

RECOMMENDATION FROM THE COMMISSION TO THE COUNCIL

authorising the Commission to open negotiations for the conclusion of an Association Agreement between the European Community and its Member States and the Central American Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

EXPLANATORY MEMORANDUM

At the European Union-Latin America and Caribbean Summit held in Vienna on 12-13 May 2006, the Heads of State and Government of the European Union and Central America decided to open negotiations on an Association Agreement between the two regions, including the establishment of a Free Trade Agreement. On the basis of Article 300 of the Treaty on European Union, the Commission herewith presents its recommendation to the Council in order to open these negotiations.

1. BACKGROUND

1.1. Situation in the region

The six Spanish-speaking countries that make up the Central American isthmus form an important Latin American sub-regional group linking North and South America. The sub region has a population of approximately 35 million inhabitants. GDP per capita ranges from below USD 1,000 in Nicaragua and Honduras to above USD 4,500 in Costa Rica and Panama, coupled with high levels of human development in Costa Rica (Human Development Index – HDI – in 2005 of 47) and medium human development levels in the remaining countries (Panama - 56, El Salvador - 104, Nicaragua - 113, Honduras - 116, Guatemala - 117).

The progress achieved in peace-building and democratisation has greatly transformed the region since the internal conflicts that plagued Guatemala, El Salvador and Nicaragua during the 1970s and 1980s. In political terms, all countries in Central America are now democracies, with peaceful and orderly elections having been held in the past two years in El Salvador, Panama, Honduras, Costa Rica and Nicaragua. However, important challenges remain in the fields of governance, the rule of law and human rights in some countries, notably Guatemala¹.

Following a decade of relative vigorous economic development in the 1990s, GDP growth in Central America averaged some 4.2% in the 2003-2005 period. This is an improvement on 2000-2002, but falls short of the recent overall performance of the Latin American region due to the structure of natural resource endowments, the current world market situation and the increase in oil prices.

General macroeconomic stability throughout Central America has been backed up by

¹ Panama has been identified as a tax haven by the OECD Global Forum on taxation in a list published in 2002 and committed on 15 April 2002 to implement the principles of transparency and exchange of information for tax purposes.

improved fiscal performance, in part assisted by debt reduction initiatives in Nicaragua and Honduras under the Heavily Indebted Poor Country (HIPC) initiative. Family remittances, mostly from the US, have been steadily growing and also play an important part in Central American economic equilibrium. Although macro-economic fundamentals such as budget and current account deficits and inflation are globally under control, the general weakness of the state in Central America, paltry tax revenues and the lack of redistributive state policies have, with the notable exception of Costa Rica, impeded the development of social cohesion.

Security matters are raising concern in the isthmus. Although Central America is not a major drug producer, it is an important transit region for South American drugs en route to the USA and, at lower levels, to Europe. At the same time, there has been a growing wave of illegal trafficking and violent crime. Particular attention has been paid to the mounting crime committed by youth gangs (known as '*maras*'). So far their activities have been concentrated in Honduras, El Salvador and Guatemala with some spill over into southern Mexico. As regards environmental and sustainability issues, the region is affected by increasing, and in some cases, irreversible environmental degradation. Additionally, natural disasters closely linked to climate variability have increased in frequency and intensity in past decades.

1.2. Regional integration in Central America

The process of Central American integration dates back to 1951 when the Organisation of Central American States (ODECA) was founded. This was followed by the creation of the Central American Common Market (MCCA), the Central American Bank for Economic Integration (BCIE), and the Secretariat for Central American Economic Integration (SIBCA) in 1960. In 1973, ODECA was suspended and progress in regional integration came to a standstill. Some 20 years later, in 1993, a new integration framework, the Central American Integration System (SICA) came into existence. SICA is made up of three bodies: the Central American Court of Justice (CCJ), the Central American Parliament (PARLACEN), and the Secretariat General of the Central American Integration System (SG-SICA). In addition, the system encompasses numerous technical secretariats (including SIECA), permanent specialised institutions (including the BCIE) and inter-governmental fora.

Economic integration has, since the 1960s, been one of the main pillars of the integration process in Central America as it is considered an essential requirement for the sustainable development of the region. At present, the regional economic integration system SIECA encompasses five countries: Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica. Panama, which is only part of the political integration system (SICA), is increasingly pondering the possibility of joining the regional economic integration sub-system, which would allow it to fully participate in future bi-regional negotiations with the EU. In March 2002, the Central American Presidents approved an ambitious Plan of Action for Central American Economic Integration in order to achieve a customs union, originally by 1 January 2004. A new date of the end of 2006 was decided by all regional heads of state during their Panama summit in March 2006 and enshrined in an agreed roadmap. The EU has proved particularly instrumental in supporting the renewed momentum in the regional integration process, notably by providing assistance to regional integration efforts and offering the perspective of a bi-regional Association Agreement.

1.3. European Union-Central American relations

The European Union and Central America enjoy a comprehensive relationship that encompasses political dialogue (the San José Dialogue), a favourable trade regime and a broad cooperation framework.

Political dialogue

The San José Dialogue forms the cornerstone of EU-Central American relations. It was initiated in Costa Rica in 1984 and renewed in Florence (1996) and in Madrid (2002). It can claim a notable historical success in that it was the key instrument in bringing about peace and re-establishing democracy in the region in the early 1990s. This success has gained the EU a high degree of political credibility and has also enabled the dialogue to focus on the important related areas of regional integration and economic and social development.

In accordance with the decision taken at the 2002 EU LAC Summit in Madrid, a new EU Central America Political Dialogue and Cooperation Agreement was signed in 2003 in order to strengthen bi-regional relations and to create the conditions under which a feasible and mutually beneficial Association Agreement, including a Free Trade Agreement, could be negotiated between the Parties. The 2003 Agreement formalises and strengthens the San José Dialogue process, and includes new areas of cooperation such as human rights, migration and counter-terrorism. Special emphasis is also placed on cooperation in support of the process of regional integration in Central America. This Agreement is currently being ratified by the Parties and will replace the 1993 Framework Cooperation Agreement.

Economic relations

The EU is the second most important trade (9% of total trade in 2004) and investment partner for the Central American sub-region after the United States (45% of total trade). Central America's share of total EU imports passed from close to 0.4% in 2000 to 0.3% in 2005, and its share of total EU exports was 0.35% in 2005, with exports from Central America being mainly agricultural goods and imports from the EU predominantly industrialised goods. Central America's traditional trade surplus with the EU has progressively increased since 2001, and reached some EUR 1 billion in 2005.

Central America's trade with the EU is highly concentrated in a few countries. Especially Costa Rica, which accounted for over 64% of EU imports from the region in 2005. In general, EU exports to the region are less focused on a specific country; however, Costa Rica and Panama together absorbed 55% of those exports in 2005.

Commercial relations between the EU and the Central American sub-region are dominated by the Generalised System of Preferences (GSP). This special arrangement provides duty-free access to EU markets for all industrial products as well as duty-free access for some agricultural products from Central America. A new GSP+ regime came into effect in 2005 and will run until 2008. In January 2006, a new tariff-only system was introduced for banana exports.

Cooperation

Cooperation with Central America is currently governed by the 1993 Framework Cooperation Agreement. Historically, this cooperation has focused on human rights and democracy, integrated rural development, disaster prevention and reconstruction, social development and regional integration. The sub-region has traditionally received the largest share of EC cooperation with the Latin American region, in both absolute and per capita terms. An average of EUR 145 million per annum was granted over the period 1995-2001. In addition to economic, financial and technical cooperation, other major initiatives have included the Central American Programme for Reconstruction and Rehabilitation (EUR 250 million) following Hurricane Mitch plus EUR 25 million for reconstruction in El Salvador, a programme of support to the BCIE for the development of small and medium-sized enterprises (EUR 120 million) plus considerable support for human rights and democracy (in excess of EUR 100 million), all of which are funded from specific budget lines.

In 2001, a series of Memoranda of Understanding were signed between the EC and the six Central American countries, establishing a five-year national and regional programme of cooperation with an indicative allocation of EUR 655 million (during 2002-2006). This funding includes EUR 75 million for sub-regional programmes aimed at supporting the process of regional integration, including the incorporation of civil society therein and reduction of vulnerability to natural disasters.

At the country level, indicative allocations range from EUR 24 million for Panama to EUR 192.5 million for Nicaragua. The principal focal areas at national level include strengthening justice and the rule of law, poverty reduction and social development, decentralisation and local development, education and economic competitiveness. Currently, the Commission is preparing new Regional and Country Strategy Papers for the period 2007-2013, which are expected to be adopted by the Commission at the beginning of 2007.

EC support at regional level is intended to facilitate negotiation and implementation of the future Association Agreement. Three groups of potential measures have been considered: (i) strengthening the institutional system for the process of Central American integration; (ii) reinforcing the regional economic integration process; and (iii) strengthening regional security.

1.4. Further developments

The decision to conclude a wide-ranging Association Agreement with Central America stems from the judgement that the context is favourable for a further qualitative step in the relationship between the two regions. This judgement is based on the following evidence:

- The clear political commitment made by both regions at the EU-Latin America and Caribbean Summits in Madrid (2002) and Guadalajara (2004) to strengthen bi-regional links and to set the conclusion of an Association Agreement as their strategic objective;
- The signature, in 2003, of a new Political Dialogue and Cooperation Agreement, which provides for institutionalised political dialogue and enhanced cooperation as a preparatory step towards Association;

- Renewed momentum towards regional integration in Central America, which has already brought concrete results during the last few years, including deeper economic integration, as confirmed by the Joint Assessment of regional economic integration carried out in 2005 and 2006.

As stated in the Vienna Declaration; the negotiation process for an Association Agreement with Central America will not start automatically. The basic assumption is that negotiations should not actually begin before Central America has fulfilled the commitments made in Vienna (essentially, setting up a Customs Union, ratifying the Central America Treaty on services and investment and developing a jurisdictional mechanism for securing the enforcement of economic legislation). In this respect, it should be noted that the Central American Presidents' Declaration of 9 March in Panama clearly established the end of 2006 as the target date for the creation of a Central American Customs Union.

2. REFERENCES

The following agreements, declarations, decisions and papers are essential reference points for drafting negotiating directives for an Association Agreement between the EU and Central America:

- The **Framework Cooperation Agreement** between the European Economic Community and the Republics of Costa Rica, El Salvador, Guatemala; Honduras, Nicaragua and Panama of 23 February 1993.
- The **EU-Central America Political Dialogue and Cooperation Agreement** signed in Rome on 15 December 2003, which aims to strengthen bi-regional links and to create the conditions under which a feasible and mutually beneficial Association Agreement, including a Free Trade Agreement, could be negotiated between the Parties.
- The Political Declaration of the EU-Latin America and Caribbean Summit held in **Guadalajara on 28 May 2004**, where the heads of state of Latin America and the EU agreed that an Association Agreement was their “common strategic objective”.
- The **December 2005 Communication** from the Commission on ‘*A reinforced European Union-Latin America partnership*’, restating its long-term aim of achieving a strategic partnership with the entire Latin American region while stressing the need for the EU to “support the sub-regional integration processes”, notably by opening negotiations towards an Association Agreement and a Free Trade Area with Central America.
- The Joint Communiqué of the **Fourteenth meeting of the EU-Central America Joint Committee** held on 2 March 2006 in Nicaragua, in which the Parties expressed their satisfaction at the useful work carried out by Ad Hoc Joint Working Group in charge of assessing economic regional integration in Central America.
- The Political Declaration of the **Fourth EU-Latin America and Caribbean Summit** and the Joint Declaration of the **Second EU-Central American Summit** held in **Vienna on 12 and 13 May 2006** respectively, welcoming the decision taken by the European Union and Central America to launch negotiations on an Association Agreement, including the establishment of a Free Trade Area.

3. THE ASSOCIATION AGREEMENT

The Agreement proposed by the Commission will be based on the following outline:

- Preamble
- Objectives nature and scope of the Agreement
- Political dialogue
- Trade
- Cooperation
- General provisions
- Institutional framework
- Structure and organisation of the negotiations
- Final provisions

An important feature of the Agreement is that it will be negotiated on a region-to-region basis in order to provide further impetus to regional integration in Central America. This excludes the possibility of negotiation with individual countries.

A clause establishing the conditions for the start of negotiations and the conclusion of the Agreement should also be considered in the negotiating directives. This clause should relate to an assessment of Central America's delivery of its Vienna Summit commitments on consolidating economic regional integration in the isthmus, in particular, setting up a Customs Union by the end of 2006.

In accordance with the Declaration made at the Vienna Summit, active participation by Panama in the negotiations will be subject to its joining the economic integration process in Central America, SIECA.

The Commission has drafted an impact assessment which analyses the possible impacts of this Association Agreement. A more detailed trade-related Sustainability Impact Assessment (SIA) examining the Agreement's potential economic, social and environmental effects will be conducted in parallel to the negotiations.

The purpose of the Association Agreement is to:

- 1) Consolidate existing relations and develop their potential and mutual benefits by providing a comprehensive, forward-looking perspective for the whole of the EU-Central America relationship;
- 2) Develop a privileged political partnership based on respect for and the promotion of human rights, democracy and good governance, and on defending these common values on the world stage, while contributing to the development of multilateralism;
- 3) Firmly root in the democratic achievements in Central America by fostering further intra-regional links and enhancing bi-regional political dialogue and cooperation;
- 4) Enhance bi-regional cooperation so as to reinforce the political, social and economic stability of the Central American countries, deepen the process of regional integration, help create conditions for reducing poverty, promote decent work and more equitable access to social services, as well as ensure an appropriate balance between economic,

social and environmental components in a sustainable development context;

- 5) Set out the conditions for the gradual establishment of a Free Trade Area between the two regions, and develop both intra- and bi-regional trade exchanges;
- 6) Provide further impetus to the regional economic integration process (notably by negotiating on a region-to-region basis), in order to contribute to higher economic growth and gradual improvement of quality of life for their peoples, integrate Central America in the world economy, harness globalisation in support of sustainable development and open up to new partnerships on the world stage;
- 7) Bolster good neighbourly relations and the principles of peaceful resolution of disputes between the Central American states.

The objective is to complete these negotiations no later than two years after their effective start. In line with normal practice, the Commission will report regularly to the Member States in the appropriate committees of the Council on progress in the negotiations.

The Agreement will build upon and replace the existing 1993 Framework Cooperation Agreement between the two regions and the 2003 Political Dialogue and Cooperation Agreement between the EU and Central America, which has yet to be ratified.

RECOMMENDATION

In the light of the above, the Commission recommends that the Council:

- authorise the Commission to negotiate an Association Agreement, including a Free Trade Area, with the Central American Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama;
- designate a special committee to assist the Commission, which in accordance with the Treaty establishing the European Community will conduct these negotiations on behalf of the European Community;
- adopt the attached negotiating directives.

ANNEX

DIRECTIVES FOR THE NEGOTIATION BY THE COMMISSION OF AN ASSOCIATION AGREEMENT BETWEEN THE EUROPEAN COMMUNITY AND ITS MEMBER STATES, ON THE ONE PART, AND THE CENTRAL AMERICAN REPUBLICS OF COSTA RICA, EL SALVADOR, GUATEMALA, HONDURAS, NICARAGUA AND PANAMA, ON THE OTHER PART

Preamble

Consideration shall be given to the traditional historical and cultural links between the Parties and to the desire to consolidate, deepen and diversify bi-regional links in areas of mutual interest in a spirit of mutual respect, equality, non-discrimination, solidarity and mutual benefit.

Mention should be made of the conclusions of the Vienna Summit, including the commitments undertaken by Central America as regards the deepening of regional economic integration.

The Association should build on the existing principles, objectives and mechanisms that govern relations between the two regions, in particular the 1993 Framework Agreement on Cooperation and the 2003 Political Dialogue and Cooperation Agreement.

The Association should be founded on

- greater political cooperation;
- progressive and reciprocal liberalisation, by means of an ambitious, comprehensive, balanced Free Trade Area fully compliant with the rules and obligations of the World Trade Organisation, as well as investment promotion;
- enhanced cooperation in all matters of common interest.

At the same time, the Parties shall reiterate their commitment to further promote and strengthen the strategic partnership developed between the European Union and Latin America and the Caribbean at the 1999 Rio Summit and reaffirmed at the subsequent EU-Latin America and Caribbean Summits in Madrid (2002), Guadalajara (2004) and Vienna (2006).

The following fundamental elements shall be contained in the Association Agreement:

- 1) Respect for and the promotion of democratic principles, fundamental human rights and fundamental freedoms as set out in the Universal Declaration of Human Rights: This shall constitute an essential element of the Agreement, including respect for the rights and fundamental freedoms of ethnic minorities and indigenous peoples. The Parties should recognise that the protection of human rights defenders and the elimination of impunity are basic conditions for progress in these areas.
- 2) The principles of the rule of law, good governance and the fight against corruption,

including international commitments on good governance, labour rights and environmental related provisions subscribed to by and applicable to the Parties at the time of the application of the Agreement.

- 3) The importance of strengthening regular political dialogue on bilateral and international issues of mutual interest as established by the 2003 Political Dialogue and Cooperation Agreement.
- 4) A commitment to the shared responsibility principle in respect of the fight against illicit drug consumption, production and trafficking; a commitment to fight money laundering, organised crime (including corruption), terrorism as well as to the need for enhanced cooperation in the field of justice, freedom and security, covering rule of law, migration, and asylum issues.
- 5) Reaffirmation of the willingness to contribute resolutely, through constructive engagement, to common responses to the main development and security problems and to combat threats to peace and security such as the proliferation of weapons of mass destruction. This shall include enhanced cooperation in foreign and security policy, with a particular emphasis on regional issues, conflict prevention and disarmament, together with cooperation in international fora, with a view to arriving at convergent positions and addressing global issues through multilateralism.
- 6) Expression of the commitment to a strong and effective multilateral system, based on international law, supported by strong international institutions and with the United Nations at its centre.
- 7) Inclusion of the standard clauses on:
 - the fight against terrorism,
 - countering the proliferation of weapons of mass destruction,
 - serious crimes of international concern (the International Criminal Court).
- 8) Reaffirmation of the need to strengthen the programme of cooperation governed by the Framework Cooperation Agreement between the European Economic Community and the Republics of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama signed in 1993.
- 9) The Agreement will recognise that sustainable development is an overarching objective of the Parties and will aim at furthering their economic development together with a high level of environmental protection and social cohesion. In particular, the Agreement should:
 - reaffirm the commitment to increase social cohesion (inter alia through investing in people and their institutions, including education, research and innovation) to promoting equitable and sustained economic growth in order to create more and better jobs, to promote decent work, foster social dialogue, as well as to fighting poverty, social exclusion and all forms of discrimination to improve the living conditions of all individuals and groups;
 - reaffirm the commitment to working together in pursuit of environmental aspects of sustainable development, for example on vulnerability to natural disasters, protection

of the environment, sustainable management of natural resources and biodiversity;

- help promote the progressive integration of Central American countries into the world economy. In this context, the relationship between poverty/social cohesion and the environment, as well as the environmental impact of economic activities shall be considered key factors.

The implementation of the conclusions of the World Summit on Sustainable Development and commitment to reaching the Millennium Development Goals should be taken into account in all activities undertaken by the Parties under the Agreement.

- 10) Provision for readmission on the basis of EU Council decisions.
- 11) The importance attached to the principles and rules which govern international trade, in particular under the auspices of the WTO, and to the need to apply them in a transparent and non-discriminatory manner will be underlined.
- 12) Provision within the Association for a comprehensive, balanced Free Trade Area, fully compliant with the rules and obligations of the WTO while going beyond the WTO's basic rules, so as to maximise the mutual and long term benefits of bi-regional trade liberalisation.
- 13) Reaffirmation of the principles and values on which both sides base their regional integration and inter-regional trade relations. The pursuit of development that is sustainable according to economic, social and environmental criteria will be the overarching objective and a criterion by which issues arising under different political, cooperation and trade headings in the agreement may be settled.
- 14) The belief that the Free Trade Area will create a new climate for economic relations between the two Parties and above all for the development of trade and investment, which are factors crucial to economic reform and development.
- 15) Region-to-region asymmetries where necessary, while limiting differentiation of commitments between Central American countries strictly to a minimum.
- 16) Recognition of the need to deepen the process of regional integration, trade liberalisation and economic reform within the Central American region. The European side supports and encourages the process of trade liberalisation and economic integration so far implemented in Central America. In this context, the two sides will pay due consideration to the conclusions of the Joint Assessment carried out by the EU and Central American countries. They shall recognise the need to pursue full region-to-region negotiations on the Association Agreement for the purpose of stimulating and consolidating regional integration efforts in the isthmus, including economic regional integration.
- 17) Commitment to work together to provide comparable statistical information on selected areas, given that high quality statistics are a prerequisite to measuring progress on many of the elements listed in the Agreement.

Nature and scope of the Agreement

The Association Agreement with Central America is envisaged as a comprehensive agreement, governing the whole array of multifaceted relations between the EU and Central America (political dialogue, cooperation and trade) in a single Agreement, thus reflecting more visibly the depth and variety of bi-regional links while developing them further.

The purpose of the Association Agreement is to:

- 1) Consolidate existing relations and develop their potential and mutual benefits by providing a comprehensive, forward-looking perspective for the whole of the EU-Central America relationship;
- 2) Develop a privileged political partnership based on respect for and the promotion of human rights, democracy and good governance, and on defending these common values on the world stage, while contributing to the development of multilateralism;
- 3) Firmly root in the democratic achievements in Central America by fostering further intra-regional links and enhancing bi-regional political dialogue and cooperation;
- 4) Enhance bi-regional cooperation so as to reinforce the political, social and economic stability of the Central American countries, deepen the process of regional integration, help create conditions for reducing poverty, promote decent work and more equitable access to social services, contribute to the protection and preservation of the environment and natural resources, as well as ensure an appropriate balance between economic, social and environmental components in a sustainable development context;
- 5) Set out the conditions for the gradual establishment of a Free Trade Area between the two regions, and develop both intra- and bi-regional trade exchanges;
- 6) Provide further impetus to the regional economic integration process (notably by negotiating on a region-to-region basis), in order to contribute to higher economic growth and gradual improvement of quality of life for their peoples, integrate Central America in the world economy, harness globalisation in support of sustainable development and open up to new partnerships on the world stage;
- 7) Bolster good-neighbourly relations and the principles of peaceful resolution of disputes between the Central American states.

The Agreement will rest on the assumption that adherence to and effective implementation of international agreed standards in the social, core labour and environmental domain is a necessary condition for sustainable development. In particular, the Agreement will aim to maintain the level of good governance, social, labour and environmental standards achieved through ratification and effective implementation of relevant international Conventions subscribed by and applicable to the Parties at the time of entry into force of the Agreement.

The Association Agreement will replace the Political Dialogue and Cooperation Agreement signed in 2003.

Political dialogue

The Title of the Association Agreement on 'Political dialogue' shall be based on Title II 'Political dialogue', Articles 3 to 5, of the 2003 Political Dialogue and Cooperation Agreement, which formalises and strengthens the San José Dialogue process and provides for a comprehensive mechanism for cooperation.

Thus, political dialogue shall cover all aspects of mutual interest and also pave the way for new initiatives pursuing common goals and establishing common ground in areas of mutual interest including regional integration, poverty reduction and social cohesion, sustainable development, regional security and stability, conflict prevention and resolution, human rights, democracy, good governance, migration, fight against corruption, counter-terrorism, illicit drugs, small arms and light weapons, weapons of mass destruction and serious crimes of international concern.

As provided for in the 2003 Agreement, political dialogue should also include terms for cooperation in the field of foreign and security policy.

Dialogue under this Title shall include political aspects of the international conventions on human rights, good governance, core labour standards and the environment subscribed to by and applicable to the Parties at the time of the entry into force of the Agreement.

In consideration of the relevance of the indigenous peoples in Central America, the Parties could analyse how to take in due account and include, in the negotiations of the Agreement, a commitment to ratify and implement ILO Convention 169². One option would be to include in the Agreement a commitment to the principles contained in the Declaration on the rights of indigenous peoples, to be adopted by the UN General Assembly before the end of 2006.

A parliamentary dialogue, which will consist of representatives of the European Parliament and Central American parliamentary bodies, will be encouraged.

² Proposal made by representatives of civil society

Trade

Nature and scope

The Trade part of the Agreement shall deal comprehensively with all trade components, and be fully consistent with WTO rules and obligations. It shall provide for the progressive and reciprocal liberalisation of trade in goods and services, and the establishment of rules on a broad number of trade-related issues as specified below. It shall also provide for progressive and reciprocal liberalisation of conditions for establishment (and liberalisation of current payments and capital movements), and mutual access to public procurement markets.

Given that sustainable development is one of the overarching objectives of the Parties, the provisions relating to trade will aim to ensure and facilitate respect on agreed environmental and social standards, and at maximising any positive and minimising negative environmental and social impacts. The Agreement will recognise that the Parties shall not encourage foreign direct investment by lowering domestic environmental, labour or occupational health and safety legislation and standards, or by relaxing core labour standards or laws aimed at protecting and promoting cultural diversity. Sustainable development will also be taken into account throughout the trade provisions of the Agreement.

In order to stimulate and consolidate regional integration efforts in Central America, and to increase the benefits of a regional market as compared to rather small individual national markets for EU operators, the Commission will pursue full region-to-region negotiations in all trade and trade-related areas detailed below. Differentiation of Central American countries' commitments to the ED shall be limited to a minimum and only where a common approach would not be possible in the short term.

Taking into account different levels of development in the EU and in Central America, region-to-region asymmetries may be considered, where necessary, in all trade and trade-related areas discussed in the course of negotiations, for instance by agreeing to different timings for transitional periods.

Negotiations should also take into account specific interests of the outermost regions of the EU.

Trade in goods

The Agreement will aim at dismantling import duties and charges having an equivalent effect on both sides over a period of time not exceeding 10 years. The Agreement will cover substantially all trade in goods between the Parties in terms of both tariff lines and the value of trade and it will aim for a maximum of frontloading of full liberalisation commitments.

Specific provisions will regulate products identified as sensitive for which, for instance, a longer dismantling period or partial liberalisation commitments will apply. Any such specific provisions or treatment will be kept to a minimum, in terms of both tariff lines and the value of trade between the Parties. A review clause will provide scope for further liberalisation for products not subject to full liberalisation commitments, following the entry into force of the overall Agreement, or of a possible Interim Agreement.

The basic duties to which the successive reductions are to be applied shall be those applied by the European Community *erga omnes* on the day before the signing of the Agreement and the common external tariff applicable by Central America *erga omnes* on the day before the signing of the Agreement.

GSP preferences currently applied by the European Community to products originating in Central American countries shall be covered in the Agreement. Simultaneously, Central American beneficiary countries shall be withdrawn from the list of countries benefiting from Regulation (EC) No 980/2005 (GSP Regulation).

With regard to tariff lines not yet harmonised in Central America, the European Community will negotiate a dismantling schedule on the basis of a 'common tariff' previously agreed, for this purpose and for each product, by all Central American countries. The European Community should not negotiate an individual dismantling timetable for any product, regardless whether it is covered by the Central American CET or not.

If, after the entry into force of the overall Agreement or of a possible Interim Agreement a tariff reduction is applied *erga omnes*, it will replace the basic duties referred to above, and successive reductions shall be calculated according to these new base rates.

The Harmonized Commodity Description and Coding System shall be used for the classification of goods in trade between the Parties.

An annex setting out the applicable preferential rules of origin and containing provisions on administrative cooperation will be annexed to the Agreement. The annex will be based on the orientations of the Commission communication of 16 March 2005 entitled '*The rules of origin in preferential trade arrangements*'. The Parties shall agree that products originating in the Principality of Andorra (falling within Chapters 25 to 97) and products originating in the Republic of San Marino will be treated when imported in Central America as if they were originating in the European Community under the rules of origin set out in the Agreement.

The Parties shall agree that goods originating in the European Community within the meaning of the Annex on rules of origin shall circulate freely in Central America as of the first day of application of the overall Agreement, or of a possible Interim Agreement.

All customs duties, taxes or charges on exports and quantitative restrictions on exports to the other party which are not justified by the general exceptions set out below shall be abolished upon the entry into force of the overall Agreement, or of a possible Interim Agreement.

To maximise liberalisation commitments, the Agreement will contain a bilateral agricultural safeguard clause by which either party may restore MFN duties where a rise in imports of a product from the other party is causing or threatening to cause serious injury to its domestic industry, taking also into account the interests of the European Community's outermost regions. This clause will also cover sensitive processed agricultural products not included in Annex I of the Treaty.

A specific clause shall set out procedures and appropriate measures that the Parties may take in the event of lack of administrative cooperation in customs and customs-related matters, or if irregularities or fraud are established.

Provisions should also be included to jointly examine the possibility of adopting appropriate measures in case of errors committed by the competent authorities in the application of the preferential rules of origin, where such errors would lead to consequences in terms of import duties.

Central America shall undertake to the same trade regime with respect to Turkey as with the EU for all areas covered by the EC-Turkey Customs Union.

Non-tariff measures

The Agreement will forbid any ban, restriction or other non-tariff barrier (NTB) to trade which are not justified by the general exceptions set out below, and which could amount to a means of arbitrary discrimination or a disguised restriction on trade between the Parties. Provisions and procedures should be included to ensure the elimination of unjustified non-tariff obstacles to trade. The Agreement shall also contain provisions concerning the prohibition of fiscal discrimination.

Product-specific NTBs could be solved on a request and offer basis, in parallel with exchanges on tariff concessions. In order to improve market access at a level which cannot be achieved sufficiently through horizontal rules, the Agreement should include sector-specific commitments on non-tariff barriers. The Agreement should also envisage appropriate domestic procedures to prevent non-tariff barriers and other unnecessary obstacles to trade including through transparency in regulations.

The Agreement will refer to a number of general principles (such as proportionality, no due restrictions, transparency, non-discrimination) to be applied by the Parties in their mutual trade. Apart from confirming the provisions of the WTO Agreement on Technical Barriers to Trade, the Parties shall also establish provisions that facilitate access to each other's markets. The aim will be to include provisions on the adoption of recognised international standards and on the streamlining of testing requirements in a number of priority sectors. The Agreement will also aim at improving dissemination of information to importers and exporters, developing common views and promoting good regulatory practice, seeking compatibility and convergence of technical regulations, promoting close co-operation with and between relevant organisations responsible for standardisation and accreditation.

On sanitary and phytosanitary measures, the conditions negotiated shall follow the provisions of the negotiating directives adopted by the Council on 20 February 1995 (Council document 4976/95). Furthermore, the Agreement will refer to a number of general principles of the SPS WTO Agreements including proportionality, undue delays, transparency and non-discrimination, to be applied by the Parties in their mutual trade with the objective of facilitating access to each party's market while safeguarding public, animal and plant health.

The Agreement should in particular seek to achieve full transparency as regards sanitary and phytosanitary measures applicable to trade, work towards the establishment of a mechanism for recognition of equivalence including the prelisting of food-producing establishments, and work towards recognition of disease-free health status of the Parties and the principle of regionalisation for both animal and plant diseases, while maintaining essential minimal checks at the external border. Animal welfare shall be within its scope.

Trade defence instruments

The Agreement shall include a clause on anti-dumping and countervailing measures providing that any of the Parties may take appropriate measures against dumping and/or countervailable subsidies in accordance with the WTO Agreement on implementation of Article VI of the GATT 1994 or the WTO Agreement on Subsidies and Countervailing Measures.

The Parties should also agree to commitments that go beyond WTO rules in this area in line with EC rules and previous bilateral agreements (e.g. public interest test and lesser-duty rule, additional consultations).

Trade in services and establishment

The Agreement shall provide for the progressive and reciprocal liberalisation of establishment and of trade in services with the aim of ensuring a high level of market access opportunities consistent with the relevant WTO rules, in particular Article V of the GATS.

Taking into account their levels of development, Central American countries will be allowed a certain measure of flexibility in overall terms as well as in individual sectors and sub-sectors. Any transitional period should in principle not exceed 10 years.

While respecting Article V of the GATS, the commitments made by the EU shall not include:

- national maritime cabotage, and
- air services, including domestic and international air transportation services, whether scheduled or non-scheduled, and services directly related to the exercise of traffic right, other than:
 - aircraft repair and maintenance services during which an aircraft is withdrawn from service;
 - selling and marketing of air transport services;
 - computer reservation-system (CRS) services, and
 - other ancillary services that facilitate the operations of air carriers.

Audio-visual and other cultural services will be treated in a specific audio-visual and cultural framework. In developing this framework, the Parties will maintain the possibility of preserving and developing their capacity to define and implement their cultural and audio-visual policies for the purpose of preserving their cultural diversity, while promoting cultural and audiovisual exchanges and favouring inter-cultural dialogue, as a complement to co-operation activities as defined in the Cooperation Title.

Respecting the respective competences of the European Community and its Member States, the Parties shall agree to establish a framework for establishment which will be based on principles of transparency, non-discrimination, market access, stability and on general principles of protection.

Within this framework the Parties shall agree to grant treatment no less favourable for the establishment in their territory of the companies subsidiaries or branches of the other party

than that accorded to their own companies subsidiaries or branches taking due account of the sensitive nature of certain specific sectors.

The negotiations should address market access and national treatment across economic sectors and modes of supply and identify areas in which regulatory disciplines have greater potential to facilitate mutual trade.

Where a Central American partner has concluded another economic integration agreement with a third country which is not within the Central American region, EU investors and service suppliers shall be granted at least parity with the treatment granted to investors and service suppliers of this third country as regards cross-border supply of services and establishment.

Each agreement will not preclude the enforcement of exceptions on the supply of services justifiable under the relevant WTO rules (Articles XIV and XIV bis of the GATS).

Capital movement and payments

The Agreement will strive for full liberalisation of current payments and capital movements, and include a standstill clause. It will entail carve out provisions (e.g. in case of serious difficulties for monetary and exchange rate policy or for prudential supervision or taxation) which will be in accordance with the provisions of the EC Treaty on free movement of capital.

Public procurement

The Parties shall agree on measures aimed at the progressive liberalisation of their respective procurement markets at all levels of public authorities and public entities in the water, energy and transport sectors. The objective is to achieve reciprocal and gradual market access on the basis of the principles of non-discrimination and national treatment. The Agreement may also support further market opening at regional level between the Central American partner countries.

The Agreement shall provide for a set of binding rules including adequate transparency provisions that support the setting up of effective procurement systems. They should also provide for timely and effective challenge procedures and cooperation on electronic procurement.

Trade and competition

The Agreement shall include provisions addressing effective competition rules and their enforcement.

These provisions shall identify anti-competitive behaviour that would be considered incompatible with the proper functioning of the Agreement and should include rules on restrictive agreements and concerted practices between undertakings abuse of dominant position merger control and state aid which prevent or lessen competition in the territory of

the European Community or Central America, to the extent that they affect trade between the Parties.

The provisions on competition should address the appropriate legal and administrative framework and national bodies in charge of implementing competition rules with a view to ensuring transparent and effective enforcement of their respective competition rules.

Intellectual property rights and geographical indications

The Agreement shall include provisions to ensure effective and adequate protection and enforcement of intellectual property rights, including detailed elements on the protection and enforcement of intellectual property rights together with commitments to adhere to multilateral agreements in this field.

The Agreement shall contain provisions effectively recognizing and protecting *ex officio* geographical indications, including the phasing out of generic denominations.

Customs-related matters and trade facilitation

Negotiations shall aim at facilitating border crossing trade while maintaining effective control by including commitments on the Parties' rules, requirements, formalities and procedures for imports, exports and transit.

The outcome of the negotiations shall promote the effective implementation and application of international rules and standards in the field of customs and other trade related procedures, including WTO provisions and WCO instruments such as the revised Kyoto Convention. It shall also promote effective regional transit arrangements.

The Agreement shall promote effective and efficient IPR enforcement by customs authorities, regarding imports, exports, re-exports, transshipments and other customs procedures, and in particular as regards counterfeit goods.

Trade and sustainable development

The Agreement will include commitments by both sides in terms of the social and environmental aspects of trade and sustainable development.

The Agreement will include trade provisions to promote adherence to and effective implementation of internationally agreed standards in the social and environmental domain as a necessary condition for sustainable development. The Agreement would therefore include mechanisms to support positively the effective domestic implementation of International Labour Organization (ILO) core labour standards, as defined in the 1998 ILO Declaration of Fundamental Principles and Rights at Work, and relevant international environmental standards, as well as enhanced cooperation on trade related aspects of sustainable development. Consideration will also be given to measures to facilitate and promote trade in environmental goods, services and technology. The Agreement will foresee the monitoring of the implementation of these commitments through inter alia review and public scrutiny as

well as instruments of encouragement and trade-related cooperation activities.

The Commission shall undertake an independent Sustainability Impact Assessment (SIA) in parallel with the negotiations and which will be finalised prior to the signature of any final agreement. The SIA will aim to clarifying the likely effects of trade, as a consequence of the agreement, on sustainable development on both sides, as well as to proposing measures to maximize the benefits of the agreement, and prevent or minimise potential negative impacts in this context.

General exceptions

The Agreement will include an exception clause based on Articles XX and XXI of GATT.

Transparency of regulations

The Agreement will include provisions on:

- commitment to consulting stakeholders before introducing regulations with an impact on trade;
- publication of and public consultations on all general rules with an impact on international trade in goods and services;
- procedures for seeking to avoid trade problems at an early stage;
- transparency as regards the administration, implementation and application of regulations, including appropriate review procedures;
- the creation of enquiry points and one-stop shops designed to provide specific information and to respond promptly to questions and enquiries by the Parties regarding the operation of the Agreement.

Dispute settlement

The Agreement will include an appropriate and well-functioning dispute settlement mechanism which will ensure that the Parties observe the mutually agreed trade and trade-related rules.

The Agreement will also include provisions for expedient problem-solving such as a flexible NTB mediation mechanism focusing on the trade effects of measures rather than on their legality. This mechanism would be without prejudice to the Parties' rights and obligations or to dispute settlement provided for under the Agreement.

Cooperation

In terms of principles, objectives, methodology and areas of activity, the Cooperation Title should be largely based on the provisions of the 2003 Agreement (Title III, Articles 6 to 50). The latter broadens coverage to include areas of cooperation such as human rights, migration and counter-terrorism. Further to the 1993 Framework Cooperation Agreement and the 2003 Political Dialogue and Cooperation Agreement:

- The Association Agreement should advocate the widest possible scope for bi-regional cooperation, from which no field of activity should in principle be excluded.
- The aim for cooperation between the two sides should be to strengthen links between the Parties while contributing to the sustainable development of the countries' economies and raising standards of living.
- Special emphasis should be put on the promotion of political and social stability, democracy, respect for human rights and good governance. A key objective of the Association will be to deepen the process of regional integration among the countries of Central America, so as to contribute to higher economic growth, gradual improvement of quality of life for their peoples, poverty reduction and the promotion of both social cohesion and sustainable development, as supported also by the expanded external lending mandate of the EIB, which will support regional integration, environmental sustainability and energy projects. As regards the response strategy to natural disasters, linkages between Relief, Rehabilitation and Development will be also addressed by cooperation activities where necessary.

As regards the specific areas of activity, the Association Agreement should inter alia include the following components:

- Articles on justice, freedom and security will cover reinforcement of institutions/rule of law, data protection, migration (including readmission - standard clause), combating money laundering (including the financing of the terrorism), illicit drugs, combating organised crime (including corruption) and counter terrorism (standard clause). They will be grouped in one JFS sub-title and will build on the relevant articles of the 2003 Political Dialogue and Cooperation Agreement. As compared to the 2003 Agreement, new articles on combating organised crime and on reinforcement or institutional rule of law will be added and the article on data protection will be presented in a new formulation.
- Cooperation on sustainable development. The Agreement should include mechanisms contributing to the effective implementation of ILO core labour and relevant international standards, as well as to reinforce cooperation on employment, social and global environmental issues. EU's cooperation activities will pay due consideration to the results of the Sustainability Impact Assessment (SIA) mentioned within the Trade Title.
- Social cooperation. This will take into account recent developments at bi-regional level, namely the conclusions of the Vienna Summit in 2006 and of the 2005 UN World Summit, which underscore the need for mutually reinforcing economic, social and environmental policies, and highlight the key role of generation of decent work and commit Parties in supporting social dialogue at national, sub-regional and bi-regional levels.

- Cooperation on trade-related matters and assistance. This should aim to strengthen regional economic integration in Central America, and contribute to the establishment of a bi-regional Free Trade Area. For example, cooperation will include provisions on Technical Barriers and SPS in order both to identify specific priority sectors where the Parties could obtain further benefits and to help Central American countries to meet relevant technical requirements and SPS standards. Activities on intellectual property rights should be aimed at substantially improving enforcement of the applicable rules in Central America. Provisions concerning cooperation on trade facilitation, customs and tax issues could also be considered.

In this framework, in accordance with the conclusions of the Second EU-Central America Summit held in Vienna, the findings of the joint assessment process for economic regional integration carried out by the Ad Hoc Joint Working Group in 2005 and 2006 should also be taken into account in defining specific cooperation activities related to regional integration.

- Mutual administrative assistance and customs cooperation. The Parties shall aim to negotiate a Protocol on mutual assistance in customs and customs-related matters, which shall include, among others, provisions on joint cooperation, mutual exchange of information, technical expertise, confidentiality and the submission of evidence in judicial proceedings. The Parties may consider drafting additional provisions concerning cooperation on customs and tax issues. The Agreement will also empower the Parties to take appropriate measures in the event of a lack of administrative cooperation in customs and related matters.
- Good governance in the tax area. With a view to strengthening and developing economic activities while taking into account the need to develop an appropriate regulatory framework, the Parties will recognise and endeavour to implement the principles of good governance in the tax area, such as transparency, exchange of information, and fair tax competition. To that effect, within the Agreement, they will aim at improving international cooperation in the tax area, at facilitating the collection of legitimate tax revenues, as well as developing measures for the effective implementation of the above mentioned principles.
- Regional integration. Cooperation in this area should be expanded to support the implementation of the Central American Customs Union, including the setting up of a commission in charge of the management of the Customs Union, if so decided by the region, or a contribution to the establishment of a Central American regional cohesion mechanism deriving from the creation of a Common External Tariff (both in terms of experience-sharing and financial cooperation with the region).
- Knowledge intensive cooperation in education, science, technology and innovation should be sought as part of the implementation of the EU-LAC Knowledge Area consistently promoted in the declarations of all EU-LAC summits since Madrid in 2002 and most recently confirmed at the 2006 Vienna Summit. High levels of engagement in knowledge-intensive areas of cooperation have good potential for enabling economic and social progress, especially if this is coordinated with bilateral development cooperation. They are essential also for mainstreaming environmental dimensions of sustainable development.

- Audio-visual and cultural cooperation will be specifically addressed by the Parties. In this regard cultural cooperation, including contacts between cultural agents, and exchanges should aim to promote mutual understanding and the knowledge of the respective cultures.

The Association Agreement should also make reference to the possibility to expand and deepen cooperation by establishing specific *policy sector dialogues* in areas of common interest. Any other type of measure to support the implementation of the Association Agreement should be also considered.

General provisions

This title will include inter alia provisions on:

- means to be made available in order to fulfil the objectives set out in the Agreement,
- possible discrepancies in the interpretation and on the application of the agreement, and
- a ‘future developments’ clause.

Institutional framework

This title will set out the necessary institutional arrangements for the application of the Agreement, namely the establishment of a Joint Council, which will meet at ministerial level, and of a Joint Committee, which will meet alternately in the European Union and Central America at senior official level, and will be responsible for the general implementation of the Agreement. The Joint Council may decide to set up any other special committee or body to assist it in the performance of its duties.

Civil society will be involved as appropriate in the implementation of the Association Agreement by means of a bi-regional Consultative Committee which will be established by the Parties to the Agreement.

Structure and organisation of the negotiations

The Commission will be in charge of the overall negotiations of the Association Agreement. The Commission shall conduct the negotiations in consultation with a special committee appointed by the Council to assist the Commission in this task, and within the framework of these directives. The Commission shall conduct the negotiations on the Trade part of the Agreement in consultation also with the Article 133 Committee.

The Commission shall report regularly to the special committee and to the other relevant committees on the progress of the negotiations. On matters falling within their competence, Member States may attend the negotiating sessions.

As established at the Vienna Summit, active participation by Panama in the negotiations will be conditional upon a formal decision on its joining the economic integration process in Central America, SIECA. The Agreement will apply to Panama subject to its full

participation in the Central American Customs Union and its ratification of the Central American Treaty on investment and services and of the regional jurisdictional mechanism referred to below.

Start and conclusion of negotiations

As laid down at the EU-Latin America and Caribbean Summit in Guadalajara, the Association between the two regions should be based on higher levels of economic integration in Central America. To this effect, at the EU-Latin America and Caribbean Summit in Vienna, Central America committed itself to further progress in economic regional integration. Accordingly, when starting negotiations, the Commission will specifically assess concrete achievements regarding:

- the implementation, as planned, of the decisions taken by Central American Heads of State on 9 March 2006 in Panama, which include the creation of a Central American Customs Union by the end of 2006;
- the ratification of the Central American Treaty on investment and services; and
- the development of a jurisdictional mechanism that could secure enforcement of regional economic legislation throughout the region.

In any event, the Agreement may only be concluded, and enter into force, after the entry into force of the Central American Customs Union, the Central American Treaty on investment and services, and the above mentioned jurisdictional mechanism.

Final provisions

This part shall include provisions on the following issues:

- definition of the Parties,
- entry into force, duration and termination of the Agreement,
- authentic languages,
- territorial application of the agreement,
- national security clause,
- non-execution clause,
- replacement of the existing Agreements between the Parties.