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STUDY OF THE BENEFITS AND CHALLENGES OF IMPLEMENTING THE DEEP INTEGRATION PROCESS FOR THE FREE TRANSIT OF GOODS: EL SALVADOR'S CASE

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ACRONYMS AND ABBREVIATIONS

ACI	Arancel Centroamericano de Importación (Central American import tariff)
BCR	Banco Central de Reserva (Central Reserve Bank)
BID	Inter-American Development Bank (IDB)
BM	World Bank (WBG)
CGA	Cámara Guatemalteca de Alimentos (Guatemalan Food Manufacturers' Association)
CAUCA	Código Aduanero Uniforme Centroamericano (Central American Uniform Customs Code)
CEPAL	Economic Commission for Latin America and the Caribbean (ECLAC)
CIFACIL	Comisión Intergremial para la Facilitación del Comercio de El Salvador (Salvadorean Inter-Association Commission for Trade Facilitation)
CFC	Centro de Facilitación del Comercio (trade facilitation center)
CCI	Centro de Control Integrado (integrated control center)
COMIECO	Consejo de Ministros de Integración Económica Centroamericana (Council of Ministers for Central American Economic Integration)
DGA	Dirección General de Aduanas (Customs Service)
DGII	Dirección General de Impuestos Internos (Internal Revenue Service)
DUCA F	Declaración Única Centroamericana para el comercio de mercancías originarias de la región centroamericana (Central American Single Declaration Form for Trade in Goods Originating in the Central American Region)
DUCA D	Declaración Única Centroamericana para mercancías importadas o exportadas con terceros países fuera de la región centroamericana (Central American Single Declaration Form for Imports or Exports with Third Countries Outside the Central American Region)
DUCA T	Declaración Única Centroamericana de Tránsito empleada para el traslado de mercancías bajo el régimen de tránsito internacional terrestre (Central American Single Declaration Form for the Transit of Goods in Transit Under International Land Transit Regulations)
ETD	Estudio de Tiempos de Despacho (customs clearance time study)
FMI	International Monetary Fund (IMF)
FEM	World Economic Forum (WEF)
FYDUCA	Factura y Declaración Única Centroamericana (Central American Single Invoice and Declaration Form)
MSF	Notificación de medidas sanitarias y fitosanitarias (SPS Notification - Notification of sanitary and phytosanitary measures)
OEA	Authorized Economic Operator (AEO)
PFI	Puesto Fronterizo Integrado (integrated border checkpoint)
PIC	Plataforma Informática Comunitaria (online community platform)
SICA	Secretaría de Integración Centroamericana (Central American Integration System)
SIECA	Secretaría de Integración Económica Centroamericana (Secretariat for Central American Economic Integration)
TN	Triángulo Norte (Northern Triangle: Guatemala, El Salvador, and Honduras)
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

On June 13, 2018, El Salvador signed the El Salvador Protocol for Accession to the Enabling Protocol for the Process of Deep Integration toward the Free Transit of Goods and Natural Persons between the Republics of Guatemala and Honduras (*Protocolo de Adhesión de la República de El Salvador al Protocolo Habilitante para el Proceso de Integración Profunda hacia el Libre Tránsito de Mercancías y de Personas Naturales entre las Repúblicas de Guatemala y Honduras*), thereby launching a process of transition toward El Salvador's full integration into the initiative undertaken by Guatemala and Honduras in June 2017. To complete the accession within the shortest possible timeframe, the government of El Salvador began the construction of new facilities at its primary border checkpoints, in an effort to achieve deep integration. After more than three years, complete accession has yet to be realized, although as of December 2021, a roadmap aimed at taking the final steps toward consolidation of the customs union is now being implemented.

The productive sectors linked to intraregional trade are also important stakeholders in this process, as a result, productive sectors have participated actively in supporting the government in transition-related activities. El Salvador's Inter-Industry Commission for Trade Facilitation (*Comisión Intergremial para la Facilitación del Comercio de El Salvador* – CIFACIL) served as an entity bringing together the country's most important trade-related business associations. Given CIFACIL role as productive actors, a need arises to determine the impacts of El Salvador's full integration into the customs union in the areas of commerce, investment, economic growth, public finance, employment, and the overall wellbeing of Salvadorean society.

Thereby, the Project conducted a study entitled *"Study of the Benefits and Challenges of Implementing the Deep Integration Process for the Free Transit of Goods: The Case of El Salvador"*. The study includes the identification of impacts in five essential areas of the customs union: economy, tax revenues, trade competitiveness, institutional framework, and regulatory framework. From the conclusions of the study, the Project formulates a series of proposals for steps to be taken to maximize the gains in efficiency deriving from trade facilitation in the three countries covered by the study, as well as in the Central American region as a whole.

DESCRIPTION OF THE STUDY

The study involved extensive field research, including the compilation of statistical data on trade and tax and customs revenues, and the conduct of interviews of different stakeholders in regional trade, including government agencies in El Salvador, Guatemala, and Honduras, private trade associations, businesses in the most representative sectors of the Salvadorean economy, international organizations, research centers, etc. It also included a series of field visits to the customs union's main border checkpoints, peripheral customs [1]offices, and facilities proposed by El Salvador for integration in the union. The purpose of these visits was to observe the potential benefits of the union "*in situ*" and ascertain the state of the installed capacity of El Salvador, Honduras, and Guatemala as it affects the integration of El Salvador.

[1] Peripheral customs given its denomination in Central American Economic Integration legal framework, and to what internationally is called a "yuxtaposed control" or "yuxtaposed customs".

REPORT ON THE ASSESSMENT'S FINDINGS OF THE IMPLEMENTATION OF THE CUSTOMS UNION BETWEEN GUATEMALA, HONDURAS AND EL SALVADOR

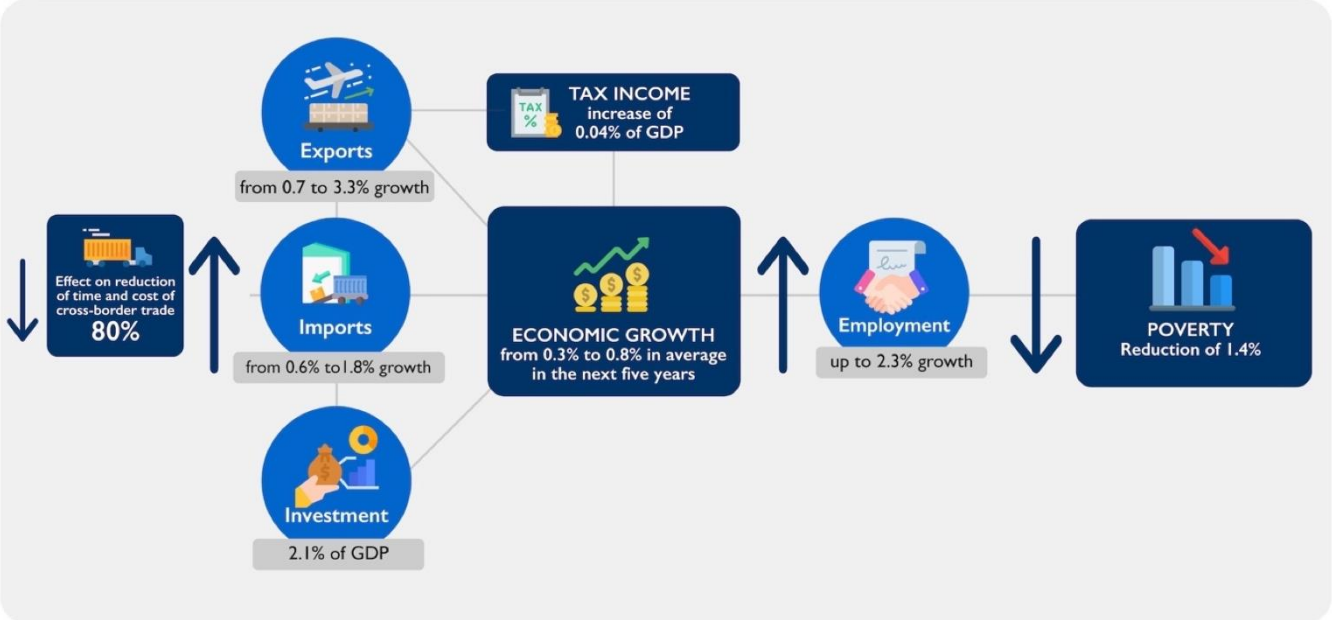
The economy

The total GDP of Central America was estimated at US$274.2 billion as of 2021, of which 50.1 percent was contributed by the Northern Triangle countries (Guatemala, El Salvador, and Honduras). Likewise, these three countries are home to 68 percent of the region's 51.1 million inhabitants. As far as trade is concerned, the Northern Triangle countries accounted for 53.7 percent of exports of goods from Central America in 2020, and 70 percent of intraregional trade. These figures demonstrate the importance of the customs union's economy, which can be strengthened even more by the full integration of El Salvador.

In terms of macroeconomic impacts, the efficiency gains in the conduct of trade with its incorporation in the union would help enable El Salvador to boost its annual rate of economic growth by as much as 0.8 percent, from 2.4 percent to an average of 3.2 percent, over the next five years. This improvement in its growth will be driven by an annual boost in its exports by as much as 3.3 percent and an annual increase in investment equivalent to 2.1 percent of its GDP. This would substantially increase employment (by 2.7 percent a year, equivalents to 6,464 new jobs) and reduce poverty by 1.4 percent.

These impacts demonstrate that El Salvador will be the country gaining the most from its full integration into the customs union. This assertion has been corroborated by studies conducted by ECLAC (the Economic Commission for Latin America and the Caribbean), the IDB (the Inter-American Development Bank), and the World Bank (WBG). On the contrary, if the country does not join the union, it will see its growth slow by approximately 0.2 percent.

Graphic 1. Macroeconomic impacts projected for El Salvador, due to the Customs Union



Tax revenues

One of the biggest myths associated with customs unions is that reductions in tariffs on trade result in a decline in tax revenues. The study made an analysis of this issue, looking to either corroborate or refute this myth, concluding that, in fact, the establishment of schedules of goods allowed to move freely within a common customs territory, with an eventual total future phase-out of tariffs altogether, will produce only a minimal loss of tariff revenues since most tariff items already have an effective import tariff rate of zero percent. Moreover, this loss would be largely offset by the boost in VAT or value added tax revenues and revenues from excise taxes, that would derive from the increase of intra-regional trade.

In brief, customs revenues could be reduced by as much as US$1.6 million over the next five years, but revenues from value added taxes would increase by US$58.7 million over the same period. Based on conservative estimates, El Salvador would see a net increase in its annual tax revenues equivalent to approximately 0.04 percent of GDP. In addition, the dynamic effects of the increase in trade with the growth in economic activity and productivity gains will generate larger revenues from domestic value added taxes, excise taxes, and income taxes.

The potential for the triangulation of goods raises an important issue to consider in this region. A number of business owners had been hoping to capitalize on tariff preferences granted to one of the union's member countries by another "rest of the world" country, mainly through a free trade agreement, to then freely move these goods through the single customs territory without paying any tariffs in the country of destination. However, this situation is already covered in the customs union's regulatory instruments by excluding all goods with tariff preferences under free trade agreements and goods subject to different types of sanitary treatment. Thus, goods in free circulation are goods with harmonized tariffs and requirements, which rules out any possible triangulation.

However, the possibility still exists that new trade trade facilitation measures will encourage unfair trade as well as the circulation of illicit or prohibited goods across the national borders of customs union member countries. In this regard, the authorities of all three countries should strengthen their risk management systems and put in place mechanisms for the continuous monitoring and surveillance of highways and merchandise storage facilities.

Commercial competitiveness

The customs union is the product of a long list of trade facilitation measures introduced by the regional countries over a period of more than 20 years, but which started to gain momentum in June of 2014 with the announcement of a "Regional Trade Facilitation and Competitiveness Strategy with the Emphasis on Integrated Border Management." As of the end of 2021, there was visible progress in the implementation of all scheduled measures, resulting, in the specific case of the Northern Triangle, in a considerable improvement in the efficiency of trade between Guatemala and Honduras. This was achieved, mainly, through reductions of anywhere from 59 percent to 80 percent in border crossing times, translating into major cost savings for businesses and, thus, productivity gains.

The impetus from trade facilitation will help improve the rankings of the Northern Triangle countries in international country competitiveness indexes, particularly in areas such as transportation

infrastructure, customs procedures, logistics performance, etc. This impetus will also help promote the integration of business and production processes in the three member countries of the customs union. The high degree of complementarity among the three economies is striking, in which El Salvador benefits from the greater complexity of its industry. In other words, El Salvador supplies the region with industrial goods, unlike Guatemala and Honduras, which supply more final goods.

It is also important to note that the customs union is fertile ground for both the creation and deflection of trade. Furthermore, El Salvador's productive sectors reflect a considerable similarity to those of Honduras, in particular as regards finished goods, a situation that provides an opportunity for those industries enjoying the greatest productivity to be the ones to specialize in the manufacturing and trading of such goods, which will ultimately be to the benefit of consumers. In addition, there exists the possibility that, following the decrease in tariffs, market forces will substitute goods produced outside the customs union for those produced within the common territory, even though they may not come from the most efficient industries. In such a case, there would exist the possibility of a deflection of trade which, though beneficial to local producers, would have a negative impact on consumers.

El Salvador's official incorporation into the union could increase its exports to Guatemala and Honduras by as much as 62 percent over the next five years. In other words, its total exports to these two countries could grow from US$2,268.6 million in 2021 to somewhere around US$3,671.4 million by 2026, of which 75 percent will consist of goods in free circulation.

Its clear comparative advantages, together with the level of sectoral linkages present El Salvador with opportunities for expanding its intraregional trade in textiles and apparel, rubber and plastic products, paper products, and food products, in industries regarded as constituting "key" sectors due to their strong backward and forward linkages. Moreover, the beverage industry and flour-milling and bakery products are "engines" or drivers of growth due to their backward linkages, while the manufacturing of metal products and electronic equipment could develop into a "basic or strategic" sector as a supplier of inputs for other industries.

The study also helped identify new products or sectors affording opportunities for growth based on the country's production capacity. Major examples include vehicle parts, electric transformers, engine parts, electric engines and generators, and miscellaneous fabricated iron and steel products.

Regulatory framework

The study of this area involved an analysis of the customs union's current regulatory instruments and an examination of the steps to be taken by El Salvador as part of its integration process and the challenges faced by the country in this process. Some of the major issues in this area have to do with compatibility with the general regulatory framework for the Central American Economic Integration System and the countries' limitations in taking certain decisions whose general nature requires their backing by the other Central American countries. For example, any decisions with respect to the definition of the common external tariff must be made by the COMIECO (the Council of Ministers for Economic Integration). However, the regulations allow for the Northern Triangle countries to take certain decisions applicable to that subregion, independently of the rest of the Central American countries.

The study also includes an analysis of the goods in free circulation between Guatemala and Honduras as this pertains to El Salvador's incorporation into the union and, more specifically, to the country's challenges in adapting to the current goods schedules or the negotiation of changes in certain goods. Moreover, there is always a possibility of the establishment of bilateral schedules of goods in free circulation by Guatemala and Honduras, excluding El Salvador.

One important feature of the customs union is the no application of rules of origin within the single customs territory, regardless of its origin. Such a measure has certain advantages in terms of improving efficiency, but there is also a risk of it affecting production linkages within the region. By the same token, the free movement of goods means fewer customs controls, with the risk of promoting illicit trade. However, at the same time, the implication is that the countries will implement an efficient risk management system under the aegis of their internal revenue services. Trade facilitation also creates opportunities for imports of goods in violation of trademark laws and agreements with distributors, for which this area should also be reviewed.

Other issues examined in this area include the situation of the special regimes, especially free zones, which benefit from being allowed to transit through the fast lane of the trade facilitation centers, but which face some challenges to operate, given that not strictly speaking, the goods are not located in the customs territory of the Union. This situation also has effects on the logistics industry.

Institutional framework

One of the primary objectives of the study was to evaluate El Salvador's institutional capacity for its integration into the customs union. To accomplish this, a series of field visits were made to El Salvador's main border checkpoints with Guatemala and Honduras, which revealed the significant progress made by the country in its preparations for integration into the customs union. There are one-off projects for the construction of new infrastructure designed to meet trade facilitation needs. However, its Guatemalan and Honduran counterparts have not made much progress in this area. This suggests the need for better inter-country coordination for the upgrading of Integrated Border Checkpoints. Road infrastructure is equally important and is one of the weaknesses at all border crossings in the single customs territory, failing to comply with space requirements for ensuring quality service for the conduct of trade.

As far as coordination is concerned, all agencies present at border checkpoints need to work towards the same goal. This implies standardizing service schedules, providing checkpoints with adequate staffs, integrating personnel from both countries, providing staff with lodging and leisure facilities, etc. The Secretariat for Central American Economic Integration (SIECA) and the Council of Ministers of the Customs Union are taking the lead in this area.

The operations at peripheral customs offices within the union are also important for the customs clearance of goods at their point of entry into the single customs territory and their subsequent free movement to their country of destination which, combined with fast-tracking, would help improve efficiency. However, there has been only limited use of this procedure in the four years of the union's existence, which can be attributed mainly to security concerns over goods moving in transit through the other union member country.

The customs union is introducing the use of the Central American Single Invoice and Declaration (FYDUCA) form, a key trade facilitation tool representing another efficiency gain for businesses. It is a free, online form used for the prepayment of taxes and duties and as basis for the generation of an SPS Notification (*Notificación MSF*) for the fast-tracking of goods through trade facilitation centers at integrated border checkpoints (without selective inspections). Obviously, a mentioned earlier, this streamlined procedure presupposes the existence of a comprehensive "post border crossing" risk management system.

Trade facilitation has significantly shortened border crossing times for trade between Guatemala and Honduras. At the Corinto Integrated Border Checkpoint alone, the wait for a "green-track" vehicle was found to have been shortened from nearly 22 hours in 2016 to a mere four hours in 2018 (with the implementation of the customs union) and further cut back to three hours by January of 2022.

A similar time savings in trade with El Salvador could cut border crossing times by as much as 80 percent in all integrated border points.

Thus, reductions in border crossing times translate into efficiency gains and cost savings for businesses. Another benefit for businesses from the free movement of goods through the customs union is that they will no longer need to hire customs brokers, customs-authorized shipping agents, or merchandise inspection services, pay for data transmission services for the completion of customs forms, etc. Other advantages include coordinated border management, standardized operating schedules, common services, pre-inspections of goods at peripheral customs offices, etc.

In short, El Salvador's full participation in the customs union involves a series of strengths and opportunities. The former includes the streamlined decision-making mechanism in place at the highest level of government; implementation of the FYDUCA; creation of Trade Facilitation Centers (*Centros de Facilitación del Comercio* – CFC) and the Structural and Investment Fund (*Fondo Estructural y de Inversión*); availability of a sound SIECA-operated IT platform; and the advantageous use of El Salvador's newly installed border infrastructure. The most significant opportunities include accession to an ongoing process, i.e., avoidance of the need to start from scratch; the generation of economies of scale; the creation of trade; the potential for the private sector to participate in the process; and the potential for institutional updating.

There are, however, weaknesses affecting the process: a long list of goods excluded from free circulation, the current low level of integration of customs processes, a weak mechanism for *a posteriori* verification, low levels of utilization of peripheral customs agencies, ongoing bottlenecks at border crossings, as well as narrow tax routes and the lack of a fast lane for Integrated Border Checkpoints (*Puestos Fronterizos Integrados* – PFI). Possible threats include the absence of a roadmap to perfect Customs Union, negotiation of new unilateral trade agreements, illicit trade, the potential for negative impacts on certain sectors, and the stigma that the customs union will generate losses for the government.

CONCLUSIONS AND PROPOSALS

- El Salvador's full integration into the customs union process would benefit the country given the characteristics of its productive sectors and the complementary nature of the economies of the three countries.

- The customs union offers a significant opportunity for strengthening the economic integration of the Northern Triangle countries through the consolidation of a common customs territory, the strengthening of trade, and the increase in employment and the distribution of wealth.

- Many of El Salvador's productive sectors will benefit from deep integration, though there also exists the possibility that some sectors will be outcompeted by more productive businesses in Guatemala or Honduras. In such cases, with Government's support, those sectors should reinvent themselves in order to compete in the expanded common territory.

- At the operational level, PFIs currently operating between Guatemala and Honduras enjoy significant improvements that set them apart from traditional border crossings, though these have room for improvement, in both the primary territory as well as its access points.

- In addition to the new facilities currently under construction, the infrastructure at El Salvador's border crossing facilities also requires in-depth attention to enable them to be transformed into PFIs. This should be done over the short-to-medium term.

However, what should it be done to maximize the efficiency gains resulting from El Salvador's integration into the customs union?

- First, El Salvador must enter incrementally, with both prior and ongoing evaluations of the effects of the integration. In particular, there should be a focus on the adoption of lists of excluded goods, with negotiation of the bilateral lists of excluded goods to be adopted.
- It is necessary to take advantage of primary areas along national borders so as to properly situate all stages of the process involving trade-related dealings: customs, immigration, sanitary, administrative, lodging and rest facilities, areas for parking and inspection, access lanes, etc.

- It is essential that the governments of the three countries assign priority to the widening of the highways leading to border checkpoints.

- Agreements should be established among the various public organizations and countries involved for the exchange of information to assist in risk management and national security.

- As free circulation with El Salvador begins to take place, authorities at border checkpoints should coordinate their efforts in the areas of business and tourism services.

- El Salvador should carefully assess which peripheral customs offices should be created, with close consideration of the volume of trade entering the country from Guatemala and Honduras. In this regard, it is recommended to subscribe mutual recognition agreements to ensure that Guatemalan and Honduran authorities are duly represented to El Salvador's authorities and mutually assist with customs clearance operations, among other improvements.

- The country should design a standard and integral plan for *a posteriori* risk management, with the participation of customs, internal revenue, phyto – zoo sanitary authorities, public safety, SIECA, etc.

- The customs union will need to be strengthened from an institutional standpoint: appropriate Ministerial Body, PFI Coordinator, national customs organizations, the internal revenue organizations of each country, Advisory Committee, as well as institutions that play a key role in the administration and efficiency of the customs union.

- Finally, productive sectors should receive training in understanding the entire customs union process, including instruments used and best practices in the use of trade facilitation mechanisms. The government should support this process by providing opportunities for the enactment of industrial development policies and also by providing support to any sectors that might be negatively impacted by the customs union, particularly SMEs.

INTRODUCTION

Economic development is a process involving the total transformation of society that includes, above all, growing at sustained rates over an extended period of time. All actions focused on boosting economic growth are vitally important for achieving the ultimate objective. Regional integration is one such action, since by implementing measures promoting the free circulation of goods and individuals it is possible to contribute to increases in business productivity, an indispensable requirement for competing in the international market. The result is the assurance of increases in growth, investment, employment, and income.

In this context, the Central America Regional Trade Facilitation and Border Management Activity Project, financed by the United States Agency for International Development (USAID) and implemented by Nathan Associates Inc., seeks to strengthen the trade capacity and competitiveness of the countries of Central America. The Project supports the implementation of key elements in the framework of the World Trade Organization's Trade Facilitation Agreement (TFA), the Process of Deep Integration toward the Free Transit of Goods and Natural Persons between the Republics of Guatemala and Honduras (*Proceso de Integración Profunda hacia el Libre Tránsito de Mercancías y de Personas Naturales entre las Repúblicas de El Salvador, Guatemala y Honduras*), and the Central American Strategy for the Facilitation of Trade and Competitiveness, through work conducted jointly at the national and regional levels with key national and regional organizations, including customs agencies and the Ministries of Economy, Health and Agriculture of El Salvador, Guatemala and Honduras, as well as with businesses and business associations within the international trade sector.

El Salvador's Inter-Industry Commission for Trade Facilitation (*Comisión Intergremial para la Facilitación del Comercio* – CIFACIL) – consisting of the Salvadorean Industrialists Association (ASI); the El Salvador Association of Distributors (ADES); the American Chamber of Commerce (AMCHAM) of El Salvador; El Salvador's Agricultural and Agroindustrial Chamber (CAMAGRO); the Chamber of Commerce and Industry of El Salvador (CAMARASAL); the El Salvador Chamber for Textile Industry, Apparel and Free Zones (CAMTEX); and the El Salvador Corporation of Exporters (COEXPORT) – is the interinstitutional forum for ongoing and proactive consultation, specializing in the facilitation of trade and whose primary priority focus is the identification of the process of deep integration via the customs union, and whose efforts are supported by the government of El Salvador with a view toward bringing about the country's accession to the process launched by the governments of Guatemala and Honduras.

Within this framework, CIFACIL asked the USAID Regional Project to approve the preparation of a Study on the Benefits or Challenges of the Implementation of the Process of Deep Integration toward the Free Movement of Goods: The Case of El Salvador, together with identification of the impacts and returns to trade and investment if operational integration fails to take place. CIFACIL feels that is extremely important that the productive sector obtain a true measure of the impacts of El Salvador's incorporation into the deep customs union process, in light of the progress made by Guatemala and Honduras.

The study was conducted within the framework of the process for incorporating El Salvador into the customs union, which began in June 2018 with the signing of the Protocol for Accession to the

Enabling Protocol and which moved forward with the construction of new infrastructure at the primary border checkpoints between El Salvador and Honduras and between El Salvador and Guatemala. This is to be followed by implementation of a roadmap for implementation of the free transit of goods and individuals.

The study required conducting a broad research effort that included the gathering of statistical information on trade and on tax and customs revenues, along with interviews with a wide variety of actors in the field of regional trade: public agencies from El Salvador, Guatemala and Honduras, private business associations, businesses from those sectors most representative of the Salvadorean economy, international organizations, research centers and others. In addition, a series of visits were conducted to the customs union's primary border checkpoints, plus peripheral customs offices and those checkpoints proposed by El Salvador for inclusion in the customs union. The purpose of these visits was to obtain confirmation of the potential benefits of the union, as well as to assess the installed capacities of El Salvador, Honduras and Guatemala vis-à-vis El Salvador's entry into the union.

The report begins with a characterization of the processes of economic integration and customs unions, with an identification of the primary benefits and costs of such policy initiatives. This is followed by a description of the primary background scenarios, the implementation process, and the characteristics of the process used in creating the customs union between Guatemala and Honduras.

The central purpose of the study was to determine the impacts of customs union implementation in five key areas: macroeconomics, tariff revenues, trade competitiveness, regulatory framework, and institutional framework.

Macroeconomic and revenue impacts were measured across a five-year period (2022-2026) and took into consideration a process of tariff elimination on items that still have positive rates. It also includes an analysis of the potential for the triangulation of goods and the risks faced by the countries in the area of contraband and illicit trade.

In the area of trade competitiveness, the study includes an analysis of the competitiveness of the three countries of the Northern Triangle, the importance of trade facilitation, and the impacts of the customs union in terms of efficiency, production chains, new business opportunities, etc.

The study also includes an analysis of the customs union's regulatory framework and its relationship to the regulatory framework of the Central American region as a whole, as well as the strengths, weaknesses and challenges produced by El Salvador's incorporation into the process of deep integration. Followed by an analysis of the institutional framework of the customs union and of the operation of the main border checkpoints between Guatemala and Honduras, peripheral customs agencies, and those border crossings identified by El Salvador for transformation into Trade Facilitation Centers. This analysis identifies the primary strengths and critical areas for each locale.

Lastly, the study lists a series of conclusions and offers a series of proposals for steps aimed at maximizing the gains to El Salvador from its integration into the customs union. These recommendations include steps to be taken as regards the customs union in general, border infrastructure and operation of border checkpoints, institutional structure of the customs union,

the role played by the private sector, and the role played by the government in promoting competitiveness.

1. ECONOMIC INTEGRATION PROCESSES AND THE CUSTOMS UNION

CHARACTERIZATION OF THE ECONOMIC INTEGRATION PROCESSES

Economic development is something to which all countries aspire, and in that effort, in both the public and private sectors, steps are taken to strengthen the capabilities of economic agents, thus enabling them to increase their productivity and, thereby, adapt to the vibrancy of the global economy as competitive enterprises. Regional economic integration is one such action that has broadened development opportunities for those countries that have made the decision to unilaterally seek to become part of an economic bloc.

According to Balassa (1961, cited in Bartesaghi, 2012), economic integration is a process that involves actions aimed at eliminating discrimination among the economic units by which countries distinguish themselves. In this same vein, Baldwin (1997, cited in Bartesaghi, 2012), complements the idea put forth by Balassa, maintaining that regional economic integration involves a group of countries in a given region that decides to reduce or eliminate tariffs or barriers to the free circulation of goods, services and factors of production.

Countries seek to join together because countries are convinced that commercial exchange among countries increases overall wellbeing (Bartesaghi, 2012). From this author, the reasons that lead countries to join together include one of a purely natural nature: geographical proximity which, among other effects, leads to a decrease in the costs of transportation and in so doing increases the benefits of integration.

By the same logic, Tamames (2010), as well as Giordano and Quevedo (2006), cited in Bartesaghi (2012), state that additional factors motivating countries to negotiate integration agreements include the following:

- To achieve economies of scale resulting from increased production, which in turn results from the growth in commercial exchange
- To gain access to an expanded market where competition is increased
- To boost productive transformation
- To attract foreign direct investment
- To decrease the balance of payments problems of participating members, by virtue of savings in convertible currencies
- The possibility to become involved in activities in which they were previously unable to participate as a result of the insufficiency of their own internal markets, technological barriers, financial inability, and others
- Increase in their negotiating power by acting as an associative bloc

- The need to carry out structural reforms which, were they to remain isolated, would remain relegated to a lower degree of priority
- The potential to accelerate the process of development
- In some cases, to preserve peace and security (Petit, 2014)

The processes of economic integration are long standing, with their origins to be found in the German Customs Union (*Zolverein*), which was key to the unification of German states and which went into effect in 1834[2]. This was followed by the Southern African Customs Union (SACU), which has operated since 1889 and, although undergoing numerous modifications to the charter by which it was created, currently operates with the participation of Botswana, Lesotho, Namibia, South Africa and Swaziland[3]. It was not until the end of World War II, however, with the signing of the General Agreement on Tariffs and Trade (GATT), that the first stage of international economic integration was institutionalized, with that milestone going on to spawn broad regional integration movements, the most significant of which is European economic integration.

Integration is a process requiring gradual implementation. Based on empirical evidence, and as developed by Petit (2014), that process involves five stages:

- Free trade zone: involves the elimination of both tariff and nontariff barriers to trade in goods originating in area member countries, with each of these maintaining its own tariffs vis-à-vis nonmember countries. One example of this plan is the North American Free Trade Agreement (NAFTA).
- Customs union: in addition to free trade, countries establish a Common External Tariff (CET) to be applied to transactions between nonmember countries. In this stage there still exist barriers that impede the free circulation of the factors of production.
- Common market: presumes the existence of a customs union, but in addition includes the free movement of productive factors (persons and capital). In this stage, there are no obstacles in any of the member countries to the free entry or exit of persons having an economic objective (businesspersons and workers).
- Economic union: this is the most advanced stage of economic integration and involves the existence of a common market and the harmonization of the economic policies of member countries, including monetary union. An example of this is the Eurozone.
- Economic community: this is the final stage of integration and involves the existence of supranatural authorities that make decisions regarding policies of a fiscal, monetary, exchange, trade, or other nature. Here again, the example is the European Union.

One important aspect is that these stages are neither perfect nor sequential; rather, there are cases that reflect a mixture of measures corresponding to different phases and that coexist due to the need to advance toward deeper stages despite not having met all of the requirements of a previous stage.

Likewise, it should be recognized that any process of integration involves costs that must be quantified and met (Requeijo, 2002, cited in Petit, 2014). One of the most important is that the elimination of economic borders increases competition, which in turn creates winners and losers. It

[2] Ver Zollverein | German Customs Union | Britannica
[3] Ver http://www.sacu.int/about.php?include=about%2Fhistory.html

is the most competitive sectors or businesses in the integrated territory that will be winners, while those businesses at a disadvantage will find that their profitability and their very existence are now threatened and that they will be required to reinvent themselves in order to compete in the expanded market. In the same vein, as the integration process moves forward, countries will face a demand for greater standardization of policies, which in turn involves the transfer of power. Thirdly, it is quite possible that economic growth will become polarized, thereby accentuating regional imbalances and social disparities. And lastly, in the topmost stages of integration, there will be significant transfers of sovereignty.

OVERVIEW OF THE CUSTOMS UNION

As previously mentioned, a customs union occurs when two or more countries decide to create a common customs territory, where both tariff and nontariff barriers to trade are eliminated for goods originating in member countries and a common external tariff is established for application to nonmember countries.

Because they constitute an intermediate phase of economic integration, customs unions, by virtue of their two components, i.e., free trade and common external tariff (CET), result in an increase in intraregional trade, which can in turn lead to increases in investment and employment, as well as the potential for businesses of a member country to compete under equal conditions with businesses from other countries of the union. As previously indicated, however, this would lead to a scenario of winners and losers. Nevertheless, the consumers of the three countries may ultimately benefit from the opportunity to purchase goods that are of lower price and better quality, as a result of increased intraregional competition.

However, according to both theory and empirical evidence, customs unions generate both positive and negative impacts for countries. The point is that all processes of economic integration involve a system of customs-related discrimination among countries, since the imports of a particular product are subject to different tariffs and barriers, depending on whether the country of origin is or is not a member of the integrating group (Petit, 2014).

There are two immediate effects generated by a customs union: trade creation and trade deflection. These concepts were introduced by Jacob Viner (1950, cited in Bartesaghi, 2012) and are explained as follows:

- Trade creation: this occurs when member countries increase exchanges of goods through the expansion of intraregional transactions or through imports from the rest of the world, signifying an overall growth of trade for member countries of the customs union. This effect is achieved when the decrease in tariffs between member countries allows for the cheaper goods of member countries to replace more expensive domestic production.
- Trade deflection: this occurs when member countries deflect into the customs union those imports that they previously requested from nonmember countries, but this deflection is not compensated by new imports. This occurs because customs unions discriminate against procurement from the rest of the world, which can cause goods that are manufactured efficiently in third countries to replace by other more expensive products from the region (Nagarajan, 1998, cited in Bartesaghi, 2012).

In practice, trade is either created or deflected based on the relationship of current prices and tariffs in force in each of the customs union member countries and in the third countries with which commercial relationships exist, as shown in the following example:

> *"Assume that production prices in three different countries are US$100 in country A, US$150 in country B and US$250 in country C, with the latter country serving as reference country for the analysis. With a tariff of 100% in country C, prices in this country will be US$200, US$300 y US$250, respectively. Following a price analysis, country C imports the good from country A. Then, if country C forms a customs union with country B, it will eliminate the tariff it applies to country B and will purchase the product from that country at a price of US$150. In so doing, it will create a deflection of trade, because it will not be purchasing the product from the most efficient producer (country A). However, if the initial tariff in country C is 200%, the prices of the goods in country C will be US$300, US$450 y US$250, respectively. In this scenario, country C would be more efficient and would produce the good. Then, if country C forms a customs union with country B and purchases from that country, it will be creating trade, because without the tariff the price of the good in country B will be US$150, which is less than the US$250 that it costs to produce it in country C (Meade, 1969, cited in Oscategui, 1999).*

At the end of the day, Viner feels that a customs union generates positive net benefits only if the effects stemming from the creation of trade are greater than those resulting from the deflection of trade.

With regard to the two above-mentioned effects, Aragäo (1997) adds that, since in a context of free international competition, where patterns of wellbeing are defined by the consumption of goods at lower costs, the existence of a customs union will lead to a reassignment of resources among sectors and countries, which will in turn lead to specialization and therefore to an overall increase in trade. Specialization will then lead to higher levels of efficiency with a reduction in costs, which will then translate into increases in both purchasing power and levels of consumption, with a corresponding impact on wellbeing.

In any case, Petit (2014) maintains that in order to deem the deflection of trade to be detrimental, one must begin with the assumption that the previously existing situation was more effective, something that is not necessarily true, since the reasons for which a customs union member imports certain goods from a third, nonmember country could be quite varied and not simply imply that the third country was the more efficient, as presumed by Viner's theory. It should also be noted that deflection may be positive if consumers successfully modify the structure of their consumption as a reaction to the relative variances in prices.

However, the theory also makes a distinction between the static and dynamic effects of customs unions. Static effects are primarily those involving the reassignment of resources within the productive system and those involving changes in the structure and patterns of consumption (resulting from the creation and deflection of trade). Dynamic effects include the long-term consequences for rate of investment, technological change, and growth (Petit, 2014).

As regards dynamic (long-term) effects, countries may also obtain benefits from the generation of economies of scale, i.e., the businesses of member countries may now serve a wider market and increase their production, thereby achieving lower average costs. In the same manner, customs unions encourage innovation, as innovations can lead to increases in business size with businesses therefore assigning proportionately more resources to research and development.

Considering both static and dynamic effects, Meade (1957, cited in Petit, 2014) affirms that the impacts of a customs union can be positive in the following cases:

- The greater the elasticities of demand and supply in a country about to join a customs union, the greater will be the creation of trade,
- The greater the importance of the trade of that country with respect to the other countries that will join the customs union, the greater the probability that the union will generate wellbeing,
- The greater the size of the union (in economic terms), the greater the gains to be obtained from the reassignment of production and the lower the possibility for the deflection of trade,
- The higher the previous tariffs between the joining countries, the greater the trade creation will be;
- The lower the common external tariff applied by the customs union to third countries, the lower the level of deflection of trade,
- When the countries who will join together have economies that compete with each other (substitutability among goods produced), both the creation of trade and the common benefit will increase,
- The increase in market size will enable industries in member countries to produce goods at a cost that is lower than what it would cost to import them (Oscategui, 1999).

Together with free trade zones, customs unions are the two instruments expressly defined by Article XXIV of the GATT as exceptions to the principle of nondiscrimination implemented by virtue of the Most Favored Nation (MFN) clause. As previously mentioned, customs unions involve the replacement of two or more territories by a common customs territory where goods circulate freely with no payment of tariffs and where these countries apply to non-member countries customs duties that are essentially identical (Bartesaghi, 2012). This latter subject, the common external tariff (CET), is the key element in a customs union because in many cases member countries make unilateral decisions that run counter to the spirit of the union, such as entering into free trade agreements with third countries. In such cases, differences arise between the tariffs applied by member countries to countries outside the integrated territory. The situation existing in the Northern Triangle contains some of these elements and will be addressed further below.

CENTRAL AMERICAN ECONOMIC INTEGRATION AND THE CUSTOMS UNION

Attempts to bring about economic integration in Central America go back a long way, even as far back as the signing of the GATT, an instrument that formed the foundation for modern economic integration efforts, with the case of the European Union being the most successful, owing to the depth reached in the more than 70 years from the creation of the European Coal Community (1952) to the last phase of the cycle – the economic community – a mere six years later, in 1958, although with a gradual implementation process culminating in the adoption of a single common currency in January 1999[4].

Similarly, in 1951 the countries of Central America signed the Charter of the Organization of Central American States (ODECA) followed nine years later, in December 1960, by the signing of the General Treaty for Central American Economic Integration (*Tratado General de Integración Económica Centroamericana* – TGIE).

The TGIE consolidates other agreements entered into earlier by the countries of the region: the Multilateral Treaty of Central American Free Trade and Economic Integration (*Tratado Multilateral de Libre Comercio e Integración Económica Centroamericana*); the Central American Agreement on Equalization of Imports Tariffs (*Convenio Centroamericano sobre Equiparación de Gravámenes a la Importación*) and its Protocol on Central American Tariff Preference (*Protocolo sobre Preferencia Arancelaria Centroamericana*); bilateral free trade and economic integration treaties between the governments of Central American countries; and the Economic Association Treaty entered into by Guatemala, El Salvador and Honduras. The goal of the TGIE was to emulate the European experience by seeking to boost the overall development of the region with a view toward improving living conditions for its inhabitants.

To achieve its objectives, the TGIE provided for the creation of the Central American Common Market (CACM), an instrument that was to be perfected within a maximum timeframe of five years, i.e., by 1965. That timeline was met and the CACM began to operate. However, during the period of its consolidation some countries experienced greater industrial development and growth than others, which led to friction among countries, which in turn culminated in the withdrawal of Honduras from the CACM and from the entire process of integration, which, when combined with the failure of the import substitution model (ISI), led each individual country to seek new means of attracting investment (Quintana, et al., 2002, cited in Pérez, 2014).

Despite these obstacles, the TGIE gave way to the creation of a series of regional institutions and in addition served to regulate certain key aspects of the exchange of goods originating in the countries that established the basis for a deepening of the integration movement, which gathered renewed momentum in the early 1990s with the signing, in December 1991, of the Tegucigalpa Protocol to the Charter of the Organization of Central American States (Tegucigalpa Protocol). This legal framework provided the basis for the creation of the Central American System of Integration (*Sistema de la Integración Centroamericana* – SICA), consisting of the original members of ODECA (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua) plus Panama.

[4] See: Historia de la UE – 1990-99 (europa.eu)

The Tegucigalpa Protocol redesigned and strengthened the institutional structure of the system by establishing its organizational hierarchy: the Meeting of Presidents, Council of Ministers, Executive Committee, General Secretariat, Central American Parliament (PARLACEN), Central American Court of Justice, Advisory Committee, and others.

Subsequently, in October 1993, the countries signed the TGIE Protocol (Guatemala Protocol) in which member countries agreed to create, in a voluntary, gradual, complementary, and progressive manner, the Central American Economic Union, the objectives of which were to be in accordance with the needs of the countries of the region.

In general terms, the Guatemala Protocol set forth a commitment to perfect the free trade zone through the gradual elimination of all tariff and nontariff barriers to intraregional trade; update common trade regulations as regards subsidies and subventions; perfect the CET by coordinating and aligning external commercial relationships up to the point of adopting a joint policy regarding relationships with nonmember countries; and promote the gradual consolidation and standardization of national export development policies at the regional level.

One basic element put into effect by the Guatemala Protocol was the possibility that, despite the agreement that the decisions made by the various entities of the economic subsystem would be made by consensus of the members, this would not prevent individual countries from making decisions that would only be binding on themselves. This clause allowed countries such as El Salvador, Guatemala, and Honduras to promote a variety of initiatives aimed at establishing partial customs unions.

One of the most significant initiatives was that undertaken by Guatemala and El Salvador in 1996, when the Council of Ministers Responsible for Regional Economic Integration and Development (*Consejo de Ministros Responsables de la Integración Económica y Desarrollo Regional* – COMRIEDRE) gave its blessing to that initiative, which took a concrete step forward in January 2000 with the signing and ratification of the Framework Agreement for Establishment of a Customs Union among the territories. Honduras would subsequently join this process. However, no further progress was recorded.

A second effort took place in December 2007 with the signing by the five countries of the Regional Framework Agreement for the Establishment of a Central American Customs Union, with an agreement to launch three stages: a) promotion of the free circulation of goods and facilitation of trade, b) regulatory updating and consolidation, and c) institutional development. In this regard, although it is true that decisions were made regarding the three phases, free circulation of goods was not achieved.

In 2009, Guatemala and El Salvador once more took up the initiative for a customs union between the two countries, with the signing (in January 2000) of the Protocol for Modification of the Framework Agreement for Establishment of a Customs Union between El Salvador and Guatemala.

The new instrument set forth the obligation to set up a common customs service which, while keeping intact national customs administration authorities, would apply uniform regulations,

procedures, administrative systems, information technology and guidelines for the mobilization of both intra- and extra-regional trade and which would promote and facilitate the exchange of information. The regulations required that the customs union would culminate in the elimination of border checkpoints among the territories of the signatory parties. During the transition process, the border checkpoints would gradually be transformed into control centers, a common external stance would be adopted, trade regulations would be standardized, tax systems would be made uniform, and an analysis would be conducted into the possibility and feasibility of incorporating into the list of free trade goods those products listed in Annex A of the TGIE.

This process began with strong support for the concept of consolidating the customs union; in practice, however, despite progress recorded in the areas of facilitation and immigration, and the free circulation of goods, the other commitments never materialized.

Subsequent years were witness to other landmarks in economic integration efforts. In 2013, within the framework of negotiations for the Agreement for the Association of Central America with Europe, Panama joined the Subsystem for Central American Economic Integration, leading to agreement on a mechanism to ensure the orderly transition toward the signing of the various legal instruments included within the Subsystem. Another step taken toward deepening was the approval by COMIECO, in 2015, of the Central American Strategy for the Facilitation of Trade. This strategy, which will be addressed below, set as its goal to promote the coordination of public and private sector agencies with a view toward improving control procedures, border security and facilitation of the transit of goods within the region.

Also in 2015, the heads of state of SICA member countries ordered COMIECO to prepare a roadmap that would address the timeframes and individuals responsible for efforts focusing on establishment of a Central American customs union in accordance with the Framework Agreement for the Establishment of a Central American Customs Union. However, very little progress has been made on this roadmap, in addition to which the steps put forth are not sufficiently robust to bring about a customs union among the countries of the region.

Within this new context, 2014 saw the most recent partial initiative: the governments of Guatemala and Honduras entered into negotiations to deepen the process of economic integration between their two countries. The process culminated in the official launching, in January 2017, of the customs union between the two countries. One year later, in August 2018, El Salvador signed its treaty of accession to the union, although as of December 2021 that country's commercial transactions did not yet involve the free circulation of goods with Guatemala and Honduras.

TARIFF AND FISCAL MODELS IN CENTRAL AMERICA

One of the most important aspects of a customs union process is the definition of the region's tariff and fiscal system. It should be noted that the key to free circulation is the elimination of tariffs in intraregional trade, the establishment of a CET for trade with third countries, and the standardization or coordination of domestic taxes, especially those involving international trade (VAT and selective taxes).

In Central America, significant progress was recorded in the initial phases of the process of economic integration with the establishment of a CET (*Arancel Centroamericano de Importación* – ACI. This instrument was institutionalized with the signing of the Agreement on the Central American Tariff and Customs System (*Convenio sobre el Régimen Arancelario y Aduanero Centroamericano*) (December 1984) and consists of: a) the CET (ACI), b) Central America legislation on the customs value of goods listed in Annex B and its implementing regulations, c) the Uniform Central American Customs Code (*Código Aduanero Uniforme Centroamericano* – CAUCA) with its implementing regulations (RECAUCA), and d) the decisions and other common tariff- and customs-related provisions set forth in the agreement.

The Central American CET (ACI) is in turn made up of the Central American Tariff System (*Sistema Arancelario Centroamericano* – SAC) and the Import Tariff Duties (*Derechos Arancelarios a la Importación* – DAI). The SAC sets the Most Favored Nation (MFN) rate as the regional CET, although, with the existence of a number of trade agreements negotiated unilaterally by individual countries, each country has list of goods with varying tariffs for each agreement. Added to these are the exclusions from free trade set forth on the signing of the TGIE (Annex A) and the Agreement on the Tariff System (*Convenio sobre el Régimen Arancelario*) (Part II), as a result of which consolidation of the CET is dependent on the existence of a number of different tariffs treatments.

In accordance with the tariff regulations, the customs service must be unified, although in practice the Agreement indicates that it is the national customs services that will operate the trade system, with a uniform organizational and functional structure, with automation of customs operations, uniform application of CAUCA, RECAUCA, legislation regarding the customs value of goods, procedures for self-clearing and self-payment of tariffs on goods, and the common regulations governing domestic, international and the community transit.

In practice, despite the fact that the customs union has not been implemented throughout the Central American region, all of the signatory countries apply the community regulations as regards import duties (DAI), customs value, origin, transit, etc.

As regards internal or domestic taxes, the Framework Agreement for Establishment of the Central American Customs Union dictates that each member country must regulate its tax system based on the principle of "destination country." It also dictates that member countries shall agree on mechanisms for collecting taxes and duties generated by the operations of international and intraregional trade. In this regard, the countries signed, in June 2006, the Agreement for Harmonization of Domestic Taxes (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua), which regulates the mandate of the above-mentioned Framework Agreement.

The Standardization Agreement establishes the concepts of "transfer" and "acquisition," in substitution of the term "export" and "import." This makes it possible for commercial transactions to be carried out between taxpayers and the various countries participating in the customs union. At the same time, the Agreement sets forth the mechanism known as Invoice and Common Central American Declaration (*Factura y Declaración Única Centroamericana* – FYDUCA) as the standardized legal document supporting transfers and acquisitions of personal property or the provision of services between economic agents of member countries and also as a declaration for the withholding, settlement, and payment of taxes.

In the mechanism for collecting internal taxes established in the Standardization Agreement a product from a third country pays the taxes in the nationalization country or in the peripheral customs agency of the union member country, whereas in the case of intraregional transfers, the VAT and selective taxes of the destination country are applied, with prevalence given to export and import treatments applied to transfers and acquisitions. In other words, transfers are taxed at a rate of 0% while imports are taxed at the general tax rate, thus facilitating the mechanism for fiscal debits and credits.

It should be noted that as of late 2021, given the fact that the only customs union in operation is that between Guatemala and Honduras, the Standardization Agreement (as regards the use of the FYDUCA and the revenue collection mechanism) is being applied in only these two countries. As will be further explained below, the FYDUCA operates on the Community IT Platform (*Plataforma Informática Comunitaria* – PIC), under the responsibility of SIECA.

As regards revenue collection, resources are received directly by the destination country, by virtue of the mechanism for prepayment of the taxes set forth in the FYDUCA and the advanced technological stage of the region's banking system. This is important in a scenario involving peripheral customs offices since taxes are not collected by the country in which the goods are entering, ruling out a mechanism for reimbursement of duties and taxes between countries.

OPERATION OF THE REGIONAL TRADE MODEL AND INSTITUTIONAL STRUCTURE

For the last 70 years, beginning with the signing of the TGIE, trade in Central America has been characterized by an open regionalism, one of the primary objectives of which is the improvement of an intraregional free trade zone for originating goods, as well as efforts to bring about the Central American Customs Union, its most notable achievement being establishment of the CET (ACI), although as mentioned above, the consolidation of this key component is constrained by the variety of tariff treatments in place in member countries.

As previously noted, the Subsystem for Economic Integration (*Subsistema de Integración Económica*), with a view toward achieving these goals, created by virtue of the Guatemala Protocol a series of institutions that would operationalize the mandates of the various legal instruments for economic integration. Notable among these institutions are the Council of Ministers for Economic Integration (COMIECO), the Secretariat for Central American Economic Integration (SIECA) and the Advisory Committee on Economic Integration (*Comité Consultivo de Integración Económica* – CCIE).

COMIECO is made up of the ministers responsible for matters of economic integration. Their primary functions include coordination, standardization, and consolidation of the economic policies of the countries of the region, and their administrative actions are expressed in the form of resolutions, regulations, agreements and recommendations.

SIECA was created as the technical and administrative organ for the process of regional economic integration and as the executive secretariat for those entities not having a specific secretariat and for the Executive Committee for Economic Integration (CEIE). SIECA is responsible for the proper application of the legal instruments involved in the integration process, as well as for implementation of the decisions made by the entities working within the Economic Subsystem.

Lastly, CCIE is the organization representing the organized private sector in the region, with ties to SIECA, and its objective is to engage with representatives of the entities and institutions working within the Economic Subsystem to discuss specific matters of economic integration or, on its own initiative, to issue opinions to such entities and institutions.

Another important entity is the Sectoral Council of Ministers for Economic Integration, consisting of the Meeting of Ministers for individual areas: Central American Agricultural Council, Central American Monetary Council, Council of Ministers of the Treasury and Finance, and Councils of Economy, Commerce, Industry, Infrastructure, Tourism and Services. Each Sectoral Council deals with specific subjects as appropriate, with a view toward coordinating and standardizing its actions at the sectoral level and in turn strengthening the process of economic integration.

Based on the institutional model for Central American economic integration, and as will be explained in more detail below, the Enabling Protocol for the Deep Process of Integration between Guatemala and Honduras and its General Working Framework, the CCIE took on an institutional structure similar to that of COMIECO, with the creation of a Ministerial Body which is made up of the ministers responsible for matters of economic integration (the ministers of economy and commerce), and whose primary function is to draw up and put into place overall policy, directives and essential legal instruments for the customs union of the two countries. Along those same lines, SIECA and the Advisory Committee for the Customs Union discharge their functions based on the powers set forth in the Central American institutional framework, the hierarchical structure of which is similar to many of the aspects of the process launched by Guatemala, Honduras and, beginning in 2018, El Salvador, for example, as regards modification of the common external tariff.

2. GUATEMALA–HONDURAS CUSTOMS UNION

BACKGROUND

As previously mentioned, El Salvador, Guatemala and Honduras have historically promoted the process of Central American economic integration, as witness by their participation in most initiatives designed to bring about consolidation of the integration process.

The governments of Guatemala and Honduras in late 2014 announced their intention to continue deepening the process of economic integration in accordance with regional legal instruments. Specifically, the Guatemala Protocol, in which articles 6 and 52 authorize two or more countries of the region to move forward with the process of economic integration at a pace to be mutually agreed upon.

In 2015 those two countries signed the Enabling Protocol for the Process of Deep Integration toward the Free Transit of Goods and Natural Persons between the Republics of Guatemala and Honduras as well as the General Framework for Work toward the Establishment of the Customs Union between the Republic of Guatemala and the Republic of Honduras, with both instruments serving to set the new bases for creating a customs union in their territories. In January 2017 that the two countries implemented, both formally and operationally, the corresponding process of deep integration through the enabling of integrated border checkpoints and particularly through the implementation of the FYDUCA to support freely circulating goods.

In 2017, El Salvador ratified the Agreement for Standardization of Internal Taxes applicable to trade among member countries of the Central American customs union and, in 2018, the Protocol for Accession to the Enabling Protocol in effect between Guatemala and Honduras, the result of which was the formal integration of the customs union of the countries of the Northern Triangle, though its operational incorporation into that process has turned out to be a challenge. However, in 2019 there was a pause in the efforts focused on accession, which were not reactivated until mid-2021. Finally, December 2021 was witness to a milestone in the process, with approval of the Roadmap for the Full Incorporation of El Salvador into the Process of Deep Integration (*Hoja de ruta para la incorporación plena de El Salvador al proceso de integración profunda*). This instrument includes the definition of lists of goods excluded from free circulation, the review and signing of administrative resolutions, improvements to be made to integrated border checkpoints and establishment of peripheral customs agencies, IT activities and adjustments to the Community IT Platform (PIC), activation of technical panels, and financing of the process of incorporation.

PROCESS OF IMPLEMENTATION

In late 2014, the presidents of Guatemala and Honduras instructed their ministers responsible for regional economic integration to map steps that would make it possible to implement the customs union. In April 2015, following the signing of the Enabling Protocol, a round of technical negotiations regarding the customs union began, with the participation of the panels on taxes, customs, immigration, sanitary measures, tariffs, security, etc. Efforts focused on the determination of which goods would enjoy free circulation and which goods would be excluded for any number of reasons, the operation of the Structural and Investment Fund, and the potential for eventual accession by other Central American members (SIECA, 2018). After 21 rounds of negotiation, the customs union

was officially launched on June 26, 2017, as recorded in Resolution No. 27-2017 of the Ministerial Body.

Implementation of this new model of integration brought a number of notable actions in terms of deep integration, such as designation of the border checkpoints of Corinto, El Florido and Agua Caliente. These border checkpoints changed from border customs offices to Integrated Border Checkpoints (Resolution No. 06-2016). In addition, approval was given to the new FYDUCA format (Resolution No. 11-2017), Customs Union Operating Regulations (Resolution No. 17-2017), establishment of peripheral customs offices (Resolution No. 18-2017) and operationalization of freely circulating goods by March 2018 (Resolution No. 32-2017).

As regards peripheral customs agencies, although the facilities prioritized by the Ministerial Body are currently operational, the challenge still exists to make them truly attractive, from the operational standpoint, to the private sectors of the union member countries.

CHARACTERISTICS OF THE MODEL

According to SIECA (2018), the process of deep integration between Guatemala and Honduras is based on the need to create a customs union gradually and incrementally between their mutual territories in accordance with the provisions of Item Two of the Enabling Protocol and article 15 of the Guatemala Protocol.

This process envisions an *ad hoc* customs union model for developing countries with high levels of regulatory standardization and one which, at the same time, meets the requirements of the World Trade Organization (WTO) in the area of multilateral trade. In this regard, the process undertaken by Guatemala and Honduras is focused on promoting institutional development and modernizing and promoting regulatory consolidation through the use of the FYDUCA; creating and implementing the peripheral customs agencies; standardizing sanitary and phytosanitary measures; and modernizing the technological infrastructure currently in place at border checkpoints through the use of new tools for automating customs management processes.

As a result of the reciprocal nature of the preferences conceded, the process can be classified as an expression of open regionalism, compatible with WTO standards, and horizontal, south-south and symmetrical (Di Filippo, 1998, cited in SIECA, 2018). In addition, it has been called a process of deep integration, inasmuch as it reconciles a variety of national practices through community regulations and supranational implementation mechanisms, which itself sets a precedent for the region, with a view toward bringing about the integration of the other Central American countries which, beginning in 1960 with the signing of the TGIE, have strived to achieve that objective (Lawrence, 1997, cited in SIECA, 2018).

As regards harmonization of a CET, the Enabling Protocol permitted the temporary exclusion from free circulation those goods with a differentiated external tariff, thereby correcting any degree of tariff exemption set forth in any trade treaties signed unilaterally by member countries. Thus, goods are excluded from free circulation if for the above-mentioned reasons they originate in a country

that is signatory to a trade agreement. Based on the reality of the situation, the process qualifies as an imperfect customs union, as will be explored below.

Any measures taken in this process, as well as the results expected to be obtained, must be viewed from a long-term perspective, contextualized in developing countries with open trade, while at the same time constituting a project under construction that satisfies the legal requirements set forth in the Guatemala Protocol and the Framework Agreement for Establishment of the Central American Customs Union.

3. IMPACTS OF THE CUSTOMS UNION IMPLEMENTATION: EL SALVADOR'S CASE

DESCRIPTION OF THE STUDY

The study involves an assessment of the impacts of El Salvador's full integration into the customs union process launched by Guatemala and Honduras. A previous collaboration with CIFACIL, the Salvadorean Inter-Association Commission for Trade Facilitation identified a series of impacts, broken down into five areas, as outlined below.

Impacts on the economy:

- Effects on economic growth;
- Effects on trade: exports and imports;
- Effects on investment;
- Effects on employment;
- Effects on poverty;
- Effects on monetary and foreign exchange policy.

Impacts on tax revenues:

- Effects on tax and customs revenues.

Impacts on commerce:

- Effects and confirmation of time and cost savings for cross-border trade;
- Impact and identification of production linkages;
- Impact on the logistics chain and other international trade-related services;
- Effects on non-harmonized products;
- Impact of unfair trade practices;
- Impacts on international trade-related services at the border;
- Identification of non-tariff barriers.

Regulatory framework:

- Strengths and weaknesses of and risks associated with the customs union's regulatory framework;
- Strengths and weaknesses of and risks associated with trade logistics;
- Strengths and weaknesses of and risks associated with the tariff harmonization process;
- Strengths and weaknesses of and risks associated with resolutions previously approved and implemented by Guatemala and Honduras;
- Strengths and weaknesses of and risks associated with regulations governing the free movement of individuals conducting business.

Institutional framework:

- Impact of reductions in wait times and costs on procedures and formalities for the conduct of trade;
- Strengths and weaknesses of and risks associated with control procedures at trade facilitation centers, peripheral customs offices, and integrated customs facilities for El Salvador;
- Strengths and weaknesses of and risks associated with the use of the FYDUCA (the Central American Single Invoice and Declaration Form) for governments, businesses, and other stakeholders.

Requests for information and interviews were sent to various national and international agencies and organizations as basis for a detailed assessment of these impacts, including:

- El Salvador's Ministry of Economy;
- The *Dirección General de Aduanas* (DGA), El Salvador's Customs Service;
- The *Dirección General de Impuestos Internos* (DGII), the Internal Revenue Service;
- The *Banco Central de Reserva* (BCR), the Central Reserve Bank;
- The *Administración Aduanera de Honduras,* The Honduran Customs Authority;
- The *Superintendencia de Administración Tributaria de Guatemala* (SAT),
- Ministry of Economy of Guatemala (MINECO)
- The Secretariat for Central American Economic Integration (SIECA);
- The Inter-American Development Bank's Country Office in El Salvador; and
- The World Bank's Country Office in El Salvador

The study process also included interviews of representatives of various private organizations such as:

- CIFACIL, the Salvadorean Inter-Association Commission for Trade Facilitation;
- The *Cámara Guatemalteca de Alimentos* (CGA) or Guatemalan Food Manufacturers' Association; and
- Salvadorean businesses in the textile and apparel, industrial, agribusiness, food, mass consumption, and other sectors.

One of the key activities included in the work plan consisted of a series of field visits to the main border checkpoints between Guatemala and Honduras (Corinto), peripheral customs offices (Puerto Santo Tomás de Castilla), and customs facilities operating on the El Salvador – Guatemala (La Ermita – Anguiatú) and El Salvador – Honduras borders (El Amatillo y El Poy).

The requested information involved figures on trade among the three regional countries, including data on exports, imports, tax and customs revenues, trade volumes, wait times and costs for cross-border trade, production linkages, and regulations and administrative provisions pertaining to trade within the customs union, information on institutional capacity and the operation of border checkpoints, etc.

Likewise, the interviews were designed to obtain assessments of the main impacts of the customs union from different stakeholders in regional trade involved in the implementation of the customs union by Guatemala and Honduras and in the full integration of El Salvador.

Lastly, the purpose of the visits made to border checkpoints was to observe the benefits or disadvantages of the implementation of the customs union "*in situ*" and survey the opinions of field-level stakeholders, including customs, agriculture, immigration, and security officials, and customs brokers, business owners in border areas, etc. The field visits were also designed to help establish the institutional capacity of the three countries in terms of infrastructure, technology, human resources, environmental protection, etc.

The findings from the field study are expected to produce valuable information in support of the impact assessment and as basis for the formulation of proposals designed to improve trade facilitation measures and maximize the benefits of the deep customs union.

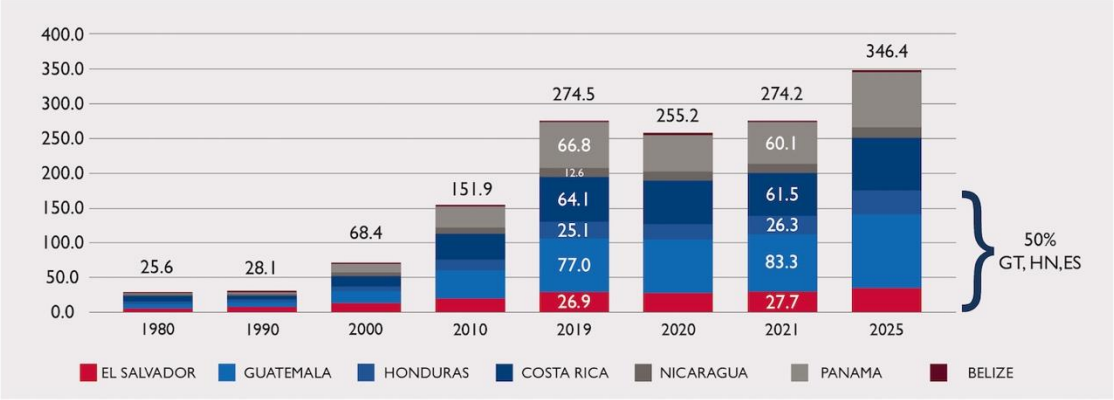
MACROECONOMIC AND WALFARE IMPACTS

TRENDS IN GROWTH, POPULATION DYNAMICS, AND POVERTY

The total GDP of Central America was US$274.2 billion in 2021, which puts it in sixth place within Latin America (behind that of Brazil, Mexico, Argentina, Chile, and Colombia) and makes this region very attractive from the standpoint of its overall market purchasing power. Bear in mind that the pandemic triggered a sharp seven percent contraction in regional GDP, which fell to US$255.2 billion in 2020. However, it was expected to rebound to close to its pre-pandemic level of US$274.5 billion by the end of 2021.

In 2021, the economies with the largest contributions to the generation of regional GDP were Guatemala, at 30.4 percent (compared with 27.2 percent in 2010), Costa Rica, at 22.4 percent (compared with 24.8 percent in 2010), Panama, at 21.9 percent (compared with 19.8 percent in 2010), El Salvador, at 10.1 percent (compared with 11.1 percent in 2010), Honduras, at 9.6 percent (compared with 10.4 percent in 2010), Nicaragua, at 4.9 percent (compared with 5.8 percent in 2010), and Belize, at 0.7 percent (compared with 0.9 percent in 2010), in that order. More specifically, the member countries of the current customs union (Guatemala and Honduras) account for a 40 percent share of the region's GDP and the incorporation of El Salvador would bring their share to 50.1 percent for 2021. According to IMF projections, Guatemala's and Panama's shares of GDP are expected to increase between now and 2025, while the shares of El Salvador, Costa Rica, and Nicaragua will shrink and those of Honduras and Belize will remain stable.

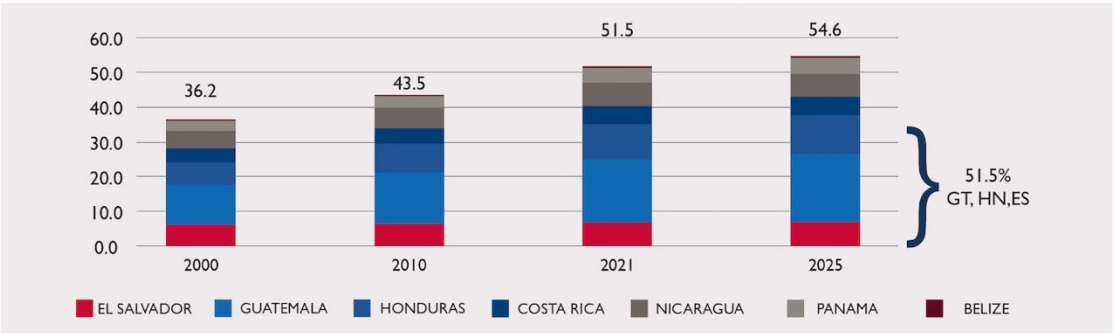
Figure 1. Central America: Nominal Gross Domestic Product (in US$ billions)



Source: IMF-WEO, October 2021

Central America had a population of 51.5 million inhabitants in 2021, 18.4 percent more than in the year 2010, which puts the average annual rate of population growth at 1.7 percent. The member countries of the customs union have a combined population of 35 million inhabitants and, together, account for the largest share of the region's total population, at 68 percent (with 35.6 percent in Guatemala, 19.7 percent in Honduras, and 12.7 percent in El Salvador). Costa Rica is in fourth place, at 12.7 percent (Figure 2). According to projections for the year 2025, the structure of the population is expected to remain stable, which means that the Northern Triangle area will continue to lead the Central American region in terms of its share of the population and, thus, of the region's consumers.

Figure 2. Central America: Population growth and projections (in millions)



Source: IMF-WEO, October 2021

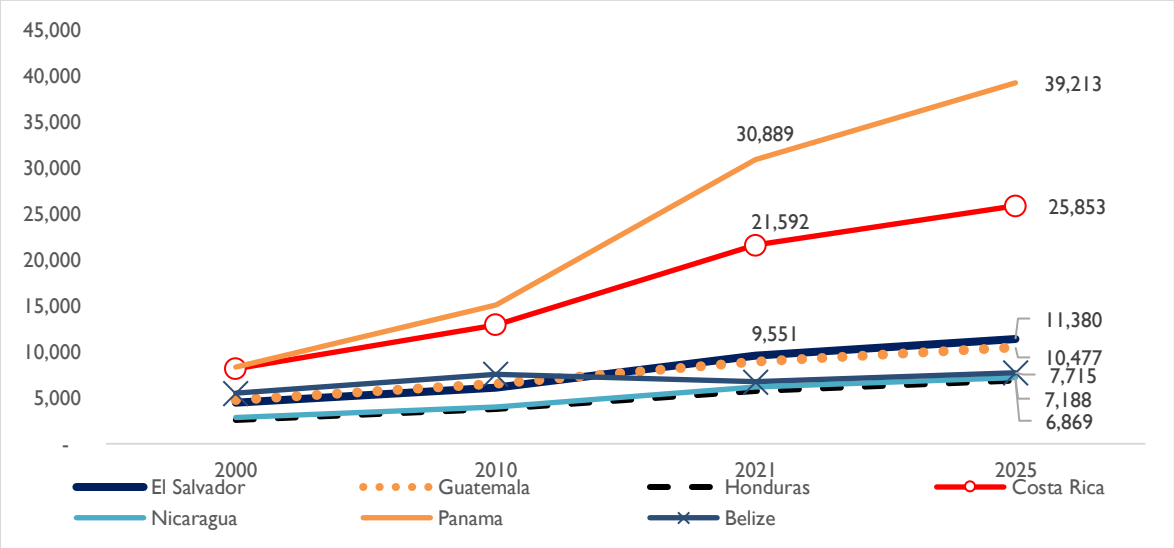
There has been a significant improvement in purchasing power in the region as a whole, as measured by the GDP per capita indicator adjusted for purchasing power parity (PPP). As of 2000, this indicator was US$5,232, climbing to US$12,795 by 2021, which would put it somewhere between that of Peru (US$13,410) and Ecuador (US$11,528), while the projection for 2025 puts it as high as US$15,528. The Central American countries with the most purchasing power in 2021 were Costa Rica, at US$21,592, and Panama, at US$30,889 (dollarized). The other two countries with similar but slightly lower levels of purchasing power were El Salvador, at US$9,551 (dollarized) and

Guatemala, at US$8,895. Honduras had less purchasing power, with an income of US$5,767, very close to that of Nicaragua, at US$6,133. The purchasing power of the Northern Triangle countries was US$8,071 in 2021, showing an improvement over the figure of US$5,473 for 2010 (Figure 3).

The Central American countries are in the following income categories within the World Bank's country classification scheme:

- El Salvador (US$3,700), Honduras (US$2,200), Nicaragua (US$1,900), and Belize (US$4,000) are classified as lower-middle income countries (US$1,046 to US$4,125).
- The main countries classified as upper-middle income countries (US$4,126 to US$12,735) are Guatemala (US$4,500), Costa Rica (US$11,500), and Panama (US$11,900). Note that Costa Rica is on the borderline for classification in the next highest income category and that Panama has fallen below the threshold for classification in the high-income category as a result of the pandemic.

Figure 3. Central America: GDP per capita adjusted for PPP (in US$)



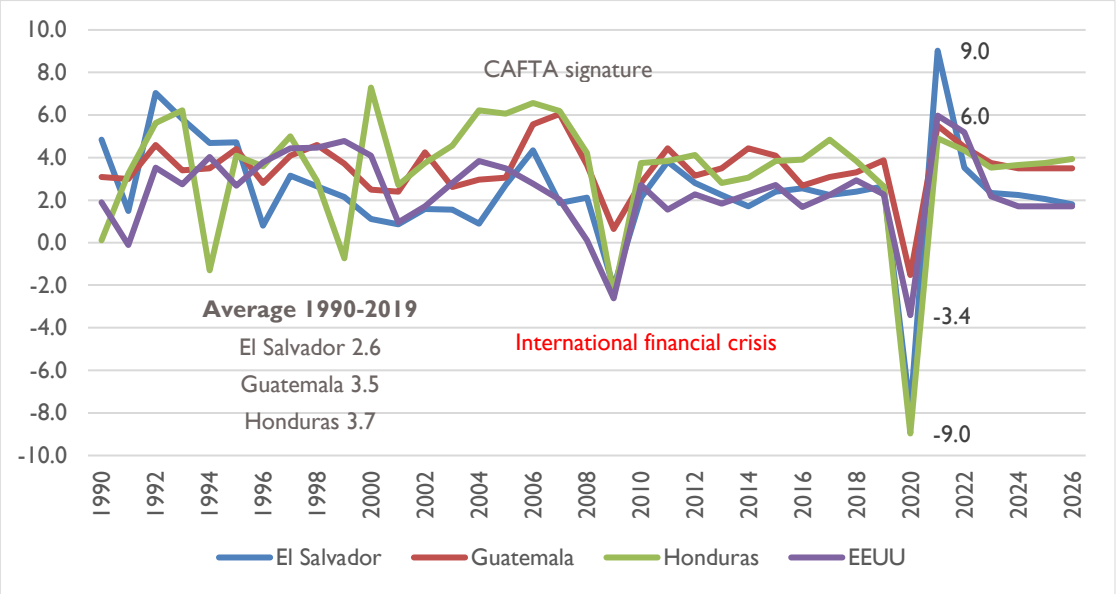
Source: IMF-WEO, October 2021

There has been more convergence in economic growth in the member countries of the customs union since the global financial crisis of 2008-2009, prior to which there had been a great deal of volatility in all three countries. Honduras has been growing at a faster and more sustained pace since 2002 (determined to get off the list of heavily indebted poor countries). Moreover, in all three countries, there is a high degree of cyclical convergence with the United States as their main trading partner (under the CAFTA-DR free trade agreement), the source of large inflows of remittances, and the largest source of direct foreign investment. The average rate of growth in the United States over the period from 1990 to 2019 (a 29-year period) was 2.5 percent, the same as in El Salvador, while Guatemala (at 3.6 percent) and Honduras (at 3.8 percent) reported higher rates of growth (Figure 4). The United States economy shrunk by 3.4 percent in 2020 during the pandemic, while the Central American countries imposed long lockdowns triggering a 7.9 percent contraction in the economy of El Salvador and a nine percent contraction in that of Honduras, which also suffered the effects of two hurricanes (Eta and Iota). The economy of Guatemala, with the lockdown in its productive sectors, shrunk by a more modest 1.5 percent. Driven by the rebound effect, the larger

demand for exports, and larger flow of remittances, El Salvador will have the highest rate of growth in 2021, at nine percent according to the IMF and 10.2 percent according to its Central Reserve Bank (BCR), followed by Guatemala, at 5.5 percent, and Honduras, at 4.9 percent (Figure 4).

Projections of growth for 2022 show a return to normalcy, with a growth rate of 2.5 percent for El Salvador and higher rates of growth in Guatemala and Honduras, at 3.8 percent (Figure 4). With this expected performance, the faster growth and higher demand will be beneficial to trade flows among the three countries. However, in order to meet these expectations, it will be important to reduce the costs of trade among the three countries for the benefit of their citizens and production chains.

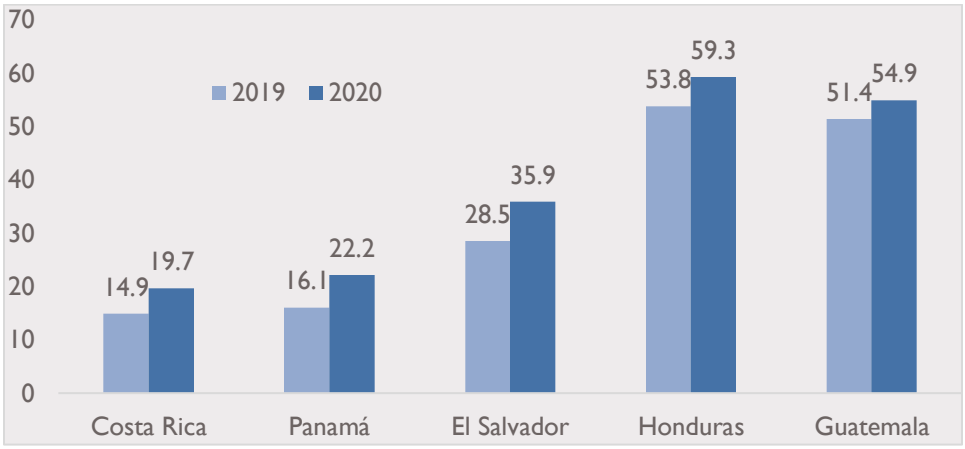
Figure 4. Northern Triangle and the United States: Convergence of economic growth



Source: Based on data from IMF projections from October 2020.

Poverty has consistently been the major problem in the Northern Triangle countries, a problem severely heightened by the impact of the pandemic, which plunged an additional 1.6 million people into poverty (536,000 in Honduras, 581,000 in Guatemala, and 478,000 in El Salvador). According to estimates by the IDB (2021), the poverty rate in El Salvador was as high as 35.9 percent in 2020, climbing approximately 7.4 percent from its pre-pandemic level, making it the country most severely affected by the COVID-19 pandemic from a social standpoint. Honduras reported a poverty rate of 59.3 percent for 2020, the highest in the region, up 5.5 percent from the previous year. Guatemala, in turn, reported its poverty rate up by 3.5 percent in 2020, putting it at 54.9 percent (Figure 5). Clearly, the pandemic has put the fight against poverty back several years and has created deep-seated problems, which will have a more permanent effect. For example, the lockdowns made it necessary to resort to online learning, which prevented children in many poverty-stricken households from continuing their education.

Figure 5. Central America: Trends in poverty rates and impact of the pandemic (%)

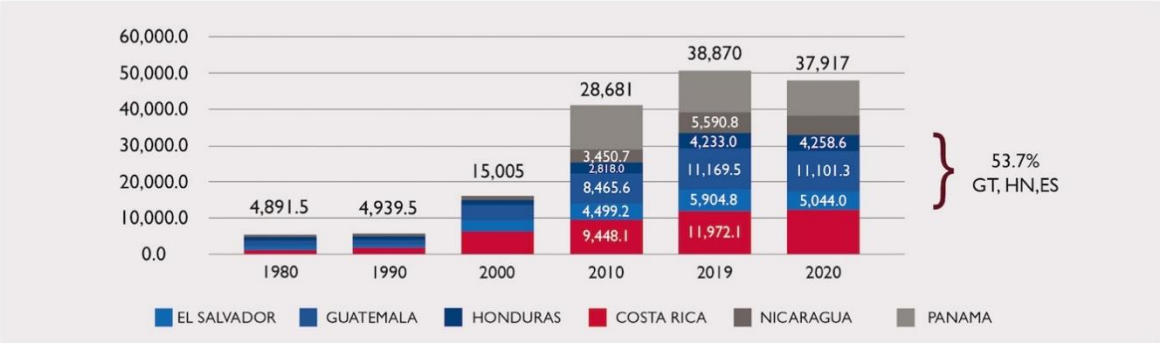


Source: Based on IDB data for 2021

TRENDS IN FOREIGN TRADE IN THE NORTHERN TRIANGLE

There was a large 28.9 percent boost in cumulative exports of goods from the Central American countries as of September of 2021 compared with the same period of the previous year. The strong recovery in the United States, the region's main trading partner, combined with the larger demand in regional countries, helped speed up exports, compensating for the slump in exports during the pandemic and easily outstripping figures for 2019. The 41.1 percent surge in exports of "maquila" services as of September of 2021 is particularly striking, attributable to the high demand from the United States and constituting an engine of growth for overseas sales.

Figure 6 Central America: Growth in exports (in US$ million)



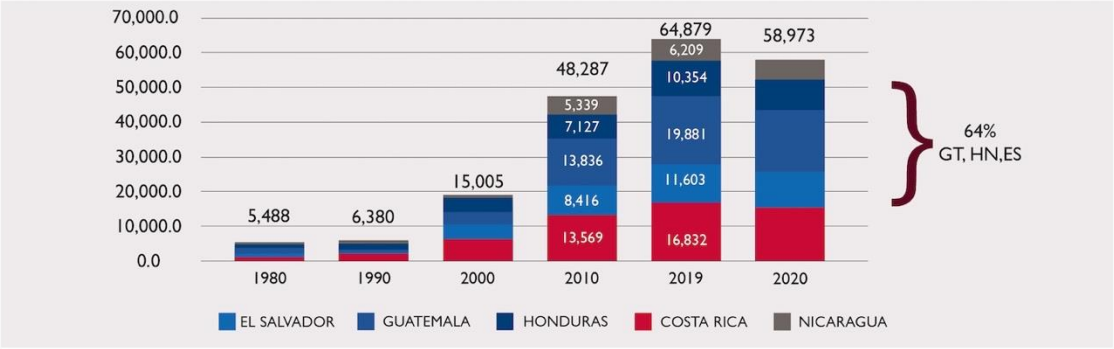
Source: Constructed by the author based on data from the SCMCA (the Central American Monetary Council Secretariat)

Annual exports for 2020 were valued at US$37,917 million, down by 2.3 percent due to the effects of the pandemic. Note that the Northern Triangle countries accounted for 53.7 percent of the value of exports of goods from the Central American region as a whole in 2020, down from 55 percent in 2010. A breakdown by country shows a decline in El Salvador's share of exports from 16 percent in 2010 to 13 percent in 2020. In contrast, the shares of Guatemala and Honduras were unchanged, at 30 percent and 10 percent, respectively.

Consumption and production dynamics in Central America are reflected by trends in imports, which were valued at US$64,879 million in 2019, showing a marginal increase of US$16,592 million from 2010. However, the restrictions imposed by the pandemic decreased the value by 9.1 percent in 2020, to US$58,973 million (Figure 7). Imports by the member countries of the customs union for 2019 were valued at US$41,838 million (accounting for 65 percent of regional imports). Including imports by El Salvador would bring their share up another 18 percent. El Salvador's share of regional imports has decreased since the year 2000, where it amounted to 21 percent.

Honduras's share of regional imports also decreased from 20 percent in 2010 to 16 percent in 2020, in contrast to the sharp growth in that of Guatemala, which increased from 20 percent in 2010 to 31 percent in 2020. Cumulative imports as of September of 2021 increased sharply, by 41.8 percent, reflecting the surge in the production of goods for export (intermediate goods) and the larger household demand (imports of consumer goods). "Maquila" imports increased by 52.6 percent, making 2021 a record year for purchases in this region.

Figure 7. Central America: Growth in imports (in US$ million)



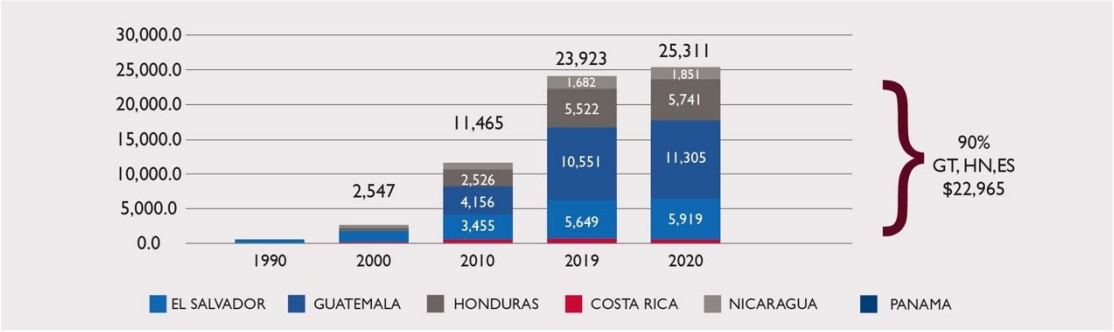
Source: SECMA (the Executive Secretariat of the Central American Monetary Council)

The role of family remittances

In 2020, family remittances accounted for 10 percent of Central America's GDP, an increase from 7.5 percent in 2010, compared with 18.2 percent in the Northern Triangle countries. Central America reported US$25.3 billion in remittances in 2020, four percent more than in 2019, which helped mitigate the negative effect of the pandemic on employment and household income in that region. Official U.S. estimates put the number of people from Northern Triangle countries living in the United States at 4.8 million, including 2.3 million from El Salvador, 1.5 million from Guatemala, and 1.0 million from Honduras (FUSADES, 2021). Remittances to regional countries as of October of 2021 increased by a record 32.4 percent from the same period of the previous year, to US$24,580 million (Figure 8), an increase of US$6,016 million from 2020. Remittances to the three member countries of the customs union reach a broad base of low-income households in different geographic areas and can represent their main source of income with the higher rates of poverty in some of these areas.

These remittances are used mainly for household consumption and, thus, play an extremely important role in intraregional imports, since many of the consumer goods bought by these households are produced in regional countries (staple and prepared foods, beverages, textiles, medicines, paper, etc.) According to El Salvador's Multipurpose Household Surveys, 95 percent of households receiving remittances used remittances for consumer spending. A large share of exports among member countries of the customs union is driven by the demand for goods from households receiving remittances. Thus, the facilitation of trade among these countries helps create a chain of prosperity, with consumption generating a demand for industrial goods whose manufacturing, in turn, requires the hiring of more workers.

Figure 8. Central America: Trends in remittances (in US$ million)



Source: SECMA (the Executive Secretariat of the Central American Monetary Council)

Exports by El Salvador to the Northern Triangle

Exports by El Salvador to Guatemala and Honduras increased by an average of four percent over the period from 2008 to 2020 according to figures published by SIECA, the Secretariat for Central American Economic Integration. The poor export performance in 2020 is striking, with the pandemic and long lockdowns affecting export industries driving down the value of exports by 11 percent (Table 1). However, as of June of 2021 (at mid-year), sales had already reached 66 percent of the total for the previous year, reflecting the strong recovery and underscoring the importance of these markets as a driver of the country's economy.

The long lines at border crossings where wait times can range from nine to as long as 21 hours in cases requiring physical inspections, increasing the cost of goods or losses in the case of perishable items, discourage exporters from taking advantage of the low tariffs for goods produced in El Salvador and traded in the Northern Triangle. However, the regional market is stable and has grown year after year, as illustrated by the figures in Table 1. Thus, a sharp reduction in border crossing times at land borders will increase trade, employment, and consumption throughout the region.

Table 1. El Salvador: Exports to Guatemala and Honduras (US$ million and annual percentage change)

EL SALVADOR						
	Guatemala	Annual percentage	Honduras	Annual percentage	Total	Annual percentage
2007	546.4		442.1		988.6	
2008	620.5	13.5%	575.2	30.1%	1,195.7	20.9%
2009	539.0	-13.1%	504.2	-12.9%	1,040.3	-13.0%
2010	626.3	16.2%	554.8	10.7%	1,181.1	13.5%
2011	733.0	17.0%	666.2	20.1%	1,399.2	18.5%
2012	711.1	-3.0%	728.0	9.3%	1,439.2	2.9%
2013	696.8	-2.0%	739.6	1.6%	1,436.5	-0.2%
2014	688.4	-1.2%	722.2	-2.3%	1,410.6	-1.8%
2015	709.7	3.1%	735.5	1.8%	1,445.2	2.5%
2016	705.2	-0.6%	744.2	1.2%	1,449.4	0.3%
2017	756.0	7.2%	760.8	2.2%	1,516.8	4.6%
2018	812.0	7.4%	848.7	11.6%	1,660.7	9.5%
2019	880.5	8.4%	859.7	1.3%	1,740.2	4.8%
2020	819.8	-6.9%	728.5	-15.3%	1,548.3	-11.0%
June 2021	551.3		472.3		1,023.6	
	Average Annual Variation					
2008 -2020	21.0	3.5%	22.0	4.6%	43.1	4.0%
2015 - 2019	42.7	5.1%	31.1	3.6%	73.7	4.3%

Source: SIECA data base

Exports by El Salvador to Guatemala and Honduras accounted for 37.9 percent of the country's total exports for 2019, exceeded only by exports to the United States. According to figures from the SIECA data base, El Salvador exported US$4,596 million worth of goods in 2019[5], of which US$1,740 million in goods were traded to Guatemala and Honduras. Most exports to the Northern Triangle countries consisted of industrial goods, which accounted for 72.3 percent of sales, with a value of US$1,258 million, including US$649.4 million worth of industrial materials, US$370.3 million worth of miscellaneous manufactured goods, and US$239 million worth of chemicals (Table 2). Guatemalan and Honduran exports of industrial goods to the Northern Triangle were valued at US$1,107 million and US$343.1 million, respectively. This data illustrates the larger value of exports by El Salvador compared with that of the other countries.

[5] The study uses the figure for 2019 to reflect normal conditions. The year 2020 was atypical due to the pandemic and the resulting lockdowns and the available data for 2021 covers only part of the year.

Table 2. El Salvador: Exports to Guatemala and Honduras in 2019, by type of product (in US$ million and percentage terms)

	EL SALVADOR						
	Total 1	Weight	GT 2	HN 3	HN+GT 4 = (2+3)	Weight	% Total 5 = (4/1)
0 Food products and live animals	**948.2**	**20.6%**	**2256**	**1256**	**3512**	**20.2%**	**37.0%**
1 Beverages and tobacco	**27.0**	**0.6%**	**30**	**133**	**164**	**0.9%**	**60.5%**
2 Raw non-edible materials except fuels	77.8	1.7%	57	39	96	0.6%	12.3%
3 Fuels and lubricants and related products	199.1	4.3%	492	181	673	3.9%	33.8%
4 Oils, fats, oils and greases of animal and vegetal origin	5.8	0.1%	21	32	53	0.3%	92.0%
5 Chemical products and related products	**424.6**	**9.2%**	**1367**	**1023**	**2390**	**13.7%**	**56.3%**
6 Manufactures articles, according to materials	**1,099.0**	**23.7%**	**3046**	**3448**	**6494**	**37.3%**	**59.6%**
7 Machinery and transport equipment	71.5	1.6%	151	166	317	1.8%	44.4%
8 Miscellaneous manufactured articles	**1,747.7**	**38.0%**	**1384**	**2319**	**3703**	**21.3%**	**21.2%**
9 Unclassified merchandise and operations	3.9	0.1%	0.0	0.0	0.0	0.0%	0.0%
O Unclassified items	0.7	0.0%	0.0	0.0	0.1	0.0%	10.7%
TOTAL	4,596		880	860	1.74		37.9%

Source: SIECA data base

Guatemala leads the Northern Triangle countries in the value of exports

Guatemala exported US$1,332.9 million worth of goods as of June of 2021, leading El Salvador and Honduras in terms of the value of trade, which reported US$1,023 million and US$416.1 million in trade, respectively. For years, Guatemala, with the largest economy in Central America and the largest population, has also held the lead with respect to the value of goods traded to other Northern Triangle countries, which is 1.3 times that of El Salvador and three times that of Honduras. Exports to both these countries increased by an average of 4.1 percent between 2008 and 2020, with exports to Honduras growing more rapidly than those to El Salvador, or by 4.6 percent versus 3.8 percent (Table 3). This export performance is consistent with growth dynamics in these countries, despite the continued high barriers to trade among the three countries engendered by customs formalities.

Table 3. Guatemala y Honduras: Exports to the Northern Triangle in 2019 (in US$ million and percentage terms)

Year	GUATEMALA						HONDURAS					
	El Salvador	annual %	Honduras	annual %	Total	annual %	El Salvador	annual %	Guatemala	annual %	Total	annual %
2007	798.1		565.2		1,363.3		242.9		173.8		416.7	
2008	901.9	13.0%	694.0	22.8%	1,595.8	17.1%	254.1	4.6%	210.7	21.2%	464.7	11.5%
2009	766.6	-15.0%	563.5	-18.8%	1,330.1	-16.6%	200.9	-20.9%	176.0	-16.5%	376.9	-18.9%
2010	921.5	20.2%	646.8	14.8%	1,5683	17.9%	219.5	9.2%	193.9	10.1%	413.3	9.7%
2011	1,041.0	13.0%	773.4	19.6%	1,814.4	15.7%	298.5	36.0%	235.4	21.5%	533.9	29.2%
2012	1,024.1	-1.6%	771.1	-0.3%	1,795.1	-1.1%	297.2	-0.4%	264.0	12.1%	561.2	5.1%
2013	1,014.3	-1.0%	765.3	-0.7%	1,779.6	-0.9%	334.3	12.5%	259.3	-1.8%	593.6	5.8%
2014	1,165.9	15.0%	850.5	11.1%	2,016.4	13.3%	321.8	-3.8%	256.4	-1.1%	578.2	-2.6%
2015	1,133.4	-2.8%	854.7	0.5%	1,988.1	-1.4%	331.5	3.0%	236.4	-7.8%	567.9	-1.8%
2016	1,090.4	-3.8%	875.1	2.4%	1,965.5	-1.1%	334.9	1.0%	256.0	8.3%	590.9	4.1%
2017	1,063.6	-2.5%	884.4	1.1%	1,948.1	-0.9%	319.5	-4.6%	235.8	-7.9%	555.3	-6.0%
2018	1,171.2	10.1%	943.7	6.7%	2,114.9	8.6%	320.3	0.3%	259.0	9.8%	579.3	4.3%
2019	1,213.3	3.6%	867.6	-8.1%	2,081.0	-1.6%	335.9	4.9%	287.0	10.8%	622.9	7.5%
2020	1,228.3	1.2%	946.9	9.1%	2,175.2	4.5%	336.9	0.3%	317.8	10.7%	654.7	5.1%
June 2021	735.8		597.1		1,332.9		212.3		203.8		416.1	
	Average annual variation						Average annual variation					
2008-2020	33.1	3.8%	29.4	4.6%	62.5	4.1%	7.2	3.2%	11.1	5.4%	18.3	4.1%
2015-2019	20.0	0.9%	3.2	0.5%	23.2	0.7%	1.1	0.9%	12.6	2.6%	13.7	1.6%
2018-2020		5.0%		2.6%		3.8%	**5.8**	**1.8%**	27.3	10.5%	33.1	5.7%

Source: SIECA data base

Half (50.9 percent) of all global exports of goods by Guatemala in 2019 consisted of food products and live animals valued at US$4,114.1 million. Chemicals accounted for the second highest percentage of at 14.1 percent of exports, followed by manufactured materials, representing 9.5 percent of the total (Table 4). Sales to El Salvador and Honduras had significant weight. The Northern Triangle countries bought mainly food products and live animals, which accounted for 12.1 percent of the total for these products, followed by chemicals, with a 41.2 percent share of global sales. Manufactured materials had a weight of 56.8 percent of the total for these goods (Table 4). In addition, 47.8 percent of exports of miscellaneous manufactured goods (valued at US$207 millions) went to El Salvador and Honduras and 49.5 percent of fuel sales were to the Northern Triangle countries. Thus, administrative barriers, adding to the costs of industrial goods, are impeding diversification and the scaling up of production, which would have positive effects on formal and informal employment.

Table 4. Guatemala: Exports to El Salvador and Honduras in 2019, by type of product (in US$ millions and percentage terms)

	GUATEMALA						
	Total 1	Weight	ES 2	HN 3	ES - HN 4 = (2+3)	Weight	Total % 5 = (4/1)
0 Food products and live animals	**4114.1**	**50.9%**	**302.7**	**195.3**	**498.1**	**23.9%**	**12.1%**
1 Beverages and tobacco	164.5	2.0%	28.9	28.6	57.5	2.8%	34.9%
2 Raw non-edible materials except fuels	338.7	4.2%	16.2	10.0	26.2	1.3%	7.7%
3 Fuels and lubricants and related products	499.9	6.2%	224.0	23.3	247.3	11.0%	49.5%
4 Oils, fats, oils and greases of animal and vegetal origin	463.8	5.7%	47.4	21-0	68.4	3.3%	14.7%
5 Chemical products and related products	**1,137.2**	**14.1%**	**234.4**	**233.9**	**468.3**	**22.5%**	**41.2%**
6 Manufactures articles, according to materials	**767.7**	**9.5%**	**215.1**	**220.9**	**436.0**	**21.0%**	**56.8%**
7 Machinery and transport equipment	167.7	2.1%	40.7	35.7	76.4	3.7%	45.5%
8 Miscellaneous manufactured articles	424.2	5.2%	103.8	98.9	202.7	9.7%	47.8%
9 Unclassified merchandise and operations	10.2	0.1%	0.0	0.0	0.0	0.0%	0.0%
O Unclassified items	0.0	0.0%	0.0	0.0	0.0	0.0%	
TOTAL	8,088		1,213	868	2,081	100.0%	25.7%

Source: SIECA data base

Honduras exports more to Guatemala since the implementation of the customs union in 2017

As of June of 2021, Honduran exports to Guatemala and El Salvador were valued at US$416.1 million, of which US$212.3 million in goods went to El Salvador, surpassing the value of exports to Guatemala, which was US$203.8 million. However, Honduran sales to Guatemala increased by more than 10.5 percent between 2018 and 2020 with the official establishment of the customs union, while sales to El Salvador increased by 1.8 percent in that same period (Table 3). This finding is consistent with the opinion expressed by a business association in Guatemala, pointing to the fact that El Salvador is suffering the most harm from its failure to join in the measures implemented by the customs union, particularly with respect to certain types of goods, with the inefficiency at border crossings making Salvadorean goods less competitive. This is also consistent with ECLAC projections (Martínez, 2019) of the impact of the customs union formed by Honduras and Guatemala, estimating that El Salvador's failure to join with the other countries could cost it 0.2 percent of its GDP.

In this same regard, Honduras exported US$623 million worth of goods to Guatemala and El Salvador in 2019, which accounted for 14.9 percent of its total global exports. El Salvador was the larger buyer, accounting for US$336 million in sales, compared with US$287 million for Guatemala. Honduras shows the same pattern as El Salvador and Guatemala, with its local production chains viewing the regional market as a natural area for expanding their operations, which is why it is vital to reduce border crossing times and costs for the expansion of trade. Sales to the Northern Triangle were led by food products and live animals, which accounted for US$174 million in exports, with a weight of 27.9 percent, followed by exports of chemicals, valued at US$169.5 million (with a weight

of 27.2 percent) and manufactured materials, valued at US$125.6 million (with a weight of 20.2 percent) (Table 5).

Table 5. Honduras: Exports to El Salvador and Guatemala in 2019, by type of product (in US$ million and percentage terms)

	HONDURAS						
	Total 1	Weight	ES 2	GT 3	ES- GT 4= (2+3)	Weight	Total % 5 = (4/1)
0 Food products and live animals	**2,488.3**	**59.5%**	**95.9**	**78.1**	**174.0**	**27.9%**	**7.0%**
1 Beverages and tobacco	156.6	3.7%	3.0	3.0	6.0	1.0%	3.8%
2 Raw non-edible materials, except fuels	216.9	5.2%	3.5	15.7	19.2	3.1%	8.8%
3 Fuels and lubricants and related products	1.8	0.0%	0.1	1.2	1.4	0.2%	75.2%
4 Oils, fats, oils and greases of animal and vegetable origin	341.7	8.2%	40.2	19.8	60.0	9.6%	17.6%
5 Chemical products and related products	**308.7**	**7.4%**	**86.7**	**82.8**	**169.5**	**27.2%**	**54.9%**
6 Manufactured articles, according to materials	**315.2**	**7.5%**	**69.9**	**55.7**	**125.6**	**20.2%**	**39.9%**
7 Machinery and transport equipment	77.6	1.9%	11.4	7.8	19.2	3.1%	24.8%
8 Miscellaneous manufactured articles	149.9	3.6%	25.0	23.0	48.0	7.7%	32.0%
9 Unclassified merchandise and operations	122.8	2.9%	0.0	0.0	0.0	0.0%	0.0%
O Unclassified items	0.0	0.0%	0.0	0.0	0.0	0.0%	-
TOTAL	4,180		336	287	623	100.0%	14.9%

Source: SIECA data base

Overall, the customs union is gradually becoming a catalyst for economic activity between Guatemala and Honduras, as seen in Figure 9. Since the official launch of the union in 2017, trade between Guatemala and Honduras has shown greater growth than the volume transacted by each country with El Salvador, the other countries of Central America (Nicaragua, Costa Rica and Panama) and the rest of the world.

Figure 9. Customs union's impact on trade of Guatemala and Honduras

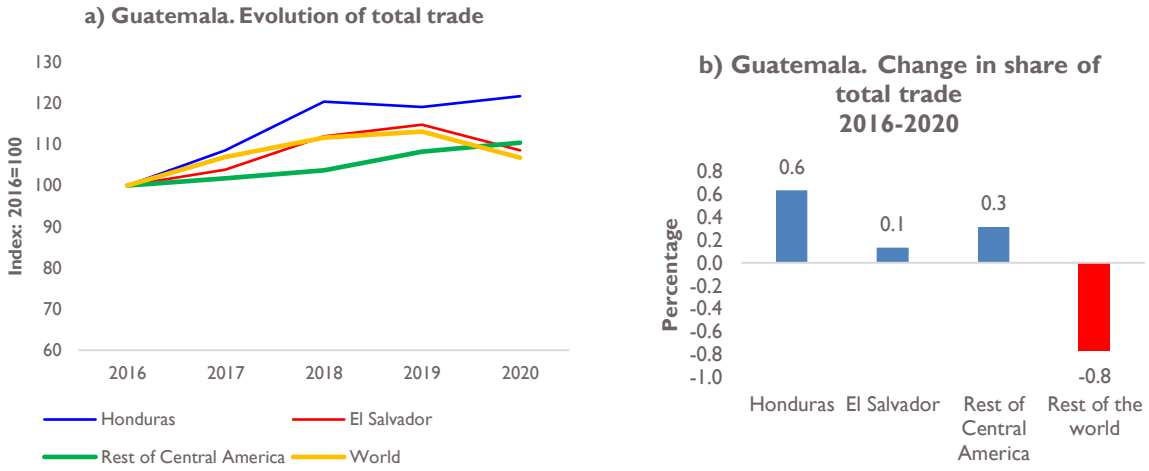
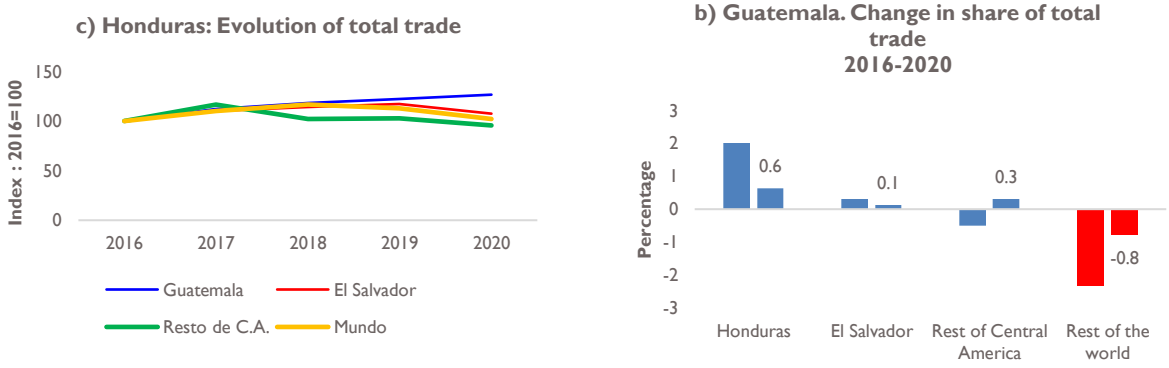


Figure 9. Customs union's impact on trade of Guatemala and Honduras (cont.)



Source: Own with data from SIECA.

In addition, integration has brought about changes in the degree of participation of each partner country in the total trade of the other countries. Thus, in the case of Guatemala, trade with Honduras has increased from 4.5 percent of total trade to 5.2 percent (an increase of 0.6 percentage points) while the corresponding figure for El Salvador only increased from 7.7 percent to 7.8 percent. Trade with the rest of Central America also increase by 0.3 percentage points, while trade with the rest of the world decreased. Data for Honduras reflects the same behavior.

IMPACTS OF THE CUSTOMS UNION ON THE CENTRAL AMERICAN ECONOMY (PRIOR STUDIES)

ECLAC conducted several impact studies with support from SIECA and the governments of the Northern Triangle countries. The first assessment dealt with the customs union formed by Guatemala and Honduras (ECLAC, 2017). This was followed by a second study which included measurements for the entire Central American region (ECLAC, 2018). Its last published study was a more comprehensive analysis of the achievements in Central American integration and related challenges (Martínez, 2019). These measurements were based on complex econometric models of international trade, which, as a first step, assess the magnitude of barriers to trade between different countries (using gravity models) and then plug this data into a general equilibrium model to simulate their macroeconomic impacts on GDP and microeconomic impacts on poverty.

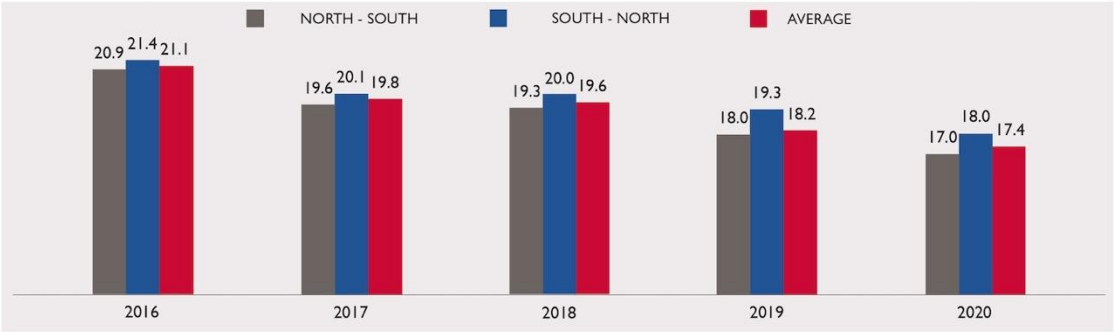
Regarding barriers to regional trade, there are previous quantitative studies supported by the World Bank (Kelleher & Reyes, 2014) measuring their effects on trade in items such as tomatoes and the resulting losses suffered by small farmers engaged in trade with regional countries. These studies used the same methodologies used for international trade simulating customs unions (in African, Asian, and European countries), underpinned by data bases and academic work with general equilibrium models.

In addition, the Inter-American Development Bank (IDB) recently published a study on the development of the model for Central American integration in which it documents this process, examining the convergence of three regional initiatives, namely: (i) the customs union established in the roadmap for 2015-2024 and the Trade Facilitation Strategy; (ii) implementation of the deep integration process by Guatemala and Honduras; and (iii) the development of a Transportation and Logistics Strategy.

One of the most notable major findings by the studies with regard to trade barriers is the reduced speed in overland trade corridors for goods traffic due to holdups at border crossings. The average speed in these trade corridors is estimated to decrease from 21.1 km/hr, as measured in 2016, down to 17.4 km/hr in 2020 (Figure 10). As pointed out in a number of studies, the fact that Columbus' ships traveled at a faster speed than that of ground freight shipments in modern-day Central America is alarming to say the least. Slow speeds increase the distances between countries and discourage trade between different countries.

The ECLAC study (ECLAC, 2018) used a gravity model to estimate time in trade for exports and imports in different economic sectors on a country-by-country basis, converting these estimates into *ad valorem* percentages or equivalents (AVEs) for the traded goods in question. According to the findings, El Salvador had the second highest overall *ad valorem* equivalent, at 18.3 percent, compared with 14 percent for Guatemala, 15.8 percent for Honduras, and nine percent for Panama, which was the lowest in the region (Table 6). This sharply increases the cost of the goods, makes them less competitive, and operates as a disincentive to trade. Given the high costs engendered by administrative non-tariff barriers to trade, El Salvador is the country which should be taking the lead in the deep customs union and in implementing the trade facilitation measures established in the Bali Agreement.

Figure 10. Average speed in Central America's Pacific Corridor (in km/hr)



Source: SIECA & SICA, 2021

A sector breakdown of the data produced by the model shows the activities most adversely affected by non-tariff barriers which, in the case of El Salvador, are: (i) agriculture, with an AVE of 36.6 percent; (ii) textiles and apparel (at 36.5 percent); and (iii) miscellaneous manufacturing activities (at 17.4 percent). Clearly, this hurts small farmers due to the system of production in that country. This also affects its major export chain, namely textiles and apparel, which is the industry generating the most formal employment.

As outlined earlier, the ECLAC study then turned to a computable general equilibrium (CGE) model using the Global Trade Analysis Project (GTAP) 9.0 data base, introducing two scenarios with respect to the *ad valorem* equivalents calculated by the gravity model. The first scenario (the ambitious scenario) assumes that the customs union has a high impact on administrative non-tariff barriers, reducing them by 60 percent, while the second scenario (the less ambitious scenario) assumes a 30 percent reduction in trade barriers (see complete methodology in Annex 7).

Table 6. *Ad valorem* equivalents of non-tariff barriers in 2017 (% of product value)

Main sectors	Costa Rica	Guatemala	El Salvador	Honduras	Nicaragua	Panama
Agriculture, hunting and fishing	26,4	26,8	36,6	26,8	33,4	11,3
Oil and mining	5.1	1,1	1,0	0,6	7,0	2,0
Food, beverages and tobacco	14,6	17,8	15,6	17,8	19,6	7,3
Textiles, apparel and footwear	33,8	30,1	36,5	28,3	61,7	21,8
Chemicals and petrochemicals	12,3	6,2	3,3	14,2	20,0	7,7
Metals and metal products	12,3	13,0	13,0	10,4	19,7	9,0
Machinery and equipment	8,1	9,7	7,5	9,4	19,0	6,2
Other manufacturing	21,0	15,6	17,4	15,6	31,2	11,5
All sectors	16,3	14,0	18,3	15,8	25,3	9,0

Source: ECLAC, 2019

According to the findings, the impact of the customs union formed by Guatemala and Honduras expressed as a percentage of GDP would be 0.2 percent in the less ambitious scenario and 0.6

percent in the more ambitious scenario. The results are similar for the Northern Triangle customs union (Table 7).

Table 7. Macroeconomic impacts of a reduction in non-tariff barriers in the Northern Triangle (as a percentage of the baseline and in US$ million)

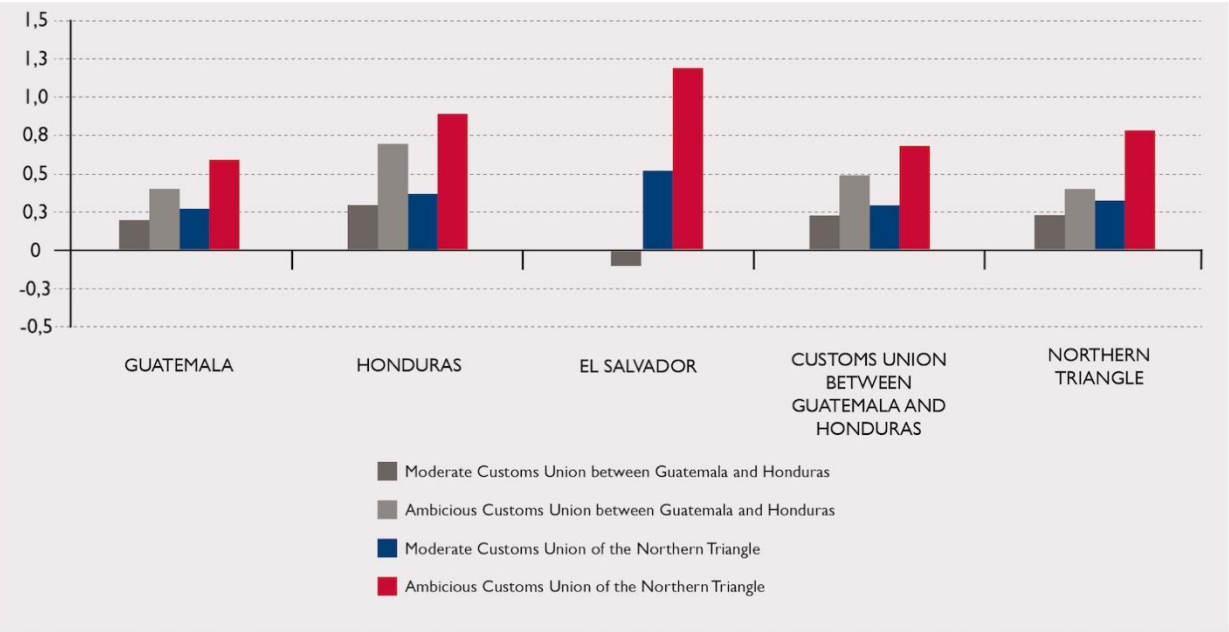
Variable	Customs Union between Guatemala and Honduras		Customs Unions enters from northern triangle	
	Less ambitious (30%)	Ambitious (60%)	Less ambitious (30%)	Ambitious (60%)
GDP	0,2	0,5	0,3	0,8
Exports	0,7	1,8	0,7	2,1
Imports	0,5	1,7	0,9	1,8
Total Employment	0,4	0,5	0,4	1,0
Employment (unskilled labor)	0,6	0,8	0,4	1,0
Welfare (in millions of dollars)	162	377	187	419
Percentage of GDP	**0,2**	**0,6**	**0,2**	**0,5**

Source: ECLAC, 2019

It is clear from this examination of different scenarios with respect to the impact on each country's GDP that El Salvador would gain the most from its incorporation in the customs union in the ambitious scenario (1.2 percent of GDP) and, even in the more moderate scenario, is still the biggest winner in all scenarios (Table 7).

Clearly, the failure of El Salvador to fully accede to the customs union with Guatemala and Honduras would have zero impact on its GDP in the moderate scenario and a negative impact in the ambitious scenario. This sends a strong message to the country, in that it has the most to gain from its integration into the union and, as an outsider, will be facing losses.

Figure 11. Central America: Impacts on GDP in different scenarios (as a percentage of the baseline)



Source: ECLAC, 2019

The United States Agency for International Development (USAID) has also been implementing an assistance program designed to facilitate trade at border crossings to shorten wait times and reduce costs, which are affecting economic growth and well-being in the Northern Triangle countries. Working with officials in all three countries, it has implemented measures designed to optimize border control systems and infrastructure, providing crucial support for the customs union process. Moreover, as a complement to this program, USAID is supporting implementation of the World Trade Organization's Trade Facilitation Agenda, strengthening national trade facilitation committees, and promoting implementation of the Authorized Economic Operator (AEO) Program.

In each of the three countries, a set of trade facilitation measures are being implemented, which were incorporated in a gravity model to assess their impact on reducing wait times and costs in the conduct of trade. One of the most notable aspects of the simulation is that it considers a package of key complementary measures for a customs union process. Exporters in El Salvador will benefit from the streamlining of customs formalities with the improvement in the management systems of national government agencies, as well as from the digitalization of customs procedures and better interoperability with other agencies to speed up trade. At the same time, USAID is supporting the process for El Salvador's accession to the customs union launched by Guatemala and Honduras and the implementation of measures for boosting trilateral trade (USAID, 2021).

The following is a description of the measures identified as crucial to trade facilitation in El Salvador:

i. Improve border control systems by modernizing the Ministry of Agriculture's IT systems. The objective is to reduce delays and costs for businesses through the introduction of electronic sanitary and phytosanitary inspection certificates and an

electronic product visa system. Among other things, this should shorten wait times for sanitary registration from 28 days to 14 days for plant products and from 114 days to 57 days for animal products, or by 50 percent (Graphic 4).

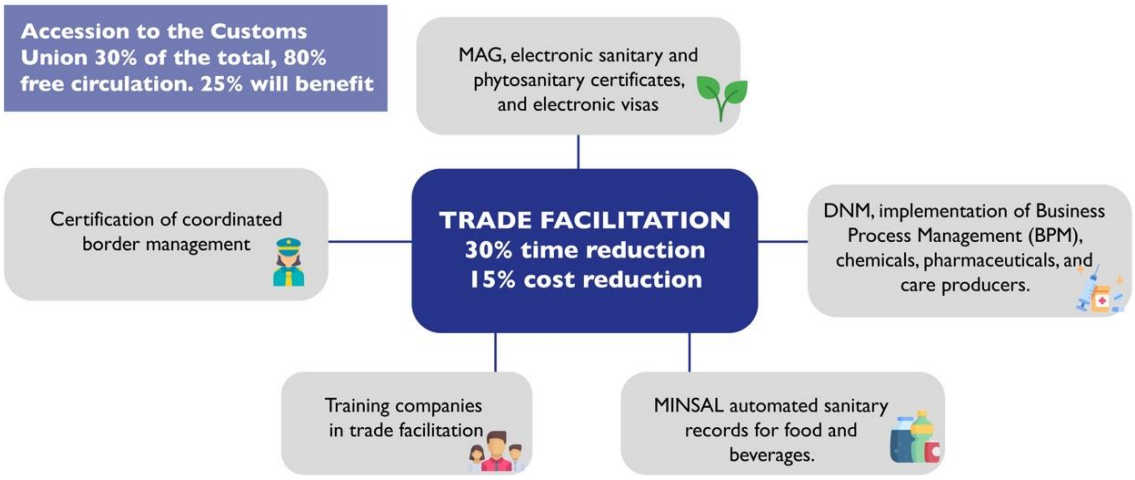
ii. Improve sanitary registration procedures and the interconnectivity of National Pharmaceutical Service (D*irección Nacional de Medicamentos* or DNM) systems. The objective in this case is to strengthen the sanitary registration process and the agency's interoperability by establishing an online administration system. This measure would shorten wait times for sanitary registration from 80 to 40 days for pharmaceuticals, from 40 to 20 days for cosmetics, from 35 to 18 days for personal care products, and from 49 to 25 days for businesses.

iii. Strengthen sanitary registration procedures and the interconnectivity of Ministry of Health (MINSAL) systems to improve the registration process for foods and beverages. The objective is to streamline sanitary registration formalities for foods and beverages by improving and automating this process. The ultimate goal is to reduce the wait time for the registration of foods and beverages from 104 days to 52 days or, in other words, by 50 percent (Graphic 2).

iv. Strengthen the private sector and provide training in trade facilitation to improve the clearance of goods through customs. The objective is to improve efficiency in foreign trade procedures at border checkpoints and port facilities by combining the implementation of measures for strengthening the private sector with the provision of training, as well as by improving the customs risk management systems of businesses engaged in foreign trade and helping them obtain certification as authorized economic operators (AEOs).

v. Develop an integrated border management certification system. The objective is to provide border control personnel with necessary training for obtaining certification in integrated border management to shorten delays and reduce costs, promoting inter-agency coordination. These measures are an extremely important part of the customs union process (Graphic 2).

Graphic 2. Measures for reducing wait times and costs in the conduct of foreign trade by 30 percent



Source: Produced by the author based on USAID, 2021

Guatemala is also implementing measures designed to improve procedures within the custom union for fulfilling tax obligations before border arrival to further improve time and cost savings. This will benefit Honduras and El Salvador when it officially accedes to the union.

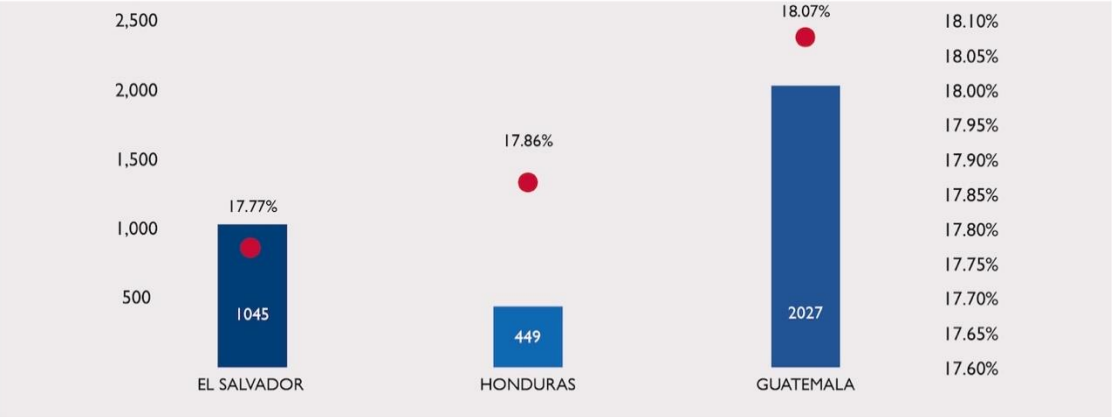
A two-step gravity model was used to assess the impacts of measures designed to facilitate trade and reduce border crossings times (USAID, 2021). The first step involved an assessment of factors with a bearing on border crossing times affected by matters which are not directly trade-related but still have an impact on trade, such as red tape (required documents and formalities), the use of technology and digitalization, geography, corruption, and the institutional environment (the ease of doing business). This more comprehensive measurement included elements other than those pertaining to the volume of trade that can affect time in trade.

The second step involved measuring distance and the size of the economy, combining multiple factors affecting trade. It also included an evaluation of the importance of other variables included in the gravity model, such as tariff costs for different country pairs, distances between countries, whether or not the country is landlocked, whether it is a party to any regional trade agreement, whether the countries share a common border (proximity), and whether they have an official reciprocal trade agreement.

The data produced by the gravity model for El Salvador assessed the impacts of trade facilitation as follows:

- The Northern Triangle countries will see a sharp growth in trade with the implementation of trade facilitation measures and improvements in the customs union. Exports by El Salvador will increase by 17.77 percent, or US$1,045 million. There will be a slightly larger increase in Honduran exports of 17.86 percent (or US$449 million), while exports by Guatemala will grow by 18.07 percent (or US$2,027 million) (Figure 12).

Figure 12. Gravity model: Impact of trade facilitation on exports (US$ million and annual percentage change)



Source: USAID 2021.

- The effect on imports is more moderate than on exports. According to the model, imports by El Salvador will increase by 4.8 percent, or US$551 million, compared with a 4.77 percent (US$431 million) boost in Honduran imports and a 4.69 percent (US$925 million) boost in imports by Guatemala (Table 6).

- Nominal GDP is projected to grow by US$442 million or by 1.6 percent compared with 2021 in the case of El Salvador, by US$910 million in the case of Guatemala, and by US$641 million in Honduras (Table 6). The average growth in nominal GDP in El Salvador is estimated at 0.64 percent.

- Table 8 shows these and other impacts on nominal and real GDP per capita, employment, and direct foreign investment.

Table 8. Impacts of a 30 percent time savings in the conduct of trade: El Salvador, Honduras, and Guatemala

Description	El Salvador	Guatemala	Honduras
Exports	17.77%	18.07%	17.86%
Imports	4.80%	4.69%	4.77%
Nominal GDP, US$ millions	442.0	910.0	641.0
Nominal GDP per capita % growth	0.14%	0.09%	0.21%
GDP per capita, real % growth 1/ employment 1/	0.22%	0.14%	0.31%
Foreign investment, US$ millions	6,692	10,923	15,712
1/GDP per capita and employment growth is for 10 years	11.5	13.5	40.3

Source: USAID 2021

IMPACTS OF THE CUSTOMS UNION ON EL SALVADOR BETWEEN 2022 AND 2026

It takes time for economic and regulatory reforms to make an impact on a country's economic development. Hence the need to establish a methodology for following up on previous studies (ECLAC, 2019 and USAID, 2021) and assessing the impacts of the customs union in a dynamic timeline, specifically 2022 to 2026. The COVID-19 pandemic created atypical volatility in economic trends and patterns of trade, with its impact on the global economy, combined with the lockdowns imposed in each country, causing their economies to contract at different rates in 2020, while the combination of reopening measures and a strong expansionary monetary and fiscal policy in 2021 triggered a sharp global expansion and strong recovery which, with the surge in demand, produced historical price hikes and created serious problems in global logistics chains. According to the IDB (2021), El Salvador, Honduras, and Guatemala were among the top ten countries with the longest lockdowns in 2020, while Honduras suffered damage from two hurricanes at the end of the year, which slowed its economy. These are all atypical, transitory phenomena creating volatility in economic variables.

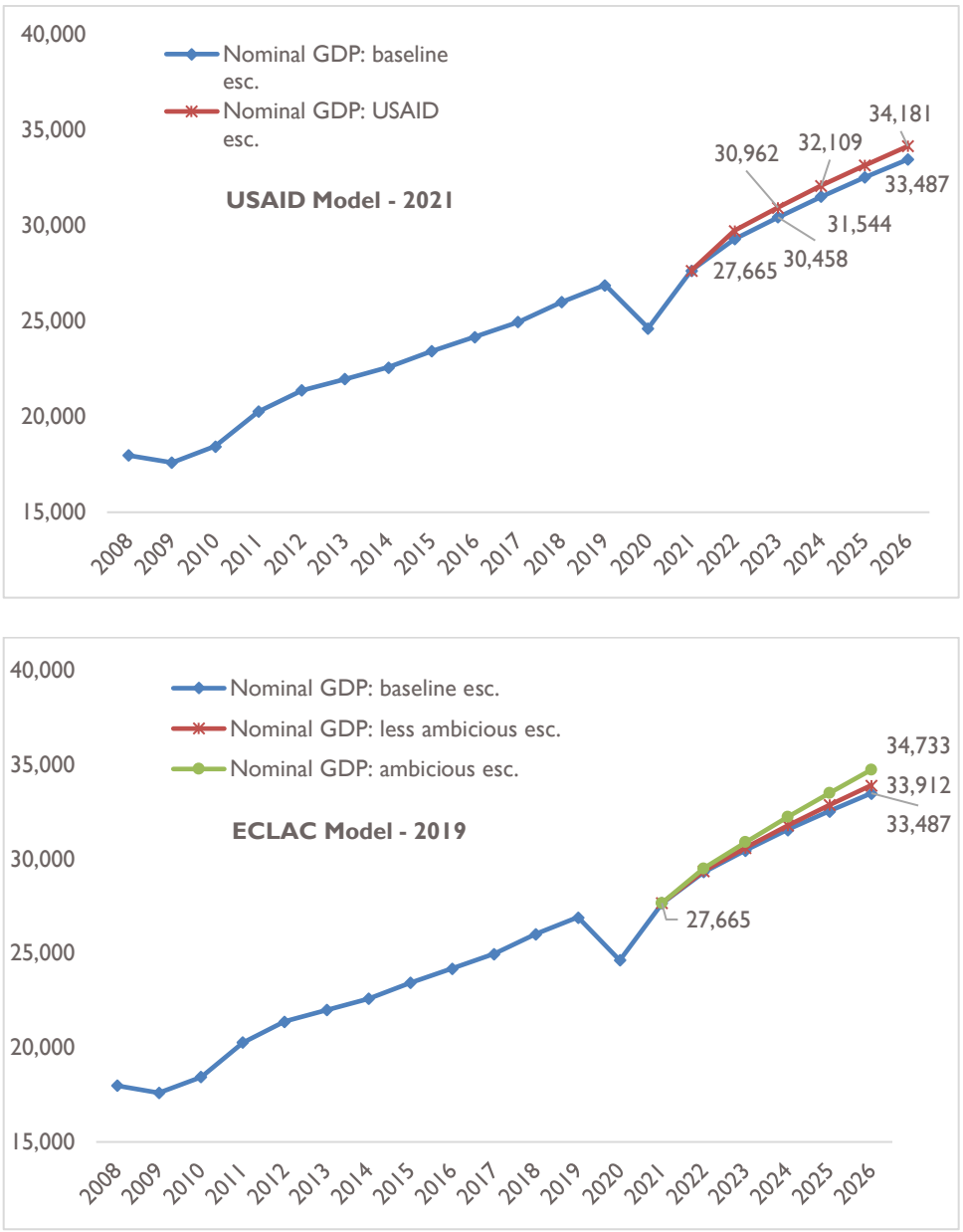
Thus, given the complicated circumstances affecting future trends in macroeconomic variables, the most recent macroeconomic projections published by the International Monetary Fund (IMF, 2021) were used to establish a baseline scenario for the period 2022 - 2026. The next step involved projecting the impact of trade facilitation measures using the parameters estimated by USAID (2021) and ECLAC (2019). This procedure used the IMF's knowledge of how to visualize the economic recovery and return to normalcy as its basis, incorporating the public policy impacts of the implementation of the customs union as estimated by ECLAC and USAID. This juxtaposition of two different methodologies based on the gravity model provided a quantitative assessment of the importance of El Salvador's accession to the customs union in an environment in which all economies are looking to accelerate their growth.

Impact on economic growth

The size of the economy in the baseline scenario (IMF, 2021) grows from US$27,665 million in 2021 to US$33,426 million by 2026, at an average rate of 3.9 percent.

The USAID model (2021) estimated that a 30 percent reduction in time in trade will increase exports by 17.77 percent, with a positive impact on the growth of GDP. This premise was used as basis for estimating nominal GDP adjusted for the trade facilitation measures by converting the annual 0.14 percent growth in GDP per capita (Table 8) into a growth rate for nominal GDP using the rate of population growth for the last five years (0.5 percent), which was added to the rate for GDP per capita, putting the annual impact on nominal GDP at 0.64 percent. Applying this rate to the baseline scenario would bring nominal GDP up from US$27,665 million in 2021 to US$34,181 million by 2026 (Figure 13), which is US$694 million above the baseline scenario and puts the average rate of growth at 4.3 percent which, again, is above the baseline scenario.

Figure 13. The customs union and trade facilitation: Impact on nominal GDP (In US$ million)



Source Projections by the author based on the IMFI-2021, USAID-2021, and ECLAC-2019 models.

ECLAC assessed the impact of El Salvador's accession to the customs union under two scenarios, a less ambitious scenario in which time in trade and costs are cut by 30 percent and an ambitious scenario in which current delays and costs are cut by 60 percent. Actually, the customs union is envisioning a substantial reduction in border crossing times for goods in free circulation, as discussed later in the report. The assessment of the union's impact over the period from 2022 to 2026 took the estimated effect of the time savings on real GDP and converted it to nominal GDP by adding

the estimated GDP deflator for each year of the IMF projection, expanding out from the year 2021. This produced the following results:

- In the less ambitious scenario, the size of the economy grows from US$27.665 million in 2021 to US$33,912 million by 2026 (Figure 13), which is under the USAID estimate, which puts the average growth rate at 3.9 percent, again, under the USAID estimate (4.3 percent).

- In the ambitious scenario, the size of the economy grows from US$27,665 million in 2021 to US$34,733 million by 2026, outstripping the USAID estimate, at an average rate of 4.7 percent.

- In the scenario in which El Salvador does not accede to the customs union, its nominal GDP is at US$33,169 million in 2026, below the figures for the baseline scenario (US$33,426 million) and from the USAID model (US$34,181 million). In this scenario, El Salvador is affected by trade diversion and the decline in investment in the region.

Impact on real growth

In the baseline scenario, the economy grows at an average annual rate of 2.4 percent between 2022 and 2026, with a 3.5 percent peak in growth in the year 2022, followed by a gradual slowdown until bottoming out at 1.8 percent in 2026.

Including the impact of the 30 percent savings in time in trade as estimated by the USAID (2021) model boosts real economic growth to 2.9 percent for the period from 2022 to 2026, averaging 0.5 percent above the baseline scenario. According to the projections, the enactment of all trade facilitation measures in Year 1 which, in this case, would be 2022, would put growth at 5.4 percent, subsequently slowing to 2.0 percent by 2026 (Figure 14). In comparison, El Salvador's economy grew by an average of 2.5 percent between 1990 and 2019. Thus, the implementation of public policies boosting productivity and improving efficiency in the conduct of trade speeds up growth significantly.

Figure 14. The customs union and trade facilitation: Impact on real GDP (%)

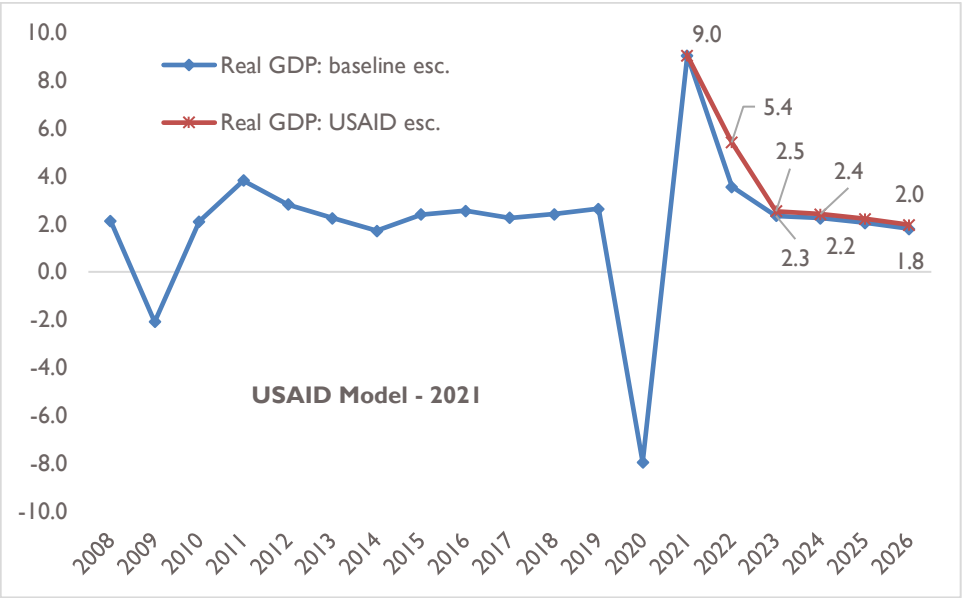
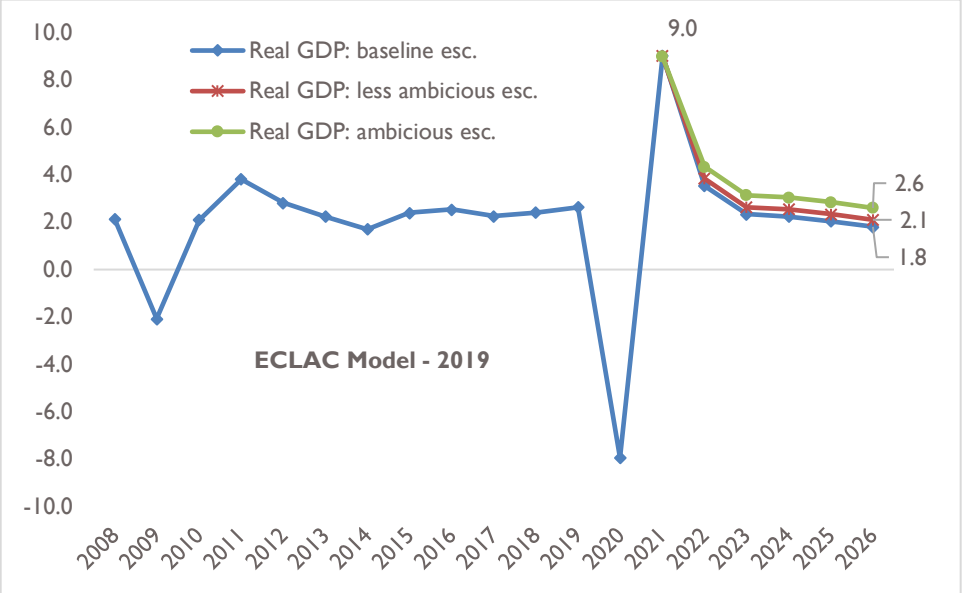


Figure 14. The customs union and trade facilitation: Impact on real GDP (%) (cont.)



Source: Projections by the author based on the IMF-2021, USAID-2021, and ECLAC-2019 models.

Meanwhile, the ECLAC model produced the following results:

- In the less ambitious scenario, the trade facilitation measures would put the average rate of growth for the period from 2022 to 2026 at 2.7 percent, surpassing the baseline scenario (2.4 percent) but under the projection by the USAID model (2.9 percent).

- In the ambitious scenario, the economy would grow at an average of 3.2 percent between 2022 and 2026, which is the highest of all the estimates (Figure 16). This is 0.8 percent a year more than in the baseline scenario and indicates that the more efficient the conduct of trade through the customs union, the greater the benefits for [economic] growth.

- In the scenario in which El Salvador does not accede to the customs union, without the country's full integration into the customs union, its average rate of growth drops to 2.2 percent, below the baseline scenario (2.4 percent) (Figure 16). This outcome is due to the fact that Salvadorean goods will more than likely be impacted by the substitution effect on Honduran and Guatemalan markets, where the lower cost of goods produced in those countries (not subject to ad valorem tariffs) will help make their prices more competitive and enable them to crowd out Salvadorean goods, which will be more expensive and less efficient in making their way onto consumer shelves. Interviews of members of trade associations in Guatemala revealed that Salvadorean goods were already noticeably suffering from the substitution effect on certain markets, which will continue to be the case as long as El Salvador is not in the union.

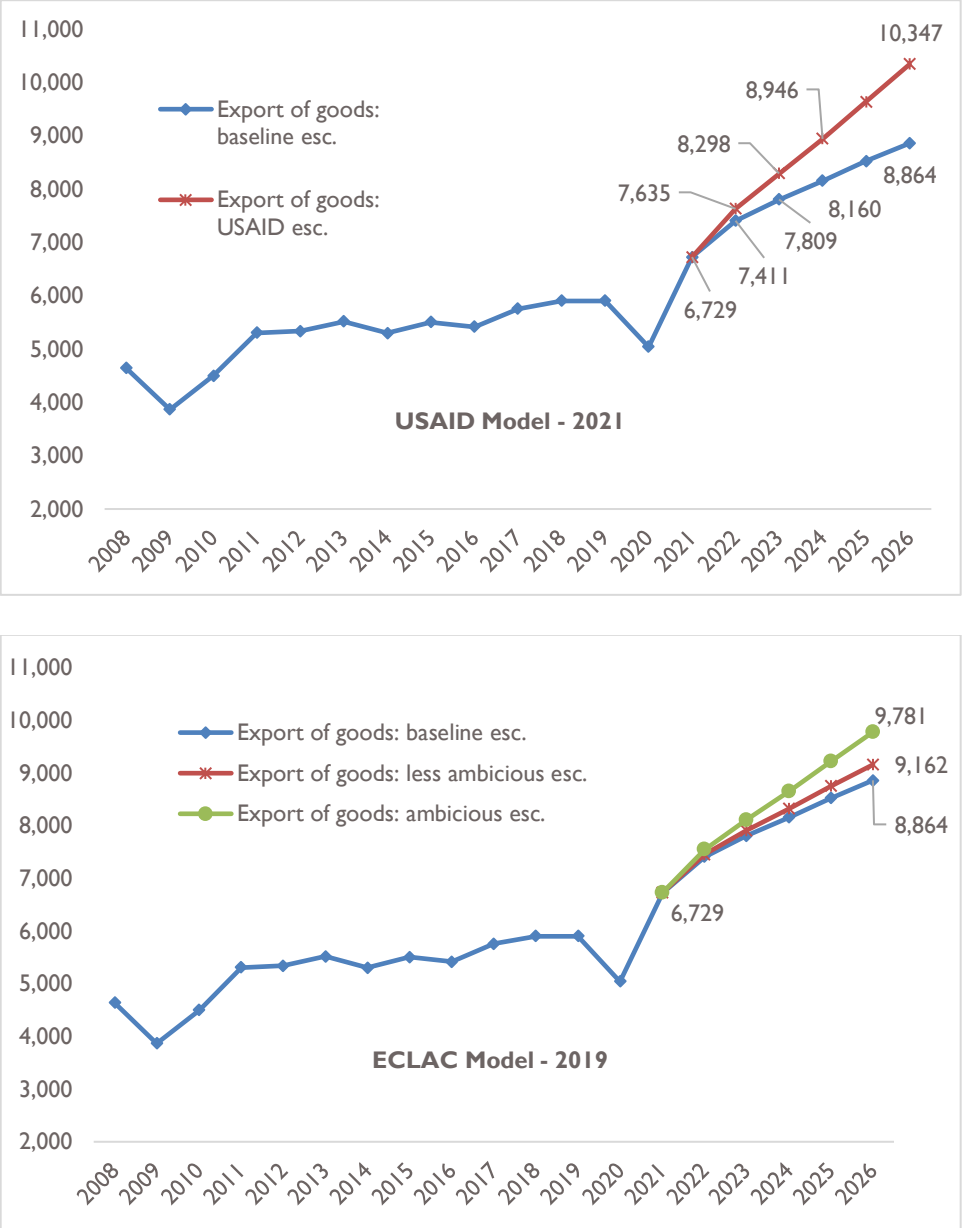
  The fact that the Salvadorean business owners interviewed were clearly interested in expanding and solidifying their logistics operations in an expanded community territory is noteworthy. Moreover, at the international level, there is a trend to relocate production chains supplying the United States from Asia to areas closer to the U.S. border, offering Latin America an opportunity to get new production facilities or distribution networks. Accordingly, this could make the existence of a

customs union more interesting for the establishment of large-scale operations. On the contrary, the installed capacity of a single individual country is not much of an attraction.

Impact on exports

In the baseline scenario, exports grow at an annual rate of 5.7 percent between 2022 and 2026, with the largest growth spurt in the year 2022, at 10.1 percent, subsequently slowing to 4.0 percent by 2026, which puts their value at US$8,864 million.

Figure 15. The customs union and trade facilitation: Impact on exports of goods (In US$ million)



Source: Projections by the author based on the IMF-2021, USAID-2021, and ECLAC-2019 models.

The USAID-2021 model estimated the impact of the 30 percent savings in time in trade at US$1,045 million, the equivalent of a 17.77 percent increase in exports over the next five years. The share of exports by El Salvador to the member countries of the customs union (Guatemala and Honduras) averaged 24 percent (for the period from 1994 to 2019) and tariff items in free circulation within the customs union are expected to account for 75 percent of trade. Applying these figures to the growth in exports puts their average rate of growth at 9.0 percent and the value of exports in 2026 at US$10,347 million, outperforming the projection for the baseline scenario (Figure 15).

Meanwhile, the ECLAC model estimated the impact at 0.7 percent in the less optimistic scenario and at 2.1 percent in the ambitious scenario. These growth rates, applied to the baseline scenario, put the value of exports at US$9,162 million in 2026 in the less ambitious scenario and at US$9,781 million in the ambitious scenario, both of which figures are under the estimate from the USAID model.

Impact on imports

In the baseline scenario, imports would grow at an average annual rate of 4.6 percent between 2022 and 2026, which brings their value to US$19,243 million by the last year of that period (Figure 18).

The effect [of the time savings] as established by the USAID (2021) model would boost the value of imports to US$19,722 million by 2026, above the baseline scenario, at an average rate of 5.2 percent, outstripping their 4.6 percent growth rate in the baseline scenario (Figure 16). According to these findings, El Salvador will increase its sales to member countries of the customs union. Thus, this is a win-win measure, benefiting consumers and importers of raw materials with time and cost savings.

Figure 16. The customs union and trade facilitation: Impact on imports of goods: (In US$ million)

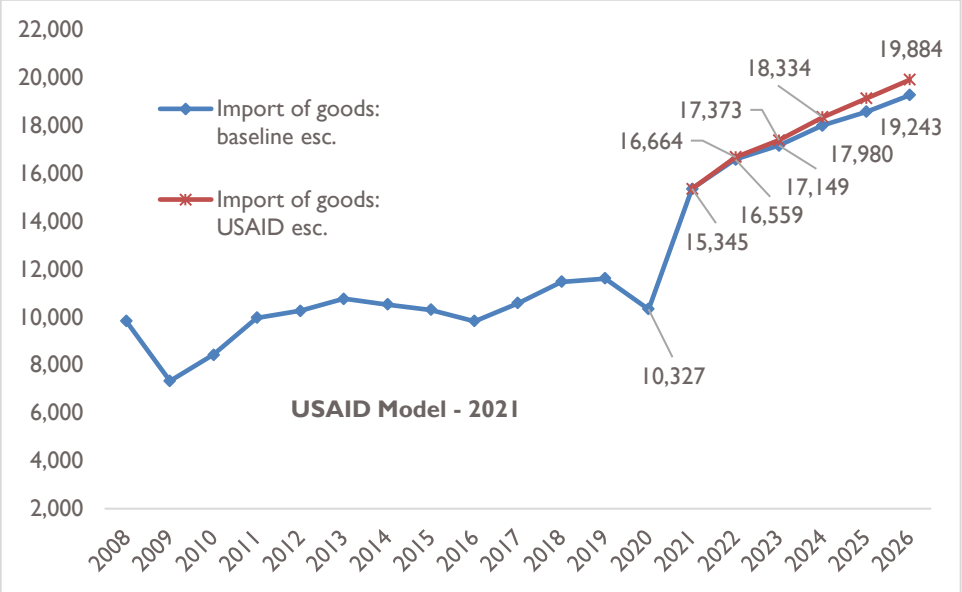
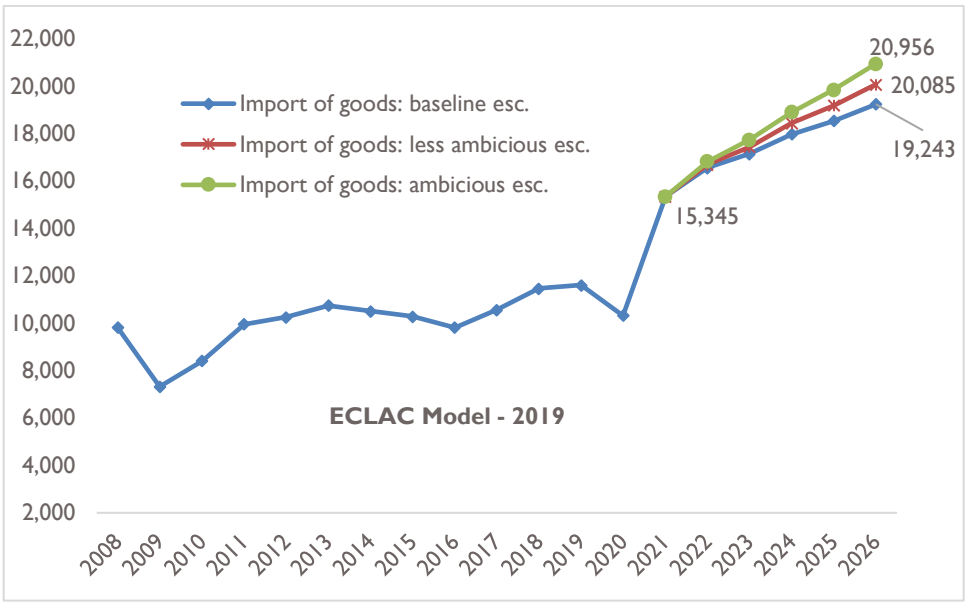


Figure 16. The customs union and trade facilitation: Impact on imports of goods: (In US$ million) (cont.)



Source: Projections by the author based on the IMF-2021, USAID-2021, and ECLAC-2019 models.

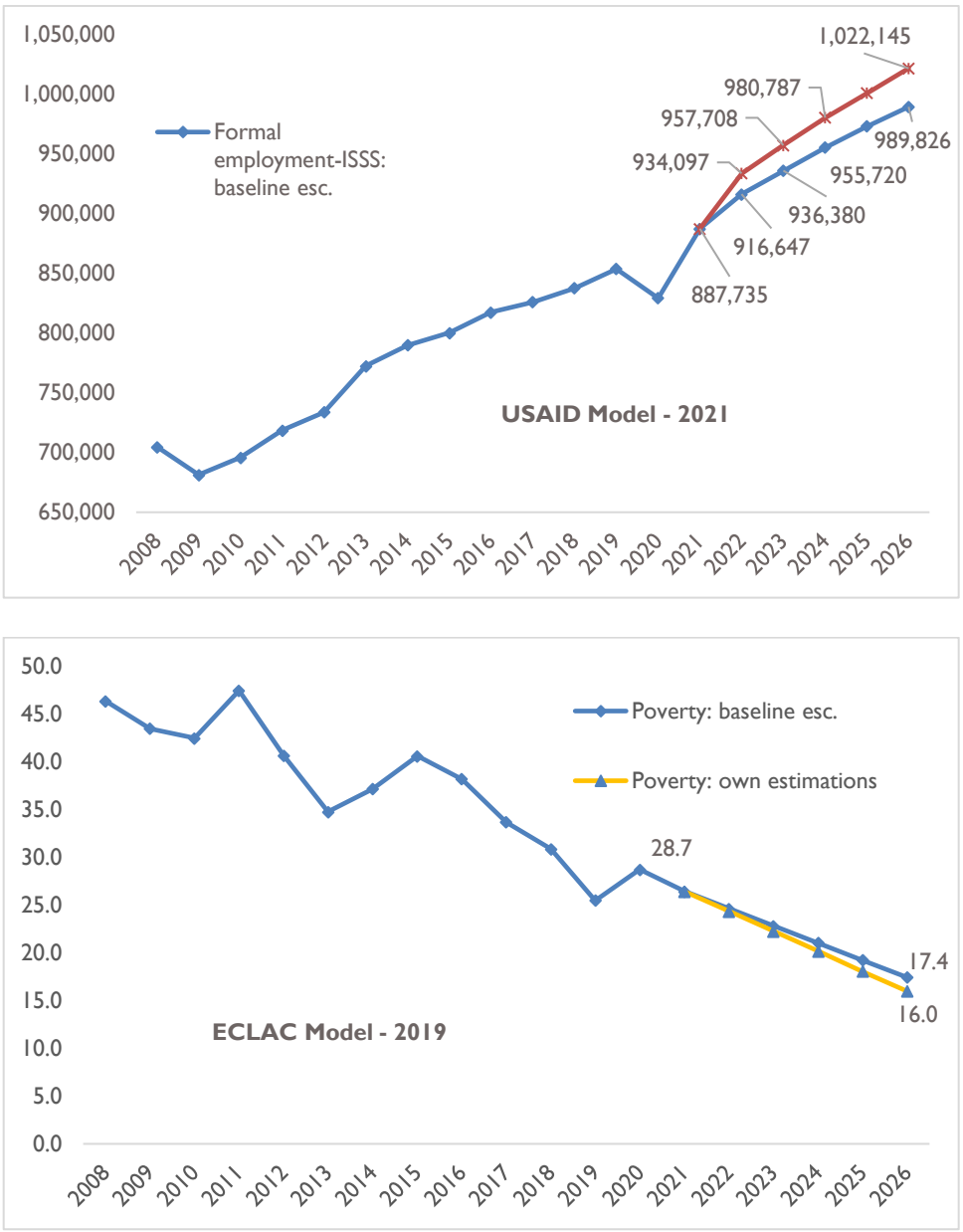
The ECLAC model estimated that El Salvador's accession to the custom union would increase imports by 0.9 percent in the less ambitious scenario and by 1.8 percent in the ambitious scenario. The application of these figures to the baseline scenario puts the value of imports in 2026 at US$20,085 million in the less ambitious scenario and at US$20,956 million in the ambitious scenario, in both cases, outstripping the US$19,884 estimate from the USAID model, by US$201 million in the less ambitious scenario and US$1,072 million in the ambitious scenario.

Impact on employment and poverty

Formal employment, as measured by the number of workers making social security contributions to the *Instituto Salvadoreño del Seguro Social* (ISSS), increased at an average annual rate of 2.3 percent between 2010 and 2019, which is equivalent to the creation of 17,268 jobs per year (prior to the pandemic). During that same period, the real economy increased by an average of 2.5 percent. In other words, on average, employment increased by eight percent in a ten-year span, below the rate of growth of the economy. Over longer time spans, formal employment has shown a high degree of convergence with the rate of growth in GDP. IMF projections of real GDP for the period from 2022 to 2026 estimate its average rate of growth at 2.4 percent. Thus, presumably, formal employment will grow at an average annual rate of 2.2 percent (adjusting for the eight percent discount factor) in the baseline scenario, which is equivalent to the creation of 20,418 new jobs per year (Figure 19).

Estimates of the impact of trade facilitation based on the USAID model projecting real economic growth at 2.9 percent, adjusting for the eight percent discount factor for the growth in formal employment, show an average of 24,623 new hires (41 percent more than reported over the period from 2010 to 2019), which brings the number of jobs in the formal sector to 1.0 million by the year 2026 (Figure 17).

Figure 17. The customs union and trade facilitation: Impact on formal employment and poverty (in numbers of workers and as a percentage of the population)



Source: Projections by the author based on the IMF-2021, USAID-2021, and ECLAC-2019 models.

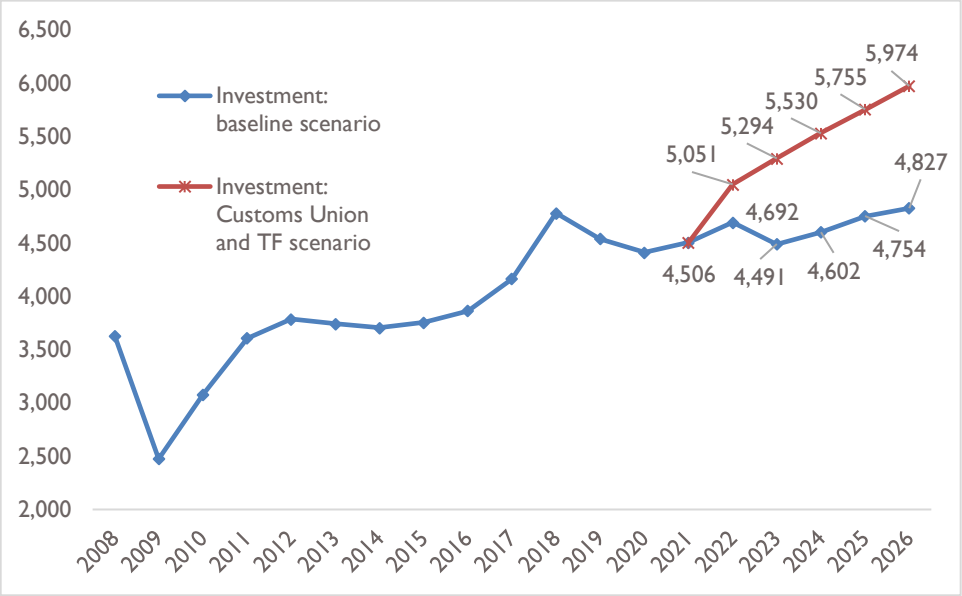
Poverty was measured in relation to economic growth. Thus, poverty rates came down by an average of 1.8 percent a year between 2010 and 2019, while the economy grew by 2.5 percent. Applying this same relationship to the estimates of growth for the period from 2022 to 2026 and estimates by USAID (2021), it follows that the poverty rate would decrease from 26.4 percent in 2021 to 17.4 percent by 2026 in the baseline scenario, while implementation of the trade facilitation measures would cut the poverty rate to 16.0 percent by 2026 and, thus, would have a marginal impact of 1.4 percent.

Impact on investment

IMF projections of investment for the period from 2022 to 2026 put it at 14.9 percent of GDP in the baseline scenario, growing at an average annual rate of 2.4 percent. This is considered low compared to the period from 2010 to 2019, when the ratio of investment to GDP was 17 percent, growing at the rate of 2.5 percent a year. Thus, given that the growth scenario based on USAID (2021) measurements projects an average 2.9 percent growth in investment, while the ECLAC model estimates the growth in investment at between 2.7 percent and 3.2 percent, the investment-to-GDP ratio will presumably remain at 17 percent, the same as it was between 2010 and 2019. While conservative, this figure is still substantially above the baseline scenario.

Thus, investment would grow by an average of US$64 million a year (between 2022 and 2026) in the baseline scenario and the annual impact in the trade facilitation scenario would average US$294 million a year, which is equivalent to 1.0 percent of GDP (Figure 18).

Figure 18. The customs union and trade facilitation: Impact on investment (In US$ million)



Source: Projections by the author based on IMF-2021.

The interviews of business owners and trade association members conducted as part of the study revealed an interest in boosting investment and capitalizing on the Northern Triangle Customs Union market. Thus, there are opportunities for fueling growth, for each country individually and for the three countries as a whole, by attracting new businesses mindful of the resources offered by an expanded customs territory but currently deterred by the red tape and delays at border crossings, discouraging investment in the three countries.

IMPACT OF MONETARY AND EXCHANGE POLICY ON COMPETITIVENESS

Monetary policy involves the decisions made by central banks to influence the cost of money and the amount of money available within an economy[6]. According to the IMF[7], the objective is to achieve price stability and reduce economic fluctuations, with the ultimate goal of softening any impacts on the economy caused by GDP variability.

The instruments of monetary policy are interest rate and the amount of money in the economy. To influence the economic cycle, the central bank can increase or reduce the volume of money through the sale and repurchase of public securities. In this way, it seeks to control interest rates over the short term, which in turn have an influence on longer-term rates and on economic activity in general, although in some countries, particularly low-income countries, the mechanism for applying monetary policy is not as effective as it is in more advanced economies.

Monetary policy operates in a manner parallel to exchange policy. A country defines its exchange rate system based on its policy preferences or its goals in terms of stability, and this policy may range from completely fixed (dollarization) to completely flexible, with a number of intermediate stages, including, among others, fixed rate of exchange, currency board, fixed bands, floating bands, and dirty floats.

In Central America, El Salvador and Panama have in place a fixed rate of exchange with substitution of their own currency for foreign currency (dollarization). Guatemala, Honduras, Nicaragua, and Costa Rica, on the other hand, have in place different types of flexible exchange rate. According to the IMF, a country with a fixed exchange rate has a more limited margin of maneuver than a country with a flexible exchange rate. Thus, it can be said that El Salvador does not have an explicit monetary policy, although it still maintains some mechanisms for influencing interest rates, such as, for example, bank reserves.

Based on the system currently in place, monetary and exchange policy is managed differently between three countries of the customs union. In recent years, there has been a trend toward a decrease in inflation in all three countries, with the exception of 2021, when as a result of effects brought on by the situation at the international level, prices reflected increases that exceeded recent trends.

As regards the impact on competitiveness, investors hope that an economy will have stable prices (with controlled inflation) and a rate of exchange that is favorable to exports. The combined effects of these two variables can be analyzed using the Real Effective Exchange Rate (REER) index, which compares the purchasing power of one country to that of one trading partner in particular or to that of a group of countries. The value of the index depends then on the price levels in the country in question and in the partner country or group of countries, as well as on the nominal rate of

[6] Banco Central Europeo: Introduction (europa.eu)
[7] Factsheet: Política monetaria y actividad de los bancos centrales (imf.org)

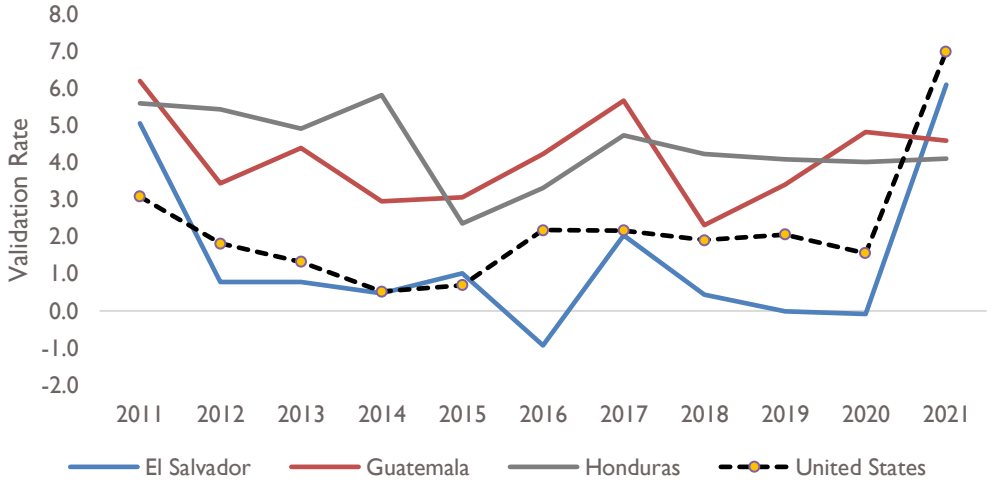
exchange[8]. If the REER is greater than 100, the rate of exchange is depreciated, indicating that the country is more competitive than the country or group to which it is being compared, while if the REER is less than 100, the rate of exchange is appreciated, indicating that the country is less competitive than its trading partners. Finally, when the index is in equilibrium at 100, it reflects a situation of indifference for the buyer, i.e., there is no difference between buying from one country or the other.

- **Dollarized El Salvador records gains in competitiveness**

In the Northern Triangle, El Salvador shows the lowest level of inflation over the longer-term, which, when added to the nominal rate of exchange pegged to the US dollar, means that businesses, in order to be competitive at the international level, must resort to strategies for increasing productivity in order to keep costs down (investments in physical capital, technological innovation, human capital, etc.). Guatemala and Honduras, on the other hand, have in place a semi-flexible rate of exchange with domestic management of inflation, which may, to some extent, affect the structural competitiveness of the businesses of those countries.

When conducting an in-depth analysis of the evolution of prices in the region of the customs union, El Salvador effectively enjoys advantages in this area, since the dollarization allows inflation in that country align with inflation in the United States. In practice, over the past 10 years, El Salvador has averaged a lower rate of inflation than the United States (1.4 percent vs 2.2 percent). Guatemala and Honduras, on the other hand, have recorded greater price increases over the past 10 years, 4.1 percent and 4.4 percent, respectively, and find themselves at a disadvantage vis-à-vis their primary trading partners (the United States and El Salvador). The exception is 2021 which was an atypical year due to the situation prevailing at the international level, involving issues with the global supply chain.

Figure 19. Inflation in the Northern Triangle and the United States 2011-2021



Source: Own elaboration with IMF data.

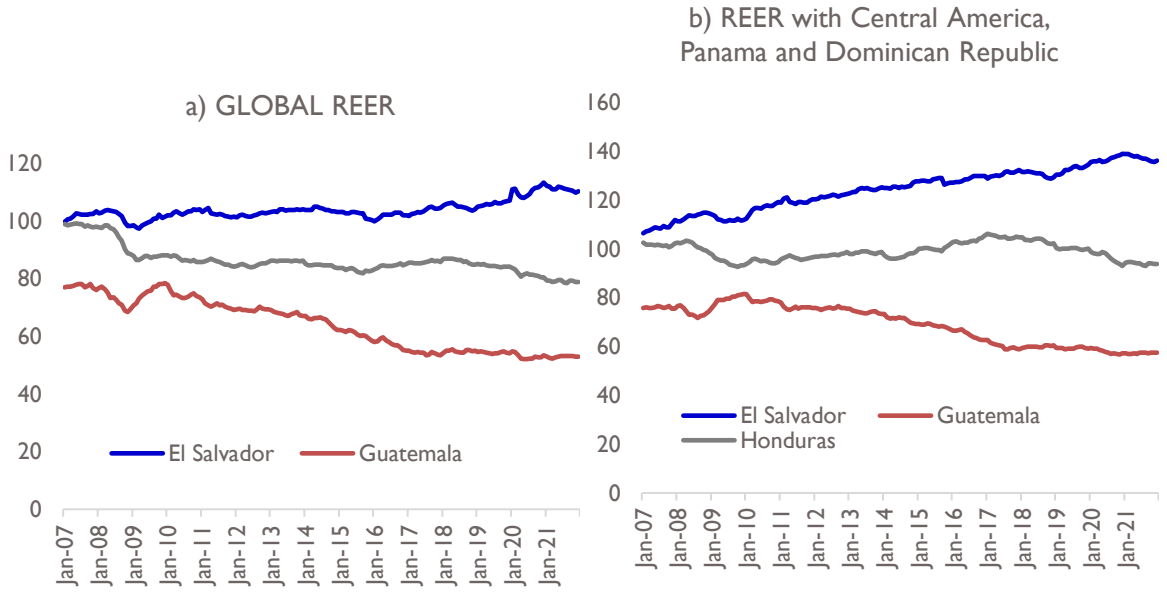
[8] REER is calculating using the formula: $ITCER = \frac{TCN * P_e}{P_i}$, where: TCN= nominal rate of exchange; Pe= external prices; Pi= internal prices.

Within aforementioned conditions and using data from the Secretariat of the Central American Monetary Council (SECMCA), over the past 15 years El Salvador has found itself on positive trend in regard to both global REER and REER with the United States, the other countries of Central America, and Panama and the Dominican Republic (CAPRD). This indicates that the country enjoys advantages when exporting its goods to those markets. REER of Guatemala and Honduras, on the other hand, is below the equilibrium point, indicating losses in competitiveness. When comparing the index for all three countries, El Salvador exceeds Guatemala and Honduras on both indices, with the gap widening in recent years.

If we analyze the relationship of each of these countries to the United States, El Salvador for the past 20 years experienced a negative trend in terms of REER, although at present it is at an equilibrium, signifying that a buyer is indifferent to purchases goods produced in the United States or El Salvador. Honduras and Guatemala, on the other hand, maintain their appreciated real rates of exchange, a situation that has led to substantial losses in competitiveness.

In the case of Guatemala, the loss of competitiveness can be explained not only by its greater rate of inflation, but also by the way in which Guatemala's exchange policy operates as it has a flexible rate of exchange, but the Banco de Guatemala has established a fluctuation band of 0.9 percent, which prompts it to participate in the market by buying or reselling dollars. In addition, Guatemala has a strict policy regarding accumulation of international reserves, but the policy is not strong enough to neutralize the substantial entry of foreign currency from family remittances, which applies pressure to maintain an appreciated exchange rate (structural Dutch disease effect).

Figure 20. REER of the countries of the Northern Triangle with the world and with Central America



Source: Own elaboration with SECMCA data.

The same is true in Honduras, whose exchange policy consists of a band that permits 1 percent fluctuations upward or downward from the center of the band. As in the case of Guatemala, the strong inflow of family remittances in dollars keeps the exchange rate at an appreciated level.

The aforementioned situation provides El Salvador an opportunity to obtain significant gains from a full incorporation into the customs union, as a result of economies of scale, increased productivity, a fixed rate of exchange and price stability. These results are also attractive to new investors, who seek an economy that can compete in the international market.

- **Impact of the use of cryptoassets in trade transactions within the Northern Triangle**

On September 7, 2021, El Salvador enacted the Bitcoin Law[9], a provision that designates the cryptocurrency as legal currency and allows the currency to be used freely and without restrictions in the discharge of any transaction that for any reason natural or legal persons wish to make (Art. 1).

To implement this provision, the government approved a US$30 voucher (subsidy) to Salvadoreans who download the Chivo electronic billfold app (a US$30 million fund had been established for the subsidy). The government supported the installation of an initial network of 200 Chivo ATMs with the ultimate goal of installing some 1,500 throughout the country). To ensure certainty vis-à-vis the dollar and to guarantee convertibility, the government created a trust known as Fideicomiso Bitcoin (FIDEBITCOIN) in the amount of US$150 million. According to the government, the Chivo app had been downloaded by 3.8 million users by the end of 2021. In addition, as of October 28, 2021, the government had acquired 1,200 bitcoins having a value of US$55 million, according to the International Monetary Fund (Art. IV 2022)[10].

However, after five months of operation, the use of cryptocurrency in daily consumption transactions has been quite limited. A number of surveys conducted by academic institutions show that, of the total number of Chivo app users, only 4.2% use it on a daily basis, while at the business level, those who report making at least one purchase during the month account for only 10% of the country's total economic units. Likewise, family remittances sent via the Chivo platform from September through December 2021, despite not having to pay a transfer fee, account for only 2.1% of the total amount received in the country during that time span.

In an evaluation conducted in January 2022, the IMF recommended that El Salvador eliminate the bitcoin as legal currency, owing to the high risks to the financial sector, the government, and consumers. It estimated that short-term costs will be greater than the benefits from bitcoin implementation, since the costs incurred total 1% of GDP and the benefits only 0.25%, with the latter estimated as a function of the arrival of more tourists, increased use of bitcoin for consumption, and the lower cost of sending remittances.

[9] D.L. 57, dated June 8, 2021.

[10] For a more complete analysis of Art. IV published by the IMF on January 28, 2022, see the following link h*ttps://www.imf.org/en/Publications/CR/ Issues/2022/01/26/El-Salvador-2021-Article-IV-Consultation-Press-Release- Staff-Report-and-Statement-by-the-512245*

Given aforementioned situation, use of the bitcoin is characterized by uncertainty. In addition, for the time being, no other country in the region has regulated the acceptance of transactions in cryptocurrencies. As a result, bitcoin's use in regional trade will be quite limited. Regional trade with cryptocurrencies is subject to the individual preferences of both consumers and the businesses that accept it. In any case, to these factors, it must be added the considerable volatility of this cryptocurrency, an issued that has been addressed by the IMF. For example, beginning with approval of the law in El Salvador in September 2021 and running through February 2022, the bitcoin/US$ quotation has ranged between US$35,075.20 and US$67,527.90, with a variability of 16.5%, which is four times greater than the volatility of both the Dow Jones and Nasdaq 100 indexes. Bitcoin functions quite well as an investment asset, although by using bitcoin as a means of payment in regional trade, businesses open themselves up to a high degree of risk and face the obligation of converting bitcoin immediately into dollars, as occurs with businesses that currently receive cryptocurrency in payment of goods and services in the country.

IMPACT ON TAX AND CUSTOMS REVENUE

OVERVIEW

In principle, the customs union aims to facilitate the countries' trade by speeding it up and lowering its cost. Guatemala and Honduras have integrated their trade procedures at three shared land borders: Agua Caliente, El Florido and Corinto. Instead of duplicate procedures and paperwork on both sides of the border, the trade between these countries requires a single stop and an online instrument called the "FYDUCA" (Central American Single Invoice and Declaration Form). The customs union established between Guatemala and Honduras liberalized 75% of the trade between the two countries, making them more competitive and productive, thereby improving trading conditions for close to 50% of the Central American population and 52% of the intraregional trade.

On August 20, 2018, the Republic of El Salvador officially joined the Customs Union process, which will bring significant advances that will contribute to the economic growth and the wellbeing of the population in each country. With the inclusion of El Salvador, the three Central American countries whose economic growth will be impacted by the union represent a total of 32.1 million people, equivalent to 73.7% of the population of Central America, and a total of US$6.208.2 million, equivalent to 69% of the region's trade. This makes the region the eighth strongest economy in Latin America.

According to Resolution No. 68-2019, with the incorporation of El Salvador in the customs union, six border customs offices will enter into operation: two with Honduras, in El Amatillo and El Poy, and four with Guatemala, in La Hachadura, Anguiatú, Las Chinamas and San Cristóbal. The increased movement of goods across borders resulting from the customs union will make it possible to speed up border crossing procedures and lower transaction costs for all exporters and for users of border checkpoints.

Customs unions are one way of integrating trade between two or more countries and provide small countries a strategy for coping with globalization. In general, a customs union expands the markets to which the region has access and grants preferential treatment among partners.

The market expansion resulting from the customs union has several positive effects:

- The progressive elimination of tariffs stimulates trade among the partners in the union.
- The increased competition and availability of supply promotes specialization and lower costs, so economic efficiency tends to improve.
- The economies of scale brought about by the increase in market size improve efficiency. The fixed unit costs of production decline because companies are able to produce a higher number of units.
- Investment increases as a broader market in the region offers incentives to domestic and foreign investors.

The region's negotiating capacity may improve because several countries can defend positions together and optimize their use of each one's technical capacity.

The tax revenue collection mechanism:

This mechanism aims to solve two problems: the one resulting from differentiated tariffs imposed on extraregional trading partners and the one resulting from the need to determine the country in the subregion to which the revenue from tariffs would correspond. This tariff revenue comes from the payment made for a good that enters Central America and moves to the country of final consumption. The Framework Agreement Establishing the Central American Customs Union stipulates that the tariff revenue will always correspond to the country in which the good is consumed (destination country principle).

Therefore, in accordance with article 7 of the Regulations for the Operation of the Customs Union, the tax treatment to be accorded to goods coming from third countries, with regard to the payment of the tariffs, is as follows:

a) Goods that come from third countries and are nationalized in the single customs territory will be subject to the tariff in the country of the union where they are nationalized.
b) Once the abovementioned goods are nationalized, they will be in free circulation, i.e., their sale to another country in the union will proceed without payment of the tariff in the destination country.

Thus, under the destination principle, the customs union aims to avoid the double payment of tariffs on products imported/acquired from third countries, making it necessary to pay the tariff just one, in the first country of the union where the goods are nationalized. This is justified by the fact that a good that has been nationalized in one of the countries in the customs union becomes a community good with the right to free circulation within the single territory.

Based on the above, there is no need to create an Import Tariff Reimbursement Mechanism similar to the one that was approved in 2015 in Central America under the EU-Central America Association Agreement.

From the fiscal perspective, customs enforcement should focus on ensuring the correct payment of the taxes applied to foreign trade. Prior to the launch of the Customs Union between Guatemala

and Honduras, the work of the Technical Groups in Central America focused on making the collection of these taxes viable in a customs union scheme that was, in this case, imperfect.

The main advances achieved before the customs union between Guatemala and Honduras entered into force include:

- The agreement on the tax revenue collection mechanism.
- The drafting of the Convention on the Reconciliation of Domestic Taxes Applicable to Trade among the Member States in the Central American Customs Union.
- The signing of the Convention on Mutual Assistance and Technical Cooperation between the Central American Tax and Customs Administrations.
- Advances in customs harmonization, customs procedures, and tariff harmonization.[11]

OPERABILITY OF EL SALVADOR'S TAX AND CUSTOMS SYSTEM

The Salvadoran tax system is composed of a set of taxes, fees and tariffs. As a result of the tax simplification trend that was dominant in the 90s, in El Salvador, 85% of tax revenue comes from Income Tax and VAT, while the remaining 15% is provided by selective taxes on consumption (alcoholic beverages, beer, cigarettes, non-alcoholic beverages, etc.), a group of special taxes called special contributions (gasoline taxes supporting the highway conservation and transportation funds FOVIAL and COTRANS, tourism taxes, etc.) and other taxes, such as the tax on the transfer of real property. These taxes are administered by the Internal Revenue Service (Dirección General de Impuestos Internos, DGII).

The tax system is complemented by the application of taxes on foreign trade, which essentially consist of tariffs, the import VAT, and the specific taxes applicable to imports. These taxes are administered by the Customs Service (Dirección General de Aduanas, DGA), an entity that is also responsible for overseeing the free trade zone regimes, inward processing warehouses and private bonded warehouses.

IMPACTS OF THE CUSTOMS UNION ON TAX AND CUSTOMS COLLECTION (PREVIOUS STUDIES)

Although the average Central American tariff (Most-Favored-Nation, MFN) is close to 6%, when all the free trade agreements signed by the region are considered together, along with those signed individually by some countries, the average tariff applied drops to 2%, which highlights these countries' high level of trade openness.

Because the free trade zone applies to 99% of the goods in the Central American export portfolio, tariff protection for intraregional trade is very low. The average tariff for intraregional flows is 0.8%, though it is higher on food, beverages, and tobacco, mainly due to some exceptions included in Annex "A" of the General Treaty on Central American Economic Integration (Tratado General de Integración Económica Centroamericana, TGIEC).

[11]The above is based on the Official website of the Central American Integration System: https://www.sica.int/iniciativas/aduanas

Although tariff protection is very low, administrative barriers to trade, reflected in the time required to export and import, as well as other non-tariff measures, mean that Central American imports face an additional tariff of 18%, on average (ECLAC, 2018). This is higher in the case of agricultural and livestock products, textiles, clothing, and footwear, as well as agro-industrial products. It is clear that the high administrative barriers to trade are the main problem for the average exporter in Central America.

According to a 2018 report by the ECLAC entitled "The Central American Trade Union: potential economic and social impacts", a deepening of the Customs Union could erode tax collection in Central American countries. The results presented in the report do not evaluate the effect of a decrease in the tariffs applied to third countries or disbursements for investments in customs infrastructure. What they do show is the impact of trade facilitation measures on the flows of traded goods, which are then subject to collection through value added taxes or special taxes. In other words, the tax collection analyzed in the report is calculated as the fiscal effects of the increase in imports following the application of a trade facilitation program.

According to the ECLAC (2018), the application of an ambitious trade facilitation program between Honduras and Guatemala would increase tax collection by 37 and 41 million dollars, respectively, which is equivalent to 0.2% and 0.1% of GDP. In a less ambitious program, the expected positive effect on tax collection is lower: 21 and 27 million dollars for Honduras and Guatemala, respectively.

The scenarios that include El Salvador in the customs union estimate slightly higher increases in tax collection in all cases, especially in the scenarios with more ambitious tariff reductions. Guatemala and Honduras would reach higher collection increases than in the case of the bilateral customs union. In any case, the increases in tax collection for the set of countries in the Northern Triangle hold steady at around 0.1% of GDP.

In simulations that consider a broader customs union, the impact is also positive, with an estimated increase in tax collection of between 324 and 652 million dollars, depending on whether the program is more or less ambitious. In the ambitious scenario, the share of GDP rises to 0.3%. The biggest impact in terms of tax collection would be in Nicaragua, Honduras and El Salvador. In Nicaragua, the increase in tax collection would reach 0.7% of GDP. This is because the tax rate in Nicaragua is among the highest in Central America. The other countries with estimated increases in tax collection under the ambitious scenario are Honduras and Guatemala: Honduras because it also has a high VAT rate (15%) and Guatemala because it would receive a larger increase in imports (9%). In all the countries considered individually, the estimated tax collection following the deepening of the customs union is higher due to the benefits generated by the expansion of the customs territory.

ECLAC-COMEX (2015) performed an exercise similar to the one presented here for the case of a drastic reduction in *ad valorem* equivalents, on the order of 95% of the calculated values. If this were the case, the increase in tax collection for all of Central America was estimated on the order of 364 million dollars in 2015 and 1,044 million dollars in an ambitious scenario, resulting in an expected tax collection of between 0.2% and 0.5% of the combined GDP for all of Central America.

Table 9. Central America: Estimated increase in tax revenues resulting from alternative trade facilitation programs by group of implementing countries (in millions of dollars and percentages of GDP)

Country / Group of countries	Million current dollars			In GDP percentage	
	Ambicious program	Less ambicious program	GDP (2017)	Ambicious program	Less ambicious program
Customs Union 2 (Guatemala and Honduras)	**78**	**48**	**93,481**	**0.1**	**0.1**
Guatemala	41	27	70,806	0.1	0
Honduras	37	21	22,675	0.2	0.1
Customs Union NT (Northern Triangle)	**160**	**101**	**120,888**	**0.1**	**0.1**
El Salvador	52	34	27,407	0.2	0.1
Guatemala	59	40	70,806	0.1	0
Honduras	49	27	22,675	0.2	0.1
Customs Union Central America	**652**	**324**	**252,540**	**0.3**	**0.1**
El Salvador	127	56	27,407	0.5	0.2
Guatemala	151	71	70,806	0.2	0.1
Honduras	113	52	22,675	5	0.2
Costa Rica	115	68	58,909	0.3	0.1
Nicaragua	91	47	13,692	0.7	0.3
Panamá	55	30	59,051	0.1	0.1

Source: ECLAC, based on micro simulations of VAT increases after the implementation of a trade facilitation program

Countries' GDP was obtained from official data base from the Study Center of SIECA. To calculate tax collection, it was considered in each case a tax rate for VAT declared in the Tax Legislation of each country, included if that were the case, some special taxes as well as particular exceptions referred to medicines or food. Tax rate generally applied was: Costa Rica, 13%; El Salvador, 13% Guatemala: 12%; Honduras 15%; Nicaragua 15% and Panama 7%. Among special cases there is a tax rate of 20% for cars in Guatemala, 18% for alcohol and cigars in Honduras and 10% for alcoholic beverages in Panamá. For further details please review ECLAC (2017). The information base to caluclate the taxes was obtained from import increase by sector and country derived from the EGC model.

The results showed that Central American trade in 2017 faced an average protection (including tariff and non-tariff barriers) of close to 20%, with significant administrative barriers, which are particularly high in Nicaragua and El Salvador. At the bilateral level, these barriers are very high in bilateral trade between Guatemala and Honduras. By sectors, the highest costs are in agricultural and agro-industrial products, textiles, clothing and footwear. All this leads to a contraction of trade and to the economic and social losses associated with lower trade flows and higher unit prices paid by consumers.

Based on the estimates, the question we are trying to answer is: What is the probable effect of the application of a concerted policy that unifies the customs territory? As part of the answer, we began by analyzing the Customs Union between Honduras and Guatemala, then the incorporation of El Salvador, and finally the creation of a broader Customs Union with the rest of the Central American countries. This analysis was conducted to observe the macroeconomic and social effects of the application of a customs facilitation program.

METHODOLOGY FOR DETERMINING THE CUSTOM UNION'S IMPACT ON COLLECTION

Conceptually, the establishment of the customs union is expected to have a negative impact on tax collection because of the direct loss of import tariffs (which would be progressively eliminated), which will, indirectly, cause a loss of VAT, since the basis for the calculation of this tax is the sum of the CIF import value and the applicable import tariff. However, this effect could be compensated if the CIF import value increases as a result of the drop in tariff and non-tariff costs, which would lead to an increase in VAT collection.

To estimate the effect that the customs union's entry into force will have on collection over the next five years (2022-2026), we adopted a set of procedures and assumptions, described briefly in this section, and applied them to three scenarios[12]:

- Scenario X: No customs union
- Scenario Y1: Customs union + import growth and total progressive elimination of import tariffs
- Scenario Y2: Customs union + export growth without the elimination of import tariffs
- Scenario Y3: Customs union + import growth and the total immediate elimination of tariffs on goods in free circulation

RESULTS AND IMPACT ANALYSIS

The main results of the estimates made using the methodology described above are presented below, taking into account the current scenario with no Customs Union and the already limited scenarios in which El Salvador joins the customs union.

[12] Details about the methodology used are included in Annex 1.

Current Scenario - Baseline (no customs union)

Table 10 shows the natural trend for trade growth between 2022 and 2026, where there is a decrease in import tariffs (Import Customs Duties, ICD) due to a downward trend in the goods to which tariffs are applied between 2015 and 2019. Import tariffs are expected to decline from US$373,000 in 2022 to US$305,000 in 2026. Likewise, VAT drops from US$13.45 million in 2022 to US$10.8 million in 2026. This is because the goods to which tariffs are applied are being imported less and less, possibly because importers are looking for other markets where tariffs are not applied to goods or where the tariffs are more competitive than those in Guatemala and Honduras.

Table 10. Determination of import tariff and VAT revenue for the chapters that have import tariffs other than zero (Baseline Scenario: no customs union)

	2022	2023	2024	2025	2026
CIF	$ 103,221,280.00	$ 93,517,083.00	$ 87,122,983.00	$ 83,566,016.00	$ 82,716,146.00
ICD	$ 357,507.00	$ 331,316.00	$ 312,660.00	$ 300,986.00	$ 295,983.00
VAT	$ 13,455,349.00	$ 12,200,056.00	$ 11,360,795.00	$ 10,898,304.00	$ 10,788,597.00

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Table 11 shows the trend for goods with tariffs equal to zero. In this case, there is a substantial difference between goods that are subject to tariffs and goods that are not; without tariffs, there is a rise in VAT revenue between 2022 and 2026, from US$218.9 million in 2022 to US$367.7 million in 2026. This increase could be explained by the fact that goods that are subject to a tariff rate of zero are more attractive to import to El Salvador than to countries where the tariff rate is above zero. In addition, the shipping costs are certainly less than they would be if the goods were brought from another region outside the Northern Triangle.

Table 11. Determination of import tariff and VAT revenue for the chapters that have import tariffs equal to zero (Baseline Scenario: no customs union)

	2022	2023	2024	2025	2026
CIF	$ 1,683,831,080.00	$ 1,904,535,899.00	$ 2,165,095,909.00	$ 2,470,169,147.00	$ 2,827,000,843.00
ICD	$ -	$ -	$ -	$ -	$ -
VAT	$ 218,949,948.00	$ 247,556,840.00	$ 321,064,639.00	$ 321,064,639.00	$ 367,715,203.00

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Adding together the sums collected from import tariffs and VAT, that is, on goods that are subject to an import tariff other than zero and on those that are subject to a zero tariff, shows that the CIF value of the goods generally increases year over year. And although the downward trend in import tariff revenue holds steady, the upward trend in VAT revenue does not change, since imports with import tariffs equal to zero far outweigh those that are subject to tariffs.

Table 12. Determination of consolidated import tariff and VAT revenue (Baseline Scenario: no customs union)

	2022	2023	2024	2025	2026
CIF	$ 1,787,052,360	$ 1,998,052,982	$ 2,252,218,892	$ 2,553,735,163	$ 2,909,716,989
ICD	$ 357,507	$ 331,316	$ 312,660	$ 300,986	$ 295,983
VAT	$ 232,405,297	$ 259,756,896	$ 292,785,464	$ 331,962,943	$ 378,503,800

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Scenarios in the context of the customs union

Scenario Y1 – Customs union + import growth and total progressive elimination of import tariffs:
This scenario shows the growth trend with the inauguration of the Customs Union and the elimination of import tariffs on 100% of products over 5 years, taking into consideration the average annual effective rate per Chapter, with the growth predicted by the ECLAC (2018), i.e., in addition to natural growth, a boost of 1.35% is derived from trade facilitation actions. Furthermore, a 20% CIF growth limit is incorporated so that the goods do not increase exponentially, assuming that the rate does not increase exponentially but rather at a lower rate of consumption.

What is shown in Table 13 is a slower decline in the CIF value, due to the fact that the tariffs are decreasing over time until reaching a value of zero over the 2022-2026 period. Here, import tariff revenue falls from nine thousand dollars to zero. The same downward trend holds true for VAT revenue. Although tariffs continue to decline, the growth rate is lower than it would be if the tariffs had been maintained as in the previous scenario. The VAT revenue in 2022 begins at US$13.6 million and ends up at US$11.4 million.

Table 13. Determination of import tariff and VAT revenue for the chapters that have import tariffs other than zero (Scenario Y1: with growth due to trade facilitation)

	2022	2023	2024	2025	2026
CIF	$ 104,788,223	$ 96,302,859	$ 90,923,026	$ 88,344,708	$ 88,458,683
DAI	$ 9,690	$ 261	$ 7	$ 0	$ 0
IVA	$ 13,614,419	$ 12,521,816	$ 11,819,876	$ 11,483,890	$ 11,504,046

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

In the estimate dealing with the products that have an import tariff equal to zero, the data show a higher growth rate, since it is assumed that in the Customs Union goods will not be subject to restrictions and the 1.35% boost in growth estimated by the ECLAC (2018) indicates that there are other measures driving trade facilitation in the Northern Triangle.

Table 14 shows the trend for goods with import tariffs equal to zero; a considerable increase in VAT revenue is projected for the period studied, going from US$221.5 million in 2022 to US$389.9 million in 2026.

Table 14. Determination of import tariff and VAT revenue for the chapters that have import tariffs equal to zero (Scenario Y1: with growth due to trade facilitation)

	2022	2023	2024	2025	2026
CIF	$ 1,704,020,575	$1,949,509,290	$2,240,334,482	$2,588,108,099	$ 2,999,215,625
DAI	$ -	$ -	$ -	$ -	$ -
IVA	$ 221,498,819	$ 253,538,699	$ 291,476,033	$ 336,407,540	$ 389,960,220

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Once the import tariff revenue from goods with tariffs equal to zero and greater than zero was determined, the VAT revenue with the Customs Union was estimated and showed a new growth trend for the 2022-2026 period, going from US$235.1 million in 2022 to US$401.4 million in 2026.

Table 15. Consolidated import tariff and VAT revenue (Scenario Y1: with growth due to trade facilitation)

	2022	2023	2024	2025	2026
CIF	$ 1,808,808,798	$2,045,812,149	$2,331,257,509	$2,676,452,807	$ 3,087,674,308
DAI	$ 9,690	$ 261	$ 7	$ 0.	$ 0
IVA	$ 235,113,239	$ 266,060,516	$ 303,295,910	$ 347,891,430	$ 401,464,266

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Scenario Y2 – Customs union + export growth without the elimination of import tariffs:

In this scenario, trade follows the same pattern as in the previous scenario, which indicates that this variable is affected more by other factors than by the tax rate. In other words, the import tariff/CIV value ratio is so low (0.02%) that importers do not take it into account in their cost structure and, therefore, the amount imported does not change at all.

Table 16. Determination of consolidated import tariff and VAT revenue (Scenario Y2: with growth due to trade facilitation, without the elimination of tariffs)

	2022	2023	2024	2025	2026
CIF	$ 1,808,808,798	$2,045,812,149	$2,331,257,509	$2,676,452,807	$ 3,087,674,308
DAI	$ 362,799	$ 341,039	$ 326,274	$ 318,235	$ 316,877
IVA	$ 235,159,142	$ 266,104,816	$ 303,338,325	$ 347,932,800	$ 401,505,460

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Scenario Y3 – Customs union + import growth and the total immediate elimination of tariffs on goods in free circulation:

If, with the incorporation of El Salvador into the customs union, the current lists are kept in force, i.e., all goods in free circulation enter with an import tariff=0, import tariff collection will suffer a (relatively) considerable blow, since it will drop by an average of 52%. However, considering the low

relevance of the amount collected, the result would not have a great impact on total collection (the loss compared to scenario Y2 would be US$172,871 per year, on average).

Table 17. Determination of consolidated import tariff and VAT revenue (Scenario Y3: with growth due to trade facilitation and the total immediate elimination of tariffs on goods in free circulation)

	2022	2023	2024	2025	2026
CIF	$ 1,808,808,592	$2,045,811,220	$2,331,255,915	$2,676,450,596	$ 3,087,671,522
DAI	$ 188,466	$ 172,143	$ 158,117	$ 146,139	$ 136,005
IVA	$ 235,145,762	$ 266,080,329	$ 303,316,375	$ 347,911,062	$ 401,477,167

Source: Prepared by the authors using data from El Salvador's Ministry of Economy (MINEC)

Impact on collection per year and overall.

By comparing the simulated scenarios, one can see how the customs collection is significantly reduced in the scenarios involving the elimination of tariffs. Nonetheless, given that more than 90% of intraregional trade is free trade, the loss of import tariff revenue is irrelevant (US$0.32 million annually, if tariffs are phased out gradually and US$0.16 if they are eliminated completely and immediately on goods in free circulation). Under the same logic, even if no tariff rates were lowered, the collection of tariffs would remain at the same level.

In terms of VAT on imports, given the growth stemming from trade facilitation actions, VAT revenue would see a moderate increase, averaging US$11.7 million annually in the three simulated scenarios. This increase would occur even with the decline in the VAT tax base resulting from the elimination of tariff collection.

If the next five years are analyzed, the impact of El Salvador's incorporation into the customs union with regard to net tax collection is a US$57.7 million increase in collection.

Table 18. Tax collection impact of the incorporation of El Salvador into the Customs Union (Thousands of US$)

Years	Ese.VI (Desgrav.total gradual)			Ese. V2 (without concession)			Ese. V3 (Desgrav.bienes e/libre cire.)		
	ICD	VAT	Total	ICD	VAT	Total	ICD	VAT	Total
2022	-3,478	2.7079	2.3601	53	2.7538	2.7591	-1,690	2.7312	2.5621
2023	-3,311	6.3036	5.9726	97	6.3479	6.3576	-1,592	6.3258	6.1667
2024	-3,127	10.5104	10.1978	136	10.5529	10.5665	-1,545	10.5308	10.3763
2025	-3,010	15.9285	15.6275	172	15.9699	15.9871	-1,548	15.9472	15.7924
2026	-2,960	22.9605	22.6645	209	23.0017	23.0226	-1,600	22.9778	22.8178
Total	(1.5885)	58.4110	56.8225	668	58.6261	58.6929	-7,976	58.5128	57.7152

Source: own with data from MINEC

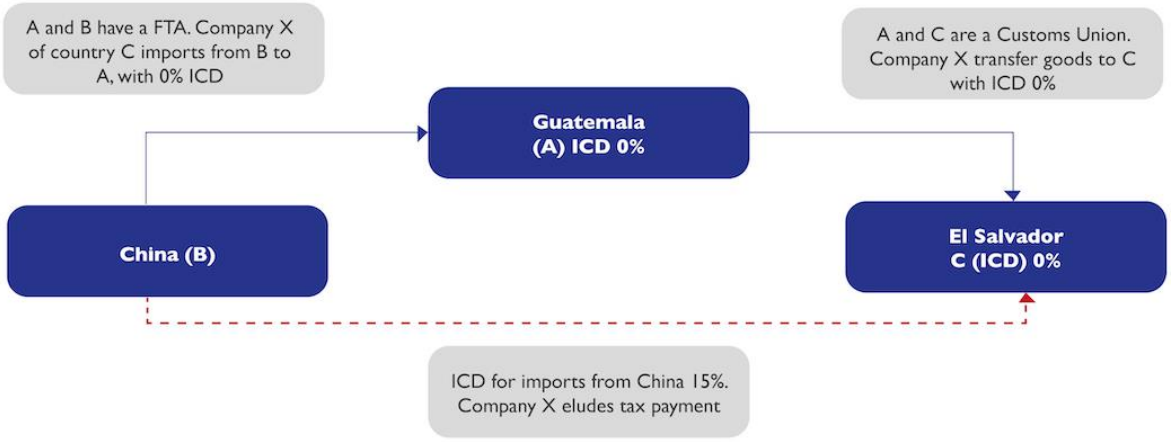
In conclusion, in contrast with the natural growth scenario, the scenarios with growth derived from the customs union and incorporating the ECLAC's prediction of a 1.35% boost in growth due to trade facilitation generate positive impacts for trade in the region, as well as an increase in tax

collection. The impact on tax collection is minimal, but if growth in intraregional trade is taken into account, the increase in collection will be larger.

TRIANGULATION OF GOODS AND UNFAIR TRADE

One of the myths about joining a customs union is that the country is going to lose tax and customs collections through the triangulation of goods by some companies. In practice, if country "A", a member of the Union, has a free trade agreement with country "B", located elsewhere in the world, a company with operations in the single territory can import goods from "B" and nationalize them in "A" without paying tariffs; later, it can take advantage of the benefits of free circulation and transfer said goods to country "C", also a member of the Union, without paying the tariffs of this last country. This practice becomes a strategy to avoid paying the import tariffs of country "C".

Graphic 3. Scheme of triangulation of goods in the customs union



In order to neutralize this practice, the customs union's regulations state that goods that are part of a free trade agreement that one country in the Union has signed unilaterally with a third country outside the region will be excluded from free circulation. This is also the case for goods that have a different sanitary profile in the countries in the Union. In these cases, the importer in the example can nationalize in country "A" the goods purchased from country "B" without paying tariffs, but if the importer then decides to send the goods to another country in the single territory, they must pay the import tariffs of destination country "C" (see figure below for reference).

With regard to VAT and selective taxes, in accordance with the Tax Harmonization Agreement (Convenio de Compatibilización de los Tributos Internos), indirect taxes on consumption are paid in the country of destination, whether the goods come from a country inside or outside of the Union. Therefore, the importer cannot escape their obligation to pay these taxes.

A feasible way to evade payment of taxes is to conceal goods with a positive DAI among goods supported by a FYDUCA. This practice may be beneficial, given the elimination of controls at PFIs, with the result that specialized controls will need to be put in place to combat illicit trade activities. The modernization of processes that will lead to deep integration should not be limited to improving

border transit but rather also include investigation techniques for countering illicit trade that may pass undetected through those checkpoints or even around them.

The fact of the matter is that those measures designed to facilitate trade that are implemented in the CFCs may be used by organized crime to introduce illicit goods, thereby affecting the fiscal revenues and the overall security of union member countries. Numerous studies show that illicit trade and tax fraud constitute a significant percentage of the GDP of the countries of the regions (laRED, 2015, estimated that the volume of illicit trade in Central America might lie between 3.4% and 4.0% of GDP), leading to job loss, promoting insecurity and criminal activity, and increasing the risks to public health from goods of uncertain origin. Despite the above, the regional institutional structure available to combat this situation is weak at best.

In addition, the gains to be had by individuals and groups involved in illicit trade are so high that the power thus accumulated has been an incentive to amass wealth, territorial control and, increasingly, political power. This reality feeds on an equally worrisome sociological phenomenon, i.e., the acceptance and tolerance by society, particularly in border areas, of numerous activities involving illicit trade, such as acceptance of the purchase-sale of contraband goods as normal or promotion of the lifestyles of those involved in such activities (laRED, 2015).

Some initial measures to prevent fraud were set forth in the Enabling Protocol of the Customs Union with the exclusion from free circulation of goods contained Part II of the Central American Import Tariff, those contained in Annex "A" of the General Treaty on Central American Economic Integration, those subject to different tax systems, etc. Nevertheless, mechanisms for efficient verification of these controls need to be developed.

The creation of the new free circulation system poses the challenge of fighting these illegal practices, which may arise from this new trade scheme between the countries in the union. For example, the illegal addition of goods excluded from free circulation covered by the FYDUCA causes inappropriate concessions in the reduction of the payment of taxes in the purchasing country and gives rise to untrue statements or the creation of invalid documents, which must be penalized. Other activities such as including volumes of goods larger than those actually declared on the FYDUCA, fraudulent price reductions for products in order to pay lower taxes in the destination country, the addition of prohibited import or export goods, taking advantage of the new free circulation system in order to avoid traditional customs controls at the border, or simply covertly adding goods of illegal origin to legal goods in free circulation, are examples of activities that must be prevented at the border in the union territory.

The traditional customs regulatory framework considers smuggling an action or omission in which the import or export of goods avoids customs intervention, producing or able to produce economic harm to the tax authority. However, in the customs union, smuggling is a priority for domestic tax authorities, and not just the customs offices, due to the fact that many products in free circulation can be brought into the countries, evading established controls. Transferors or buyers of illegal goods could be benefitting from the new policy in order to strengthen their tax evasion schemes, so it would be a great help to establish a customs union penalty code.

Deep integration should not only be for trade facilitation, but also the integration of institutional efforts to ensure the control, suppression and punishment of activities with the aim of fighting illegal trade and smuggling through the creation of regional plans that ensure the participation of safety, customs, tax, immigration and public health officials, as well as the implementation of the operations activities arising from these plans.

Article 19 of the Customs Union Operating Regulations authorizes operational procedures coordinated between different officials; and Articles 25-27 of this same regulatory framework establish security as a priority subject in the union, promoting the creation of comprehensive risk criteria with the objective of prevention and detection of illegal [activities] at PFIs, which should enhance operations on highways and in the warehouses of transferors and buyers of goods with free circulation. All of which brings to the forefront the need to form a permanent security committee for the customs union, with emphasis on integrated border checkpoints and peripheral customs offices, which will have the equipment necessary to effectively conduct joint regional security tasks.

The Maya-Chortí Task Force in Honduras and the Interinstitutional Customs Fraud and Smuggling Committee (COICON) in Guatemala are examples of positive efforts made by the countries to combat illegal trade and smuggling. However, their achievements would be more productive if they worked in coordination for the customs union.

In light of the existing scarcity of resources in the region to combat these illegal activities, the Customs Union Structure and Investment Fund is seen to be an important tool to help fund joint security plans in the community territory. Finally, the full incorporation of El Salvador in the customs union is an excellent opportunity to provide a major boost to this area.

IMPACT ON TRADE COMPETITIVENESS

OVERVIEW OF THE REGION'S COMPETITIVENESS

Previous studies conducted by different regional institutions and organizations, such as the ECLAC, the IADB, USAID and the SIECA, were used to identify diverse areas of impact on trade competitiveness that can be linked to the implementation of the trade facilitation measures established in the Customs Union, including:

1. Estimate of economic costs in current trade operations in El Salvador, versus the costs of generating trade through the FYDUCA in the Customs Union.

2. Estimate of costs in customs clearance times in current trade operations in El Salvador, versus the costs of generating trade through the FYDUCA in the Customs Union.

3. Estimate of the increase in trade following El Salvador's incorporation into the Customs Union.

4. Estimate of the impact on national productive chains.

5. Estimate of private intermediary sectors that could be affected by the implementation of the Customs Union.

What follows is a comparative technical analysis of the three countries that make up the Union. It uses macroeconomic indicators from the System of National Accounts and microeconomic indicators from household surveys in each country, as well as trade dynamism and pattern measurement tools, grounded in the analysis of indicators related to the growth of global and intraregional trade flows, the degree of diversification/concentration of the export portfolio, revealed comparative advantage indicators, intra-industry trade indexes and more, to characterize the trade flows among the three countries in the region.

The proposed impact model also requires a review of the indicators for measuring Competitiveness and Logistics; therefore, publications by specialized international organizations such as the World Economic Forum's Global Competitiveness Report and the World Bank's Logistics Performance Index, among others, will be taken as references. The analysis of these performance measurements will focus on the timeliness, cost, efficiency, and the quality of the logistics processes at border checkpoints between the three countries. The availability of information on the three (3) Integrated Border Checkpoints between Honduras and Guatemala will also be evaluated to determine improvements in efficiency or the lack thereof, resulting from the implementation of the Customs Union.

As outlined in the macroeconomic section, logistics costs are a determining factor in the competitiveness of a nation. Measures that favor trade facilitation are, therefore, fundamental to the successful insertion of economic sectors into international trade flows, to their integration into global value chains and to their ability to take advantage of the trade opportunities stemming from the growing development and utilization of information technologies.

It is precisely because of the change observed in current consumption patterns—explained in part by uncertainty around the evolution of the COVID-19 pandemic, which has led households to make greater use of e-commerce channels—that productive structures around the world have come under pressure, causing disruptions in global supply chains, one of the main downside risks in perspectives on the recovery of economies worldwide. This situation reveals the importance of logistics and their associated costs, which in this context translate into significant challenges for companies of all sizes, especially those that are solely exporters using just-in-time production and shipping models that require speed, reliability, and efficiency in the movement of goods.

In the Central American region, the growing interconnection and complementarity of the economies has led to conditions for the development of a trade facilitation agenda at the regional SICA level (2015) geared towards, among other things, the standardization, harmonization and simplification of the trade paperwork and procedures in the Central American territory. As a result, in 2015, the Council of Ministers for Central American Economic Integration (Consejo de Ministros de Integración Económica Centroamericana, COMIECO) approved the Central American Trade Facilitation and Competitiveness Strategy with an Emphasis on Coordinated Border Management (Agreement No. 01-2015), which calls for strengthening the single windows for foreign trade, the performance of inspections based on comprehensive risk management, trustworthy economic operators, quarantine inspections, the overhaul of border equipment and infrastructure, the

coordination and integration of inspection procedures and the attention given to the social and economic impacts of interventions at border zones. The purpose of all this is to simplify the processes for importing, exporting and transporting goods in the region, which will dynamize the trade of goods, promote competitiveness and improve the positioning of the region's companies at the global level.

These actions aim to, among other things, improve the infrastructural conditions that have been identified as restrictions to competitiveness and, as a result, factors that limit economic growth and prosperity in the region. Some of the weaknesses previously identified in the Central American Trade Facilitation and Competitiveness Strategy (ECFCC) with regard to logistical efficiency include the lack of systems and mechanisms for exchanging information among countries as well as the lack of regulatory frameworks to govern cooperation among the countries' authorities, the absence of an integrated risk management system, low articulation among the national institutions that carry out control and inspection activities at the borders and inadequate infrastructure and equipment at border checkpoints.

Therefore, and with the goal of adhering to the Regional Trade Facilitation Strategy, an agenda was defined in the Declaration of Heads of State issued as part of the XLIII Ordinary Meeting of the Heads of State and Government of the Member Countries of the Central American Integration System (SICA) held on June 27, 2014; this agenda outlined five facilitation measures to be implemented in the short term and called for the creation of measurement and evaluation indicators using shared regional parameters based on international best practices.

Their advances as of the third quarter of 2021 are detailed below:

- **Measure 1. Declaration of goods in advance:**
    a. Proposal: Electronic transmission of the customs declarations backing the trade of goods in Central America prior to their arrival at the border checkpoint, depending on the category of goods. The FYDUCA form applies to operations involving goods that originated in the region and that enjoy free circulation; the DUCA-F applies to operations involving goods that originated in the region; the DUCA-T applies to goods in transit under international land transit regulations; and the DUCA-D applies to goods that originated in third countries or to which the DUCA-F does not apply.
    b. Progress: i) Nicaragua applied the measure through the technical notice Ref. CT/070/2017 of June 22, 2017; ii) Costa Rica and Panama applied the measure as optional; iii) Guatemala and Honduras implemented the measure for all customs regimes and at all border checkpoints on June 1, 2021, under Customs Union Resolution (Resolución Instancia Ministerial-Unión Aduanera, RIM-UA) No. 01 83-2020, of October 1, 2020; iv) El Salvador applied the measure on April 25, 2019, under General Administrative Resolution (Disposición Administrativa de Carácter General, DACG) No. DGA.00074-2019 of April 5, 2019.

- **Measure 2. Acceleration and coordination of immigration enforcement:**
    a. Proposal: Performance of a single inspection in the country of departure and interface with the country of arrival.
    b. Progress: The Customs Committee agreed on the conceptual framework and the proposal presented in the technical document on the Database of Drivers. The road map for its implementation is pending approval.
    c. Goals:
        a. Finalize the revision of the Technical Guide for the Acceleration and Coordination of Immigration Enforcement.
        b. Define the Central American Immigration Procedure for prechecking drivers that transport cargo internationally by land through the DUCA-T.

- **Measure 3. Electronic sanitary and phytosanitary certificates:**
    a. Proposal: System for issuing and sending health certificates over a regional server or Single Window for Foreign Trade (Ventana Única de Comercio Exterior, VUCE).
    b. Progress: The information contained in the SPS certificates will be transmitted through the Digital Platform for Central American Trade for the implementation of Measure 3, "Electronic sanitary and phytosanitary certificates".
    c. Goals:
        c. Revise the Technical Guide on the Electronic Transmission of the Data Set in Portable Document Format (PDF) for the information contained in the Sanitary and Phytosanitary Certificates.
        d. Present a study on the formalities, requirements and procedures related to SPS measures to promote the creation of proposals aimed at simplifying procedures and reducing times and costs at the border as well as proposals introducing key measures for aligning the administrative requirements and procedures related to SPS measures at the border.

- **Measure 4. Implementation through radio frequency (RFID) devices:**
    a. Proposal: Management that provides real information about border crossing times.
    b. Progress: To date, 19 RFID read points have been installed along the Pacific Corridor and 9 RFID arches are currently operational.

- **Measure 5. Installation of cameras at border checkpoints:**
    a. Proposal: Deployment of web cameras and informative videos
    b. Progress: In 2020, dome style web camera systems were installed at border checkpoints in: Panama, with 2 camera systems in Paso Canoas; Costa Rica, with 2 systems in Paso Canoas; Nicaragua, with 2 systems in Peña Blanca and 2 systems in Guasaule; Honduras, with 2 systems in El Amatillo and 2 systems in Guasaule; El Salvador, with 2 systems in La Hachadura; and Guatemala, with 2 systems in Pedro de Alvarado.

The following advances were made on the cross-cutting aims of the ECFCC:

- **Digital Platform for Central American Trade (Plataforma Digital de Comercio Centroamericana, PDCC):** This is a digital tool geared toward achieving the centralized interoperability of the existing national systems for the integration of the information and processes involved in the management of customs, immigration and single windows. The PDCC aims to strengthen the capacities of the national systems and promote new solutions both for basic processes, such as the electronic transmission of customs declarations, and for more sophisticated functions (e.g., risk analysis, management of the economic operator registry, standardization, automation and national and regional interoperability). This tools forms part of the Regional IT Platform of the Central American Economic Integration Subsystem administered by the SIECA as of 2021.
    a. Progress: Advance of 60% in the physical execution of the PDCC as of December 31, 2020.
        - Advance of 47% in the development of the software for the PDCC as of December 31, 2020.
        - Advance of 67% in the acquisition and deployment of hardware required for the countries' Immigration, Customs, VUCE (Single Window for Foreign Trade) and Sanitary institutions.
        - Advance of 53% in the acquisition and deployment of hardware for the incorporation of the PDCC into the SIECA platform.
        - Advance of 67% in technical assistance for Vulnerability and Penetration Tests and Analysis for the PDCC and Comprehensive Risk System.
        - Advance of 54% in the analysis and design of the Comprehensive Regional Risk Management System.

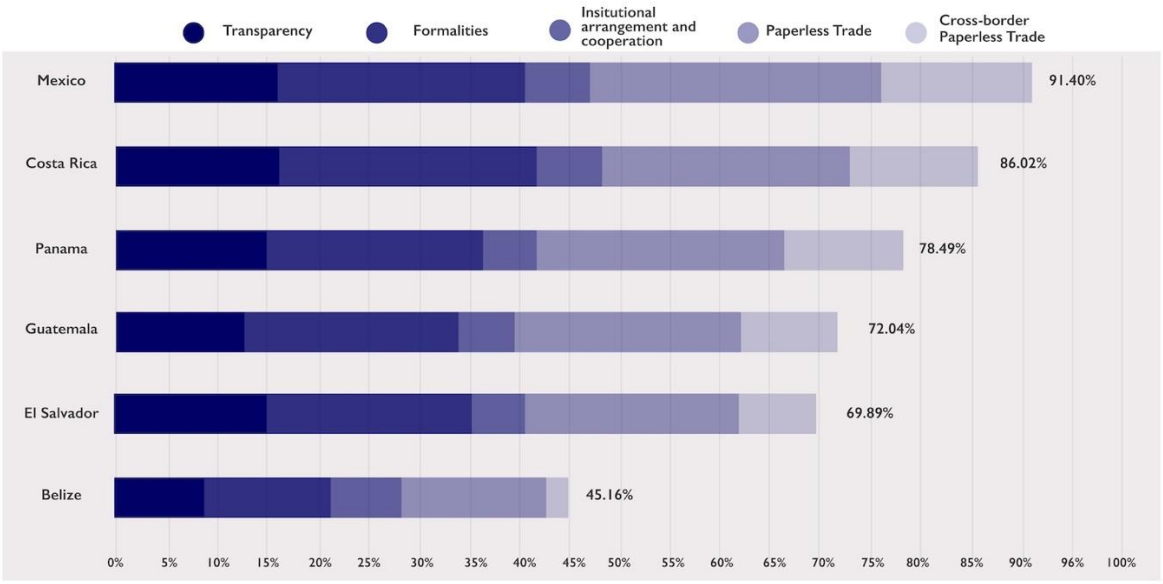
- **Comprehensive Regional Risk Management System (Sistema Integral de Gestión de Riesgos Regional, SGIRR)**: This system is complementary to the PDCC and the risk systems operated by each country and makes it possible to identify, analyze and compile early information to make decisions about risks related to transporting goods. Its purpose is to improve the efficiency of border inspections. The benefits of the SGIRR include: generating inputs for the national risk systems; interoperating (exchanging information) among risk units through previously identified parameters for each institution/country and contributing to the predictability of the system through the generation of alerts using Artificial Intelligence (AI) tools.

    a. Objective: Completion of IT developments and approval of the legal framework, implementation plan and sustainability mechanism.
    b. Current situation: Most of the countries' institutions have risk management and mitigation processes (a risk matrix). In some cases, these processes are automated; in others, they are still manual. Nonetheless, at the regional level, there is no integrated database that would make it possible to establish a system of rules for evaluating risk more effectively and in a more coordinated way for the region.
    c. Progress:

- At the IT level, receipt, validation and vulnerability tests have been performed on the SGIRR software and its integration into the PDCC.
- At the operative level, advances have been made in the receipt of each country's risk matrix, following international best practices, and preparations are being made to conduct pilot tests of the system and its features. The system will move on to production once the countries have approved it.

Progress in the establishment of an institutional framework for trade facilitation in the Central American region, as well as the development of a cross-border technology infrastructure to support and facilitate regional trade, exemplified by the PDCC and the SGIRR, have made it possible to achieve significant breakthroughs in digitalization, process modernization, standardization, electronic transmission and interinstitutional coordination, among other non-tariff barriers to trade, in particular in the countries of the Northern Triangle, which form part of the deep integration process, and in FYDUCA-backed goods that enjoy free circulation in the community territory.

Figure 21. Central America and Mexico: Advances in the implementation of trade facilitation and digitalization measures (2021)



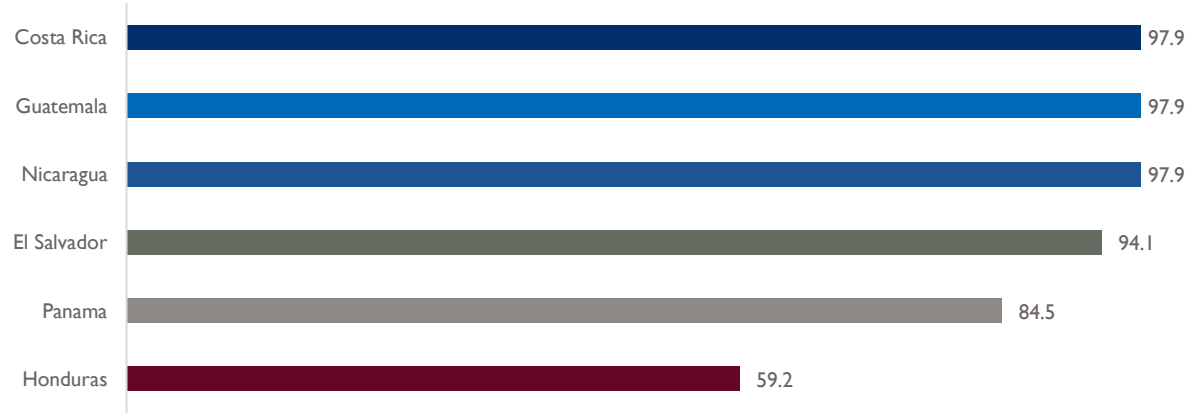
Source: UN Global Survey on Digital and Sustainable Trade Facilitation

Progress towards the commitments enshrined in the WTO Trade Facilitation Agreement (TFA) of 2014, which was ratified by each country between 2015 and 2017, was achieved at different speeds in the region. Costa Rica has implemented close to 97.9% of the measures, as have Guatemala and Nicaragua (97.9%), followed by El Salvador (94.1%), then Panama (84.5%) and Honduras (59.2%). The OECD estimates that the complete implementation of the TFA will lead to a 15.5% reduction in the cost of trade in the Central American region (Moise y Sorescu, 2013).

Logistics requirements and their corresponding drag on countries' economies vary according to the productive structure of the economy and also vary between industries. The World Bank study states

that, in the Northern Triangle subregion, El Salvador, given its productive structure, is the country with the highest economic complexity. This noteworthy result points to the relatively high chances the Salvadoran economy has to accelerate its growth rate, insofar as it can attend to the needs of productive sectors, eliminate market distortions and close gaps in competitiveness in the economy, which have translated into real bottlenecks in the country's production processes, keeping economic growth low.

Figure 22. Central America: Advances in compliance with the WTO Trade Facilitation Agreement (2021)



Source: Trade Facilitation Agreement Database, World Trade Organization (WTO)

The ECLAC and the World Bank indicate that the Salvadoran economy would reap the greatest benefits if an ambitious package of measures to facilitate trade in the Northern Triangle region was introduced. This package could be launched as part of El Salvador's incorporation into the customs union process between Guatemala and Honduras. As mentioned above, the results of the CGE model developed by the World Bank (2021) to calculate the economic benefits that would come with an increase in intraregional trade stemming from a gradual and sustained reduction in trade and transport costs over the long term, based on the implementation of trade facilitation measures, show that EL Salvador's GDP would rise 8.8% by the year 2030, followed by Honduras, with a 5.2% increase in GDP in the same period[13].

This study also asserts that the decrease in trade costs resulting from trade facilitation measures could also boost the competitiveness of the region, support the diversification of its export portfolio and attract higher value-added industries to the region. In addition, the ECLAC (2017) suggests that a reduction in customs formalities would benefit small and medium-sized enterprises, strengthening their participation in international trade.

The countries in the region should continue advancing their trade facilitation agenda with initiatives and reforms aimed at achieving substantive improvements in the region's trade competitiveness;

[13] These estimates are based on simulations that use the dynamic GTAP CGE model (GDyn). The percentage changes in the volumes reported are in relation to the baseline hypothesis in 2030. Source: World Bank (2021), Unleashing Central America's Growth Potential.

these improvements will translate into increased earnings from trade and facilitate conditions for the effective and dynamic insertion of Central America into the international economy.

EVOLUTION OF REGIONAL COMPETITIVENESS INDICATORS

Global Competitiveness Ranking – World Economic Forum (WEF)

The latest edition of the Global Competitiveness Report, published by the World Economic Forum in 2019, again identifies Costa Rica as the leader in the region, ranking it 62nd (out of 141 economies), followed by Panama (66th), Guatemala (98th), Honduras (101st), El Salvador (103rd) and Nicaragua (109th). A country's capacity to compete reflects the productivity conditions that allow it to create more or fewer opportunities than other countries.

This report evaluates a county's degree of competitiveness based on 12 pillars divided into four categories: enabling environment, human capital, markets, and innovation ecosystem. In its annual survey, the WEF asks about the main problems affecting the enabling environment. For El Salvador, Honduras, and Guatemala, the three top problems across the board are crime, bureaucracy, and corruption; the second-most pervasive problems are tax rates and political instability. In this context, the existence of a customs union contributes considerably to reducing costs (bribe payment and extorsion) and trade times, since it reduces corruption and bureaucracy.

Table 19. Central America: Main factors that affect the enabling environment and competitiveness

	Problem 1	Problem 2	Problem 3	Problem 4	Problem 5
El Salvador	Crime an theft	Corruption	Political instability	Tax rates	Government instability
Guatemala	Crime an theft	Corruption	Bureaucracy	Inadequate infrastructure	Political instability
Honduras	Tax rates	Crime an theft	Bureaucracy	Corruption	Tax complexity
Panamá	Bureaucracy	Corruption	Labor force preparation	Labor force preparation	Poor work ethic
Costa Rica	Bureaucracy	Inadequate infrastructure	Tax rates	Access to finance	Labor regulations
Nicaragua	Bureaucracy	Corruption	Labor force preparation	Political instability	Access to finance

Source: WEF, Trade Facilitation Index, several years

In the 2019 results, the WEF evaluates two components that are correlated with the deep customs union process; in the Infrastructure Pillar, road connectivity and road infrastructure quality are evaluated in the context of global competition. The "Connectivity" component is a measure of the average speed of connectivity between 10 or more important cities in each country, whereas the "Road Infrastructure Quality" component is the result of opinion surveys conducted with productive sector respondents.

At the regional level, challenges remain with regard to infrastructure quality. At the country level, the greatest advances in this area have been in countries like Costa Rica (rating of 68.7), which rose 15 positions thanks to improvements to highways and ports, and Panama (69.5), whereas El Salvador, Guatemala and Honduras saw some backward movement in this pilar in the 2018-2019 period.

A closer analysis of Guatemala and Honduras shows that the greatest advances were observed in Honduras, particularly in the Road Infrastructure Quality component, which rose 14 positions between 2017 and 2019.

Table 20. Northern Triangle: Ranking of Countries in the Transport Infrastructure Pillar of the Global Competitiveness Index, 4.0

Row headings	2017	2018	2019
El Salvador			
GCI 4.0: Quality of roads	70	66	61
GCI 4.0: Road connectivity index	79	79	78
GCI 4.0: Roads	77	78	67
Guatemala			
GCI 4.0: Quality of roads	105	128	132
GCI 4.0: Road connectivity index	131	131	134
GCI 4.0: Roads	134	139	140
Honduras			
GCI 4.0: Quality of roads	80	65	66
GCI 4.0: Road connectivity index	106	106	120
GCI 4.0: Roads	98	96	96

Source: WEF, Transport Infrastructure Pilar of the Competitiveness Index, several years

In this period, the WEF noted that most governments had shown little progress towards improved efficiency in the administration of their borders, an easily accessible opportunity that is capable of generating advantages for companies both large and small that far outweigh the financial and political capital needed to implement it.

Table 21. Central America: Global Competitiveness Index, Burden of Customs Processes, WEF

(1=Very inefficient to 7=Very efficient)

Country	2010	2011	2012	2013	2015	2016	2017	Changes 2017-2015
Costa Rica	4.0	3.9	4.1	4.0	3.8	3.8	3.7	-0.1
El Salvador	**4.2**	**3.9**	**3.5**	**3.4**	**3.5**	**3.5**	**2.8**	**-0.7**
Guatemala	4.2	4.2	3.9	3.9	3.5	3.5	3.2	-0.3
Honduras	4.2	4.0	3.7	3.5	3.5	3.5	3.3	-0.2

Source: WEF, several years

In this area, the PDCC, conceived as a broad scope tool for the automation of procedures and reduction of import and export times, will address the existing inefficiencies in cross-border operations and have a positive impact on the competitiveness of the countries in the customs union. Moreover, the PDCC incorporates high security protocols in arrival and departure operations, for goods, transport vehicles and drivers, with immigration prechecks, among other controls, that will contribute to gains in efficiency at border checkpoints.

Prior to the change in methodology introduced in 2018, the WEF included the Trade Facilitation Index, which evaluated the performance of economies in terms of access to national and international markets, border administration, digital infrastructure and transport, transport services and operating environment. In this analysis, all the countries in the region shared one thing: a continuous fall in the rankings from 2008 onward.

The results of the last available Trade Facilitation Index (2016) showed that, for the countries in the region, doing international business (importing and exporting) was becoming comparatively more onerous than in other countries; in other words, although reforms have been implemented by some countries, the rest of the world has moved more quickly than the region.

It is important to note that the countries that form part of the customs union show the greatest declines in trade facilitation:

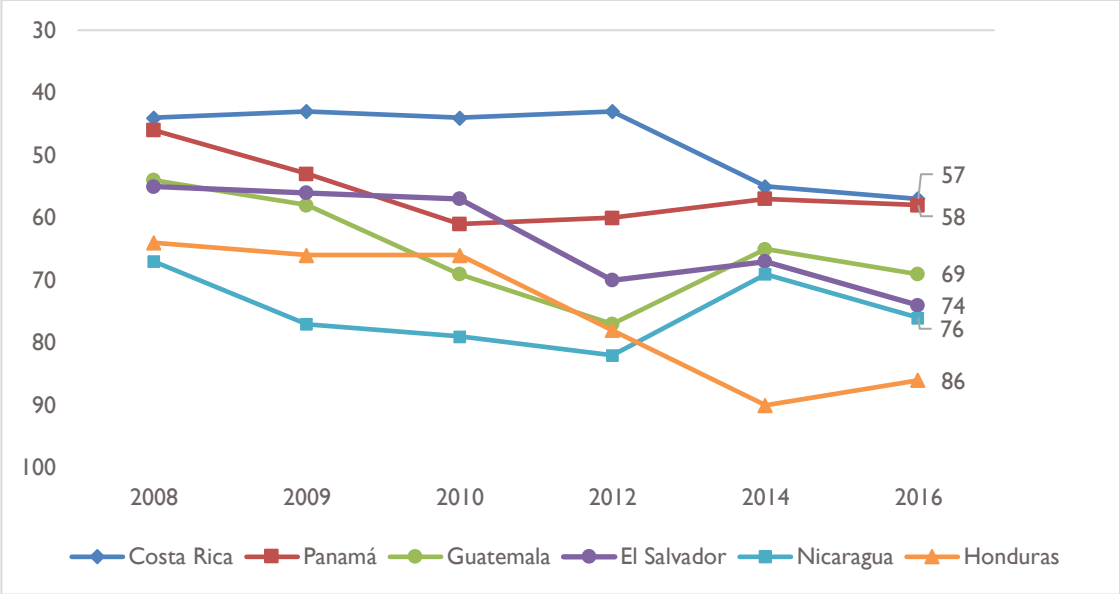
- **El Salvador:** El Salvador ranked 74th out of 136 countries in the last global measurement taken in 2016, down 19 spots from 2008, when it ranked 55th. The country was lagging behind the most in the pillars related to: operating environment, 121st; availability and use of ICTs, 92nd; customs administration, 8; and availability of infrastructure, 84th. Access to markets was its strongest area, where it ranked 13th. The three most problematic factors for importing were customs procedures (22%), tariff and non-tariff barriers (18%) and robbery and crime (18%).

- **Guatemala:** Guatemala ranked 69th, down 15 spots from 2008, when it ranked 54th. The country fell behind the most on infrastructure indicators, such as: availability and quality of infrastructure, 105th; availability and quality of infrastructure services, 94th; and availability and use of ICTs, 91st. Its greatest strength was access to the domestic market, where it ranked 5th. The problems mentioned the most with regard to importing were customs procedures for importing (22%), corruption at the border (19%) and crime (14%).

- **Honduras:** Honduras ranked 86th in 2016, down 22 spots from 2008, when it ranked 64th. The greatest lags were related to customs efficiency and transparency, 109th; availability and quality of infrastructure, 111th; and operating environment, 100th. The main advantage was access to the local market, where it ranked 16th. The factors that most affected imports were customs procedures (24%), tariff and non-tariff barriers (17%) and corruption at customs (13%).

The WEF's 2016 Trade Facilitation Report confirmed that free trade continues to be the most powerful engine of economic and social progress worldwide; however, it observed the growing tendency to establish tariff barriers that threatened future growth and heightened the risks of starting a trade war, whose implications have been associated with a global downturn, stemming from the economic crises provoked in certain countries.

Figure 23. Central America: Trade Facilitation Index



Source: WEF, Trade Facilitation Index, several years

Logistics Performance Index (LPI) – World Bank

The Logistics Performance Index (LPI) is a tool developed by the World Bank that measures the logistics performance of the supply chain in a sample of 160 countries by evaluating 6 areas: customs performance, infrastructure, shipment prices, logistics quality, tracking and tracing (traceability) and timeliness in deliveries.

The LPI makes it possible to establish metrics around certain operations associated with a country's trade, transport services and trade facilitation conditions, which are measured in two large areas: the "inputs", meaning customs, infrastructure and international deliveries (international shipments), which depend on the processes, regulations and performance of institutions, and the "outcomes", meaning service quality, traceability and timeliness, whose performance is related to the infrastructure conditions and political decisions surrounding the "inputs".

The international score uses six key dimensions to compare country performance; these dimensions are evaluated on a scale of 1 to 5, where 5 is the highest score. The six key dimensions are detailed below:

1) Efficiency of the customs clearance process (i.e., speed, simplicity and predictability of formalities) handled by border control agencies, including customs;

2) Quality of the trade and transport infrastructure (for example, ports, railroads, highways and information technology);
3) Ease of arranging competitively priced shipments;
4) Competence and quality of logistics services (for example, transport operators, customs agents);
5) Ability to track and trace shipments;
6) Punctuality of shipments' arrival at the destination within the scheduled or expected delivery time.

For the countries in the Northern Triangle, the results of the 2018 LPI demonstrate improvements in the quality of the infrastructure involved in trade and transport. Honduras, in particular, demonstrated improvements, which may be linked to investments the country has made in highway infrastructure and in the development of technological and computer processes that support trade operations. In this area, the country made gains in the competitiveness of its logistics services (rising 35 spots) and, to a lesser extent, its tracing capabilities, up 6 spots from its position in the previous 2016 edition.

Table 22. Central America: Logistics Performance Index Results, 2016 – 2018

Description	Costa Rica	El Salvador	Guatemala	Honduras
Overall LPI rank				
2016	89	83	111	112
2018	73	101	125	93
Customs rank				
2016	113	107	91	126
2018	70	120	132	125
Infrastructure rank				
2016	107	114	127	143
2018	84	114	122	88
Logistics quality and competence rank				
2016	94	83	130	110
2018	79	91	136	75
Tracking and tracing rank				
2016	77	76	110	99
2018	67	117	122	93
Timeliness rank				
2016	101	74	100	108
2018	83	90	88	118
International shipments rank				
2016	73	76	120	97
2018	76	86	130	93

Source: LPI, World Bank 2016-2018

Guatemala showed more modest improvements in the quality of its infrastructure, which had a positive impact on delivery times (punctuality of shipments), up 12 spots from its 2018 ranking. El

Salvador, by contrast, demonstrated a loss of efficiency in practically all of the dimensions measured by the LPI.

The results of the 2018 edition of the LPI barely reflect the effects of the Deep Integration process between Guatemala and Honduras; however, the performance of both countries shows, to a certain extent, the effects of the preparatory investments made by the countries prior to the implementation of the process, which officially began with the launch of the FYDUCA Form in March 2018. For the 2018 edition of the LPI, the surveys of logistics professionals were conducted between September 2017 and February 2018.

IMPORTANCE OF TRADE FACILITATION IN REGIONAL PRODUCTION CHAINS

Advances in information and communication technologies in recent decades have contributed to the fragmentation of production worldwide into separate links, which can be forged by companies in different highly interconnected economies that are engaged in production and trade networks that span national boundaries (ECLAC, 2021) and that benefit from the trade liberalization processes that have become widespread around the globe. The delocalization and fragmentation of the production processes that make up productive chains make it possible to, on the one hand, determine the impact of one economic sector on another in a dynamic of interrelations among diverse economies and, on the other, transfer the added value generated by these processes across multiple boundaries before final consumption. Therefore, this fragmentation defines global value chains (GVCs).

Several authors have conceptualized value chains from different perspectives; however, Michael E. Porter is perhaps the most widely recognized among them because of his novel and coherent approach to value chains, presented in his texts about competitive advantages and his studies of industrial sectors. For Porter (2006: 33 and 34), the value chain is a management tools that makes it possible to analyze the sources of competitive advantage. In other words, the value chain makes it possible to divide a company into its strategically relevant activities in order to understand the behavior of costs as well as the current and potential sources of differentiation. Similarly, authors such as Peña et al. (2008: 78 and 79), citing Porter, assert that the value chain concept facilitates the creation of productive alliances by allowing the most efficient use of resources. Distribution and marketing are key factors in achieving greater competitiveness; they facilitate the flow of information between actors; they aid in the development of joint solutions by identifying problems and bottlenecks throughout the chain; and, lastly, they make it possible to analyze each link in the chain independently and together.

The Food and Agriculture Organization (FAO) of the United Nations makes a distinction between production chains and value chains. The term production chain, it explains, is generally used in a broad sense to describe the interactions that take place in the market between the different private actors that intervene from the production to the consumption of a good (vertical dimension). A value chain, on the other hand, is a strategic network or alliance that is established, formally or informally, by a number of independent business actors that participate in one or more production chains in order to produce differentiated and/or specialized goods and maintain cooperative and

coordinative relationships based on clearly defined and implicit rules of the game, i.e., rooted in business experience and culture (FAO, 2006:39).

The deepening and complexity of the interrelations among regions and countries that participate in the different stages of production leading to the delivery of a good or service to its end user or consumers in a global context has been tied to the increasing relevance of the delocalization of vertical production processes and trade chains among countries, i.e., cross-border value chains, whether regional or global. In this regard, Padilla (ECLAC, 2017) points out that value chains tend to be regional when two or more countries that have a productive affinity, territorial proximity and trade complementarity integrate their processes, with the goal of achieving greater productive articulation and generating higher local value-added processes that link up regionally (SIECA, 2018). This process makes it possible for economies to specialize in links of the process (tasks) instead of final products, which keeps them from having to build an entire value chain from zero and allows them to take advantage of the competitive advantages each economy has to offer. At the same time, it gives them the ability to regionally manage information flows and exchanges, standards, regulations, capacities, and performance in each one of the links, while addressing associated risks through collaborative regional governance.

In the area of institutionality and governance, the SICA region has an institutional structure based on four subsystems (economic, social, cultural, and political) defined in the Guatemala Protocol, which establishes in article 16 that cabinet ministers can hold intersectoral meetings, in accordance with the nature of the topics to be discussed. This implies that there are spaces for the dialogues needed to promote and design a governing framework for regional chains. The ministers also have technical groups and their own private sector advisory bodies, in which the Central American business federations participate. The possibilities for scaling up value chains depend on the kind of governance that is in place, as well as the local economic and technological environments in which the companies operate and the restrictions they face.

The SICA region has undertaken different efforts aimed at identifying and strengthening national value chains using the methodologies proposed by the ECLAC and the German Agency for Technical Cooperation (GIZ). These efforts led to technical assistance for four value chains that were identified: the shrimp and synthetic fiber sportswear chains in El Salvador and the non-traditional vegetable and timber chains in Guatemala. Also, since 2014, the region has been working with the International Fund for Agricultural Development (IFAD), in conjunction with the ECLAC, on the assessment and design of a rural industrial policy strategy focused on strengthening chains in the region and scaling up manufacturing and service activities in Costa Rica, El Salvador, Guatemala and the Dominican Republic. In the case of El Salvador, the chains identified include: dried fruit-based nutritional snacks, tomatoes, green sweet peppers and tourism, a chain also identified in Guatemala. As for regional value chains, the Regional Program to Support the Quality and the Application of Sanitary and Phytosanitary Measures in Central America (Programa Regional de Apoyo la Calidad y a la Aplicación de Medidas Sanitarias y Fitosanitarias en Centroamérica, PRACAMS) has also identified six (6) products of Central American origin that have the potential to generate regional chains and that are exports in high demand in the European market: Natural honey (El Salvador, Guatemala, Nicaragua and Honduras); Foliage (Costa Rica, Guatemala, El Salvador, Honduras and Panama); Cardamom (Guatemala, Honduras and El Salvador); Tilapia (Honduras, El Salvador Costa

Rica and Panamá) and Shrimp (Panamá, Honduras, Nicaragua, El Salvador, Guatemala and Costa Rica) (SIECA, 2016).

LEVEL OF TRADE AND PRODUCTION INTEGRATION AMONG NORTHERN TRIANGLE COUNTRIES

The countries in the region show a high level of regional trade integration, as a result of efforts to deepen their economic integration, which began in 1960 with the signing of the General Treaty on Central American Economic Integration, through which the Central American Common Market (CACM) was created. Since then, the integration process has experienced ups and downs and has recently been strengthened by the customs union between El Salvador, Guatemala, and Honduras[14].

According to the ECLAC (2019), exports from Central America rose by 300% between 1995 and 2019, which represents an average annual growth of 6.3%. However, the growth was not equally dynamic in all the different countries. Exports from El Salvador increased by 375% (an annual average rate of 7.4%), whereas the rest of the Central American countries saw an increase in exports close to the average for the subregion.

At the same time, the share of intraregional exports in total exports from Central America increased, from 22.2% in 1995 to 31% in 2019[9], also with significant differences between countries. In 1995, El Salvador was the country with the largest share of exports to Central America (44%), a share that continued rising, accounting for 54.5% of its total sales in 2019, the highest level in the region[10].

With regard to the nature of Central American trade, the exchange of products is concentrated in low and medium-technology industrial and agroindustrial categories, such as prepared foods, plastics and chemicals. Central America has a growing service export sector, in which the travel sector plays a large role. The relative weight of the service sector varies by country. In El Salvador, the service sector accounts for around 15.5% of all exports and includes services such as aircraft maintenance, travel, transportation and logistics, and financial services. Although it is growing, the service sector in El Salvador is still much smaller than in other countries such as Panama, where services make up a large portion of total exports (ECLAC, 2020).

The regional Input-Output Matrix (IOM) developed by the ECLAC (2021)[15] is an extremely useful tool for analyzing intersectoral relationships between countries. A regional input-output matrix is a snapshot of a region's economy that captures the national and international trade of goods and services conducted by a number of standardized sectors among the countries that make up the region. In addition, the regional matrix incorporates information about final intraregional and

[14] Martínez Piva (2019) offers a complete overview of the stages of the Central American integration process.

[15] Between 2016 and 2019, the Economic Commission for Latin America and the Caribbean (ECLAC) worked closely with the countries of the subregion on the construction and standardization of national matrixes and the first subregional matrix. This initiative was financed by the United Nations Secretariat as part of the Development Account program. The main objective was to strengthen Latin American countries' statistical and analytical capacities as well as their ability to design and monitor industrial and trade policies.

extraregional demand, extraregional intermediate imports and different value-added components. Using this methodology, it is possible to identify the imported intermediate goods that are incorporated into the manufacturing processes underlying a country's export portfolio, using the concept of vertical specialization (Hummels, Ishii and Yi, 2001). This methodological approach adopts two assumptions that are relevant to relationships between productive activities: i) at least two countries participate in a good's production sequence, and ii) in this production sequence, the good being produced crosses at least two international borders. Using this approach, it is possible to identify the net import or export sectors within a regional or global production network.

Table 23. Gross value of the production and export of goods and services, by country, 2011

In Millions of US$ and as a % of GPV

Country	Total Gross Value of Production	Northern Triangle: Breakdown of the gross value of production (GVP) on the supply side									
		Intermediate Consumption (IC)		Intermediate Imports		Taxes		Shipping and Insurance		Domestic Value Added	
		Flow	% GVP	Flow	% GVP	Flow	% GVP	Flow	% GVP	Flow	% GVP
Guatemala	76.338	21.036	27.6%	9.156	12.0%	793	1.0%	686	0.9%	44.667	58.5%
Honduras	36.108	10.892	30.2%	6.950	19.2%	465	1.3%	523	1.4%	17.278	47.9%
El Salvador	34.959	10.295	29.4%	5.336	15.3%	365	1.0%	428	1.2%	18.535	53.0%
Northern Triangle (NT):	**147.405**	**42.223**	**28.6%**	**21.442**	**14.5%**	**1.623**	**1.1%**	**1,637**	**1.1%**	**80.480**	**54.6%**

Source: ECLAC using the multi-regional matrix for Central America, Mexico, and the Dominican Republic.

Below are some of the results of the analysis conducted using the regional input-output matrix developed by the ECLAC (2021) for the baseline year 2011, with a focus on characterizing the intraregional trade among the Northern Triangle countries. This analysis begins by identifying the sources of value added to the economies, measured from the supply side as a share of the gross value of production (GVP).[16] The main source of value added to the Northern Triangle economies is of local or domestic origin. This means that the transactions that contribute the most to the output are generated within and are destined for the domestic economy. This, in turn, means that payments for factors of production, including wages, net tax payments and gross operating surpluses, come from local intersectoral transactions. Guatemala has the highest domestic value added as a percentage of the total gross value of production (58.5%), followed by El Salvador (53.0%) and Honduras, with the lowest percentage (47.9%) in the Northern Triangle region. An important component in the generation of value added to economies is intermediate consumption, meaning the intersectoral spending on goods and services—local or imported—that the production process requires. The country in the Northern Triangle with the highest local intersectoral consumption is Honduras, which also has the highest share of imported intermediate goods in the composition of its gross value of production. The unique characteristics of the Honduran economy correlate with country's productive structure, positioning it as the economy with the highest gross exports relative

[16] The gross value of production from the supply side is defined as the total sum of the value of the goods and services produced by an economy and includes all productive inputs—whether local or imported—as well as payments for the factors of production that are required in the process of manufacturing a good or providing a service and that are supplied by other sectors of the economy.

to production value, with an export portfolio composed, primarily, of final goods, i.e., goods that are intended for final consumption, either by households or industries, and that, therefore, do not require further processing. In this sense, the destination markets for Honduran exports are more diversified outside the region than what is seen in El Salvador, which shows the highest rates of market concentration in the Northern Triangle region.

The Hirschman-Herfindahl Index (HHI) is an indicator that measures the diversification/concentration of a country's trading partners compared to all the countries in the world, in terms of both their exports and imports. According to the parameters of this indicator, scores can range from 0 to 1, where 0 indicates totally diversified and 1 indicates totally concentrated.

Table 24. Hirschman-Herfindahl Index Exports

Country	2011	2015	2019	2020
Guatemala	0.20	0.15	0.14	0.13
Honduras	0.15	0.22	0.19	0.19*
El Salvador	**0.25**	**0.26**	**0.23**	**0.21**

Where:

Between 0 and 0.15: Diversified (green).
Between 0.15 and 0.25: Moderately concentrated (yellow).
Greater than 0.25: Concentrated (red).

Source: Graphic System of International Economic Trends (Sistema Gráfico de Comercio Internacional, SIGCI), ECLAC
*Data corresponding to 2019

The HHI for the Northern Triangle region reveals the great strides Guatemala has made with regard to market diversification, and this finding correlates with the analysis of its gross exports in the regional input-output matrix. The HHI also reveals the trading partner diversification challenges facing El Salvador, which managed to move down from the high market concentration category (red) and join Honduras in the moderately concentrated category in 2019.

The results of the HHI match the patterns revealed in the analysis of the subregional input-output matrix. Both show trade integration patterns that differ by country and make it clear that, in spite of the high level of integration in the region, the value added from the trade of goods and services is lower than the added value generated by domestic intersectoral transactions.

Honduran exports destined for the region are equally relevant, accounting for 42.3% of its gross exports; of these, the majority are destined for El Salvador (56.4%), then Guatemala (43.4%). The Honduran products destined for the Salvadoran market consist, mainly, of final products (78.2%), especially refined oils (palm oil), soaps and detergents, plastic containers, dog and cat food, cheeses, vegetables and cement.

Table 25. Composition of gross intraregional exports of goods and services by type of use (intermediate or final), 2011

As a percentage of Total Gross Intraregional Exports

Country	Intermediate Exports % Total Intraregional Exports	Final Exports % Total Intraregional Exports
Guatemala	59.2%	40.8%
Honduras	21.9%	78.1%
El Salvador	53.5%	46.5%
Northern Triangle (NT):	**45.0%**	**55.0%**

Source: ECLAC using the multi-regional matrix for Central America, Mexico and the Dominican Republic.

The Guatemalan economy has the lowest share of gross exports to gross value of production (13.3% of GVP); however, its exports are geared more towards markets outside the region, even more than Honduras' are. Guatemala's main trading partner is the United States (43.6%), followed by the rest of the world. It even has participation in the Asian market, making it the only country in the Northern Triangle region with a relevant presence in that region. With regard to intraregional exports, Guatemala is the Northern Triangle country with the lowest participation (36.7%) in this market. Its exports within the Northern Triangle region tend to be divided between a mix of intermediate products (59.2%) and final products (40.8%), which are destined primarily for Honduras (52.6%). Its export portfolio is fundamentally made up of intermediate goods such as iron bars; rolled iron products or unalloyed steel; surfactant preparations; compound food preparations for soups and broths; and preparations for animal food, among others.

The Salvadoran economy, the smallest in the Northern Triangle region, has the second highest trade openness, in terms of the share of its total gross exports in the value of its total production (14.4% of GVP), and the second highest local intermediate consumption (29.4% of GVP), after Honduras. As for the origin of the value added to the economy, El Salvador has the second highest percentage of domestic value added in the region (53%) after Guatemala.

Table 26. Gross intraregional, extraregional and total exports of goods and services, by country, 2011

In Millions of US$ and as a % the total gross export of goods and services

Country	Total Gross Exports	Gross Intraregional and Extraregional Exports							
		Total Gross Intraregional Exports						Total Gross Extraregional Exports	
				Gross Intermediate Exports		Gross Final Exports			
		Flow	% Total Gross Exports	Flow	% Total Gross Intraregional Exports	Flow	% Total Gross Intraregional Exports	Flow	% Total Gross Exports
Guatemala	10.119	3.710	36.7%	2.197	59.2%	1.513	40.8%	6.409	63.3%
Honduras	7.806	3.304	42.3%	723	21.9%	2.581	78.1%	4.502	57.7%
El Salvador	5.032	2.740	54.5%	1.465	53.5%	1.275	46.5%	2.292	45.5%
Northern Triangle (NT):	**22.957**	**9.754**	**42.5%**	**4.385**	**19.1%**	**5.369**	**23.4%**	**13.203**	**57.5%**

Source: ECLAC using the multi-regional matrix for Central America, Mexico and the Dominican Republic.

El Salvador shows a high market concentration with regard to the destinations of its gross exports. It is particularly oriented towards the regional market, which accounts for 54.5% of its exports and to which it offers a basket of intermediate goods (54%) destined primarily for Honduras and final goods (47%) destined for Guatemala. In terms of exports to the Honduran market, El Salvador primarily sells textile products and clothing, especially knitted fabrics, jerseys, sweaters, T-shirts, cotton fabrics and pants, among others. Exports to the Guatemalan market mainly include items such as toilet paper, plastic containers, medicines, polyester thread, snacks, silverware, sacks and bags, cheeses and sweets, among others.

Complementary analysis conducted by the ECLAC (2021) related to the measurement of the value added by trade in Central American countries, the Dominican Republic and Mexico reveals that, despite the importance that the intraregional market has in the trade of goods and services, the value added by intraregional exports and imports, the multilateral value added and the reimported value added in the region, which are key indicators of regional production chains, is very low, ranging from 7.8% in Honduras (the highest) to 0.2% in Mexico. These results do not reveal a significant degree of integration among the countries of the region and, instead, highlight an absence of significant, deep and long regional chains. The document points out that "*...the value added by intraregional trade is primarily generated by direct exports and imports between the countries in the subregion, but with a reduced share of intraregional intermediate inputs...*" The results of the methodology used in the study indicate that the textile and clothing sector is the one with the largest productive chain in the region, with the highest shares of intraregional intermediate inputs and, therefore, with the highest external, intraregional, multilateral, and reimported added value.

With regard to the economic sectors, the study points out that the primary sectors are characterized by the limited value added by intraregional trade, in which the agricultural and forestry subsectors of Guatemala stand out as net generators of domestic value added. Guatemala is, therefore, a supplier of primary goods and a consumer of secondary and tertiary goods. In aggregate terms, all the productive sectors of El Salvador and Honduras are net generators of bilateral value

added, i.e., the value they add to their trading partners' economies through intraregional imports is greater than the value added to their own economies through their exports to the rest of the region. El Salvador is an exceptional case in that the agricultural and forestry subsector's imports represent a high value added by intraregional trade in the primary sector (this variable represents 77.7% or $102 million dollars). Therefore, El Salvador and Honduras are net consumers of both primary and secondary goods, as well as services.

These results expose the importance of trade facilitation measures that can build on improvements in the efficiency and standardization of technical/administrative processes, interinstitutional coordination, permit issuing procedures and other measures in the common territory, based on effective compliance with community regulations on the origin of goods, that contribute to building and deepening production chains between the countries of the region, deep and long chains that drive economic development and facilitate better conditions for their international insertion, by taking better advantage of the competitive advantages the economies offer together.

Developing and strengthening the regional value chains will bring opportunities to achieve improvements in efficiencies and productivity, based on vertically integrated processes, which will contribute to deepening the integration and supporting the productive specialization of the countries in the region.

EL SALVADOR: IDENTIFICATION OF PRODUCTS AND SECTORS WITH OPPORTUNITIES FOR TRADE IN THE CUSTOMS UNION

The characterization of the Salvadoran economy presented above highlights the increased opportunities that come with the diversification of the country's export activity, through the development of products with greater economic complexity and the expansion to new export markets, objectives that can be achieved by implementing measures that facilitate the cross-border trade that would allow it to, among other things, improve the competitiveness of its export portfolio and take greater advantage of its existing productive capacities.

The strength of the country's productive capacity can be seen in its position in the economic complexity ranking, which places El Salvador in spot 54, between Brazil (53) and Colombia (55), two countries that have ample resources as well as markets and territories that are significantly larger than El Salvador's. One of the country's greatest challenges involves achieving the conditions required to scale up its more complex productive sectors, which are currently show budding development and which can drive the diversification and sophistication of the country's export portfolio, with a basket of higher value-added goods that would contribute to improving the levels of remuneration for the national factors of production and bring about an acceleration of the country's economic growth.

In the economic and trade area, the bottlenecks that limit the establishment of these more complex production chains are related to the difficulty of scaling up productive processes beyond national borders. This difficulty may be addressed by the launch of the economic integration strategy that, in terms of cross-border trade, proposes the implementation of measures to simplify, standardize and speed up the movement of goods and people in the territory shared by the counties of the region. These measures will improve the region's positioning as a destination for foreign investment and

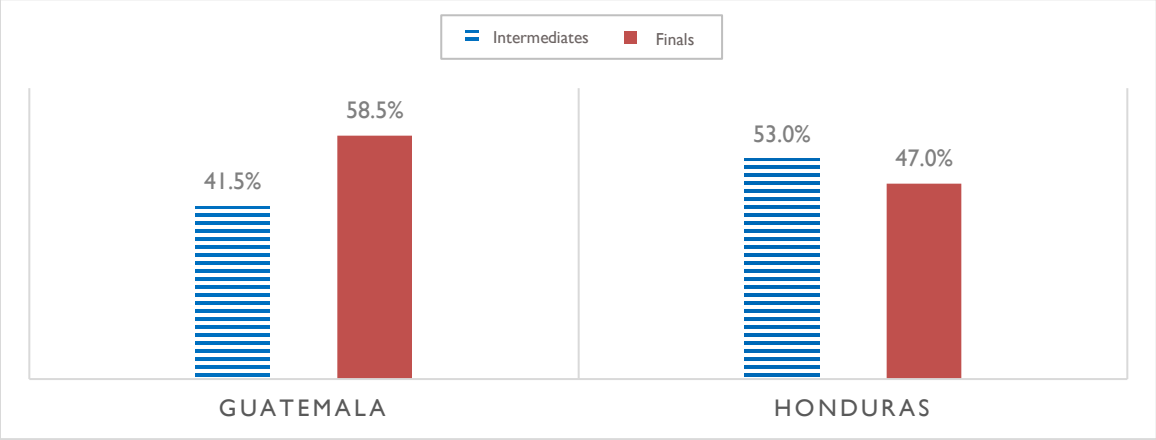
contribute to the expansion of a consumer market that will be more attractive than the sum of the small individualized markets, which will significantly benefit the smaller economies like El Salvador.

The potential benefits of economic integration in the region, therefore, depend on the establishment of production processes that add more value and have the potential to be integrated regionally, in accordance with the economies' existing capacities, degree of specialization and productive complementarity. For the Salvadoran economy, this integration may represent opportunities for the diversification and sophistication of its production, as well as an expansion of the consumer markets for its products and services, which have limited opportunities for greater growth (higher demand) in the local market.

The bilateral trade relationships between El Salvador and its trading partners Guatemala and Honduras are determined by the capacities and productive structure of each country, as detailed above, and are based on a basket of industrial goods, mainly for final use by households and industries, as well as intermediate inputs, mainly destined to complement productive processes carried out in Honduras.

The trade among the three countries is relevant for each one of the economies. Looking at the relationships synthesized in the regional input-output matrix developed by the ECLAC, it is clear that exports among the three Northern Triangle countries make up at least 50% (Honduras) and up to 60% (El Salvador) of intraregional exports.

Figure 24. El Salvador: Composition of gross intraregional intermediate and final exports of goods and services, by trading partner, 2011

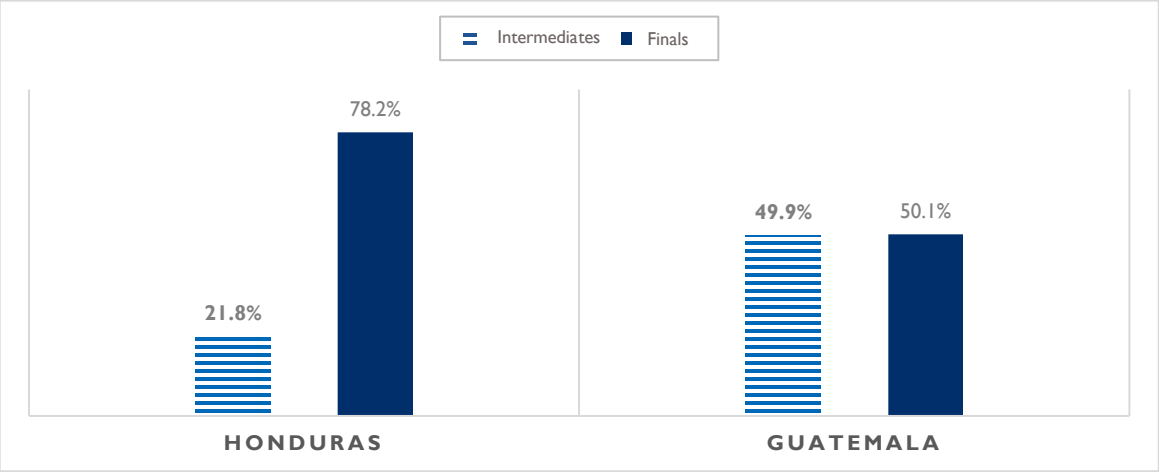


Source: Prepared by the authors using the multi-regional matrix for Central America, Mexico and the Dominican Republic, created by the ECLAC

Honduras and Guatemala export a basket of goods for final use to El Salvador. The majority of Honduras' exports to El Salvador are for final use (78.2%), whereas Guatemala's exports to El Salvador are more evenly divided between intermediate goods (49.9%) and goods for final use (40.1%).

This characterization provides clues about the region's potentialities to articulate production networks, which can be identified based on indicators of intra-industrial connection and trade complementarity that evaluate the levels of specialization between the countries in specific sectors, in this case, between the export specialization of one country and the import requirements of the trading partner. The three economies meet one of the basic requirements for the formation of production networks, which is geographic proximity, a condition that favors the articulation of a region's production and trade.

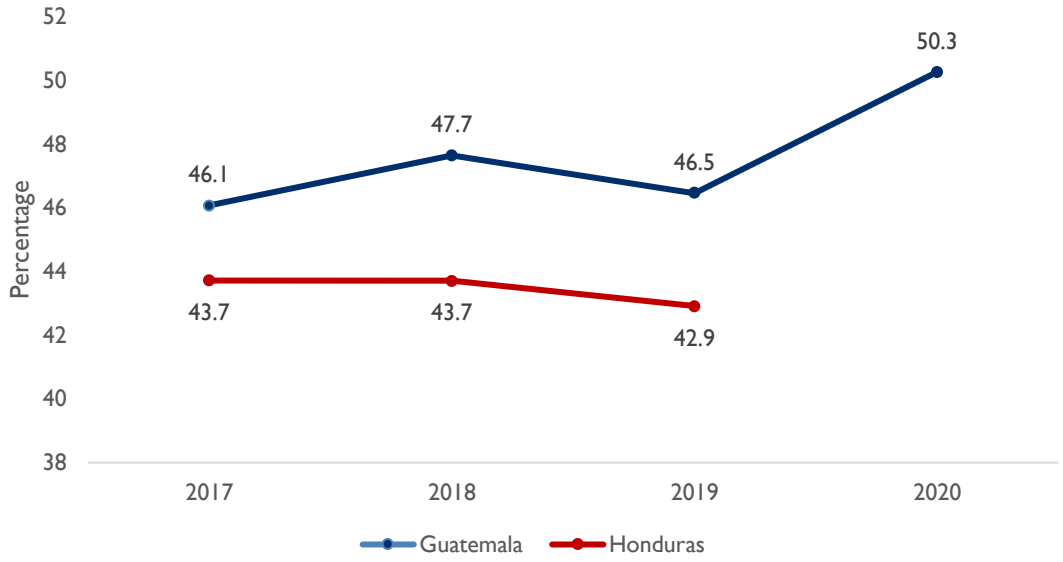
Figure 25. Guatemala and Honduras: Composition of gross intraregional intermediate and final exports of goods and services destined for El Salvador, 2011



Source: Prepared by the authors using the multi-regional matrix for Central America, Mexico and the Dominican Republic, created by the ECLAC|

These results provide signs of an important affinity between the productive structures and the degree of export specialization of each of the countries. In this regard, the results of the Commercial Complementarity Index (CC) indicate that the greatest coincidences in terms of the export supply and demand for imports are observed between El Salvador and Guatemala, while with Honduras the result shows a slightly lower affinity.

Figure 26. El Salvador: Trade Complementarity Index (CC) with Guatemala and Honduras



Source: own elaboration based on World Bank data

$$índice\ de\ complementariedad = 100 * \left[1 - \sum_k \left|\frac{m_{jk}}{M_j} - \frac{x_{ik}}{X_i}\right|\right]$$

Complementary Index; where: x is the exports value of product k since i, and x the total exports since I; m is importing value of product k of economy j and their total imports M.

The values of the Trade Complementarity Index (ICC) can range from 0 to 100; a value of 100 shows that the economies are ideal partners, and therefore the export basket of one economy complements the import basket of another. Meanwhile, a value tending to 0 indicates that they are perfect competitors. In the evaluation of the commercial exchange of El Salvador with Honduras and Guatemala, the values average 43, while in the case of Guatemala it reaches a value above 50 points, which reveals the opportunities to productively integrate sectors of both countries.

This index can provide useful information on the prospects for intra-regional trade as it shows how well a country's import and export structures match up and is used by countries to assess whether trade agreements have been formed to take advantage of these similarities.

These results can be complemented with the analysis of the Similarity Index (SI), which evaluates the similarities in the exporting and importing structures of the countries, and therefore can be considered as an indicator of the level of competition between them. In the results of the NT countries, it can be concluded that the economies effectively have a moderate level of competition among themselves, but that, in turn, they find spaces for their commercial complementarity, as confirmed by the results of the ICC. It should be noted that between the years 2018-2020, the

Honduran economy shows a greater degree of rapprochement with the productive structures of Guatemala and El Salvador.

Figure 27. El Salvador: Similarity Index (SI) of exports with Guatemala and Honduras

$$IS = \sum_{k=1}^{n} \text{Min}\left[\frac{x_i^k}{x_i}, \frac{x_j^k}{x_j}\right]$$

Where:

xik: exports of product k from country i.

xjk: exports of product k from country j.

xi: total exports of country i.

xj: total exports of country j.

n: total number of SITC Rev.2 products.

For its part, the Herfindahl-Hirschman Index (IHH), which has been previously presented to assess the degree of diversification of export markets for the NT countries, is applied this time to assess the presence and weight of the categories at the level of products exported by the country to the world. In this sense, the IHH could reinforce the analysis that the greater the diversification of the markets of an export product, the greater opportunities can be generated for the construction of linkages between both countries. Therefore, an HHI indicator that indicates a high concentration of markets (few markets for the same product) would limit the spaces to regionally integrate a production process between several countries. Its formula is:

$$IHH = \frac{\Sigma\left(\frac{V_i}{V_t}\right)^2 - \frac{1}{n}}{1 - \frac{1}{n}}$$

Where:
Vi: exports or imports of product i.
Vt: total value of all products Vi.
n: is the number of selected products.

The HHI is an indicator of market diversification/concentration, in which an index between 0.0 and 0.10 is considered as diversified, between 0.10 – 0.18 as moderately concentrated, and greater than 0.18 is considered as a "concentrated" market.

Table 27. El Salvador: Export Market Concentration Index (IHH)

Description	HH Market Index			
	2017	2018	2019	2020
Metals	0.581	0.556	0.55	0.559
Manufactured stone, glass	0.509	0.328	0.498	0.526
Wood - Paper and cardboard	0.684	0.382	0.334	0.475
Plastics	0.503	0.48	0.439	0.428
Live animals	0.184	0.209	0.28	0.351
Chemicals	0.252	0.28	0.287	0.298
Art. Leather and Fur	0.175	0.18	0.196	0.203
Minerals	0.182	0.171	0.183	0.187
Miscellaneous	0.174	0.177	0.183	0.181
Footwear	0.175	0.171	0.169	0.164
Machinery	0.21	0.188	0.205	0.164
Vegetables	0.162	0.165	0.171	0.157
Fuels	0.146	0.13	0.104	0.156
Textile and clothing	0.156	0.143	0.145	0.151
Vehicles transportation	0.172	0.15	0.15	0.14
Food Products	0.085	0.11	0.116	0.106

Source: WTIS, World Bank

Where:

	0.0 - 0.10	Diversified
	0.10 -0.18	Moderately concentrated
	Más de 0.18	Concentrated

In the categories of products exported by El Salvador to the world with the highest rates of diversification in their destination markets, Food and Beverages stand out, which, based on the number of its commercial partners, show a balanced commercial participation among their destination markets, while products such as those of the Metalworking sector, which despite presenting a significant number of destination markets, reveal a greater dependence on these export flows, therefore, any change in demand or application of trade barriers in these countries would have a negative effect. negative in the performance of this industry. On the other hand, the sectors

that present the greatest concentrations of export markets (due to the smaller number of partners) are stone, ceramic and glass manufactures; chemicals and to a lesser extent mineral products.

For their part, the products of the Textiles and Clothing, Footwear and Equipment and Machinery Manufacturing industries show lower levels of market concentration, which, in turn, coincides with the vertical integration of these industries and the level of development of regional chains. , being the case of the textile and clothing sector, the greatest exponent of the country's participation in global value chains. For its part, trade in primary products, such as vegetables, also shows a relative diversification of export destination markets.

An interesting approach to the impact that trade can have on the level of chaining of economies is precisely through the Grubel Lloyd Index (GLL), which becomes relevant in the context of a trade based predominantly on industrial goods. In this sense, the manufacturing process of industrial products tends to be organized vertically and with the right conditions, allows the incorporation of various sectors in the production process, through its different links or chains, within the economy and therefore, value added generators.

The mathematical formula for calculating the index is presented below:

$$\mathrm{IGL}_{ij}^{k} = 1 - \frac{\left|\mathrm{X}_{ij}^{k} - \mathrm{M}_{ij}^{k}\right|}{X_{ij}^{k} + M_{ij}^{k}}$$

Where:
X: are exports.
M: they are imports.
i: country
j: partner.
k: 3-digit productive sector of the SITC product classification

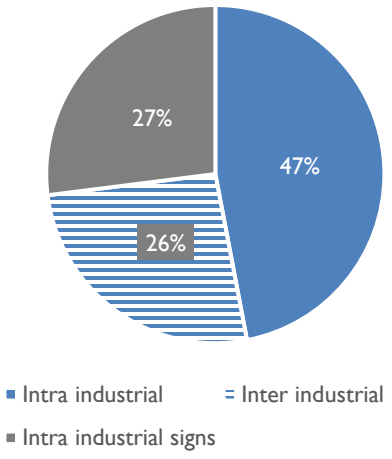
The GLL Index makes it possible to identify the "intra-industry" trade flows that result from the exchange between the same sectors and the "inter-industry" trade that is carried out between different economic sectors in a bilateral relationship. The interpretation of this indicator provides information on the levels of productive complementarity between the countries, in which higher levels of intra-industry trade, such as that which characterizes the bilateral relationship with Guatemala, reveal an endowment of similar factors of production and therefore with greater spaces to generate productive complementarities. Among the products that present the highest rates of intra-industry trade are perfumes, essential oils, food products, various chemical products, photographic equipment, fertilizers, clothing, seafood, iron structures, cocoa, rice, medicines and preparations of cereals and/or flour.

For its part, bilateral trade with Honduras presents a relatively lower level of intra-industry trade than that observed with Guatemala, which is related to a slightly higher share of products whose trade is of an intersectoral nature, among which the trade of textile fabrics stands out. synthetic fibers, alcoholic beverages, milk, sugar and honey, manufacture of mechanical equipment and tools,

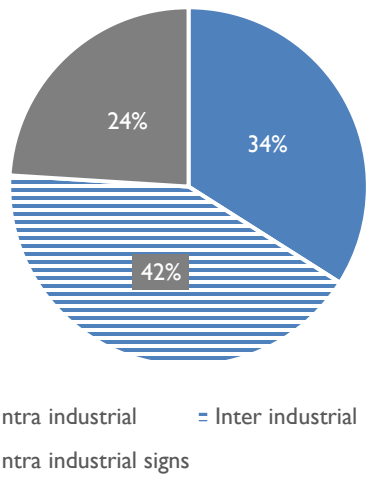
optical, medical, electrical instruments, jewelry, manufacture of ceramic products, paints, varnishes, medicines, footwear, leather products, among the main ones.

Figure 28. Grubel – Lloyd Index (IGGL) in trade with Guatemala and Honduras, 2019

a) El Salvador - Guatemala



b) El Salvador - Honduras



Regarding the results of products with intra-industry trade between El Salvador and Honduras, women's/girls' outdoor clothing (except knitwear) stands out; other clothing (except knitted); flour; food products; refractory building materials; animal feed, organic chemicals, bars, rods of iron or steel.

The selection process for products/sectors with the greatest opportunity in the bilateral exchange between El Salvador must consider the existence of comparative advantages among the products participating in the trade, with the aim of identifying the sectors that have the highest levels of export specialization. For these purposes, the Index of Revealed Comparative Advantages (RCA) is used, an indicator that measures the commercial performance and the productive-commercial competitiveness of a country, and provides information on the potential of a product to increase its exports. competitively regarding the performance of world exports of the product, providing useful information about possible business prospects with new business partners.

This measurement acquires greater relevance, since it indicates the comparative advantages of trade based on its current flows, which makes it possible to point out differences between countries, due to their relative costs and other factors that are not necessarily market factors. The RCA is defined as the ratio between the share of a product in a country's exports and the share of that same product in world exports. An index greater than unity indicates that the share of a country in the exports of a certain sector exceeds the share of the same sector in global exports. If this is the case, we infer that the country has a comparative advantage in that sector.

Country i's RCA index for product k is often measured by the product's share of the country's exports relative to its share of world trade. Its calculation is as follows:

$$RCA_{ijk} = \frac{\frac{x_{ijk}}{X_{ij}}}{\frac{x_{wjk}}{X_{wj}}}$$

Where:
- x is the value of exports of product k from country i to destination j;
- X is the total exports from country i to destination j;
- w indicates total world exports;
- xij and xwj are the values of country i's exports of product k and world exports of product k
- Xi and Xw refer to the country's total exports and the world's total exports.

In the context of El Salvador's bilateral trade with Guatemala and Honduras, the results of the RCA indicate that more than 89% of the total Salvadoran products exported to both destinations have a comparative advantage, with the highest percentage being observed in exports to Guatemala with a 91% of all products with at least one revealed comparative advantage.

Table 28. El Salvador: Index of Revelated Comparative Advantages (RCA) 2020.
Exports to Guatemala and Hondiras (In Index, Export values in thousand of US$, participation % and annual growth rate %)

Categories	GUATEMALA				HONDURAS			
	Trade Exchange (Thousands US$)	Part. % categories over total	Index of Revealed Comparative Advantages (RCA)	Compound annual growth rate %	Trade Exchange (Thousands US$)	Part. % categories over total	Index of Revealed Comparative Advantages (RCA)	Compound annual growth rate %
Food products	183,413	21.53	2.63	1.4	89,885	11.54	1.09	-0.8
Paper and paperboard	82,944	9.74	2.19	-2.56	80,961	10.4	2.76	6.57
Plastics	111,451	13.08	2.01	-1.19	94,180	12.1	1.91	2.7
Metals	96,092	11.28	1.89	0.38	34,185	4.39	0.74	-9.14
Live animals	44,719	5.25	1.51	23.91	3,762	0.48	0.24	12.02
Textile and clothing	95,564	11.22	1.34	-2.15	285,177	36.63	1.9	-4.74
Chemicals	104,427	12.26	1.15	9.86	87,594	11.25	1.05	7.89
Footwear	6,676	0.78	1.05	-10.57	1,482	0.19	0.49	-24.71
Vegetables	39,273	4.61	0.71	8.39	39,456	5.07	0.91	4.03
Minerals	488	0.06	0.43	20.27	207	0.03	0.17	-24.78
Fuels	45,864	5.38	0.38	9.38	16,602	2.13	0.21	1.37
Manufacture stone, glass	3,702	0.43	0.35	-2.57	5,806	0.75	0.66	7.07
Art. Leather and Fur	584	0.07	0.29	-28.16	179	0.02	0.15	4.43
Miscellaneuous	15,869	1.86	0.23	1.53	19,107	2.45	0.38	-3.21
Machinery	17,769	2.09	0.15	6.4	15,666	2.01	0.15	-4.56

Categories	GUATEMALA				HONDURAS			
	Trade Exchange (Thousands US$)	Part. % categories over total	Index of Revealed Comparative Advantages (RCA)	Compound annual growth rate %	Trade Exchange (Thousands US$)	Part. % categories over total	Index of Revealed Comparative Advantages (RCA)	Compound annual growth rate %
Vehicles transportation	3,129	0.37	0.05	55.05	4,389	0.56	0.14	2
Overall Total	**851,963**	**100.01**	**16.36**	**89.37**	**778,637**	**100**	**12.95**	**-23.86**

Source: WITS, World Bank.

In trade with Guatemala, food products stand out (milling, pastries, cheeses, non-alcoholic beverages, such as juices, waters), with a 21.5% share of the total exported and presenting the most important revealed comparative advantages of the export basket, followed by by products from the paper and cardboard sector, plastic manufactures, products from the iron and steel industry, live animals (poultry) and products from the textile and clothing sector (synthetic and cotton yarn). As a whole, these categories represent 72% of the total value exported from El Salvador to Guatemala. Other products and services also stand out in this export basket, such as exports of electricity, cement products and paints/varnishes.

Table 29. El Salvador: Ranking of the main 25 export products with the greatest revealed comparative advantages with Guatemala, 2020

N°	SAC	Description	Index of Revealed Comparative Advantages (RCA)	Part. % categories over total	Trade Exchange (Thousands US$)
1	481810	Paper and paperboard	15.5	4.3	36,769.7
2	392330	Plastic and its Manufactures	12.3	3.5	30,138.5
3	190590	Pastry products	9.0	3.5	29,904.0
4	220299	Non-Alcoholic Beverages, Water and Carbonated Waters	8.8	3.1	25,973.1
5	40620	Dairy, cheese	8.4	2.4	20,825.3
6	190410	Cereal-based food preparations	13.9	2.4	20,101.9
7	540233	Synthetic yarn	9.8	2.4	20,091.3
8	722599	Iron and Steel Foundry	14.9	1.6	13,573.9
9	392020	Plastic and its manufactures (propylene polymers)	5.3	1.5	12,384.7
10	392321	Plastic and its manufactures (ethylene polymers)	6.8	1.4	11,991.0
11	730661	Iron and Steel Foundry Manufactures	8.9	1.3	11,355.0
12	200559	Vegetable Preparations	14.9	1.3	10,723.4
13	481910	Paper and paperboard	11.8	1.3	10,678.8
14	110220	Milling products (flour)	12.1	1.2	10,297.1
15	730890	Iron and Steel Foundry Manufactures	7.3	1.2	10,059.0
16	320910	Paints and Varnishes	8.7	1.1	9,471.4
17	721420	Iron and Steel Foundry	15.7	1.1	8,980.5

N°	SAC	Description	Index of Revealed Comparative Advantages (RCA)	Part. % categories over total	Trade Exchange (Thousands US$)
18	520513	Cotton yarn	8.8	1.0	8,687.3
19	170490	Refined sugar	5.6	1.0	8,601.2
20	481920	Paper and paperboard	11.8	0.9	8,049.9
21	200811	Preparations of Vegetables or other fruits (nuts)	13.0	0.9	7,925.6
22	151710	Fats and oils	14.3	0.9	7,505.4
23	190490	pastry products	13.5	0.9	7,376.2
24	390422	Plastic and articles thereof (vinyl chloride)	13.4	0.9	7,351.8
25	10511	Live poultry	6.4	0.8	7,141.3
		TOTAL		41.8	355,957.0

Source: Central Reserve Bank of El Salvador and WITS, World Bank

In the other hand, in trade with Honduras, the products of the Paper and Cardboard industry lead -in terms of comparative advantages-, mainly composed of items such as toilet paper and to a lesser extent folding cartons; These products show even greater advantages than those registered in exports to Guatemala. They are followed by plastic products such as plastic bottles, sacks and plastic bags. Likewise, significant revealed comparative advantages are observed in a basket of textile and clothing products, mainly made up of knitted fabrics and synthetic fibers, as well as final products, such as sweaters, knitted pants, and chemical products, among others. them medicines and chemical bases for industrial use. This basket of products represents 82% of exports to the Honduran market.

Table 30. El Salvador: Ranking of the main 25 export products with the greatest revealed comparative advantages with Guatemala, 2020

N°	SAC	Description	Index of Revealed Comparative Advantages (RCA)	Part. % categories over total	Trade Exchange (Thousands US$)
1	481810	Paper goods; toilet paper	7.5	4.8	37,648.8
2	611030	sweaters	8.6	4.8	37,335.5
3	392330	Plastic; jugs	9.2	4.7	36,238.4
4	600632	Knitwear	7.6	3.0	23,695.4
5	611020	sweaters	10.9	2.8	21,636.6
6	600622	Knitwear	6.7	2.5	19,257.8
7	110220	Cereal flour; corn	10.8	2.3	18,257.8
8	392321	ethylene polymers; sacks and bags (including cones)	6.5	1.6	12,223.0
9	580620	Special fabrics; containing elastomer threads	7.4	1.5	11,641.1
10	481920	Paper and paperboard; folding cartons	5.9	1.3	9,798.9
11	110100	Wheat flour	9.1	1.2	9,390.3

N°	SAC	Description	Index of Revealed Comparative Advantages (RCA)	Part. % categories over total	Trade Exchange (Thousands US$)
12	481910	Paper and paperboard; cartons	7.8	1.1	8,795.3
13	600192	Knitwear	11.3	1.1	8,744.7
14	610463	Knitted pants	9.2	1.1	8,612.6
15	482110	Paper and paperboard; labels of all kinds	5.7	1.0	7,540.0
16	610342	Knitted pants	11.0	0.9	7,080.8
17	600621	Knitwear	9.5	0.9	6,908.6
18	151790	Edible mixtures or preparations of fats or oils of animal or vegetable origin.	8.7	0.8	6,556.5
19	300310	Medicines; that contain penicillins	11.5	0.8	6,322.2
20	940370	plastic furniture	8.1	0.7	5,723.1
21	610343	Knitted pants	9.3	0.5	4,197.6
22	310520	Mineral or chemical fertilizers	6.2	0.5	3,644.6
23	960711	Zippers and their parts	10.1	0.5	3,627.7
24	271119	Petroleum gases and other gaseous hydrocarbons	11.5	0.5	3,627.0
25	200989	Juice of any fruit or vegetable n.e.c.	6.3	0.4	3,276.2
		TOTAL		41.3	321,780.3

Source: Central Reserve Bank of El Salvador and WITS, World Bank

The sectors/products with the greatest opportunity and competitiveness for the country in the trade between Guatemala and Honduras identified in the previous diagnosis will be used in the subsequent exercise to estimate the impacts of the accession of El Salvador in the process of deep integration between Guatemala and Honduras. Honduras, serving as the basis for the evaluation of the treatment that these products from El Salvador may receive, in accordance with the provisions of the resolutions of the Ministerial Instance in relation to the lists of exceptions to free circulation in force between Guatemala and Honduras, and in this way, estimate the impact on the trade flows of El Salvador as a result of the incorporation to this process.

SITUATION OF THE BASIC BASKET OF PRODUCTS WITH THE GREATEST IMPACT IN THE LISTINGS OF EXCEPTIONS OF FREE TRANSIT BETWEEN GUATEMALA AND HONDURAS

The Second Ordinal of the Enabling Protocol established the categories of goods that are excluded from the free circulation regime within the single territory:

a. Goods contained in Part II of the Central American Import Tariff;
b. Goods subject to tariff quotas with third countries within the framework of preferential trade agreements;
c. Goods subject to safeguards in accordance with Article 26 of the Agreement on the Central American Tariff and Customs Regime;
d. Merchandise with differentiated phytosanitary and zoosanitary regimen;
e. Goods subject to substantially different tax regimes

f. Goods contained in Annex "A" of the General Treaty of Central American Economic Integration

Based on that categorization, the Community Information Platform (PIC) segregated the goods into six lists applicable to the Customs Union as follows:

a. L1: Tariff positions excepted from free circulation.
b. L2: Complete list for acquisitions from Guatemala and Honduras
c. L3: Tariff positions that require SPS Notification
d. L4: Tariff positions excepted by Regional Trade Agreements
e. L5: Tariff positions excepted by rules of origin
f. L6: Goods with free circulation based on the Resolution of the Ministerial Instance No. 24-2017

Table 31. List (L6): Goods with free transit based on the Resolution of the Ministerial Instance No. 24-2017, which require MSF notification

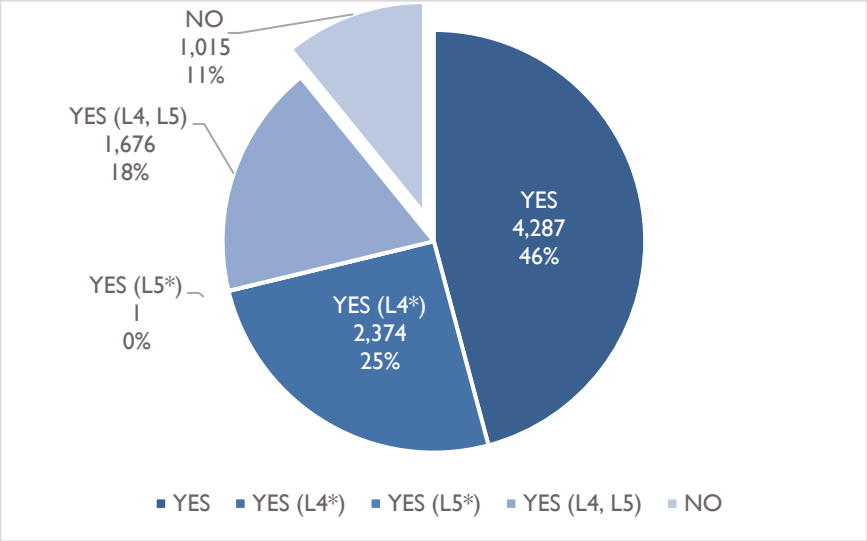
TARIFF HEADING	DESCRIPTION OF TARIFF HEADING
511	Animal products not elsewhere specified or included; dead animals of chapter 1 or 3, unfit for human consumption
2308	Vegetable materials and vegetable waste, vegetable residues and by-products, including pellets, of a kind used for animal feed, not elsewhere specified or included
2309	Preparations of a kind used for animal feeding
2503	Sulfur of any kind, except sublimed, precipitated and colloidal
2510	Sulfur of any kind, except sublimed, precipitated and colloidal
2518	Dolomite, whether or not calcined or sintered, including dolomite roughly trimmed or merely cut, by sawing or otherwise, into square or rectangular blocks or slabs; dolomite agglomerate
2519	Natural magnesium carbonate (magnesite); electrofused magnesia; dead-burned (sintered) magnesia, whether or not containing small amounts of other oxides added before sintering; magnesium oxide, whether or not pure
2520	natural plaster; anhydrite; setting plaster (consisting of natural calcined gypsum or of calcium sulfate), whether or not colored or containing small amounts of accelerators or retarders
2522	Quicklime, slaked lime and hydraulic lime, excluding calcium oxide and hydroxide of heading 28.25
3002	Human blood; Animal blood prepared for therapeutic, prophylactic or diagnostic uses; antisera (antibody sera), other blood fractions and immunological products, whether or not modified or obtained by biotechnological processes; vaccines, toxins, cultures of microorganisms (except yeasts) and similar products
3003	Medicines (except products of headings 30.02, 30.05 or 30.06) consisting of products mixed together, prepared for therapeutic or prophylactic uses, not dosed or put up for retail sale
3004	Medicines (except products of headings 30.02, 30.05 or 30.06) consisting of mixed or unmixed products, prepared for therapeutic or prophylactic uses, dosed (including those administered transdermally) or packaged for retail sale
3006	Pharmaceutical preparations and articles referred to in note 4 of this chapter
3101	Fertilizers of animal or vegetable origin, whether or not mixed together or chemically treated; fertilizers from the mixing or chemical treatment of products of animal or vegetable origin

Source: SIECA.

In turn, the Resolution of the Ministerial Instance No. 24-2017 approved the lists of goods with differentiated health status for agricultural inputs, which may enjoy free circulation as long as they originate from the countries of the Union and have recognition of its sanitary registration and are made up of the merchandise detailed in Table 31.

Based on the treatment of merchandise defined in the current free circulation exception categories, 45.8% of the tariff universe of products between Guatemala and Honduras enjoy free circulation in the single territory, of which 13.8% require an SPS notification. by the health authorities, totaling 1,315 tariff items. Then, 43.3% of tariff positions are added whose free circulation is evaluated based on the exception lists L4 (due to differences in regional trade agreements) and L5 (due to differences due to rules of origin), which total 4,051 items of the tariff universe. of the two countries, which require a detailed analysis according to the countries of origin of the goods. In this way, 89.1% of the universe of merchandise that can be traded from both countries are likely to enjoy free circulation, provided that the requirements demanded in the resolutions of the Ministerial Instance approved to date are met.

Figure 29. Treatment of goods according to lists of exceptions to free circulation
Percentage distribution over tariff universe, Honduras and Guatemala



Source: PIC-SIECA
L4 and L5: The goods may enjoy free circulation as long as they are not detailed with the countries of origin referred to in said lists.

In the event that these percentages (of free circulation and exceptions) are maintained with the full incorporation of El Salvador, it means that 91.4% of the total products - equivalent to 81.5% (year 2019) of the value exported - to the Guatemalan market would enjoy free circulation, either immediately or after fulfilling the requirements (MSF notification); while for Honduras it would apply to 92.1% of merchandise, which represents 89.2% of the total exported value (2019).

As for imports, the free circulation conditions would apply to 90.6% of the total merchandise – equivalent to 76.3% of the total imported from Guatemala–, while, for imports from Honduras, it would apply to 91.8% of the merchandise. which represent 85% of the total imported value, according to the figures for the year 2019. Regarding the analysis of imports, of the total products imported from the two countries, more than 60% of them come from Guatemala, while that approximately 39% is from Honduras. In this sense, it should be noted that, for the effects of the impact of the accession of El Salvador, in terms of intra-regional imports, purchases from Guatemala will be taken as a reference, given its high participation in the volume of merchandise and values imported from the TN region.

The estimation of the impact, on the import side, requires evaluating the requirements of the demand for imported products from the different economic sectors and then relating them to their countries of origin, in order to validate compliance with the criteria and classifications expressed in the lists L4 and L5, which are analyzed in later sections.

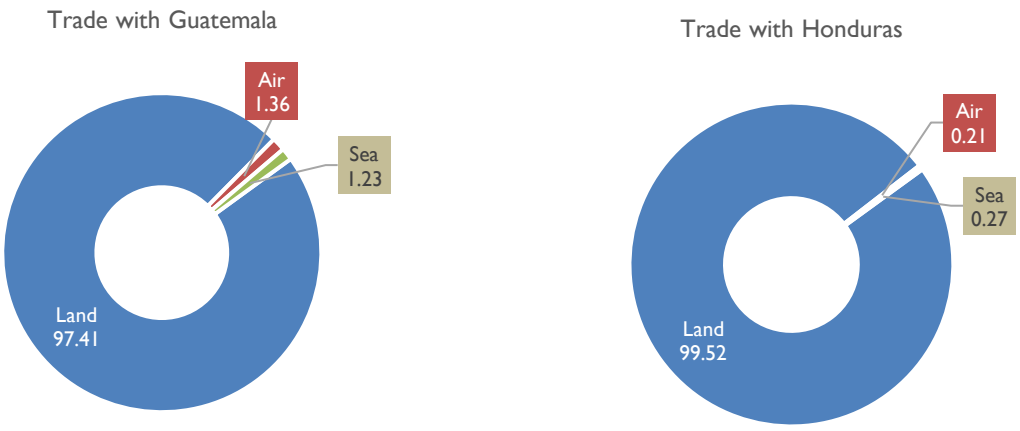
Turning now to an analysis of the customs most used by El Salvador in trade with Guatemala and Honduras, according to their type, they are: land, sea and air. It is highlighted that the terrestrial modality is the most used (97%); and in the particular case of Guatemala, there is a lower share of trade by air, as well as by maritime customs. While with Honduras it concentrates practically 99% of trade by land.

With regard to the evolution of exports by land, a larger share was destined for Honduras (14.9% of total exports) than for Guatemala (14.2% of total exports). In addition, it bears noting that exports by land to Honduras account for 99.2% of all sales to this market.

With regard to Guatemalan and Honduran products imported by El Salvador, Guatemalan products account for the larger share, 10.3% of all El Salvador's imports, of which 98% enter through different land borders. Honduran products account for a smaller share of imports, approximately 50% of the value imported from Guatemala, and enter El Salvador primarily by land.

Figure 30. Bilateral trade of El Salvador with Guatemala and Honduras, according to type of customs.

Percentage distribution of the value of total trade (exports + imports) by type of customs



In that same order, when considering the participation of each one of the customs according to their type (land, air and sea), it is confirmed that the greatest incidences of an eventual adhesion of El Salvador to the deep integration between Guatemala and Honduras, will be registered by land, which is why a diagnosis of the evolution of land trade between the Northern Triangle countries is presented below, along with an estimate of the treatment that this basket of goods from El Salvador could receive, based on the application of the manifest criteria in the current exception lists for Guatemala and Honduras.

Current situation of land trade between El Salvador and Guatemala and Honduras

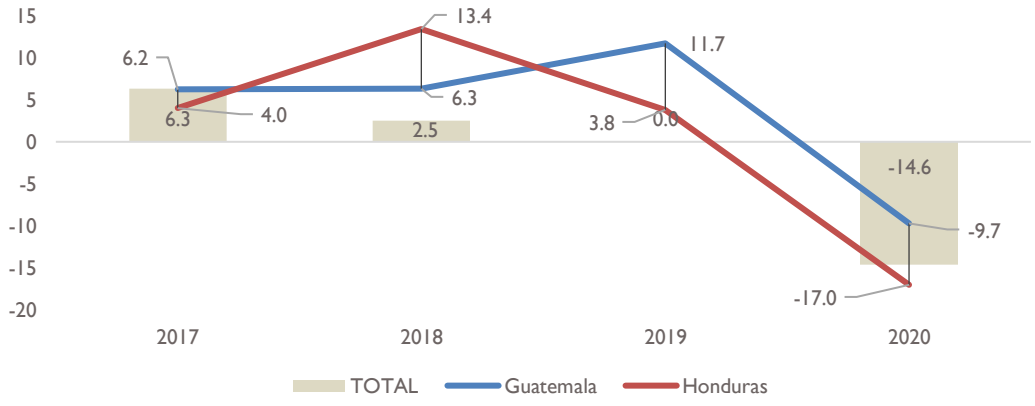
The evolution of El Salvador's trade with its two main trading partners in the region, Guatemala and Honduras, has maintained a positive dynamism in recent years, with the exception of 2020, when the flow of trade with these countries reported a contraction of - 13.2% in the case of exports and 9.1% in imports, as a result of the initial impact of the Covid-19 pandemic in the region. In this sense, the 2017-2019 period will be considered for the analysis of trade flows, in this way, the average growth of exports was 7.3% per year, while for imports, the average rate is 11.4%. annual.

The importance of land trade with the TN region is also confirmed by the high contribution that this exchange of goods exerts on the global behavior of the country's trade. In this way, total exports to the TN region, which represent an average of 30% of the country's exports, allow us to point out that, for each percentage point of increase, about 25% is explained by the performance of the goods that transit by land route. In this same sense, the importance of imports that enter by land, contributes 16.5% on average to the global increase in purchases.

The performance of trade between the three countries by land experienced a rebound between the years 2018 - 2019, exceeding the average growth of total exports and imports of El Salvador, consolidating itself as one of the factors that inject dynamism and drive the economic growth of the country.

Figure 31. El Salvador: El Salvador: Total and Bilateral Exports with Guatemala and Honduras

(Annual % variation rate)

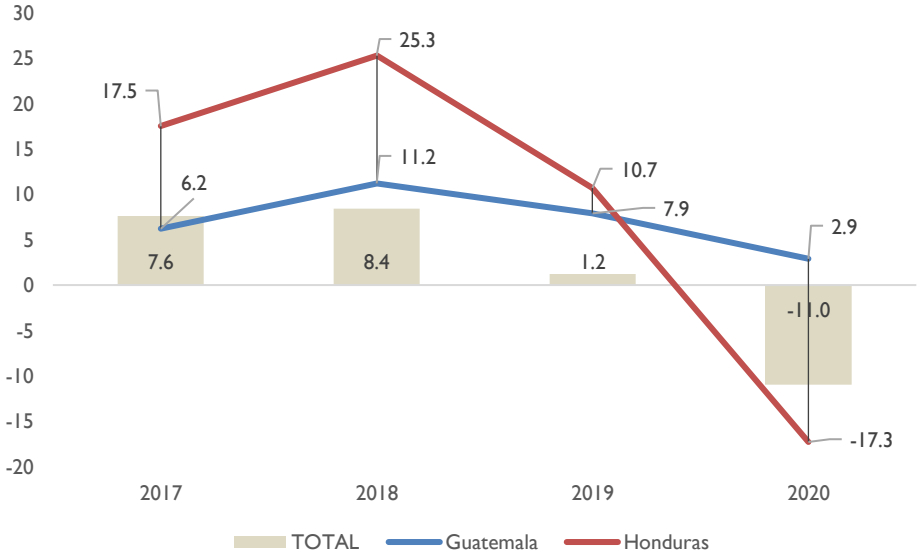


Source: own elaboration based on BCR and DGA data

In attention to the evolution of exports by land, those destined for Honduras stand out, which present a greater participation (14.9% of total exports) compared to those destined for Guatemala (14.2% of total exports). On the other hand, the greater importance of exports by land to Honduras stands out, which represent 99.2% of total sales to this market.

Regarding Salvadoran merchandise imports from Honduras and Guatemala, those of Guatemalan products stand out for their greater participation, which represent 10.3% of the country's total imports, of which 98% enter through different land borders. On the other hand, the participation of imports from Honduras, observe a lower participation, approximately 50% with respect to the values imported from Guatemala, which enter mainly by land routes.

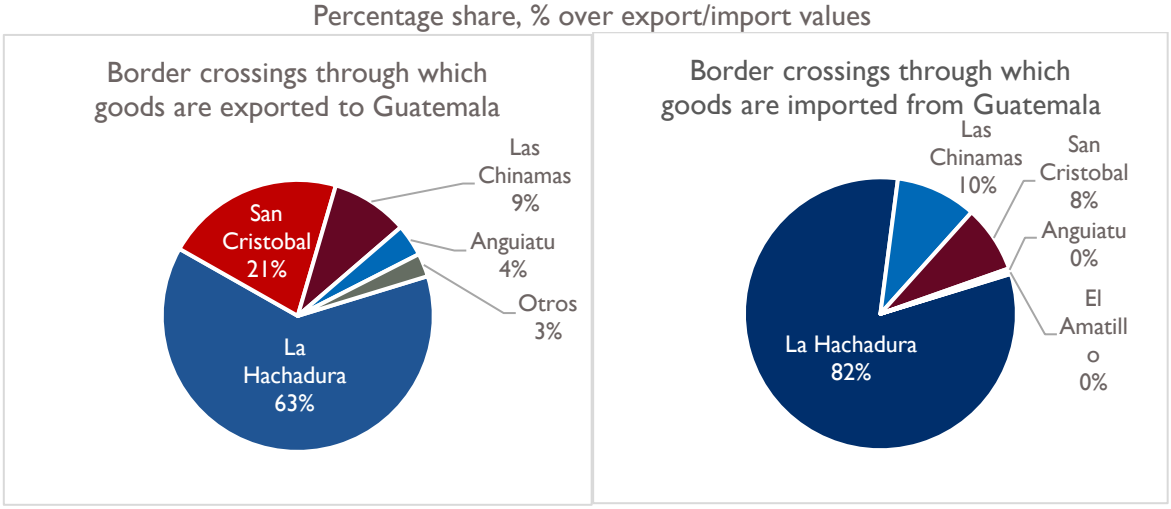
Figure 32. El Salvador: Total imports and bilateral imports from Guatemala and Honduras
(Annual variation rate %)



Source: Central Bank of El Salvador based on information from the Customs Service

With regard to the land border checkpoints most used by private actors from El Salvador in bilateral trade with the Northern Triangle region, more than 60% of the goods exported to Guatemala pass through the La Hachadura border checkpoint, followed by the San Cristóbal (21%) and Las Chinamas (9.0%) customs offices; in turn, more than 80% of the goods imported by El Salvador from Guatemala pass through La Hachadura, followed by Las Chinamas (10%), San Cristóbal (8%) and Anguiatú (the remaining 2%).

Figure 33. Bilateral trade El Salvador – Guatemala: Main land ports of entry through which goods arrive and depart



Source: Central Bank of El Salvador based on information from the Customs Service

One characteristic that is relevant to the operation of the border checkpoints through which goods are imported from Guatemala is that 90% of the operations are temporary; therefore, the goods are not nationalized at the border checkpoint but are instead directed to a customs enforcement point inside the territory (the San Bartolo or Santa Ana customs office) or have a bonded warehouse or free trade zone warehouse as their final destination.

A field study conducted at different border checkpoints confirms that more than 90% of these temporary imports come from Puerto Barrios and, especially, from Santo Tomás de Castilla, both in Guatemala, and enter El Salvador through the Anguiatú - La Ermita border checkpoint.

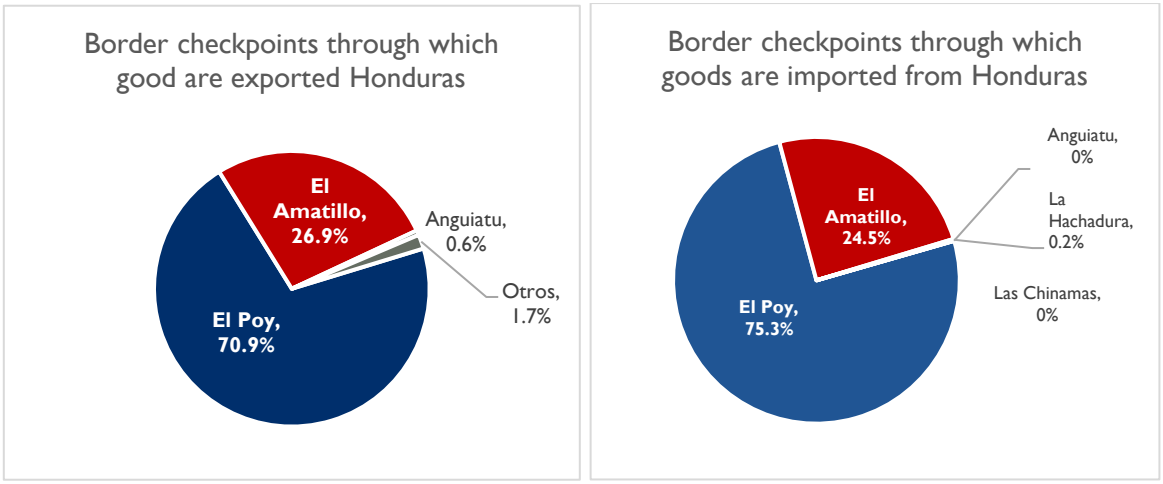
With regard to the operating facilities and infrastructure conditions at border checkpoints, La Hachadura made significant adaptations, completed in 2018, with the goal of speeding up the customs clearance process, especially for exports, given their relevance for the country. In 2019, the value of the exports that passed through this border checkpoint was US$572.6 million, much higher than the value of the goods imported from Guatemala, which was US$109.9 million.[17] The Anguiatú-La Ermita customs office also made adaptations to operate as an integrated border checkpoint for trade with Guatemala. Four percent of El Salvador's export value passes through this checkpoint to reach the Guatemalan market. This checkpoint also processes a significant number of temporary imports, coming mainly from Santo Tomás de Castilla and destined for different internal customs offices or bonded warehouses in El Salvador.

[17] Government of El Salvador verifies operations at First Binational Intermediate Customs Office - Trade Intelligence System (minec.gob.sv)

As for trade with Honduras, the most important border checkpoints are El Poy, which processes more than 70% of exports and 55% imports, and El Amatillo, which accounts for 27% of exports and 17.8% of imports.

Figure 34. Bilateral trade El Salvador – Honduras: main land ports of entry through which good arrive and depart

Percentage share, % over export/import values



Source: Central Bank of El Salvador based on information from the Customs Service

Some customs offices are located at bonded warehouses and industrial parks. Those with the greatest shares of imports from Honduras are the El Pedregal, American Park, Exportsalva, San Marcos and San Bartolo Free Zones, which together represent 25% of the total value imported in 2019. The customs offices located on the grounds of industrial parks are becoming increasingly important. There, goods are registered directly in the different free zones and are predominantly inputs, accessories and final products for the textile and clothing industry. These customs offices' participation can be seen as an opportunity to speed up good clearance and release processes based on the dynamic of the private actors operating in these bonded warehouses.

With regard to the operating installations and infrastructure conditions of border checkpoints, El Poy is notable for its strategic importance in trade with Honduras and for having made significant investments to adapt its operation to the customs union's integrated border checkpoint model[18].

IDENTIFICATION OF NON-TARIFF BARRIERS IN COMMERCIAL TRADE

In accordance with the implemented customs union model, administrative and operational procedures and measures have been developed to improve efficiency in the administration of border checkpoints, and to provide appropriate infrastructure and personnel. Channels of communication and interinstitutional coordination have also been improved for trade processes between the union member countries. This improvement, based on the establishment of new regulations through the Enabling Protocol and the resolutions issued by the Ministerial Body, has helped to reduce the time

[18] Inauguration of the first phase of the El Poy border checkpoint modernization - Trade Integration System (minec.gob.sv)

and cost of logistics and transportation operations in the community territory, thereby boosting the competitiveness of trade and goods circulating in the region.

The deep integration process in the Northern Triangle aims to create a single customs territory and includes the elimination of tariff and non-tariff barriers between Union member countries, as well as the adoption of a common external tariff or duty for products coming from or going to third countries or other trade blocs.[19] It also seeks to overcome inefficiencies arising from various practices or measures implemented by governments with specific trade policy objectives, which, while pursuing legitimate objectives for the countries, such as the protection of human, animal and plant health, can lead to trade restrictions, known as non-tariff measures (NTMs). According to the World Bank (2015), the economic impact of NTMs can affect regional integration, impact domestic prices, divert trade and penalize small exporting companies.

The implementation of NTMs by a country - including those with a protectionist intent - can therefore adversely affect the competitiveness of companies and their export portfolio. According to the United Nations Conference on Trade and Development (UNCTAD), NTMs are classified into technical and non-technical measures, which in turn are grouped into those that are applied to imports and exports. The classification of NTMs by chapter is presented in the table below.

In order to overcome these non-tariff barriers, efforts within the framework of the customs union have faced significant challenges with respect to streamlining excessively bureaucratic procedures, mitigating discretionary practices in customs and tax control at borders, advancing the unification and standardization of criteria for risk management at borders, improving coordination among the various institutions that exercise control, including beyond goods of quarantine concern, and disseminating best business practices to prevent further delays at border checkpoints. The impact of these and other inefficiencies that have remained embedded in the region's trade procedures has resulted in "***bulging borders,***" in reference to the greater costs and times private actors face in marketing their goods, which diminishes the region's competitiveness.

The implementation of the goods in free circulation regime through the FYDUCA is the most impactful trade facilitation measure developed within the framework of the customs union, which is a uniform legal document applicable to the States Parties used to support the transfer and acquisition of movable goods or provision of services between economic agents of the States Parties and serves as the declaration form for the withholding or liquidation and payment of taxes.

The introduction of FYDUCA is supported by the Convention on the Harmonization of Domestic Taxes, and its format was approved by Ministerial Resolution No. 11-2017, in accordance with the provisions of the last paragraph of Article 16 thereof. Trade through the FYDUCA replaces the traditional concept of export and import of goods with the new terms of "transfers" and "acquisitions."

[19] Customs Union - SICA Portal, accessed on January 8, 2022.

Table 32. Classification of Non-Tariff Measures by Chapter
UNCTAD 2019

Import Measures	Technical Measures	A Sanitary and Phytosanitary Measures (SPS)
		B Technical Barriers to Trade (TBT)
		C Pre-shipment inspections and other formalities
	Non-Technical Measures	D Trade defense/protective measures
		E Licenses, quotas, prohibitions, and other quantity control
		F Price control measures, including charges and taxes
		G Financial measures
		H Measures affecting competition
		I Trade-related investment measures
		J Distribution restrictions
		K Restrictions on post-sales services
		L Subsidies
		M Government Procurement
		N Intellectual Property
		O Rules of Origin
Export Measures	P Export measures	

Source: International Classification of Non-Tariff Measures, 2019 Edition. UNCTAD

Given the functionality and characteristics of the FYDUCA, in international trade, the common customs procedure is replaced by an internal tax procedure, in which the transmission of the FYDUCA and the payment of tax obligations according to country of destination is carried out electronically and in real time, through the Online Community Platform (PIC) administered by SIECA. Through this procedure, goods in free circulation can be processed using the "fast lane" at the Trade Facilitation Centers (CFC) of the integrated border checkpoint, significantly reducing border crossing times and translating into transportation cost savings for the private sector.

For products (tariff items) which, due to their nature, are subject to control by the health or agricultural authorities, an SPS Notification must be issued prior to the FYDUCA. An SPS Notification is the electronic document through which the sanitary and phytosanitary authorities validate and report compliance with permits and authorizations, such as sanitary and phytosanitary certificates for the goods, as well as the agricultural inputs used, from the transferring State Party to the acquirer. As mentioned above, the SPS Notification is applicable to 13.8% (1,315 tariff items) of the goods that enjoy free circulation between Guatemala and Honduras, provided they are not included in the lists of countries of origin referred to in the L4 and L5 lists defined in the Ministerial resolutions.

Border times improve significantly once the SPS Notification has been confirmed and sent, given that physical inspections and quarantine treatments - fumigation, spraying, nebulization - are avoided, among other control procedures to which goods may be subject at the border checkpoint, and therefore, these goods benefit most from the customs union process in terms of efficiency gains.

Another key aspect of the implementation of the FYDUCA in terms of its impact on trade facilitation is that the goods are exempt from the selection criteria defined by the risk management systems of each of the States Parties, which places private actors at a significant advantage. However, it entails greater requirements for visual or on-site controls carried out through inspections at warehouses or at the facilities of companies by the competent public authorities in order to ensure the respective control and inspection.

Finally, in addition to the cost savings the reduction in border crossing times may represent for businesses, another advantage of the implementation of FYDUCA is the fact that it is completely free for users and taxpayers to use the platform and electronic declaration system. This situation contrasts with the recent announcement of the increase in the cost of the Single Window for Foreign Trade (VUCE) service. According to a bulletin released by the entity, as of January 1, 2022, companies must pay US $17.50 plus VAT (US $19.77) for each transaction authorized within the Integrated Foreign Trade System (Sicex), an increase of more than 200% over the previous cost, which was set at US $6.00 plus VAT (US $6.78) per transaction.

The most relevant NTMs impacted by the implementation of FYDUCA are contained in Chapter A of the International Classification of Non-Tariff Measures (UNCTAD, 2019): sanitary and phytosanitary measures that are usually referred to as "SPS." The measures covered by this chapter are related to measures to restrict the use of substances or ensure food safety, and measures to prevent the spread of diseases and pests. In this regard, FYDUCA provides standardized and predictable procedures to confirm and validate compliance with these procedures, permits and all other authorizations required by various authorities for the free circulation of these goods prior to their entry into national territory (imports / acquisitions) through the integrated border checkpoints of the customs union. Next are the measures contained in Chapter P, which are those that countries apply to their exports, particularly those that refer to compliance with requirements or export authorizations for technical reasons related to the characteristics of the product or its production processes, as well as other export formalities related to requirements for passing through certain border checkpoints, which in both cases are specified through the highway trade corridors and PFI and requirements for filling in the fields of the FYDUCA form. In addition, the FYDUCA procedure simplifies the immigration control to which drivers of freight transport vehicles, previously registered and authorized through the SIECA platform, are subject.

FYDUCA procedures also address compliance with formalities at the time Central American goods are cleared, including the measures in Chapter C. Such goods will enjoy free circulation and will not be subject to checks or any other type of quarantine control at the integrated border checkpoint specified according to the highway trade corridor, which means that they will also not be subject to other inspections prior to clearance. In these areas, the response capacities of authorities responsible for customs and quarantine control must be strengthened in order to develop post-clearance controls.

Other NTMs with relevant impacts relate to the policy measures applied at borders for compliance with origin criteria for products or their inputs, which are included in Chapter O, and are also addressed through the FYDUCA. In the first instance, the implementation of the FYDUCA is limited to goods of Central American origin and this is also complemented by the definition of lists of exceptions to free circulation, in particular lists 4 and 5, which detail the exclusions of tariff positions

due to differences in rules of origin or according to their country of origin, depending on whether or not they are covered by trade agreements.

The procedures introduced by the FYDUCA also address certain measures included in Chapter G, which groups financial measures, particularly those related to restrictions or limitations on making import payments, which the operation of the FYDUCA addresses in the sense that the invoice becomes valid once the value of the goods and the tax obligations arising therefrom based on the destination market have been paid by the purchaser. And finally, positive impacts of the measures indicated in Chapter J on distribution restrictions are also identified, i.e., measures that restrict the distribution channels or sales of goods in the destination market, which as of the establishment of the customs union between the three States Parties are expanded and favored with free circulation within the Community territory, benefiting the development and growth of logistics services and distribution channels in the NT region.

The list shown in Annex 3 identifies the prevalence of non-tariff measures corresponding to Chapter A, related to SPS measures applied by the authorities of Guatemala and Honduras, either by national criteria or implementation of Central American Technical Regulation (RTCA), which are considered in compliance with the requirements demanded in the completion of the FYDUCA with the respective MSF confirmation codes according to the applicable regulations.

IMPACT ON TRADE PROCEDURES FOR COMMUNITY GOODS IN THE FRAMEWORK OF THE CUSTOMS UNION: GOODS IN FREE CIRCULATION

The impact of the trade facilitation measures promoted by the customs union has helped reduce the costs associated with administrative barriers to trade and non-tariff measures, which according to the World Bank, represent 18.3% *ad valorem* equivalent in the case of El Salvador, indicating the additional costs that these barriers represent for the production sectors, while for Guatemala and Honduras these measures are slightly below at 14% and 15.8%, respectively. The introduction of the FYDUCA has improved border crossing times, significantly expediting the passage of goods subject to quarantine controls or other controls, based on a streamlining of processes, the promotion of paperless trade and incentives for advance electronic payment of goods (digitization).

The implementation of trade facilitation measures in the common territory through the digitalization of international trade declarations, with the implementation of the Central American Single Declaration Form (DUCA) and the FYDUCA, have contributed to the standardization and digital transformation of customs forms and tax for trade operations in the region based on the electronic transmission and governance of data at the regional level.
The implementation of the DUCA made it possible to unify three of the customs declarations that covered the trade of goods in the region, the DUCA-F (formerly the Central American Single Customs Form - FAUCA), used for trade in goods originating in the Central American region; The DUCA-D form (formerly the Declaration of Goods) for imports or exports with third countries outside the Central American region and the DUCA-T (formerly the Declaration for International Land Customs Transit - DUT) for the movement of goods under international land transit regulations.

The introduction of the DUCA, in its different forms, has contributed to progress in the implementation of cross-border trade facilitation measures, whose digitalization and electronic transmission allow for paperless operations, which have had a positive impact on the deepening of trade between countries and have contributed to the strengthening of regional value chains. According to statistics from SIECA's Electronic Platform, transactions transmitted by DUCA-F (FAUCAS) in the region reached a value of US $3,189 million in the first five months of 2021, of which 68% corresponds to transactions between the countries of the Northern Triangle.

Table 33. Value of operations measured by DUCA - F
Figures in USD millions / Cumulative to May of each year

Country	2019	2020	2021	Average 2019-2021	Δ% 2021/2020	Δ% 2021/2019
El Salvador	607.4	505.3	640.6	584.4	26.8%	5.5%
Guatemala	954.1	966.5	1,222.0	1,047.5	26.4%	28.1%
Honduras	260.8	234.7	298.6	264.7	27.2%	14.5%
Northern Triangle	***1,822.3***	***1,706.4***	***2,161.2***	***1,896.6***	***26.6%***	***18.6%***
Central America	**2,455.6**	**2,367.4**	**3,189.2**	**2,670.7**	**34.7%**	**29.9%**

Source: SIECA Electronic Platform

The implementation of the FYDUCA for the procurement (import) and transfer (export) of goods between Guatemala and Honduras became mandatory in March 2018, after several pilot tests and offering it for optional use by private sector users (taxpayers) since in 2016.

The graphic 4 illustrates the streamlining of FYDUCA customs procedures (transfers and acquisitions) and compares it to a conventional customs process, in this case, a final import/export of goods between two countries. The diagram highlights the reduced workload of the officials responsible for customs and immigration control, as well as the number of steps the user must perform to initiate the customs clearance and passage at the border checkpoint.

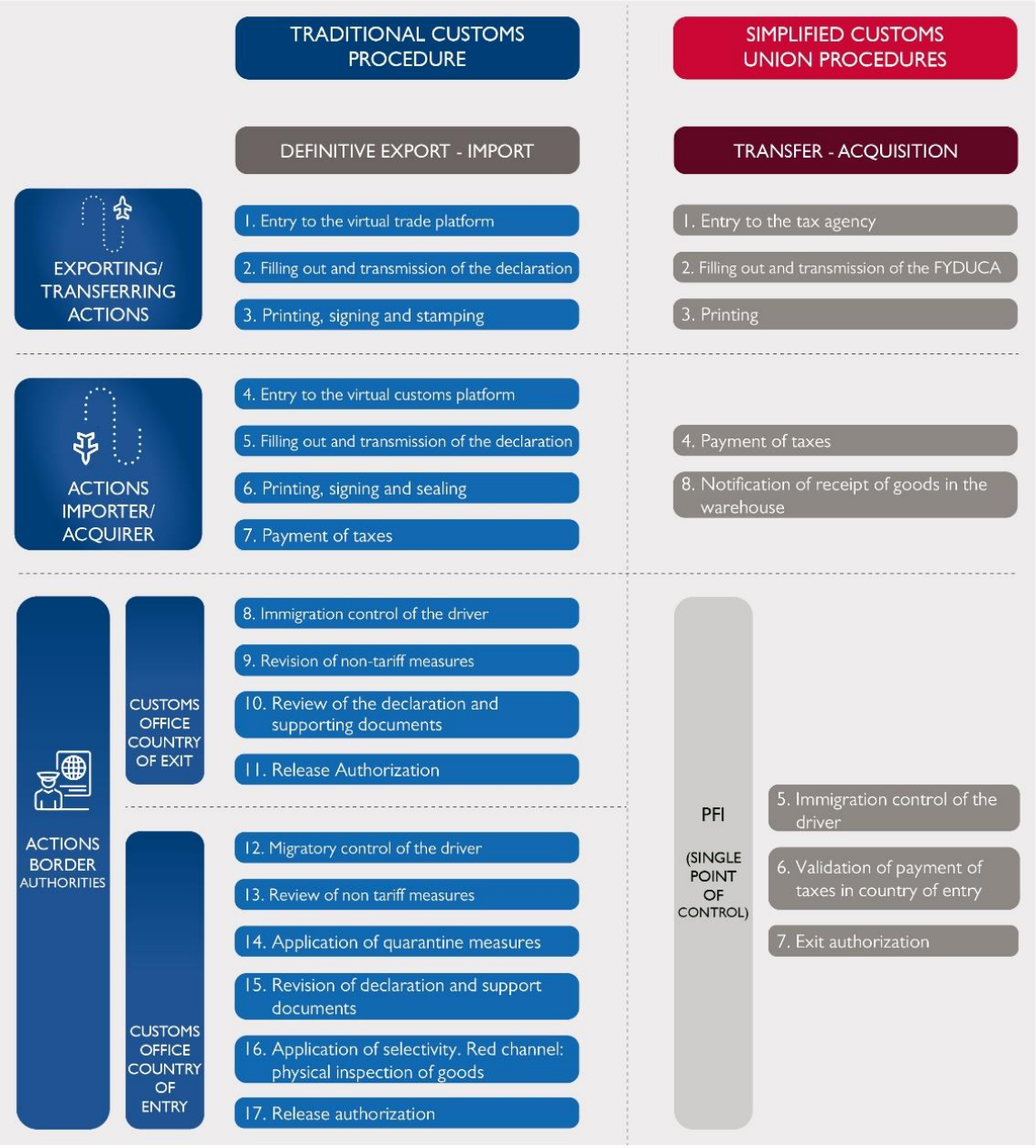
With the installation and operation of the trade facilitation centers, advances in trade facilitation arising from the customs union model will allow for:

- Free movement of goods through the FYDUCA
- Customs transit procedures covered by the DUT-C
- Clearance control for paid goods declarations at peripheral customs offices (unrestricted community movement)

Operations that enjoy free circulation and transit through the CFC fast lanes reported in community territory represent an average of US $398 million per year, equivalent to 32% of total exports between Guatemala and Honduras in the 2019 – 2020 period.

A comparison between the number of steps required in a traditional customs operation and the processing of goods in free circulation shows a clear reduction in the number of procedures to be carried out for the latter category of products, dropping from 17 to 8, as shown in the following diagram:

Graphic 4. Comparative Process Diagram: Traditional Customs Procedure and Simplified Customs Union Procedure using FYDUCA.



Source: prepared in-house.

Based on the consolidated reports in the SIECA's IT platform (PIC), the largest volume of transactions registered with FYDUCA in transfers from Guatemala to Honduras use the Corinto Integrated Border Checkpoint, which accounted for 61.5% of total transactions reported in the first half of 2021.

In order to evaluate the impact on time improvements resulting from the implementation of the customs union between Guatemala and Honduras, the performance observed at the Corinto Integrated Border Checkpoint will be used to estimate, based on observations made during field visits, the time savings that the implementation of the FYDCA has represented and to compare in two time periods, the first at the beginning of the Customs Union between the two countries (2018) in order to determine the level of adoption of this tool and the response of the designated institutions and officials at the integrated border checkpoint; and in a second period, the results were compared with those of traditional customs procedures using the Central American Single Form (FAUCA) in 2016.

Based on the measurements taken and interviews with users and officials at the Corinto integrated border checkpoint, it was found that passage by means of transportation using the trade facilitation center fast lane has been expedited, including improvements in service times for means of transportation that pass through as international transit and those that are allowed to use the fast lane.

Table 34. Corinto Border Checkpoint: Comparison of average clearance times for goods without customs union and with customs union

Guatemala – Honduras Operations

Average time	2016 FAUCA*	2018 FYDUCA*	2022 FYDUCA	CHANGES %	
				FYDUCA 2018 / FAUCA 2016	FYDUCA 2022 / 2018
Border Checkpoint Entry (PFI Boom Barrier) **	10:00:00 – 24:00:00	08:00:00 – 12:00:00	06:00:00 – 09:00:00	-71.4%	-25.0%
Customs clearance time	07:50:00	00:04:02	00:02:46	-99.1%	-31.4%
TOTAL	**21:50:00**	**04:04:02**	**03:02:46**	**-81.4%**	**-25.1%**

* Times obtained from the World Bank (2019).

** Estimated wait times at the entry point of the Corinto Border Checkpoint (Boom Barrier) for means of transport carrying goods in free circulation with green light status.

The results obtained show that the average times for a means of transport to cross the border checkpoint—including an estimate of wait times prior to entering the integrated border checkpoint (road congestion), which account for the longest delays—are more than 80% lower when comparing the January 2022 results with the measurements taken in 2016, before the implementation of the customs union, when the import / export procedures for goods of Central American origin were carried out with the FAUCA. The greatest reductions are observed in the clearance times for goods,

falling from an average wait time of approximately eight hours in 2016 to a quick clearance of just two minutes through the trade facilitation center modules for goods covered by the FYDUCA under the customs union scheme.

The reductions in border crossing times recorded during a visit to the integrated border checkpoint in January 2022 show that the customs union is a developing, continuous improvement process. A comparison between the January 2022 results and those obtained when the customs union was implemented (2018) shows that times continue to decrease as procedures are adapted and operational innovations are incorporated at the border checkpoints.

It is important to note that this study does not incorporate measurements of times in FYDUCA operations in air or sea ports because, in the customs union implemented between Guatemala and Honduras, currently only free movement operations are recorded by land.

With respect to the adoption of the FYDUCA by the private sectors in Guatemala and Honduras, the records show that as of October 2021, the volume of customs transactions continued to increase at a rate of 11.1% with respect to the volume observed at the end of 2020, which means that by the tenth month of the year, transactions already exceeded the volume reported for all of 2020, a period that includes the negative impacts of the onset of the Covid-19 pandemic in the region.

Table 35. Guatemala - Honduras Transfers: FYDUCA Transactions, 2018 - 2021
Values in USD, volume in number of transactions and growth rates.

Country / Transaction	2018	2019	2020	2021	Annual % change		
				October	2019 / 2018	2020 / 2019	Oct-21 / 2020
Guatemala							
Amounts - Transfers	287,427,471	321,364,636	341,597,559	387,149,543	11.8%	6.3%	13.3%
% Share GT -HN Exports	*29.2%*	*35.3%*	*36.1%*				
Volume - Operations	70,151	93,911	98,148	108,644	33.9%	4.5%	10.7%
Honduras							
Amounts - Transfers	54,774,219	71,089,852	64,458,404	70,763,938	29.8%	-9.3%	9.8%
% Share HN -GT Exports	*21.0%*	*24.4%*	*20.3%*				
Volume - Operations	22,269	29,229	21,988	24,853	31.3%	-24.8%	13.0%
Total general							
Amounts - Transfers	342,201,690	392,454,487	406,055,963	457,913,480	14.7%	3.5%	12.8%
Volume - Transactions	92,420	123,140	120,136	133,497	33.2%	-2.4%	11.1%

Source: SIECA

With respect to the products that benefit most from the time and cost savings offered by the FYDUCA, the top 25 Guatemalan products with the highest values transferred to Honduras,

showing the most relevant increases are food products, bakery products, snacks, mineral and carbonated waters, condiments, fruits, as well as a basket of household consumption products, such as personal hygiene products, bed linens, clothing, and various industrial and chemical products. This basket of products represents 58% of the total value transferred to Honduras and 29% of the transaction reported in 2019.

The 25 Honduran products that have most benefited from the implementation of the free circulation regime with FYDUCA are mainly found in the categories of tools, machinery, construction supplies, boxes and cardboard, labels, plastic packaging, textile industry products, soaps, confectionery, palm oil, bakery products and flour, among others. This basket of products represents 80.3% of the total value transferred to Guatemala and 41.3% of the customs transactions reported in 2019.

The level of utilization of FYDUCA by the production sectors is positive in both countries; however, in the case of Honduras, greater efforts are being made to promote sales to Guatemala through this new trade platform, although the export structure is more concentrated than reported by Guatemala, which has a greater diversification of products.

In the analysis of the 25 main products with the highest recorded transfers, Guatemala shows sustained growth in its traditional agro-industrial product basket, with increases of between 30% and 70% in sales, while Honduras is seeking to add new industrial products, which show growth rates of over 100%, suggesting that sales in these product categories have doubled or even tripled with the implementation of the customs union process.

The trade pattern of this basket of products also shows that certain sectors present challenges in terms of adapting to this new modality or that they may have experienced a certain displacement due to higher competitiveness of the other country for a specific product, a situation that may occur more frequently when there are similarities in the exportable supply of both countries. On this point, it is worth mentioning that the improved conditions provided by trade facilitation also help to boost the competitiveness of economic sectors and their products, because by increasing the availability and diversity of product supply with different price/quality ratios based on their characteristics and production processes, consumers are able to select those that present the best value based on their preferences.

Table 36. Guatemala – Honduras Transfers: Performance of transactions with FYDUCA based on trade of inter-sectoral products*, 2019.

Growth rates and % share of total value of transfers.

Tariff Item	Item Description	Annual % change Guatemala Values	Percentage Share GT Values	Annual % change Honduras Values	Percentage Share HN Values
1905	Bread, pastry, cakes, biscuits and other bakers' wares, whether or not containing cocoa; communion wafers, empty cachets of a kind suitable for pharmaceutical use, sealing wafers, rice, flour or starch paper, and similar products	14.4%	9.0%	13.6%	8.2%
2106	Food preparations	71.8%	1.4%	77.7%	1.3%
2202	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavored, and other non-alcoholic beverages, not including fruit or vegetable juices of heading No. 20.09	26.1%	5.6%	-30.5%	1.2%
3401	Soap; organic surface-active products and preparations used as soap	68.0%	1.6%	-9.0%	11.3%
3923	Articles for the conveyance or packing of goods, of plastics; stoppers, lids, caps	25.5%	3.1%	47.8%	10.9%
Total			20.7%		32.9%

* Product categories belonging to the same economic sector.

Source: Prepared in-house based on SIECA.

ESTIMATED IMPACT OF EL SALVADOR'S ACCESSION TO THE DEEP INTEGRATION PROCESS BETWEEN GUATEMALA AND HONDURAS

Trade facilitation is a relevant factor for the economic development of countries, which becomes even more important for economies with high levels of trade openness, as is the case of El Salvador, whose economic performance is strongly linked to the behavior of its foreign sector, through foreign exchange earnings from exports of goods (22% of GDP), family remittances (21% of GDP), exports of services (12% GDP) and, to a lesser extent, by FDI flows with 2.4% of GDP, which together make up more than 57% of GDP, according to official figures for 2019.

The impact of El Salvador's full accession to the deep integration process will lead to meaningful progress in the development of the political agenda that the country has been promoting in recent years, aimed at facilitating trade and addressing the bottlenecks faced by the economic sectors in their trade operations. It is estimated that the operational entry of El Salvador into the customs union will enhance efficiencies in the movement of goods within the community territory, increasing the speed, reliability and predictability of trade transactions, which would have a positive effect on the economic growth of El Salvador by adding, in a conservative scenario, an additional point of growth to the estimated Real GDP for the 2022-2026 period.

In terms of trade, the implementation of these measures would boost the competitiveness of exports destined for the regional market, as a result of the streamlining, standardization and digitalization of processes, improvements in inter-institutional coordination at borders, the introduction of mechanisms for electronic advance payment of goods, among others, which have a positive impact on the reduction of border crossing times. Based on the methodology of the Computable Gravitational Model, used in trade theory to estimate the relationship between export and import times and trade volumes, a 30% reduction in export and import times would translate into a 17.7% increase in El Salvador's exports and a 4.8% annual increase in imports.

The Gravitational Model is based on the principle of gravity in physics, i.e., how the attraction/gravity between two objects is dictated by their mass and the distance between them. The gravity model hypothesizes that trade between two countries is dictated by the relative size of their economies and the physical distance between them. Over the years, this theoretical construct has been expanded and researchers have added other factors, including geographic factors (such as whether or not the country has access to the sea or whether the countries share a common border), historical factors that may influence trade (such as whether the countries share a common language or have a common colonial history), and the direction of trade policy in tariff and non-tariff barriers and what their impacts are over time and on trade.

The Gravity Model suggests that, given the composition of GDP, an increase in exports as a result of reductions in export times is in turn the result of enhanced economic activity required to boost production levels in order to meet the increased demand for the exported products, which in turn creates a greater demand for resources (raw materials, labor, capital, technology) used to produce these products. This greater demand for resources increases the income and compensation of the factors of production. The increase in income therefore stimulates consumption and, again, boosts domestic economic activity.

The positive prospects for growth in export flows will be evaluated in the structure of El Salvador's export supply to Guatemala and Honduras, taking into account the characteristics and composition of trade between the three countries, according to the analysis presented in previous sections of the study. Some of the relevant aspects are:

1. Estimates will be based on the evolution of El Salvador's land trade with Guatemala and Honduras.
2. The basket of exported products will be selected based on criteria of competitive advantages revealed in El Salvador's bilateral relationship with Guatemala and Honduras.
3. Two growth scenarios are considered for the selected products:
    a. Scenario 1: Basket of products that is expected to have immediate free circulation based on the current lists of exempted goods for Guatemala and Honduras;
    b. Scenario 2: Basket of products that are excluded from free circulation and whose growth will be related to progress in the facilitation agenda and infrastructure improvements derived from the implementation of the customs union.
4. The results of each scenario will be used to determine their contribution to the performance of the country's total exports.
5. The impact of the products with the highest export earnings resulting from the incorporation of El Salvador into the production chains will be identified at the production

structure level, according to the structure of the country's sectoral economic relations as defined in the Input-Output Matrix.

Table 37. Base Indicators for Estimating Impact on Trade Competitiveness

INDICATOR	Measure	YEAR 2019
Total exports (FOB)	**USD Millions**	**5,904.7**
	Annual % growth rate	-0.01%
Total imports (CIF)	**USD Millions**	**11,603.8**
	Annual % growth rate	1.2%
Total exports to Guatemala	**USD Millions**	**940.3**
	As % Total Country Exports	15.9%
	Annual % growth rate	10.9%
Total exports to Honduras	**USD Millions**	**938.7**
	As % Total Country Exports	15.9%
	Annual % growth rate	1.4%
Exports to Guatemala, by land	**USD Millions**	**910.3**
	As % Total Country Exports	96.8%
	Annual % growth rate	11.7%
Exports to Honduras, by land	**USD Millions**	**930.8**
	As % Total Country Exports	99.2%
	Annual % growth rate	3.8%
Basket of products with advantages revealed in bilateral exports with Guatemala*	**USD Millions**	**331.7**
	As % Total Country Exports	36.4%
	Annual % growth rate	13.6%
Basket of products with advantages revealed in bilateral exports with Honduras*	**USD Millions**	**345.7**
	As % Total Country Exports	37.1%
	Annual % growth rate	5.3%
Estimated time reduction at the border (C.U. Model)	Border crossing times	**- 81.4%**
Estimated export growth resulting from the implementation of the trade facilitation program (includes C.U.) 1/	Annual % growth rate	**17.7%**

* Exports by land

1/ Results of the Economic Impact Study of the Trade Facilitation Program, Nathan Associates Inc., 2021

Source: Prepared In-House.

The results of the scenario building of the operational incorporation of El Salvador into the Customs Union between Guatemala and Honduras consider the impact of the improvement in the times and conditions of the trade infrastructure, which refers to the transport services, customs processes, institutional and operational capacities of the border checkpoints. It also seeks to recognize the strains that an abrupt increase in trade operations, for example, by the production sectors motivated by the implementation of the customs union, may exert on the installed capacities of border checkpoints and diminish the efficiency gains derived from the administrative and operational restructuring brought by the customs union. Thus, the model aims to show in the scenarios the limitations in the current capacities of the infrastructure of the country's various border checkpoints.

The proposed impact modeling is based on the contribution of a basket of products identified as opportunities for El Salvador, evaluated based on an RCA analysis for the country in its bilateral relationship with both countries and simulating the conditions to which they would be subject within the framework of the customs union, according to the lists of exceptions to free circulation currently in force between Honduras and Guatemala.

Table 38. El Salvador: Ranking of the top 20 export products with the greatest revealed comparative advantages with Guatemala.

Tariff Code	Description	Revealed Comparative Advantage (RCA)	Free Circulation	Requires SPS Notif.
4818100000	- Toilet paper	15.49	**YES (L4)**	NO
2005590000	- Other processed vegetables	14.87	**YES (L4)(L5)**	NO
1517100000	- Margarine, except liquid margarine	14.29	**YES (L4)**	NO
1904109000	- Cereal-based products obtained by swelling or roasting:	13.90	**YES (L4)(L5)**	NO
1904909000	- Other cereal products	13.51	**YES (L4)(L5)**	NO
3904221000	- Plasticized vinyl chloride polymers:	13.35	**YES (L4)(L5)**	NO
2008119000	- Peanuts (ground-nuts):	12.99	**YES (L4)(L5)**	NO
3923309100	- Carboys (demijohns), bottles, flasks and similar articles:	12.30	**YES (L4)**	NO
4819100000	- Boxes of paper or corrugated cardboard	11.82	**YES (L4)**	NO
4819209000	- Folding cartons, boxes and cases, of non-corrugated paper or paperboard:	11.75	**YES (L4)(L5)**	NO
5402330000	- Polyester textured yarns	9.81	**YES**	NO
1905900000	- Other bakery products	8.95	**YES (L4)(L5)**	NO
7306610000	- Square or rectangular section tubes and profiles	8.88	**YES (L4)**	NO
5205130000	- Single yarns of uncombed fibers, measuring less than 232.56 decitex but not less than 192.31decitex	8.78	**YES (L4)**	NO

Tariff Code	Description	Revealed Comparative Advantage (RCA)	Free Circulation	Requires SPS Notif.
2202999000	- Other non-alcoholic beverages	8.76	**YES (L4)(L5)**	NO
3209109000	- Paints and varnishes based on acrylic or vinyl polymers:	8.69	**YES (L4)**	NO
3923219000	- Ethylene polymer sacks:	6.77	**YES (L4)**	NO
1704900000	- Other confectionery products	5.64	**YES (L4)(L5)**	NO
3920201900	- Plates, sheets of propylene polymers	5.31	**YES**	NO
3920202100	- Plates, metallized flexible sheets	5.31	**YES (L4)(L5)**	NO

Source: Central Reserve Bank of El Salvador (BCR) and WITS, World Bank and online community platform (PIC).

The basket of opportunity products identified in the bilateral relationship represents 44.2% of the total products that are expected to enjoy free circulation and show a positive growth of 13.6% per year as of 2019. The growth rate of this selection of products exceeds the growth rate of total exports from El Salvador to Guatemala, which was 10.9% per year.

The basket of products identified with Honduras accounts for 41.6% of the total value exported under the free circulation category, and despite a 5.3% reduction in its growth rate in 2019, its average rate for the 2016 - 2019 period was 11.8% per year, higher than the growth of total exports to Honduras, which in 2019 was 3.6% per year.

Table 39. El Salvador: Ranking of the top 20 export products with the greatest revealed comparative advantages with Honduras.

USD Millions

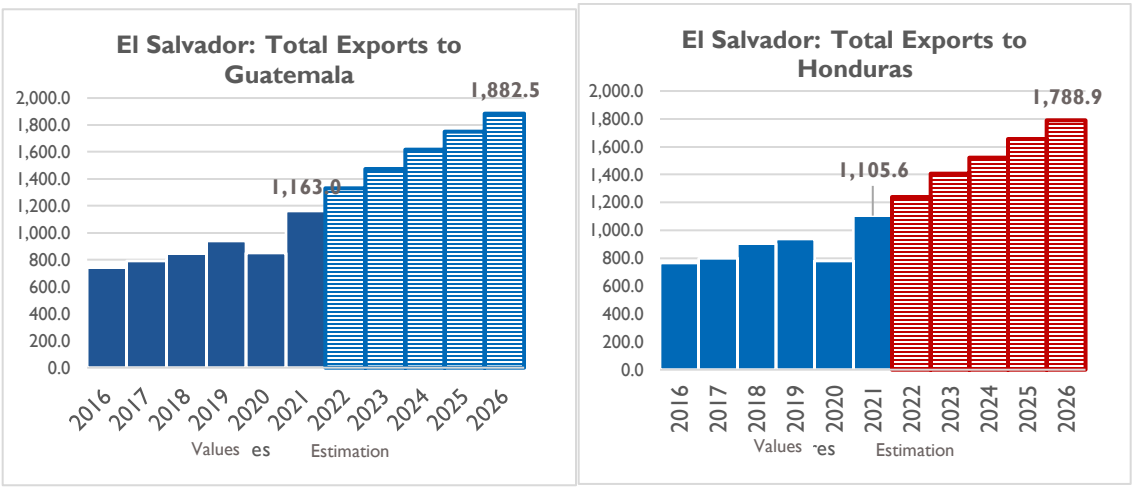
Tariff Code	Description	Revealed Comparative Advantage (RCA)	Free Circulation	Requires SPS Notif.
3003101000	- Medicines containing penicillin or derivatives thereof with a penicillanic acid structure, or streptomycin	11.50	**YES**	NO
6103420000	- Cotton pants	10.99	**YES (L4)(L5)**	NO
6110200000	- Cotton sweaters	10.91	**YES (L4)(L5)**	NO
9607110000	- Zipper closures with common metal teeth	10.10	**YES (L4)**	NO
6006210000	- Unbleached or bleached cotton knitted fabrics	9.52	**YES (L4)(L5)**	NO
6103430000	- Synthetic fiber pants	9.32	**YES (L4)(L5)**	NO
3923309100	- Carboys (demijohns), bottles, flasks and similar articles	9.19	**YES (L4)**	NO
6104630000	- Synthetic fiber pants	9.17	**YES (L4)(L5)**	NO
1101000000	- Wheat or meslin flour (tranquillon)	9.12	**YES(L4)**	YES

Tariff Code	Description	Revealed Comparative Advantage (RCA)	Free Circulation	Requires SPS Notif.
1517909090	- Other margarines	8.73	**YES (L4)**	NO
6110300000	- Of synthetic or artificial fibers	8.56	**YES (L4)(L5)**	NO
9403700000	- Plastic furniture	8.10	**YES (L4)(L5)**	NO
4819100000	- Boxes of paper or corrugated cardboard	7.78	**YES (L4)**	NO
6006320000	- Dyed synthetic fiber knitted fabrics	7.55	**YES (L4)(L5)**	NO
4818100000	- Toilet paper	7.51	**YES (L4)**	NO
5806200000	- Other tapes, containing by weight 5% or more of elastomeric yarns or rubber thread	7.44	**YES (L4)(L5)**	NO
6006220000	- Dyed cotton knitted fabrics	6.71	**YES (L4)(L5)**	NO
3923219000	- Ethylene polymer sacks	6.48	**YES (L4)**	NO
4819202000	- Folding cartons, boxes and cases, of non-corrugated paper or paperboard:	5.86	**YES (L4)(L5)**	NO
4821100000	- Printed labels	5.68	**YES (L4)(L5)**	NO

Source: Central Reserve Bank of El Salvador (BCR) and WITS, World Bank and PIC

The results of the scenario modeling show that these 40 products exported to Guatemala and Honduras under the customs union will inject an average of more than US $120 million annually into El Salvador's total exports, which in the 2022 - 2026 period will total US $604 million, equivalent to 1.8% of the projected GDP of US $34,181 million for 2026.

Figure 35. Estimated impact of El Salvador's operational incorporation into the customs union on El Salvador's total exports to Guatemala and Honduras
USD Millions

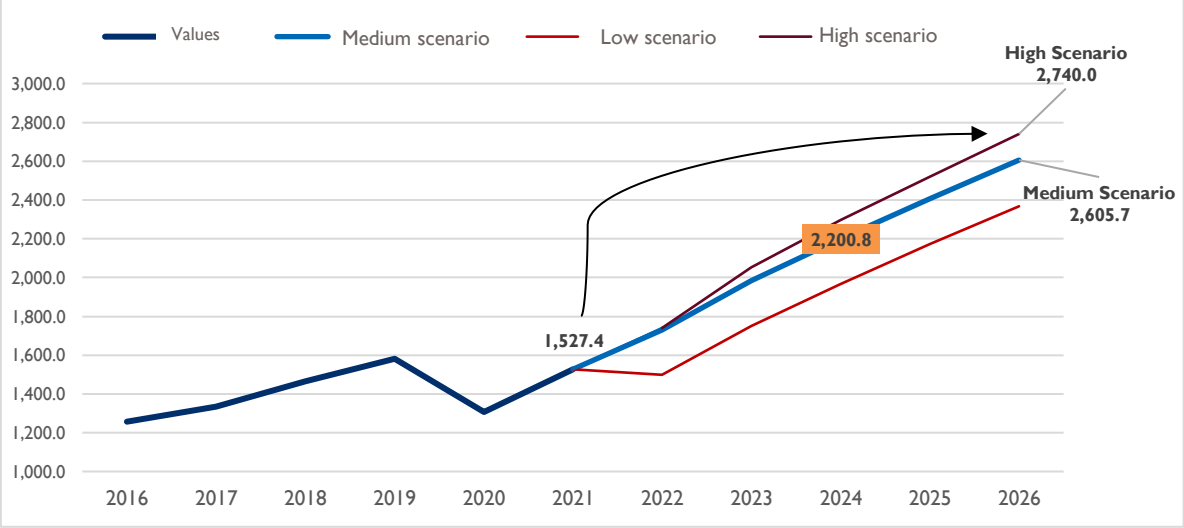


Source: Prepared in-house based on the results of the scenario model of the impact of El Salvador's operational entry into the Customs Union with Guatemala and Honduras

Salvadoran exports by destination are expected to increase by US$719 million to Guatemala and US$683 million to Honduras. As a result of this increase, the value of exports to the Guatemalan market will exceed US$1,882.5 million, while exports to Honduras are expected to reach US$1,789 million by 2026.

Figure 36. Estimated impact of El Salvador's operational incorporation into the customs union. Value of El Salvador's FYDUCA transactions: Transfers to Guatemala and Honduras.

USD Millions



Source: Prepared in-house based on the results of the scenario model of the impact of El Salvador's operational entry into the Customs Union with Guatemala and Honduras

Furthermore, when considering all of the products that could enjoy free circulation (more than 8,300 tariff items), the improved facilitation conditions contribute an average annual increase of

US$215 million in total exports in the study period (2022-2026), accumulating a total of US$2,606 million by 2026. The expected operating income contribution to the customs union and in particular with the introduction of the FYDUCA for trade operations with Guatemala and Honduras would contribute 4.2% of the projected GDP by 2026.

In a context of enhanced facilities for trade operations and improvements to the infrastructure of border checkpoints, the basket of products excluded from free circulation could also benefit from the consolidation of the customs union, as well as for other trade operations that could be carried out from El Salvador. On average, excluded products account for 15% of all goods exported to the Honduran and Guatemalan markets, and, according to the simulation model, will see an increase of around US$330 million five years after the implementation of the customs union for El Salvador.

POTENTIAL LINKAGE AND IMPACT ON DOMESTIC VALUE ADDED AS A RESULT OF EL SALVADOR'S FULL INCORPORATION INTO THE CUSTOMS UNION

In this section, we will examine the potential effects of El Salvador's entry into the customs union, in view of an increasing dynamism of trade operations between the Party countries.

Based on the identification of the products that present revealed comparative advantages for the country in its trade relationship with Guatemala and Honduras, the branches of economic activity that could be positively impacted were identified in terms of their production and employability, by an increase in the demand for exported products within the framework of the Union.
Based on the production sectors prioritized through the analysis of trade with both countries, we are able to identify the following production branches, classified according to El Salvador's 2014 Input-Output Matrix:

1. Branch I 21. Textile products and garments
2. Branch I 24. Manufacture of paper and paper products.
3. Branch I 29. Manufacture of rubber and plastic products.
4. Branch I 16. Processing of milling products and starches.
5. Branch I 17. Preparation of bakery and pasta products

In addition to these activities, the following are added due to their relevance in the country:

6. Branch I 20. Beverage and tobacco processing
7. Branch I 33. Manufacture of metal and electronic products

Combined, these seven industrial branches in the Input-Output Matrix structure contribute 45.1% to the country's total export value and contribute 9.6% to the economy's total value added, totaling US$2,082 million, with the highest levels of value added concentrated within the industrial sectors. This shows that the highest production surpluses or profits are held by the companies operating in these sectors, thereby allowing for a higher level of private investment, which in turn helps to boost the domestic economy and generate new jobs.

Given the characteristics of the Salvadoran economy, these industrial activities present important backward and forward linkages, creating a significant "drag" and "push" on the rest of the economic activities, based on the intersectoral links required in their production processes. In this regard,

these sectors demand both local and imported inputs and services for their operations, in an amount equivalent to US$8,628 million, representing 80.6% of the total gross value of production. It should be noted that despite the distributed composition between local and imported purchases in the consolidated sectors, some industrial branches show a greater dependence on imported inputs, such as the manufacturing of metal and electronic products, whose 92% of input purchases come from abroad, followed by the manufacturing of other food products at 46.4%, and the manufacturing of paper and paper products, with a 45% share of inputs coming from outside the country. These imports of intermediate goods are critical to the production process because, although such inputs are produced abroad and thus contribute to boosting foreign economies, they complete the production process when they are incorporated into the national production system.

Table 40. El Salvador: Industry Input-Output Matrix, 2014
At basic prices, USD Thousands

BRANCH	INDUSTRY	EXPORTS	GPV	TOTAL INTERMEDIATE CONSUMPTION	VA	GDP
121	Textile and apparel products	1,609,659	3,305,259	2,654,515	650,744	631,825
129	Manufacture of rubber and plastic products.	327,877	961,500	799,663	161,836	143,060
124	Manufacture of paper and paper products.	262,011	830,407	729,000	101,407	95,622
120	Beverage and tobacco processing	141,416	712,354	444,922	267,432	244,607
116	Processing of milling products and starches.	106,864	601,178	426,543	174,635	173,072
119	Processing of other food products.	217,224	1,224,645	1,017,913	206,732	200,068
133	Manufacture of metal and electronic products	168,425	2,163,328	2,005,511	157,817	160,564
117	Preparation of bakery and pasta products	39,793	911,750	549,982	361,768	349,802
SUBTOTAL	Selection	2,873,269	10,710,420	8,628,049	2,082,371	1,998,621
TOTAL		**6,373,973**	**49,247,472**	**27,524,282**	**21,723,190**	**21,199,335**

Source: Prepared in-house based on the Input-Output Matrix of El Salvador, Central Reserve Bank (BCR)

A powerful indicator of the dynamizing effect of El Salvador's export sectors is precisely the level of linkages that these sectors have on the rest of the economy's activities, as this makes it possible to quantify the aggregate effect of a potential increase in the final demand of a specific sector, in this case, derived from an increase in the demand for exported products as a result of El Salvador's operative entry into the customs union, on the production of the other sectors.

To develop this concept, this section calculates the Rasmussen-Hirschman indices, which have been widely used in literature to identify key sectors in the processes of economic growth and structural change, and which seek to differentiate between groups of highly interrelated activities. According to Rasmussen (1957) and Hirschman (1958), an efficient public policy should encourage sectors with

a strong linkage capacity in order to maximize a country's economic growth rate. Porter (1990) reaffirms the previous position by pointing out that if the most interlinked sectors of an economy are encouraged, higher rates of economic growth will be achieved in the long run. Thus, the identification of the sectors with the greatest linkage potential can become a key pillar for the country's economic development.[20]

The Rasmussen-Hirschman indices make it possible to classify the production branches into four groups:

- Key industries: have large backward and forward effects
- Industries with backward linkage effect
- Industries with forward linkage effect
- Independent industries

The key industries thus defined are essential to addressing certain economic policy issues, because when they are boosted, they impact many other industries and can bring about a generalized increase in economic activity.

Backward linkages measure a sector's capacity to stimulate the activity levels of the other sectors that make up the national economy, linked directly or indirectly to it, based on the demand for intermediate inputs from these sectors. On the other hand, forward linkages are generated when a given sector sells intermediate inputs to the remaining sectors, which are used by the latter in their production process. Thus, forward linkages measure the sector's potential to encourage others by virtue of its supply capacity and the quality of its supply.

Table 41. El Salvador: Rasmussen-Hirschman indices for selected industries, 2014

BRANCH	INDUSTRY	aj = dispersion or backward linkage	ai = absorption or forward linkage	Median	Power of dispersion Uj = Backward linkage / average linkage of the economy	Sensitivity of dispersion Ui = Forward linkage / Average linkage of the economy	Classification
I 21	Textile and apparel products	1.806307	2.112461	1.543842	1.170008	1.368314	**Key**
I 29	Manufacture of rubber and plastic products.	1.619226	1.807827	1.543842	1.048829	1.170992	**Key**
I 24	Manufacture of paper and paper products.	1.779037	2.095387	1.543842	1.152344	1.357255	**Key**
I 20	Beverage and tobacco processing	1.690870	1.153119	1.543842	1.095235	0.746915	**Driver**
I 16	Processing of milling products and starches.	1.854325	1.464268	1.543842	1.201110	0.948458	**Driver**
I 19	Processing of other food products.	1.712346	2.180199	1.543842	1.109146	1.412191	**Key**
I 33	Manufacture of metal and	1.097099	1.949025	1.543842	0.710629	1.262451	**Core or strategic**

[20] The methodology for the construction of the indices is presented in Annex 2.

BRANCH	INDUSTRY	aj = dispersion or backward linkage	ai = absorption or forward linkage	Median	Power of dispersion Uj = Backward linkage / average linkage of the economy	Sensitivity of dispersion Ui = Forward linkage / Average linkage of the economy	Classification
	electronic products						
117	Production of bakery and pasta products	1.861087	1.043624	1.543842	1.205491	0.675991	**Driver**

Source: Prepared in-house based on the Input-Output Matrix of El Salvador, Central Reserve Bank (BCR)

Concepts:

Independent Product:	Show little linkage
Driver Product:	Growth driver
Core Product:	Strong forward linkage and weak backward linkage
Key Product:	Driver and core

Based on the results, the textile and garment industries, the plastics, paper and cardboard industry, and the food processing industry, are the ones that present the strongest backward and forward linkages and are therefore classified as KEY sectors of the economy. This category shows that these sectors are strong demanders as suppliers of intermediate inputs and thus have a greater capacity to influence the activity of the rest of the economic sectors. In other words, they are the sectors with the greatest capacity to dynamize the economy. These sectors account for the largest share of total exports (38%) and, in turn, have the largest share of their exports in the value of their production (32.50%), which provides information on their commitment to export.

The second group includes the DRIVER Industries, also called driving industries, because they have weak forward linkages and strong backward linkages, and thus a high level of vertical specialization, which evidences the high demand for intermediate inputs of the remaining economic sectors. Therefore, they have a high capacity to boost the economy. This category includes certain agro-industrial branches, such as the beverage industry, the production of milling, bakery and pasta products, whose intermediate consumption is mostly local in percentages of 70% to 90%, which shows their high demand for consumption of domestic goods and services. Another relevant characteristic of these industries is that their production supply is mainly aimed at supplying the end-consumer demand within the economy, and they have a lower export share, unlike the industries classified as key.

Finally, the metal and electronic products manufacturing industry is included among the prioritized sectors and is classified as a CORE or STRATEGIC industry due to the fact that the demand for inputs is small with intermediate destination primary production, that is, its products are classified as intermediate inputs for the economy, and thus are intended to supply other sectors and to channel a smaller part of the product to the market as a final good.

Thus, this type of analysis allows us to identify the sectors with the greatest potential benefit from the implementation of the Customs Union, which are precisely those with the greatest "pull", i.e., those that are driver industries (growth drivers) and core industries (with strong forward linkage),

and therefore have a greater capacity to spill over domestic value added and boost employment at the national level.

PRODUCTS WITH THE OPPORTUNITY TO INCREASE THE ADDED VALUE OF SALVADOREAN EXPORT SUPPLY

The method developed by the Harvard Growth Lab with its Economic Complexity Index makes it possible to evaluate the growth prospects of economies based on the industrial capacities and technical knowledge developed in a country, combining trade flows and how they drive growth.

The table presents various indicators that assess the installed capacity of a country and the knowledge necessary to develop a new product. The "Nearby Distance" indicator measures the country's capacity to develop a new product based on existing products and installed capacity, with the dark diamond symbols indicating greater probability of success for their production in the country; similarly, it includes an "Opportunity Gain" indicator, which measures opportunities for future diversification in the development of a new product, which introduces new connections for the development of more complex products; and finally, the "Product Complexity" indicator, which measures the wide range of technical knowledge necessary to manufacture the product.

In the case of El Salvador, the profiling of new products that present the greatest opportunities to be developed in the country and that would introduce links for the manufacture of other products of greater complexity include: manufacturing of motor vehicle parts (8708), electrical transformers (8504), parts suitable for use with spark-ignition engines (8409), engines and electric generators, electric heaters, among other iron and steel articles, which together belong to the metal mechanical sector. Considering it is estimated that El Salvador's membership in the customs union will create incentives for the formation of new product networks, which can be integrated regionally around the development of new products that are more complex and add greater value to both domestic and regional exports.

Table 42. El Salvador: New products with greater growth opportunities based on the strategic focus

Name of the product	"Close" distance	Earning opportunities	Product complexity	Global size (billion USD)	Global increase (5 years)
Automotive vehicle parts (8708 SA4)	●●●○○	●●●●●	●●●●○	$ 378.00	5.50%
Electric transformers (8504 HS4)	●●●○○	●●●●○	●●●●○	$ 90.10	4.20%
Other furniture and parts (9403 HS4)	●●●●○	●●●○○	●●●○○	$ 85.90	4.90%
New rubber tires (4011 HS4)	●●●●○	●●●○○	●●●○○	$ 76.50	-5.20%
Parts suitable for use with spark ignition engines (8409 HS4)	●●●○○	●●●●○	●●●●○	$ 62.60	-4.70%

Name of the product	"Close" distance	Earning opportunities	Product complexity	Global size (billion USD)	Global increase (5 years)
Electric motors and generators (8501 HS4)	●●●●○	●●●●○	●●●●○	$ 54.20	8.90%
Other articles of iron or steel (7326 SA4)	●●●●○	●●●●○	●●●●○	$ 50.10	9.30%
Electric heaters (8516 HS4)	●●●●○	●●●○○	●●●○○	$ 48.50	14.10%
Refrigerators and freezers (8418 HS4)	●●●●○	●●●○○	●●●○○	$ 44.40	4.50%
Other elevation machines (8428 HS4)	●●○○○	●●●●●	●●●●○	$ 31.80	12.60%

Source: Atlas of Economic Complexity, Harvard.

REGULATORY FRAMEWORK

GENERAL CHARACTERISTICS OF THE CUSTOMS UNION

In the framework of the Economic Integration Subsystem (SIE), the customs union concept is standardized in Article 15 of the Guatemalan Protocol, which provides for the following, as applicable: "*The states parties agree to form a Customs Union between their territories for the purpose of free transit of goods independent of the origin of the same, provided products originating from third countries clear customs in any of the member states.*" While this is not a definition *per se*, it is the closest one that exists in the regulatory framework for characteristics of a Customs Union.[21]

This first characteristic is that the Customs Union represents a union of the territories of its members for customs purposes.[22] This is a *sine qua non* requirement, and no customs union can exist without this requirement. Therefore, by signing the Enabling Protocol, the nations of Guatemala, Honduras and now El Salvador, have agreed that they are a single territory for customs purposes. In accordance with Article 3 of the Customs Union Operating Regulations (Resolution No. 17-2017, substituted by the Resolution 90-2021), the single customs territory "is, *the one composed of the customs territories of the states parties that are part of the customs union*."

[21] Resolution No. 17-2017 (substituted by Resolution 90-2021) includes in its definitions the concept of "Customs Union." However, it is not a definition, but rather a reference to another regulatory framework.

[22] The annotation "for customs purposes" is made in order to clarify that from the political perspective, they continue to be separate territories, where each of the states exercises full sovereignty. The single customs territory is a legal invention to ensure that goods that transit within it are subject to free circulation.

The second element arising from Article 15 of the Guatemalan Protocol is that the purpose of creating a single customs territory is to ensure the "free transit" of goods, irrespective of their origin.[23] "Freedom of transit" is a term that is not currently used, but its use in this provision is equivalent to the concept of "free circulation" used in the doctrine and in the customs union between Guatemala and Honduras. According to Article 3 quoted, free circulation of goods "*is the system enjoyed by community goods according to that set forth in this Resolution*." Not much can be determined from this definition about what free circulation of a good entails, but it is important to highlight because it provides that only "community goods" will be subject to this system.

Community goods are defined in the cited Article 3 as "*movable property obtained, collected, produced, made or processed in the single customs territory, as well as movable property from third countries that have cleared customs in any of the states parties, fulfilling fiscal and non-fiscal obligations.*" Two types of goods are covered by this provision; those made in the single customs territory and those entering said territory from third countries. The effect is the same for both; they enjoy free circulation in the single customs territory, but the practical implications are different.

Goods made in the single customs territory may circulate freely, irrespective of how they were made. This means that it is not necessary for the product to fulfill the provisions set forth in the Central American Regulation on the Origin of Goods (RCOM) because the goods would circulate freely, i.e., without paying duties upon entering the territory of a member state, irrespective of how they were made. For example, at this time, in order for a soda classified in subsection 2202.10 made in a member state of the subsystem to be able to enter the territory of El Salvador with tariff preferences, it must use sugar originating from the region. However, under the customs union, it would no longer have to fulfill that requirement, and be able to circulate freely even though it was made with sugar from outside the region, unless it had been excluded from free circulation. The only requirement is for it to have been manufactured in a Member State of the customs union, since one of the objectives of the RCOM is to promote production networks between the region's producers.[24] This is a substantial change since it is not necessary to purchase Central American products to circulate freely.[25]

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[23] For the purposes of this article, "origin" is understood as the location from which the goods originate and does not refer to the technical concept of originating goods.

[24] In principle, a specific origin rule requires regional content because production exists in at least one of the states of the subsystem, and therefore regional supply capacity exists. Eliminating this requirement in the customs union could affect the regional producers of this good. This is not necessarily resolved by exempting the product from the free circulation system because regional production can be established in a country of the subsystem that is not part of the GT-HN customs union.

[25] This situation would also apply to goods made under the CAFTA-DR, in the sense that they could circulate freely without the need to fulfill the specific origin rule of the Treaty. Nevertheless, in cases of co-production of goods to be exported to [the] United States, as is the case for example in the textile and clothing sector, compliance with the rule of origin is necessary in order to obtain tariff preference upon entering [the] United States.

As for goods coming from outside the region, they will be able to circulate freely after they have cleared customs in one of the member states of the union. This means that when they cross the border, they will not have to pay tariffs again, and only have to pay the indirect taxes applicable in the destination country.

As noted above, the treatment of non-originating goods is set forth in Article 7 of the Customs Union Operating Regulations through which Article 32 of the Convention on the Reconciliation of Domestic Taxes is established. Therefore, upon entering the customs territory, the goods must pay the applicable import taxes, a process called "customs clearance". If they are goods originating from another country with which the countries in the customs union have a preferential agreement, they will pay the applicable import customs duty according to said treaty, be subject to the payment of the applicable consumption tax,[26] and fulfilling any other applicable non-tax obligations. If the goods originate from a country with which none of the countries in the union have a preferential agreement,[27] they will be subject to payment of the most favored nation tariff and other applicable fiscal and non-fiscal obligations.

Goods clearing customs and subject to free circulation upon being transferred to the territory of another member state of the customs union will not be required to pay duties again, only paying the applicable consumption tax in the destination country. On the other hand, if the goods are excluded from free trade, they must as a general rule[28] pay the applicable duty upon being sent to the territory from the other member state of the union.

A final aspect to be highlighted concerning the definition of community goods is that goods must be made in the single customs territory or clear customs in a member country of the union. This means that goods made in a free trade zone or other territories subject to special rules will not be considered community goods because they were not made in the single customs territory nor nationalized by it. Therefore, in order for these goods to circulate freely, they must enter the single customs territory earlier ("clear customs"), as if they were goods originating from non-member states of the customs union.[29] A later section will explore in greater depth the trade of goods produced under special rules.

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[26] Consumption tax refers to the taxes generated by the trade operation, and may be general like the value added tax or specific like the tax on alcoholic beverages.

[27] As will be explained below, if only one of the member states of the GT-SV CU have signed the trade agreement, the goods covered by that treaty are excluded from the free circulation system.

[28] Exceptions to this general rule would be goods originating from the European Union since the European Union - Central American Association Agreement establishes an obligation that these goods would not be subject to payment of double tariffs, and goods originating from a member state of the CAFTA-DF given the multilateral nature of said Treaty for the trade of goods.

[29] Section X on special rules will cover this in greater depth, but this restriction will not apply to Guatemalan companies covered by Decree 29-89 since they operate, even when they enjoy benefits similar to those granted in free trade zone systems, from the single customs territory, and consequently produce community goods.

In conclusion, the establishment of a customs union involves the free circulation of all goods, both those produced in the single customs territory and those imported from third countries. This is because when a single customs territory is created, tariffs inside the territory are eliminated for both local and foreign products. There are no tariffs when a product made in San Salvador department is sent to La Libertad department, nor are there tariffs when goods are sent from one member state to another. From this perspective, it is not possible to make a customs union otherwise.

However, these measures were not adopted in a vacuum, and it was necessary to make certain adjustments to ensure that a customs union could be implemented, even partially. In fact, the Enabling Protocol is focused on the exceptions to free circulation necessary in order for Guatemala and Honduras to be able to implement a customs union partially.

RELATIONSHIP TO THE CENTRAL AMERICAN REGULATORY FRAMEWORK

The customs union between Guatemala and Honduras is an instrument that is part of the Economic Integration Subsystem (SIE), even though it does not apply to the six member countries. In fact, its legitimacy is derived from the provisions of Art. 6 of the Guatemala Protocol – as recognized in Clause II of the Enabling Protocol, under which "*all or some members may progress with the swiftness that they grant within this process.*" The Enabling Protocol also mentions as a reason in its Clause III, Article 15 of the Guatemala Protocol, where it is provided that the customs union "*will be achieved gradually and progressively, based on the programs, which will be established for that purpose, approved by consensus.*"

The fact that the customs union between Guatemala and Honduras is part of the SIE has many implications, but for the purposes of this report, two stand out: the implications on regulatory aspects and the institutional framework. The first case involves the regulatory base being the subsystem, with this being the minimal regulatory framework applicable to the customs union between Guatemala and Honduras. In other words, in all areas without a more in-depth regulatory framework, the regulations that will apply will be those of the subsystem. For example, in the framework of the process under review, aspects related to trade protection are not regulated, and therefore, if one of the member states wishes to apply a measure of this nature, it must do so in accordance with what is established in the Central American Regulation on Unfair Trade Practices.

Similarly, the legitimacy granted by Article 6 is to ensure that they make progress on their level of integration, and therefore, only measures for deep integration can be adopted. In this sense, the member states of the Northern Triangle customs union could not adopt measures that move them away from the deep integration that they seek to achieve with the customs union, especially if this nullifies or diminishes the rights of other member states of the subsystem. For example, the member states of the customs union between Guatemala and Honduras could eliminate the application of the Central American Regulation on the Origin of Goods for trade within their community, i.e. all goods produced in the single customs territory would not be subject to customs duties upon importation, independent of how they were made. However, they could not require stricter rules on origin for trade in the single customs territory because that would be against the deep integration

pursued with the adoption of the Enabling Protocol, since they would be measures that are not "*consistent with the principles and objectives*" of the subsystem, contradicting that established in Article 13 of the Enabling Protocol.

The second case involves the institutional framework of the customs union between Guatemala and Honduras being hybrid. Decisions on most subjects will be made by the ministerial body of the customs union. However, there are some aspects that cannot be decided/regulated by the specific institutional framework because they are under the exclusive competence of the bodies of the subsystem, which will be called the "*general institutional framework*". The next section will explore this in greater depth.

Finally, it is necessary to mention what the relationship is between the member states of the customs union between Guatemala and Honduras and the other members of the subsystem. This relationship is the subject of Article 12 of the Enabling Protocol, which provides that member states of the customs union "*will continue to manage their economic relations with the other states parties of the General Treaty on Central American Economic Integration and its Protocols in the context of said legal instruments and the resulting regulatory framework that is applicable to the trade of goods and services, respectively.*" This provision confirms what was stated previously, that member states of the customs union between Guatemala and Honduras maintain their rights and obligations in the framework of the subsystem. It also confirms that they can only adopt measures for deep integration, since only these measures are permitted by Article 6 of the Guatemala Protocol, and due to that requirement, they could not adopt measures that discriminate against or diminish the rights of the other member states of the subsystem.

INSTITUTIONAL FRAMEWORK OF THE GUATEMALA – HONDURAS CUSTOMS UNION

As mentioned, the institutional framework of the customs union is hybrid. The Ministerial Body of the Customs Union, created under Item No. Three of the Enabling Protocol, is the entity responsible for the "*implementation, administration and development of the customs union model*." In accordance with the provisions of Item Four, it "*will define and adopt the general policies, guidelines and essential legal instruments of the customs union.*"

The Ministerial Body of the Customs Union is composed of the Minister of Economy of the Republic of Guatemala and the Minister of Economic Development of the Republic of Honduras.[30] Similarly, sectoral ministerial bodies may be established to handle regulated subjects. For example, employees from the ministries of economy and agriculture of the countries may be convened to adopt the corresponding administrative action for an agricultural subject. Decisions of the ministerial body of the customs union must be adopted by consensus.

However as said, the member states of the customs union between Guatemala and Honduras continue to be bound by the General Treaty on Central American Economic Integration (TGIE), its

[30] El Salvador has already joined the Enabling Protocol and the El Salvador Ministry of Economy is part of the ministerial body of the customs union. In fact, all the decisions adopted now require the consensus of the Ministry of Economy of El Salvador, even when they do not apply to the Republic of El Salvador.

Protocol and CRAAC. This involves certain aspects that are regulated by the general institutional framework of the subsystem, primarily the COMIECO and the sectoral or intersectoral councils of ministries. General institutional competence is granted to Founding Treaties, and therefore, they cannot be modified by a later instrument, as the Enabling Protocol would be. In these areas, even when the member states of the customs union want the ministerial body of the customs union to decide on that subject, they will not be able to do so because the general institutional framework must regulate it.

In practical terms, where this institutional environment will have a greater impact for the purposes of consolidation of the customs union between Guatemala and Honduras is in the area of tariffs. As a general rule,[31] only COMIECO can modify the common external tariff, both in terms of nomenclature and customs duties. To that end, if Guatemala and Honduras wish to harmonize the import tariff rate (DAI) applicable to a product contained in Part II of the Central American Import Tariff, the only entity competent to make the corresponding change is COMIECO, which must adopt the corresponding resolution even though it is only applicable to Guatemala and Honduras, as occurred in Resolution No. 389-2017 (COMIECO-LXXIX). Consequently, a resolution of the ministerial body of the customs union that changes the Central American Import Tariff would not be applicable since this institution does not and cannot have the competence to amend it. This means that in order to make progress toward improving the union in terms of tariffs, the consensus of the six member states of the subsystem is required.[32]

The same situation applies to products excluded from free trade contained in Annex A of the TGEIC. The inclusion of these products in free trade is the exclusive authority of the general institutional framework[33] and they cannot be incorporated by the ministerial body of the customs union, even when this exclusion only applies to trade within the union. While there are no bilateral exclusions between Guatemala and Honduras, only applicable between them, El Salvador and Honduras do have bilateral exceptions in Annex A. If, for example, one wanted to incorporate trade of alcoholic beverages, that decision could not be made by the ministerial body of the customs union.

Although this varying institutional authority appears confusing, the competence of the bodies is clearly outlined, and the member states are fully aware of the cases in which decisions must be made through the general institutional framework and when [they must be made] by the ministerial body of the customs union. And although the consent of states that are not part of the customs union is

[31] In accordance with Article 26 of the CRAAC, member countries of the Subsystem may unilaterally change the tariff in certain situations. This power must, in principle, be provisional. However, in practice, measures adopted in application of this article have been maintained indefinitely.

[32] Although Article 52 of the Guatemala Protocol permits decisions made by groups of countries, in order to have the necessary quorum – 4 member states – a minimum of one state in the GT-HN CU would be necessary. Without prejudice to the foregoing, throughout the entire Central American Integration System, the rule is always consensus, and therefore, it is considered unlikely that there would be a situation in which a decision is made without the 6 member states of the Subsystem.

[33] While there is no agreement, the position of the member states of the Subsystem is that the Executive Committee on Economic Integration is the entity competent to incorporate goods excluded from free trade.

required in order to move forward on certain important subjects, this has not impeded its function to date, and with the exception of the exclusion of products from Annex A, it is considered unlikely that the other countries would oppose intensification of the process initiated by Guatemala and Honduras, which El Salvador has already joined.

EXCEPTIONS TO FREE CIRCULATION

The exceptions to free circulation are established in Item No. Two of the Enabling Protocol, which due to its relevance, is cited verbatim below:

"*TWO: The Customs Union, which shall be formed between the states parties, shall be adapted to the model approved in the "General Framework of Studies to Establish the Customs Union between the Republic of Guatemala and the Republic of Honduras," signed by the presidents of both countries on February 26, 2015, which is incorporated as Annex I of this Protocol.*

Based on the customs union model adopted, the states parties will develop procedures for administration of the system of free circulation of goods, with the ability to establish provisionally and while the Customs Union is being developed, exceptions to the free circulation system, considering among other circumstances, the following:

- *i. Goods contained in Part II of the Central American Import Tariff;*
- *ii. Goods subject to tariff quotas with third countries in the framework of preferential trade agreements;*
- *iii. Goods subject to protections pursuant to Article 26 of the Agreement on the Central American Customs and Tariff System (CRAAC);*
- *iv. Goods with defined phytosanitary and zoo sanitary rules;*
- *v. Goods subject to substantially different tax rules.*

The ministerial body shall define other circumstances in which products may be included in the exceptions to free circulation, as determined by the parties.

Goods that, as of the effective date of this Protocol, are exceptions to free trade between the states parties in the framework of the Central American Economic Integration Subsystem (Annex "A" of the General Treaty on Central American Economic Integration) shall maintain said status after the customs union between the states parties is established. These goods shall be incorporated in the free circulation system after it is determined that the necessary conditions have been satisfied."

As can be seen, the general rule is free circulation of community goods, as confirmed in Article 5 of the Customs Union Operating Regulations. However, Item No. Two includes five specific situations through which goods may be excluded from free circulation. In addition, goods excluded from free trade contained in Annex A of the Guatemala Protocol are excluded[34]. Finally, the ministerial body is the competent entity to exclude other goods for reasons it deems appropriate, and it must take

[34] If El Salvador is fully incorporated in the GT-HN CU, the addition of unroasted coffee and sugar, goods excluded from free trade between El Salvador and Honduras would also be excluded from free circulation at a minimum for trade between these two countries.

the corresponding administrative action. The latter exception is ultimately the way in which the member states of the customs union are given a degree of discretion in excluding products that do not have conditions regulated by the Treaty. For example, products can be excluded if so requested by the private sectors of the countries.

In principle, goods excluded from the free circulation of goods system were established in Resolution No. 09-2017. These goods are classified into three groups, with the first being "Exceptions to the Free Circulation of Goods System," which include goods in the following sectors[35]:

a) Live animals: cattle, hogs, hens, and chickens;
b) Beef; meat, pork, and bacon; hen and chicken meat;
c) Dairy products, substitute dairy products and ice cream;
d) Eggs;
e) Vegetables: for onions and beans;
f) Yellow rice and white rice;
g) Rice and rice flour pellets;
h) Corn flour and semolina;
i) Vegetable oils;
j) Sausage and meat preparations;
k) Baby formula preparations;
l) Juices and nectars;
m) Live culture yeast;
n) Beer;
o) Wine made from grapes;
p) Fermented beverages;
q) Ethyl alcohol;
r) Eau-de-vie and other spirits;
s) Dog and cat food;
t) Tobacco and tobacco products;
u) Concrete;
v) Gasoline and gas;
w) Human and veterinary medications;
x) Compost (fertilizers);
y) Retread or used tires;
z) Used footwear; used clothing and other old clothing;
aa) Iron and steel products; and
bb) Tractors, automobiles, automotive parts and chassis, trucks, motorcycles and trikes and their parts, bicycles and their parts.

The second group is "Exceptions to Free Trade pursuant to Annex A of the "General Treaty on Central American Economic Integration," which include:

a) Roasted coffee
b) Sugar and by-products

[35] Each of these categories include specific tariff items that are excluded from the free circulation system.

The third group is "Exceptions to free circulation of goods for non-trade reasons" and includes

c) Species of flora and fauna contained in the cited agreement;
d) Restricted items;
e) Gun powder and explosives;
f) Weapons and ammunition;
g) Radioactive chemical elements;
h) Precursors.

Resolution 09-2017 does not indicate why these goods are included in the exclusion rules. However, it can be assumed that they include a combination of all the cases contained in Item No. Two of the Enabling Protocol. This resolution has not been amended since it was adopted.[36]

As of December 2021, the competence of the ministerial body had been used on three occasions, first with the adoption of Resolution 10-2017, which created exceptions to the free circulation of goods categories "Goods with different sanitary condition for agricultural supplies[37]" and "Goods excluded due to tariff differences in free trade treaties in force through the states parties"[38]. Resolution 20-2017 created a third category "Goods excluded from free trade due to differences in the specific origin rules of international trade agreements in force in the states parties[39]".

It is important to highlight that these lists are not final, and goods may be added or removed. These changes can be made due to a change in circumstances, for example, as taxes on goods are eliminated in tax relief programs of the trade agreements.[40] In other cases, this is due to decisions made by the member states, such as for example, because they decide to harmonize tariffs. Sometimes, this could be unilateral, for example if one of the member states adopts a sanitary or phytosanitary measure on its own. In addition, the ministerial body may decide to add or remove products, in the exercise of its discretionary authority.

ABILITY TO AMEND RESOLUTIONS ADOPTED PREVIOUSLY

All resolutions adopted previously can be amended, but this requires the consensus of all member states of the customs union. In order to do so, El Salvador must obtain the consensus of Guatemala and Honduras in order to amend resolutions that are in its interest and relevant to it in its process of full incorporation in the union.

As explained in the other section of this document, resolutions are adopted by the Ministerial Body, which is a body with supranational authority. As a result, this body will have the ability to amend a

[36] If El Salvador fully enters the GT-HN CU, this resolution must be amended for the first time to include products, which must be added to this list, as a result of this incorporation.
[37] The current list is contained in Resolutions 24-2017 and 64-2019.
[38] The current list is contained in Resolution 84-2020.
[39] The current list is contained in Resolution 85-2020.
[40]For example, the list of these goods was established by Resolution 19-2017. This list was subsequently updated by Resolution 34-2018, Resolution 73-2019, and most recently, Resolution 84-2020.

resolution adopted previously by issuing a new one, as was done on multiple occasions during this process. Similarly, it may adopt a new resolution to regulate subjects that El Salvador considers worthy of a specific regulatory framework. However, in all cases, these changes are not automatic and require the consent of the states through their representatives in the Ministerial Body.[41]

One of the resolutions that is probably of greatest interest to El Salvador for review and amendment is Resolution No. 09-2017, which contains lists of the exceptions to free circulation. The products were cited in the previous section, so it is pertinent to highlight the principles applicable to this resolution. Item No. Two of the Enabling Protocol, "*establishes a list of categories of products that are excluded from free circulation, which requires identification of the goods, which provides legal certainty to the economic agents of those [goods] that will not enjoy free circulation in the common customs territory.*" Based on the preceding, it can be concluded that if a good is in one of the product categories listed in Item Two, it must automatically be excluded from free circulation. Under this interpretation, the ministerial body's job is simply to identify products that satisfy any of the characteristics and add them to the various lists of excluded products.

This would appear to be simple for goods in Part II of the Central American Import Tariff, goods with a different sanitary condition for agricultural supplies, and goods subject to protections or quotas. The same situation applies to goods excluded due to tariff differences in free trade treaties in effect in the states parties and goods excluded from free trade due to differences in specific origin rules of international trade agreements in effect in the states parties, even when they are not expressly excluded in Item Two. In all these cases, the incorporation should be automatic given that the case enabling amendment is an actual fact: different sanitary measures, different tax relief programs, different origin rules, etc.

However, a new variable may arise with El Salvador's inclusion: in accordance with these automatic rules, any good that currently receives this treatment in relations between Guatemala and Honduras is excluded from free circulation. If this occurs, resistance from the economic agents affected should be expected and options of how to handle this situation will have to be evaluated. One option could be to maintain free circulation of those products only in trade between economic agents from Guatemala and Honduras, but not with El Salvador, and efficient mechanisms must be established for this type of control.

There is one category and one scenario from Item No. Two in which the application is not automatic, this concerns what should be understood by "substantially different tax rules," considering that it is not defined in the regulatory framework, although incentive programs granted by the countries could be included here. Which specific programs are covered and under what terms is not determined automatically, but rather requires discussion by the ministerial body. As will be explored in greater depth later, goods produced under these incentive programs are not excluded *per se* from free circulation.

[41] A similar situation occurred when Panama joined the Economic Integration Subsystem. The terms of its incorporation were negotiated in good faith and the states that were already members of the subsystem addressed Panama's concerns.

The last scenario is the discretionary power of the ministerial body to add other goods. As mentioned in the previous section, this power is used to create categories of goods with tariff differences in the tax relief programs of trade treaties and origin rules. Similarly, an additional category was created in Resolution 09-2017 using this power, which consisted of exceptions to the free circulation of goods for non-trade reasons.

There is no indication why the goods listed as exceptions to the free circulation system were included on the list. However, in any case, El Salvador could request that goods on this list be included through other categories described here, pursuant to the discretionary authority granted to the ministerial body to add more goods to the list of excluded products. The only limitation, as noted previously, is that Guatemala and Honduras must agree with this inclusion, even if the exclusion will only apply to El Salvador.

HARMONIZATION OF THE CENTRAL AMERICAN IMPORT TARIFF

As indicated, COMIECO is the sole entity with the power to harmonize the Central American Import Tariff (ACI), and the ministerial body is not competent in this area. As such, tariff harmonization between countries of the customs union between Guatemala and Honduras requires the consensus of the other states of the Economic Integration Subsystem.

This does not mean that the ministerial body does not have a role, in fact, it can be a forum for negotiation between the states to agree, amongst themselves, on harmonization of tariffs. In this particular case, the ministerial body adopted Agreement No. 02-2016 in which it decided: a) to harmonize 14 tariff items, and as a result of the decision, they harmonized the ACI; and b) to harmonize 66 tariff items, and although it did not harmonize the ACI and they continued to be in Part II, it harmonized the tariffs of both countries. In both cases, the impact in terms of the customs union was that the goods classified in those tariff items were removed from the free circulation exceptions.

The agreement binds the states of the customs union between Guatemala and Honduras and does not amend the ACI. For this reason, Item 3 of this agreement makes clear "*submitting for the knowledge and consideration of the Council of Ministers for Economic Integration (COMIECO) approval of the harmonization reached in this agreement, according to the legal instruments of Central American Economic Integration*." Therefore, the effect of this agreement is to create an obligation for the states of the CU to propose the amendment to COMIECO and vote in favor of the same.

In fact, not all of this harmonization was approved by COMIECO. COMIECO approved through Resolution No. 389-2017 harmonization of the 14 tariff items, which led to harmonization of the ACI. However, harmonization between Guatemala and Honduras for the remaining 66 tariff items has yet to be approved, and therefore, these tariffs continue not to be harmonized in the ACI.

ORIGIN RULES

As mentioned previously, one of the characteristics of the customs union[42] is the fact that goods made in the single customs territory circulate freely with no need to comply with origin rules. Therefore, in the framework of the customs union, compliance with the Central American Regulation on the Origin of Goods is not a requirement to circulate freely. For this reason, if a given economic sector is interested in maintaining the Central American origin rules for goods of interest, it must request that they be excluded from free circulation.[43]

Goods that are imported to the single customs territory, which are not excluded from free circulation, receive this same treatment. In other words, after the corresponding customs import formalities have been fulfilled, including payment of the resulting import duties and taxes, the goods may circulate freely in the single customs territory, without the need to pay tariffs when they cross their countries' integrated border checkpoints.

Unlike goods made in the single customs territory, imported goods must follow the origin rules that may apply if they are requesting a tariff preference under a trade agreement or treaty when they enter the single customs territory. Consequently, customs officials of the member states of the customs union maintain the ability to verify that these goods comply with any origin rules applicable to them.[44]

If the customs official is interested in verifying the origin, the official of the state where the goods entered the single customs territory would carry out the procedure established in the corresponding treaty or agreement, as is done currently. However, it is possible that the customs official interested in verifying the origin is not from the state where the goods entered the single customs territory, which is why a specific procedure is established for origin verification in this case, which appears in Article 24 of the Customs Union Operating Regulations (Resolution No. 90-2021), cited below:

*"**Article 24. Verification of the origin of goods with free circulation.** When the competent official, pursuant to the applicable international trade agreement, of the purchasing state party has questions about the origin of goods originating from a member state of the Economic Integration Subsystem or goods from a state with which the state party has an international trade agreement in force and they have been imported into a state party and transferred to the other state party using a Central American Single Invoice and Declaration Form (FYDUCA), the competent official of the purchasing state party may request that*

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[42] For example, Article 14 of the Framework Agreement on the Establishment of the Central American Customs Union provides as follows: *"Upon forming the customs union, the states parties shall not apply origin rules requirements to the trade of goods within the customs territory created by this instrument, irrespective of their origin."*

[43] As can be seen in Appendix 4 of the Goods Excluded from Free Circulation, Section 4.2, a legal document that covers goods excluded from free circulation, goods excluded from free circulation must be covered by a FAUCA if they satisfy the corresponding origin rule.

[44] This includes the power to verify the origin of goods made in the customs territory that are excluded from free circulation.

the transferring state party initiate the origin verification procedure established in the applicable trade agreement.

The transferring state party will review the request and will have 60 days to state whether it is appropriate or not carry out the origin verification procedure. States parties shall provide the due mutual cooperation.

After the origin verification procedure has been carried out, the competent official from the transferring state party will report the results of the verification and send the final decision to the competent official of the purchasing state party within the period set forth in the corresponding trade agreement for notification of the exporter."

TRADE OF AGRICULTURAL GOODS

In the SIE, the trade of agricultural goods usually has protections, either through tariff measures or non-tariff measures. In this sense, and to a certain extent as a result of it, the Guatemala and Honduras customs union is not an exception.

As mentioned previously, the products contained in Annex A are excluded from free circulation and many of the products excluded in the cited Resolution No. 09-2017 are agricultural. The latter mainly occurs because the tariffs for many agricultural products are not harmonized, but it can occur due to quotas or protections or simply by decision of the states.

With the entry of El Salvador in the customs union, the number of agricultural products excluded from free circulation will increase, given the amount of these products included in Part II of the ACI. However, each sector concerned will have to confirm the specific case of its goods because based on the review of Resolution 09-2017, there are cases in which Guatemala and Honduras included on the list of excluded products goods that are harmonized between them, but not with El Salvador or other states of the Economic Integration Subsystem. For cases in which that did not occur, El Salvador must request, in accordance with the rules established in Item No. Two of the Enabling Protocol, exclusion of the agricultural products that it wishes to exclude from the free circulation of goods.[45]

RISK MANAGEMENT

Risk management, according to the Revised Kyoto Convention of the World Customs Organization, is defined as the systematic application of management procedures and practices that provide to customs the information necessary to manage movements and/or shipments that present a risk. For that reason, Central American customs officials have developed the risk management systems that

[45] In accordance with the Enabling Protocol, if a product is not harmonized in the ACI (Part II), it should be excluded from free circulation. However, it is possible for a product to be harmonized between Guatemala and Honduras and the reason why it is in Part II is because it is not harmonized with El Salvador. In this case, a product with free circulation would become excluded, thereby affecting the economic agents involved in Guatemala and/or Honduras. If this occurs, it should be possible in principle to maintain the free circulation of these products only with respect to Guatemala-Honduras, but it would be excluded if the origin or destination is El Salvador. The latter could be controlled with computer systems, excluding the possibility of being on the FYDUCA when the origin or destination of that operation is El Salvador.

they use to, among other things, determine the level of intensity of the customs controls for goods, which are the subject of external trade operations, undergo.

Economic agents know that when a foreign trade operation takes place, specifically upon faxing a declaration of goods, the risk management systems are set in motion, and depending on the operation, they may be subject to a physical inspection of the goods. This necessarily involves the procedures having to be performed in arrival customs of the different states, which can make passing through the border checkpoint tedious.

A substantial change has been introduced to this system with the implementation of the customs union, in which these controls are eliminated for operations covered with FYDUCA, i.e. risk management will only apply to external trade operations and those that are excluded. This involves goods that take on the community quality and are exchanged within the single customs territory not being subject to the customs risk system, and therefore, when they go through an integrated border checkpoint, no customs procedures have to be carried out, just the simplified procedure using FYDUCA.
In the case of goods originating from a third country, they are subject to the risk management system in the peripheral customs offices where they enter the single customs territory. However, after they are definitively imported, if said goods are exchanged within the customs territory, they are not subject to the customs risk management system and go through the integrated border checkpoint without being subject to additional customs controls.

The lack of application of the customs risk management system to intracommunity transfers is a natural aspect of the customs union.[46] This, however, does not mean that there are no controls that officials use to verify compliance. Article 20 of the Union Regulations provides the following:

"*Article 20. Control and audit of purchases, transfers and other operations. The competent officials of the states parties shall apply uniform and harmonized control procedures such as road operations through inter-institutional coordination, warehouse checks and other controls within their remit.*

In exercise of their management, audit and collection authority, tax authorities may apply the provisions contained in Article 25 of the Convention on the Reconciliation of Domestic Taxes, as well as the provisions in the Convention on Mutual Assistance and Technical Cooperation of April 25, 2006, on the exchange of information."

With respect to Article 25 of the del Convention on the Reconciliation of Domestic Taxes, the applicable measures include:

1. "*Requiring reporting by any individual or legal entity with the capacity of taxpayer or responsible person, related to the provisions contained in this convention.*

[46] Using the case of El Salvador as an example, pursuant to the laws in force, the risk management system would not be applicable to transfers of goods covered by a FYDUCA that have become community goods because the latter are not covered by a declaration of goods, a requirement set forth in Article 12 of the Simplified Customs Law.

2. *Auditing and monitoring the payment of taxes arising from purchases or transfers of movable property or services provided in the customs union.*

3. *Withholding, with the support of the corresponding officials, as a precautionary measure, goods circulating or found within the territory of each country that are not supported by a legal document proving ownership and payment of the respective taxes, or that have the corresponding documentation, and establish as the sending individual an individual registered as a taxpayer in another state party.*

4. *Exchanging information in the exercise of its control, inspection or audit authority, according to its national laws and agreements signed by the states parties.*

5. *Coordinating efforts with other institutions on the national and regional levels to fight tax evasion, smuggling and any other behavior that harms the tax authority."*

Three major conclusions can be drawn from these examples described; the first being that the goal is for any control measure to be carried out outside of the integrated border checkpoint. And if controls are performed at integrated border checkpoints, community goods will not receive the benefits of ease of passage. The second objective is migration to *a posteriori* control system. In terms of customs, it is normal, in the application of customs authority and according to the risk management system, for officials to carry out immediate checks as a control and safety measure. However, in terms of domestic taxes with the FYDUCA, there must be subsequent audits. Nevertheless, the implementation of some measures similar to the controls performed by customs officials is planned, as described below. The third conclusion is that in order to strengthen *a posteriori* control, customs union officials must manage risk in a comprehensive manner, i.e. through inclusion of their risk criteria in the same community database that contains the risks associated with the passage of goods through integrated border checkpoints, by officials from customs, the tax authority, immigration, sanitary and phytosanitary and safety services.

Article 22 of Resolution 90-2021 transcribed below includes special safety measures.

"*Article 22. Special safety measures. Customs, sanitary and phytosanitary services and tax authorities will be able to employ special safety measures for community transit, transfers and purchases of goods with free circulation and other customs operations conducted in the single customs territory, through the use of electronic tags or customs seals placed in the transportation units, bar[codes] for immediate verification using optical readers, which enables their monitoring through satellite systems, non-intrusive means of control such as scanners, x-rays and similar means, which must comply with the security specifications upon which the states parties agree.*

The competent officials will do their best to ensure that such measures do not present an unnecessary barrier to the operations of the customs union between the states parties."

As mentioned, this list includes measures traditionally implemented by customs in their control duties. For example, the use of customs seals is a standard measure for controlling goods subject to

a transit rule, whether domestic or international. Similarly, the use of optical readers with RFID technology has been implemented in customs offices in the region, as well as the use of non-intrusive controls. Finally, this is a bet on the use of technology as a way to minimize the impact of control on operations. Also, optical readers with RFID technology are installed at integrated border checkpoints of the union between Guatemala and Honduras, and pursuant to Resolution No. 44-2018, RFID labels are required in all means of transportation registered in the states parties that conduct international customs transit operations, with free circulation of goods and free community transit.[47]

Having said that, although these measures are similar to those already used by customs officials in order to implement them in community goods when they cross integrated border checkpoints, it may be necessary to amend the domestic legislation of the member states of the customs union. One example is Salvadorean legislation that regulates the rate for non-intrusive inspection services. Since community goods with free circulation are not subject to a customs risk analysis, they cannot be subject to the US$18 rate for the use of non-intrusive inspection systems because this analysis is the event that gives rises this rate. Therefore, if the Simplified Customs Law is not reformed, community goods could be subject to review by non-intrusive equipment, but free of charge.

Finally, and as stated, the officials that carry out this control in the union for community goods are the tax authorities, which is logical given that these are not foreign trade operations, but rather domestic transfers and purchases. However, this determination was made in the discretionary exercise of their authority and is not an obligation imposed by the Enabling Protocol. Therefore, if El Salvador becomes a full member of the customs union, it may elect to have the Board of Customs perform these controls. However, this is a domestic and purely formal decision; the competence that the Board of Customs will be able to exercise is the same described in this section because the relaxation of controls is consistent, in the end, with eliminating the management of customs risk.

SPECIAL SCHEMES

For the purposes of this report, "special schemes" refer to free trade zones or similar schemes through which El Salvador, Guatemala and Honduras grant tax incentives to their producers. This section will address two main subjects: a) operations between beneficiaries of these rules, and b) transfers of goods produced under these rules which are intended for use or consumption in the single customs territory.

Vertical integration exists in the Northern Triangle countries between beneficiaries of these programs, especially in the textile and clothing sectors.

So, much of the trade volume generated on given land borders involves operations between beneficiaries of these schemes. Under current customs regulations, these operations are handled as customs traffic. These operations are generally conducted as follows:

[47] If El Salvador becomes part of the customs union, means of transportation registered in the country must be enrolled in the RFID program.

a) The beneficiary of these systems begins internal transit upon leaving the free trade zone or equivalent territory, which covers movement from the point of departure to the border customs office of its country.
b) Upon arrival at this customs office, it must follow the procedure established for ending internal transit.
c) Next, it moves to the arrival customs of the destination country, the location from which a new internal transit begins, which covers movement of the goods to their destination.
d) Finally, upon arrival at the free trade zone or its equivalent in the destination country, the procedure is carried out for import of the goods at the customs house.

Under this plan, the party concerned must carry out a double procedure at the departure customs of one country and arrival customs of another; and this is why it is said that there is a "double procedure" on the borders. The two required procedures are what considerably increase the times of these operations at the borders.

The customs union eases this situation substantially since these operations are considered "community transit" within the single customs territory. For this reason, these goods are documented through a Community Land Transit Single Declaration Form (DUT-C) used to cover goods in land transit in the customs union territory, and upon arrival at the borders, they move through the Trade Facilitation Center (CFC), eliminating the need for the double procedure mentioned[48].

The second element to be addressed on this subject refers to the transfer of goods made under the free trade system or equivalent schemes for their use or consumption in the single customs territory. The national legislation of each country has an impact on this component, and in particular the rules applicable to sales on the national market. For the purpose of considering the most variables possible, it will be presumed that all the countries call sell on their national market.

Except in the case to be reviewed later, goods made in a free trade zone, or the equivalent shall be considered outside the single customs territory, and consequently, are not community goods subject to free circulation. Therefore, if a free trade zone makes a transfer to a recipient located in the single customs territory, the goods must first be imported definitively in said territory, as if they were goods originating from a third country and then be transferred to the other country. This is why these operations cannot be covered by a FYDUCA from the start, and therefore, must carry out the traditional customs procedure at the Integrated Control Center of the integrated border checkpoints.

[48] The procedure is established in Appendix 3, Section 3.4.2 Operations and Procedures at the CFC, item e) Operations that are supported with DUT-C at the CFC, which sets forth: *"For better understanding, goods that can be moved between free trade zones, customs warehouses and bonded warehouses of the states parties must be done under the DUT-C, according to the community transit procedure described above."*

It can be inferred from the foregoing that a beneficiary of these programs could convert their goods into "community" goods by clearing customs in the country of operation. For example, a beneficiary established in a free trade zone in El Salvador can have the goods clear customs by paying the corresponding import taxes and duties. Upon being imported into the single customs territory, the goods can move freely and be covered by a FYDUCA when a transfer is made to the other economic operator in the single customs territory.[49]

The exception to this rule is the benefits system established in Guatemala by Decree 29-89, since the beneficiaries of this system do operate in Guatemala's customs territory, and therefore, they are community goods that can circulate freely. Resolution No. 42-2018[50] adopted the "Procedure for FYDUCA to cover transfers and purchases of goods not exempted from free circulation that companies included in the systems of Decree No. 37-84 of December 20, 1984, of the Republic of Honduras and its amendments and Decree No. 29-89 of May 23, 1989, of the Republic of Guatemala and its amendments [sic]." The resolution was adopted on October 10, 2018, and effective on January 1, 2019. However, the effective date of the procedure was postponed multiple times and it finally entered into force on June 1, 2021.[51]

The second aspect to mention is that this an operating procedure, and as such, it does not modify the general principles applicable to trade in the framework of the customs union. Its function is only operational in order to tailor the procedure to the specific characteristics of these customs schemes.[52] Therefore, the existence of this procedure as such is not the problem. The problem is the different conditions of the main incentive programs of El Salvador and Honduras *vis-à-vis* that of Guatemala, in particular the customs territory where they operate. So, any solution is not resolved with the nullification or non-application of this resolution because this procedure only reflects the application of the general principles of the customs union. The main solution would be comprehensive adjustment of the tax incentives in the territory of the union.

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[49] Even starting with the assumption that this admission can be carried out in accordance with the corresponding national legislation, a tariff barrier could exist for some goods. When the goods clear customs, the beneficiary must pay the most favored nation tariff. On the other hand, if the export is made directly from the free trade zone, entry into the destination country could be subject to tariff preferences under a trade agreement, eliminating payment of the tariff.

[50] This procedure is also applicable to a Honduran incentive program. However, this program is not the main incentive program that said country grants.

[51] Resolution 87-2020 of December 16, 2020. However, there are doubts as to whether this resolution is being implemented.

[52] Given the nature of the special rules, and specifically the fact that the goods are subject to customs control, the customs services of the states party participate in the operational process. This is necessary in particular to ensure that the corresponding arrival declarations are deleted in the customs inventories. Everything is established in the process that they must follow, which includes the participation of the customs services to ensure that the tax inventories that the beneficiaries of special rules must follow are downloaded.

LOGISTICS HUB

For the purposes of this section, the subject of distribution will be focused on El Salvador's interest of being an International Logistics Center for the region. The customs union does not have specific regulations for this activity; therefore, the analysis will be focused on how the characteristics of the union will impact this activity, especially considering the current legislation in El Salvador.

El Salvador is the only country in the region that has legislation – the International Services Law (LSI) – with customs facilities to perform international distribution and logistics operations[53]. Generally, under this law, the importation of goods to warehouses of a logistics operator is permitted under a duty suspension system until said goods are assigned to a final regime, whether final importation or re-exportation. Similarly, while the goods are under the duty suspension system, they do not have to comply with Salvadorean regulations in other areas that could apply to a given product if it cleared customs in the Salvadorean customs territory.[54]

As can be seen, the legal invention of being considered outside the Salvadorean customs territory is the characteristic that makes this trade plan attractive, and it is the *sine qua non* requirement to be logistics hub. However, for the purposes of the potential full incorporation of El Salvador in the union, this characteristic hinders the ability of goods to move freely.

As explained, in order for goods to be considered community goods, they must clear customs in the single customs territory. However, the logistics operators are outside the Salvadorean customs territory, and therefore, goods that enter there are considered outside the single customs territory. To that effect, in order for them to circulate freely, they must be imported definitively into the customs territory. In principle, this could be done at the customs office of the free trade zone where logistics operator is established. However, the following problems may arise:

a) The importation would have to be carried out by the holder of the goods which, in most cases, are legal entities not domiciled in El Salvador and normally do not have operations or staff in the country. In addition, the LSI does not establish the possibility of final importation of the goods to El Salvador by the holder.

b) Import taxes and duties must be paid when the final importation occurs [55] in addition to the satisfaction of any non-customs measures applicable to the product in El Salvador.

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[53] The only focus is on logistics operations under LSI given the specific impact that the implementation of the customs union would have. Normal logistics operations, understood as those in which extra-customs areas are not used, do not have specific allocations or benefits with the implementation of the GT-HN CU. In other words, these activities will benefit from the implementation of the integrated border centers as will other economic activities.

[54] For example, it is not required as a condition of entry in the parque de servicios [extra-customs area for companies that provide services receiving tax incentives] for a product obtain Salvadorean sanitary registration. This requirement will only be necessary with final importation to El Salvador.

[55] As double charging of tariffs is eliminated with the implementation of the GT-HN CU, the impact would be on paying the Tax on the Transfer of Movable property and Provision of Services (VAT). However, this VAT could be recovered given that the goods will not remain in Salvadorean territory.

c) Since the product cleared customs, the goods will be transferred in the Salvadorean customs territory, and for this reason, it would be an operation subject to income tax[56] and other domestic taxes.

Another option would be for the holder to send the goods to an extra-customs territory in Guatemala and Honduras in order for their customer to later carry out the final importation in any of said countries. While this would resolve the points indicated, the need to use an intermediary reduces the attractiveness of this operation.

Finally, for distribution operations, it is quite possible for community goods and goods excluded from free circulation to be sold. Given the difference in the rules applicable to each one, they must necessarily be subject to different controls, since the first case concerns an internal operation and the second concerns an external operation. These operations are regulated in Appendix 3 of the Customs Union Operating Regulations, specifically, "Goods with Free Circulation and Free Community Mobility," section 3.1.1.2 e), which sets forth:

"***e) Grouping of operations***. *One means of transport may contain multiple purchase operations covered by FYDUCAS. Provided they are distinguished from one another, these goods may move through CFCs for electronic verification of each of the FYDUCAS.*

In addition, one means of transport may contain multiple operations covered by the FYDUCAS and goods declaration forms, as applicable, provided each of the operations are itemized by the taxpayer and the means of transport is duly approved by the customs service.

The grouped land operations mentioned in the preceding paragraph must move through integrated border checkpoint control centers. Air or maritime operations will be controlled by air or maritime customs and these operations may not in any case move through CFCs."

As deduced from the that set forth in the second item, it is possible to mix operations under different systems in the same means of transport, which facilitates these operations being carried out. However, the means [of transport] must be approved by the customs service, given that one part of the freight, the part excluded from free circulation, is carrying out foreign trade operations. Similarly, this operation must be performed at the control center, since it is necessary for the customs service to exert its control over the goods excluded from free circulation. Otherwise, it would involve goods excluded from free circulation, effectively receiving that treatment, [thereby] affecting the sectors with an interest in these goods being excluded.

Considering the preceding, under the customs union terms, but in particular in view of the special features of Salvadorean law, there will likely be little interest in goods stored with a logistics operator

[56] Pursuant to the last item of Article 8 of the International Services Law, transfers made by holders of goods stored with a logistics operator are considered made outside of the national territory, and therefore, exempt from paying income tax. Therefore, the transaction cost is increased for the owner of the goods.

enjoying free circulation. What is more probable is for these goods to maintain status quo, and for the benefits of the customs union to be indirect, arising from streamlined procedures at integrated border checkpoints.

DISTRIBUTION CONTRACTS AND INTELLECTUAL PROPERTY RIGHTS

While distribution contracts and intellectual property rights are different subjects, they have one aspect that justifies their similar treatment in this report: the use of border measures to ensure protection of their rights.

Goods distribution contracts are not regulated in the union's regulations and because they are private acts with legal consequences, they are governed by the domestic regulatory framework of each of the countries that make up the customs union. From the regulatory perspective, the fact that El Salvador is part of the customs union does not affect the rights and obligations of distributors set forth in their contracts with the brands they represent. And many products that could be considered sensitive such as vehicles, agricultural products and some medications are excluded from free circulation, and consequently, the current trade terms are maintained. Similarly, there are no regulations on aspects of intellectual property, and as a result, the applicable rules pursuant to the national regulatory framework of each country are maintained.

A potential impact has been foreseen in the application of border measures. One of the most efficient ways to ensure the compliance of distribution contracts and protected use of trademarks or other distinguishing trademarks are measures that prevent the said goods from entering the country. For goods originating from third countries, the situation will not be changed given that the imposition of border measures can be requested at the time of entry from the single customs territory. However, application of these measures could be complicated for community goods; either because they are produced in the region or because they entered the single customs territory in a third country.[57] The main control carried out in facilitation centers is done according to the tariff item of the goods established on the FYDUCA, which is useful in order to determine whether goods have free circulation, but it is not to determine whether these goods are subject to a border measure. Two goods can be classified in the same tariff item, but not necessarily be affected by the border measure (for example, they may be different trademarks). This is the reason why the impact of border measures will be reduced in the case of community goods circulating freely.

Finally, a possible scenario for the distributors sector is that, due to the creation of single customs territory, the trademark holder wants to grant exclusive distribution to the three countries in the customs union, given the ease of circulation for community goods. This, however, would be a business decision that is difficult to control, since it would be the consequence of facilitating the circulation of community goods.

[57] This hypothetical case is when a border measure is decreed, for example in El Salvador, but the goods are imported definitively to the single customs territory in a customs office located in Guatemala. A court order issued in El Salvador would not be applicable to stop the entry to the single customs territory.

TRADE PROTECTION

As noted, because this is single customs territory, exchanges of community goods are internal operations and not foreign trade, i.e. they are not imports/exports. One consequence of this is that the member countries of the customs union cannot apply trade protection measures among themselves, whether they be protection, antidumping measures or compensatory measures, to community goods made in their territories. The preceding is true because these mechanisms, in accordance with WTO regulations, are measures permitted for protection from imports from third countries, a characteristic that exchanges of community goods will no longer have. This is why these measures would only be available in the case of goods excluded from free circulation, since these operations will continue to be considered foreign trade operations.

Trade protection measures will still be able to be imposed on goods imported from third countries of the single customs territory, but some terms for their application have been modified, in particular with respect to domestic industry.[58] In consideration of the fact that it is a community territory, as a general rule,[59] domestic industry will be all the producers that operate in the single customs territory. For example, if a determined good is produced in Honduras and Guatemala, the producers of both countries would be understood to be part of the domestic industry, and it could be necessary sometimes for producers from both countries to agree to support the specified investigation.

FREE MOBILITY OF PEOPLE

Another important aspect included in the process of deep integration of the Northern Triangle countries is that while the primary focus is the creation of a customs union in their territories, Item No. One of the Enabling Protocol also includes the objective of "*achieving the free mobility of persons in their territories.*" In turn, free movement of persons is defined by the Customs Union Operating Regulations as "*the system that guarantees free mobility of persons in the single customs territory, which comply with the provisions of Article 4 of these Regulations*." This Article 4 makes a reference to Appendix 2, which contains the Procedures Manual for Immigration in the Single Customs Territory. This manual is the principal regulatory framework on this subject.

The manual primarily regulates three procedures. The first is applicable to drivers of goods covered in the FYDUCA who carry out their customs procedures in the CFC. The second is the procedure applicable to other persons, including tourists who carry out the procedure at the Integrated Control Center (CCI). In both cases, dual procedures are maintained, one for export from the first country and import to the other, although there are plans to establish a single immigration control in the medium term. The third procedure is the one that regulates the entry of persons into the

[58] In accordance with WTO regulations, in order to request an investigation for the application of trade protection measures, it is necessary to have the support of a substantial portion of the producers from the corresponding state, which is called the domestic industry.

[59] The WTO regulatory framework includes the possibility of only producers from one country requesting the investigation, when they sell all, or virtually all, of their production of the product involved in that market, and that market, the demand is not substantially covered by the producers of the good in question which are established in another location of the customs union.

single customs territory, i.e. the procedure applicable at peripheral customs offices for both their entry and exit.

In all cases, substantive law, i.e. the requirements that must be fulfilled in order to enter or exit the territory, are those established in the existing regulatory framework, whether on the regional level, as is the case of the Convention on Creation of the Single Central American Visa for Free Mobility of Foreigners between the Republics of El Salvador, Guatemala, Honduras and Nicaragua, or the requirements set forth in the domestic regulatory framework of each of the countries. Therefore, the purpose of the regulations contained in the manual is to facilitate the process with immigration officials.

Nevertheless, achieving the free movement of persons in the single customs territory according to the guidelines of the Enabling Protocol stated in its Fiftheenth Ordinal, i.e., free mobility, independent of their nationality, origin and destination among the territories composing the union, remains a true challenge for immigration officials of Guatemala and Honduras; and this will also be true for El Salvador.

INSTITUCIONAL FRAMEWORK

BORDER INFRASTRUCTURE ANALYSIS

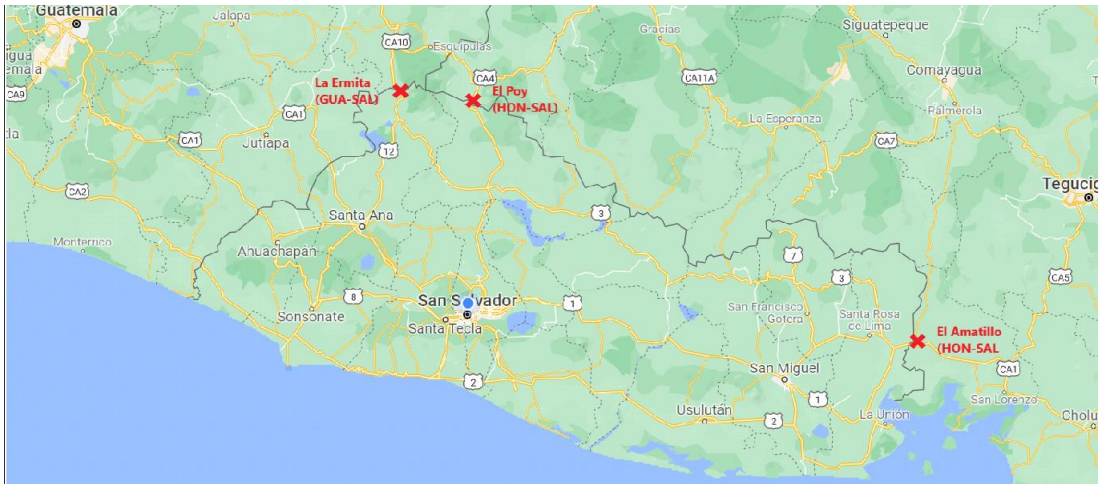
As addressed in this study, trade facilitation is a subject of recent international relevance, for various reasons.

This results from the fact that trade does not flow efficiently due to the impact of certain non-tariff factors. In Central America, the low tariff amounts charged between the countries demonstrate that the problem for goods entering is not tariff-related, but rather due primarily to non-tariff barriers, technical barriers to trade, sanitary and phytosanitary measures, added to extensive import and export procedures, the absence of border coordination, etc.

Developing countries, such as those in the Central American region, have the challenge of improving trade conditions in order to improve their competitiveness in the region and in trade globally. Under this reasoning, reduced time in trade-related processes and procedures, with the introduction of the *just in time* model and improvements in logistics becomes an important benefit for achieving this competitiveness, which also contributes to more efficient public services and the enhanced well-being of society.

Due to the proximity and cultural and commercial identification with Guatemala and Honduras, El Salvador must drive its full membership in the customs union with these countries, with a view to increase trade flows from its strategic production sectors with partners of the three countries, and with the rest of the world, making the Northern Triangle a more competitive region.

Graphic 5. Border Checkpoints Visited



Source: Google maps

Based on the history outlined and with the objective of an initial evaluation of the current border infrastructure situation and function of the customs offices that share a border with El Salvador, field visits were made to the El Poy and El Amatillo customs offices in Honduras and the La Ermita customs office on the border between Guatemala and El Salvador.

These visits were also conducted for the purpose of assessing the installed capacity and infrastructure of the customs facilities in order to handle new trade flows with inclusion of El Salvador in the customs union's operations, as well as identifying potential benefits and barriers that impact the transit of goods; and making recommendations on the location of CFC and CCI offices in those places, according to the operations model established by the union.

The work performed during the visits was possible thanks to interviews with the customs administrators of those countries to gather information and tours through the border installations.

Similarly, the customs clearance times (ETD) at these customs offices reviewed previously by USAID were considered for this analysis.

The main activities during the visits are as follows:

A) Interviews with customs administrators
B) Verification of goods loading flows under the current customs model
C) Identification of operational deficiencies, blockages or bottlenecks of freight transport units in the entrance of customs facilities
D) Gray infrastructure analysis to identify locations where the CFC and CCI can be placed
E) Human resources available with the current operations processes
F) Robustness of computer platforms, networks, telecommunications and support
G) Electrical systems and backup power supply
H) Verification of employee housing units
I) Confirm the existence of coordinated border management

The investigation yielded the following findings:

El Poy Customs Office (Honduras):

1. Exports, imports and traffic between Honduras and El Salvador move through this customs office.

2. Its hours of operation are 5:00 a.m. to 12:00 a.m., although due to the fact that the public service hours at other entities such as Immigration and Public Health are shorter than the customs office hours, the effective service time is reduced by at least two hours.

3. In terms of human resources, the customs office has 10 customs officials serving users, divided into five employees for each of the two daily work shifts.

4. Thursdays and Fridays are the days with the most congestion in the freight units, seeing up to 450 trade operations, the majority of which are customs traffic originating from the free trade zones of El Salvador with the destination of the Puerto Cortés customs office.

5. The stability of the computer systems is acceptable for information transmission. Two internet providers support the electronic operations.

6. SIECA's transmission system for the DUCA-T is also reported as stable.

7. Power outages are infrequent in the summer and very frequent in the winter, therefore the customs office has an electric generator that supports the customs office and the other institutions coming together at the border checkpoint during outages.

8. This customs office does not have housing units for its employees, so it is necessary to obtain private housing in the municipalities near the border area.

9. Some of the main causes of freight congestion at this checkpoint include:

    a. Limited road infrastructure both internally and in the areas surrounding the border checkpoint.

    b. Immigration and health checks for transport unit drivers interrupt the natural flow of freight through the customs office. Drivers must park their transport units in any space available in the border area to carry out their immigration and health checks in offices quite far from one another, obstructing the main roads of the border crossing.

    c. Importers process payments for taxes on goods until the transport units pull in to the border checkpoint, creating congestion outside the facility.

    d. There is no expedited immigration step between El Salvador and Honduras officials, so duplicate immigration controls are necessary for both the exit and entry of persons in both countries.

    e. The longest delays in freight occur on the weekends due to the shorter hours of operation for the customs agencies adjacent to the checkpoint.

    f. Team service to carry out physical inspections of goods is limited.

    g. There is no support from highway safety officials for traffic management around the customs office, which also causes freight units to park on the road rather than around the customs facility.

10. According to the customs clearance times (ETD) study by USAID for this border checkpoint, procedures for customs traffic can vary between two and three hours, and if an import is formalized at the checkpoint, this procedure will take between seven and 11 hours. These times do not take into account physical inspections of goods, that exceed these times.

11. There is no coordinated border management between officials coming together at the checkpoint, nor does this exist with their counterpart from El Salvador.

El Amatillo Customs Office (Honduras):

1. This customs office handles exports, imports and traffic between Honduras and El Salvador and the other countries of Central America.

2. It operates 24 hours per day, although Immigration and Public Health do not have the same hours as the customs office.

3. Tourism traffic is high at this checkpoint and handled separately with immigration controls for freight unit drivers.
4. In terms of human resources, the customs office has 26 customs officials serving users, divided into 13 employees for each of the two daily work shifts.

5. The most congestion occurs Thursday through Sunday, the majority of which is international customs traffic to the other countries of Central American

6. The stability of the computer systems is acceptable for information transmission. Two internet providers support the electronic operations.

7. SIECA's transmission system for the DUCA-T is also reported as stable.

8. FYDUCAS created between Guatemala and Honduras go through this checkpoint. However, their amount is not characteristic of the other trade operations handled daily.

9. Power outages are infrequent in the summer and somewhat frequent in the winter, therefore the customs office has an electric generator that supports the customs office and the other institutions coming together at the border checkpoint during outages.

10. Housing units are being built for employees at this customs office.

11. Some of the main causes of freight congestion at this customs office include:
    a. Limited road infrastructure both internally and in the areas surrounding the border checkpoint.

    b. Immigration and health checks for transport unit drivers interrupt the natural flow of freight through the customs office, blocking the main roads through this border checkpoint.

    c. Along the same lines, insufficient Immigration and Public Health personnel also creates a considerable delay in handling the exit of drivers from transport units, and therefore goods clearing customs.

    d. There is no expedited immigration step between El Salvador and Honduras officials, so duplicate immigration controls are necessary for both the exit and entry of persons in both countries.

e. The customs office infrastructure is minimal, limited to customs operations in container-type booths or units not properly designed to facilitate customs processing for drivers of freight units. However, the Honduran Customs Administration is making an effort to build new control booths, which will logically be installed at the entrance of the transport units. There are plans to increase staffing for this duty. Similarly, new offices are being built for officials doing checks in the area of physical capacity of the customs office, which will provide greater organization in its trade operations.

f. The longest delays in handling freight occur on weekends due to the limited hours of the customs agencies and banks around the checkpoint, since they work until noon on Saturdays and are not open on Sundays.

g. Public safety checks of freight units by the El Salvador National Civil Police are not random or coordinated with the other officials coming together at the border checkpoint, creating a glut transport means at the checkpoint installations.

h. Quarantine controls (National Agriculture Safety Service - SENASA) of goods are usually high, significantly delaying the exit of transport units.

i. Many freight units that arrive at the checkpoint carry out the tax payment process by the time they arrive at the checkpoint. Others arrive with incomplete documentation to begin clearing customs, so they park on public roads around the customs office and do not park on the adjoining private property due to the cost, creating congestion with the other units that arrive at the checkpoint with their customs documents completed.

12. According to the customs clearance times (ETD) study by USAID, the average time required to complete importation to Honduras from El Salvador, if the export operation resulted in "selectividad amarilla" (document review), is 20 hours and 44 minutes, while the red lane is 19 hours and 27 minutes and a green lane is 10 hours and 53 minutes.

13. There is minimal coordinated border management between officials from Honduras and El Salvador, with this coordination being limited to processing empty freight units, which is insufficient for the volume of trade handled at these customs offices and does not translate into more streamlined trade.

La Ermita Customs Office (Guatemala):

1. This checkpoint handles the largest portion of international customs traffic between Guatemala and El Salvador for goods whose origin and destination are Guatemalan Atlantic maritime ports; Puerto Barrios and Santo Tomás de Castilla in particular post a low volume of export and import procedures.

2. The greatest congestion at customs occurs Wednesday through Saturday.

3. It operates 24 hours per day, although Immigration (5 to 12 a.m.) and Public Health (7 a.m. to 3 p.m.) service hours are not the same as the customs office, which hinders full-service processing for users.

4. Twenty-three employees work at this customs office, and cover two daily shifts.

5. Tourist immigration flows are not separated from trade cargo, creating inconveniences for tourists, especially on weekends. Expedited Immigration has been implemented with El Salvador.

6. Power outages are frequent and supported by the customs office's electric generator, which also supports the other institutions coming together at the border checkpoint.

7. The stability of the computer systems is acceptable for information transmission, although a contingency plan had to be used in December 2021[60] due to failure of its computer systems.

8. SIECA's transmission system for the DUCA-T is also reported as stable, however, in December 2021, problems were reported with the SIECA platform because it was not answering back to the tax authority (SAT) computer system with all transit closures. This situation was resolved quickly.

9. Customs employees have housing units on the second floor of the customs facility. Employees of other institutions such as Immigration and Health rent rooms in areas neighboring the border.

10. There is some degree of border coordination with the El Salvador customs office, especially in the management of freight unit spaces to be fumigated by health officials.

11. Some of the main causes of freight congestion for this customs office are:

[60] It consists of the declaration processing manual, in order to permit the crossing of means of transport.

a. Limited road infrastructure in the areas surrounding the border checkpoint
b. Guatemala's immigration service for freight drivers is inconsistent, in addition to having to get out of the freight units for their check.
c. There is no support from highway safety officials for traffic management around the customs office, which also causes freight units to park on the road.
d. A large volume of traffic from Santo Tomás de Castilla or Puerto Barrios to El Salvador arrive for final importation (customs clearance) at Anguiatú customs office, producing congestion for freight at La Ermita customs office and its surrounding area while awaiting completion of these procedures.
e. A great deal of consolidated cargo from Atlantic ports does not enter La Ermita at the same time and has to wait at the customs office for all the units to arrive in order to begin customs processing of all the units.
f. Fumigation ordered by El Salvador officials is frequent, causing long wait times for freight units at the Guatemalan customs office.

12. According to the customs clearance times study by USAID for this border checkpoint, the average time required to complete exportation varies from 9 to 12 minutes and 5 to 7 minutes for transit with the destination of El Salvador. In the opposite direction, it takes an average of 3 hours and 8 minutes for customs transit from El Salvador and if said transit becomes an import in Guatemala, it may take between 4 and 7 hours, depending on whether the green or red (physical inspection) lane is determined.

CHANGES TO CROSS-BORDER CUSTOMS OFFICES OF THE CUSTOMS UNION

Initially, the customs union between Guatemala and Honduras agreed to create integrated border checkpoints (PFI) that replaced the cross-border customs offices between the two countries, now the Corinto, El Florido and Agua Caliente PFIs.

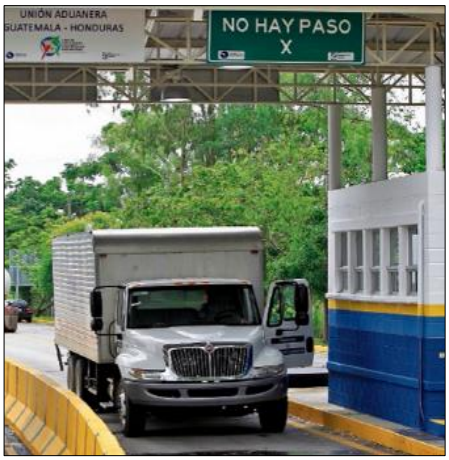
It is important to mention that, in accordance with Resolution No. 06-2016 of the ministerial body, the functional operation of these PFIs was moved to the border installations of Honduras, and this resolution granted legal authority to the Guatemalan employees who were transferred to perform their administrative duties in that location, and ordered that they have [appropriate] human and financial resources for their proper function.

Due to the preceding, the PFIs were modernized to perform freight operations, creating two service areas: a) the CFC, which gives preferential treatment to freight flows in free circulation and free community mobility, and b) the CCI, which handles goods excluded from free circulation.

According to the Customs Union Operating Regulations, the CFC is a place where integrated, simplified and modern procedures are carried out for the transit of people and community goods in free circulation and other operations set forth in that regulatory framework.

The following competitive advantages for trade with the installation of a PFI stand out:

a) Service for tax, customs, immigration, and quarantine operations at the same control point and coordinated to handle goods in free circulation, free mobility and transit in the community.
b) Tax, customs, and quarantine systems integrated for trade.
c) Streamlined service for goods processed with FYDUCA in free circulation, due to the fact that:
    - There is no selective customs process for these operations, but rather electronic validation only using a QR code to verify the payment of taxes (VAT and select others) at the destination.
    - Complete online processing and no intermediary customs agencies required.
    - Domestic taxes of the destination country are paid before the freight unit arrives at the CFC.



Corinto Facilitation Center, Honduras

The general procedure for handling an operation with free circulation follows:

1. Immigration control of the driver
2. If the goods are of concern for quarantine, approve the SPS Notification on the FYDUCA
3. Validation on the FYDUCA for proof of payment of taxes in the destination country.

As noted, the PFI also has a CCI, which according to the Customs Union Operating Regulations, is defined as the place where integrated control functions are carried out and simplified and modern

procedures are applied to persons, goods excluded from free circulation and other operations contained in the regulatory framework of the union.

Some of the benefits of having the CCI include:

a) Coordinated handling of customs operations related to goods excluded from free circulation.

Corinto Control Center, Honduras

b) Immigration controls of both countries at a single physical facility for tourism.

c) Joint checks of goods by customs and quarantine officials.

d) Handling of the Advance Declaration, pursuant to ministerial body [Resolution] No. 83-2020, accelerating the time for goods to clear customs.

e) Standardized work schedules for all officials through a resolution of the ministerial body.

f) The problem of vague or discretionary controls that occur every day at customs are reduced considerably at CCIs because the customs offices of both countries are located in the same office, making operations at the border more efficient.

g) The preceding promotes coordinated management of the border and ensures a streamlined flow of trade.

However, one detail that may contribute to increasing the added value of the PFIs is the implementation of new and appropriate signage, based on the new freight flows for trade and tourism under the customs union plan, with the following signs, for example:

Graphic 6. Recommended PFI signage

Source: Customs Union between Guatemala - Honduras

Finally, in accordance with Resolution No. 68-2019, El Salvador's full membership entails the incorporation of border customs offices that must be modified according to the Integrated Border Checkpoint model. These Salvadorean border customs offices follow:

Graphic 7. Integrated Border Checkpoint designated by El Salvador

Source: El Salvador Directorate General of Customs (DGA)

PERIPHERAL CUSTOMS OFFICES OF THE CUSTOMS UNION

In accordance with the Customs Union Operating Regulations, the peripheral customs office (AP) of the customs union is defined as the land, maritime or air control location authorized for entry or exit operations for goods whose origin or destination is a country in the union, where legal customs, taxes, immigration and sanitary and phytosanitary provisions of any of the states parties are enforced, understanding that the jurisdiction and competence of these officials shall be considered extended to those areas.

Before analyzing the infrastructure of the APs, it is important to put into context the different decisions that have been made in the customs union process, in terms of their designation and implementation.

First, in accordance with ministerial body Resolution No. 18-2017, 10 APs were designated for the customs union, 5 for each country, as follows:

Graphic 8. Peripheral Customs Offices for the Guatemala – Honduras Customs Union

In Guatemala	In Honduras
Puerto Barrios	Puerto Cortés
Tecún Umán II	La Mesa
Santo Tomás de Castilla	La Fraternidad
Puerto Quetzal	Guasaule
El Carmen	El Amatillo

Source: author

Then, the Ministerial Body, through Resolution No. 82-2020, amended Resolution No 18, to prioritize the implementation of the Puerto Cortés and Guasaule Peripheral Customs Offices in favor of Guatemala and Tecún Umán II for Honduran customs operations.

Graphic 9. Integrated Border Checkpoints and Peripheral Customs Offices for the Guatemala – Honduras Customs Union

Source: Guatemala – Honduras Customs Union White Paper

With the inclusion of El Salvador in the negotiations, it was agreed in Resolution No. 58-2019, that the peripheral customs offices located in El Salvador would be Puerto de Acajutla and Oscar Arnulfo Romero International Airport.

With respect to the operation of the peripheral customs offices, it is important to point out that the community legislation empowers officials, who due to their duties, transfer to work in a peripheral customs office of another country of the union, are sworn to enforce the legal provisions of their country in those peripheral facilities, by virtue of the fact that the jurisdiction and competence are considered extended to those locations.

Similarly, the regulatory framework empowers the customs agents of a country in the union to work in peripheral customs offices located in another country of the union, with no need to require being established in a given peripheral customs office in order to work.

Given that, customs agents who perform their duties in a peripheral customs office possess, in principle, the full legal authority granted by the CAUCA and RECAUCA to fulfill all the obligations and rights arising from their position such as: representation of their principal in customs operations, procedures and systems, in particular intervention, when concerning the following: physical inspection of goods, receiving notifications from customs officials about the actions of their principal, prior examination of goods, transfer, reloading, etc.

The general procedure for customs clearance when an importer decides to clear goods through customs from a peripheral customs office (known as free community mobility) would be the following:

Graphic 10. Customs Clearance Procedure at Peripheral Customs Offices

Source: author

Based on the procedure above, it is established that import taxes are received directly by the tax authority in the destination country (Step 3), doing away with the implementation of a system for reimbursement of customs tariffs or distribution of the same among the countries in the customs union.

It is also important to highlight that after the means of transport clears customs from a peripheral customs office, it has a maximum of 24 hours to cross through one of the peripheral customs offices to its destination country in the union.

Clearly, the main impact pursued with the operation of peripheral customs offices is that for goods clearing customs from these facilities (whether through the free community mobility system or community transit), they easily pass through the CFC during their arrival at peripheral customs offices, provided that said operations are already prechecked and sealed by the competent official from their departure in the peripheral customs offices. Therefore, the procedure to be carried out at the CFC of peripheral customs offices is limited to the driver's immigration form and electronic confirmation of the DUCA-D sent to the peripheral customs offices.

Notwithstanding the advantages noted, it has been confirmed that the experience implementing peripheral customs offices of the customs union between Guatemala and Honduras has been very timid, without the response anticipated, creating little impact on the effectiveness of the customs union.

Some of the reasons could be causing the low interest of the private sector in paying import taxes from a peripheral customs office may be the fact that this ability [to pay] is optional in the union. In addition, the difficult nature of having representation of customs agents at peripheral customs offices of the other country in the union or the presentation of SPS import permits raise the price of the operation and hinder its practical implementation. Affirming the preceding, there is limited staff at these peripheral facilities, and officials cite the high operations and economic cost that moving their employees to these locations in the other country, represents, all of which have been a barrier to their optimal function.

Puerto Santo Tomás de Castilla customs office visit (Guatemala):
In order to learn about the experience implementing peripheral customs offices and their importance with operations in El Salvador, a visit was made to Puerto de Santo Tomás de Castilla, in Guatemala, which could be considered a future peripheral customs office.

Some important aspects gathered during the visit concerning the function of this facility follow:

a) Large quantities of goods are handled through this customs office such as vehicles, family packages, used clothing, tools, agricultural supplies, etc. Most of the customs regimes used are exportation, importation and international customs transit.

b) The operations area has a 24-hour schedule, while administrative staff work from 8 a.m. to 10 p.m.

c) Customs, public safety and sanitary officials carry out integrated risk management of goods.

d) According to the customs office quality standards, the customs clearance times permitted for imports should not exceed 46 hours.

e) As a reference for the importance that these customs offices represent to El Salvador, customs officials reported that during the month of December 2021, 100% of the international customs transit was handled from this location, and El Salvador was the destination for 92%, entering through the La Ermita-Anguiatú border crossing.

f) Finally, as for experience operating as the peripheral customs office with the Republic of Honduras, it was reported that although this customs office was considered a peripheral customs office of the customs union from the beginning, in 2017, with international cooperation and support, adaptations were made to the workspaces in order receive officials from Honduras. However, the transfer of these officials did not materialize so this location does not have experience in peripheral operations.

ANALYSIS OF GOODS IN FREE CIRCULATION

Exporter and especially importer companies currently delay their trade processes due to preparation of customs documents, contracting approved drivers and customs agents, presentation of documents at the border, the time for customs clearance by officials including the levels of physical inspection of goods by both customs and other government bodies, in particular inspections of

phytosanitary and zoo sanitary products, resulting in longer processing times, which increase the cost of trade operations.

Similarly, land transport of goods represents another one of the main drawbacks in terms of the cost of exportation in Central America and the lack of competition in that sector in the region results in the higher prices of goods or lower quality of the service provided.

Upon arrival at the borders, business people are faced with a limited border infrastructure with no or minimal coordinated management between officials, and slow and discretionary procedures with user wait times that are not coordinated, often due to insufficient staff to handle the volume of processes building up in these locations.

Similarly, the time taken to review customs declarations and their support documents such as commercial invoices, consignment notes, cargo manifests, licenses or permits required for non-tariff regulations (for example, food and beverages, products of plant or animal original, hazardous substances, drugs or narcotics, etc.), the customs declaration of value, certificates of origin, proof of fumigation, writs of payment etc., slow trade operations even further and increase costs for companies. Added to that, the lack of promotion of advance customs clearance and uncertainty with respect to the payment of taxes in the destination country create major delays in trade.

In this context of border bureaucracy, the procedures introduced by the customs union for goods in free circulation are shaping up to be a valuable opportunity to facilitate trade in the region.

In keeping with the preceding, per Customs Union Operating Regulations, all goods enjoy free circulation, with the exception of those excluded by the ministerial body from receiving this benefit. Consequently, if a businessperson wants to know whether their goods qualify for the free circulation regime, they must check in advance whether this product is on the list of excluded goods (see the section following the analysis of good excluded from free circulation).

To facilitate import and export operations, SIECA has a web site that contains the Online Community Platform (PIC) at: https://www.ua.sieca.int/PIC, where basic information for new users of the customs union can be found and it is possible to identify whether a good is subject to free circulation by accessing products lists.

One of the main operational effects goods enjoy as a result of free circulation is that they are no longer subject to traditional customs controls, but rather verified by the internal tax authorities of the countries of the customs union; and instead of being covered by DUCA, they are documented through the FYDUCA, which is the document that constitutes the invoice supporting transfer and purchase operations of movable property or the provision of services by businesspeople in the union, and it is also the declaration for the purpose of withholding or payment of the taxes in the destination country.

As noted, the provisions governing the FYDUCA are based primarily on the Convention on the Reconciliation of Domestic Taxes applicable to Trade between the States Parties of the Central American Customs Union (CCTI), the Customs Union Operating Regulations (Resolution No. 90-

2021) and the administrative act of the ministerial body approving the format of the FYDUCA (Resolution No. 11-2017).

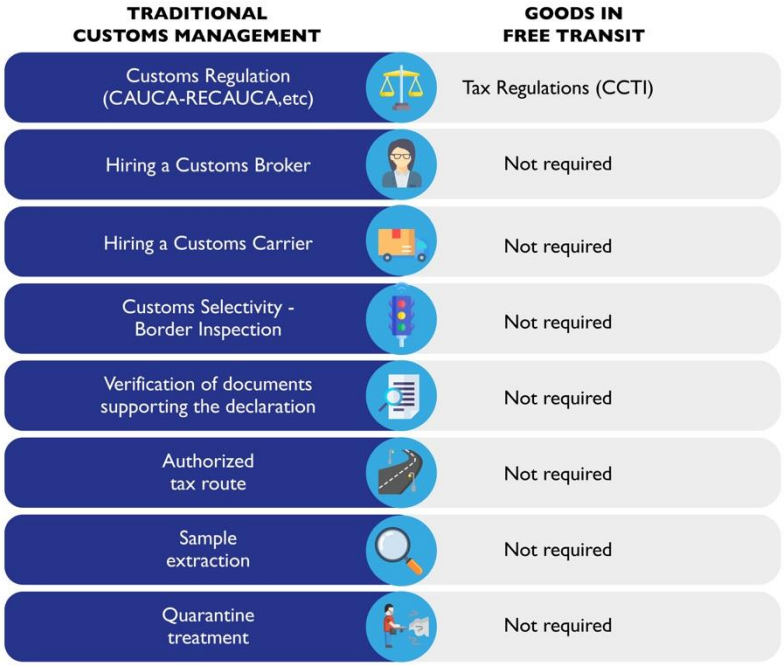
On the other hand, for goods that enjoy free circulation and are of quarantine concern, it is no longer necessary to process the sanitary, phytosanitary and agricultural supply certificates used in traditional exports. Likewise, licenses, certificates or approvals that have been used to validate importations have been replaced by the electronic permit known as "SPS Notification," the cost of which for regulated services is determined by the legislation of each country in the union.

To learn whether goods in free circulation require an SPS Notification, see the aforementioned PIC. Then when goods require SPS Notification, taxpayers must go to the SPS Notification System portal at https://www.ua.sieca.int/NotificacionesMSF.

The procedure for transferring goods from one country to another in the customs union begins when the transferring taxpayer enters their country's virtual tax office to begin the process of completing the FYDUCA, which is free of charge to the transferor or purchaser of the goods and replaces the procedure of using the Single Windows for Foreign Trade platform to generate an export DUCA-F if the goods originate in the region or the need to hire a customs agent to process a DUCA-D if they are not from the region, eliminating in all cases the costs that they procedures entail under a scheme with no customs union.

A basic comparison of goods subject to traditional customs processing and those with free circulation follows:

Graphic 11. Traditional Customs Process vs. Free Circulation



Source: author

As a reference and according to the information provided by the Guatemalan private sector, the average time required for a transferor to process a FYDUCA with the destination of Honduras is 10 minutes and 30 seconds, based on the steps below:

Another item that can promote trade through the FYDUCA consists of there being, at the time the goods are transferred to the other country in the union, free contracting for the transport, i.e. the taxpayer is not required to contract a transport company approved by the customs service, and contracting a transport company of Central American origin, and not only countries that are part of the union, is allowed.

Upon arrival of goods in free circulation at a PFI, while the border infrastructure remains limited, the customs union has an easy pass lane in the CFC for these operations, which is where coordinated processing of immigration forms and electronic validation of the payment of taxes on the FYDUCA take place.

Table 43. Average FYDUCA Issue Time in Guatemala

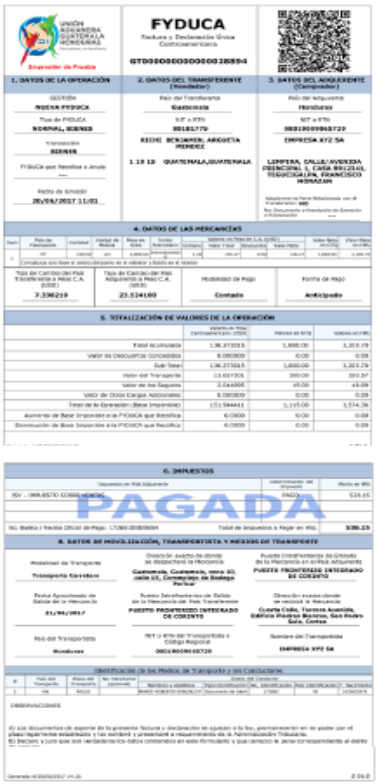
Step	Activity	Average Time
1	Time required to access the virtual tax administration agency	00:00:30
2	Time to access the FYDUCA system	00:00:55
3	Time to complete a normal FYDUCA online	00:07:30
4	Time required by the tax administration to validate the information and confirm the FYDUCA	00:00:35
5	Printing the FYDUCA issued to initiate transit to Honduras	00:01:00
	Total time:	**00:10:30**

Source: Created by the author using data from the Guatemalan Food Manufacturers' Association (CGA).

Under the current model, the immigration form is handled by both the authority in both the departure and arrival country of the union, a situation that can be improved with El Salvador's full entry [in the union] as a result of the immigration fast pass implemented between Guatemala and El Salvador. In addition, immigration processing provides the advantage that drivers can be prechecked by officials from the time in which the FYDUCA is completed by the goods transferor.

In terms of control of the FYDUCA, the tax authority of the import country of the goods only performs electronic validation to ensure payment of its domestic taxes, after which, no additional control is conducted at the border, approving dispatch of the goods to the company in the

Graphic 12. FYDUCA



purchasing country. These procedures have been demonstrated to be very streamlined and predictable, preventing discretionary actions by employees on the borders.

As shown, the implementation of goods in free circulation resolves the issues persisting in customs operations involving failure to pay taxes in the destination country, due to the fact that the regulatory framework of the union establishes that prior to the arrival of goods at the CFC, the taxes on goods covered by the FYDUCA must be duly paid, or be subject to the applicable tax penalties.

Similarly, the customs clearance time of goods includes physical inspection of the goods if the customs risk management system indicates physical inspection of the goods. Added to this, in traditional customs processes, phytosanitary and zoo sanitary officials also carry out their physical inspection procedures, which include quarantine procedures. In contrast, goods in free circulation do not require physical inspection at the border.

Likewise, the time officials usually take to review documents accompanying the declaration has been substantially reduced by having goods in free circulation. However, this does not mean that these documents should not be processed prior to the transfer of the goods, as they may be required at any time after the goods leave the CFC.

Visit to the Corinto Integrated Border Checkpoint (Guatemala - Honduras):
In order to establish the benefits of free circulation, we visited the Corinto PFI between Guatemala and Honduras, and included an exercise to measure the customs clearance times for goods at the CFC, which, in turn became a baseline scenario to be considered in the full incorporation of El Salvador in the customs union.

Some aspects relevant to the operation of this PFI, which must be taken into account in the full incorporation of El Salvador follow:

1. According to ministerial body Resolution No. 06-2016, this installation was designated an integrated border checkpoint of the customs union between Guatemala and Honduras, enabling officials from Guatemala to transfer for joint work with Honduras in the same physical installations, for one-stop trade between the two countries.

2. Based on the customs union model implemented, Corinto has CFC offices where goods in free circulation, community transit and free community mobility are handled, and a CCI that handles operations with goods excluded from free circulation, official FYDUCAs and tourism in general.

Graphic 13. Corinto Integrated Border Checkpoint

Source: Google Maps and Guatemala – Honduras Customs Union White Paper.

3. According to the operating procedures approved in Resolution No. 90-2021, the work model in place in this checkpoint is coordinated border management.

4. The work schedules for the institutions at this checkpoint varied, as in the other border checkpoints, but they were standardized beginning in January 2022, and are Monday through Sunday, 5 a.m. to 10 p.m. for all operations related to the crossing of goods, empty means of transport and tourism. This resolves the lack of coordinated user service and further streamlines the flow of trade.

5. The days with the most congestion at this PFI are Wednesday, Thursday and Friday, with 300 to 400 operations handled weekly.

6. No connectivity problems were reported at this location and there are redundancies in place.

7. Employees of all the institutions and from both countries in the union have assigned housing units duly equipped with a dining area, kitchen, meeting rooms, etc. located inside the physical facility, all of which were financed by the Customs Union Investment and Structural Fund.

8. Other Structural Fund investments at Corinto include the purchase of two power generators, drinking water service connection, payment of maintenance services, and other infrastructure improvement projects at the site.

9. However, some opportunities for improvement of this checkpoint were identified during the visit:

a) Limited road infrastructure in the areas surrounding the border checkpoint (one outbound and one return lane), resulting in congestion for means of transport on both sides of the PFI.[61]

b) No separate lanes for tourism and trade operations at the PFI entries.

c) Lack of customs and private property for parking [transport] units, which creates congestion around the border checkpoint, and would free up the main entrances.

d) There is no support from highway safety officials around the facility to give priority to operations involving free circulation and perishables.

e) An Immigration Fast Pass between Guatemala and Honduras has not been implemented, resulting in duplicate immigration controls for both tourism and freight transport.

f) Limited human resources for customs and immigration operations in the different work areas of the checkpoint. However, the Guatemalan Tax Administration (SAT) is making up for this deficiency at the CFC by using the same employee to handle fast pass customs as well as free circulation operations.

g) The Honduran Agency of Sanitary Regulation operates on a restricted schedule compared to the other border checkpoint authorities, causing delays in the handling of some trade operations.

h) The Guatemalan and Honduran selective customs process criteria are not yet standardized.

i) Limited infrastructure for quarantine processing, especially during peak work times.

j) Limited number of a posteriori controls for goods in free circulation that go through this checkpoint.

In terms of the customs clearance times for goods in free circulation covered by FYDUCA at the CFC, a sample of approximately 40 operations was made (in a two-hour period, in both directions at the border), and an average of 2.46 minutes per operation was obtained, including the immigration form and verification of the FYDUCA.

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[61] It was established that it takes a means of transport with FYDUCA approximately four hours to go through the PFI, from the time it arrives at the end of the line (on the Guatemala side), until it leaves the CFC.

This time could be reduced even further if the Immigration Fast Pass between Guatemala and Honduras were implemented, as drivers of means of transport would only need to have one immigration form. It should be noted that the time currently is a bit longer than average when driver immigration processing is handled using a passport instead of the unique identification document.

Table 44. Customs Clearance Times of FYDUCAs at the Corinto CFC

Step	Activity	Average Time
1	Immigration control for transport unit driver	00:02:05
2	Verification of the payment of domestic taxes made in the destination country of the union	00:00:41
	Total time	**00:02:46**

Source: Author.

However, as covered in commerce, the time that the means of transport is in line before entering the PFI time must be added to the CFC time, which according to the measurements at the visit, is currently four hours. Accordingly, the total time estimated to go through the Corinto PFI is 3 hours, 2 minutes and 46 seconds. In any case, between 2016 and January 2022, the time was reduced from 21 hours and 50 minutes, therefore the increased efficiency is more than noteworthy.

Major reductions could be obtained compared to the current times with El Salvador's incorporation in the customs union, assuming the border crossing time achieves the same level as at the Corinto PFI.

It is important to note that the fact that goods in free circulation are not subject to checks at the border does not mean that the customs union is devoid of controls since the regulatory framework establishes the authority for competent officials to fight behavior that causes any harm to the tax authority, and they may conduct highway operations and warehouse checks for transferors and buyers of goods covered by the FYDUCA. In this case, responsibility is transferred from the customs offices to the domestic tax administration.

Table 45. Anticipated Impact of the Customs Union on Border Crossing Times from El Salvador

Border	Border crossing time			Border crossing time at Corinto	Reduction (%)
	Queue	Clearance	Total		
El Amatillo	12:00:00	09:02:00	21:02:00	03:02:46	-85.5
El Poy	09:00:00	09:13:30	18:13:30	03:02:46	-83.3
Angiatú - La Ermita	09:00:00	02:25:00	11:25:00	03:02:46	-73.3

Source: Own elaboration based on TFB data

Finally, Table 46 presents a comparison of the main aspects that increase the operating costs of goods in regional trade based on their treatment *with and without* a customs union, which highlights

improvements in cost and efficiency that exporters and importers operating in the customs union receive.

Table 46. Summary of Benefits of Free Circulation in the Customs Union

Aspects that increase the cost of goods in regional trade		Without Customs Union		With Customs Union	
		Yes	No	Yes	No
Associated to cost in money	Hiring of a customs broker	x			x
	Hiring of an authorized transport company	x			x
	Authorization rights to transmit an export declaration	x			x
	Payment for non-tax licenses	x			x
	Payment of import taxes	x		x	
	Payment of transportation freight	x*		x**	
Associated to cost in time	Inscription of exporters and importers registries	x		x	
	Obligatory pre-arrival processing	x			x
	Establishment and use of common services at borders		x	x	
	Single stop for goods control		x	x	
	Integrated border management		x	x	
	Equal customers service hours		x	x	
	Pre-checked goods in peripheral customs		x	x	
	Pre-checked drivers in FYDUCA		x	x	
	Exclusive line for goods that have free transit		x	x	
	Obligatory payment of taxes in the country of destiny		x	x	
	Electronic generation of MSF notifications		x	x	
	Taxes administrations interconnected on line		x	x	
	Physical inspection at borders	x			x
	Verification of attached documents in the declaration	x			x

* Payment of ICD and VAT if is not originary from the region

** Just payment of VAT no matter the origin

ANALYSIS OF GOODS EXCLUDED FROM FREE CIRCULATION

The categories and lists of goods excluded from free circulation have been developed sufficiently in this report so the analysis in this section will be limited to unusual aspects of the treatment these types of products receive.

In practical terms, to determine whether goods are excluded or in free circulation, check the online list at: https://www.ua.sieca.int/PIC.

As we have seen previously, goods not subject to free circulation in the customs union cannot use the preferred treatment arising from use of the FYDUCA, and consequently must continue to be

sold under the DUCA in a traditional scheme. As a result, when moving through the PFIs, they must be handled at the CCI office where community customs and customs-related controls are carried out, i.e. as if there were no customs union.

Other scenarios requiring use of the DUCA, with goods therefore excluded from free circulation follow:

a) Operations of goods originating [in the union] that are carried out from or to countries in the customs union with other countries in the Secretariat for Central American Economic Integration (SIECA).

b) Operations of goods originating [in the union] that are invoiced by an economic agent established in a third country (invoicing of third parties) and

c) In trade operations, goods originating from a country in the union that cross through a third country in the SIEC, which is not part of the customs union.

As a result, these goods continue to use the customs export, import and international goods transit rules, as well as other routine procedures such as advance inspection of goods, transshipment, reloading, traveler baggage and quarantine treatment, which applicable.

Nevertheless, while the implementation of the customs union does not have a direct impact on goods excluded from free circulation, it has driven improvement in the controls by officials of this type of goods, establishing for these purposes coordinated border management, in which benefits such as the following have been achieved:

a) Officials performing their duties physically at a border checkpoint, sharing facilities and serving users through integrated windows, which ensure a single stop for goods control.
b) Better controls over the physical inspection of goods because they are performed jointly by employees from countries in the union that share a common border.
c) Standardized public service schedules for all PFI officials.
d) Greater efficiency in controls related to customs transit.

ANALYSIS OF IT DEVELOPMENTS

Transborder commercial transactions involve multiple procedures that businesspeople must carry out, and each of these procedures involves presentation, analysis, processing and preparation of information related to their goods clearing customs. This is why communication and information technology (CIT) is presented as a necessity in order to automate processes and obtain higher levels of trade facilitation, which requires improving the information systems of officials for optimal flow of the presentation, analysis and processing of information.

El Salvador's full incorporation in the customs union gives rise to the need for government officials to modernize the function of their information systems so that they are compatible with automatic operations and new flows of trade and people between Guatemala and Honduras.
Due to the preceding, some important IT aspects that El Salvador should consider for its effective membership in the customs union follow:

For processing the FYDUCA, the tax authority should develop IT systems to interface with the online community platform (PIC) administered by SIECA so that it can do the following, among other activities:

1. Create forms, print, complete and change the information entered, save and update information, do large information downloads, confirm, correct and cancel FYDUCAs that were created, calculate taxes, report arrivals of goods in warehouses, etc.
2. Interface with the platforms of quarantine officials in the case of SPS notification.
3. Interface with the platforms of immigration officials for online pre-checks of drivers of goods in free circulation.
4. Interface with banking platforms for VAT payments.
5. FYDUCA payment notification when El Salvador functions as a transit or destination country of the union.
6. FYDUCA transmission and receive tests between the Northern Triangle countries.

Similarly, the sanitary and phytosanitary officials that will work in the operations models of the customs union should confirm the optimal IT function in order to permit the request, approval and confirmation of SPS notifications on the FYDUCA, in goods classified as sent (SPS) and goods (SPS), for both the transfer and purchase of goods with free circulation. Similarly, IT tests should be modified for efficient operation of the sanitary and phytosanitary warning.

The electronic function for bank payments of charges of shipments (SPS) and goods (SPS) on the FYDUCA should also be tested. Additionally, electronic notification of the Sanitary Warning interfacing with the PIC to Integrated Border Checkpoints must be confirmed; and electronic transmission of quarantine importation permits with the customs officials at goods importation in peripheral customs offices of the customs union should be successfully tested in El Salvador.

On the other hand, the El Salvador **Customs Service** should be prepared for its online interface in the border-crossing point control unit at the CFCs for border crossing clearance of the transit of goods covered under the Community Transit Declaration. Similarly, the computerized border-crossing point control should interface with customs to permit free community mobility, which

entails export authorization and online confirmation of the payment of DUCA-D import taxes from peripheral customs offices. Finally, per the work models approved by the ministerial body, connectivity at new PFIs should be checked, especially if they are allocated from the Guatemalan or Honduran side.

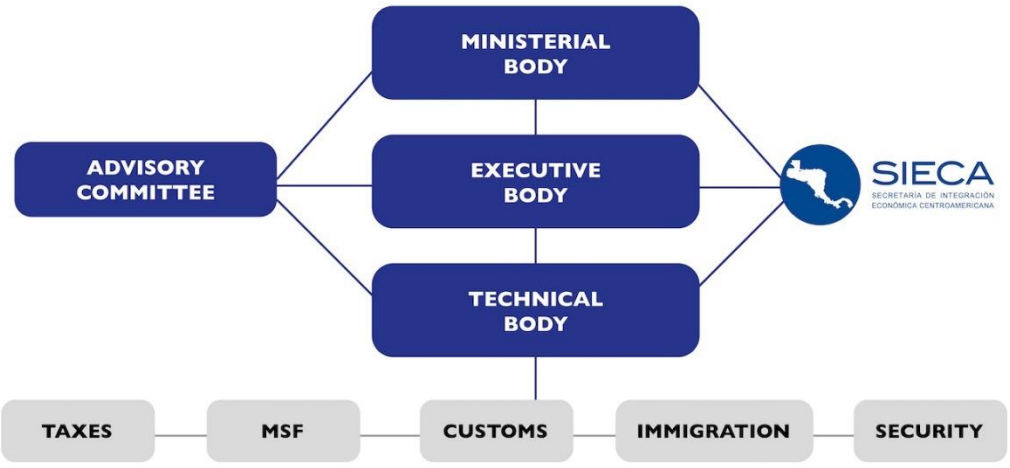
With respect to **immigration**, an Immigration Fast Pass has been suggested, so that officials from El Salvador and Honduras can perform a single immigration procedure, transmitting in real time the immigration form made in the person's departure country to the arrival country, which requires the interface of their computer systems and eliminates the (current) duplicate immigration controls for both drivers of transport units and for tourism in general, the reducing times and costs in the immigration processes of the customs union.

As a corollary of the above, prior to the effective start of El Salvador in the customs union, SIECA must be prepared to ensure that the PIC can efficiently perform all the computerized transactions arising from the incorporation of a new country in the union's bill of fare, especially and as we have seen, in the online transmission of the FYDUCA, SPS notification, Community Transit Declaration, declarations paid at peripheral customs offices, etc. This is why work activities must be scheduled together, such as finalizing software development and computer tests, updates, rollouts and generally all improvements to ensure the successful incorporation of the new member in the customs union.

ANALYSIS OF THE INSTITUTIONAL FRAMEWORK OF THE CUSTOMS UNION

The implementation of the customs union between Guatemala, Honduras and the upcoming full incorporation of El Salvador, involves the creation of a new community institutional framework, with the follow principal entities:

Graphic 14. Organizational Structure of the Guatemala – Honduras – El Salvador Customs Union



Source: Author

Ministerial Body:
In accordance with the Enabling Protocol, the ministerial body of the customs union is composed of the Minister of Economy of Guatemala and the Minister of Economic Development of the Republic of Honduras (Item No. Three) and, after the Accession Protocol signature as of June 2018, by the Ministry of Economy of El Salvador. The main function of this body is to define and adopt the general policies, guidelines, and essential legal instruments of the customs union.

To achieve this purpose, the ministerial body is empowered to issue and adopt the acts with legal effect governed by Article 55 of the Guatemala Protocol, being: resolutions, regulations, agreements, etc. These acts must be limited to those specified in the applicable "Framework Agreement on the Establishment of the Central American Customs Union," among other legal texts in the region.

And like COMIECO in the Central American region, the Ministerial Body will support the sectoral ministerial bodies set forth for all relevant purposes in Article 41 of the Guatemala Protocol (Item No. Four) in the administration of the customs union.

It is noteworthy that the decisions of the Ministerial Instance are adopted by consensus, however, this does not prevent the adoption of unilateral decisions by any of the countries, but they will only be binding in said country.

It should be noted that the framework for the customs union, an annex to the Enabling Protocol, establishes the creation of other bodies subordinate to the ministerial body, such as the executive body and the technical body of the customs union.

Advisory Committee:
Pursuant to customs union legislation, the customs union advisory committee was established as a permanent entity in the customs union process composed by the organized private sector[62] of the countries forming the union (Item No. Five of the Enabling Protocol and Article 14 of the Regulatory Framework of the Ministerial Body).

The committee's function is advisory and will be based for all relevant purposes on the provisions of Article 49 of the Guatemala Protocol (Article 3 of the Advisory Committee Regulations).

In accordance with Article 6 of the committee regulations, its primary functions are:

a) Examine and give a legal opinion on questions presented by the ministerial body of the customs union.
b) Act on its own initiative to issue opinion on subjects related to the implementation, administration, and function of the customs union or those that could affect its function.
c) Make recommendations concerning the customs union, with the objective of driving integration.

[62] The advisory committee is currently composed of representatives of the Agricultural, Trade, Industrial and Financial Associations Coordination Committee (CACIF), the Honduran Private Enterprise Council (COHEP) and the El Salvador National Association of Private Enterprise (ANEP).

d) Promote conciliation of interests among the different sectors of the single customs territory to strengthen and develop the union.

It is important to highlight the role the committee plays in establishing regulatory proposals that contribute to strengthening trade in the customs unions, due to the fact that before the ministerial body approves any trade-related regulation, it must share the proposal with the advisory committee for its prior analysis and observations. It has 30 calendar days to issue its observations (Articles 21 and 22 of the Committee Regulations).

SIECA:

According to the Regulatory Framework of the Ministerial Body, (Article 13) SIECA is the body that provides technical support for the implementation process, administration, and development of the customs union, in all its bodies.

For those purposes, SIECA performs the following functions, among others:

a) Oversees the correct implementation of commitments obtained by the countries forming the customs union.
b) Establishes technical proposals and studies that it sends to the ministerial body and other forums of the union.
c) Manages the Customs Union Structure and Investment Fund.
d) Serves as the technical advising and support body during the process of a third party joining the customs union.

Peripheral customs office and PFI Coordinator:

Resolution No. 30-2017 established the regulatory framework of the customs union's integrated border checkpoints, which contains the principal responsibilities of the integrated border checkpoint coordinator.

In accordance with Article 6 of the regulations, its main functions include:

a) Coordination with all competent officials the operation and support for proper operation of the PFIs.
b) Convene and preside over work meetings to ensure the proper operation of the checkpoint.
c) Propose to superiors in the customs union improvement projects, among other items, for the optimal operation of the checkpoint.

The operating model in the customs union establishes a coordinator for each PFI, i.e. one for Corinto, another for El Florido and yet another for Agua Caliente, not including, to date, the legal role of the coordinator, which oversees the operation of the peripheral customs offices, as established in Item No. Six of the Enabling Protocol of the Customs Union.

Customs Union Structure and Investment Fund:

The member states of the customs union agreed to create a structure and investment fund based on Article 24 of the Framework Agreement on the Establishment of the Customs Union (Item No. Ten of the Enabling Protocol), the purpose of which is to contribute to the sustainable development of the states parties of the custom union to capitalize on the benefits that this union confers, by

funding projects and programs that impact the customs union (Articles 3 and 4 of the Customs Union Structure and Investment Fund Regulations).

In addition, the commitment was established for each member state of the union to contribute five million U.S. dollars to be deposited in the fund, and the annual budget of each country must include the contributions that they will make to the fund in subsequent years (Article 5 of the Customs Union Structure and Investment Fund Regulations).

This fund has been vital to the customs union between Guatemala y Honduras because it has fulfilled the basic needs of the operations, primarily at the PFIs of both countries, helping to create a work environment that is favorable to the employees in these locations who work hard every day by building housing units, checkpoint maintenance services (water, internet, telecommunications) and technical supplies to perform their duties, etc. Without this contribution, it would have been difficult to implement the integration of both countries in the union.

With the full incorporation of El Salvador, it is anticipated that there will be more resources in the structure fund for all the activities to advance and develop the customs union between the three countries.

SECTORS IMPACTED BY THE CUSTOMS UNION

The implementation of new processes in the trade of the countries in the customs union inevitably introduces changes in the manner in which goods have been traded in the region for over 60 years. Clearly, these changes bring benefits for some and encumbrances for others; and provided the benefits affect most parties, the changes can be described as positive.

By virtue of that fact, the sectors negatively impacted can be identified as those involved in the goods supply chain.

The first sector is made up of the various players that currently benefit from the excessive bureaucracy or red tape required to move goods from one country to another. Affected parties can be identified both in the export (currently transfer) and import (currently purchase) process, as follows:

a) Exportation: single window for the DUCA-F, customs agent for the DUCA-D, approved carrier, crew companies, customs broker

b) Importation: customs agent (DUCA-F or DUCA-D), approved carrier, crew companies, customs broker.

On the other hand, in the customs union environment, the online tax agency makes it possible to generate a FYDUCA free of charge and replaces the Single Window for Foreign Trade online platform that exporters use to process an export DUCA-F, which comes with a cost for authorization and fees to transmit the declaration, which will no longer be paid. Similarly, it will no longer be necessary with the FYDUCA to contract a customs agent to process an export DUCA-D.

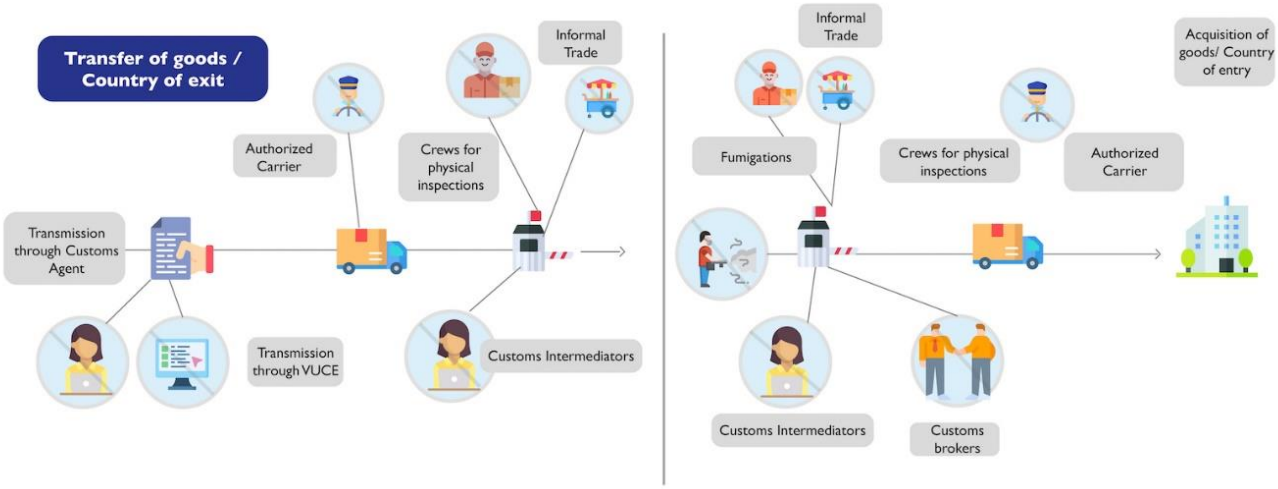
Due to free contracting of the transport of goods with free circulation, transferors will no longer be required to use an approved customs carrier, and they may move goods to the other country in the union using pilots or drivers from the transferor company.

Along the same lines, when the transport unit arrives with at a PFI with the FYDUCA, it is not necessary to carry out any procedures at the border, so broker services are not required.

During traditional customs processing, there is a possibility of physical inspection of the goods at the border, and it is necessary in these cases to use crews that aid businesspeople in handling goods subject to customs inspection. With the implementation of the FYDUCA, it is no longer necessary to contract this type of service since physical inspection of the goods at the border is no longer possible.

Similarly, in the purchase of goods with free circulation, the destination country is eliminated from the processing of the import DUCA-D or DUCA-F, as applicable, and therefore, it is no longer necessary to contract a customs agent or broker. The same applies to approved customs carriers, which can absolutely be replaced by transport unit drivers of the company transferring or purchasing the goods, as applicable. Companies that provide the crew service for physical inspections of goods are also not used in these cases.

Graphic 15. Parties affected by trade facilitation in the customs union



Informal trade is also affected by streamlined trade and the elimination of procedures and actors at the border since it loses customers that were reliable previously due to the excessive delays and bureaucracy in the management of customs clearance at the borders.

In some measure, the customs offices also lose the power to control trade and charge fees for providing non-intrusive inspection services, advance inspection of goods, advance opinions and physical inspections, among other things. However, from the perspective of a unified region, these costs compensate for the heavier flow of trade, which results in more economic growth.

SUMMARY OF THE DETERMINED IMPACT

The incorporation of El Salvador in the customs union process, which is already underway between Guatemala and Honduras, involves a series of effects on the Salvadorean economy, most of which are positive. The analysis performed shows that, if the country is incorporated in the union, trade, investment, economic growth, tax collection, employment and poverty will receive a substantial boost, making it possible for El Salvador to be the country benefitting most from the customs union. In this context, Salvadorean countries, in addition to those from Guatemala and Honduras, will see gains in efficiency (time and cost), which in turn, will become the means to achieve greater productivity, and with this, be more competitive on the regional and global markets.

This is a summary of the impact determined in the analysis, beginning with the immediate quantitative results (Table 47), where improvements in macroeconomic, tax and socioeconomic variables stand out, in addition to gains in efficiency to be achieved due to improvements in border crossing times, as well as production chains, which will be strengthened when deep integration is established. It should be emphasized that some sectors are negatively affected, mainly small and medium enterprise located in border territories since this economic activity has survived due to inefficiencies in the system, which will cease to exist with the implementation of trade facilitation measures. In this case, reinvestment should be made in this production sector for its continued participation in economic activity.

Table 47. Customs Union - Summary of Impact for El Salvador

Impact	Result/Effect	Annual value
Immediate cuantitative impacts:		
Effect on economic growth	Positive	0.3% - 0.8%
Effect on economic growth if El Salvador does not join Customs Union	Negative	-0.20%
Effect on exports	Positive	2.1% - 3.3%
Effect on imports	Positive	0.9% - 1.8%
Effect on investment	Positive	2.1% of GDP
Effect on job creation	Positive	6,464 jobs
Effect on poverty	Positive	-1.40%
Effect on tax collection	Positive	0.04% of GDP
Effect on time and cost reduction in border crossing	Positive: time will be reduced	-80%
Cualitative impacts:		
Effect on time and cost reduction in procedures and other trade related activities	Positive: integrated service and efficiency and quality improvement	
Impact and identification of national, regional and international production chain	Positive: El Salvador with a high potential of production chain sectors that are strategic and key	

Impact	Result/Effect	Annual value
Impact on logistic chain and other trade services	Positive: efficiency improvement on integrated border points	
Effects on no harmonized products in the Customs Union	Positive: efficiency improvement on integrated border points	
Effects on no harmonized products to trade of third countries	Positive: efficiency improvement on integrated border points	
Impact on trade sectors for unfair trade in El Salvador: including triangulations	Potentially negative: smuggling	
Impact on the services provided in border zones: small, informal businesses	Negative: decrease of demand of services in border zone	

Next, Table 48 presents an analysis of the regulatory and institutional frameworks of the customs union. The most important aspect here is to show the context that El Salvador faces, its capabilities and the risks and challenges to be addressed in order to achieve full incorporation in the customs union and capitalize on the anticipated benefits.

Table 48. Analysis of the Strengths, Weaknesses and Risks of the Regulatory and Institutional Frameworks

Description	Strengths	Weaknesses	Risks
Regulatory Framework of the Customs Union	It is based the scenario in which deep integration will be gradual. It establishes its own institutional framework with supranational characteristics, making it possible to adopt decisions for immediate enforcement. It establishes flexibility so that sensitive subjects do not slow down the overall progress of the process. It establishes a customs union for most products, which enables free circulation and free mobility in internal borders with tangible benefits.	The CU is part of the Central American Economic Integration Subsystem. As a result, decisions on certain subjects require the consensus of 6 countries, although they only apply to the CU countries.	Given that El Salvador is joining the already-advanced process, consensus from Guatemala and Honduras will be required in order to change matters of interest.
Exclusions from free circulation	Many grounds for the exceptions are set forth in the Enabling Protocol and their enforcement should be automatic.	Need for consensus from Guatemala and Honduras.	Honduras and Guatemala do not agree to the exclusion of products that El Salvador considers sensitive.
Amendment of resolutions adopted previously	Amendment of adopted resolutions is permitted and Guatemala and Honduras have done so previously.	Need for consensus from Guatemala and Honduras.	El Salvador does not obtain the amendments it desires due to a lack of consensus.

Description	Strengths	Weaknesses	Risks
Harmonization of the Central American Import Tariff (ACI)	Not envisioned because there is no specific regulation.	Not envisioned because there is no specific regulation.	Regulated by the Central American Economic Subsystem.
Origin rules	Trade is simplified because no origin rules are required for free circulation (which also entails tariff preferences).	Regional production supply chains can be affected because no origin rules are required for free circulation (which also entails tariff preferences).	Possible effect on producers of intermediate goods in the CU as in the other countries in the Central American Economic Subsystem.
Trade of agricultural goods	There are sufficient mechanisms for sensitive agricultural products to be excluded from free circulation, as occurs in Guatemala and Honduras, without this depending on the willingness of these 2 countries.	Consensus from Honduras and Guatemala is required in order to exclude agricultural products that: a) are not in Annex A, b) are not harmonized in the ACI or c) are not subject to another type of measure.	Honduras and Guatemala do not agree to the exclusion of products that El Salvador considers sensitive.
Risk management	The absence of customs control is what enables easy and expedited border crossing.	The absence of customs control can facilitate smuggling or triangulation of products.	Unfair trade practices increase in the absence of customs control.
Special rules	Not envisioned because there is no specific regulation.	Given how the Guatemala [Decree] 29-89 system works, goods produced there could circulate freely without having to pay import taxes, as a condition for entering the single customs territory.	Products made in Guatemala with tax incentives are able to circulate freely in the CU.
Logistics hub	Not envisioned because there is no specific regulation.	Difficult for products covered by the LSI to circulate freely in the CU given the domestic legislation in El Salvador.	Products covered by the LSI cannot to circulate freely in the CU.
Distribution contracts and intellectual property rights	Not envisioned because there is no specific regulation.	No regulations arising from them wherein appropriate control measures can be established.	No measures on the border leads to the import of products that breach distinguishing marks and/or territorial restrictions of the distribution contracts.
Trade protection	Not envisioned. Elimination of the possibility of using these measures is consequences of creating a single customs territory.	Not envisioned. Elimination of the possibility of using these measures is consequences of creating a single customs territory.	Salvadorean producers will not be able to request the adoption of trade protection measures for products made in Honduras and Guatemala.

Description	Strengths	Weaknesses	Risks
Free transit of people for business	Simplification of the process by only requiring one entry and exit procedure.	Not envisioned.	Not envisioned.
Institutional capacity of El Salvador to conduct controls in CFCs, APs and PFIs	New infrastructure and in construction in several PFIs, availability of technology and connectivity.	Delays in adaptation of the border infrastructure, lack of property, insufficient access roads.	Possible lack of coordination between customs offices and domestic tax services.
Function of the FYDUCA: for public institutions, companies and other actors in the logistics chain	Online, free, advance payment of taxes, fast border crossing at the CFC, SPS not reviewed, no selective customs process, etc.	Less customs control.	Possibility of smuggling, undervaluation, tax evasion.

Source: Author

As in the case of manufacturing, export, import, logistical and other business firms, the government of El Salvador is a primary actor in the process of full incorporation into the customs union. A series of specific impacts related to the provision of high-quality goods and public services arises during this process, which contributes significant inputs to enable other actors in the economy to increase their productivity and compete in the expanded market, i.e., in the common territory as well as at the global level. Table 49 presents a summary of the positive impacts and some of the implicit disadvantages in acceding to the process launched by Guatemala and Honduras. As previously indicated, there exists at the governmental strategic decision-making level the stigma that the creation of a customs union will automatically generate losses in revenue. That myth has been debunked by research, which has identified increases in VAT and selective taxes as well as, by virtue of the dynamic effects, increases in income and other taxes.

The benefits outweigh the disadvantages, and disadvantages should not deter taking the final step in enacting the free circulation of goods and persons.

Table 49. Customs Union impacts for government

Advantages	Disadvantages
Increase in internal tax collection due to increase in trade with Guatemala and Honduras. It is estimated an increase of at least 0.04% of GDP	Less ICD for the products that enter El Salvador from Guatemala and Honduras
There is an Estructural and Investments Found to advance on improvements for Customs Union process	Less income associated to the inspection fee that products of free transit will no longer pay
Better performance at border points due to integrated border management with Guatemala and Honduras	Less income associated to the service fee of electronic transmition of the DUCA for products of free transit
Expedited services such as: customs procedures, agricultural notifications, migration, among others	Less income associated to the cuarantine inspection fee that products of free transit will no longer pay

Advantages	Disadvantages
Hiring of a Border Points Coordinator with Customs Union funding	Decrease in control measures at borders for the products of free transit, which will imply to foster post-arrival control procedures
Better efficiency in issuing FYDUCA and tax collection, due to the interconnection with tax institutions in the three countries	Provide USD 5 million per year for the Estructural and Investment Found
Verification of goods before they enter the country, through perpherical customs	Decisions for Customs Union are taken by the three countries and not just by one country
Greatest wellnes and better working conditions for border officers	

Finally, graphic 16 presents a SWOT analysis (Strengths, Weaknesses, Opportunities, Threats) and provides a graphic overview of all of the benefits to be garnered from the customs union, as well as of the challenges to be faced, both in the process of incorporation as well as following the effective free circulation of goods in commerce between El Salvador and its trading partners Guatemala and Honduras.

The SWOT analysis conveys the positive elements is that strengths and opportunities are quite strong and, following a cost-benefit analysis in which they are compared with weaknesses and threats, a net positive is obtained, as has been shown by the identification of impacts carried out in this research study.

Graphic 16. SWOT analysis of El Salvador's accession to the Customs Union

Strengthens	Opportunities
Agil mechanism of decision making at high level	Accesion to an ongoing process, it is not starting from zero
Implementation of goods of free transit	Economy improvement at regional level
Creation of Trade Facilitation Centers	Trade creation due to increase of competitivenness
Availity of the Estructural and Investment Founds	Greater involvement of the Consultive Mechanism
Solid IT platform administered by SIECA	Design of an intgerated risk management strategy
New border facilities in El Salvador	Sthrengthen of customs union regulations
	Modernization of facilities of border crossings

Weaknesses	Threatens

Extensive list of exceptions of goods	Lack of a road map to improve Customs Union
Little integration of customs and migratory procedures	Negociation of new trade arrengements on a unilateral way
Weak mechanism of post-verification of products	Unfair trade for products of free transit
Minimum use of peripherical customs	Ignorance from the private sector regarding Customs Union
Persistence of traffic at border crossings	Productive sectors affected for trade facilitation
Lack of large trade corridors and easy access to border points	Stigma that Customs Union causes lost for governments

4. CONCLUSIONS

The findings obtained from the study make it possible to draw significant conclusions regarding the importance of El Salvador's full integration into the customs union launched by Guatemala and Honduras, as well as the impacts that would occur in the absence of such integration.

The most significant points for each study area covered in this report are as follows:

ECONOMY

El Salvador would benefit most from the existence of a functioning Northern Triangle customs union, as El Salvador would obtain additional benefits amounting to as high as 0.8% growth in average GDP over the next five years, as well as greater impacts from increases in exports, imports, employment generation, reduction of poverty and overall wellbeing. In addition, El Salvador would be the most harmed of the three countries in the event that it did not join the union, as it would experience a slow down in average growth (of 0.2% per year) resulting from the deflection of trade that would benefit both Guatemala and Honduras.

REVENUES

Since tariff revenues are further reduced as a result of the consolidation of the lists of goods enjoying free trade between Guatemala and Honduras, El Salvador's incorporation into the customs union signifies a loss in tariff revenues, though this is amply offset by an increase in revenues from VAT imports and selective taxes resulting from the increase in commerce that would come with facilitation of trade (even despite a slight increase in trade flows). The net annual benefit has been estimated at 0.04% of GDP.

The Project's study in the area of revenues stressed particularly the potential for the triangulation of goods for the purpose of evading payment of import duties. In this regard, customs union

regulations have taken such a situation into account and offer a solution by excluding from the benefits of free circulation all those goods enjoying preferential tariffs in any of the countries and those that are included in other tariff systems. This ensures that trade facilitation will be carried out solely in goods subject to standardized tariffs.

TRADE COMPETITIVENESS

Trade competitiveness offers the greatest benefits at the macroeconomic level. The three countries meet the basic requirements for establishing regional trade networks: a positive degree of complementarity and geographic proximity, both conditions necessary for commercial and productive linkages within a region. The development and strengthening of regional value chains provides opportunities for making improvements, in terms of efficiency and productivity, at the base level of vertically integrated processes, which will contribute to the deepening of integration and support the productive specialization of the countries of the region. However, the current performance of trade exchange among the countries of the region points to a still incipient process of linking together production networks, a process that can be further developed and strengthened by a concerted and consensual effort by the countries to install the physical, technological, and institutional infrastructure necessary to facilitate the integration of economic operations among businesses.

The improvements in the time and costs of transborder trade that will result from El Salvador's operational integration into the customs union process will enable businesses to reap substantial gains in terms of efficiency, which in turn will translate into increased productivity and competitiveness at both the regional and global levels. Moreover, the expansion of common territory will create opportunities for developing and strengthening productive chains as well as new opportunities for trade expansion. The study has identified key strategic and "engine-of-growth" sectors having the potential to boost the country's economic growth as a result of the operationalization of the customs union, including the generation of dynamic effects on trade beyond the impacts identified in this study. However, there will also be sectors facing disadvantages as regards the elimination of protective measures and the expanded openness to the regional market, which means that there will be competition with sectors offering similar exportable goods in two or even three of the countries. These businesses must therefore put forth additional efforts to increase their productivity in order to compete effectively in the expanded market.

The improved conditions generated by trade facilitation also contribute to increasing the competitiveness of the various economic sectors and the goods they produce, since with an increase in the availability and diversity of products having different price/quality ratios based on their characteristics and production processes, consumers will be able to select those offering the best ratio, in accordance with their preferences.

The potential benefits deriving from the implementation of the customs union are the generation of opportunities for the countries of the region to promote increased levels of specialization within their economies and develop productive processes with greater value-added having the potential for integration at the regional level based on their installed capacities and the productive complementarity of their economies.

Within the context of increased facilitation of trade operations and improvements in border checkpoint infrastructure, the basket of goods excluded from free circulation could likewise benefit from a consolidated customs union as well as from other trade operations that might be conducted from El Salvador.

The improvements in the country's conditions for trade facilitation and infrastructure that may result from the customs union in turn represent opportunities for development and consolidation of a supply of trade support services (logistical) by virtue of the competitive advantages provided by the Salvadorean economy.

REGULATORY FRAMEWOK

Guatemala's and Honduras' progress to date does not constitute a customs union in the way in which such an entity is defined in either the Guatemala Protocol or in doctrine. Although certain customs union related principles do exist, existing exceptions to free circulation prevent the categorization as a true "customs union." The primary consequence being that the regulatory characteristics of trade between these two countries bear many similarities to the regulatory characteristics of trade with the other countries in the Subsystem. This does not mean that significant progress has not been made in terms of deepening economic integration; progress has indeed been made and this progress generates concrete benefits for economic agents, specifically as to the possibility of concrete savings stemming from the streamlining of operations at intra-border checkpoints. Although as this is not a true customs union, many of the issues of concern for economic agents fail to materialize, at least in the current stage of progress.

The design of the process of integration between Guatemala and Honduras is innovative and makes it possible to offer a concrete benefit to economic agents by facilitating many of the operations in the common territory. It is a creative means for deepening the degree of integration and one that can be adopted by all Subsystem member states, without having to address the political and economic costs of adopting a full-fledged customs union.

One of the requests made by El Salvador's productive sectors is the adoption of incremental steps that will make it possible to analyze the benefits to be gained. This customs union model makes it possible to launch a process of deep integration, but in such a way that it will be possible to analyze potential impacts before deciding on the merits of each step. In the four years of operation of the Guatemala-Honduras customs union, there has been no deepening of commitments to integration. The model does benefit private sectors, and at the very least most of the excluded sectors are comfortable with its implementation. It can thus be concluded that presently, the customs union is generating adequate benefits, with no need at this time to include, for example, additional goods in the system of free circulation.

INSTITUTIONAL FRAMEWORK

The institutional capabilities of the countries are key to the success of the Northern Triangle customs union. Steps must be taken to transform existing border facilities into Integrated Border Checkpoints that are functional and able to increase the efficiency of processes related to customs, taxes, phytosanitary, immigration, and other similar processes that are necessary to streamline the flow of trade within the region. Business associations of both countries have confirmed the realization of the reduction in time spent at border crossings between Guatemala and Honduras. This reduction in time spent at borders is a great benefit for the productive sectors involved in regional trade, as benefits include reductions in costs and increases in productivity. Regarding peripheral customs, its implementation and operation still persists as a challenge to be achieved by the countries.

5. PROPOSALS FOR IMPROVEMENT

The core objective of this study is to determine the impacts generated by El Salvador's full incorporation into the Guatemala-Honduras customs union, a task that is complemented by the formulation of a series of recommendations based on the results of the study. However, during the planning stage, an additional goal was set to go beyond simple quantitative and qualitative indicators and explore proposals aimed at facilitating and optimizing El Salvador's incorporation into the process of deep integration, and strengthening the customs union as a whole, which has been made possible thanks to the numerous consultations and interviews conducted with the Northern Triangle's most important stakeholders and the visits made to border crossing checkpoints in El Salvador, Guatemala, and Honduras. Accordingly, presented below are a series of general observations regarding all of the areas included in the study.

OVERALL CONTEXT

Based on the results of the research, the most important recommendation is for El Salvador to join the customs union as soon as possible. As previously indicated, Guatemala and Honduras are El Salvador's natural trade partners in the region, which means there are no reasons for delaying entrance into the process of deep integration with these two countries. Once this accession has been finalized, of the three countries, El Salvador will benefit most in terms of trade, investment, growth, employment, and reduction of poverty.

One of the basic characteristics of a customs union (as supported by the Guatemala Protocol) is the potential for moving forward incrementally to a deeper stage of economic integration, and the existing regulatory structure is sufficiently flexible for this purpose. This has been the case for both Guatemala and Honduras which, in the four years of operation of the union, have recorded progress in a number of areas, the most important of which being introduction of the FYDUCA.

Within the context of the next full incorporation of El Salvador into the union, it is proposed that El Salvador do so incrementally, with both a prior and along-the-way assessments of the effects of any decisions made by the productive sectors participating in intraregional trade. This idea is especially applicable, as regards to the opening of PFIs and CFCs, to the adoption of lists of goods benefiting, and those excluded, from free trade. An additional possibility would be conducting negotiations aimed at the adoption of bilateral lists of excluded goods and also, among other things,

of agreements regarding the application of rules of origin for certain of the region's sensitive line items and modifications to certain resolutions previously adopted that might be of interest to El Salvador. However, as mentioned above, consideration should be given to having all decisions made by the Ministerial Body (*Instancia Ministerial*), with the agreement of all three member countries.

In order to maximize the efficiency gains that the customs union will provide to the productive sectors of El Salvador, it is recommended to approve reforms to the legislation of the regimes of free zones and international services, in the sense that the companies covered by said regimes can enjoy all the concessions of free movement in the single territory.

BORDER INFRASTRUCTURE AND OPERATION OF BORDER CHECKPOINTS

Over the short term, El Salvador should complete improvements to its border checkpoints with Honduras and Guatemala. Facilities in El Amatillo are in their final phase of construction and El Poy now has facilities meeting the minimum conditions for operating as a PFI, though there is room for improvement. However, construction of facilities at Anguiatú is currently in an intermediate phase and there has been little progress on the remaining border checkpoints.

El Salvador Customs Office at El Poy, newspaper image

As previously indicated, Corinto (Guatemala-Honduras) serves as the model PFI. Construction work on Salvadorean border posts should follow that model and improve upon it.

In this regard, as set forth in the customs union regulatory framework, institutions of both countries that operate at border checkpoints (El Salvador-Guatemala and El Salvador-Honduras) should likewise operate in the same facilities, which would result in coordination among countries for an optimum PFI facility.

As regards the border checkpoints at El Amatillo, El Poy, and Anguiatú, although the primary PFI operations could be carried out on the El Salvador side, it would be possible to take advantage of the customs facilities of Honduras and Guatemala respectively to carry out physical inspections, quarantine treatments, etc., for goods dealt with at the integrated control center (CCI).

It is essential that the governments of El Salvador, Guatemala, and Honduras prioritize expansion of highways leading to border checkpoints, particularly along the final section leading to the border checkpoints. It is recommended that a minimum of at least one additional lane be added to the access road (along the final two-kilometer section), so that there will be one exit lane and two entry

lanes, with preference granted to vehicles heading to the CFC. This recommendation is also applicable to currently operating PFIs, such as Corinto, El Florido, and Agua Caliente.

As regards highway connectivity, it is recommended that the governments of the three countries improve road conditions along the primary fiscal routes, which will make it possible to reduce transit times for goods within the common territory.

Regarding transit within the PFI and its access roads, it is essential that support be obtained from highway safety authorities, in order to ensure an orderly flow of traffic, with preference to be given to incoming vehicles within the CFC. In this regard, sanctions should be established for vehicles arriving at PFIs with incomplete documentation, as they would obstruct the transit of vehicles carrying freely circulating goods.

It will be necessary to develop and implement a plan for transforming border customs offices into PFIs. That plan should stipulate the incremental incorporation of El Salvador's PFIs and take into account issues such as determination of a single-function (*cabecera única*) or dual-function (*doble cabecera*) operating model, based on the location of the Trade Facilitation Center (*Centro de Facilitación del Comercio* – CFC) and Integrated Control Center (*Centro de Control Integrado* – CCI), technological outfitting, signage, collectivity, essential services, safety and security, provision of sufficient staff in the various operating areas, lodging for all staff, break rooms, etc.

As regards staff in the CFCs, to optimize countries' resources, it is suggested that a single person be responsible to both fast-track customs operations (customs transit and free community movement) and free-circulation operations (FYDUCA), which would be handled by each office.

New Anguiatú Customs Office, El Salvador, Source: FOMILENIO II

As is already occurring in the customs union between Guatemala and Honduras, steps should be taken to establish the necessary Ministerial Body accords to standardize the hours of operation of all organizations operating within the PFIs: customs, internal revenue, immigration, agriculture, health, security, etc.

Likewise, agreements should be established among the authorities operating within the PFIs to provide for the exchange of information for use in risk management and national security. For example, El Salvador's customs authority might share the principal results of its noninvasive controls (scanner images). This legal authority is set forth in Article 23 of the Customs Union Operating Regulations.

Until El Salvador's full integration into the customs union, it is imperative for the authorities of Honduras and Guatemala to establish agreements for coordinated efforts among their institutions and with El Salvador's institutions, not only to deal with flows of freight but also influxes of tourism, particularly as regards standardization of hours of operation for the public; performance of joint

inspections by customs, quarantine and public safety agencies; and improvement of horizontal and vertical signage over trade control areas.

Since the implementation of the Guatemala-Honduras customs union in 2017, there has been little interest in using peripheral customs offices, which has contributed to operational difficulties of both countries' governments. A consultation made with the Honduran customs administrator at the Corinto PFI revealed that in recent months, only two operations involving nationalized goods originating in peripheral customs agencies of Guatemala passed through that checkpoint. For this reason, and prior to the incorporation of El Salvador, an analysis should be made of the possibility that Guatemala's Port of Santo Tomás de Castilla be converted into a peripheral border checkpoint for El Salvador, given the importance of the flow of transit operations through that fiscal post. Peripheral customs offices involve other functions in addition to the transit of goods, and as such this should be an issue to be addressed by Salvadorean authorities with their private sector.

To improve the current operation of peripheral customs agencies, it is necessary to enter into mutual recognition agreements so that the authorities of Guatemala and Honduras (and El Salvador, when its operative accession comes true) will have appropriate representation and involvement in customs clearing operations, physical inspections, quarantine treatments, etc. Consideration should be given to the possibility of mutual representation agreements to be signed by the customs authorities of countries of the union, so that there will be no need to travel physically from one country to another. The legal bases for establishing this type of agreement can be found in the CAUCA and RECAUCA and also in the Customs Union Operating Regulations.

In view of the low level of interest in processing the payment of import taxes through a peripheral customs agency, probably due to the lack of trust created by the occasional loss of tax revenue from theft of goods in the other member country, authorities should support public security activities along the tax routes extending between the peripheral agencies and the PFIs, in order to instill an atmosphere of trust among importers and encourage them to conduct their operations at the peripheral checkpoints.

As regards the designation of peripheral customs agencies in El Salvador, as set forth in the provisions of Resolution No. 58-2019, since these fiscal posts operate to the benefit of Guatemala and Honduras, it is suggested that, prior to their implementation, steps be taken to confirm the interest of those countries in using the Port of Acajutla and the International Airport to deal with operations with those countries. If this is not required, this service will not need to be implemented, which will in turn lead to significant savings.

The countries should design, *a posteriori,* a uniform risk management plan for the entire region, with participants to include, among others, representatives from customs, internal revenue, animal health and phytosanitary control, public safety, the Ministerial Body and SIECA. Such a system should stress the implementation of controls along the highways and in the various storage and distribution centers operated by businesses in the destination country. However, although the Manual of Control and Supervision Procedures for Transactions of Transfers and Acquisitions of Community Goods Not Excepted from Free Circulation (Agreement No. 01-2021) is in force, there is still not enough data on the impacts achieved with the application of this manual.

Steps should also be taken to institute fast-track migratory flow between El Salvador and Honduras, which will lead to reductions in immigration registration times at PFIs.

Steps should be taken to standardize fees charged for the MSF notification service and other fees paid in compliance with regional customs regulations. The objective here would be to have a uniform tariff in place in the entire common territory.

Considering that goods excluded from free circulation are dealt with in the CCIs at the PFIs, it is recommended that joint efforts be made by all authorities conducting operations in those centers to prioritize the following: a) standardize risk criteria and percentages of physical inspections; b) conduct procedures for the joint physical inspection of goods by the customs and sanitary authorities of both countries; c) put in place an action protocol for public security authorities that conduct inspections of cargo transport units, particularly as regards narcotics; and d) make advance declaration a mandatory requirement for the three countries.

Steps should be taken to hold in place the pre-check posts of Metalío and Santa Ana, in El Salvador, to permit pre-check of those operations that will pass through the CFC and the CCI on the way to Guatemala.

In IT area, steps should be taken to improve and ensure the connectivity of data transmission systems at the PFI with the servers of SIECA and those of the domestic taxation, sanitary, and customs authorities of union member countries.

Countries should ensure the proper technological outfitting of PFIs and peripheral customs agencies. In addition, PFIs should have in place contingency plans for possible downtime affecting IT systems in operation in the PFI. This would include power outages, system crashes, etc.

An additional priority will be to coordinate with SIECA all matters dealing with the operation of the PFIs and the provision of administrative services at those points. Of importance here is the Border Checkpoint Coordinator as PFI Administrator.

INSTITUTIONAL STRUCTURE OF THE CUSTOMS UNION

The Ministerial Body should take steps to ensure that union member countries sign a commitment to refrain from unilateral negotiation of trade agreements with countries outside the region. The purpose of this is to avoid violation of the spirit of deep integration and expansion of the list of goods excluded from free circulation.

The three countries should agree on joint action guidelines to ensure uniform decisions that are in accordance with the objectives of the union.

A roadmap with a short- to medium-term timeline should be established for making improvements to the customs union, and should include such activities as PFI modernization, implementation of techniques for the investigation and prevention of illicit trade, approval of a Common Code of Sanctions, coordinated management of risk in the common territory, etc.

In the area of risk management, it is essential that plans to combat illicit trade in the common territory be designed and implemented. It is necessary to have the participation of public entities of all three countries: customs, domestic taxation, immigration, security, agriculture, health, etc.

Steps should also be taken to include the public works and public safety authorities of all three countries in the negotiation sessions dealing with El Salvador's incorporation into the process of deep integration, so that plans to make improvements to highway connectivity and border crossing safety can be designed and put in place.

To increase the efficiency of those activities involving consolidation of the process of deep integration, it is recommended that the Advisory Committee and the Ministerial Body reach an agreement on a permanent work agenda between the two entities, in order to ensure the active participation of both in the process of building and perfecting the customs union.

Working panels should be created among members of the Advisory Committee and customs union authorities to analyze such issues as might arise along the way and to seek practical and efficient solutions to any problems that might occur at PFIs, peripheral customs agencies, tax routes and other key areas of the customs union.

Steps should be taken to take advantage of the technical assistance that, as mandated by the Advisory Committee Operating Regulations, SIECA is required to provide to the Committee as regards the formulation of technical proposals and recommendations for procedural improvements.

In order to contribute to the improvement of the customs union, the immediate reactivation of the participation of the private sector of El Salvador in the Consultative Committee is recommended.

It will be necessary to strengthen the stature and list of functions to be carried out by the Coordinator of PFIs and peripheral customs agencies as a high-level executive with the ability to further promote deep integration and oversee the operation of border checkpoints, rather than simply devoting him/herself to the provision of administrative services at the border agencies.

In this regard, it is suggested that the coordinator be included in deep integration negotiating sessions so that he/she might provide appropriate technical contributions regarding the improvement of ongoing processes at the PFIs and peripheral agencies, and other subjects as appropriate.

Likewise, consideration should be given to having the coordinator participate in such working panels as may be created jointly with the Advisory Committee.

PRIVATE SECTOR AND THE ROLE OF GOVERNMENT IN PROMOTING COMPETITIVENESS

Both the government and the business associations representing private sector interests in the area of trade, should design and implement training programs for businesses and all other stakeholders participating in regional trade focusing on the process of deep integration; the regulatory and institutional structure of the union; rules applicable to trade facilitation; lists of goods (both free circulation and exclusions); management of the FYDUCA; MSF notifications and related procedures; operational guidelines; rights and obligations; and other similar matters.

Both the government and business associations should work toward identifying sectors that could be negatively affected by expansion of the market and the arrival of regional competitors in their areas of activity. These particular sectors or businesses should receive assistance in developing programs to increase productivity. These programs should include support for the development of plans for expanding regional production and distribution facilities, investments in technological innovations, implementation of new models of production, quality control, management, and marketing.

It is also important that government of the three countries work in a community regulatory framework that fosters the consumer confidence to e-commerce models. That framework must address all the edges related to that matter: digital commerce; electronic payments; use of digital wallets and other means; information protection; systems security; prevention and combat of cybercrime; etc.

On the same logic, progress must be made by the govenments in enabling the FYDUCA for the aerial trade. In this effort it is key to provide assistance to the MSMESs (MIPYMES), as they are an important sector in the regional market and, as they do not have the technical and financial capacities, they require of the support of the government to access the benefits of the deep integration and the expansion of trade.

Import and export firms should receive training in best practices to properly utilize of trade facilitation mechanisms. Training should include appropriate management of goods, with criteria to be used regarding consolidation of goods, as is the case with the consolidation in a single carrier products allowed and excluded from free circulation; knowledge of products restricted or disallowed on the FYDUCA; inclusion of an excessive number of transportation units on a single FYDUCA or the implications of conducting unfair trade practices for the purpose of avoiding payment of appropriate duties and other taxes, not to introduce goods, etc.

Precisely, in order to take advantage of the operational advantages granted in the CFC to goods with free circulation, it is recommended not to combine goods with free circulation (FYDUCA) and excepted goods in the same transport unit, otherwise the benefit would be lost. of the agile step, since all combined operations begin to be reviewed in the Integrated Control Center.

Government support in this process takes on a significant role for the private sector, by offering opportunities for updating and relaunching industrial development policies in support of productive

sectors, with emphasis on those with fewer advantages regarding the possible elimination of protective measures and opening of the regional market. Priority sectors include small and medium enterprises (SMEs) and industrialized sectors characterized by low value-added processes.

The government's development of support policies should consider those sectors offering trade support services with the potential to be affected by deep integration, particularly sectors where small and medium enterprises operate. These sectors include customs agents, transportation providers, and businesses and services operating in border areas.

Within the framework of this process of integration, the development of an agenda focused on consolidating the position of the country as a regional logistical center takes on considerable importance. This agenda should focus on the competitive advantages offered by the country. Government participation is extremely important when designing of policy measures that will facilitate procedural digitalization and investments favoring the facilitation of trade, as well as during the development of infrastructure, both technological and physical. It is also important that the government participate in the development of logistical corridors and the widening of highways providing access to the El Poy and Anguiatú border crossings. It is recommended that the following be prioritized: a) completion of the primary road and highway networks (construction of four lanes on the Pan-American Highway from San Vicente to San Miguel and the Military Route to El Amatillo, and construction of four lanes on the Coastal Highway, from La Hachadura to the International Airport, from Zacatecoluca to San Miguel, and from San Miguel to La Unión and El Amatillo); and b) consolidation of the air hub.

ROADMAP PROPOSAL FOR THE IMPROVEMENT OF THE CUSTOMS UNION

In order to contribute to the improvement of the customs union, a roadmap is proposed that contains a proposed sequence of activities to be carried out, which take as a reference the phases established in the Framework Agreement for the Establishment of the Central American Customs Union. To maximize efficiency gains for the productive sectors and for the countries, in general, the proposed activities should be carried out gradually and sequentially, without exceeding a maximum term of five years (Table 50).

Table 50. Roadmap proposal for customs union improvement

Customs Union phases	Actions	Responsable	Short term (1 year)	Medium term (2-3 years)	Long term (4-5 years)
FREE TRANSIT AND TRADE FACILITATION	Technological and equipment improvements of Integrated Border Points (PFI)	Ministerial Instance, SIECA			
	Improvement implementation to the FYDUCA	Ministerial Instance, Tax, SIECA			
	Improvement implementation to the DUCA F and DUT-C	Ministerial Instance, Customs, SIECA			

Customs Union phases	Actions	Responsable	Short term (1 year)	Medium term (2-3 years)	Long term (4-5 years)
	Implementation of agile migratory passage between the 3 countries for operations in the Trade Facilitation Centers and Integrated Control Centers	Ministerial Instance, Migration			
	Implementation of operational improvements in the Facilitation and Control Centers	Ministerial Instance, Tax, Customs, Migration, MSF Coordinator PFI, SIECA			
	Implementation of peripheral customs under new facilitation schemes	Ministerial Instance, Customs, MSF, SIECA			
	Improvements to the infrastructure of the PFIs in the places that are required	Ministerial Instance, SIECA			
	Expansion of entry lanes to PFIs	Ministerial Instance, MOP, SIECA			
	Construction of residential modules on land borders that are required	Ministerial Instance, SIECA			
ORDERIZATION AND REGULATORY CONVERGENCE	Harmonization of pending immigration procedures	Ministerial Instance, Migration			
	Harmonization of pending customs procedures	Ministerial Instance, Customs, SIECA			
	Harmonization of pending health procedures	Ministerial Instance, MSF, SIECA			
	Harmonization of intellectual property regulations and border measures	Ministerial Instance, Minec			
	Harmonization of competition regulations	Ministerial Instance, Minec			
	Implementation of comprehensive risk management at border posts and peripheral customs	Ministerial Instance, Tax, Customs, Migration, MSF Coordinator PFI, SIECA			
	Approval of sanctioning code of the customs union	Ministerial Instance, Tax, Customs, Migration, MSF Coordinator PFI, SIECA			

Customs Union phases	Actions	Responsable	Short term (1 year)	Medium term (2-3 years)	Long term (4-5 years)
	Approval of the FTA convergence mechanism between the countries of the Union	Minsterial Instance, Origin, Duty			
	Implementation of a comprehensive post-clearance verification plan in the customs union	Ministerial Instance, Tax, Customs, Migration, MSF Coordinator PFI, SIECA			
	Implementation of the customs union security plan	Ministerial Instance, Tax, Customs, Migration, MSF Coordinator PFI			
	Implementation of a mechanism for the harmonization of merchandise exempted from free circulation	Ministerial Instance, Origin, Dutty, MSF, Tax			
	Implementation of the free transit of natural persons in the single territory	Ministerial Instance, Migration			
	Harmonization of the ACI between countries of the Union	Ministerial Instance, Duty			
INSTITUTIONAL DEVELOPMENT	Approval of agreement of joint actions of the Ministerial Instance	Ministerial Instance, SIECA			
	Permanent involvement of the Consultative Committee in the main activities of the customs union	Ministerial Instance, Consultative Committee			
	Improvements to the visibility of the customs union	Instancia Ministerial, Comité Consultivo			
	Implementation of improvements to the Institutionality of the customs union	Ministerial Instance, Consultative Committee			
	Implementation of Common Foreign Policy	Ministerial Instance, SIECA			
	Implementation of a policy to strengthen the private sector to take advantage of the customs union	Ministerial Instance, Consultative Committee, SIECA			
	Implementation of trade defense mechanism with third countries	Ministerial Instance, SIECA			

Source: own elaboration

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ANNEXES

Annex 1. Methodology for determining the impact of the customs union on tax revenues in El Salvador

In developing the simulations for the study, we used information on El Salvador's trade flows with Guatemala and Honduras for the 2015-2019 period which we obtained from MINEC for the CIF value of Salvadorean imports as well as revenues from import tariffs (*Derechos Arancelarios a la Importación*, or DAI) and Value Added Tax (VAT), disaggregated by country and tariff chapter. For purposes of the study, the following scenarios were considered:

- Scenario X: With no customs union
- Scenario Y1: With customs union + growth in imports and full progressive reduction of import tariffs
- Scenario Y2: With customs union + growth in exports with no reduction in import tariffs
- Scenario Y3: With customs union + growth in imports and immediate and total tariff reduction for goods enjoying free movement

The following algorithm was then applied:

(i) Imports originating somewhere other than Honduras and Guatemala were eliminated from the database.

A. Imports that continue to pay import tariffs

(ii) Imports showing a positive CIF value but with tariff revenues equal to zero were eliminated from the database.

A1. Scenario X (With no customs union):

For each Chapter of the Tariff System (*Sistema Arancelario*):

(iii) We calculated the CIF value of imports between 2015 and 2019 as well as the average annual rate of growth (α_x), using the formula: $\alpha_x = (\frac{CIF_{19}}{CIF_{15}})^{\frac{1}{4}} - 1$. If $\alpha_x < -0.2$, then $\alpha_x = -0.2$, and if $\alpha_x > 0.2$, then $\alpha_x = 0.2$, so as to avoid overly drastic fluctuations.

(iv) Using the above information, we projected the CIF value of imports for the following periods (2022-2026) by applying the formula: $CIF_t^x = CIF_{t-1}^x * (1 + \alpha_x)$.

(v) We then calculated the effective rate of import tariffs (β_x), defined as the percentage of CIF import value represented by tariff revenues. Thus, $\beta_x = \frac{\sum_{t=15}^{19} DAI_t^x}{\sum_{t=15}^{19} CIF_t^x}$.

(vi) Based on the above calculation, we projected import tariff revenues ($R1_t^x$) for the period 2022-2026 by multiplying CIF import value by the effective import tariff rate, using the following formula: $R1_t^x = \beta_x * CIF_t^x$.

(vii) Once the import tariff had been estimated, we projected VAT revenues ($R2_t^x$) for the period 2022-2026 by multiplying the sum of CIF value plus applicable import tariffs by the VAT rate, per the following formula: $R2_t^x = 0.13 * (CIF_t^x + R1_t^x)$.

A2. Scenario Y1 (With customs union + growth in imports and full progressive reduction of import tariffs):

(viii) We estimated the average annual rate of growth in the CIF value of imports (α_y) by adding 0.013 to α_x, since according to CEPAL (2018), entrance into the customs union would increase imports by 1.35% in an average scenario.

(ix) We projected the CIF value of imports for the following periods by multiplying the CIF value for each period by its corresponding rate of growth, using the formula: $CIF_t^y = CIF_{t-1}^y * (1 + \alpha_y)$.

(x) We calculated the annual average rate of decrease that in 5 years would result in an effective import tariff rate of 0% for each chapter, as follows: $\delta_y = (\frac{0.000001}{\beta_x})^{\frac{1}{5}} - 1$.

(xi) We calculated the effective tariff rate applicable to each period subject to projection by multiplying the actual effective rate for each period by the average annual rate of decrease, using the following formula: $\beta_t^y = \beta_{t-1}^y * (1 + \delta_y)$.

(xii) Based on the preceding calculation, we projected tariff revenues ($R1_t^y$) for the period 2022-2026 by multiplying the CIF value of imports by the actual effective tariff rate, using the following formula: $R1_t^y = \beta_y * CIF_t^y$.

(xiii) Following projection of the import tariff, we projected VAT revenues ($R2_t^y$) for the period 2022-2026 by multiplying the sum of the CIF value and applicable import tariff by the VAT rate, using the following formula: $R2_t^y = 0.13 * (CIF_t^y + R2_t^y)$.

A3. Scenario Y2 (With customs union + growth in exports with no reduction in import tariffs):

(xiv) We estimated the average annual rate of growth in the CIF value of imports (α_y) by adding 0.013 to α_x, since according to CEPAL (2018), entrance into the customs union would increase imports by 1.35% in an intermediate scenario (study attached).

(xv) We projected the CIF value of imports for subsequent periods by multiplying the CIF value for each period by its rate of growth, using the formula: $CIF_t^y = CIF_{t-1}^y * (1 + \alpha_y)$.

(xvi) We calculated the actual effective rate of import tariffs (β_y), which is identical for all periods.

(xvii) We projected tariff revenues ($R1_t^y$) for the period 2022-2026 by multiplying the CIF value of imports by the actual effective tariff rate, using the following formula: $R1_t^y = \beta_y * CIF_t^y$.

(xviii) Following projection of import tariffs, we projected VAT revenues ($R2_t^y$) for the period 2022-2026 by multiplying the sum of the CIF value and applicable import tariffs, using the following formula: $R2_t^y = 0.13 * (CIF_t^y + R2_t^y)$.

A4. Scenario Y3 (With customs union + growth in imports and immediate and total tariff reduction for goods enjoying free movement):

(xix) We estimated the average annual rate of growth of the CIF value of imports (α_y) by adding 0.013 to α_x, since according to CEPAL (2018), entrance into the customs union would increase imports by 1.35% in an intermediate scenario (study attached).

(xx) We projected the CIF value of imports for subsequent periods by multiplying the CIF value for each period by its rate of growth, using the formula: $CIF_t^y = CIF_{t-1}^y * (1 + \alpha_y)$.

(xxi) We calculated the actual effective tariff rate (β_y), which is identical for all periods.

(xxii) We projected tariff revenues ($R1_t^y$) for the period 2022-2026 by multiplying the CIF value of imports by the actual effective tariff rate solely for those goods not enjoying free movement between Honduras and Guatemala, using the following formula: $R1_t^y = \beta_y * CIF_t^y$.

(xxiii) Once the import tariff had been projected, we projected VAT revenues ($R2_t^y$) for the period 2022-2026 by multiplying the sum of CIF value and applicable import tariff by the VAT rate, using the following formula: $R2_t^y = 0.13 * (CIF_t^y + R2_t^y)$.

A5. Impact

(xxiv) We calculated the impact of tariff revenues (ε) as the difference between Scenario Y and Scenario X, using the following formula: $\varepsilon_t = R1_t^y - R1_t^x$.

(xxv) We calculated the impact of VAT revenues (μ) as the difference between Scenario Y and Scenario X, using the following formula: $\mu_t = R2_t^y - R2_t^x$.

(xxvi) We calculated the impact of total revenues by adding tariff impact to VAT impact.

B. Imports that do not pay import tariffs

Only those imports with a positive CIF value but with DAI revenues equal to zero were kept in the database.

B1. Scenario X (With no customs union):

For each Chapter of the Tariff System:

(i) We calculated the CIF value of imports from 2015 and 2019 and we calculated their average annual rate of growth (α_x), using the following formula: $\alpha_x = (\frac{CIF_{19}}{CIF_{15}})^{\frac{1}{4}} - 1$. If $\alpha_x < -0.2$, then $\alpha_x = -0.2$, and if $\alpha_x > 0.2$, then $\alpha_x = 0.2$, in order to avoid overly drastic fluctuations.

(ii) Using the preceding information, we projected the CIF value of imports for subsequent periods (2022-2026), in accordance with the formula: $CIF_t^x = CIF_{t-1}^x * (1 + \alpha_1)$.

(iii) We projected VAT revenues ($R2_t^x$) for the period 2022-2026 by multiplying the sum of CIF value by the VAT rate, using the following formula: $R2_t^x = 0.13 * CIF_t^x$.

B2. Scenarios Y1, Y2 and Y3 (With customs union):

(iv) We estimated the average annual rate of growth in the CIF value of imports (α_y), by adding 0.0135 to α_x, since according to CEPAL (2018), entrance into the customs union would increase imports by 1.35% in an intermediate scenario (studio attached).

(v) We projected the CIF value of imports for subsequent periods by multiplying the CIF value for each period by its rate of growth, using the following formula: $CIF_t^y = CIF_{t-1}^y * (1 + \alpha_y)$.

(vi) We projected VAT revenues ($R2_t^y$) for the period 2022-2026 by multiplying the sum of the CIF value by the VAT rate, using the following formula: $R2_t^y = 0.13 * CIF_t^y$

B3. Impact

(vii) We calculated the impact of total revenues (μ) as the difference in VAT revenues in Scenario Y and Scenario X, using the following formula: $\mu_t = R2_t^y - R2_t^x$.

Annex 2. Ranking of the main customs offices used in El Salvador's bilateral trade with Guatemala and Honduras, 2016-2021

Percentage distribution of the total value exported and imported by type of customs

Country	Item	Type of Customs	Customs	2016	2017	2018	2019	2020	2021
GUATEMALA	*EXPORT.*	Air	Comalapa, El Salvador	0.5	0.4	0.5	0.3	0.3	0.3
		Sea	Cutuco, La Unión	2.3	2.8	3.3	2.7	2.8	4.1
			Acajutla	0.1	0.0	0.1	0.2	0.4	0.4
		Land	La Hachadura	62.5	62.7	60.7	60.9	61.3	63.4
			San Cristóbal	23.9	21.7	22.1	20.6	19.7	18.3
			Las Chinamas	3.3	5.9	7.4	8.9	9.7	8.9
			Anguiatú	4.7	4.1	3.8	3.7	3.4	2.7
	IMPORT.	Air	Aeropuerto Ilopango	0.0	0.0	0.0	1.2	0.7	0.2
			Comalapa, El Salvador	0.5	0.5	0.4	0.9	0.5	0.2
			Fardos Postales	0.0	0.0	0.0	0.0	0.0	0.0
		Sea	Acajutla	1.7	0.7	0.0	0.0	0.1	0.0
		Land	San Salvador	56.2	58.0	60.1	60.5	64.2	64.3
			Santa Ana	20.6	19.5	21.2	22.9	23.3	23.0
			La Hachadura	16.7	15.4	13.2	8.7	6.0	6.2
			Las Chinamas	0.2	0.6	0.5	1.0	0.6	0.7
			San Cristóbal	1.4	1.5	1.0	0.8	0.4	0.5
			Anguiatú	0.1	0.1	0.1	0.0	0.3	0.3
HONDURAS	*EXPORT.*	Air	Comalapa, El Salvador	0.4	0.3	0.4	0.3	0.2	0.2
			Aeropuerto Ilopango	0.0	0.0	0.0	0.0	0.0	0.0
		Sea	Cutuco, La Unión	0.5	0.5	0.6	0.5	0.6	2.0
			Acajutla	0.0	0.0	0.0	0.0	0.0	0.0
		Land	El Poy	67.9	68.3	70.8	70.3	68.2	68.9
			El Amatillo	29.4	29.2	26.4	26.7	29.2	26.6
			Anguiatú	0.0	0.2	0.0	0.6	0.1	0.0
	IMPORT.	Air	Comalapa, El Salvador	0.1	0.1	0.1	0.1	0.0	0.0
		Land	El Poy	42.9	45.6	52.7	54.6	55.5	53.2
			El Amatillo	24.6	20.0	15.8	17.8	21.5	20.4
			San Salvador	2.5	1.0	0.7	0.3	0.1	0.0
			La Hachadura	0.0	0.0	0.1	0.1	0.0	0.0
			Anguiatú	0.4	0.2	0.1	0.0	0.0	0.0

Source: own elaboration based on BCR and DGA data

Annex 3. Identification of Non-Tariff Measures implemented by Guatemala and Honduras on products from the rest of the world

COUNTRY IMPOSING NTMs	NTM CODE	PRODUCT DESCRIPTION	RESPONSIBLE INSTITUTION
Guatemala	A15	Wooden packaging.	Ministry of Agriculture, Livestock and Food
	A21	Whipped Cream.	Ministry of Agriculture, Livestock and Food
		Pasteurized milk.	Ministry of Agriculture, Livestock and Food
		Unripe cheeses.	Ministry of the Economy
	A22	Cream and prepared cream.	Ministry of the Economy
		Cheeses.	Ministry of the Economy
	A32	Wooden packaging.	Ministry of Agriculture, Livestock and Food
	A33	Pasteurized milk.	(blank)
		Unripe cheeses.	Ministry of the Economy
	A42	Cream and prepared cream.	Ministry of the Economy
		Whipped cream.	(blank)
		Pasteurized milk.	(blank)
		Unripe cheeses.	Ministry of the Economy
		Cheeses.	(blank)
	A53	Wooden packaging.	Ministry of Agriculture, Livestock and Food
	A64	Pasteurized milk.	(blank)
	A69	Food of animal and vegetable origin.	Ministry of Agriculture, Livestock and Food
	A82	Pasteurized milk.	(blank)
		Unripe cheeses.	Ministry of the Economy
	P11	Petroleum products.	General Directorate of Hydrocarbons
	P12	Botanical pesticides for agricultural use.	(blank)
Honduras	A13	Commercially sterile meat products of bovine, poultry and swine origin.	Ministry of Agriculture and Livestock
	A14	Poultry and poultry products.	Ministry of Agriculture and Livestock
		Citrus plants.	Ministry of Agriculture and Livestock
		Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
	A15	Cocoa planting stock.	Ministry of Agriculture and Livestock
		Products and by-products of animal origin for human consumption.	Ministry of Agriculture and Livestock
	A19	Vegetative material of Coffea arabica.	Ministry of Agriculture and Livestock
		Vegetative material of the Malvaceae family, mainly of the Hibiscus, fam. Fabaceae, fam. Moraceae genuses, and other potential hosts of Maconellicococcus hirsutus (Green).	Ministry of Agriculture and Livestock
		Sharks, parts and derivatives.	Ministry of Agriculture and Livestock
	A21	Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Pasteurized milk.	(blank)
	A22	Cheeses.	Ministry of the Economy
	A31	Poultry and poultry products.	Ministry of Agriculture and Livestock
	A32	Pasteurized milk.	(blank)
	A33	Poultry and poultry products.	Ministry of Agriculture and Livestock
		Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Cocoa planting stock.	Ministry of Agriculture and Livestock
		Commercially sterile meat products of bovine, poultry and swine origin.	Ministry of Agriculture and Livestock
	A42	Pasteurized milk.	(blank)
		Cheeses.	Ministry of the Economy

COUNTRY IMPOSING NTMs	NTM CODE	PRODUCT DESCRIPTION	RESPONSIBLE INSTITUTION
	A53	Cocoa planting stock.	Ministry of Agriculture and Livestock
	A61	Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Cocoa planting stock.	Ministry of Agriculture and Livestock
	A63	Commercially sterile meat products of bovine, poultry and swine origin.	Ministry of Agriculture and Livestock
	A64	Poultry and poultry products.	Ministry of Agriculture and Livestock
		Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Pasteurized milk.	(blank)
		Commercially sterile meat products of bovine, poultry and swine origin.	Ministry of Agriculture and Livestock
	A69	Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
	A81	Cocoa planting stock.	Ministry of Agriculture and Livestock
	A82	Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Pasteurized milk.	(blank)
		Citrus plants.	Ministry of Agriculture and Livestock
	A83	Poultry and poultry products.	Ministry of Agriculture and Livestock
		Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Vegetative material of Coffea arabica.	Ministry of Agriculture and Livestock
		Vegetative material of the family Malvaceae mainly of the genera Hibiscus, fam. Fabaceae, fam. Moraceae and other potential hosts of Maconellicococcus hirsutus (Green).	Ministry of Agriculture and Livestock
		Cocoa planting stock.	Ministry of Agriculture and Livestock
		Citrus plants.	Ministry of Agriculture and Livestock
	A84	Vegetative material of Coffea arabica.	Ministry of Agriculture and Livestock
		Commercially sterile meat products of bovine, poultry and swine origin.	Ministry of Agriculture and Livestock
	A851	Cocoa planting stock.	Ministry of Agriculture and Livestock
	A86	Vegetative material of Coffea arabica.	Ministry of Agriculture and Livestock
		Citrus plants.	Ministry of Agriculture and Livestock
	P11	Radioactive materials and ionizing radiation generating equipment for industrial, medical, veterinary, agricultural and teaching purposes, as well as any other activity that could involve sources of ionizing radiation or that are specified by the relevant provisions.	Ministry of Energy, Natural Resources, Environment and Mines
	P12	Fresh and processed fruits and vegetables.	Ministry of Agriculture and Livestock
		Cocoa planting stock.	Ministry of Agriculture and Livestock
		Metal materials of copper, aluminum, bronze, iron and other metal alloys as raw material or for recycling.	(blank)
	P31	Red bean (tariff item numbers 0713.32.00 and 0713.33.40).	Ministry of Economic Development
		Sharks, parts and derivatives.	Ministry of Agriculture and Livestock
	P5	Animals, vegetables and their by-products and inputs for agricultural use.	Ministry of Agriculture and Livestock

Source: TRAINS Data Base, UNCTAD

Annex 4. Guatemala – Honduras Transfers: Ranking of the 25 top customs transactions with FYDUCA, by tariff item, 2019

Values in USD, volume in number of transactions and growth rates.

Tariff Item	Tariff Item Description	2019		Annual % change	
		Guatemala Values	Guatemala Transactions	Guatemala Values	Guatemala Transactions
2106	Food preparations	4,611,437	696	71.8%	35.7%
3401	Soap; organic surface-active products and preparations used as soap	5,014,208	1,637	68.0%	29.8%
3214	Putty, resin cements and other mastics; plasters (spackle compound) used in painting; non-refractory plaster (spackle compound) of the kind used in brickwork	3,405,651	739	65.7%	65.3%
3305	Hair preparations	2,984,560	971	61.4%	61.3%
1904	Prepared foods obtained by the swelling or roasting of cereals or cereal products (for example, corn flakes); cereals (other than maize (corn), in grain form, or in the form of flakes or other worked grains (except flour, groats and meal), pre-cooked or otherwise prepared, not elsewhere specified or included	4,511,104	408	56.7%	67.2%
3306	Preparations for oral or dental hygiene, including denture bonding powders and creams; yarn used for cleaning interdental spaces (dental floss), in individual retail packages	7,033,101	1,083	46.0%	40.1%
6305	Sacks (bags) and bags for packaging	2,925,644	220	35.7%	64.2%
2828	Hypochlorites; commercial calcium hypochlorite; chlorites; hypobromites; hypobromites	10,617,958	1,340	32.2%	34.0%
5407	Woven fabrics of synthetic filament yarn, including fabrics obtained from materials of heading No. 54.04	3,736,679	333	31.1%	50.7%
2008	Fruits, nuts and other edible parts of plants, otherwise prepared or preserved, whether or not containing added sugar or other sweetening matter or spirit, not elsewhere specified or included	4,522,337	1,462	26.6%	22.4%
2202	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavored, and other non-alcoholic beverages, not including fruit or vegetable juices of heading No. 20.09	17,927,234	1,942	26.1%	44.1%
3923	Articles for the conveyance or packing of goods, of plastics; stoppers, lids and caps	9,976,980	2,701	25.5%	-1.3%
3809	Finishing agents, dye carriers to accelerate the dyeing or fixing of dyestuffs and other products and preparations (for example, dressings and mordants), of a kind used in the textile, paper, leather or like industries, not elsewhere specified or included	3,073,212	1,093	24.2%	24.6%
8506	Primary cells and primary batteries, electrical	3,291,105	101	18.0%	48.5%
2103	Sauces and preparations therefor; mixed condiments and mixed seasonings, mustard flour and meal and prepared mustard	12,345,932	715	15.6%	11.7%
1905	Bread, pastry, cakes, biscuits and other bakers' wares, whether or not containing cocoa; communion wafers, empty cachets of a kind suitable for pharmaceutical use, sealing wafers, rice paper and similar products	28,861,879	3,177	14.4%	6.5%
9404	Mattress supports; articles of bedding and similar furnishing (for example, mattresses, quilts,	10,663,977	1,062	13.1%	17.2%

Tariff Item	Tariff Item Description	2019		Annual % change	
		Guatemala Values	Guatemala Transactions	Guatemala Values	Guatemala Transactions
	comforters, cushions, pouffes, pillows) with springs or stuffed or internally fitted with any material, including cellular rubber or plastics, whether or not covered				
6907	Unglazed ceramic flags and tiles for paving, flooring or wall tiles; unglazed ceramic mosaic cubes and the like, unglazed, whether or not on a backing	15,054,885	1,722	10.4%	19.0%
3405	Polishes and creams for footwear, encaustics, polishes for bodywork, glass or metal, scouring pastes and powders and similar preparations (including paper, wadding, felt, nonwovens, cellular plastics or cellular rubber, impregnated, coated or covered with such preparations), excluding waxes of heading 34.04	5,156,212	1,270	5.5%	20.6%
7216	Iron or non-alloy steel sections	5,417,088	574	5.3%	7.5%
7010	Carboys, bottles, flasks, jars, jars, tubular containers, ampoules and other containers for the conveyance or packing of goods, of glass; preserving jars, of glass; stoppers, lids and other closures, of glass	6,641,319	616	-0.7%	7.3%
3917	Pipes and pipe fittings (e.g., joints, elbows, elbow joints, (fittings)), plastic	7,810,694	812	-8.2%	20.8%
4819	Boxes, sacks (bags), pouches, cones and other packing containers, of paper, paperboard, cellulose wadding or webs of cellulose fibers; office, store or similar containers	3,094,834	836	-9.7%	28.0%
3402	Organic surface-active agents (other than soap); surface-active preparations, washing preparations (including auxiliary washing preparations) and cleaning preparations, whether or not containing soap, other than those of heading No. 34.01	4,179,103	1,567	-21.0%	15.6%
1104	Cereal grains otherwise worked (for example, hulled, rolled, rolled, flaked, pearled, sliced or kibbled), except rice of heading 10.06; germ of cereals, whole, rolled, flaked or milled	3,398,585	144	-22.7%	-12.7%
	Sub total	**186,255,719**	**27,221**		

Source: SIECA

Annex 5. Honduras – Guatemala Transfers: Ranking of the 25 top customs transactions with FYDUCA, by tariff item, 2019

Values in USD, volume in number of transactions and growth rates.

Tariff item	Tariff Item Description	2019		Annual % change	
		Honduras Values	Honduras Transactions	Honduras Values	Honduras Transactions
8463	Other machine tools for working metal or cermets, without removing material	908,289	12	90728.9%	1100.0%
8429	Bulldozers, angledozers, graders, levelers, scrapers, mechanical shovels, excavators, loaders, shovel loaders, tamping machines and roadrollers, self-propelled	1,218,533	16	485.8%	433.3%
4823	Other paper, paperboard, cellulose wadding and webs of cellulose fibers, cut to size; other articles of paper pulp, paper, paperboard, cellulose wadding or webs of cellulose fibers	1,063,117	161	320.5%	140.3%
0902	Tea, whether or not flavored	484,657	10	138.9%	100.0%
4821	Paper or paperboard labels of all kinds, whether or not printed	745,927	46	121.5%	130.0%
2106	Food preparations	902,136	54	77.7%	50.0%
1101	Wheat or meslin flour (tranquillon).	7,709,230	669	71.8%	55.2%
4415	Packing cases, boxes, crates, drums (cylinders) and similar packings, of wood; cable-drums of wood; pallets, box pallets and other load boards, of wood; pallet collars of wood	874,735	74	62.5%	94.7%
1704	Non-cocoa confectionery (including white chocolate)	1,521,923	127	62.4%	98.4%
2306	Oilcake and other solid residues, whether or not ground or in the form of pellets, resulting from the extraction of vegetable fats or oils, excluding those of heading No. 23.04 or 23.05	744,500	290	62.1%	271.8%
6205	Men's or boys' shirts	539,213	1,388	58.1%	18.5%
0805	Fresh or dried citrus fruits	1,022,830	1,624	53.5%	51.4%
6109	T-shirts and jerseys, knitted	2,619,544	164	48.0%	49.1%
3923	Articles for the conveyance or packing of goods, of plastics; lids, caps	7,772,526	2,266	47.8%	118.1%
4820	Registers, account books, checkbooks (for notes, orders or receipts), diaries, memorandum pads, blocks of stationery and similar articles, notebooks, desk folders, files, binders (loose-leaf or otherwise), folders and covers for documents and other school, office or stationery supplies, including forms in packets or manifold forms, whether or not containing carbon paper, of paper or paperboard; albums for samples or for collections and covers for books, of paper or paperboard	3,144,905	115	20.4%	-0.9%
1905	Bread, pastry, cakes, biscuits and other bakers' wares, whether or not containing cocoa; communion wafers, empty cachets of a kind suitable for pharmaceutical use, sealing wafers, rice, flour or starch paper and similar products	5,861,219	645	13.6%	137.1%
6203	Men's or boy's suits (two or three pieces), ensembles, blazers (jackets), trousers, bib overalls, boxers and shorts (except swimwear)	3,558,298	1,222	13.5%	-1.7%
1502	Fats of bovine animals, sheep or goats, other than those of heading No. 15.03	441,984	26	6.5%	18.2%
6204	Tailored suits, ensembles, jackets (coats), dresses, skirts, skorts, trousers, bib overalls, knickers and shorts (except swimwear), for women or girls	1,568,792	1,758	2.4%	-13.5%

Tariff item	Tariff Item Description	2019		Annual % change	
		Honduras Values	Honduras Transactions	Honduras Values	Honduras Transactions
3401	Soap; organic surface-active products and preparations used as soap	8,032,611	494	-9.0%	10.3%
1511	Palm oil and its fractions	1,754,195	137	-15.4%	-1.4%
7204	Waste and scrap of iron or steel, smelting, scrap ingots of iron or steel	2,577,169	503	-17.1%	-6.3%
2202	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavored, and other non-alcoholic, beverages, not including fruit or vegetable juices of heading No. 20.09	833,751	117	-30.5%	-31.2%
3302	Mixtures of odoriferous substances and mixtures (including alcoholic solutions) with a basis of one or more of these substances, of a kind used as a raw material in industry; other preparations based on odoriferous substances, of a kind used for the manufacture of beverages	754,871	20	-44.9%	122.2%
6406	Parts of footwear (including uppers whether or not attached to soles other than outer soles); removable in-soles, heel cushions and similar articles; gaiters, leggings and similar articles, and parts thereof	423,100	125	-48.5%	13.6%
	Sub total	**57,078,056**	**12,063**		

Source: SIECA

Annex 6: Methodology for constructing Rasmussen-Hirschman Indices[63]

Rasmussen compares the degree of interdependence of one industry with all industries, leaving the indices such that they subsequently undergo only minor revisions. The author used Leontief's inverse IOM (Import-Output Matrix) coefficients to calculate the overall effects of one industry on all others — and not only direct effects. By totaling the columns of the inverse IOM, it was possible to obtain the power of dispersion of an industry or the expansion of its effects on the industrial system (an expansion brought about in the industrial system following an increase in demand for industry *j).*

This coefficient is defined as U_j:

$$U_j = \frac{\frac{1}{n} Z_{i}}{\frac{1}{n^2} \sum_{i=1}^{n} Z_{\bullet j}}$$

where *n* is the number of areas of activity, and

$$Z_{\bullet j} = \sum_{i=1}^{n} Z_{ij}$$

where z_{ij} is the generic element of Leontief's inverse.[64]

The numerator reflects the average uses that one activity *(j)* makes of the production of other activities.[13] A comparison of the coefficients of use with the average for all activities (denominator) gives us areas having greater power of dispersion than the average *(Uj* > 1), which are the areas having the greatest drag capacity. When their final demand increases, they drag the others more intensively than the average.

A similar approach is used to define dispersion sensibility indexes of *i* (U_i), which indicate how activity *i* is dragged when it increases by one unit the final demand in all areas or the extent to which *i* is dragged (demand for product *j)* by the expansion of the industrial system; in other words,

$$U_i = \frac{\frac{1}{n} Z_{i\bullet}}{\frac{1}{n^2} \sum_{i} Z_i}$$

where Zi = Zij, with the rest of the elements being interpreted as in the preceding case.

Incorporation of weights

These indices can be perfected to the extent that those industries with identical indices may not equally affect (or be affected by) the rest of the system since *a)* not all industries have the same

[63] Sources, Noé Arón, & Sastré Gutiérrez, Myrna. (2001). Identificación empírica de sectores clave de la economía sud baja californiana. Frontera norte, 13(26), 51-76. Recuperado en 21 de enero de 2022, de http://www.scielo.org.mx/scielo.php?script=sci_arttext&pid=S0187-73722001000200003&lng=es&tlng=es.

[64] The denominator is, more clearly:

weight within the system (as measured, for example, by the weight of each activity in final demand) and *b)* a given industry may have a high dispersion index but one that is extremely concentrated in a small number of facilities.

The first problem is that of weights. This is an important issue, since an increase in final demand does not get distributed uniformly across all industries. If we take into consideration that such an increase is distributed among all industries as a function of their participation in final demand, equal to *n,* the significance would be as follows for industry *i:*

$$\frac{n X_{i\Delta}}{\sum_{i=1}^{n} X^{n\Delta}}$$

If we incorporate this weight into the sum of the elements in each row, we would have the following for activity *j:*

$$Z_{i\bullet}^{w} = \frac{n \sum_{j=1}^{n} Z_{ij} X_{j\Delta}}{\left[\sum_{j=1}^{n} X_{j\Delta}\right]}$$

as a result of which the increases are distributed among industries as a function of their participation in final demand. If we define total average as:

$$\frac{1}{n^2} \sum_{i} Z_{i\bullet}^{w}$$

the weighted dispersion sensibility index is as follows:

$$U_{\Delta}^{w} = \frac{\frac{1}{n} Z_{j\bullet}^{w}}{\frac{1}{n^2} \sum_{i} Z_{i}^{w}}$$

The index is similar to that obtained previously but the interrelationships are weighted by the weight of the various activities in final demand.

The problem of the dispersion of effects

The indices calculated to this point are average, and accordingly, sensitive to extreme values. Effects may be concentrated in a very few areas that depend to a large extent on other industries. It nevertheless appears to be reasonable to select as key industries those whose effects are reflected in many industries, because their effects will be dispersed to a greater extent within the industrial network.

To measure the greater or lesser concentration of drag effects, the following indices are calculated, which reflect the coefficients of variation (standard deviation from the mean):

$$v_{\bullet j} = \frac{\sqrt{\frac{1}{n-1}\sum_i \left(Z_{ij} - \frac{1}{n}\sum_i Z_{ij}\right)^2}}{\frac{1}{n}\sum_i Z_{ij}}$$

which makes it possible to determine whether the industry does or does not drag uniformly within the industrial system. By the same token,

$$v_{i \bullet} = \frac{\sqrt{\frac{1}{n-1}\sum_j \left(Z_{ij} - \frac{i}{n}\sum_j Z_{ij}\right)^2}}{\frac{1}{n}\sum_j Z_{ij}}$$

which makes it possible to determine whether (or not) the industrial system equally influences activity *i*.

Those industries having a high U_i (industries with great power of dispersion of their effects on the industrial system) and a relatively low V_i (industry *i* depends to a large extent on the overall system rather than on a small number of individual industries) may be considered to be key industries. In other words, key industries have significant effects on many industries. See Figure 2.

FIGURA 2.

	$\upsilon_j > 1$	$\upsilon_j < 1$
$\upsilon_i > 1$	1. Industrias clave (v_i y v_j pequeñas)	2. Industrias efecto de arrastre hacia adelante (v_i pequeño)
$\upsilon_i < 1$	3. Industrias con efecto de arrastre hacia atrás (v_j pequeño)	4. Industrias Independientes

Annex 7: Modeling methodology to determine the impacts of trade facilitation

In order to estimate the impacts of the full incorporation of El Salvador into the deep integration process, this study uses a series of coefficients determined by ECLAC, in 2017, 2018 and 2019, and USAID, in 2021. These measurements were based on models' complex econometric models for international trade, which in the first part estimate the magnitude of the barriers to trade between countries (gravitational models), and then these results are used to be incorporated into other general equilibrium models to simulate the macroeconomic impacts on the GDP, and microeconomics in poverty.

Gravitational models:
Gravitational models of world trade are analogous to Newton's law of gravity, which states that the attraction of gravity between any two objects is proportional to the product of their masses and decreases with distance. This is replicated in trade between two countries and is key to understanding what happens in a customs union. Between countries, the model explains that trade will be proportional to the size of their GDP (the larger the greater the trade), but it will decrease depending on the distance between the countries (Krugman and Obsftel 2017). One way to put it is as follows:

$$Tij = A * Yi * Yj/Dij \qquad (1)$$

Where: *Tij* is the value of trade between country *i* and country *j*; *A* is a constant; *Yi* is the GDP of country *i*; *Yj* is the GDP of country *j*; while *Dij* is the distance between the two countries.

Based on this general equation, ECLAC (2018) determines the effects of reducing the time to export and import in different economic sectors by country, and then convert these impacts into ad valorem percentages of the products marketed.

The gravitational model used by ECLAC (2018) was as follows:

$$ln(X_{ij}k) = A+\beta_1\, ln(Y_ik) + \beta_2\, ln(Y_jk) + \lambda_j + \chi_i - \gamma_{ij}k\, ln(D_{ij})+\omega_{ij}k+e_{ij}k \qquad (2)$$

Where: *Xij* represents the exports from country *i* to country *j*; *Yi (Yj)* represents the GDP of country *i (j)*; *k* represents a classification of product groups; D is a vector that represents the variables linked to the distance (including time, the main variable used to define the cost due to administrative barriers) between countries; the variables χi and λj are fixed effects associated with each country; τt is the year fixed effect; ωij is the variable associated with the probability of trading between countries and a partner j, and *eij* is the stochastic error associated with the unobservable variables.

The results of the estimated parameter γijk, which expresses changes in trade levels, were transformed into a policy variable, taking the gain or loss of trade derived from time to an equivalent tariff for bilateral trade of each of the countries considered in the study. model.

The transformation of the estimated parameter into ad valorem tariff equivalents (AVEs) was carried out by computing the ratio between the predicted coefficient for the variable of time to

export (import) and the elasticity of demand, a value that was multiplied by the time expressed by the number days needed to complete the process, as follows:

$$EAV_{f,i-j}^{k} = \left(\frac{\gamma_i^k}{\varepsilon_{ik}} * t_f\right) \qquad (3)$$

Where: γ is the coefficient associated with time in the gravitational equation; f represents the trade flow that can be an export or import; i the exporting or importing country; k identifies the product group; t the time expressed in number of days; and εik is the demand elasticity of country i for product k.

The result obtained is the ad valorem equivalent associated with exports/imports of goods from the kth sector of the economy.

Computable General Equilibrium Model

Computable General Equilibrium Models (MEGC) are tools that allow modeling the behavioral relationships of economic agents (producers, consumers, government and external sector) in the different markets of the economy (goods market, financial market, etc.) and the closing conditions necessary for them to be simultaneously in equilibrium. To do this, use is made of sharing functions of the economic agents –based on economic theory– that depend on relative prices and that allow their decisions to be modeled, at the same time, the set of relative prices that clear the markets is determined. , that is, the functions of excess demand and supply of all markets are equal to zero. Thus, the CGEMs allow synthetically modeling different markets at the same time, which makes it easier to assess the impact of an economic policy on the different productive activities, factors of production and even with respect to different economic agents at the same time (ILO, 2018).

Between 2015 and 2018, ECLAC has used the MEGC GTAP, a multi-regional and multi-sector model that uses databases of the input-output matrices of each country, guaranteeing that the model responds to the productive structure of the countries and regions analyzed. International trade and transportation data complement the information in the input-output matrices. All the countries in the model are interconnected with each other based on bilateral trade flows. In this way, the multiple value chains in the global economy are considered, and particularly the interconnection between the Central American economies, since they are all part of the GTAP (Global Trade Analysis Project) database and model.

The model is represented as a set of simultaneous equations, and can be schematized through the interaction between households, companies and the government, all economic agents in each region or country of the model. It is assumed that each firm produces a single good, and that for this it requires primary factors (skilled and unskilled labor, land, capital, and natural resources) and the respective intermediate inputs. In each economy, the behavior of production is characterized by the maximization of company profits. It combines resources or factors with intermediate inputs in a nested Constant Elasticity of Substitution (CES) structure, with imperfect substitution at each stage of production (between factors of production and intermediate inputs, and between domestic intermediate inputs and domestic inputs). intermediates imported from various regions of the model).

The model includes a regional household in each economy, which allocates income through private household consumption, public consumption through the government, and future consumption in the form of savings. Savings from each region are collected by a Global Bank and distributed among the regions in the form of capital investments dictated by rates of return.

The consumption decisions of households and companies distinguish between domestic and imported goods, and between imported goods according to their origin (Armington, 1969, cited in ECLAC, 2018). This assumption makes it possible to model the flows of the same good in two directions: the same good can be exported and imported simultaneously. However, it makes imports perfect substitutes for domestic products.

The baseline for the structure of the model used for the simulations carried out by ECLAC corresponds to the year 2011. For tariff protection, the revision of tariffs was carried out until 2017, including the status of the tariff preferences received and granted by the countries of other countries. trading partners until December 2017 (United States, European Union, and others), and ad valorem estimates calculated according to the method described.

The applied model considers an opening of 33 sectors of goods and one of services, and a set of 34 regions and/or countries, which considers all the Central American countries individually (See lists).

Main groups of products considered in the MEGC

Individuales series	Main groups of products
rice wheat other cereals fruits and vegetables oilseeds vegetal fibers other crops cattle raising forest fishing	Agriculture, hunting and fishing
Crude oil, gas and coal non-energy mining	oil and mining
meat dairy products vegetable oils sugar other foods drinks and tobacco	food, beverages and tobacco
textiles confections leather and footwear	textiles, clothing and footwear
oil and byproducts chemicals	chemical and petrochemical
iron and Steel metal products	Metals and derived products
vehicles	machinery and equipment

Countries and regions that formed the MEGC

Individual regions/countries	Sub-regional groupings
Costa Rica El Salvador Guatemala Honduras Nicaragua Panamá	Central American Common Market
Argentina Brasil Paraguay Uruguay Venezuela, R.B.	MERCOSUR
Chile	Chile
Bolivia, E.P. Colombia Ecuador Perú	Andean Community
República Dominicana Jamaica Trinidad y Tabago Resto del Caribe	Caribbean countries
México Canadá Estados Unidos Unión Europea	North American Free Trade Agreement
Japón China	Asia and The Pacific

Main groups of products considered in the MEGC

Individuales series	Main groups of products
Transportation equipment	
electric equipment	
machinery and equipment	
paper products	Other manufacturing
wood products	
non-metallic minerals	
other manufactures	
services	services

Countries and regions that formed the MEGC

Individual regions/countries	Sub-regional groupings
Australia	
Nueva Zelanda	
Corea del Sur	
ASEAN	
Otros Asia Pacífico	
Medio Oriente y Norte de África	Middle East and Africa
África Subsahariana	
Resto del Mundo	Rest of the world

Source: ECLAC (2018), based on data and model of GTAP 9.0