of the system.

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Chart 24 compares the performance of exports from SICA in real terms to the RLAC with the volume of exports from the EE&DC. For the period 2001-2013, real exports from SICA to the RLAC increased at an average rate of 18.97%, well above the 6.53% rate at which real exports of goods from the EE&DC expanded. Excluding the outliers of 2013, real exports from SICA towards the RLAC grew on average 12.56% (2001-2012), compared to 6.75% for the volume of exports from the EE&DC.

**CHART 24**

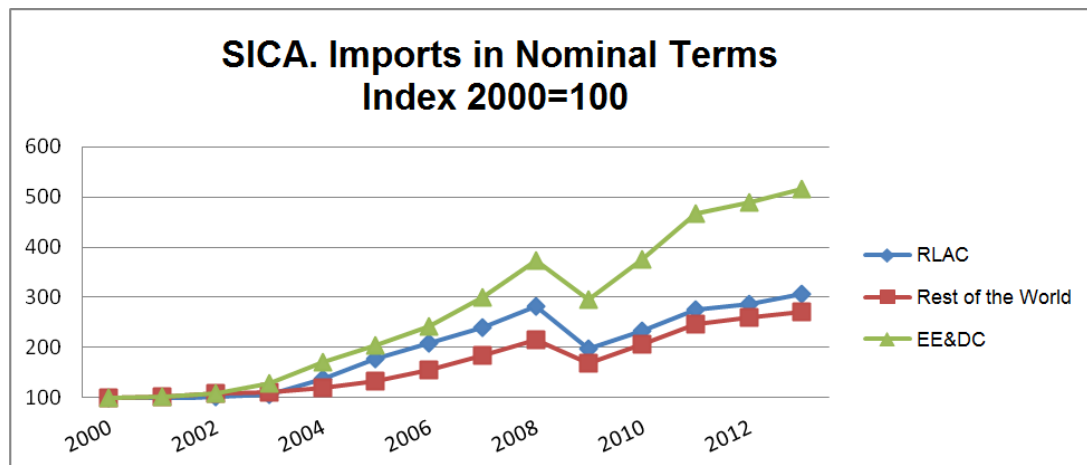


Source: IMF; calculations by the author.

**2. Imports**

Imports of goods from SICA to the RLAC in nominal terms grew at an average rate of 8.97% during the period 2001-2013, slightly above the 7.94% increase shown by imports from the rest of the world, but below the average expansion of nominal imports from the EE&DC, which stood at 13.45% (Chart 25).

**CHART 25**

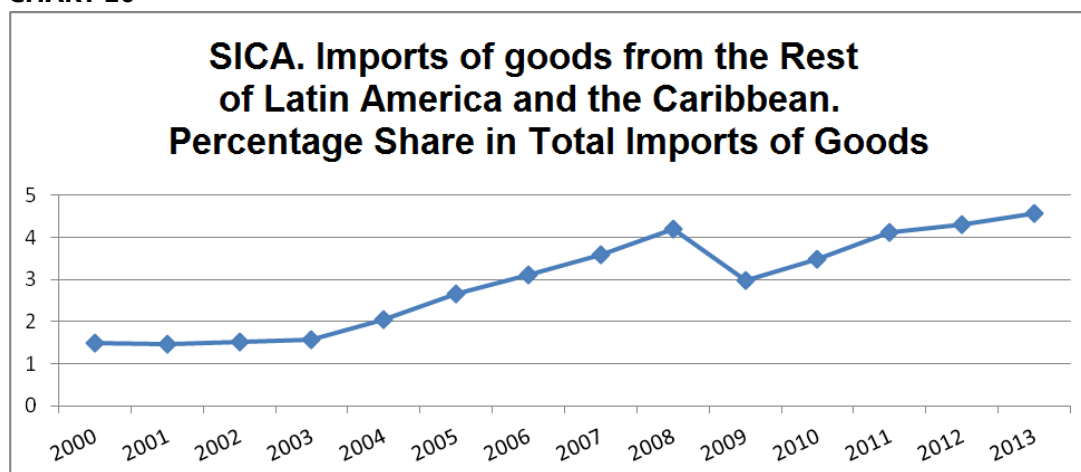


Source: IMF; calculations by the author.

In terms of the share of imports from SICA to the RLAC in total imports, Chart 26 shows a significant increase from 1.5% in 2000 to 4.21% in 2008. In 2009, a marked decrease can be seen down to 2.97%, but as of 2010 imports began to recover to reach a share of 4.58% in 2013.



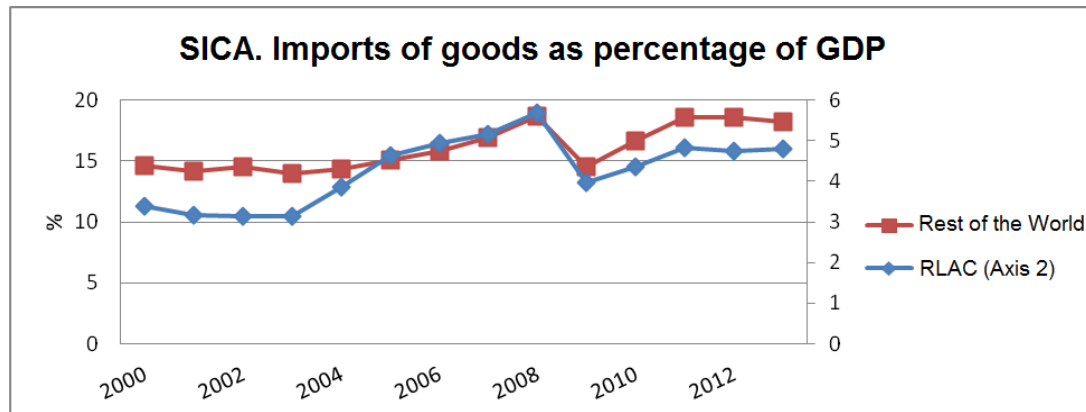
**CHART 26**



Source: IMF; calculations by the author.

As a percentage of GDP (Chart 27), imports of goods from SICA to the RLAC expanded from 3.4% in 2000 to a record high of 5.69% in 2008. In 2009, however, they decreased to 3.96% of GDP, and from 2010 they began to recover, reaching 4.79% of GDP in 2013, still below the level of 2008. The share of imports made by SICA from the rest of the world in its GDP went from 14.63% in 2000 to 18.67% in 2008. In 2009, such share fell to 14.52%, and from 2010 on they began to recover to reach 18.23%, still below the value of 2008.

**CHART 27**

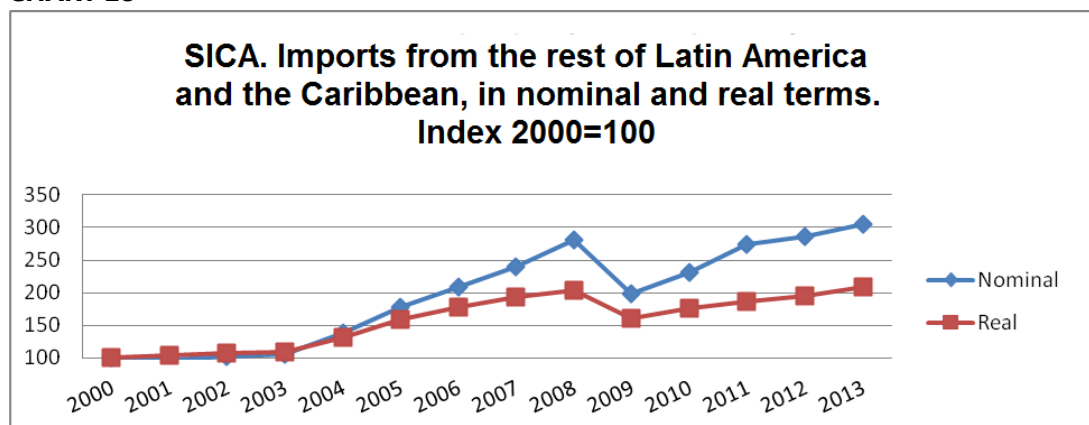


Source: IMF; calculations by the author.

Chart 28 compares the performance of imports from SICA to the RLAC in nominal and real terms.<sup>4</sup> During the period 2001-2013, imports of goods in real terms from SICA to the RLAC increased at an average rate of 5.8%, quite lower than the imports recorded in nominal terms (8.97%). Thus, for imports of goods from SICA, a significant increase in prices can be seen during the period under analysis.

<sup>4</sup> Imports in real terms were estimated by using a deflator of the prices of imports from SICA which was based on the individual deflators for the member countries of SICA reported by ECLAC.

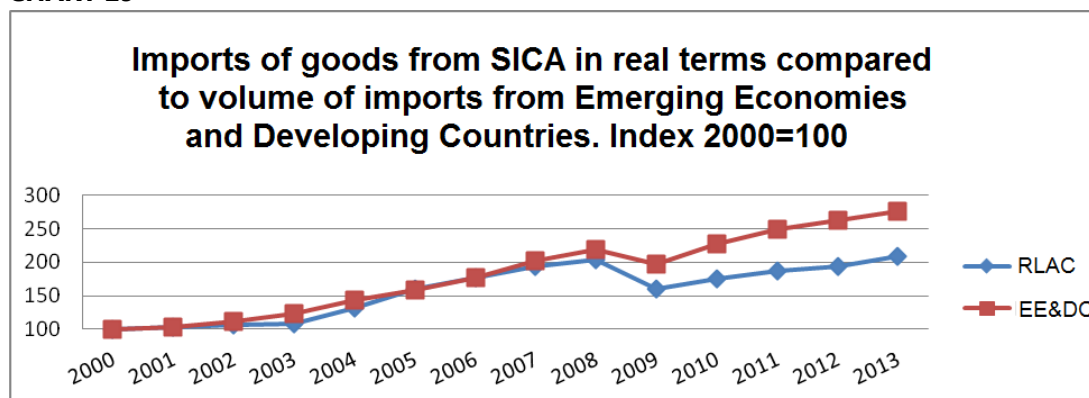
**CHART 28**



Source: IMF; calculations by the author.

Chart 29 compares the performance of imports of goods in real terms from SICA to the RLAC, with the volume of imports from the EE&DC. For the period 2001-2013, imports of goods from SICA to the RLAC expanded at a lower average rate with respect to the volume of imports from the EE&DC (5.8% vs. 8.15%, respectively).

**CHART 29**

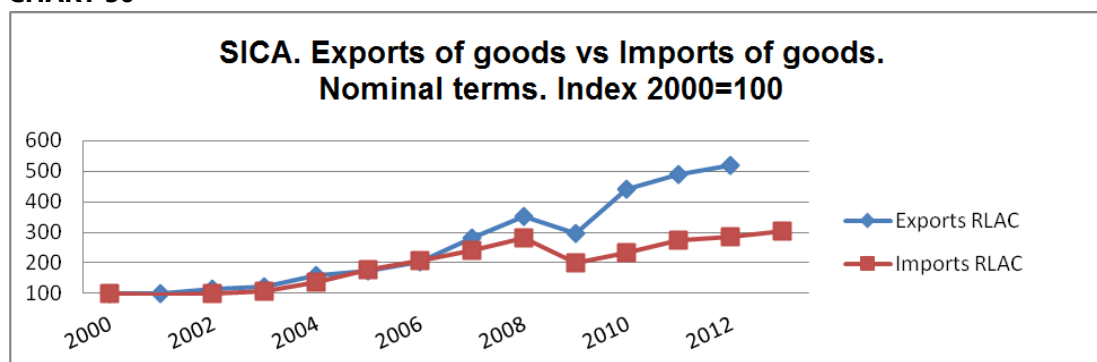


Source: IMF; calculations by the author.

### 3. Exports vs Imports

Chart 30 shows that for the period 2001-2013, nominal exports of goods from SICA to the RLAC grew at a much faster pace than SICA’s imports from the RLAC. Excluding the outlier of 2013, exports in nominal terms from SICA to the RLAC increased at an average rate of 14.71%, against a 9.18% average increase of SICA’s imports from the RLAC. However, it can be noted that between 2001 and 2006, SICA-RLAC exports and SICA-RLAC imports grow at a similar pace, and since 2007 a greater dynamism in exports can be clearly seen.

**CHART 30**



Source: IMF; calculations by the author.

In real terms, exports of goods from SICA to the RLAC also show a greater dynamism than SICA's imports from the RLAC. Excluding the outlier of 2013, SICA-RLAC exports in real terms during the period 2001-2013 grew at an average rate of 12.56%, much higher than the average expansion of SICA-RLAC imports of goods (5.7%). Additionally, it can be noted that the gap between these two series becomes more remarkable since 2007.

**CHART 31**



Source: IMF; calculations by the author.

#### IV. ENCOURAGING TRADE FLOWS BETWEEN SICA AND THE REST OF LATIN AMERICA AND THE CARIBBEAN

Based on the analyses made in the previous sections, the main components characterizing trade flows between SICA and the rest of Latin America and the Caribbean (RLAC) can be determined:

- In general, exports of goods from SICA, and those directed to the RLAC in particular, show a relatively high level of diversification.
- Exports of goods from SICA to the RLAC comprise mainly manufactured goods.
- Exports of services represent a significant proportion of the total exports in the cases of Belize, Dominican Republic, Panama and Costa Rica.
- SICA's exports are highly concentrated towards the United States. Few countries from the rest of Latin America and the Caribbean appear among the five main destinations of exports from SICA.
- Exports of goods from SICA to the RELAC in nominal terms for the period 2001-2013 have expanded at a quite greater average rate than exports to the rest of the world.

## 24

- Exports of goods aimed at the RLAC significantly increased their share in total exports of goods and the GDP, but still represent relatively small percentages with respect to both magnitudes.
- Exports of goods from SICA to the RLAC in nominal and real terms grew at very similar rates.
- Imports of goods made by SICA from the RLAC in nominal terms, for the period 2001-2003, expanded at an average rate slightly higher than SICA's imports from the rest of the world.
- SICA's imports from the RLAC increased their share in total imports of goods and in the GDP, between 2001 and 2008, but after a sharp decline of both in 2009, their recovery has been relatively slow.
- Imports of goods made by SICA from the RLAC, in nominal terms, increased at an average rate substantially higher than that of imports of goods in real terms.

Whereas exports of goods from SICA aimed at the RLAC showed a major expansion during the period under analysis, their relatively low participation in SICA's total exports and GDP suggests that there is still ample room for growth. Similarly, imports made by SICA from the RLAC experienced a relatively slow recovery until 2013, after the sharp decline seen in 2009.

The best mechanism to encourage, diversify and stabilize trade flows between countries or regional schemes is the negotiation and adoption of agreements to spur free trade and economic integration.

Following is an analysis of how well connected is SICA to the RLAC through Free Trade Agreements (FTA), Economic Integration Agreements (EIA) and Partial Preferences Agreements (PPA).

Table 1 provides a list of trade agreements in force between the members of SICA and the RLAC, obtained from two main sources of information: the List of Regional Trade Agreements (RTA) developed by the World Trade Organization (WTO, January 2014) and the System of Information on International Trade of the Organization of American States (OAS, 2014).

**TABLE 1**

<b>Associated countries</b>	<b>Type of Agreement</b>
CARICOM – Costa Rica	FTA
CARICOM – Dominican Republic	FTA
Chile – Costa Rica	FTA/EIA
Chile – El Salvador	FTA/EIA
Chile – Guatemala	FTA/EIA
Chile – Honduras	FTA/EIA
Chile – Nicaragua	FTA/EIA
Colombia – El Salvador, Guatemala, Honduras	FTA/EIA
Costa Rica – Peru	FTA/EIA
Mexico – Central America	FTA/EIA
Panama – Chile	FTA/EIA
Panama – Peru	FTA/EIA
Colombia – Nicaragua	PPA
Colombia – Panama	PPA
Costa Rica – Venezuela	PPA
Ecuador – Guatemala	PPA
El Salvador – Cuba	PPA
El Salvador – Venezuela	PPA

Guatemala – Venezuela	PPA
Honduras – Venezuela	PPA
Mexico – Panama	PPA
Nicaragua – Venezuela	PPA

It should be noted that the information obtained from the WTO and the OAS does not include ALBA-TCP and PetroCaribe integration initiatives. Nicaragua is a member of ALBA-TCP, while Belize, Guatemala, Honduras, Nicaragua and the Dominican Republic are members of PetroCaribe.

Table 1 reveals several interesting aspects of the existing commercial agreements between SICA and the RLAC:

- i) The Member States of SICA hold a significant number of trade agreements (22 in total) with the RLAC.
- ii) The member countries of SICA do not have agreements in force with the majority of MERCOSUR countries: Argentina, Brazil, Paraguay and Uruguay.
- iii) Ten out the 22 reported trade agreements are Partial Preferences Agreements.

## V. SOME KEY FACTORS AFFECTING COMPETITIVENESS IN SICA

Although the negotiation of free trade and economic integration agreements is a very important tool to encourage, stabilize and diversify trade between SICA and the RLAC, there are other relevant factors that may severely limit trade flows. This section examines the situation of SICA in terms of a number of factors that are crucial for encouraging international trade and economic growth: the administrative process required for cross-border trade; the connectivity of the region via maritime cargo transportation; the general environment for doing business and promoting entrepreneurship; the situation of the economic infrastructure, with special emphasis on those most directly linked to international trade; the capacity of the educational system to provide the necessary labour force in quantity and quality; and the progress made in the regional integration process.

### 1. Cross-border trade in SICA

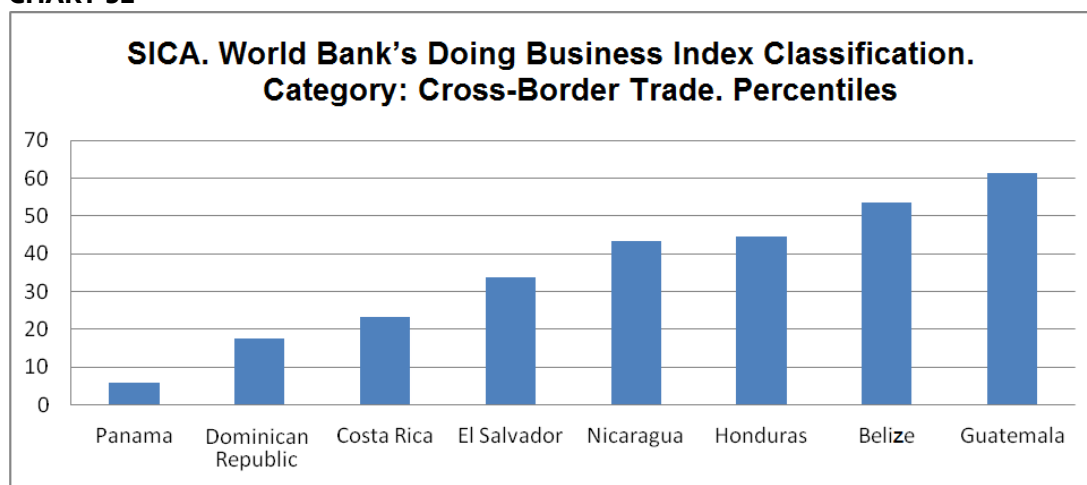
This analysis of the administrative efficiency of cross-border trade agreements in SICA is based on the summarized Cross-Border Trade Index, which is one of the ten categories included in the global Doing Business Index prepared by the World Bank. According to its methodology, the Cross-Border Trade Index takes into consideration the following aspects: "Doing Business measures the time and cost (excluding tariffs) associated with the export and import of a standardized cargo of goods transported by sea. The time and cost required to complete all formal procedures for the export and import of goods are considered. However, the time and cost involved in shipping are not included. All documents required for exporting or importing goods across the borders are also recorded. For the export of goods, procedures range from the packaging of goods and cargo in the container in the store, until its departure from the port of origin. For imported goods, procedures include from the arrival of the ship at the port of destination, to the delivery of the cargo in the warehouse."

For the analysis, the positions of the economies of SICA in the category Cross-Border Trade among the 189 economies examined by the World Bank (2014) are expressed as percentiles. The median of the percentiles where the economies of SICA are located is used as a descriptive measure of their efficiency in cross-border trade. The median of the percentiles of the positions of SICA economies is compared with that obtained for the countries of South America, and in addition, as

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a control group, with the median of the ASEAN-5 bloc (IMF): Indonesia, Malaysia, Philippines, Thailand and Viet Nam.

Chart 32 shows the position of the economies of SICA within the classification of the Cross-Border Trade Index. The best classified member of SICA in this category is Panama, which is located in the percentile 6. This means that only 6% of the countries included in the survey are better ranked than Panama. The worst rated economy of SICA in this category is Guatemala, which stands in the percentile 61. In other words, 61% of the economies included in the survey are better classified than Guatemala. Also with a good ranking in terms of this index are Dominican Republic in the percentile 17, Costa Rica in 23, and El Salvador in 34. At an intermediate level, closer to the median are Nicaragua in the percentile 43 and Honduras in the percentile 44. Belize is positioned in the percentile 53. The median of the percentiles of the countries of the bloc is 38.62, which is significantly lower than that of the countries of South America (65.08), but higher than the one corresponding to the ASEAN-5 bloc, with a value of 22.22.

**CHART 32**

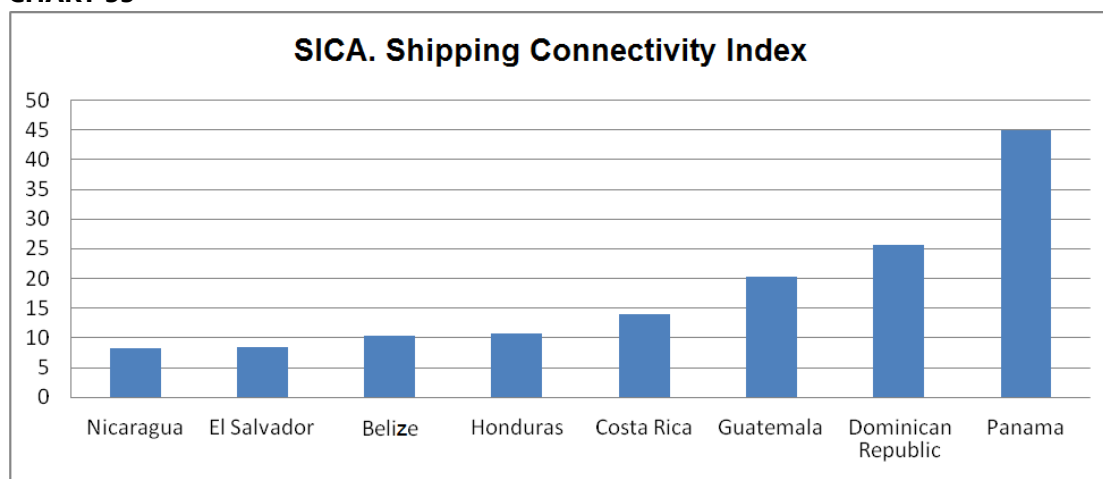
*Source: World Bank; calculations by the author.*

## 2. Shipping connectivity

Access of countries to international markets depends on their connectivity, especially in terms of freight services for imports and exports of goods. UNCTAD estimates the Liner Shipping Connectivity Index, which indicates the degree of integration of a country with the global networks of maritime cargo. The base year for this index is 2004, and the base value takes as a reference the country showing the maximum value (connectivity) for 2004 (China 2004=100). The current version of this index is derived from five components: (a) the number of vessels; (b) the total capacity of cargo container of those boats; (c) the maximum size of ships; (d) the number of services; and (e) the number of companies handling container ships from and to the ports of the country.

Chart 33 presents the values of the Shipping Connectivity Index for the member countries of SICA. In the majority of the cases, connectivity levels are fairly low. The highest value of the index corresponds to Panama, with 44.88. The lowest values are seen in the cases of Nicaragua with 8.3 and El Salvador with 8.36. Dominican Republic, with 25.57, and Guatemala, with 20.28, show intermediate values, while the rest of the economies show values close to 10: Belize 10.32, Costa Rica 14 and Honduras 10.73. The median in the shipping connectivity index for the whole group stands at 12.37, well below the median for South America (excluding Bolivia and Paraguay) with a value of 32.91, and for ASEAN-5 (38.32).

**CHART 33**



Source: UNCTAD.

### 3. General environment for doing business and entrepreneurship

Baumol et al. (2007) argue that innovation is a key factor for economic growth; in addition, it requires a series of institutional arrangements to encourage the development of entrepreneurs. Baumol et al. attempt to identify a set of rules and institutions that provide incentives for employers to create and disseminate new products and production techniques. Baumol et al. (2007) proposed four elements that they consider to be essential for developing a business economics:

- It should be relatively easy to create a new business without excessive bureaucratic hurdles, which are expensive and time consuming.
- Institutions must reward entrepreneurial activity that is socially useful. For this purpose, a strict enforcement of laws is essential, particularly as regards property rights and the compliance with contracts.
- Government institutions should discourage activities that aim at dividing the "economic pie" instead of increasing its size (e.g. rent-seeking activities).
- Government institutions must ensure that successful entrepreneurs and long-established businesses continue to have incentives to innovate and grow. Openness to international trade is a key factor to achieve such goal.

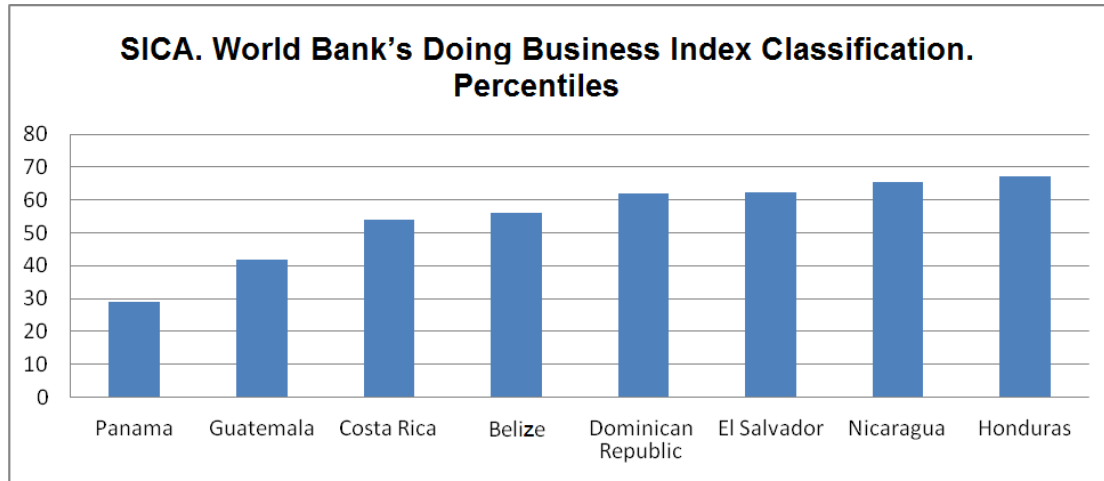
The situation of SICA economies in terms of these elements is evaluated on the basis of their ranking in the World Bank's 2014 Doing Business Global Index. Additionally, an analysis is made of three of the ten categories of this global index which, according to Baumol et al. (2007), are can be considered to be especially relevant to enterprise development: Starting a Business, Protecting Investors and Paying Taxes. Just like in the analysis of the Cross-Border Trade Index, the position of SICA's economies among the 189 economies examined by the World Bank is expressed in percentiles, and it is compared with the median of the positions (in percentiles) of South America and ASEAN-5.

Chart 34 shows the position of the member countries of SICA in the global ranking of Doing Business 2014. The best positioned SICA economy in the global ranking is Panama, in the percentile 29, followed at some distance by Guatemala in the percentile 42. The country with the worst position is Honduras, in the percentile 67. All the other members of SICA are above the percentile 50: Belize in the percentile 56, Costa Rica at 54, Nicaragua in the percentile 66, and

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Dominican Republic in the percentile 62. The median of the percentiles of SICA is 58.99, slightly below the percentile for South America (59.52), but above the one for the ASEAN-5 bloc (52.38). Noteworthy, although the ASEAN-5 median is relatively high, there are countries that are among the best classified in the global index: Malaysia in the percentile 3 and Thailand in the percentile 10.

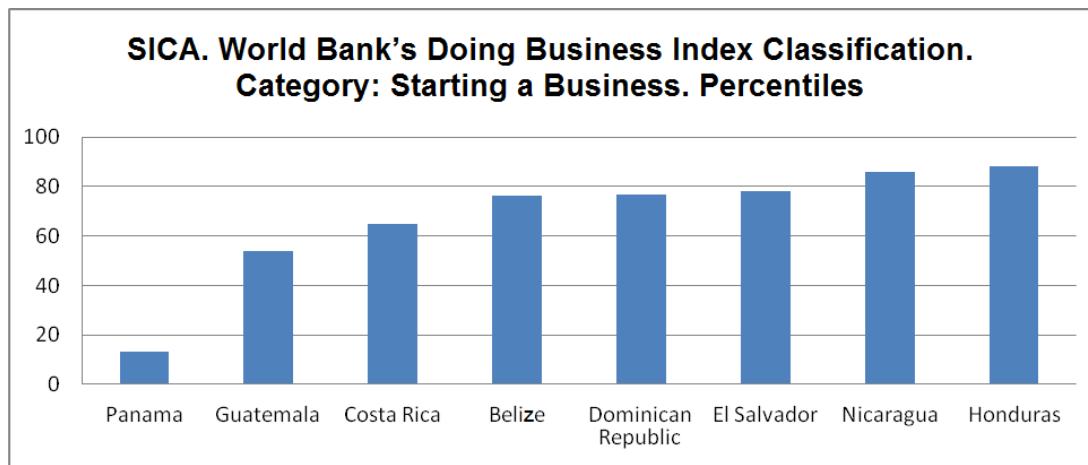
**CHART 34**



Source: World Bank; calculations by the author.

Chart 35 depicts the situation of SICA member countries in the category "Starting a Business" of the Doing Business Index 2014. The best ranking SICA economy in this category is Panama, in the percentile 13. The worst positioned is Belize in the percentile 88. The rest of SICA economies are above the percentile 50: Costa Rica percentile 54, El Salvador 78, Guatemala 77, Honduras 86, Nicaragua 65, and Dominican Republic 76. The median percentile of SICA members is 76.19, markedly higher than that of South America (62.43), and the ASEAN-5 (57.67).

**CHART 35**



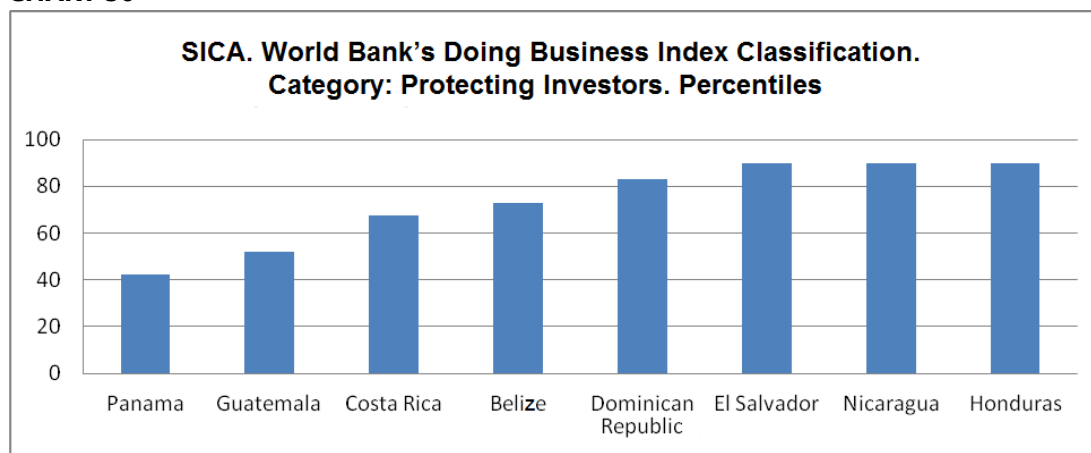
Source: World Bank; calculations by the author.

In the category Protecting Investors, Chart 36 shows that the top ranking country is Panama, in percentile 42, followed by Dominican Republic in percentile 52. The worst positioned countries in this category are Costa Rica, El Salvador and Honduras, which are in the percentile 90. A little better positioned, but still well above the percentile 50, are Belize, in percentile 68, Guatemala, 83,



and Nicaragua, 73. The median percentile of SICA economies in this category is 78.04, a value much higher than that recorded by South America (47.09) and the ASEAN-5 (27.51).

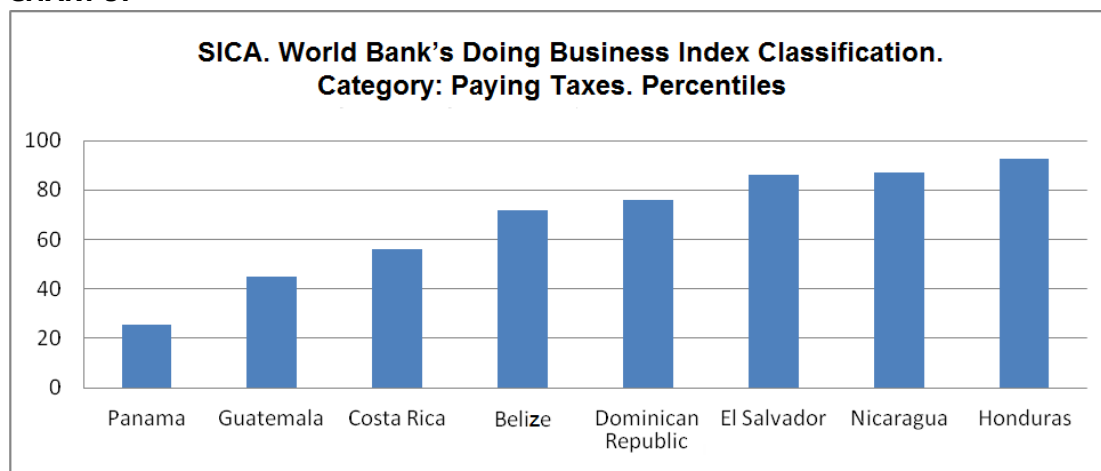
**CHART 36**



*Source: World Bank; calculations by the author.*

Chart 37 presents the position of SICA countries in the category Paying Taxes of the Doing Business Index 2014. The best positioned economy is Belize in percentile 25, followed by Guatemala in percentile 45. The worst ranking country in this category is Panama, in percentile 93. All other SICA countries are quite above percentile 50: Costa Rica percentile 72, El Salvador, 87, Honduras, 76, Nicaragua, 86, and Dominican Republic in percentile 56. The median percentile of the block is 74.07, moderately above that of South America (71.69), and ASEAN-5 (69.31).

**CHART 37**



*Source: World Bank; calculations by the author.*

#### 4. Economic infrastructure in Central America: A brief assessment

"Economic infrastructure refers to all the permanent engineering structures, equipment and physical facilities that are the basis for providing energy, transport, telecommunications, water and sanitation services to productive sectors and households." (ECLAC, 2011) Publicly provided infrastructure promotes growth, mainly by increasing the marginal product of private production factors. There has been some controversy about the effect of the investment from the public sector on the formation of private capital (Agénor and Montiel, 1999). Some empirical studies conducted

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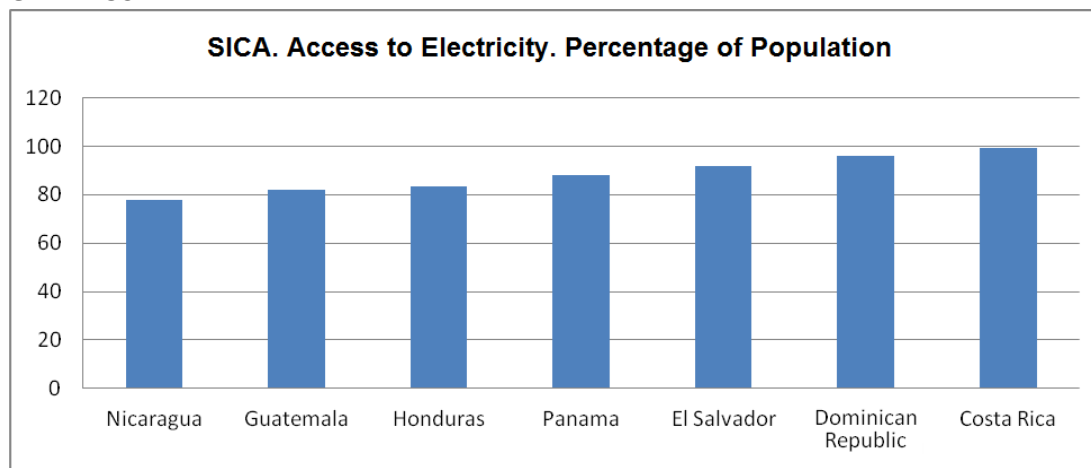
during the 1980s found no clear evidence of the impact of public investment on private investment, whereas the studies conducted during the 1990s did identify a positive effect. However, when a distinction is made between the investment on infrastructure and other types of public investments, more clear results emerge. Agénor and Montiel (1999) reported that, by using panel data for twenty-four developing countries for the period 1971-1979, Blejer and Kahn (1984) found that a real increase of US\$ 1 in infrastructure investment would increase real private investment by US\$ 0.25.

More recently, Calderon and Servén (2004) conducted an empirical evaluation of the impact of infrastructure development on economic growth and income distribution. By using a large data sample comprising 100 countries for the period 1960-2000, these authors found strong evidence that economic growth is positively affected by the stock of infrastructure assets.

Regional organizations such as the Andean Community (CAF) (2010) and ECLAC (2011) have conducted studies which indicate that Latin America and the Caribbean show serious deficiencies in terms of the quantity and quality of available infrastructure, compared to more thriving economies in Asia, for instance. Even though the region has made progress in this area, progress has been slow and quite uneven among the countries of the region (CAF, 2010).

Following is an analysis for SICA countries with respect to a series of indicators linked to infrastructure, obtained from the database World Development Indicators from the World Bank.

Chart 38 shows the indicator Access to Electricity (percentage of population) for 2011. The member country of SICA with the highest rate of access to electricity is Costa Rica (99.1%), followed by Dominican Republic (96.1%). Nicaragua has the lowest access to electricity (77.7%). The following values are recorded for the rest of SICA countries: El Salvador, 91.7%, Guatemala, 81.9%, Honduras, 83.3%, and Panama, 88.2%. The median of individual indices is 88.2%, which is considerably lower than those of South America (97.8%) and of ASEAN-5 (96.1%).

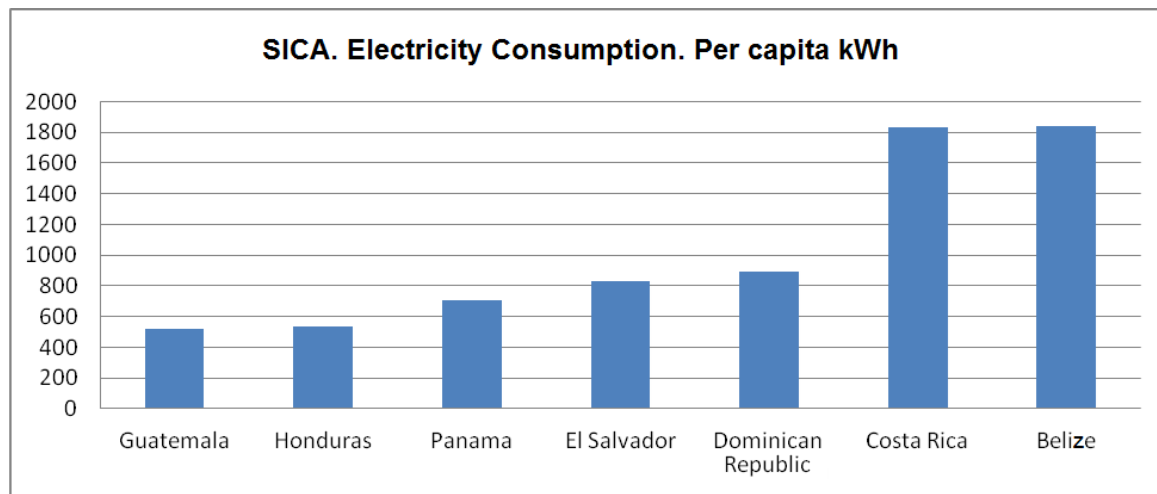
**CHART 38**

*Source: World Bank.*

An important indicator of the level of economic infrastructure is the Per Capita Consumption of Electricity (per capita kWh). CHART 39 illustrates this indicator for the economies of SICA with data from 2011. The economies of the region with the largest per capita consumption of electric energy is Costa Rica with 1,843.94 kWh, followed closely by Panama with 1,829.01 kWh. The rest of the economies have a per capita consumption much lower than 1,000 kWh of electricity per capita: El Salvador with 829.57, Guatemala, 539.06, Honduras, 707.76, Nicaragua 521.59 (the lowest of SICA)

and Dominican Republic (893.31). The median of this indicator for SICA is 829.57 kWh per capita, lower than that of South America (1,842.86 kWh per capita), and the ASEAN-5 block (1,073.28 kWh per capita). Interestingly, in the ASEAN-5 group the consumption of electricity per capita in Malaysia stands out, as it reaches 4,246.47 kWh per capita.

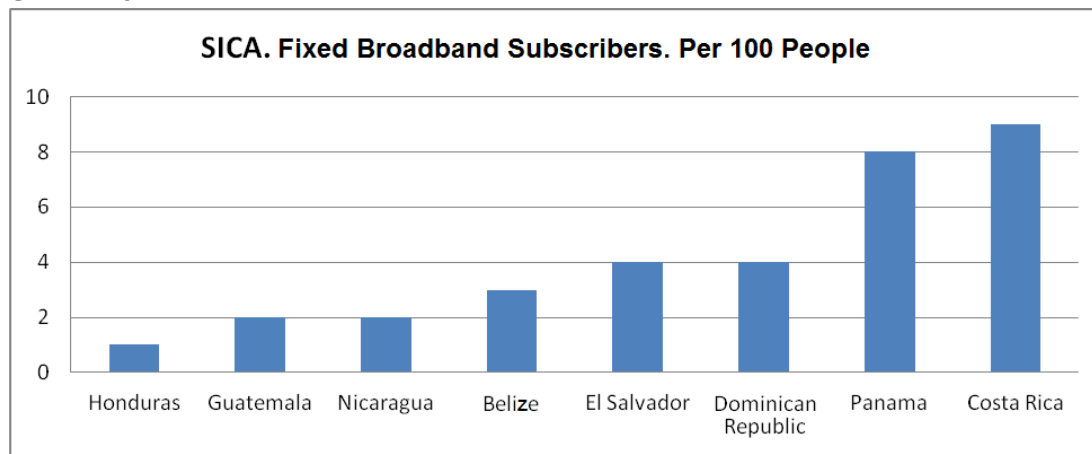
**CHART 39**



Source: World Bank.

Chart 40 shows data on the indicator of the number of fixed broadband subscribers (per 100 inhabitants) for the year 2012. The country with the highest value of this indicator is Costa Rica with 9 subscribers per 100 people, followed by Panama with 8. The rest of SICA countries show values below 5 subscribers: Dominican Republic 4, Belize 3, Guatemala 2, Honduras 1, Nicaragua 2, and El Salvador 4. The median of this indicator for SICA is 3.5 subscribers per 100 inhabitants, well below the values for South America (7.5) and the ASEAN-5 block (5).

**CHART 40**



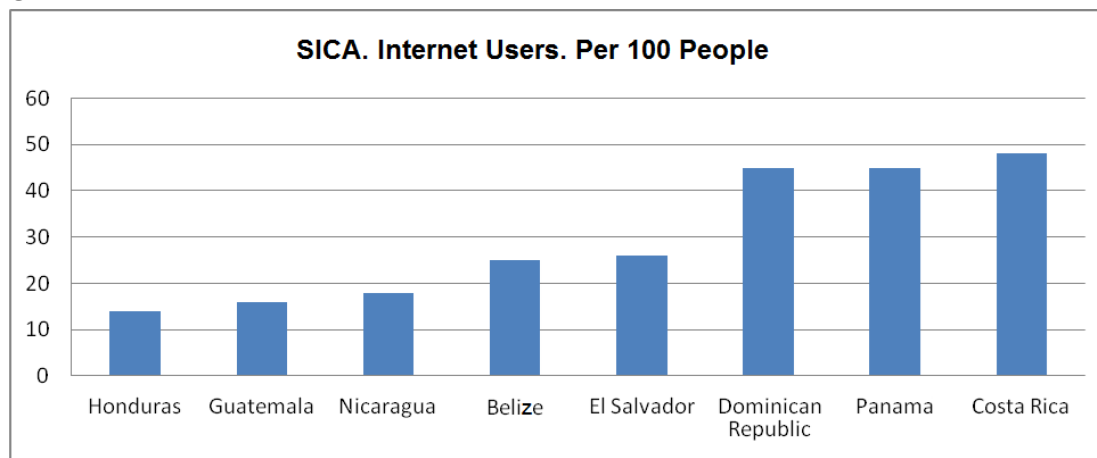
Source: World Bank.

The indicator of Internet Users per 100 inhabitants for SICA for the year 2012 is shown in Chart 41. The SICA economy with the highest value for this index is Costa Rica with 48 users per 100 inhabitants, followed closely by Panama and Dominican Republic with 45 each. El Salvador registered 26 internet users, and Belize 25. The rest of the countries show values below 20 users per 100 inhabitants: Guatemala 16, Honduras 18, and Nicaragua 14. The median of this indicator

# 32

for SICA is 25.5 users per 100 inhabitants, lower than the median for South America (46.5) and for ASEAN-5 (36).

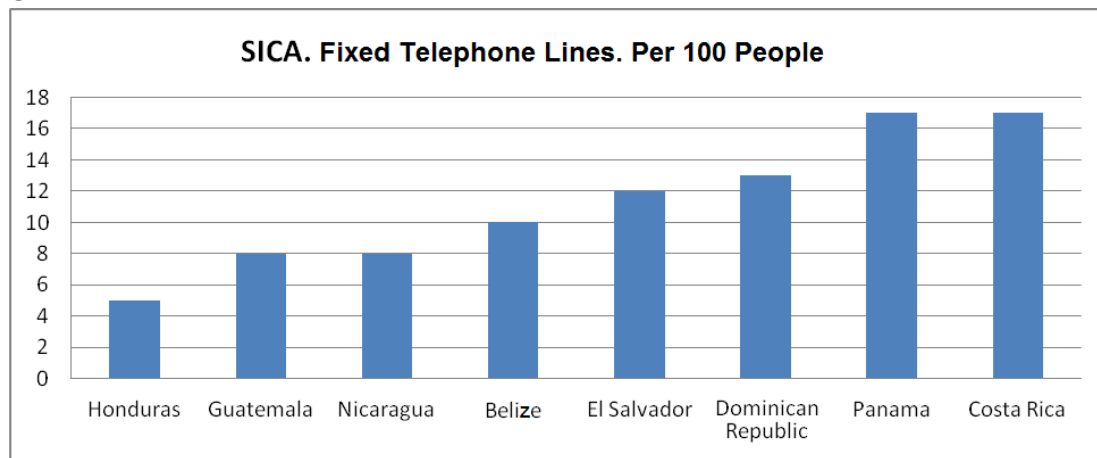
**CHART 41**



Source: World Bank.

Chart 42 depicts the values of the indicator Fixed Telephone Lines per 100 inhabitants for 2012. The SICA economies with the highest values for this indicator are: El Salvador and Panama with 17 per 100 inhabitants. Nicaragua shows the lowest number of fixed telephone lines per 100 inhabitants, with 5 lines. For the rest of the countries, the values of this indicator are: Belize 8, Costa Rica 13, Guatemala 12, Honduras 8 and Dominican Republic 10. The median of the individual values for SICA is 11, which is lower than that for South America, which stands at 17, and equal to that for the ASEAN-5 (11).

**CHART 42**



Source: World Bank.

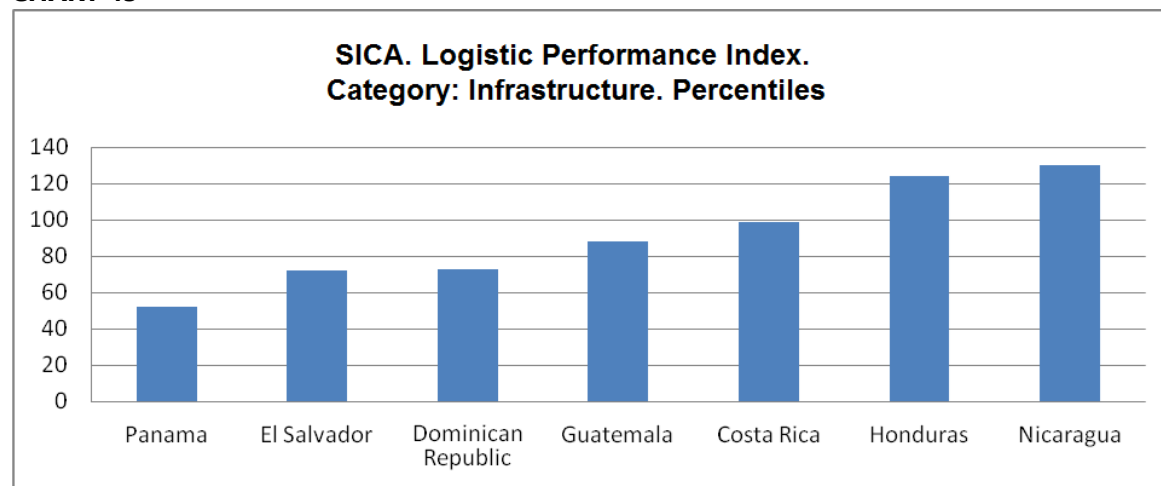
The Paved Roads indicator, as a percentage of the total, is available only for a small number of countries of SICA and the groups which are used as reference. The data up to the year 2011 indicates that El Salvador is the country with the highest value of this indicator with 53.14% of paved roads, followed by Guatemala with 44.76%, Panama 41.78%, Costa Rica 25.97% and Nicaragua 13.32%. The median of these values is 41.78%. In South American countries the values of this indicator were as follows: Argentina 32.16%, Brazil 13.56%, Chile 23.76%, Paraguay 15.55%, and Peru 13.33. The median of these values is 15.55%. For the ASEAN-5, the only available data as

regards this indicator is for Indonesia, with 57.01%, which is higher than all countries in Central America and South America with published data.

The situation of the economies of SICA in terms of infrastructure linked to international trade, is analysed by using the 2014 international Logistic Performance Index (LPI) of the World Bank. The LPI classified 160 countries under six dimensions of trade – including customs performance, quality of infrastructure, and timeliness of arrival and departure of cargoes – which are frequently recognized as being important for development. The information used in the classification is obtained from surveys conducted among logistics professionals working outside the evaluated countries, who are asked about the countries where they operate. The component infrastructure, which refers to the quality of the infrastructure related to trade and transport.

The position of the countries of SICA for 2014, expressed in percentiles, in the classification of the LPI in the category infrastructure, is shown in Chart 43. The SICA economy that shows the best position in this ranking is Panama in the percentile 42. It is followed by El Salvador in the percentile 45 and Dominican Republic in the percentile 46. Above the 50 percentile are: Costa Rica in the percentile 62, Guatemala 55, Honduras 78, and Nicaragua, 81. The median of the individual positions of the economies of SICA is 55, slightly higher than that of South America (51), but well above the median recorded by the ASEAN-5 Group (28).

**CHART 43**



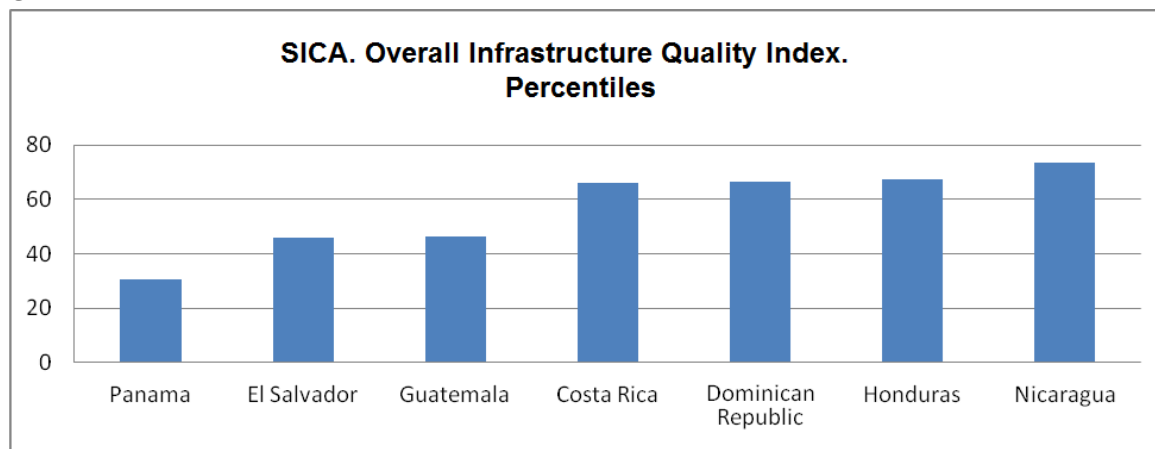
*Source: World Bank; calculations by the author.*

The quality of the infrastructure for the economies of SICA is evaluated by using the Quality of Infrastructure Global Index, calculated by the World Economic Forum (WEF). This index is based on a survey which covers 144 countries, which poses the following question: How would you rate the general infrastructure (e.g. transport, telephony and energy) in your country? The value of the index is located between 1 and 7, with 1 being equal to "extremely underdeveloped" and 7 being "extensive and efficient" according to international standards. The latest index values are a weighted average for the years 2011 and 2012.

Chart 44 presents the position of the SICA countries (excluding Belize, which does not appear in the survey) expressed in percentiles, in the ranking of quality of global infrastructure. The best positioned country in the classification of the LPI index is Panama in percentile 31. The worst ranking is Nicaragua in percentile 74. Costa Rica is in percentile 66, El Salvador 46, Guatemala 47, and Honduras and Dominican Republic in percentile 67. The median of the percentiles for SICA is 65.97, which is significantly lower than the one corresponding to South America (76.04), but

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slightly higher than the median of the ASEAN-5 Group (63.89). In the ASEAN-5, Malaysia stands out, as it is positioned in percentile 20 of the quality of global infrastructure index.

**CHART 44**

Source: World Economic Forum; calculations by the author.

Most of the examined indicators of coverage and quality of services of electricity, communications, transport and ports suggest that the economies of SICA, in general, have a very fragile situation that severely limits their competitiveness and capacity for economic growth. In addition, there is a marked disparity between indicators among the countries that make up the group.

##### 5. Situation of education in Central America: A brief review

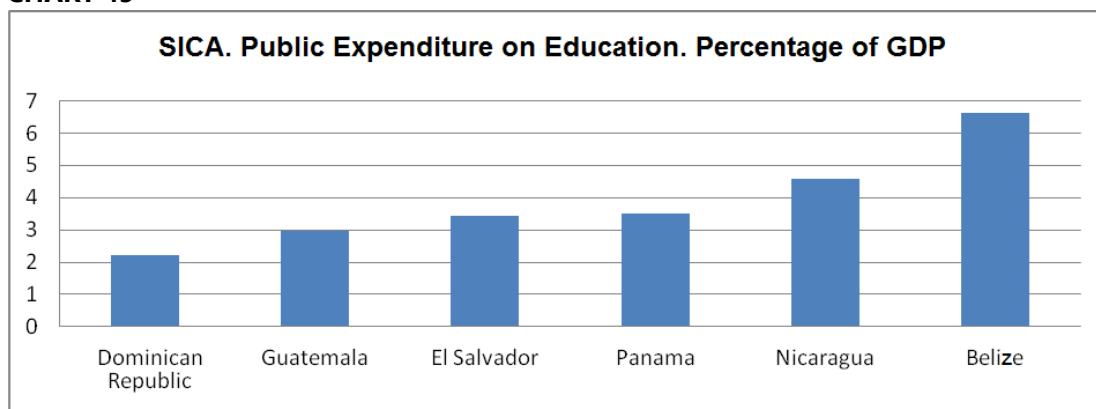
The majority of experts recognized that education is a key factor for economic growth, especially in a world where technology advances constantly. Lucas (1988), in *On the Mechanics of Economic Development*, explains how an economy in which agents can build human capital through education, can grow without limits. In contrast with the physical capital that is subject to a decreasing marginal productivity, the marginal product of human capital does not decrease to the extent that the quantity used in production increases. Baumol et al (2007) considered that education is an important factor for the development of enterprise capabilities, even though additional elements are required to propel such skills. The empirical studies of the 1990s found statistical support for the argument that education, measured in years of schooling or school registration fees, plays a significant role in the increase of economic growth (Dornbusch, 2000). However, the most recent empirical literature has focused on the quality of the education as a relevant variable for growth (Hanushek and Woessmann, 2007).

For the countries SICA and the groups which are used as comparative reference, a series of indicators of the resources devoted to education are examined, as well as the coverage of the educational system, and the quality of education. Expenditure on education and coverage indicators are obtained from the Indicators of World Development (IWD) collected by the World Bank. The source of indicators of quality of education are the surveys conducted by the World Economic Forum (WEF) and the results of the Programme for International Student Assessment (PISA), conducted by the Organization for Economic Cooperation and Development (OECD).

Public expenditure on education as a percentage of GDP for SICA economies (excluding Costa Rica and Honduras due to lack of information) is shown in Chart 45. The data were obtained from the World Development Indicators compiled by the World Bank, and the latest available data between 2010 and 2012 is taken for each country. The SICA economy with the greatest value in this

indicator is Belize, with 6.61% of public expenditure on Education/GDP. Dominican Republic presented the lowest value at 2.22%. For the remaining countries of the group, using available information, the values of this indicator are: El Salvador 3.42%, Guatemala 2.97%, Nicaragua 4.57% and Panama 3.5%. The median public expenditure on education as a percentage of GDP of SICA stands at is 3.46%, a value which is inferior to that of South America (excluding Venezuela due to lack of information), which reaches the 4.56%, and of the ASEAN-5 (excluding Philippines due to lack of information), which is 5.87%.

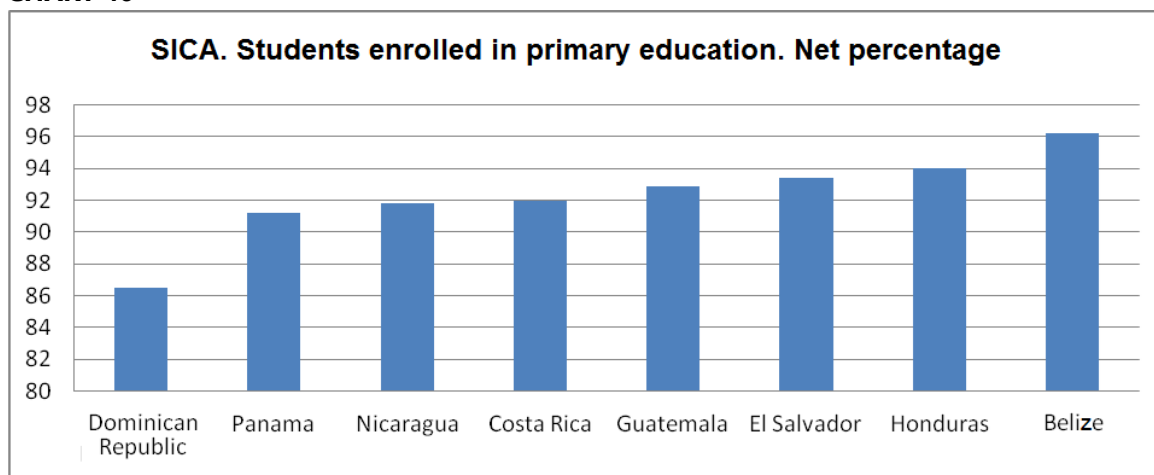
**CHART 45**



Source: World Bank.

Chart 46 contains data on the net percentage of students enrolled in primary education in SICA countries. The member of SICA with the highest percentage of students enrolled in primary education is Belize with 96.24%, while Dominican Republic, with 86.53%, exhibits the lowest value of this indicator. For the rest of the SICA countries, the percentages of students enrolled in primary education are: Costa Rica 91.98%, El Salvador 93.4%, Guatemala 92.84%, Honduras 94.01%, and Nicaragua 91.82% and Panama 91.23%. The median of the individual values for SICA is 92.41%, above the value for South America (excluding Brazil due to lack of information), which is 90.81%, but lower than the average for Indonesia and Viet Nam (ASEAN-5), which stands at 95.87%.

**CHART 46**



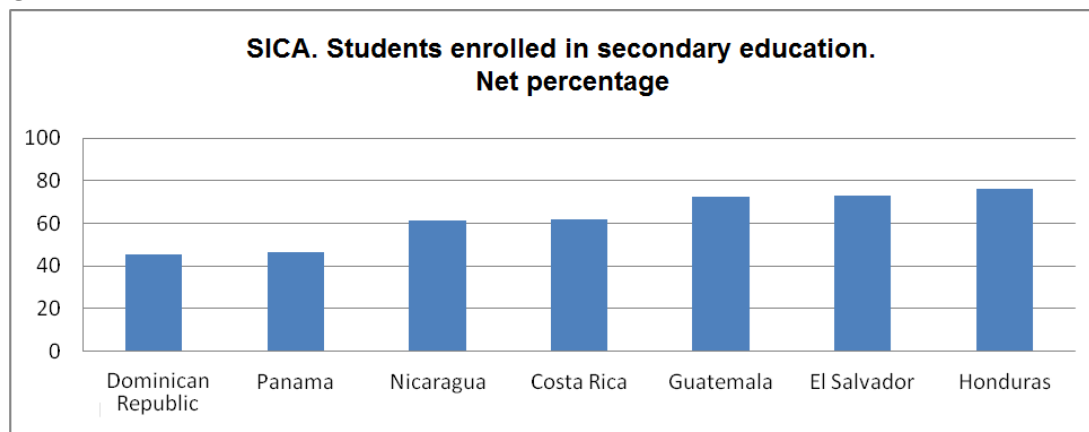
Source: World Bank.

The net percentage of students enrolled in secondary education for the countries of SICA (excluding Honduras due to lack of information) is shown in Chart 47. The economy of SICA with the highest percentage of students enrolled in secondary education is Panama with 76.39%,

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followed closely by Costa Rica with 72.91%, and Belize with 72.36%. The lowest values in this segment correspond to Nicaragua with 45.43%, and Guatemala with 46.43%. Dominican Republic with 62.09% and El Salvador with 61.6% are in an intermediate position in terms of this indicator. The median of the percentage of students enrolled in secondary education for SICA countries is 62.09%. South America (excluding Brazil due to lack of information) presents a median of 72.58%, while in the case of the ASEAN-5 (excluding the Philippines and Viet Nam due to lack of information) it is 74.81%.

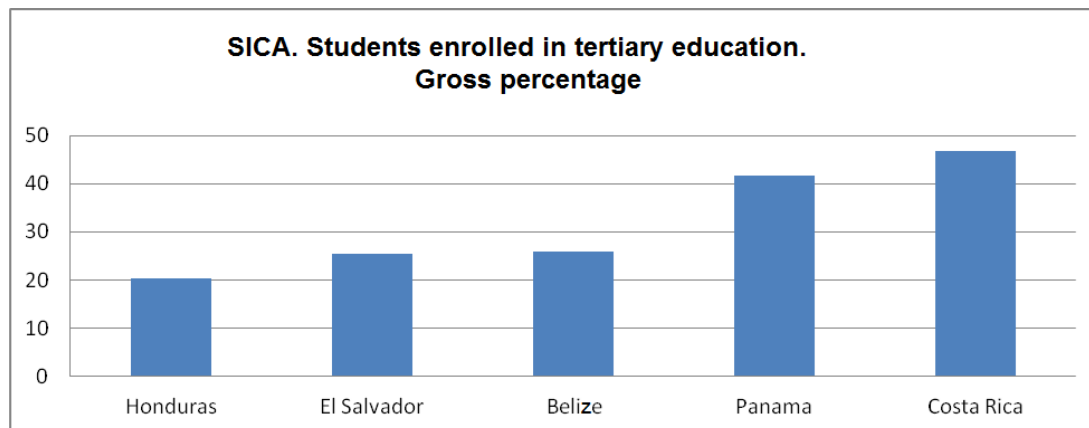
**CHART 47**



Source: World Bank.

With respect to the (gross) percentage of students enrolled in tertiary education, Chart 48 shows that the country of SICA (excluding Guatemala, Nicaragua, and Dominican Republic due to lack of information) with the highest level is Costa Rica, with 46.74%, followed by Panama with 41.78%. Honduras shows the lowest level of this indicator with 20.4%, followed by Guatemala with 25.45% and Belize with 25.79%. The median of the individual values for the countries with available information is 25.79%. For South America (excluding Bolivia, Brazil, Ecuador and Venezuela due to lack of information), the median of this indicator is 57.1%. In the case of the ASEAN-5, the median (excluding Philippines due to lack of information) is 31.59%.

**CHART 48**



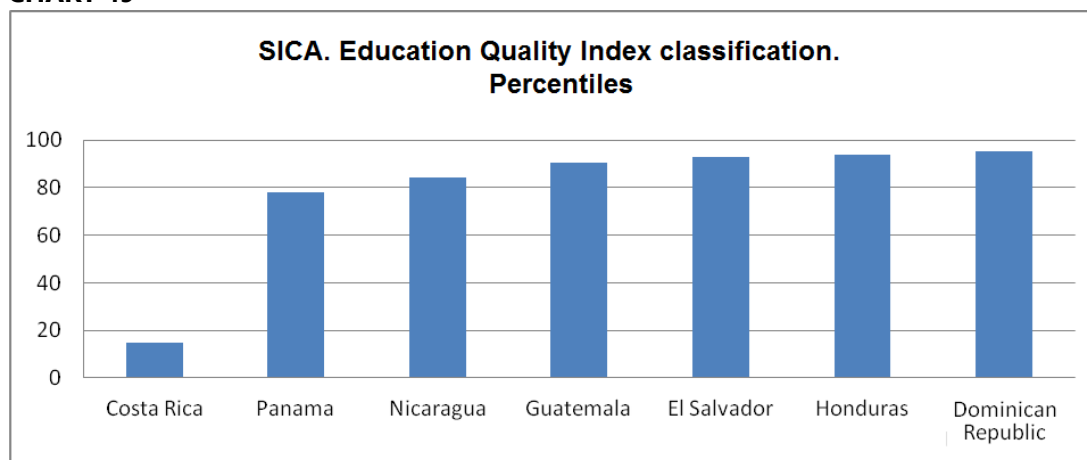
Source: World Bank.

In relation to the quality of education, Chart 49 presents the positions of the countries of SICA (in percentiles) as regards the Education Quality Index as calculated by the World Economic Forum (WEF). This index is calculated on the basis of a survey with the following question: How well does



the educational system of your country respond to the needs of a competitive economy? The index has a minimum value of 1, which equals "not well" and a maximum value of 7, or "very well". Costa Rica is the best-ranking country in percentile 15. The worst-ranking country is Dominican Republic, in percentile 95. The rest of SICA countries are positions in fairly high percentiles (well above percentile 50): El Salvador percentile 93, Guatemala 90, Honduras 94, Nicaragua 84, and Panama percentile 78. The median of the individual percentiles for SICA is 90.28, markedly above the ones corresponding to South America (70.49) and to the ASEAN-5 (32.64).

**CHART 49**



*Source: World Economic Forum; calculations by the author.*

Costa Rica is the only member country of SICA which participated in the PISA 2012 test, conducted by the Organization for Economic Cooperation and Development (OECD). This test evaluates the skills of students aged 15-16 in three areas: Mathematics, Reading and Science. Costa Rica is in position 56 out of the 65 economies (percentile 86) which participated in the test. This result places it below Viet Nam, position 17 (percentile 26), Thailand 50 (percentile 77), Chile 51 (percentile 78), Malaysia 52 (percentile 80), Mexico 53 (percentile 82), and Uruguay 55 (percentile 85).

Interestingly, the results for Costa Rica in the PISA test are not consistent with the perception of relative high quality of education which is reflected for that country in the survey conducted by the WEF.

In general terms, the indicators for coverage and quality of education evaluated here suggest that the education systems of SICA countries present serious deficiencies that limit the countries' competitiveness and economic growth.

## **6. Regional Integration within the framework of SICA**

Economies that make up SICA are small economies. Their GDP in dollars, calculated on the basis of the purchasing power parity of all the economies of SICA (2013), represents 23% of the GDP of Mexico. Therefore, regional integration is a crucial aspect to achieve the economies of scale that are required by most of the modern economic activities, and to increase their bargaining power vis-à-vis their main trading partners. Thus, strengthening the integration process among the economies that make up SICA can be a vital element to encourage growth of trade flows with the rest of Latin America and the Caribbean and the world.

An assessment of several quantitative and qualitative indicators suggests that the integration process among the members of SICA has had significant progress in recent years, especially

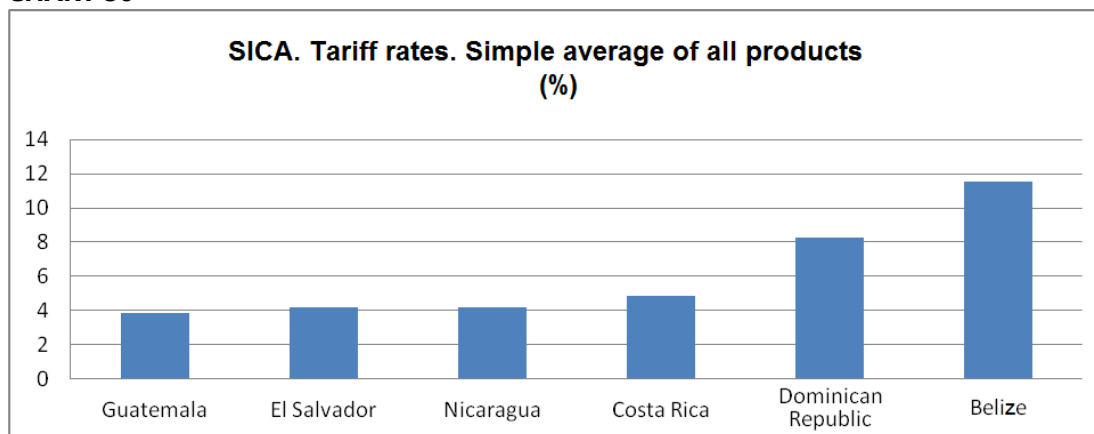
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among countries that are also part of the Central American Common Market (CACM): Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

The SELA document Assessment Report on Trade in the Central American Common Market: 1980-2011 points out that reciprocal exports of goods within the CACM accounted on average for 17.57% of total exports for the period 1980-1989; for the period 1990-1999 their share increased to 18.60%; and between 2000 and 2011 it grew to 22.19%. This last value is above the average share of intra-regional exports in total exports of goods from Latin America and the Caribbean for the period 2000-2011 (18.64%).

Chart 50 shows average (simple) tariff rates of all products for those SICA economies with available data (2010-2012) from the Economic Development Indicators of the World Bank. The chart reveals that the economies that are part of the CACM have very similar tariff rates, which is an important factor to achieve a high level of trade integration.

**CHART 50**



Source: World Bank.

Another evidence of the progress of trade integration process in SICA, as noted in section II, is that one or more countries commonly appear among the five major trading partners of the other member countries.

In addition, SICA has made important strides towards the development of legal instruments to facilitate the movement of goods, capital and people, and to liberalize trade in services within the system.

Nevertheless, as argued in the study conducted by the Andean Development Corporation (CAF), *Latin America 2040: Breaking Away from Complacency: An Agenda for Resurgence (2010)*, the economic integration process in Latin America and the Caribbean shows a less encouraging advance when compared to the results seen in Asia. The share of local exports in total exports in Asian countries increased from 24.1% in 1980 to 47.3% in 2009 (CAF, 2010).

## **CONCLUDING REMARKS AND POLICY RECOMMENDATIONS**

This document examines in detail the structure of exports from the Central American Integration System (SICA) and the evolution of trade flows between SICA and the rest of Latin America and the Caribbean (RLAC) for the period 2000-2013, in order to propose a series of national and regional policies aimed at promoting, stabilizing and diversifying the exchanges of goods and services between SICA and the RLAC.

The data analysed indicate that: a) Exports of goods from SICA, in general, and those exports directed to the RLAC in particular, show a relatively high level of diversification; b) Exports of services account for a significant percentage of total exports in the cases of Belize, Dominican Republic, Panama and Costa Rica; c) Few countries of the rest of Latin America and the Caribbean appear among the five main destinations of exports from SICA; d) Exports of goods from SICA to the RLAC, during the period 2001-2013, have expanded at a quite greater average rate than exports to the rest of the world; e) Imports of goods to SICA from the RLAC, in nominal terms, for the period 2001-2003, expanded at an average rate slightly higher than imports of goods to SICA from the rest of the world; and f) Exports of goods aimed at the RLAC significantly increased their share in total exports of goods and in the GDP, but still represent relatively small percentages with respect to both magnitudes.

From the above, one can conclude that, even though there have been substantial improvements in trade flows between SICA and the RLAC, there is still much room for expanding exchanges between the two regions. However, to attain such expansion in trade relations, the economies of SICA need to adopt a well-coordinated set of policies, which are essential to promote their trade flows, and in general, they need to strengthen the exporting orientation of the members of the system.

- **Promotion of free trade and economic integration with the RLAC agreements**

The best way to encourage, diversify and stabilize trade flows between SICA and the rest of Latin American and Caribbean countries is by negotiating and adopting agreements to spur free trade and economic integration. The review of existing trade agreements in Latin America and the Caribbean indicates that SICA members have a fairly high number of trade agreements with the rest of Latin American and Caribbean countries. However, the absence of trade agreements between SICA and the members of MERCOSUR (Argentina, Bolivia, Brazil, Paraguay and Venezuela) provides an interesting opportunity to boost trade between SICA and the RLAC.

Moreover, 10 out of the 22 trade agreements identified between SICA and the RLAC are Partial Preferences Agreements. Converting these partial agreements into free trade and economic integration agreements could provide a remarkable boost to trade relations between SICA and the rest of Latin American and Caribbean countries.

Nevertheless, in order to take advantage of the benefits from wide-ranging trade agreements, SICA needs to address a number of fundamental aspects that limit its international competitiveness and its capacity to generate and maintain a robust economic growth.

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- **Correction of fiscal and macroeconomic imbalances**

Although the aggregated Public Debt / GDP ratio of SICA has remained relatively stable below 50% in recent years, the fiscal situation as measured by the global financial balance has deteriorated since 2007. In 2013, the aggregated global financial deficit of SICA stood at 3.6% of GDP, compared to 2.95% in 2012. In addition, the fiscal situation of SICA economies shows marked differences. In 2013, Honduras posted a financial deficit of 7.4% of GDP, Costa Rica 5.58%, El Salvador 4.04% and Dominican Republic 3.59%. The rest of SICA countries reported an average financial deficit well below the median. This divergence in the fiscal situation represents a serious obstacle to the progress of both the Central American Common Market and the integration process of SICA. Policymakers in Honduras, Costa Rica, El Salvador and Dominican Republic should pay closer attention to this situation, and design and implement fiscal adjustment programmes that allow for gradually achieving a more balanced fiscal situation.

A more prudent fiscal policy can significantly contribute to reducing the high and persistent current account deficit as a percentage of GDP in these countries. However, it is important for fiscal adjustment programmes to preserve public investment in infrastructure and expenditure on education, which are vital for boosting competitiveness.

- **Improvement and standardization of administrative processes for cross-border trade**

The analysis of the Cross-Border Trade category of the Doing Business Index of the World Bank suggests that most of SICA countries have ample space to undertake improvements in the institutional arrangements related to international trade. A thorough review of the entire administrative process involved in cross-border trade and the best practices adopted by the most efficient countries in this area could be crucial to improve trade flows between SICA and the rest of Latin America and the Caribbean and the world.

Through its Technical Economic Secretariat (SIECA), SICA can play a crucial role in improving and standardizing processes related to cross-border trade. In this connection, the experience of Panama, which is positioned in percentile 6 of this category, could be very valuable for the other members of SICA, since they have worse rankings in this category, which is crucial to strengthen regional integration and competitiveness.

- **Increased connectivity of maritime transport of goods**

All members of SICA, with the exception of Panama, have very low rates for cargo shipping connectivity. Strengthening shipping connectivity is a key factor for any strategy aimed at transforming SICA into a major global player in international trade.

Trade agreements, combined with concrete reforms to streamline the processes linked to the cross-border trade, and improvements in terms of infrastructure, can be very important to increase maritime connectivity.

SICA could play a central role in designing a plan to increase its maritime connectivity and achieve convergence of its individual members in this area.

- **Improving the environment for business and promoting entrepreneurship**

Most of SICA economies are above percentile 50 in the Global Doing Business Index of the World Bank (2014); and their classification into the three fundamental categories for entrepreneurship (Starting a Business, Protecting Investors, and Paying Taxes) is even worse than that of the global index. Therefore, this is a particularly weak point for the region, which requires member countries of SICA to make considerable efforts in order to improve the indexes related to the context for starting a business and promoting entrepreneurship up to the levels of the most successful countries in these aspects, as is the case of Malaysia.

Reforms in this area, along with a more balanced fiscal situation, could have very positive effects on trade and growth. SICA should aim to improve and homogenize the factors related to the environment for doing business and entrepreneurship in the bloc.

- **Investment on Infrastructure**

Another particularly weak point of SICA is infrastructure, especially infrastructure linked to international trade, such as ports and roads. SICA shows a relatively low level of public and private investment as a percentage of GDP, and its indicators of coverage and quality of infrastructure are quite modest.

Improving coverage and quality of infrastructure requires a coordinated regional approach. In this connection, SICA can contribute by preparing a strategic plan that set clear goals, deadlines for compliance, and monitoring indicators. A basic element of such plan should be achieving a balanced development of infrastructure among Member countries. The plan should also boost the generation of public goods at the regional level, mainly as regards transport connections.

Developing and maintaining infrastructure works require a large amount of resources. In view of the limited saving capacity of the region and the tight fiscal situation in a number of the member countries, advances in this area represent a daunting challenge. Therefore, a plan to achieve a good quality level of infrastructure, similar to that of more successful developing economies, should include measures to encourage investment through partnerships among national and foreign private sectors, as well as international cooperation. Improvements in the environment for doing business can be very valuable in order to increase private investments in infrastructure.

- **Reforms of the education systems**

SICA countries show a relatively low public expenditure on education as a percentage of GDP, and their indicators of coverage and quality of education are quite precarious.

Although the best choice to introduce improvements in the education system would be increasing public spending on education, this would have a very limited effect if a proper diagnosis of the problems of the system is not conducted. Therefore, the region requires a comprehensive review of its most important weaknesses in the area of education. In this regard, the participation of SICA countries in international evaluation programmes such as the OECD's PISA test, is a valuable tool to diagnose the quality of the educational system, and to propose measures improve it. Thus far, the only member of SICA which participates in the PISA test is Costa Rica.

Education is a powerful tool to eradicate poverty and improve income distribution among the population. SICA countries should implement policies to increase the incorporation of population into education, especially at the secondary and tertiary levels, where participation indicators are

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more precarious. However, for education to have a significant effect on the reduction of inequality, it is necessary to implement policies to promote the incorporation and permanence of the poorest social groups in the education system.

Combining the efforts of public and private sectors is crucial to achieve an effective reform of the education system. Collaboration between the public and private sectors can help identify more clearly the skills needed in the labour market, and determine an efficient approach in terms of costs and quality to develop such skills. The private sector should have an active participation in the design of curricula at different levels, and promote training programs at work for students.

- **Deepening regional integration**

Given that the economies that make up SICA are relatively small, strengthening regional integration is a central element to increase competitiveness in a globalized world.

SICA, and particularly the countries that form part of the Central American Common Market, have made significant progress in the integration process. However, it is necessary for them to increase efforts so that they can achieve an effective integration that allows them to raise their competitiveness up to similar levels to those of the most successful developing countries in Asia.

SICA could play a leading role in designing, implementing and monitoring a regional strategy to achieve convergence among its members at the macroeconomic, institutional and infrastructural levels.

In addition, SICA should devise a strategy to reap the maximum possible benefit from trade agreements in force and negotiate new treaties that can help it expand its ability to export goods and services.

- **Exploring opportunities in the fields of services and Information and Communications Technologies**

In El Salvador, Guatemala, Honduras and Nicaragua, exports of services represent a relatively small percentage of total exports. For these countries, the search for opportunities in the area of services can be an interesting option in order to imprint more dynamism to their exports to the rest of Latin America and the Caribbean and the rest of the world. In the case of Belize and Dominican Republic, exploring options in non-tourism service activities could also contribute to boost their exports and their diversification.

Many activities in the area of services are less dependent on economies of scale and complex productive chains. However, as any modern economic activity, services require a highly skilled workforce. Therefore, developing a competitive services sector requires SICA countries to actively address the deficiencies faced by their education systems in terms of coverage, inclusion and quality. In addition, developing a more dynamic services sector depends on improving remarkable weaknesses observed in doing business and promoting entrepreneurship.

The share of exports of goods in the area of Information and Communications Technologies (ICTs) in total exports is very low for the majority of the members of SICA, with the exception of Costa Rica and Panama. Developing the production and export of ICT goods can be very important to increasing and diversifying exports. However, just as in the case of services, making improvements in the education system and in the environment for business are vital steps to achieve concrete results in developing a high technology sector.

- **Reduction of barriers to competition**

In their study *Latin America in the Rearview Mirror* (NBER Working Paper 11008, 2004), Cole, Ohanian, Riascos and Schmitz, Jr. argue that Latin America is one of the few groups of countries that has not been able to gain ground with respect to the United States in terms of per capita income. This is even true for Chile, which is considered to be the economy of the region that has made the greatest progress in terms of macroeconomic and institutional reforms.

The authors consider that the disappointing economic performance of Latin America is caused, mainly, by the systematic application of policies that impose severe barriers to competition. Latin America imposes more barriers to competition than the United States, Europe and East Asia; moreover, such barriers are associated with low productivity. Based on an analysis of various industries, the authors show that policy changes adopted in the region, which eliminate competition, are associated with strong and permanent reductions in productivity and production, while policies that increase competition are associated with increases in productivity and production.

- **The role of international cooperation**

SICA countries are small economies with little capacity for saving and an underdeveloped financial sector. This, together with the need for some countries to reduce their fiscal deficit, poses a major constraint to generating the necessary resources to bring about reforms that are vital to increase competitiveness within SICA.

Investment in infrastructure and maintenance, improvement of maritime connectivity, a review of the administrative processes involved in cross-border trade and the context for doing business, as well as the reform of the education system, require a substantial amount of financial and technical resources. Therefore, international cooperation plays a central role as a source of funding and technical support for the design and implementation of the policy recommendations proposed in this document.

International cooperation must respond to a regional strategy aimed at promoting the convergence of SICA economies, which is required in order to achieve an effective integration and a successful integration into the global economy.

For international cooperation to effectively contribute to increase competitiveness and promote economic growth, it is necessary to develop an appropriate institutional framework to ensure efficiency, transparency and accountability in the use of the resources provided through aid programs. SICA must play an important role in developing an institutional structure that defines a long-term strategy for international cooperation and an adequate management of the resources provided within the framework of such cooperation.





**SICA. MAIN EXPORTS OF GOODS AND DESTINATIONS OF EXPORTS**



<b>Country</b>	<b>5 Main Export Products</b>	<b>5 Main Destination of Exports</b>
Belize	Crude Oil (18%), Wheat (14%), Fruit Juice (6.4%), Plantains (6.2%), Automobiles (5.6%)	Nigeria (41%), United States (25%), United Kingdom (8.6%), Cameroon (3.2%), Costa Rica (2.1%)
Costa Rica	Integrated Circuits (41%), Office Machine Components (11%), Plantains (6.0%), Tropical Fruits (5.5%), Medical Instruments (4.4%)	United States (38%), Netherlands (11%), Mexico (7.8%), China (4.2%), Hong Kong (3.6%)
El Salvador	Woven shirts (13%), Coffee (8.6%), Electrical Condensers (5.7%), Knitting and hosiery socks (3.7%), Point Jerseys (3.6%)	United States (44%), Guatemala (14%), Honduras (12%), Nicaragua (5.0%), Costa Rica (3.9%)
Guatemala	Coffee (11%), Unprocessed Sugar (8.7%), Precious Metals (8.0%), Plantains (6.1%), Rubber (3.5%)	United States (42%), El Salvador (9.2%), Honduras (6.6%), Mexico (5.1%), Costa Rica (4.0%)
Honduras	Coffee (16%), Woven shirts (11%), Point Jerseys (9.8%), Insulated Cable (5.8%), Petroleum Gas (3.1%)	United States (55%), El Salvador (6.1%), Germany (5.1%), Guatemala (4.0%), Mexico (4.0%)
Nicaragua	Coffee (14%), Gold (10%), Frozen Bovine Meat (8.2%), Cargo and Passenger Ships (5.9%), Unprocessed Sugar (5.0%)	United States (40%), Canada (9.2%), Venezuela (7.8%), Nigeria (6.2%), El Salvador (5.5%)
Panama	Antibiotics (28%), Refined Oil (6.9%), Cargo and Passenger Ships (6.0%), Packaged Drugs (4.6%), Crude Oil (4.1%)	United States (29%), Ecuador (13%), Venezuela (11%), Guatemala (3.8%), Peru (3.5%)
Dominican Republic	Medical Instruments (10%), Rolled Tobacco (4.4%), Low-Voltage Protection Equipment (4.4%), Plantains (4.3%), Cotton Lightweight Mixed Fabric (3.1%)	United States (51%), Haiti (11%), China (4.6%), Netherlands (2.6%), United Kingdom (2.3%)

Source: Observatory of Economic Complexity (MIT).



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