

Evaluation of the PROALCA II Program

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Executive Summary

PROALCA II was a wide-ranging set of activities initially promoting the Free Trade Area of the Americas, and later CAFTA. More specifically, it aimed to increase Central American competitiveness in global markets by promoting economic integration in Central America and promoting integration with the world economy. The program, originally approved for \$28 million and lasting through 2006, was reduced to \$18 million, with the implementation period shortened to the end of 2005. The program included three, and later four, Intermediate Results, or IRs, and some 20 sub-IRs. The specifics of program achievement at the IR or sub-IR level are discussed in detail in the full report. This Executive Summary instead attempts to address only two very broad issues relating to PROALCA II.

1. What difference did PROALCA II make for Central America?

It may be important to emphasize that the four members of the evaluation team – each with experience on Central American issues ranging from a minimum of one to a maximum of four decades – carried to the evaluation an anti-SIECA expectation, based on previous experience with regional programs in Central America. The four team members came away from the experience with a considerably higher assessment of the quality and impact of the SIECA professional staff than they held at the outset.

Overall, the team concludes that the PROALCA II program was highly successful. It provided substantial resources that significantly increased the capacity of Central American governments to understand their obligations under the WTO and CAFTA, and to carry out concrete actions to implement them.

In characterizing PROALCA II as a very successful program, it is important to emphasize that PROALCA II was a *facilitator*, not a *driver*, of the program outcome. USAID has provided considerable financial support for Central American integration through SIECA over the past 45 years. During much of the period, USAID support was based more on hope than expectation. In the USAID worldview, high-quality analysis by SIECA might convince Central American governments to undertake reforms. The experience of PROALCA II suggests the opposite: that SIECA can only be effective when Central American governments are committed to economic reforms. SIECA's technicians are most effective when they are driven by demands for expert opinion.

Examples that illustrate progress during PROALCA II that was absent during the previous four decades of Central American integration include:

- *Implementation of CAFTA*: The public education carried out under PROALCA II contributed to the timely approval of the CAFTA agreements.
- *Harmonization of regional tariffs*: 96% of Central America external tariffs are now harmonized.
- *The Commercial Dispute Settlement Mechanism*. This mechanism, with its firm deadlines for resolution of commercial disputes among CACM members, offers

the possibility of use of rule of law in such cases. Implementation so far has been promising, but the real challenge will come when a CACM member refuses to implement the conclusion reached by the arbitrators.

- *Streamlining of border crossings.* Again, after decades of discussion, CACM members, with Guatemala and El Salvador in the lead, have begun to simplify the movement of persons and goods within the region.
- *Labor Ministry modernization;* While much remains to be done, significant progress has been made in improving the capacity to monitor compliance with labor regulations and to resolve disputes.
- *Uniform product registries:* Work remains, but there has been great progress in harmonizing product registries across the region, which is needed to meet CAFTA source and origin requirements.

These results seem to have been achieved because of the prospect of qualifying for CAFTA, for the FTAA, or for a trade agreement with the European Union. For USAID, the critical factor was its capacity to support Central American initiatives with substantial resources, available in a flexible manner in response to progress on important issues.

2. What should be the U.S. Government agenda for the future?

The critical priority for future USAID assistance – and probably for the success of U.S. policy with respect to Latin America – is successful implementation of CAFTA. Latin America is engaged in a leadership struggle between those who pursue the type of economic policies that have led to rapid economic growth in Asia, and those who pursue a return to populist policies that failed Latin America in the past. A successful CAFTA will reinforce those who share the US vision of a stable and prosperous Latin America based on open, competitive economies fully integrated into the world trading system. A successful CAFTA is also essential to demonstrate that this can be achieved while meeting world standards for product quality, environmental safeguards, and protection of fundamental labor rights.

The fact that the CAFTA countries represent the tenth largest export market for the U.S. contributed to the US Government's decision to give priority to a free trade agreement with Central America. A successful CAFTA will require significant changes in the C.A. countries' legal and institutional norms. They will face major problems in addressing the ramifications: including the legal and regulatory framework; governance issues, especially pertaining to business, and in adopting and enforcing world standards. CAFTA's success has to demonstrate that free trade with the United States is a road to economic prosperity.

To successfully exploit CAFTA, the Central American countries must greatly improve the environment for business activities, as reflected in the five USAID-funded studies of the legal climate for business in the region, and in the World Bank's *Doing Business in 2006* database. In the past, USAID support for regional initiatives has focused more on improving regional trade than on extra-regional trade (with the latter addressed more by bilateral Missions). The political commitment to the emerging Central American

customs union, however, adds a new dynamic to this process. As the region moves to an integrated market that exports through designated regional ports, the bureaucratic inefficiencies of the countries where these ports are located become a regional concern. While much of the investment may correspond to bilateral Missions, the new regional dynamic should not be ignored. Clearly, PROALCA II has made a significant contribution to regional efficiencies, but there is still a large unfinished regional agenda.

The significant reduction of regional trade barriers has proven an effective incentive for private sector entrepreneurs to expand regionally. While this process promises substantial benefits to the region, it also creates risks. Unless the region adopts appropriate competition policies, monopolistic tendencies may create large inefficiencies. This issue should be addressed regionally, although the ultimate legal remedies may require national legislation.

It is impossible to envision a successful CAFTA without a successful Central American customs union. Although CAFTA is a collection of bilateral agreements, the terms of these agreements concerning rules of origin, sanitary and phytosanitary standards, product registry, and many other matters will be extremely cumbersome without a fully functioning customs union. And the potential benefits of CAFTA to each of the C.A. countries will be greatly restrained in the absence of an effective union. The European Commission is funding two projects supporting the customs union, but they are somewhat narrowly defined, and more support is needed.

Labor policies and practices also need to meet scrutiny under CAFTA. Most of the region's Ministries of Labor are weak, as is the judicial sector's capacity to address labor issues. Bilateral USAID Missions are probably better positioned to address these concerns. However, there is also a need to modernize labor codes and reduce labor market rigidities, and this might be best addressed through a regional effort.

Implementation of CAFTA will require effective oversight institutions in each country, and the private sector also requires extensive orientation concerning the new standards and regulations governing their activities (whether they are exporting or competing with imports). While such assistance was envisioned under PROALCA II, it is clear that these initiatives are more easily addressed by bilateral Missions (except for Costa Rica).

In preparation of this report, the evaluation team considered a various options for potential future implementation partners (INCAE, BCIE, SICA). For issues related to the consolidation of the customs union, and facilitation of compliance with key CAFTA provisions, none of these regional organizations has the institutional mandate, technical competence, and access to regional decision makers as does SIECA. This is not to say that these institutions do not have a role to play, but primary regional responsibility for future progress in the themes addressed by PROALCA II will certainly remain with SIECA. That does not mean that USAID and the rest of the USG must turn to SIECA for everything. PA Consulting (a for profit consulting firm) did outstanding work on energy policies, and there are other areas where a professional consulting firm may perform with

greater speed and agility than SIECA (for example on regional labor justice and business climate issues).

SIECA is a much more effective institution that it was 10 or 20 years ago. However, it is important to structure any future assistance program through this institution so as to maximize the incentives for efficient performance. One interviewee commented on the fact that at times SIECA's bureaucratic processes have delayed program results. USAID should examine options to structure any future assistance via a results based grant that will disburse resources against agreed targets achieved. Also, SIECA is not structured to serve as an effective interface with the private sector in the region. As private sector interests become increasingly regional, it would be appropriate for SIECA to have an institutional capability to link more directly with it, in order to address the "Doing Business" constraints.

The "implementation options" question was asked in terms of potential future USAID project initiatives. However, perhaps the more important question is, "What are the institutional implementation options for CAFTA?" SIECA is the technical secretariat of the Central American Ministers of Economy, and in the past its role was basically limited to collecting and publishing data and analyses, and coordinating negotiation sessions, as requested by the Ministers. However, SIECA is now beginning to assume permanent implementation responsibilities related to CAFTA and the customs union.

The United States has strong federal institutions that oversee trade and investment policies and programs within the US; most notably the Federal Trade Commission. At this point, Central America does not seek a federal structure, but instead strongly preserves national sovereignty. However, an effective customs union (and an effective CAFTA) will require that a regional entity oversee many regional issues, including issues concerning regional competition policy. It is up to the Central American governments to decide whether SIECA as presently structured is the appropriate institution for these responsibilities, but if not decisions will be required to find an appropriate institution (or to reengineer SIECA to assume this role).

Whatever institution is assigned this role, it will require financial support from the Central American governments. It would be inappropriate to depend on time-limited external donor support for such basic functions, although this may be appropriate during a transition period. The evaluation team was highly impressed with the professional staff of SIECA, but many of those interviewed were paid with PROALCA resources, and their continued employment is now in question. There is an apparent reluctance among C.A. governments to increase the annual contributions to regional institutions, but either existing resources will need to be realigned or new resources identified to cover the support costs of a truly integrated Central America. USAID could consider bridge support for these services linked to a credible plan to meet long term needs.

Regrettably, at the time when USAID support for implementation of the Central American commitments to open trade and economic integration is most needed, funding has been greatly reduced. Also, the multiple USG agencies that now share responsibility

for supporting CAFTA implementation lack an understanding of the role that regional Central American initiatives should play in achieving that goal. Central America has made enormous progress in addressing key constraints to growth, and it would be a terrible mistake to lose momentum before this progress can be consolidated.

ACRONYMS

AAD	Activity Approval Document
BCIE	Banco Centroamericano de Integración Económica
C.A.	Central America
CACM	Central American Common Market
CAFTA	Central American Free Trade Agreement
COHEP	Consejo Hondureño de la Empresa Privada
CRIE	Comisión Regional de Interconexión Eléctrica
DR	Dominican Republic
EC	European Commission
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
FTC	Federal Trade Commission
FUNPADEM	Fundación del Servicio Exterior para la Paz y la Democracia (an NGO based in Costa Rica)
G-CAP	Guatemala and Central American Programs (USAID)
GDP	Gross Domestic Product
IDB	Interamerican Development Bank
ILO	International Labor Organization
INCAE	Instituto Centroamericano de Administración de Empresas
IPR	Intellectual Property Rights
IR	Intermediate Result
PROALCA	Program Supporting Central American Participation in the Free Trade Area of the Americas
SICA	Sistema de la Integración Centroamericana
SIECA	Secretaría de Integración Económica Centroamericana
TCB	Trade Capacity Building
TRIPS	Trade Related Intellectual Property Rights
USAID	United States Agency for International Development
USDOL	United States Department of Labor
USTR	United States Trade Representative
WTO	World Trade Organization

Evaluation of the PROALCA II Program Report

I. Introduction

USAID Guatemala and Central American Programs (G-CAP) provided assistance to increase Central American competitiveness in global markets during July 2001 through December 2005 through the PROALCA II program. The objectives of this program were to expand trade and improve regional economic integration in Central America, and thus improve employment and incomes on a sustainable basis.

The program pursued four intermediate results or program components:

- IR 1: More Open Trade and Investment Policies. Under this component assistance was provided to prepare Central Americans for free trade agreement negotiations, create public understanding of the need for open trade and investment policies, assist Central American countries to meet World Trade Organization commitments, improve monitoring and enforcement of intellectual property rights (IPR), and increasing awareness about support for competition policy, antitrust laws, and related legislation."
- IR 2: Accelerated Central American Market Integration. Assistance was provided to continue reducing barriers to intraregional trade, create a commercial dispute resolution mechanism, further develop the regional customs union, and harmonize regional laws and regulations affecting commerce, electrical power policies, and road construction standards.
- IR 3: More Equitable and Efficient Labor Markets. In order to improve labor rights protection, assistance was provided mainly to strengthen the region's Ministries of Labor through technical assistance, equipment, and training, and through improved private sector understanding and acceptance of modern labor relationships. Some activities under this result also sought to raise the competitiveness of the Central America labor force and to make progress in labor law harmonization.
- IR 4: Effective Central American Preparations for Trade Negotiations. This was a demand driven activity that supported specific interventions in each Central American country to prepare Central Americans for free trade agreement negotiations, improve public understanding of CAFTA and its benefits, assist the Ministries of Economy and other entities to prepare for CAFTA implementation, and increase private sector understanding of CAFTA requirements and standards.

The PROALCA program contributes directly to the joint State Department/USAID Strategic Plan performance goal "Economic Prosperity and Security" and its components "Institutions, laws, and policies foster private sector-led growth, macroeconomic stability, and poverty reduction;" "Increased trade and investment achieved through

market-opening international agreements and further integration of developing countries into the trading system;” and “Secure and stable financial and energy markets.”

PROALCA II was implemented via two Agreements; the first with the Ministries of Economy of Central America, and the second with the Ministries of Labor of Central America, Belize, Panama, and the Dominican Republic. Direct responsibility for the program implementation was assigned primarily to the Secretaría de Integración Económica Centroamericana (SIECA). Other implementation mechanisms included a contract with the private firm PA Consulting (assistance in the energy sector), and seven smaller agreements with global development alliance partners or contractors. A total of \$28,750,000 was authorized for PROALCA II, but the actual amount obligated through the various agreements was \$18,216,000.

Wingerts Consulting was contracted to evaluate the impact of the PROALCA II program on “trade policy and regional economic integration, and the effectiveness and appropriateness of the implementing units in managing the implementation of the program, developing program activities, and achieving intended results.” The terms of reference focused attention on the activities of SIECA and PA Consulting. A description of the evaluation team and methodology used in the evaluation is provided in Annex 1.

The following section will provide, for each of the four program components, a description of the objectives and activities, what was achieved, problem areas and constraints encountered, strengths and weaknesses of the implementing units and their staffs, effectiveness of the training and technical assistance provided, gender considerations, quality of the monitoring and evaluation program, lessons learned, and a description of pending activities. The final sections of this document will provide recommendations for future program initiatives and options for implementation of those initiatives.

II. Evaluation of program impact

A. IR 1: More Open Trade and Investment Policies

1. Objectives

The principal objective under this IR was to promote more open trade and investment regimes in Central America with respect to the world economy, and especially with the United States. The principal focus was on helping Central America meet obligations under the WTO and to help move toward free trade with the United States, initially under the FTAA, and later under CAFTA.

2. Activities implemented

The overall objective was pursued through five areas of activity:

- Public efforts to promote greater support for open trade,

- Assistance in meeting WTO obligations, mainly in the areas of customs valuation and with trade-related intellectual property (TRIPS),
- Increased transparency and agility in customs and other business procedures,
- Increased capacity to monitor and enforce intellectual property rights, and
- Strengthening of national and regional capacity regarding international trade.

3. Achievement of the objective

The overall objective was achieved more completely than any reasonable expectations at the outset of PROALCA II. This overall success was due to the operation of larger forces – most notably to the prospect of CAFTA in light of other threats to the future growth of the region. The ending of Central America’s preferential access to the U.S. market for apparel with the lapsing of the quota system for such products at the end of 2004, and the emergence of China as a powerful competitor on world and U.S. markets were spurs that created strong support for CAFTA. The project did not set these forces in motion, but it did much to help them be realized through the provision of technical expertise, training, public awareness campaigns and other vehicles that helped achieve the overall objective. In sum, the project did not *drive* the very desirable outcome that has been achieved, but it was important in *enabling* it to be achieved once the critical political decisions regarding the direction of Central American government policy had been made. During an earlier period, this level of support for SIECA would have (and past USAID experience shows that it did have) little impact. When Central American governments see little benefit to harmonizing policies, no level of effort by SIECA will produce much progress.

More specifically, the project did achieve real progress in each of the sub-IR areas:

- Seminars and publicity campaigns did improve the climate for open trade. People interviewed generally considered the effort successful. Moreover, the use of SIECA as a vehicle for transferring resources for programs designed by the individual ministries of economy was an effective means for giving the public education programs a national character.
- SIECA was able to help the countries to meet WTO standards for customs valuation (except for used equipment, including vehicles) and to revise their legislation to meet TRIPS obligations, at least in the formal legal sense. Interviewees generally considered the technical assistance in design of legislation and training provided in the new approaches to have been appropriate.
- Customs procedures have been simplified, though this work is not yet complete, particularly for trade outside the CACM. More progress has been made on documentation for intra-Central American trade. Nevertheless, the process of

moving to an electronic registration of external trade, pioneered by El Salvador, is gradually being adopted by other countries.

- Some enforcement of IPR laws has occurred, with Costa Rica and Guatemala moving from the USTR priority watch list to the watch list, and the other three countries remaining off it. At least in El Salvador, a special police unit has begun making arrests of intellectual property pirates.
- Finally, there has clearly been a strengthening of the capacity of the governments in the region to deal with trade issues in a professional manner. Technical staffs in the ministries of economy in all the countries appear to have become more capable. Nevertheless, the impact of elections (or even ministerial changes during a single government) on the staffing of such positions continued to present a challenge for PROALCA II throughout the implementation period.

4. Problem areas and constraints that affected results

The most significant area where constraints appear to have affected results is structural. The principal implementing agency, SIECA, faces major challenges in two important respects.

First, there is a problem of alignment of incentives between SIECA and USAID. SIECA is nominally a creature of the Central American governments, but they have traditionally provided only part of the cost of maintaining the organization. USAID, has provided about 30% of SIECA's budget, and other donors (notably the EU and Canada) have also funded the organization. Any such organization wants to preserve itself by having a permanent staff of high quality (though subject to compromises when necessary to satisfy its formal masters) in order to be able to offer high-quality services as a means of assuring its continuance. To maintain a high-quality staff, some assurance of the continuance of the organization is needed; otherwise some of the best will leave for more promising, or more secure, opportunities. In sum, the primary goal of SIECA leadership would be expected to be preservation of the technical capacity of the organization. For USAID, on the other hand, the primary goal is achievement of specific outcomes for Central American growth, with SIECA as only one possible vehicle to achieve it.

Second, SIECA is the servant of the ministers of economy in the region – their “technical secretariat” for regional matters. The ministers of economy serve as the board of directors of SIECA, via the regional COMIECO structure. But for most governments in the region, the ministry of economy is less important than the ministry of finance or foreign affairs. It consequently may fall to individuals with only limited vision, or as with the four ministers of economy during the recent Portillo Administration in Guatemala, to people seen as easily expendable. Ministers of economy can fall like leaves from trees, and with no great mourning. Even without intra-Administration changes, the four-year presidential terms with no re-election (except for El Salvador's five-year presidency) would assure at least one change in SIECA's board of directors annually, and a complete turnover in five years or less. (El Salvador has been the big

exception to this, with its three top officials all having been in senior positions in the ministry of economy throughout the entirety of PROALCA II.

These problems, inherent in SIECA as presently structured, do create a dilemma for USAID. Does USAID have to provide the continuity at SIECA that its creators and direct beneficiaries fail to provide? If the Central American governments are unwilling to provide an adequate level of financial support for a necessary regional institution, does USAID need to fill the gap? In the starkest terms, is USAID in the position of caring more about the future of Central America than the governments of Central America?

An analysis of the extent to which the Central American governments are willing to commit adequate resources to SIECA seems warranted. There were complaints that some governments were failing to make agreed payments for the operation of the institution. This would seem an important area for dialogue between USAID and the five ministers of economy.

5. Strengths and weaknesses of the implementation units

The quality of the SIECA professional staff in this area appeared to the team to be extremely high. They possessed a broad and clear understanding of the issues, and seemed to be focused on the most important issues. In other countries, interviewees offered views that were sometimes quite different. Some accused SIECA of “amiguismo,” with personal relationships, or Guatemalan nationality, being the source of employment. Others complained that the political level at SIECA (the Director General and the Executive Director) was capable, but the technical professionals were less capable. There is no objective way to evaluate such comments. Based on our limited interaction, however, we judge the quality of the technical staff to be high – though there are surely cases of professionals in the organization, as in any organization, that do not meet this standard. As perceived by the team, it may be at the policy level that the SIECA has shown less willingness to help guide the regional process than at the technical level. Several interviewees called for a more strategic role for SIECA with regard to the key issues that the region faces, and for more effort to “educate” new ministers of economy on the technical aspects of their mandate.

6. Quality of the technical assistance and training, its responsiveness to participant needs and lasting effects

Some of the training and technical assistance was regarded by interviewees as of very high quality. The training course early in PROALCA II at Antigua offered by Harvard was mentioned by several people as a critical base for understanding of the issues and for subsequent capacity to perform. The studies by Booz-Allen-Hamilton of the business environment in the region also appear to have been of high quality. A few complaints of trainers lacking the appropriate level of knowledge were also received.

7. Participation by women

All of the activities for which reporting is provided had substantial participation of women. In some areas, notably IPR, they were a substantial majority of the people trained. In the interviews with government officials in the trade area, women were prominent in executive and professional positions. SIECA reports that 44% of the 3,050 participants in PROALCA II training activities under IR 1 were women.

8. Quality of monitoring and evaluation

Monitoring and evaluation of this IR has been deficient. There was a long lag between the beginning of the project and the establishment of a monitoring and evaluation plan. Monitoring of performance was not a useful management tool, as indicators used by USAID typically lacked a clear enough connection to project performance for management to link shortfalls in any particular quantitative indicator to remedial action. In sum, USAID indicators were too distant from the USAID manageable interest to be an effective tool for project management.

The above said, there is no easy means to establish quantitative monitoring indicators for an activity – even in regard only to IR1 – that is so broad and aimed at very general (and therefore not easily quantifiable) but nevertheless very important goals.

Nevertheless, some indicative indicators that offered a more concrete relationship to outcomes from the supported activities might have been useful. For example, regular surveys of exporters in the apparel *maquila* sector regarding the time necessary for shipments to clear borders within Central America, and the time and cost necessary to get an average shipment on board ships bound for the United States would have given both USAID and SIECA a clearer idea of what was actually happening with customs simplification. It might also have identified other issues, either of cost or time delay that could have suggested other actions. More broadly, the lack of connection with the private sector – whose costs of doing business are a key factor in the competitiveness of the region – seems a weakness in the monitoring of performance. Another example might have been the number of pirated movies or music CDs seized by government officials in the countries of the region.

9. Efficiency and effectiveness of implementing staff performance

As noted earlier, the quality of SIECA professional staff and its engagement with regional issues appears to be high. Nevertheless, there were complaints of slowness in SIECA's administrative procedures, such as failure to provide airplane tickets to experts being brought in from other countries to give seminars or to conduct studies. Others regarded SIECA as carrying out these tasks quickly and efficiently. The limited time of the team for interviews in other countries precluded anything but anecdotal views on these issues.

10. Lessons learned

The largest lesson that can be drawn from the experience is that regional institutions like SIECA can only play an effective role when strong political commitment exists on the part of the governments that determine the outcome from its programs.

11. Needed future actions

The largest challenge facing the region at present is that of successful implementation of CAFTA. The response to this challenge will be determined heavily by the extent to which the private sector is able to take advantage of the opportunities offered by better access to the U.S. market. The poor showing of Central America in the World Bank's *Doing Business in 2006* database is a strong indication that much needs to be done to improve the business environment if firms are to be able to compete successfully in the U.S. market with other countries. (In the 2006 overall rankings of this data source, out of 155 countries, Nicaragua was ranked 59th, El Salvador 76th, Costa Rica 89th, Guatemala 109th, and Honduras 112th. Clearly, there is much to be done to bring the business environment in the region up to world standards. Nevertheless, the surprisingly good ranking for Nicaragua suggests that government actions can lead to important improvements within the space of several years. The rapid rise in exports of apparel and other manufactures from Nicaragua over the last several years, as they have begun to decline elsewhere, is testimony to this. (While Nicaragua has long had the lowest wages in the region, it is only over the last several years that the growth of its manufactured exports has begun to outpace other countries.)

Besides business facilitation, a second major area where action may be warranted is competition policy. Monopolistic practices much in evidence in the region, as in regional air travel. Although this was included as a possible sub-area for action under PROALCA II, little was done. Indirectly, some progress was made in this area through the development of the commercial dispute settlement mechanism. That mechanism should help introduce greater competition, and therefore greater efficiency, into the region.

In both areas, it is not clear what the proper mix between bilateral and regional activities would be most appropriate. It would appear that a regional approach would be needed in areas where the participation of Costa Rica was important.

B. IR 2: Accelerated Central American Market Integration

1. What were the objectives?

Increased intra-regional trade within Central America is the expected result of IR 2. The five sub-IRs, with their corresponding expected achievements – as presented in the AAD and reproduced below – provide more detailed objectives for IR 2. From the viewpoint of a results framework, the expected achievements could be considered “intermediate outcomes” that contribute to the overall IR 2 result calling for increased intra-regional trade in Central America.

a) Sub-IR 2.1: Remaining Intra-regional Barriers to Trade of Goods and Services Eliminated

For this Sub-IR, the Activity Approval Document (AAD) expected two achievements at the end of the strategy period:

- Substantial shrinking of tariff and non-tariff barriers to intra-regional trade in goods
- Loosening of constraints to trade in services in at least two of four areas of interest (banking, insurance, telecommunications and transport), accompanied by harmonization and modernization of the respective regulatory frameworks

b) Sub-IR 2.2: Regional Trade Dispute Mechanism Established

The AAD expected two achievements at the end of the period:

- A new dispute resolution mechanism established and operating efficiently
- Stakeholders have bought into the system and support it

c) Sub-IR 2.3: Customs Union

The AAD established two expected achievements for this Sub-IR:

- Movement toward full Customs Union in C.A. via implementation and fine-tuning of regional trade regulations, and supplementary actions in the area of operational convergence
- Significant advances in harmonization of Customs policies such as sanitary registers of medicines and food products, sanitary and phytosanitary norms, hydrocarbon import registers, and IVA legislation

d) Sub-IR 2.4: Energy Systems Strengthened and Integration Advanced

This Sub-IR seeks progress toward the construction of a strong regional energy sharing system that is stable, reliable, accessible and affordable. This will make the region better integrated and attractive to productive investment, and therefore, better prepared to compete in global markets.

For this Sub-IR, the AAD expected the following achievements:

- Regional energy laws, regulations and standards developed and implemented
- Regional action plans for seismic and volcanic emergencies developed and implemented for energy sector

- Regional power market developed

e) Sub-IR 2.5: Harmonization of Regional Road Standards

At the end of the strategy period, the AAD expected the following achievement:

- Manuals developed with Mitch project funding and under PROALCA II widely used by CA governments, private sector and international institutions.

2. Were the objectives achieved?

There is evidence that the region is on track toward meeting the IR objective. USAID established a target, accompanied by a baseline and monitoring indicators, which corresponds to the IR 2 objective: an increase in intra-regional trade (exports plus imports) as a percentage of GDP by 0.4 percentage points, using the 2001 percentage as the start of a baseline. The Mission's Portfolio Review of November 2005 shows that, after a downturn in intra-regional trade as a percentage of GDP in 2002, subsequent increments – especially in 2005 – put the region on track toward meeting the IR 2 target.

Although recent increases in intra-regional trade cannot be attributed to PROALCA II alone, interviews conducted by the evaluation team indicate that PROALCA II-financed activities indeed facilitated this result, and that the Program merits some – albeit a quantitatively undetermined – amount of credit for the increased intra-regional trade.

a) Sub-IR 2.1: Remaining Intra-regional Barriers to Trade of Goods and Services Eliminated

The remaining barriers to the trade of goods decreased over the PROALCA II implementation period, and many of the persons interviewed by the evaluation team stated that the outputs delivered by the Program contributed to the reduction of these barriers. These barriers have not been eliminated, however and despite the political commitment of the Central American Presidents to a Customs Union in 2006, the elimination of the remaining barriers to trade will still involve difficult decisions.

Several tariff and non-tariff barriers were indeed reduced over the PROALCA II implementation period. However, specific targets for the expected result were not established for the trade in goods, thus making it difficult for the evaluation team to determine to what degree PROALCA II met its expectations.

At the beginning of PROALCA II implementation, barriers to the intra-regional trade of goods applied to seven products: non-toasted coffee, sugar, toasted coffee, alcoholic beverages, petroleum products, wheat flour and ethyl alcohol. Non-toasted coffee and petroleum products were subject to tariffs, and sugar to control (quotas) at the regional level. Alcoholic beverages and toasted coffee were subject to tariffs at the bilateral level. Wheat flour and ethyl alcohol were subject to quotas. At the time of this evaluation, only

two generalized barriers remain: on non-toasted coffee (tariffs) and sugar (quotas). In addition there remain three bilateral restrictions between certain country pairs on toasted coffee, ethyl alcohol, and petroleum products. Restrictions on wheat flour and alcoholic beverages were dropped.

In addition, several months prior to the approval of PROALCA II, SIECA identified 11 additional obstacles to intra-regional trade, such as requirements for additional custom forms, administrative surcharges, and other charges. According to the SIECA website, the additional obstacles dropped to three as of May 5, 2006.¹

The impact of these trade barriers and obstacles on intra-regional trade is not very significant and dropping them probably would contribute little to the volume or value of intra-regional trade. However, the barriers take on considerable importance as the region moves toward a Customs Union with the free flow of goods across borders in the region.

In reference to the second expected result, the region did loosen constraints to trade in three of the four cited services (banking, insurance, telecommunications and transport). PROALCA II financed analyses of the trade barriers affecting the four services, and accompanied three of the countries (Honduras, Nicaragua and El Salvador) as they presented a proposal on the liberalization of restraints in trading these services to the WTO. CAFTA also requires a liberalization of investments and trade in these services.

Barriers to free trade in banking services, insurance and telecommunications dropped during PROALCA II implementation. In particular, regional banking and insurance services grew outside their home countries. From its base in El Salvador, the Banco Cuscatlán expanded to Guatemala, Honduras, Costa Rica and Panama. New insurance services are now available in the region, in particular through the internet. As a result of increased competition in the telecommunications sector, the evaluation team observed a sharp decrease in the rates on international phone calls from Guatemala.

Regarding transport (principally road transport) major obstacles remain. The countries agreed to allow trucks crossing regional boundaries to return to their country of origin with a full load. In practice, however, this still is not permitted. Safety concerns are among the principal reasons cited for sending trucks back to their country of origin empty.

b) Sub-IR 2.2: Regional Trade Dispute Mechanism Established

This Sub-IR has been successfully completed. Through its support to SIECA, PROALCA II played a leadership role in developing this system. The Program provided technical assistance, software, hardware, equipment, and training needed to set up the system and disseminate information about it in the five Central American countries. The

¹ However, on June 5, 2006 (after the field work for this report was completed) the number of barriers increased to four. All involve issues related to sanitary requirements between country pairs, such as requirements for fumigation, refusal to certify milk products and sanitary barriers and registries. The reference to these barriers is found on the SIECA website (www.sieca.org.gt).

regional mechanism to resolve commercial disputes began functioning in December 2005. It was approved by the five Central American governments and for the first time, offers the possibility of quick resolutions – in no more than 90 days – of disputes involving intra-regional commerce. Any of the five Central American governments can bring a case before the mechanism, which consists of three steps: (i) consultations among the parties; (ii) presentation to the Council of Ministers, which means negotiations among the affected States, possibly with the help of a third party; and (iii) binding arbitration.

To date nine disputes have been presented to this mechanism. Seven were resolved at the consultation stage, and a recently introduced case is about to enter this phase. One dispute is currently at the arbitration phase.² SIECA posts basic data concerning the disputes brought to this mechanism on its web site. The data include a brief description regarding the nature of the dispute, the countries involved, and the result, if any.

Among the persons interviewed by the evaluation team, the latter found widespread support for the dispute resolution mechanism. The approval of this mechanism by the five countries coupled with nine cases brought before it in its first 4-5 months provide evidence that stakeholders (regional governments and the private sector) have bought into the system and support it.

However, despite the training of over 900 persons in the dispute resolution mechanism, several persons interviewed by the evaluation team, including a leader of an association of producers and exporters, did not know about the mechanism. More dissemination is still needed. The leader who did not know about the mechanism quickly mentioned three cases which he will request that his government submit for resolution.

One interviewee expressed a concern that some country or countries may refuse to abide by the result of binding arbitration, arguing that an arbitration decision contradicts a national law. This could undermine the procedure, and more time is needed to determine whether it is sustainable.

c) Sub-IR 2.3: Customs Union

The AAD established two expected achievements for this Sub-IR:

- Movement toward full Customs Union in C.A. via implementation and fine-tuning of regional trade regulations, and supplementary actions in the area of operational convergence.
- Significant advances in harmonization of Customs policies such as sanitary registers of medicines and food products, sanitary and phytosanitary norms, hydrocarbon import registers, and IVA legislation.

² The arbitration process concluded after completion of this evaluation report. The case responded to an accusation by Costa Rica of dumping of ice cream products by Guatemalan retailers and wholesalers. The dispute was resolved in favor of Guatemala and Costa Rica accepted the ruling.

Principally through technical assistance delivered through SIECA, Central America moved closer to a Customs Union. The technical assistance focused on intensive work by SIECA with the five Central American countries to harmonize, and in some cases to standardize, tributary procedures, product registries in six areas (foods and beverages, medicines, sanitary and phytosanitary measures, petroleum and petroleum products, norms, and agricultural inputs), and customs procedures and forms. It also supported collaboration between countries at ports of entry, with several countries having customs officials at ports and border crossings that serve more than one country.

In several countries, in particular Guatemala and El Salvador, movement toward a Customs Union has been especially rapid. In others, namely between Nicaragua and Costa Rica, progress has been slower. The project also supported one-stop border crossings, most of which are now open daily for 24 hours. In addition, PROALCA II supported advances in information systems, which will facilitate the flow of information within countries (from customs to tributary authorities) and between countries.

Also through technical assistance channeled through SIECA, PROALCA II helped harmonize tariffs in the region. In October 2003, 73 percent of Central American tariffs were harmonized. This percentage climbed to 93 percent in August 2004 and is currently (May 2006) close to 96 percent.

According to SIECA officials, the result of all the above measures has been a rapid decrease in border crossing times. They stated that these times have decreased, over the time-period spanned by PROALCA II from many hours, frequently more than 24 hours, to about 10-15 minutes. The evaluation team was not able to verify these figures.

The work described above is still not finished. In many cases the countries will have to approve legislation that puts into effect agreements negotiated at the Ministry level. A few examples include legislation regarding product registries including sanitary and phytosanitary measures, tributary procedures and eventually the harmonization of tax rates, and customs reforms. Considerable technical work is still pending regarding a large number of technical points regarding the standardization of customs procedures. Despite important agreements regarding product registries, standards and norms in the six areas noted above, this work is far from finished and even as this work progresses, it will have to be continually updated to address product changes.

d) Sub-IR 2.4: Energy Systems Strengthened and Integration Advanced

USAID contracted with PA Consulting (PA) to implement this Sub-IR, and its assistance began in August 2002. Since then, PA provided a variety of services to the five Central American countries. PA's work consisted of, *inter alia*, diagnoses and options for sustainability, support for regional interconnections, electricity sector strategies, energy audits, technical support for the regulatory agencies, and policy recommendations for disaster planning. PA also provided support aimed at institutional strengthening to the

regional regulatory commission (CRIE – Comisión Regional de Interconexión Eléctrica) in its initial transition period, 2004-2007.

Professionals in the energy sector interviewed by the evaluation team in Guatemala, Nicaragua and El Salvador had only praise for the support provided by PA. However, the evaluation team was not able to find clear impact of the work PA did in Honduras. Apparently PA's work led to the submission by the Executive branch to the legislature of a project law that incorporated PA's suggestions for reforming the energy system in Honduras. However the legislative process in Honduras seems to have been too cumbersome and a new energy law has not been produced yet.

Interviewees considered PA's technical expertise to be excellent and helpful in responding to pressing issues. However, one entity reported that it would have liked a larger role in determining the types of activities to be supported by the Program, and it believes that PA's work would have been more relevant to the institution if the consultant's work permitted PA consultants to focus on additional issues important to the entity.

As is the case for several other Sub-IR's, the evaluation team could not find baselines, targets and monitoring indicators, which would help assess progress toward meeting results. Nevertheless, based on USAID reporting and the interviews conducted by the evaluation team reporting, there is evidence that energy systems, at least on a country by country basis, have been strengthened during the period of PROALCA II implementation.

PA monitored three important regional indicators for USAID including: private investment in the power sector, the expansion of electricity coverage, and the value of energy exchanges in Central America:

- Over the 2001-2004 period private sector investment in the sector increased from US\$ 220 million to US\$ 387 million, but the time series is too short and the figures show too much year to year variation to discern a clear trend (Private investment was US\$ 357 in 2002 and US\$ 266 in 2003). It is noteworthy that electricity investments in the four cited countries of Central America (data were not presented for Costa Rica) rose at a time when worldwide private investment in electrical energy declined.
- Household coverage increased in the four countries. The largest increment was from 72 percent to 88 percent of the households in Guatemala and the smallest was an increase from 46 percent to 49 percent in Nicaragua.
- Regarding energy exchanges, PA estimated a 21 percent increase in energy exchanges from 2003 to 2004 (data were not presented for other years). Energy sharing in Central America is severely limited by aged, and insufficient, infrastructure. However, energy sharing is expected to grow considerably in 2008 when a transmission line becomes operative through the SIEPAC project.

Regarding the first expected result for this Sub-IR, the evaluation team found evidence that regional energy laws, regulations and standards are in a development stage. PA helped CRIE draw up transitory norms, which are currently in effect. A Protocolo al Tratado Marco (a framework agreement), is under discussion by the governments, and several recommended modifications of CRIE's internal statutes have been partially implemented. In addition, PROALCA II's work with bilateral electricity regulators and planning agencies is a step in the direction of permitting a stronger regional approach to electrical energy. Strengthening of CRIE is an additional step in this direction.

The second expected result refers to plans and regional action plans for seismic and volcanic emergencies developed and implemented for energy sector. PA prepared a report, financed by Mitch Program assistance: "*Fortalecimiento de las Políticas Regionales Relativas a la Seguridad del Sistema Eléctrico a los Desastres Naturales de Origen Climático, Sísmico y Vulcanológico*" in 2002. The content of the report and its recommended plans, standards and regulations were presented in regional workshops. El Salvador's Plan de Rehabilitación del Sistema de Transmisión incorporated many of these measures. It increased the participation of soil and geotechnical specialists in civil Works and in determining the location of transmission towers.

The third expected result calls for progress toward the development of a regional energy market. Through activities which strengthen CRIE, PROALCA II contributed toward the development of the expected result. PA helped establish a transitory administrative structure for CRIE and it contributed to defining CRIE's rules and procedures. In addition, PA developed a tool to monitor the regional energy market and trained CRIE staff in its usage. PA installed the model on CRIE's computers and trained staff to use it.

e) Sub-IR 2.5: Harmonization of Regional Road Standards

An important output of this Sub-IR is the development and approval at the Ministry level of road standards for Central America. These include standards pertaining to maintenance, specifications (for example, for signs), and construction norms for roads. This work was carried out through PROALCA II support to SIECA leadership as it carried out intensive work with the corresponding Ministries in the five countries. PROALCA II also supported the publication and dissemination of the manuals in the five countries. The manuals are available on SIECA's website.

Although SIECA noted that the manuals are being used in the five countries, in order to complete this process, legislation is also needed in the five countries. In addition to approving the content of the manuals, the legislation would permit future updates in the manuals to be approved at the ministerial level. To date, the legislation has been approved by Nicaragua and is pending in the other countries. SIECA expects that the manuals will be used by the international agencies that finance road construction. In addition, SIECA advised that the content of the manuals has been introduced into engineering courses in Guatemala and Costa Rica.

3. What problem areas or constraints affected results?

Sub-IR 2.1. Even with the best of intentions, it would be difficult to eliminate the sugar quotas, because they reflect bilateral agreements with the United States.

Sub-IR 2.2. More experience is needed prior to verifying the dispute resolution mechanism's sustainability. Legislation may need to be passed in each country to grant the mechanism legal precedence.

Sub-IR 2.3. Regarding the Customs Union several issues have arisen:

- **Will there be a Customs Union and, if so, when?** Whether or not there will be a Customs Union (or something close to a Customs Union) at all, and if so, when it will be put into place will depend in large part on the commitment of the countries to follow through with initial progress. Despite a commitment by the region's president's to establish a functioning Customs Union in 2006, this is highly unlikely. A key piece of legislation (a customs code) is not expected to be ready until 2007. In addition, numerous actions that could be very useful to the Customs Union (such as harmonized tax rates, interconnection of information between customs agencies and tax authorities within and between countries, more progress on product registries with their corresponding standards, expansion of information flows between customs agencies and other ministries between and among countries) will require considerable work and intensive negotiations among the countries. While generally supportive, even the private sector has voiced several concerns with a Customs Union. One leader decried the possible loss of temporary relief of import duties for products exported within the region if, for customs purposes, the distinction is eliminated between sales within a country and the region. The evaluation team has heard a wide variety of predictions regarding when a Customs Union might be in place. Several believe it to be possible in 2007 (albeit, in an incomplete form), while other believe that 10-15 years, or even more, might be a more realistic estimate.
- **CAFTA and the Customs Union.** Bilateral CAFTA agreements are different for each country. This could impede rapid movement towards a Customs Union, especially if phase-out periods are different for tariffs on the same goods. Within SIECA, the evaluation team heard widely differing opinions regarding the importance of this issue.
- **Continuity of the progress towards a Customs Union.** The sustainability of PROALCA II-supported work toward a Customs Union is in question. As noted above, the work of many PROALCA II-supported professionals is clearly not finished. In several cases, SIECA has managed to find short-term solutions to keep them working and in several cases a new project funded by the European Commission may finance some of the technical personnel previously supported by PROALCA II. However, at the time this evaluation report is being written, there is still no solution in place to permit them to finish their work. USAID will

have to determine how high a priority it assigns to a Customs Union, and whether it wants to continue its support or perhaps hope that others take up where it left off.

- **Powerful vested interests.** Powerful vested interests and privileges, especially in the customs agencies, work against the types of reforms that could make a Customs Union possible.
- **Distrust among countries.** Levels of professionalism vary considerably across customs officials, and the stronger countries fear that this could lead to loss of revenues for the region. Increased transparency, stronger standards of professionalism in customs agencies and less room for arbitrary decisions could facilitate efficiency through cooperation among the countries in revenue collections. Despite progress in these areas, concerns about corruption and arbitrary decisions continue and there remains room for improvement.

Sub-IR 2.4. Weaknesses in the electrical energy sector in specific countries, in particular in Honduras and Nicaragua, threaten to set back plans to strengthen their electrical energy sectors and in turn a regional approach to strengthening the sector. CRIE is only beginning to function and will undoubtedly require ample technical assistance to support the harmonization of regional energy policies and standards.

Sub-IR 2.5. An important issue refers to the passage of legislation needed to formalize country approval of the norms and standards in the new transport manuals. An additional issue affecting Sub-IR 5 refers to trade with Mexico. The latter permits heavier trucks and heavier weight per axle than in Central America. This issue is in the process of negotiation and SIECA believes that a solution is in sight.

4. What are the strengths and weaknesses of the implementation units?

SIECA: Under PROALCA II, the evaluation team was impressed by the high quality technical work provided by SIECA. Their presentations were excellent. Several of the evaluators observed marked improvements in the quality of SIECA-led products in relation to those produced in the 1990s and earlier.

In addition, SIECA maintains excellent communications with the Ministries of Economy, the regional government agencies to whom it formally responds. However, the evaluation team found that the quantity and quality of SIECA's communications with other Ministries and the private sector to be mixed. One private sector leader resented that he was not invited to SIECA-provided training. Many felt that decisions regarding the content, scope and participants in the training sessions were taken far away without sufficient stakeholder participation. Several Ministries, other than Ministries of Economy, voiced similar opinions. Although SIECA's principal responsibilities are clearly linked to the Ministries of Economy, perhaps it could solicit more inputs for its programs, especially its training programs, from private sector entities.

However, the quality of the training was generally regarded as high. Likewise, the topics treated in the training sessions were considered highly relevant to issues and opportunities present in the region.

An important issue concerns the sustainability of the high quality technical support that SIECA has provided to the economic integration process. As mentioned above, this work is not finished. Many of the leaders of this process were USAID-funded, and SIECA does not appear to be able to continue its work without additional external support. The European Commission (EC) will take over some of these activities, but questions remain concerning the degree to which the EC will continue supporting previously PROALCA II-financed programs.

PA Consulting: As noted above, there was widespread praise for the quality of services delivered by PA.

5. Quality of the technical assistance and training, its responsiveness to participant needs and lasting effects

As noted above, the interviews conducted by the evaluation team amply confirm the high quality of the technical assistance and training programs carried out by SIECA and PA. Participants responded favorably to questions regarding the relevance of the training. Ample progress toward Central American economic integration realized in recent years attests to the lasting and multiplicative effect of the technical assistance and training. The evaluation team reviewed a small sample of the materials left behind by SIECA. They are indeed useful, and many of them are posted on SIECA's website.

6. Was there significant participation by women?

Regarding IR 2 and gender, the evaluation team could not identify gender-specific thrusts to the Program. About 41 percent of the trainees were women.

7. Was there a monitoring and evaluation program to measure impact?

As noted above, USAID established a baseline, target and monitoring system that permitted measurement of progress toward a high-level result: increased intra-regional trade in Central America. However, PROALCA II lacks a sound results framework that would permit monitoring and evaluating its contribution to increased Central American trade. Other than the broad indicator corresponding to the Mission's Strategic Objective 5 mentioned above, the evaluation team could only find a lengthy list of output indicators prepared by SIECA, with few outcomes. Likewise, PA produced a lengthy accomplishment list, dominated by outputs, without a clear vision of progress and steps needed to reach overall outcomes.

The Performance Monitoring Plan at the end of the AAD presented a sound basis for a results framework, with suggested approaches to progress measurement. It also specified that USAID would work with executing agencies to present a final performance

monitoring plan, with quantitatively verifiable indicators to measure results, to be produced within twelve months. The evaluation team could not find evidence that this work was accomplished.

The expected achievements for the Sub-IRs, which generally represent intermediate outcomes supporting increased intra-regional trade, lack specificity. Most do not contain specific time-bound quantitative targets. Expected achievements – such as substantial shrinking of tariff and non-tariff barriers, movement towards a customs union or regional energy laws, regulations and standards developed and implemented – impart ambiguity to the results framework because the evaluators could not find more specific targets, such as what or how many tariff and non-tariff barriers would be shrunk? By when? How far would Central America be expected to move toward a Customs Union by program completion? Baselines, targets and monitoring indicators do not appear to have been designed for the intermediate outcomes corresponding to the Sub-IR's expected achievements.

PROALCA II missed several good opportunities to measure important IR 2 project outcomes. A couple examples include:

- Estimating the reduction in border-crossing time during the course of Program execution. This could have been measured at a reasonable cost on a sample basis.
- Using the SIECA database to measure the changes in intra-regional trade in specific goods before and after agreement on their corresponding registries.

The lack of a sound results framework complicated the work of evaluators trying to assess PROALCA II's contribution to IR 2 results. In lieu of a quantitative assessment of the contribution of the Program based on baselines, monitoring indicators and targets, the evaluation team had to turn to a second-best approach: interviews to identify stakeholder appreciations regarding the importance of PROALCA II outputs to important outcomes.

8. Was the implementing staff performance efficient and effective?

As mentioned above, the answer is positive. The interviews generally attest to the effective and efficient delivery of important outputs by SIECA and PA staff to regional integration.

9. What lessons have been learned?

Lessons learned include:

- Pay more attention to the results framework and, in particular, specify baselines, monitoring indicators and targets for key program outcomes.
- Monitor progress toward the targets corresponding to key program outcomes.

- SIECA and PA Consulting are capable of providing high quality technical assistance and training.

10. What else needs to be done?

Key future actions mentioned earlier are summarized below:

- The most important actions call for the region to do all it can to fully take advantage of new export opportunities associated with a liberalized trade regime. This means improving the legal and regulatory framework, promoting good governance especially in areas pertaining to business, simplifying procedures for starting and operating businesses, and improving the infrastructure needed for trade. The Seldon Report, produced by Booz Allen Hamilton, amply attests to the importance of the legal and regulatory settings.
- Remove remaining tariff and non-tariff barriers to intra-regional trade.
- Remove the remaining obstacles to intra-regional trade cited on the SIECA website (See the discussion of IR.2.1 and the footnote on this topic). This and the previous action are important not only because they would facilitate greater intra-regional trade, but also because they would also help several countries gain quicker access to port facilities in neighboring countries, and thus promote exports outside the region.
- Complete and constantly update the registry of goods, including sanitary and phytosanitary standards and norms.
- Harmonize tributary policies and rates for the IVA and selective consumption taxes.
- Finish and approve a regional customs code.
- Complete information systems linking customs points and central ministries within and between countries.
- Design and approve laws, regulations and standards needed to expand the regional energy market. In addition, complete the improvements in regional infrastructure needed for an expanded regional energy market.
- Approve legislation pertaining to standards in the transport manuals and permit future revisions to be approved at the ministerial level.

C. IR 3: More Equitable and Efficient Labor Markets

Although the PROALCA II agreement with SIECA was signed in 2001, actual interventions in the labor area started in July 2003. It is the team's opinion that work under this component had a positive impact and helped achieve its strategic objective.

1. What were the lower level objectives (intermediate results)?

There were three objectives.

- (1) Enhancing the capacity of Labor Ministries.** This objective initially involved achieving: a more active and effective leadership of Labor Ministries in economic policy-making relative to labor; better functioning of labor markets in specific areas addressed by PROALCA II; establishment of one or more Alternative Labor Dispute Resolution systems in the region; and the development of corps of trained technical staff in the Labor Ministries.

Nonetheless, the above sub-objectives experienced various changes over time. For example, amendment 6 makes reference to somewhat different sub-objectives or intermediate results – greater respect for internationally recognized labor rights; enhancing the training of technical personnel who would support the CAFTA negotiation rounds; and, labor markets that performed better. Yet, SIECA's monitoring report for January-December 2005 explains that some activities had been redefined and makes reference once again to such sub-objectives as supporting alternative conflict resolution mechanisms and enhancing the capacity of labor ministries to have an impact on policy.

- (2) Increasing the competitiveness of the region's labor force.** This initially meant: shifting from public occupational training to public-private skills based training; harmonization of skills standards and standards of certification methods; initiation of skills certification programs throughout the region; increased voluntary mobility of workers inside their countries; and, changes in labor codes to incorporate policies that facilitated adjustments to work schedules without weakening the protection of core labor rights.

As with the previous objective the intermediate results or sub-objectives changed over time. The final focus seems to have become harmonization of skills standards and the establishment of certification programs.

- (3) Labor laws and regulations harmonized in the region.** The initial sub-objectives were: region wide-respect for core labor rights; changes in national legislation to conform to a regional norm; and, increased convergence of labor laws in the region. Again the sub-objectives changed so that only the "increased convergence" result remained.

The changes mentioned above were the consequence of budget cuts and, possibly, evidence a learning curve in programming activities in the labor area.

2. What activities were implemented?

a) Enhancing the capacity of Labor Ministries

Activities included:

- Training labor ministries staff. For example in 2005 the program supported a regional training program on labor rights. The seminar took place in Panama. In addition, there were training events in Costa Rica (on labor fairs), in El Salvador (two seminars on labor inspections) and other relevant interventions in Panama.
- Preparation and publication of training and information manuals. For example publications on labor relations and the social responsibility of enterprises, labor fairs and information bulletins. The program also produced a number of publications on alternative dispute resolution.
- Workshops. The themes included labor fairs (Costa Rica), labor inspections (El Salvador), alternative dispute resolution (Guatemala), minimum wage policy (Panama), and competitiveness and social awareness of international trade issues (Guatemala, Dominican Republic, Panama).
- Fellowships on alternative dispute resolution and other labor themes. These included a fellowship for Guatemalan officials and fellowships for Honduras Labor Ministry staff.

b) Labor Force Competitiveness

Activities included:

- Technical assistance on standardization and certification of skills training programs. For example to Costa Rica, Dominican Republic and Panama.
- Publications. Included one relating to the Panamanian labor force.

c) Labor Law Harmonization

Activities included:

- Technical assistance and studies. These included studies on minimum wages (e.g. in Guatemala) and micro-enterprises (e.g. in Nicaragua).
- Labor Ministers meetings. SIECA provides technical and logistical support for annual meetings of Ministers of Labor. As noted elsewhere in this evaluation report, the Ministers indicated little interest in implementation activities in this area.

- Meetings with labor ministries technical staff for programming activities on labor law harmonization. There was at least one of such meetings.

3. Were the objectives achieved?

Given the changing targets, it is difficult to be categorical. Nonetheless, it seems that, indeed, PROALCA enhanced the capacity of labor ministries. There is no evidence, however, of successful impact on the five Central American CAFTA countries regarding increasing the competitiveness of the regional labor force or harmonization of labor laws and regulations.

Under labor force training, SIECA reports on normalization of skills certification programs (January-December 2005 Monitoring report, page 28) and mentions that the target was met. Nonetheless the team notes that the same report indicates that only the Dominican Republic and Panama expressed interest in the topics and that Costa Rica previously had been interested in it but later changed its mind. This suggests that on this topic, there was little or no impact in any of the five Central American CAFTA countries and, perhaps more importantly, the targets mentioned are not impact indicators.

In addition, it is noteworthy that SIECA indicated that Labor Ministers showed little interest in the adoption of concrete actions to promote the convergence of labor laws (Annual Monitoring Report January-December 2005, footnote page 19.) This raises the issue of the relevance of this objective at the time of program design and implementation and whether the approach to regional harmonization while important, should have been approached differently (more on this later).

The lack of or weak impact regarding the last two sub-objectives or intermediate results does not mean that the program failed. An important factor – although not the only one, see problem areas below -- is the budget cuts experienced. In light of such factors and the repeated changes in lower-level objectives, the team judges that the effectiveness of the labor component should be based essentially on qualitative criteria and on whether the interventions, whether adequately programmed or not, contributed to the attainment of Strategic Objective 5.

The team notes that most of the comments received on the effectiveness of SIECA in the labor area were positive. PROALCA II and SIECA were highly praised especially for the interventions leading to:

- Progress in the development of alternative dispute resolution mechanisms.
- The establishment (under PROALCA I) of a Regional Council of Labor Ministers (Consejo de Ministros de Trabajo).
- Enhanced use of information technology.
- Training of judges and others on labor law and related matters.

- Enhanced capacity and effectiveness of labor ministries.

In the team's opinion these are all valuable contributions.

4. What problem areas or constraints affected the results?

As noted above, budget cuts were a factor. While initially the resources to be allocated to the labor component were to be much bigger, in the end only about \$500,000 was disbursed. And of these, according to SIECA, \$200,000 was earmarked thus further limiting the scope of their programming.

Yet apparently there were also problems with project design, communication with program partners, and in the implementation process. Specifically, the labor ministers conveyed lack of interest in labor law harmonization to SIECA at a meeting that had been preceded by work on the subject with technical staff of the respective ministries.

The criticisms leveled against SIECA tended to be of two kinds. One consists of the allegation that SIECA tended to act in a somewhat heavy-handed manner in its relations with the Ministries of Labor – the issue here related to not having adequately integrated the Ministries in program design work and in relevant financial management. The reference to financial management was attributed to administrative deficiencies and no malfeasance was insinuated.

The second criticism was that SIECA's consultants did not always have the required level of competence. This allegation was independently made to different members of the evaluation team in more than one country.

In arriving at its overall favorable view of PROALCA II labor component, the team weighed the praise for and the criticisms of SIECA. It took into account that, even in countries where there was criticism there also was high praise for the quality of SIECA's professional services. Moreover, the evaluation team also considered the high quality of the presentations made to it by SIECA staff and the mastery of their technical fields by the presenters.

A related point is that at least some of SIECA's weaknesses are the result of its structure, and the frequent change of the region's Ministers of Economy, to whom SIECA reports. Furthermore, the evaluation team felt that the number of SIECA technical staff was less than adequate for the tasks undertaken by SIECA under PROALCA II. This does not necessarily mean that donors should increase their contributions to SIECA or any other such regional entity, but that to the extent the region's governments value the services of an institution such as SIECA they should increase their support to it.

Most (if not all) of the interviewees indicated that the main problem in the labor area is not one of legislation but of enforcement, information, and judicial and quasi-judicial performance. The poor quality of labor inspection services, the poor training of inspectors, and the problem of corruption was a recurrent theme. A related point is the

need to confer career civil service status to inspectors and other key labor Ministries' staff.

With respect to cooperation between bilateral USAID missions and the regional mission, no friction was evident. The same cannot be said in connection with perceptions of the cooperation and coordination among US government agencies involved in labor-related interventions. In three of the CAFTA countries, interviewees referred to the very heavy transaction costs involved in having labor projects pass through the scrutiny of several US agencies.

While agencies such as USAID, USDOL, USTR and State are perceived as not always delivering consistent messages, the problem may basically reflect tensions at the operational level (at Ministries and contractor level) rather than at the level of USG officials. For example, USAID and USDOL are both supporting activities in the labor area and in many cases, although not always, their programs pursue the same objectives. A case in point relates to "Cumple y Gana", a project supported by the USDOL and implemented by FUNPADEM and Abt Associates Inc. The objective of "Cumple y Gana" is to strengthen the enforcement of labor law in Central America. To that end, this project seeks to: disseminate information about labor law and regulations among workers and employers; enhance the effectiveness of labor inspections; and enhance the effectiveness mechanisms for the settlement of labor disputes and the awareness of the existence of such mechanisms by workers and employers.

Clearly the objectives and interventions are similar to PROALCA's and coordination among the project should have flowed naturally. While such coordination existed in at least one country, in at least two others the coordination was not only lacking but duplication of activities and even rivalry among the respective projects' personnel seems to have been the prevailing norm. While in these latter cases a clash of personalities, differences in the projects' time frame, as well as the different mandates of the respective USG agencies, may have played a role, the fact is that two USG-financed programs with congruent objectives did not complement each other.

Recommending greater coordination among agencies is the easy recommendation. But thinking about potential future activities, it is a fact that there can be tension between the objectives of supporting economic development by promoting more competitive markets, including the labor market, and the objective of enforcing laws and regulations. The reason is that some norms may raise excessively the cost of doing business.

On the other hand such tension is not necessarily a preordained result. First, there is no doubt that core labor standards ought to be enforced. Second, in itself, respect for the rule of law can encourage entrepreneurial drives and thus enhance the potential for economic development – something that would translate into more productive jobs and higher real wages. The challenge is finding some reasonable point where effective protection of workers' rights and labor market efficiency are well served.

Probably meeting such challenge requires acting beyond the scope of labor-market related policies. For example, the greater access to US markets by the Central American countries resulting from CAFTA should help. Especially a fast opening of the US market to all agricultural exports from Central America would make the task easier.

5. What are the strengths and weaknesses of the implementation units?

Much of the answer to this question has been made in the previous section. The strengths consist in SIECA's technical capacity and its links to high-level government decision-makers. The weaknesses related to deficient consultation and teamwork with program partners, limited institutional experience in the labor area, and (at least in a few countries) less than strong program administration.

Probably SIECA could have been more effective in the labor area if it had worked closer with labor ministries and the private sector at the design stage. This issue was raised in more than one country and may account for the less than favorable feedback received in some countries.

Likewise better communication and teamwork with SIECA's counterparts in the labor area could have avoided frictions or misunderstandings regarding financial administration.

6. Quality of the technical assistance and training, its responsiveness to participant needs and lasting effects

As noted above the technical assistance and training programs were generally perceived as of high quality. These interventions were consistent with the ILO recommendations, the April 2005 report to labor Ministries and the 2006 assessment of labor justice commissioned by USAID – please refer to Annex 3, Status of Central American labor markets in the present evaluation report.

Nonetheless, by and large, the interventions did not have a lasting and multiplicative effect. While there have been gains from the activities in this component such gains are reversible and in jeopardy. One reason is the traditional technical and political weakness of labor ministries, often coupled with alleged corruption in some of their activities – labor inspections, for instance. Given low salaries, high staff turnover, and the politicization in hiring practices nothing less than a change in the institutional culture of the ministries would ensure sustainability in gains so recently achieved.

Another reason is the disproportion between the magnitude of the task involved and the resources mobilized through PROALCA II to reach it. For instance, while PROALCA II has provided valuable support in information technology to the region's Ministries of Labor, the capacity of the Ministries in information technology still falls quite short of adequate. Some ministries still rely on traditional methods for recording data and for providing information to users of the Ministries' services. The team underlines that

continued improvement in applied information technology affects the effectiveness of key labor services such as placement.

In some countries (Nicaragua for example) the needed hardware and software is simply not there, in others (e.g. Honduras and Guatemala) personnel turnover and the ensuing loss of human capital may account for deficiencies and services and lack of technical capacity. Further support for enhancing the information technology seems warranted but its effectiveness will continue to be excessively limited unless staffing policies become less politicized, labor ministry staff become career civil servants, and labor turnover is decreased.

Useful reference materials were left behind – manuals and needs assessments, for example. Whether such material will be used effectively is another issue.

7. Was there significant participation by women?

Yes, there was. In all labor ministries visited women were in leadership positions. Many of the women interviewed had directly benefited from training seminars, fellowships, and technical assistance. SIECA reports that 427 or the 942 participants in training events were women (45%).

8. Was there a monitoring and evaluation program to measure impact?

There was a monitoring and evaluation program to track progress in implementation. However, as is implicit in the discussion in a previous subsection, the program was changed repeatedly and no clear indicators of impact were used. The team could not avoid the impression that SIECA found it very difficult to establish a clear and definitive monitoring/evaluation program. As mentioned above, this may have been due to factors such as budget cuts.

9. Was the implementing staff performance efficient and effective?

For the most part it was. As previously mentioned, SIECA's interventions frequently received high praise for the services rendered.

10. What lessons have been learned?

Aspects relating to the need for a more collegial approach to program design and more attention to the planning and monitoring of performance and evaluating impact have already been mentioned. Likewise the issue of USG inter-agency cooperation was discussed previously.

A different point has to do with how well PROALCA II and USAID's role were known. A significant number of the persons interviewed were not familiar with PROALCA II although they were familiar with SIECA's work and output. An implication is that

USAID's support of SIECA's interventions was not given adequate publicity. In future efforts USAID's role should be given higher visibility.

11. What else needs to be done?

Many among the persons interviewed expressed the view that PROALCA II-type activities are worthy of further support. The reasoning is that the region may be experiencing a breakthrough in terms of trade policy, regional integration and general market liberalization and that not continuing with PROALCA-type interventions risks losing the gains that have been made. This applies as well to the labor area. We believe that the USG should continue its involvement in support of modernizing the labor markets. To do this it is essential that USAID and the USDOL reach clear agreement about their respective agendas.

The more critical question is the relative role that should be played by bilateral USAID Missions versus the regional program in addressing labor sector issues. To a great extent, the binding constraints at this time appear to be in institutional consolidation of the labor Ministries, and enforcement capacity both within the Ministries and the judicial system. These issues might be more easily addressed at the bilateral level.

There can be tension between the objectives of (1) raising the efficiency with which the labor market allocates resources, and (2) the strict and full enforcement of existing labor codes. This is in part due to the fact that some aspects of the codes are very liberal, and thus far unenforceable (or if enforced they would decrease the cost competitiveness of C.A. products). Central American entrepreneurs are increasingly aware that they must meet world standards in respecting basic labor rights, if they are to have access to world markets. But some aspects of local labor codes go beyond such standards, and lead to labor market rigidities (see Annex 3). In pursuing stricter enforcement of labor codes, Central Americans will eventually have to assure that the codes are realistic. This effort could perhaps best be undertaken on a regional level as part of an effort to harmonize the laws across the region, in keeping with world standards.

Finally, the evaluation team must note that apparently PROALCA II did not contribute significantly to the enhancement of the labor Ministries' capacity to do labor market analysis. Apparently, neither did it focus significantly on labor force training or on directly improving employment systems – although the program's information technology interventions may have had an indirect impact on placement services. These are important areas. While the team mentions these gaps, it is evident that given resource constraints the program could not address all areas of importance. Nonetheless, were USAID to continue its involvement in labor market reform the importance of the just-mentioned areas should be given further consideration.

D. IR 4: Effective Preparation of Central America for Trade Negotiations

1. What were the objectives?

Intermediate Result 4 was added to the PROALCA II Program through Amendment 2 to the Strategic Objective Agreement in August 2002 (this represented an expansion of a sub-component previously included under IR 1). The objective of the new IR was to “help Central American Countries to prepare effectively for the negotiations of the FTA between Central America and the U.S. (CAFTA).” This was to be achieved through activities pursuing the following sub-objectives: 1) Strengthened regional and national trade capacity to negotiate FTAs; 2) Increased private sector involvement in CAFTA negotiations; 3) Increased public support for the FTA between C.A. and the U.S. (CAFTA); and 4) Increased understanding of U.S. technical requirements for product entry into the U.S. market.

2. What activities were implemented?

In contrast to the other intermediate results, IR 4 was implemented by each Central American country separately, based on each Ministry of Economy’s assessment of its country’s needs. A fund of \$1,875,000 was established in SIECA, and each of the five Central American countries was allotted \$385,000 to be invested over a two year period. To access these resources, each Ministry of Economy developed an implementation plan based on its needs, and submitted it to the bilateral USAID Mission (the US Embassy in the case of Costa Rica) for approval. Once approved, the plan was forwarded to the USAID/G-CAP PROALCA II Program Manager in Guatemala for review and approval, and then sent to SIECA for implementation. SIECA would directly contract consultants, purchase equipment, arrange training courses, contract publication of brochures, etc., to implement the approved activities in each country. The selection of the consultants to be hired, equipment to be purchased, etc., was carried out by the Ministries using competitive practices required by USAID and SIECA. Thus this aspect of the PROALCA II program was implemented through a regional institution on a quasi-bilateral basis. This mode was adopted primarily because the individual bilateral Missions lacked appropriate implementation mechanisms, and it was fastest to channel the resources through the existing regional program. The following describes the activities by sub-objective:

a) Strengthened regional and national trade capacity to negotiate FTAs

This sub-objective was modified in practice to also include strengthening the capacity to implement CAFTA. This modified sub-objective was the most important one pursued by El Salvador, with activities implemented including training of Ministry of Economy officials, purchase and installation of equipment for units responsible for CAFTA implementation, orientation trips to Mexico and other countries to gain from their experiences, etc. Honduras also carried out some activities under this sub-objective similar to those in El Salvador, but on a smaller scale. And in Costa Rica six specialized, small activities were carried out that helped prepare for CAFTA implementation.

b) Increased private sector involvement in CAFTA negotiations

Only Honduras implemented activities related to this sub-objective. It sponsored workshops with the umbrella council of private sector organizations (COHEP) to exchange views with the private sector during CAFTA negotiations.

c) Increased public support for the FTA between C.A. and the U.S.

Implementation activities under IR 4 in Guatemala and Nicaragua focused exclusively on this third sub-objective. In Guatemala 52,000 pamphlets and brochures and 5,000 interactive CDs were produced, some of them in the principal four indigenous languages as well as Spanish. Workshops were held on 16 different themes related to CAFTA. In Nicaragua, a wide range of activities were implemented, including the strengthening of the Information Center in the Ministry of Fomento, Industria y Comercio. Information was disseminated via radio spots, bulletins, a website, etc., contributing to a 62% support for CAFTA among the Nicaraguan public. The majority of activities related to IR 4 in Honduras also focused on this sub-objective, including seminars, workshops, and mass information campaigns. In Costa Rica, training courses, public opinion surveys, and mass information campaigns were also carried out, including a study of the impact of CAFTA on women. In El Salvador, very few activities were carried out related to this sub-objective.

d) Increased understanding of U.S. technical requirements for product entry into the U.S. market.

Technical assistance and training activities related to this sub-objective were carried out in El Salvador, Honduras, and Costa Rica. This sub-objective received a relatively low level of attention via SIECA. However, USAID G-CAP via PROALCA II and the Washington EGAT Bureau provided significant support for regional and national workshops through a task order with Robert Nathan Associates (not examined under this evaluation).

3. Were the objectives achieved?

In terms of the sub-objective 3: Increased public support for the FTA between C.A. and the U.S., the fact that CAFTA was signed by all five countries, was ratified by four, and is being implemented by three is an indication of success. Clearly, many factors contributed to CAFTA approval besides the PROALCA II program investment in public education. However, without this investment, it would have been much more difficult to overcome organized opposition to CAFTA ratification in Honduras and Guatemala, and even in Nicaragua and El Salvador approval would have been more difficult. However, the fact that the treaty has yet to be ratified and implemented in Costa Rica, and implemented in Guatemala, is a sign that this sub-objective was not fully achieved.

El Salvador appears to have made significant use of the IR 4 resources to strengthen the capacity of the CAFTA implementation units, which is related to sub-objective 1. Much more needs to be done to assist the other Central American countries to prepare for CAFTA implementation.

Interviews with public and private sector officials indicate that relatively little was done to involve the private sector in CAFTA negotiations (sub-objective 2), or to increase their understanding of U.S. technical requirements for product entry into the US market (sub-objective 4). SIECA appears to have been more effective in assisting public sector organizations, and did not develop effective links to the private sector. It must be noted that the Ministries of Economy had full responsibility for setting priorities and selecting the activities to be financed. It is apparent that they assigned highest priority to sub-components 3 and 1, and resources were insufficient to address other needs. We do note that private sector organizations in several countries complained that they were not adequately consulted during negotiations.

4. What problems or constraints affected results?

As noted earlier, this intermediate result is unique for a regional program, as it actually consists of country specific activities that would normally be supported via bilateral USAID Missions. This resulted in an awkward implementation structure, involving multiple approval steps. Also, SIECA was assigned responsibility for direct contracting of goods and services to be used at the country level, because (1) PROALCA was the fastest available mechanism to disburse funds to benefit individual Ministries of Economy and (2) the internal management costs to USAID to manage numerous purchase orders and other procurements for each of the five countries would have been too costly and impracticable. On the whole, the arrangement appears to have worked surprisingly well, although frustration was experienced by those not familiar with SIECA's need to meet USAID procurement regulations. We received reports of delays in payment of fees, processing travel advances, purchase of airplane tickets, etc. for consultants contracted by SIECA as requested by at least one Ministry of Economy, although we did not determine if this resulted from delays by SIECA or failure to adequately document the requests.

The development and submission of proposals by each Ministry of Economy took a long time, resulting in delay of activity start-up. At times these delays were due to changing staff in the Ministry, and at other times by lack of understanding of the program.

Some countries were slower in implementing the program than were others, resulting in some reallocation of resources between countries prior to termination.

5. What are the strengths and weaknesses of the implementation units?

As noted above, there were some complaints about the speed of implementation by SIECA. At times this was due to unrealistic expectations, but in other instances it appears to have resulted from bureaucratic delays. It should be noted that SIECA did not receive an overhead or direct support for its increased operating costs for this IR. It also was not assigned a substantive role in directing the utilization of the resources as such decisions were the sole responsibility of the Ministries of Economy. It is remarkable that SIECA successfully assumed this responsibility, despite isolated examples of

inefficiency, since direct contracting for provision of goods and services within member countries is not a role that it normally assumes. It is also clear that this proved to be an extremely cost effective way for USAID to manage these limited resources. If a contractor had been hired to manage the program, a significant portion of the budget would have gone to cover administrative costs.

6. Quality of the technical assistance and training, its responsiveness to participant needs and lasting effects

The activities carried out under IR 4 were often the most visible PROALCA II activities in the Central American countries, as the educational activities affected many elements of society. However, the fact that SIECA's role in IR 4 was virtually that of a pass through institution (responsible merely for contracting goods and services selected by the recipient Ministries of Economy) clouds our ability to comment on the quality of SIECA's substantive input. As noted earlier, each Ministry of Economy was responsible for design of IR 4 activities, including selection of consultants and trainers, design of training courses, design of brochures and pamphlets, etc. SIECA only had an administrative role in the implementation of this component. In our interviews in the region, in general we received positive responses to the four questions posed above from public sector institutions that were the main recipients of the support, but this appears to be primarily due to the effective work of the Ministries of Economy.

7. Was there significant participation by women?

According to SIECA, 46% of the 4,223 participants in training events under IR 4 were women. Women were observed by the evaluation team to occupy many key positions in these public sector institutions visited, so it is not surprising that their participation in the training programs was significant. It should also be noted that in Costa Rica, one of the activities funded under IR 4 was an education program on the impact of CAFTA on women.

8. Was there a monitoring and evaluation plan?

As noted above, the SIECA performance monitoring plan was apparently elaborated prior to the creation of IR 4, and we did not find any performance reporting on this component. Each of the Ministries of Economy prepared a report at the end of FY 05 summarizing the activities carried out in FY 03 and FY 04 with program funds, and these reports did contain information on number of workshops and seminars held, number of pamphlets and bulletins produced, etc. But there are no targets against which to measure this performance.

USAID/G-CAP reported on the following indicators in its annual portfolio reviews:

- TCB assistance to the nine negotiations meeting to end by Q2 of FY04.
- TCB assistance to Ministries of Trade/Economy: Percentage of allocated funds implemented.

- Number of people trained.
- Technical assistance (person-months) to Ministries of Trade/Economy.

The results reported against these indicators show that the targets were either reached or substantially exceeded. However, these are all indicators of outputs rather than impact. Therefore, we conclude that neither USAID nor SIECA had an appropriate monitoring and evaluation program to measure impact under IR 4.

9. Was the implementing staff performance efficient and effective?

We received mixed reviews on the speed with which SIECA performed its duties under IR 4. The Ministry of Economy staff in the region praised SIECA's performance and with a few exceptions USAID staff generally felt that performance met expectations, although there were a few USAID staff members who felt that SIECA's management of this program was poor. The generally positive appraisal is remarkable since, as noted earlier, the administrative and funds management functions it performed under IR 4 were different from those that it normally assumes. This effort was also an exception for USAID, as the activities implemented would normally have been funded directly by the bilateral Missions, probably via a US implementing contractor or partner. IR 4 was created in response to a Bush Administration initiative, and there was strong emphasis on having this assistance implemented in an expedited manner. It appears that SIECA rapidly put the administrative procedures in place to meet this expectation, but the program was delayed by slow planning in the Ministries of Economy.

10. What lessons have been learned?

The most important lesson learned is that donor resources can be channeled to public education programs that have a significant impact on attitudes in a region like Central America, and this can play an important role in achieving important policy decisions. Clearly, sole responsibility for CAFTA approval and implementation cannot be given to PROALCA II, but it was an important contributing factor.

A second important lesson is that SIECA and the Ministries of Economy did not prove themselves to be effective channels of assistance to private sector organizations. Whether this is because the assistance to public sector institutions warranted higher priority, given the limited resources, or that these institutions do not have effective linkages to serve as channels for this assistance, is unclear. If assistance is ever to be channeled to private sector entities through such a mechanism in the future, this issue should be carefully examined.

11. What else needs to be done?

The Costa Rican legislature still must approve both the CAFTA treaty and the implementing regulations. PROALCA II played a very useful role in obtaining such approval in the other Central American countries, and consideration might be given to

providing additional support for public education in Costa Rica. USAID will need to await an indication from the new Arias administration in Costa Rica of the path it intends to follow before it can be decided whether additional support for public education would be warranted there. Since there is no USAID Mission in Costa Rica, any such support would probably need to be implemented via SIECA in consultation with the U.S. Embassy in Costa Rica.

Considerable work remains to prepare the public sector institutions in Central America to meet their responsibilities for CAFTA implementation. Only El Salvador seems to have made significant progress in getting ready, but much remains to be done there also. This appears an appropriate area for USAID investment during the next several years. However, it is not clear that this investment should be made via regional as opposed to the bilateral programs. Achieving rapid and effective implementation of CAFTA should be a major objective of each bilateral Mission, and it would seem more efficient to manage resources targeted at the disparate requirements for CAFTA implementation in the five nations via bilateral assistance programs.

Finally, considerable work also must be done to prepare the private sectors in each of the Central American countries to compete under CAFTA. Again, this would seem to be a more appropriate task for the bilateral Missions, especially considering the fact that such assistance did not receive priority attention under PROALCA II. The one area where a regional assistance mode might be appropriate would be dissemination of US sanitary and phytosanitary requirements, and harmonization of these policies in Central America.

III. Conclusions and Recommendations

Conclusions about the impact of PROALCA II on trade policy, economic integration, labor market efficiency, and preparation for CAFTA were described in detail in section II. In addition, specific recommendations were made concerning potential future program initiatives and implementation mechanisms. In this section the evaluation team will outline its assessment of the major program impacts across the program, and the key challenges and opportunities that warrant future USAID attention.

A. Conclusions

The following are the key cross program conclusions concerning implementation and impact:

- The program components were well designed and provided timely assistance to the renewed Central American political commitment to open market economics.
- Central America has made impressive progress over the past five years in harmonizing external tariffs, improving intra-regional trading efficiency, and preparing for dynamic integration into the world economy. However, the task remaining to consolidate these initiatives is enormous.

- SIECA provided excellent leadership to the PROALCA II program, and its technical competence was surprisingly high. Central American leaders have asked SIECA to assume new roles in recognition of its improved competence. At the same time, many interviewees commented that SIECA needs to significantly improve its administrative processes and become more results oriented.
- Many of the professionals who managed key components of the PROALCA II program were paid with program resources, and their future employment status is in question. The new assistance from the European Commission in support of the customs union may enable SIECA to keep some of this staff.
- The Central American governments need to review SIECA's mandate and funding. The customs union and CAFTA will require permanent regional support mechanisms, and if SIECA is to assume this role, its budget will need to be realigned accordingly, and appropriate funding provided by the region's governments.
- SIECA did not prove to be an effective channel for communication with and assistance to the private sector. However, regional organizations representing the private sector at this point appear weak and ineffective. And SIECA has never been given a mandate to provide direct assistance to national level private sector organizations, as this is the prerogative of each of the Ministries of Economy.
- Very little assistance has been provided by SIECA to the private sector to help prepare it for the new challenges of CAFTA. Using other available contract and grant instruments, however, PROALCA II did finance assistance to the private sector. Those included the "Continuous Improvement in the Central American Workplace" alliance between USAID, Development Alternatives, Gap, Inc., Social Accountability International, and the International Federation of Textile, Apparel, and Leather Garment Workers; the "Alliance for CAFTAction" between USAID, Caribbean-Central American Action (CCAA), and the American Chambers of Commerce; training in technical barriers to trade and in electronic commerce through Nathan Associates, Inc.; and trade and commercial law assessments in each of the CAFTA countries prepared by Booz Allen and Hamilton. In addition, substantial amounts of trade capacity building technical assistance and training to private enterprises were channeled through USAID bilateral missions in the region.
- SIECA's assistance to labor ministries was judged as excellent in some instances and weak in others. However, the level of funding under PROALCA II for this initiative was minimal, and it appears that SIECA made effective use of the resources.
- PA Consulting received almost uniform praise for its assistance. Its efforts were seen to be well focused, both in terms of integration of the electrical grid and modernization of the codes in the assisted countries.

- The initial Activity Approval Document contained a matrix to be used in measuring program impact that contained appropriate indicators and identified how the required information should be gathered. However, the Mission and the implementing partners did not define baseline data, set targets for performance, or obtain the required information. The performance monitoring reports from SIECA and PA Consulting focused exclusively on outputs, not results.
- SIECA did record information on participants in training events disaggregated by gender, and women participated in almost equal numbers with men.

B. Future program initiatives

The following are considered the most important priorities for future assistance:

- The most critical priority for future USAID assistance is to assure the successful implementation of CAFTA. CAFTA is far more than a simple trade agreement, as it represents an integration of the economies of the US and the C.A. region, and requires profound changes in the C.A. countries' legal and institutional norms. Assistance will be needed to support their efforts to address the ramifications of this new status, including improving their legal and regulatory framework, promoting good governance especially in areas pertaining to business, simplifying procedures for starting and operating businesses, improving the infrastructure needed for trade, and adopting and enforcing world standards of fundamental labor rights.
- The Central American countries must greatly improve the environment for business activities, as reflected in the World Bank's *Doing Business in 2006* database. In the past, USAID support for regional initiatives has focused more on improving regional trade, rather than on extra-regional trade (with the latter addressed more by bilateral Missions). However, the new dynamic of regional integration and interdependence should not be ignored, as PROALCA II clearly made significant contributions to regional efficiencies. USAID should recognize that some of the solutions to improved extra-regional trade should be pursued on a regional basis.
- The significant reduction of regional trade barriers has proven an effective incentive for private sector entrepreneurs to expand regionally. While this process promises substantial benefits to the region, it also creates risks. Unless the region adopts appropriate competition policies, monopolistic tendencies may create large inefficiencies. As an example, it is currently less expensive to fly from Guatemala to Costa Rica (a route with competition) than it is to fly from Guatemala to San Salvador (no competition). This issue should be addressed regionally, although the ultimate legal remedies may require national legislation.

- Although CAFTA is in many respects a collection of bilateral agreements, the terms of these agreements concerning rules of origin, sanitary and phytosanitary standards, product registry, and many other matters will be extremely cumbersome without a fully functioning customs union. The European Commission is providing assistance with certain aspects of the custom union consolidation, but the task is very large and USAID should consider further assistance. The key agenda items are to complete external tariff harmonization, attain harmonization of tributary policies, adopt uniform sanitary and phytosanitary standards, and address migratory policies.
- Although USAID has provided important assistance to regional energy and transport policies in the past, given funding limitations, and the important initiatives in these areas by other donors, it would appear that these warrant less attention for USAID in the future. However, this assumes continued implementation of the Plan Puebla Panamá program, supported by the Government of Mexico, the IDB, and BCIE.
- Effective implementation of CAFTA also requires that labor policies and practice meet world standards. The weak link in achieving this objective is the status of the region's Ministries of Labor, as well as the effectiveness of the judicial sector in addressing labor issues. Bilateral USAID Missions are probably better positioned to address these concerns. However, there is also a need to modernize labor codes and reduce labor market rigidities, and this might be best addressed through a regional effort.
- Implementation of CAFTA will require creation of effective implementation oversight institutions in each country, and the private sector also requires extensive orientation concerning the new standards and regulations governing their activities (whether they are exporting or competing with imports). While such assistance was envisioned under PROALCA II, it is clear that these initiatives are more easily addressed by bilateral Missions (except for Costa Rica).

C. Implementation options

The previous section commented on what future initiatives could be more effectively addressed via bilateral programs, rather than regional initiatives. The following provides recommendations for implementation options for those activities that are determined to be regional in nature.

- In preparation of this report, the evaluation team considered a wide range of options for potential future implementation partners. Particular attention was given to the Instituto Centroamericano de Administración de Empresas (INCAE), the Banco Centroamericano de Integración Económica (BCIE), and the Sistema de la Integración Centroamericana (SICA). For issues related to the consolidation of the customs union, and facilitation of compliance with key CAFTA provisions, none of these regional organizations has the institutional mandate, technical

competence, and access to regional decision makers as does SIECA. This is not to say that these institutions do not have a role to play, but primary regional responsibility for future progress in the themes addressed by PROALCA II will certainly remain with SIECA.

- The one exception may be issues related to labor law and labor-management relations. SIECA has just recently started to address these issues. The US Department of Labor is channeling significant assistance in this area through its “Cumple y Gana” project implemented with the US consulting firm Abt Associates and FUNDAPEM, an NGO based in Costa Rica. As previously mentioned, this project’s goal is strengthening labor law enforcement in Central America and is concentrating on a number of institution-building activities.. USAID will apparently focus its future efforts on improvement of the judicial sector’s capacity to enforce labor codes. USAID has extensive experience with the implementation of administration of justice projects through a small group of very specialized consulting firms, and this may be an effective route for its future assistance to labor courts.
- SIECA is a much more effective institution that it was 10 or 20 years ago. However, it is important to structure any future assistance program through this institution in a way that will maximize the incentives for efficient performance. Several interviewees commented on the fact that at times SIECA’s bureaucratic processes have delayed program results. USAID should examine options to structure any future assistance via a results based grant that will disburse resources against agreed targets achieved, rather than expenses for process activities.
- The “implementation options” question was asked in terms of potential future USAID project initiatives. However, perhaps the more important question is, “What are the institutional implementation options for CAFTA?” SIECA is the technical secretariat of the Central American Ministers of Economy, and in prior years its role was basically limited to collecting and publishing data and analyses, and coordinating negotiation sessions, as requested by the Ministers. However, SIECA is now beginning to assume permanent implementation responsibilities related to CAFTA and the customs union. The responsibility for funding these permanent functions clearly rests with the Central American governments, but it is likely that it will take time to define and consolidate the needed support. In the meantime, USAID should consider providing bridge support (keyed, as noted above, to specific results). SIECA has made enormous progress in improving its technical competence, and it would be a terrible mistake to lose this at the point where its regional role is most critical.
- One possible solution for consolidating the funding of SIECA’s new regional roles, which was expressed by one of the interviewees, is for SIECA to negotiate a substantial loan from the World Bank or the IDB, with the objective of facilitating further economic integration in Central America, and successful

implementation of the CAFTA agreements. The loan would be guaranteed by the five C.A. countries, and they would have to assume proportional responsibility for its repayment. The funds generated through such a mechanism would guarantee coverage of the institutional oversight and implementation responsibilities incurred under CAFTA, and the customs union, over a fifteen to twenty year period. However, given normal IDB and World Bank processes, it would take a minimum of several years to establish such an arrangement.

Description of the Evaluation Team

Wingerts Consulting has successfully provided technical assistance to developing countries and donor agencies over the past ten years on a broad range of economic and social development issues. The firm's vision is that development initiatives succeed through excellence in program management, activity design, and project implementation. All activities must be based on best technical practices and on careful attention to the needs of all stakeholders. Wingerts Consulting has completed over 50 consulting assignments in 20 developing countries (Egypt, Jordan, Guatemala, Honduras, Colombia, Peru, Ecuador, Panama, the Dominican Republic, Jamaica, Grenada, Eritrea, Mozambique, South Africa, the Philippines, Slovakia, Macedonia, Bulgaria, Romania, and Kazakhstan). The following provides background information on the team members:

Stephen Wingert

Mr. Wingert is a retired senior Foreign Service officer and owner of Wingerts Consulting. He has worked on development issues in Central America for four decades, starting as a Peace Corps Volunteer in Guatemala in 1968. He joined USAID in 1976, and among significant assignments he served as Deputy Mission Director in Guatemala (1989-93) and Mission Director in Costa Rica (1993-95). In both of these roles he played a leadership role in promoting policies facilitating free trade arrangements in Central America, and between the region and the US.

Since retiring from USAID ten years ago, Mr. Wingert has served successfully as a consultant in a broad range of development issues. In 2004, Mr. Wingert led the development of the regional program plan for the USAID Central American and Mexico program. In 1998 he evaluated the proposed Guatemalan Industrias para la Paz strategic initiative, and in 1996 he guided the design of the USAID/G-CAP country strategic plan to support the Peace Accords in Guatemala.

Mr. Wingert had direct responsibility for assessing the extent to which the PROALCA II program assisted with Effective Central American Preparations for Trade Negotiations. He also was responsible for analyzing the extent to which the program took into consideration women in development issues. He has focused extensively on these concerns, both as a senior USAID officer and in his work as a consultant.

James Fox

Mr. Fox spent seven years as the chief of economic growth evaluation for USAID's Central Evaluation Unit, CDIE. During that time, he led several important evaluations in Central America, including an assessment of the overall impact of U.S. assistance to Costa Rica, an impact assessment of non-traditional agricultural exports from Guatemala, and an evaluation of the impact of food aid in Honduras. After leaving USAID in 1999,

Mr. Fox continued to work on evaluations in Central America, assessing the impact of competitiveness-promotion programs in El Salvador for the Inter-American Development Bank, and of the overall program of the World Bank in Honduras between 1994 and 2005, for the World Bank's Independent Evaluation Group.

Mr. Fox's Central American experience spans more than four decades. As a Peace Corps volunteer, he spent two years teaching engineering at the University of El Salvador in the mid-1960s, returned to the region in 1970 as the USAID economist in Costa Rica, and continued his involvement through the 1980s and early 1990s as chief economist for the LAC bureau at USAID. He helped design the Central American Initiative that flowed from the Kissinger Commission Report in 1984, and made frequent trips to the region during that entire period. In 2000, he prepared a report for USAID/Guatemala on possible new directions for the Central American regional program. For that exercise, he visited all five Central American countries, talking with government, academic, private-sector and civil-society leaders. His prior visits to all five countries for this purpose were in 1983, to lay the groundwork for a Central American strategy, and in 1987 to assess progress. In 2004, Mr. Fox helped design a new EG strategy for USAID/El Salvador.

Mr. Fox is widely recognized as an expert on *international trade*, and he had the lead role in assessing the impact of PROALCA II on trade liberalization. His evaluation with Cressida McKean of previous USAID promotion of trade and investment in 1994 still stands as one of the most important studies of these issues. More recently, his evaluation of USAID's activities in export promotion and trade capacity building identified the weaknesses of recent USAID practice in this area. His study for USAID of the economics of regional integration among developing countries in 2004 is an important reference for thinking about the topic.

Charles Richter

Mr. Richter has more than 30 years experience working on economic development issues in Latin America, primarily in Central America. He served as chief economist in USAID Honduras from 1988 to 1992, and worked on Central American issues for the IDB from 1992 to 2003. He served as head of the IDB Country Division's Economic and Strategy Unit, which oversaw preparation of IDB Country Strategies, supported country-led Poverty Reduction Strategies, and promoted reforms to enhance economic growth through sound economic policies, competitiveness, trade and integration. He has worked with and supervised analyses of key institutions in Central America while with the IDB and USAID.

Mr. Richter has a strong knowledge of Central America (CA) -- in particular, its economics, politics and institutions, having worked as an economist in the five CA countries and Belize for about 25 years with the IDB, USAID and the UN/TCO. Mr. Richter took the lead role in addressing the PROALCA II impact on IR 2: Accelerated Central American Market Integration. He has performed institutional analysis of SIECA and other key Central American institutions while with the IDB.

Mr. Richter also has considerable experience with program evaluation, having worked in the IDB for the past two years on an effort to measure the effectiveness of the Bank, which entailed setting up Bank goals and measuring whether it is on a path toward attaining them. Finally, while working as an economist with USAID Egypt, Mr. Richter prepared an in-depth economic assessment of proposed energy sector strategies, and he took the lead in assessing the impact of the PROALCA II assistance in this area, with support from the other team members.

Juan Buttari

Mr. Buttari served for 20 years with USAID, including assignments in USAID Missions in Honduras and El Salvador. As Chief Economist for the Africa Bureau, Mr. Buttari led, on behalf of USAID, the successful reformulation and launching of President Bush's Trade for African Development and Enterprise (TRADE) Initiative. Since retiring from USAID in 2003 he has worked as a senior consultant and researcher on development economics. Prior to joining USAID, he was regional economic advisor for Central America and the Caribbean with the International Labor Organization. During that time he was based in Guatemala and in Panama and traveled frequently to all CA countries.

Mr. Buttari authored a working paper on the Free Trade Area of the Americas Initiative in the late 1990s that assessed how countries were likely to gain from the agreement based on their institutional and policy framework. He has also published analyses of trade, industrialization and reforms in Central America, addressing outcomes and lessons learned. Finally, he is conducting ongoing work on CAFTA which seeks to identify the comparative advantage of the Latin American signatories in specific industries as indicated by trade flows and quality of institutions.

Throughout Mr. Buttari's career he has taken special interest in policies that affect employment creation, and he took the lead in examining the PROALCA II impact on intermediate result 3; More equitable and efficient labor markets

Individuals Interviewed

Guatemala

Institution	Name	Title
USAID	Glen Anders	Mission Director
USAID	Jim Stein	SO 5 Team Leader
USAID	Ana Vilma Pocasangre	PROALCA Program Manager
USAID	Josefina Martinez	SO 5 Team
USAID	Zoila Aurora Letona	SO 5 Team
USAID	Liliana Gil	SO 5 Team (PRM)
U.S. Embassy	Troy Fitrell	Labor Attache
SIECA	Haroldo Rodas Melgar	Secretario General
SIECA	Alfonso Pimentel	Director Ejecutivo
SIECA	Laura Quinteros de Aguilera	Directora, Dirección de Integración y Comercio
SIECA	Maynor Ottoniel Alarcón	Director General de Asuntos Jurídicos
SIECA	Edgar J. Chamorro Marín	Asesor de la Secretaría General
SIECA	Hugo Ruano	Asesor
SIECA	Rubén E. Nájera	Coordinador del Proyecto de la Unión Europea
SIECA	Alvaro Sarmiento	Coordinador del Proyecto BID/SIECA Modernización de Aduanas y Pasos Fronterizos
SIECA	Silvia Rivera	Asistente del Director Ejecutivo
SIECA	Ana Vilma de Pontaza	Asesor Registros
SIECA	Edna Valenzuela	Consultora de PROALCA
SIECA	Jorge Ardon	Técnico Especialista en Procedimientos Aduaneros
SIECA	Pluvio Mejicanos	Técnico en Tributos
Palacios & Asociados	Marco Antonio Palacios Lopez	Abogado y ex-funcionario SIECA
Ministry of Economy	Julio René Aguilar	Asesor del Vice Ministro
Ministry of Economy	Ana Clarisa Villacorta Cabarrás	Coordinadora Departamento de OMC
Ministry of Economy	Victoria Mesa	Directora de Integración
Ministry of Economy	Sonia Lainfiesta	Coordinadora de Política Comercial Externa
Ministry of Labor	Bertha Leonor Falla Alonzo	Directora de Planificación y Cooperación
Superintendencia de Administración Tributaria (SAT)	Lic. Francisco Ovando	Intendente de Aduanas
Gobierno de Guatemala	Richard Aitkenhead	Comisionado Presidencial para el Seguimiento al Plan de Gobierno
AGEXPRONT	Fanny de Estrada	Directora Ejecutiva
PA Consulting	Ignacio Rodriguez	

El Salvador

Institution	Name	Title
USAID	Tully Cornick	Deputy Mission Director
USAID	Larry Brady	Regional Deputy Mission Director
USAID	Lawrence Rubey	Director, Economic Growth Office
USAID	Carlos Arce	Manager, Trade and Enterprise Development
USAID	Victoria Walton	Sr. Regional Trade & Investment Advisor
USAID	Flora de María de Rivera	
U.S. Embassy	Jessica M. Webster	Economic Attaché
U.S. Embassy	Philip Alan Thompson	Labor Attaché
U.S. Embassy	Geoffrey F. Schadrack	Second Secretary, Economic Affairs
Ministry of Economy	Jorge Mauricio Guzmán Valdéz	Subdirector Política Comercial
Ministry of Economy	Sulma de Martinez	Directora de Cooperación Internacional
Aduanas	William García	Director Adjunta
Ministry of Labor	Walter René Palacios	Director de Relaciones Internacionales de Trabajo
Ministry of Labor	Elia Estela Avila de Peña	Asesora del Despacho Ministerial
SICA	Carlos Roberto Perez G.	Director de Asuntos Económicos
FUSADES	Emma Arauz M.	Directora, Programa de Promoción de Inversiones y Diversificación de Exportaciones
FUSADES	Carlos Orellana Merlos	Gerente, Sección Economía Internacional
FUSADES	Carolina Alas de Franco	Analista Señor = Sección Economía Internacional
Superintendencia General de Electricidad y Telecomunicaciones (SIGET)	José Calixto Arias	Asesor Económico
CIMA	Ricardo Vaistero, Reynaldo Ruano, Joaquín Guzmán, Luis Carlos Duarte, Rosario Abrego de Barriere	Directors

Honduras

Institution	Name	Title
USAID	Randall Peterson	Deputy Mission Director
USAID	Julius Schlotthauer	Senior Economist and Donor Coordinator
USAID	Porfirio Fuentes	Office of Agriculture, Development and Trade
USAID	Eduardo Chirinos	Specialist in Program Development
U.S. Embassy	Derrick M. Olsen	Chief Political Section
U.S. Embassy	Swati M. Patel	Political Officer
Office of the President	Ricardo Arias Brito	Under Secretary of State PROALCA specialist on CAFTA Negotiations
Ministry of Industry and Trade. Hugo Castillo	PROALCA Coordinator CAFTA negotiations	Honduras
Ministry of Industry and Trade	Mario R. Martinez	General Director for Economic Integration and Commercial Policy
Ministry of Labor	Mirta Madariaga de Bueso	Honduran Coordinator Cumple y Gana Project
Central American Bank for Economic Integration	Marvin Taylor	Chief Economist
Fundacion de Inversiones y Desarrollo de Exportaciones (FIDE)	Arturo Chavez	Executive Director
Individual	Norman Garcia	FIDE Executive and Former Honduran Ambassador to the United States
Individual	Carlos Alvarez	PROALCA Specialist on CAFTA Negotiations
Individual	Jacquelyn Fuglia	CAFTA Negotiator
Individual	Caelo Montenegro	CAFTA Negotiator
Individual	Jackie Cruz	former assistant to Minister of Labor Official responsible for PROALCA Program activities

Nicaragua

Institution	Name	Title
USAID	Steve Olive	Chief, USAID's Trade and Agribusiness Office
USAID	Tim O'Hare	USAID Trade Advisor (PSC)
US Embassy	Jeffrey Giaque	Labor Attaché
Central Bank	Mario Arana	President, and he led the CAFTA negotiations for Nicaragua when he was Ministro de Fomento, Industria y Comercio
APEN (Asociación de Productores y Exportadores de Nicaragua)	Jorge Brenes	Gerente General
Ministerio de Trabajo	Virgilio Gurdian Castellón	Ministro de Trabajo
Ministerio de Trabajo	Luis Rodríguez,	Asesor del Ministro
Ministerio de Trabajo	Licda. Yadira Martínez	Directora de Cooperación Internacional
Ministerio de Fomento, Industria y Comercio (MIFIC)	Ana María Tórriz	Dirección Negociaciones Comerciales Internacionales
Comisión Nacional de Energía (CNE)	Gioconda Isabel Guevara	Directora de Políticas Energéticas

Costa Rica

Institution	Name	Title
Individual	Eduardo Lizano	former president Banco Central de Costa Rica
Individual	Ricardo Monge	former chief economist CINDE
Individual	Silvia Saborio	former Alternate Executive Director IDB
US Embassy	Whit Witteman	Economic Counselor
US Embassy	Brian Simmons	Labor Officer
US Embassy	Maria Villanueva	Coordinator with USAID

Status of Central American Labor Markets

This section describes conditions in Central American labor markets from two complementary perspectives. The first one briefly goes over aspects of job quality and the potential to generate good jobs. The second presents the conclusions of recent reviews of the labor law framework in the region.

Jobs and Economic Growth

With high rates of labor force growth and gross capital formation Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua (the CAFTA-5) have high economic growth potential.³ However, from 1994 to 2004 these countries experienced annual GDP growth rates ranging from 2.8 percent (El Salvador) to 4.4 percent (Costa Rica). Economic growth rates of around 4 percent are not trivial. But they are a far cry from the growth rates experienced by many emerging economies – the “Asian tigers” for example – and the growth rates needed to significantly reduce poverty.

Why are Central American countries not achieving their growth potential? Disincentives to the efficient allocation of resources resulting from market rigidities are an important factor. For example, labor market rigidity in the region is high. The World Bank’s Rigidity of Employment Index (the higher the index, the more rigid the labor market) shows the following. As of 2004, the OECD index was 34.4 while the Central American average was 44.0. Honduras and Costa Rica had the least rigid labor markets in the region with indexes of 31 and 35 respectively; El Salvador and Nicaragua had the most rigid labor markets with indexes of 52 and 51; and Guatemala held a middle position with an index of 40.

A result of labor market rigidities is the existence of a broad informal labor market in Central America. According to International Labor Organization data, informal employment for the CAFTA-5 averaged some 52 percent,⁴ and 2005 reported unemployment for the region was high. For example: Costa Rica experienced a total unemployment rate of 15 percent; El Salvador reported an urban underemployment rate of 33 percent; Guatemala’s total unemployment rate was 32 percent; Honduras invisible underemployment rate was 23 percent; and Nicaragua’s total unemployment rate was 16 percent.⁵ While such unemployment rates are not strictly comparable, together with the

³ For the period 1998-2004 annual labor force growth ranged from 2.2% for El Salvador to 3.4% for Guatemala with a mean rate of 2.8 % for the CAFTA-5. Relative to GDP, gross capital formation in 2003 ranged from 16.5% (El Salvador) to 35.7 (Nicaragua) with a mean rate of 24% for the same countries. See World Bank, “Country at a Glance” data.

⁴ The ILO measures such sector as the sum of own account workers (excluding professionals and technicians), unpaid family workers, employers and employees in establishments with less than five persons engaged, plus domestic workers. The informal employment rate is obtained by dividing the informal sector by the number of employed workers.

⁵ Figures are from Banco Centroamericano de Integración Económica, “Tendencias y Perspectivas Económicas de centroamérica,” October-December 2005.

sizeable rates of informal employment, they are a strong indicator of inefficient allocation of labor and low productivity.

In sum the region suffers from high levels of underutilized labor resources and low productivity that translate into relatively low real wages. Therefore a key policy objective must be enhancing the productivity of Central American workers to facilitate sustained economic growth with higher quality jobs.

Labor Law and Enforcement: Recent Reviews

The Central American countries are largely in conformity with the fundamental International Labor Organization (ILO) obligations. Moreover an April 2005 “Report to the Ministers Responsible for Trade and Labor in the Countries of Central America” notes that the region has a recent record of labor law reforms and a robust record of ratifications of the ILO Convention covering the fundamental labor standards. However, as determined by the ILO, the enforcement of those laws needs more attention and resources, and the ILO made recommendations for improvements.

The April 2005 report echoes such recommendations but underlines the serious resource limitations Central American countries face and the challenge that high rates of idle labor resources represent (see preceding subsection). Despite those limitations and challenges progress has been made.⁶ According to the 2005 report, the greatest concerns are:

Labor law and implementation. In this area the particular concerns are freedom of association, trade unions and labor relations, and inspection and compliance. The issues are enforcement of the freedom of association and the effectiveness of labor inspections. *Budget and personnel needs of the Labor Ministries.* In general labor ministries suffer from relatively limited budgets and inadequate staffing.

Strengthening the judicial system for labor law. The issue is the frequent delays in the resolution of cases. Such delays are in part the result of too few judges, support personnel and equipment. In addition many of the judges, lawyers and other involved parties lack adequate training on national labor law and international labor standards.

Protection against discrimination in the workplace. The problem seems to be particularly acute in countries with a large maquila or free trade zone industry. Of special concern is the treatment of women.

Worst forms of child labor. While all Central American countries are participants in the ILO’s International Program on the Elimination of Child Labor (IPEC) and all have ratified ILO Convention 182 on the worst forms of Child Labor, the issue is generally present in countries of relatively low levels of income per capita.

⁶ The United States Trade Representative Office’s (USTR) website gives a number of examples of recent reforms that the USTR views as resulting from the CAFTA negotiation process.

Promoting a culture of compliance. This involves enhanced education on the obligations relating to fundamental labor rights and training in how to effectively implement them.

A framework for technical assistance and capacity building. The concern is having an adequate strategic framework and resources targeted to the priority issues. Also relevant, the region needs an on-going mechanism to assure follow through and coordination.