Working together

By GINA MONTIEL

Manager, Central America, Mexico, Panama and the Dominican Republic Country Department, IADB

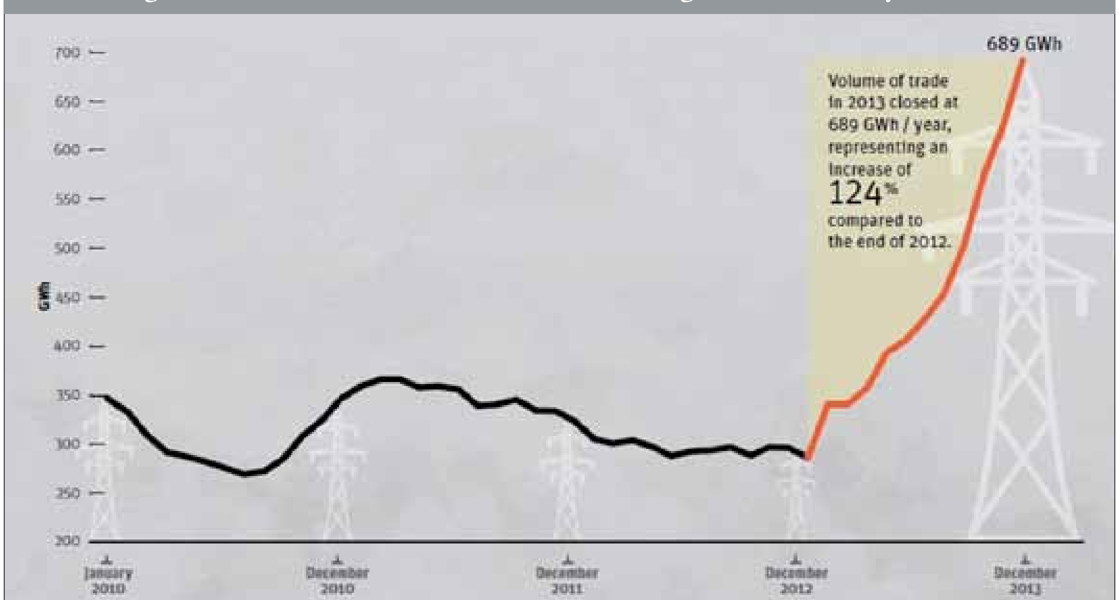
GINA MONTIEL is the Manager of the Central America, Mexico, Panama, and the Dominican Republic Country Department, IADB. Prior to assuming her current position, she was a senior advisor in the Office of the IADB Presidency. A graduate in economics from the University of Zulia, she has a master's degree in economics from Boston University and has done postgraduate work at George Washington University. Previously, she was the Manager of Financial Affairs at the Central Bank of Venezuela (BCV), and a member of the Executive Board of the International Monetary Fund.

Central American integration is getting a boost, with support from the Inter-American Development Bank (IDB). Central American countries have engaged in regional integration initiatives since their emergence as independent states. Within the last decades, it has become clear that integration constitutes a key element in the development process of each country, since many of their economic and social challenges overtake the national borders and must be handled from a regional and collaborative approach. Consequently, the region has made important progress to reach out and work together in order to improve the living standards of its population.

Central America's contemporary integration efforts started in the 1950s and 1960s, with the creation of a regional political structure and a path for economic integration. This framework was revamped during the 1990s with the establishment of the Central American Integration System (SICA), which constitutes an institutional framework that promotes integration in the political, economic, social, cultural and environmental dimensions. This coincided with a renewed effort towards trade openness, reflected in the Central America – Dominican Republic Free Trade Agreement (CAFTA-DR) with the USA; and in Central American countries joining the World Trade Organisation. In 2012, a regional agreement was reached with the European Union, including an ambitious trade component and support to improve the investment climate. Panama has now joined the Central American Economic Integration System (SIECA). The region committed to the Bali Declaration in 2013 and is interested in joining the Pacific Alliance. It has also improved political integration through the Mesoamerica Project, an expanded platform for integration and development that includes Mexico and Colombia.

These agreements – coupled with the region's strategic location, close to the strong North American economy – have created an opportunity to promote foreign investment as a platform for succeeding in global markets. In addition, the regional framework has facilitated the implementation of regional-level projects in the fields of energy, communication, transportation, trade facilitation, health and environmental sustainability, among others. But for the region to compete successfully with larger countries, it urgently needs to strengthen the integration of its power grid and logistics networks. The IDB - a long-time partner in Central American integration - is helping address these challenges.

Figure 1: 2010-2013 Annual trade in the regional electricity market



Reinforcing recovery with regional investments

Like most developing regions, Central America was hard-hit by the 2008 global financial crisis. But now, economic growth has recovered, led by export demand, private consumption and a domestic fiscal stimulus. At the same time, the region's governments have promoted investments in energy and transport logistics. The IDB has supported these projects, as well as supporting productive development, fiscal and financial policy reforms, and improved social protection, healthcare and education.

The average wholesale price of electricity in the region is high and volatile. Oil derivatives account for 51 per cent of power generation.[1] The pressure to avoid price rises affects the sector's financial sustainability, reduces investment opportunities and adds to the fiscal deficit. Between 2003 and 2010, energy subsidies and oil-related tax breaks added 1.2 per cent of GDP to the average public sector deficit in the region.

To tackle this situation, with funding from the IDB, the region has invested in the regional electrical transmission line, SIEPAC, which integrates Central America's power supply system and enables a regional electricity market (MER). The result has been substantial growth in electricity trade, by 124 per cent between 2012 and 2013 (Figure 1). The SIEPAC-MER program will also increase the viability of renewable energy generation, reduce the average cost of electricity, improve supply reliability and make it easier to increase electrification rates. It is estimated that the region needs 10,000 MW of additional generation capacity over the next 15 years - an investment of US$10 billion. This will open the way to rebalance the generation matrix, with increased use of renewable energy and natural gas.[2]

Economic growth in Central America is also hampered by the poor quality of infrastructure and the lack of efficient connectivity, within and beyond the region. Poor transport infrastructure and logistics bottlenecks increase the FOB cost of exports. Poor border management causes severe delays and increases costs, particularly for small producers and shippers of perishable and time-sensitive goods. The region needs to reduce the cost and increase the reliability of transport and to streamline regulation. That is why the IDB is supporting the development of the Pacific Corridor, which carries 95 per cent of goods transported by land in the region, covering 3,241km in seven countries. So far, 57 per cent of the Corridor has been funded, but major investments are still needed in Honduras, El Salvador and Nicaragua. Central America is also advancing with a regional framework to harmonise border processes and create shared check-points.

The way ahead

Looking forward, there is still great potential to further advance in integration and foster economic development in Central America. SIEPAC and the Pacific Corridor have shown that regional projects can work. The authorities should continue to promote regional initiatives and the private sector should voice its ideas on priorities. On the other hand, the European Union - Central America Association Agreement, which comprehensively addresses political, cooperation and trade issues, represents a key element in this process. The Central American countries will have to strengthen their links and work together in order to comply with the commitments established in the agreement and take full advantage of the benefits it offers. This will consolidate the integration efforts made so far and will ultimately contribute to a more competitive Central America. The long-awaited integration of Central America is moving forward. The potential benefits are enormous, and the IDB will continue to give high priority to supporting this process. F

1. The prices of electricity are around of 140 US$/MWh – but there are variations depending on the country and the season. The comparable prices in other electricity markets in the world are lower: US$95/MWh (Mexico) and 60$/MWh (EU).

2. Currently 35 per cent of this new capacity could come from hydropower generation, 5 per cent from geothermal and 7 per cent from wind and solar sources. There is a "gap" where around 2/3 (half of the total increase) could come from natural gas.

The long-awaited integration of Central America is moving forward

Figure 2: Bank financing of the Pacific Trade Corridor during 2013