

OECD Territorial Reviews: the Mesoamerican Region

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Introduction

The Mesoamerican region, covering southeastern Mexico and Central America, has rich economic potential thanks to its strategic geographic location, natural and cultural environment and light manufacturing industries.

But the economies of the region face a broad range of difficulties, including high poverty levels, rural-urban disparities, individual income disparities and the presence of a large informal economy.

The Central American region has been trying to promote economic integration to help realise its potential since the 1950s and the process entered a new era in 2001 with the launching of the Puebla Panama Plan. This plan helped shift the focus to the greater "Mesoamerican region" (MAR), which includes the seven Central American countries (Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama) plus the nine southeastern states of Mexico (Campeche, Chiapas, Guerrero, Oaxaca, Puebla, Quintana Roo, Tabasco, Veracruz and Yucatan).

However, economic integration *per se* is just part of the solution to the Mesoamerican region's challenges. Realising the MAR's economic potential requires regional policies that can better exploit its many comparative advantages coupled with better governance at mesoregional, national and local levels. The MAR could spur development through inclusive competitiveness policies that address cross-cutting measures for all firms, such as improving the region's human capital, firms' quality standards and networks between cities, as well as specific policies for promising sectors, including tourism, agro-industry, light manufacturing and logistics. Recommendations for governance reform include:

- Improving co-ordination across borders and between levels of government within the same borders;
- Strengthening administrative and planning capacity at the national and sub-national levels;
- Reforming regional governance institutions; and
- Introducing territorial development policies.

This *Policy Brief* looks at some of these challenges and the possible solutions put forward in *OECD Territorial Reviews: The Mesoamerican Region – Southeastern Mexico and Central America*. ■

What is the MAR's shared economic potential?

Geographically and economically, the Mesoamerican countries are small individually, but the region as a whole has a large shared economic potential. However, many of Mesoamerica's rich resources are currently under-utilised. To move beyond its current economic situation, the region should look to create competitive advantages by exploiting more effectively its privileged geographic location and its wealth of natural and cultural resources. This could be done by targeting the following sectors: logistical services, natural and cultural tourism, agriculture and value-added agro-industry and the apparel and light manufacturing industries. By taking fuller advantage of the region's potential in these sectors, Mesoamerica has an opportunity to achieve more sustainable and equitable development, to improve its competitiveness and to strengthen the region's position in the world economy. In time, Mesoamerica could become a multi-faceted and integrated economic region that:

- effectively utilises its proximity and access to major world trading partners, as well as its improved logistical services sector to remain a leading world player in such markets as apparel and electronic components;
- offers a tourist destination with world-class natural, archaeological and cultural attractions; and
- offers year-round primary agricultural production of a variety of high-quality traditional and non-traditional products, as well as processing high value-added agro-industrial products. ■

How are the MAR economies currently performing?

Despite possessing a variety of rich but often under-utilised resources, Mesoamerica's economic and social landscape continues to be marked by fluctuating economic growth rates, inequality and overall lagging development. Within the Mesoamerican region, there are stark disparities in gross domestic product (GDP) per capita, human development, income distribution and basic service provision levels.

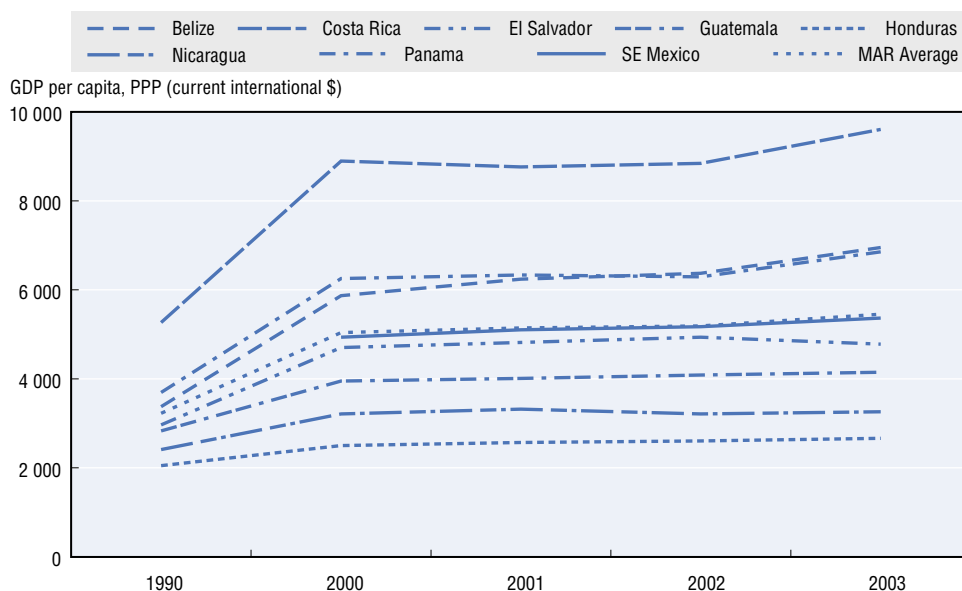
Figure 1.
THE MESOAMERICAN REGION



While all of the MAR countries face similar macroeconomic issues, their individual macroeconomic performance varies significantly, as shown by the wide gaps in per capita GDP levels between countries. In the midst of fluctuating but positive overall growth rates for all countries in the region, distinct above average (Belize, Costa Rica and Panama), average (El Salvador, Guatemala and SE Mexico) and below average (Honduras and Nicaragua) performers emerge based on GDP per capita figures on a purchasing power parity (PPP) basis. The average GDP per capita (PPP) of the MAR in 2003 was USD 5 454, but this ranged from USD 9 605 in Costa Rica to USD 2 665 in Honduras. The average economic growth rates from 2000 to 2003 of the high-end (2.05%), mid-range (0.9%) and the low-end (0.8%) groups show that the high-end producers are growing faster and extending their gap over the other groups. This three-tiered structure of production levels has been a rather permanent phenomenon.

Gaps in GDP, income and overall human development are not closing in part because of the weaknesses in the labour market. Costa Rica, Belize and Panama, which are consistently the region’s leading economies, are the only countries where the formal sector is larger than the informal sector. Labour income is the main factor in determining family income in Mesoamerica, yet the labour market is filled with low-productivity, low-wage and unstable jobs that often do not cover health and insurance benefits. Since the majority of new jobs are created in the informal sector, the productivity and income gains for the region are limited. Thus, to help reduce the MAR’s poverty and inequality, it is not just that more jobs need to be created, but that more formal sector and productive jobs need to be created. Measures that could help increase the productivity and human capital of the informal and low-productivity sectors include capacity-building programmes and improving credit access. To further reduce informal activity and facilitate the transition of informal businesses into the formal sector, there is a greater need for support for micro businesses and legal framework reforms. ■

Figure 2.
MESOAMERICA’S
THREE-TIERED
PRODUCTION STRUCTURE



Source: WDI Online (2005).

What determines Mesoamerica's competitiveness?

Overall, despite successes with macroeconomic stabilisation, structural reforms and better investment legislation, MAR countries score poorly on international evaluations of competitiveness. Improving Mesoamerica's competitiveness involves upgrading capacities in areas that have a general impact on productivity. Three key cross-sectoral determinants of competitiveness are described below.

1) *Regional programmes to improve human capital development are a priority.* Sustained productivity growth depends on human capital investment. Despite greater investment and commitment to reform, the education systems in the region face daunting challenges (high drop-out rates, poor school infrastructure, etc.) with very limited resources. Although the overall situation remains poor by international standards, several regional success stories such as EDUCO in El Salvador, PRONADE in Guatemala and a number of programmes in Mexico (e.g., PIARE or PAREIB), suggest that innovative solutions and systemic reforms can increase educational system access, equity and local autonomy.

For higher education, opportunities to increase quality and supply would involve greater harmonisation of diplomas to facilitate labour mobility and resource pooling, accreditation mechanisms to help monitor quality and other regulations to facilitate multi-country consortia. MAR countries have also made some progress in combining education and vocational training with the needs of firms, but greater progress is needed to enable them to complete the transition from a public-centred to a private-centred model. Given that fewer than 20% of skilled workers in surveyed firms had training in 2002, public policy could provide greater incentives for firms to invest in human capital.

2) *Improved quality standards and technological upgrades will help increase productivity and access to new markets.* The countries in the region have had limited success in helping local businesses to compete in global markets. This is partly because of limited human capital, partly because of inadequate integration into key markets, but also because of the relative "isolation" of both small and large firms in the region from international production chains.

Strategies for technology upgrading should take into account the type of upgrade relative to the nature of the firm's position in the value chain and its relationship to other actors in the chain. To reach the large number of disparate firms throughout the MAR who need to improve quality standards, there are alternative upgrade methods such as learning by monitoring. Government research institutions and universities could play a stronger role in linking firms to the information and methods for the upgrades required to expand into new markets opened through intra-regional or extra-regional trade integration. This requires support for co-ordination among firms as well as the use of capacity-building agents who can reach entrepreneurs and producers at the local level.

3) *Regional networks between cities could foster the co-ordinated and specialised supply of services.* The region has urbanised significantly. At the same time, its cities remain relatively small and tend to provide the same kinds of services, both within and between countries. In the framework of an "open" mesoregional economy, MAR's urban areas will face increased competition from much larger metropolitan hubs which count on strong agglomeration economies. In this context, there is some potential to develop a more strategic approach to the issue of the respective roles of the cities by means of networking or other mechanisms to structure complementarities among urban areas. Both citizens and enterprises would gain better access to higher-order and more specialised services than are currently available. ■

Which key industries present opportunities for greater specialisation?

A second key to improving the MAR's competitiveness involves seizing opportunities in more specific sectors where the region has some comparative advantage. Policies to support industries with significant potential could address specific barriers as well as develop cluster linkages. Macroeconomic stabilisation and structural reform programmes can be effectively complemented by strategies that target specific sectors, whether located in regional clusters or more diffuse specialisations. Four sectors – tourism, the agro-industry, light manufacturing and logistics industries – while far from being the only such options have significant growth and employment-generation potential, given the regional endowments.

Although the MAR countries should not rely exclusively on *tourism*, this sector can become one of the principal drivers of future development. The *agro-industry* has great potential to expand beyond regional production to world exports and to diversify and upgrade to higher quality products, while *light manufacturing industries* in the MAR will face increased competition from overseas as a result of integration and will need to move to higher value-added production. Finally, the privileged geographical location of the region would support further development of *logistics industries*.

In parallel with the more general policy actions described above, investment in targeted measures for these sectors in a cluster framework could produce good returns. Within these four sectors, cluster initiatives should not be limited to large firms but should also focus on micro-enterprises and SMEs. ■

How to achieve more effective mesoregional governance?

The strategies outlined and the policy actions suggested to exploit the MAR's competitive advantages require modification in the governance framework of Mesoamerica as a whole and within its member countries. On the one hand, it is important to reconsider the status of *mesoregional governance*, that is, to what extent are countries co-ordinating their policy in the region. On the other hand, it could help to consider *multi-level governance* issues and in particular, to what extent decentralisation processes and bottom-up initiatives can contribute to engage and co-ordinate into development processes relevant actors at all levels of government.

At the mesoregional level, while economic integration has advanced, regional institutions are not in a position to design and implement a common development strategy. Despite advances in mesoregional co-ordination in key policy areas such as tourism development, disaster prevention and border region management, the lack of policy co-ordination among Mesoamerican countries emerges as a key obstacle to the development of the area. The modest coherence between national and mesoregional agendas in key policy areas, such as competitiveness, trade or infrastructure policy, is evident and has only partially been corrected by the Puebla Panama Plan (PPP) launched in June 2001, which is currently mainly working as a portfolio of large infrastructure projects. Mesoamerica as the target area of co-ordinated policy is a recent concept whose functioning will largely depend upon the successful integration of Mexico (and possibly other countries) into a renewed Central American system. To help establish a governance framework for the mesoregional integration process, three key areas for action stand out.

First, *regional institutions need to be reformed*. The institutional framework created around the Central American Integration System (SICA) by the Tegucigalpa Protocol in 1991 has been hampered for years by a lack of strategic focus and by discrepancies between the commitments made in Presidential Summits and the actual policies pursued by Central American governments.

Despite important advances made in 2004, much remains to be done to establish an actual governance framework for the MAR. Advisable reforms could include:

- re-organising SG-SICA's institutions to favour greater institutional efficiency and effectiveness;
- having the member countries reassess the role of the Central American Parliament (PARLACEN); and
- reforming the Central American Court of Justice.

A second key challenge for the MAR's institutions is to *find new ways to address the relations between regional integration and territorial development* so as to ensure that integration results in balanced growth across the region. To meet this aim, integration could be coupled with place-based development policies that are capable of:

- helping areas in an advantageous position to reap all the benefits;
- preventing negative effects of trade opening to some regions; and
- fostering a bottom-up approach to regional integration, thereby enhancing civic participation and reducing public opposition to this process.

In particular, a regional development programme covering the entire MAR could serve as a cohesion mechanism at the mesoregional level. Drawing on lessons provided, among others, by the EU's regional competitiveness policy, a MAR territorial development policy would work to valorise the competitive advantages of all regions and to counterbalance the inequalities resulting from the integration process. In this framework a prominent role would be given to sub-national governments. A territorial development fund could be created within the PPP as an additional initiative which could serve to give more strategic focus and co-ordination to the PPP's existing sectoral initiatives. This fund could be financed by a redefinition of financial resources assigned to different PPP axes and by resources proceeding from a common customs system. Moreover, a territorial development fund could provide the opportunity to better frame the action of international agencies whose contributions are decisive to the development of Central America but also often a source of distortions and un-coordinated actions.

Third, reforming the MAR governance system by introducing regional development mechanisms would not be possible without *filling the current lack of intelligence concerning development dynamics at the local level*. A permanent forum should be formed putting together those responsible for territorial development policy in the MAR countries as well as experts on territorial indicators. This forum could act initially as a consulting body within the PPP framework and would have as its priority tasks to develop a regional information system capable of providing policy makers with up-to-date comparable data on socio-economic trends at the local levels. The forum should not only work on setting standards for collecting quantitative information but also sharing qualitative information on successful local development policies that already exist in the MAR but that are mostly unknown by other countries in the region. To this extent, in the short term, a MAR Web site could be created to facilitate exchanges at low cost. This forum would benefit from assuming observer status in international committees, including some specialised bodies of the OECD, discussing trends in regional policy and indicators. ■

How can the MAR improve its multi-level governance framework?

Reforms of regional institutions should be coupled with reforms at national and sub-national levels so that economic integration of Mesoamerica develops towards a process of *integración desde abajo* (bottom-up integration). This implies that strategic policy decisions are nourished by knowledge held at different levels

of government and that the design and implementation of policies is supported by appropriate co-ordination mechanisms at both national and local government levels. Important obstacles to an effective multi-level governance framework in the MAR are the weak fiscal, administrative and planning capacities of both national and sub-national governments. The tax burden of some Central American countries has increased between 1990 and 2000 but is still very low (an average of 13% compared to 30% in OECD countries). The resulting limited fiscal capacity of these countries has an important impact on spending in key areas, such as education and healthcare, and these low levels of social expenditure are reflected by the key social indicators in the region. The administrative and technical capacity of Central American municipal governments is also extremely limited. Until recently, planning processes have been nearly absent from local governance in the Central American region. During the past decade, internationally-funded projects have particularly targeted local planning capacity building.

If on the one side, there is a lack of resources at both national and sub-national levels, on the other side the introduction of coherent territorial development strategies is often hampered by the lack of co-operation among and within levels of government. *Vertical relations across levels of government* are regulated by complex sets of administrative laws which are often unknown even by the officials. These laws tend to assign competences for territorial development to different central level ministries without specifying how sub-national authorities should be involved. The result is that there are several areas where neither the central nor the local level act. This is often the case in policy areas such as urban and rural development, environmental protection and water management.

Problems with *horizontal co-ordination mechanisms* are found in both national and sub-national governments. At the central level, there is little sign of co-ordination across sectoral ministries. This is exemplified by the lack of widely-shared national strategies for rural and urban development. At the local level, thanks to the action of agencies such as the National Development Commission (CND) in El Salvador or the Nicaraguan Institute for Municipal Promotion (INIFOM), the *asociacionismo municipal* is more and more diffused and takes the form of *mancomunidades* or *asociaciones de municipios*. These are often geared towards the supply of services to contiguous municipalities but are rarely framed within a provincial or departmental development plan.

A number of these governance framework limitations could be addressed within both the vertical and the horizontal governance dimensions in order to couple good governance at the mesoregional level with capacity to involve intermediate and local actors in the design and implementation of regional development strategies. An agenda for reforms should aim at:

- improving co-ordination by introducing innovative contractual relations across levels of government;
- fostering co-ordination mechanisms within levels of government and innovative frameworks for local development in both urban and rural areas; and
- strengthening the administrative and planning capacity of both national and local governments. ■

For further information

For more information about the OECD's work on the Mesoamerican region, please contact: Nicola Crosta; tel.: +33 1 45 24 98 45; e-mail: nicola.crosta@oecd.org or Brian McCauley; tel.: +33 1 45 24 13 59; e-mail: brian.mccauley@oecd.org.



For further reading

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Where to contact us?

OECD HEADQUARTERS

2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD Berlin Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN

OECD Tokyo Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD Mexico Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560 MEXICO, D.F.
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.ocdemexico.org.mx

UNITED STATES

OECD Washington Center
2001 L Street N.W., Suite 650
WASHINGTON DC. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323

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