Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

Hacia un mecanismo para la aplicación regional de políticas de competencia en Centroamérica

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Executive Summary

Central American integration has problems typical of all economic integration processes. Trade liberalization measures taken at the community level, which include abolishing customs and tariff barriers, setting up common tariffs, standardizing regulations, etc., give rise to trade practices tending to establish other forms of protections and restrictions on trade and competition in the intraregional market. Central American integration is at a turning point where new, determined drive is needed – drive to which national competition authorities can contribute decisively through the orderly enforcement of competition policies aimed at blocking anti-competitive conduct with regional implications and through encouragement of more consistency among national legal frameworks. A coordinated effort by said competition authorities would foreseeably be more effective than the individual, independent efforts of each. The mechanisms implemented up to now for coordinating among authorities, however, have not been sufficient to this end, however.

This paper analyses the workings of the Central American economy’s three basic sectors (banking, pharmaceutics, and air passenger transport), outlines the main competition problems and offers recommendations for solving these problems – or at least for alleviating them. For each of these sectors, it has been found that a coordinated effort by the region’s competition authorities would provide many advantages over the isolated efforts of each, so a repeated recommendation is to move forward on instruments that can improve coordination among the region’s competition authorities.

In banking, for example, regulatory problems have been found that may be blocking market entry for potential new competitors or limiting the ability of some to compete with others by imposing discriminatory treatment. Specific structural weaknesses (the lack of market development, related financial instruments or alternative technologies) were also found that could be restricting the contestability of markets in which commercial banks operate. The competition authorities in this sector have an essential task. Firstly, they should be advocating for regulatory changes to improve competitive conditions. Secondly, they need to be attentive to anti-competitive practices in the sector, such as the coordinated setting of bank fees or interest rates, especially where the supply structure for bank services is already concentrated. Thirdly, they have to watch over these markets and foresee concentration transactions that may be harmful for competition.

In the pharmaceuticals sector, specific national regulations concerning the authorization of drugs or drug production and distribution – and others that restrict activities or limit parallel imports and intra-regional trade in generic drugs – may be placing constraints on the development of free competition in this sector's markets. With respect to public procurement, direct purchase abuse should be prevented and truly competitive tenders should be promoted (joint Central American price negotiating is a good initiative), and the necessary mechanisms need to be put into place for detecting bid rigging practices. In addition, competition authorities have to be alert to eventual anti-competitive practices in this sector, which could show up in the form of price fixing or market sharing agreements, exclusivity contracts in vertical relationships, or practices such as bundled pricing, predatory behaviours, loyalty discounts, etc., by companies with market power. They also need to analyse
potentially harmful concentration transactions from an intra-regional market perspective in order to maintain effective competition in this sector.

In the air passenger transport sector, international air fares between Central American countries are out of reach for most of the population, significantly impacting the ability of people to move around the region since there is no comparable travel alternative with other means of transportation. The sector is clearly dominated by two major companies (Avianca and Copa), which operate routes between the region’s cities as a monopoly or duopoly. Although the problem may be partially structural, regulations and administrative practices do tend to “protect” the installed operators from potential entrants. Moreover, the airports – essential facilities for the activity – need investment for expanding and modernizing, along with clear, pro-competitive policies for allocating existing capacity. Other types of entry barriers may come from the strategic behaviour of the installed operators. Competition authorities need to pay special attention to agreements between airlines (Avianca and Copa have recently joined the same alliance) or between airlines and the travel agencies marketing their tickets, and to business concentration moves in the sector.

Coordination among the region’s competition authorities is seen as a necessity for making their advocating efforts more effective and improving the quality of their investigations and punishments (take the case of anti-competitive conducts with cross-border effects, or anti-competitive conducts which, though lacking cross-border effects, are repeated in different jurisdictions), in addition to strengthening their control of mergers and acquisitions (think about economic concentrations that affect various jurisdictions in the region).

This paper suggests that it is not essential to create a new institutional structure at the regional level, independent of national competition authorities, to achieve stronger coordination between them. It recommends, instead, that an institutional structure be formed by all the competition authorities that would enable them to take advantage of their own structures, knowledge, experience and know-how; it would be created on the basis of new regional rules that would put into place the necessary coordination mechanisms for building a coherent and cohesive regional policy. The regional rule model proposed in this paper involves having the region’s national competition authorities jointly address regional problems, thus improving the efficacy and efficiency of their efforts to the benefit of Central American consumers, all within a relatively short space of time and with very limited financial investment.
Background and explanatory notes

This paper is framed within the Regional Component of the Programme for Strengthening Capacities and Institutions in the area of Competition and Consumer Protection Policies for Latin America, phase II (COMPAL II) of the United Nations Conference on Trade and Development (UNCTAD).

COMPAL II has been underway since 2009 and is now coming to an end. Several countries have had direct support from the Programme, which had a budget for strategic activities at the national level. In the Central American region, Costa Rica, El Salvador and Nicaragua were thus direct beneficiaries of the Programme through various national components, while Honduras and Guatemala were able to participate through the Programme’s Regional Component and using their own resources.

One of the objectives of this Regional Component is to strengthen relationships and cooperation between Central American countries on matters of competition. Several activities have been planned and carried out with this objective; these are described in the COMPAL II evaluation report for 2012.

Central American countries began enacting competition laws last century in the mid-90s: Costa Rica in 1994, Panama in 1996, El Salvador in 2004, Honduras in 2005, and Nicaragua in 2006. Guatemala is the only country in the region that still lacks a competition law, although the Guatemalan Ministry of the Economy’s Directorate for the Promotion of Competition was set up with the primary goal of pushing through such a law.

The fact that all the countries in the region, save one, already have competition laws and institutions for overseeing enforcement is encouraging, but may not be enough. Central American economies are small and open, with national markets closely tied to those of their neighbours, so they need to cooperate in order to prevent, investigate and punish, if necessary, anti-competitive behaviours, and to advocate for competition, especially with governments and administrations in regard to regulations blocking the development of effective market competition.

Given this relationship between Central American economies, free trade agreements have been careful to defend and promote competition and have recognized the need for a regional competition system. Thus, the recent European Union Central American Association Agreement urges the region to create competition rules and a regional supranational competition authority.

This paper seeks to point out the competition problems in three chosen economic sectors in Central America (banking, medicinal drugs and international air passenger transport) and set forth some recommendations for improving competition in these sectors. As we will see, these recommendations include a proposal for strengthening cooperation between the region’s competition authorities.

The paper’s geographical scope is the Central American region, by country (in alphabetical order): Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

1 http://www.programacompal.org/
2 For more on the evaluation: http://www.programacompal.org/informes_evaluacion-intro.html
3 The competition authorities themselves chose the sectors during the Central American Competition Forum held in El Salvador in August 2013.
The idea is not to begin research on the three aforementioned sectors on the basis of data extracted from primary sources, but rather to use secondary sources of information to identify the main competition problems in these sectors.
Introduction

Central American regional integration is critical for strengthening the region’s economic position in the international setting. Central American integration is characterized as much by its dynamism – at this point it is the most active integration process in the Americas – as by its significance in the different areas (economic, financial and political) in which it is reflected.

Already the Central American countries as a bloc have signed international trade agreements, particularly with the United States (Dominican Republic – Central America – United States Free Trade Agreement, or DR-CAFTA), Mexico and the European Union. This is a sign of the region's unquestionable importance and attractiveness, with more than 41 million inhabitants (52 million if we include the Dominican Republic), rising purchasing power and high growth potential.

The trade integration process, which is still underway, has to consider the elimination of tariffs and other non-tariff barriers and the adoption of a common customs tariff and common rules and regulations for reducing technical trade barriers; it must be complemented with firm efforts to promote competition in many basic sectors of the regional economy. Indeed, regional integration cannot be successfully completed if the necessary complementary mechanisms are not set up for fostering effective market competition.

This paper attempts to show the obstacles to effective competition occurring in intra-regional trade in three basic sectors of the Central American economy: banking, medicinal drugs and international air passenger transport. Further, the paper recommends, as a priority, the adoption of concrete, feasible and efficient measures to deal with these obstacles, including a valid, sustainable strategy to reinforce and consolidate the headway made on integrating markets and prevent the appearance of new hurdles to trade. It proposes that regional rules be adopted to set up a control system for anti-competitive behaviours and facilitate coordinated interventions for promoting pro-competition policies and preventing actions that distort the normal workings of intra-regional markets to the detriment of the common interest.

The first chapter describes the current status of Central American integration. It looks at the legal and institutional framework of the Central American Common Market, the latest progress in the integration process, and the region’s foreign trade situation.

The second chapter covers the institutional and legal framework for defending and promoting competition in Central America. It analyses the situation of Guatemala, the only country in the region lacking an institutional and legal framework for competition, and describes the main characteristics of current competition laws in the region's countries and their main differences.

The third chapter deals with the current status of competition in the three aforementioned sectors. First, each sector’s main characteristics are set forth. Secondly, the regulatory, structural or business behaviour problems blocking competition are identified. Thirdly, a description is given of the actions undertaken by the region’s competition authorities, and fourthly, recommendations are made for improving the competitive climate and the intra-regional trade flows of the goods and services involved.

The fourth chapter includes a concrete proposal for a regional system to defend and promote competition, since the analysis of how the three sectors work identified
problems that are better addressed by a regional authority. From a legal standpoint, the regulatory framework within which the region’s integration policies are formulated provides for a regional competition system that, though needed, does not exist at present.

The proposed model has taken into consideration other regional systems, which have contributed interesting aspects to the proposal. UNCTAD’s own experience through its technical assistance for competition in various parts of the world gives an advantage that should not be underrated. Of particular interest is the technical support currently provided by UNCTAD to the West African Economic and Monetary Union (UEMOA) to reform its regional competition system. Other, more consolidated, models have also been taken into account, such as the European Union (EU) or the Andean Community.

We have opted for a simple model, adapted to the region's circumstances and characteristics and based on the fostering of cooperation between national competition agencies and the search for complementarity between national policies, to conform an efficacious, operative and efficient inter-institutional system for dealing with the region’s competition problems.
I. The status of Central American integration

Most regional integration agreements include the creation of a free trade area for the member countries, but the degree to which integration is developed varies depending on the type of agreement, with that of the EU being the most complete integration project.\(^4\) As experiences such as that of the EU have shown, the integration of markets and infrastructure networks stimulates growth and development. In fact, elimination of trade barriers encourages trade, accelerates technology transfer, spurs investment and innovation, improves connection efficiency between demand centres and production and distribution points, creates job opportunities, and tends to expand the variety and reduce the prices of goods and services.

Thus, greater integration of Central American markets would be expected to bring significant benefits with repercussions for all Central American consumers. The process of Central American integration is at a turning point where new drive is needed to reinforce the achievements and progress that have already been made. For unrestricted circulation of goods and services to finally become a reality, effective elimination is needed of the business, administrative, legal, technical, and tariff barriers that still plague trade between the region's countries. This takes on special relevance in a region comprised by relatively small countries with similar economies, where trade barriers impede economies of scale and discourage national and foreign capital investments.

In the words of an Economic Commission for Latin America (ECLAC) study: “In a new global context where the most dynamic sources of aggregate demand have shifted to the developing world, integration is becoming more and more valuable. In this context, with growing third country competition and stagnant main destination markets, it becomes essential not only to increase productivity but also to ensure access to broad domestic markets, which in the Central American case could be achieved with smoother, more efficient integration of the subregional markets for goods and services. Central America continues to operate below its long-term potential for integration. Using a gravity model, Gordillo, Stokenberga & Schwartz (2010) quantify the impact of poor connectivity and border frictions on intra-regional trade (…). The authors conclude that intra-regional exports might potentially double if Central America could achieve true integration.”\(^5\) (ECLAC 2010)

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\(^4\) The States have begun the process of economic integration to take advantage of a larger territory: economies of scale, reduced costs, greater project efficiency and financial and economic soundness. From a theoretical standpoint, we can refer to six stages or degrees of integration: a preferential trade zone, where customs duties between participating countries are reduced; a free trade zone, where tariffs are eliminated for part or all of the merchandise circulating between participating countries; a customs union, where common tariffs are established for third countries and a common trade policy is formulated; a common market, where regulations are developed for most goods and services and free circulation is permitted for merchandise, capital, workers and services; an economic union, where the different national economic policies (monetary, financial, tax, industrial, agricultural, etc.) are harmonized (monetary policy could give rise to the creation of a common central bank and the adoption of a common currency, which would lead to a monetary union); and economic integration, where an economic space is governed by common economic policies that also require an institutional organization with effective powers. The EU has already gone through the first four levels of integration and is in the stage of economic union. Giant strides have been made towards a monetary union, with the circulation of a common currency and application of a single monetary policy in a significant number of countries.
A brief description of the current institutional and legal framework is appropriate at this point, with some data on foreign trade that shows the escalating growth of trade between member States, despite still existing barriers.

I.1. Institutional and legal framework of Central American integration

The December 13, 1960 signing of the *General Treaty on Central American Economic Integration* between Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua initiated the process of creating the Central American Common Market (MCCA)\(^5\) by developing a free trade zone, adopting a standard Central American tariff, and committing to the construction of a customs union among the territories.\(^6\)

The treaty provided for the creation of the Central American Bank for Economic Integration (CABEI) as a finance instrument and a permanent Secretariat with a legal entity status charged with overseeing proper enforcement of the legal instruments for economic integration.

Later, the December 13, 1991 *Tegucigalpa Protocol* set new goals for strengthening the integration process, modifying the Charter of the Organization of Central American States (ODECA). This Protocol set up the Central American Integration System (SICA) as the institutional framework for the region (ODECA member States and Panama). In December 2000, Belize joined as a member State, and three years later the Dominican Republic joined as an associated State. SICA’s goal is Central American integration to transform it into a region of peace, freedom, democracy and development.

Another major landmark in the integration process was the October 29, 1993 signing of the *Guatemala Protocol*, which establishes and consolidates the Central American Economic Integration Subsystem (SIECA) in order to attain sustainable economic development that translates into social well-being for the region.

The main bodies for Central American integration are the Meeting of Presidents, CABEI with headquarters in Tegucigalpa, SICA with an Executive Secretariat in San Salvador, SIECA with a Secretariat in Guatemala, the Central American Monetary Council with an Executive Secretariat in San José, the Central American Parliament (PARLACEN) seated in Guatemala, and the Central American Court of Justice (CCJ) seated permanently in Managua.

The Tegucigalpa and Guatemala protocols marked a new stage in Central American integration by giving the States the flexibility of opting out of any agreements negotiated within the scope of SICA and signing only those that interest them. Thus, for example, Costa Rica is not a member of PARLACEN or the CCJ. As a


\(^6\) *Proceso de Integración Económica Regional. El Mercado Común Centroamericano*. Luis Fernando Castañeda Galdámez. UNAM
consequence of this freedom, the speed and depth of integration has differed from one country to another. Countries are also starting to adopt an openly regionalist policy for signing different treaties with third countries and international organizations, and even between themselves, such as the customs union between El Salvador and Guatemala in 2000, which Honduras and Nicaragua later joined.

In December 2007, the MCCA member countries signed a framework agreement for the gradual, progressive establishment of a Central American customs union (with a roadmap).

Panama has recently joined in the integration process; its relationship with the rest of the region was governed until then by the free trade agreement signed in 2002. In 2007, a study began of the conditions needed for Panama’s membership and in 2011 the Protocol for the Inclusion of Panama was signed. In May 2013, this protocol was ratified by the Panamanian National Assembly and deposited at SIECA to enter into effect. The protocol sets the terms and modalities for Panama to adopt the Subsystem’s legal instruments before 2018; within the next two years Panama must negotiate a tariff elimination schedule to achieve free trade with the rest of the region’s members. Central American rules of origin applied immediately, and Panama was given six months to adapt to the technical rules. It is worth noting that Panama’s inclusion was a requirement for its participation in the Central American Association Agreement with the EU.

I.2. Attainment of the customs union: Pacts and agreements between Central American common market members

The Central American Tariff System, based on the Harmonized System of the World Customs Organization, is the official classification for imported and exported merchandise in Central America. At present 95.7% of all merchandise is harmonized (the remaining 4.3% includes products such as medicines, metals, oil and food products). The Central American Uniform Customs Code was modified in 2008 for the purpose of establishing the basic customs laws for the region’s countries pursuant to the requirements of MCCA and regional integration instruments. That same year the Regulations for the Code were signed. Both instruments have been in effect in El Salvador, Guatemala, Honduras and Nicaragua since August 2008, while Costa Rica is still in the process of ratifying them. Other agreements, such as the Central American Customs Appraisal Regulations or the Codes of Conduct for Customs Officers and Employees, contribute to speeding up and consolidating the integration process.

According to the Guatemala Protocol, goods originating in Central American countries are traded freely. The exceptions are contained in Annex A of the General Treaty: sugar and unroasted coffee (among the five countries), petroleum derivatives (between Honduras and El Salvador), ethyl alcohol (between Honduras and El Salvador and between Costa Rica and El Salvador), distilled alcoholic beverages (between Honduras and El Salvador), and roasted coffee (between Costa Rica and the other countries).

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7El comercio de bienes y servicios en Centroamérica: una nueva mirada. ECLAC, with the participation of an advisory group consisting of SG-SICA, SIECA, CENPROMYPE and the Fondo España-SICA. ECLAC, 2012
The headway made on developing the free trade zone and setting up the Central American Customs Union has contributed to the growth of trade among MCCA members. Central American trade grew at an average annual rate of 11.3% from MCCA’s creation until 2012, more dynamically than exports to other world markets (8%). The annual growth trend has been interrupted only by the two global crises (1980 and 2009).

Dynamic intra-regional trade translates into broad benefits for the region, activating small and medium enterprises and driving the development of trade-related services and the creation of a new entrepreneurial class.

El Salvador and Guatemala, the first Central American countries to sign up for creating a customs union, are developing transit infrastructural improvements (modernization of a border post and implementation of new technology for speeding up immigration procedures). Peripheral and adjacent customs have been set up between El Salvador, Guatemala, Honduras and Nicaragua at different border crossings.

I.3. Foreign Trade Data

I.3.1. Foreign Trade with Third Countries

The region’s total foreign sales grew by 7% in 2012, reaching USD 29,359.9 million FOB (sales grew by 11.1% in 2011).

The main export items, classified by Central American Tariff System chapter, were as follows:

- Coffee, tea, mate, and spices – USD 3,779.4 million (12.8%)
- Machinery, appliances and electrical material – USD 3,052.7 million (10.3%)
- Edible fruit and nuts, and peel of citrus fruits, melons or watermelons – USD 2,996.8 million (10.1%)
- Cinematography, photography or optical appliances and instruments, and medical and surgical appliances, parts and accessories – USD 1,502.9 million (5.1%)
- Sugars and confectionery – USD 1,448.0 million (4.9%)
- Animal or vegetable fats and oils and their cleavage products, prepared edible fats, animal or vegetable waxes – USD 1,029.0 (3.5%)

The United States imports one third of Central American exports, the region itself imports 25.2%, and the EU imports 14.7%.

Imports grew by 5.9% in 2012 (9.6% in 2011), reaching a total of USD 56,977.4 million CIF, driven by fuels (20% of the total) and machinery, appliances, electrical material and parts thereof (11.5%).

Contributing most to the region’s import dynamism were the following merchandise classes:

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8 IDB Monthly Newsletter. September 2013
- Mineral fuels and their derivatives – USD 11,426.4 million (20.1%)
- Machinery, appliances and electrical material and parts thereof – USD 6,555.3 million (11.5%)
- Nuclear reactors, boilers, machinery and mechanical appliances and parts thereof – USD 4,420.1 million (7.8%)
- Vehicles other than railway or tramway rolling stock, and parts and accessories thereof – USD 3,444.5 million (6.0%)
- Plastics and articles thereof – USD 2,873.2 million (5.0%)

40.9% of purchases came from the United States, 12.8% from Central America, and 8.0% from Mexico.

The balance of trade showed a 4.8% larger deficit in 2012 (USD 27,341.5 million) than in the previous year. The deficit by country was as follows:

- Guatemala: USD 7,726.8 million
- Costa Rica: USD 5,868.1 million
- El Salvador: USD 5,319.3 million
- Honduras: USD 5,088.0 million
- Nicaragua: USD 3,339.3 million

I.3.2. Intra-regional Trade

Central American intra-regional exports totalled USD 7,473.7 million in 2012. By export country, the figures are as follows:

- Guatemala: USD 2,659.4 million (35.6%)
- El Salvador: USD 1,987.2 million (26.6%)
- Costa Rica: USD 1,497.8 million (20.0%)
- Honduras: USD 816.4 million (10.9%)
- Nicaragua: USD 512.9 million (6.9%)

The main intra-regional export products, classified by Central American Tariff System chapter, were as follows:

- Miscellaneous edible preparations – USD 602.6 million (8.1%)
- Plastics and articles thereof – USD 594.0 million (7.9%)
- Paper and paperboard, articles of paper pulp, paper or paperboard – USD 403.5 million (5.4%)
- Iron and steel – USD 389.5 million (5.2%)
- Preparations of cereals, flour, starch or milk, pastry products – USD 339.1 million (4.5%)
Intra-regional imports in Central America totalled USD 7,312.6 million in 2012. By import country, the figures are as follows:

- El Salvador: USD 1,853.7 million (25.3%)
- Honduras: USD 1,817.8 million (24.9%)
- Guatemala: USD 1,562.6 million (21.4%)
- Nicaragua: USD 1,234.4 million (16.9%)
- Costa Rica: USD 844.2 million (11.5%)

The main import products from MCCA were as follows:

- Plastics and articles thereof – USD 577.7 million (7.9%)
- Iron and steel – USD 449.2 million (6.1%)
- Miscellaneous edible preparations – USD 406.2 million (5.6%)
- Paper and paperboard, articles of paper pulp, paper or paperboard – USD 384.8 million (5.3%)
- Preparations of cereals, flour, starch or milk, pastry products – USD 373.2 million (5.1%)
The following table shows the weight of the Central American region in the foreign trade of each of its countries.

<table>
<thead>
<tr>
<th>Imports 2012</th>
<th>Exports 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main Trading Partner</strong></td>
<td><strong>% of Total</strong></td>
</tr>
<tr>
<td>United States</td>
<td>39.3%</td>
</tr>
<tr>
<td><strong>Central America</strong></td>
<td>13.3%</td>
</tr>
<tr>
<td>Mexico</td>
<td>11.6%</td>
</tr>
<tr>
<td>China</td>
<td>6.7%</td>
</tr>
<tr>
<td>Colombia</td>
<td>3.5%</td>
</tr>
<tr>
<td>United States</td>
<td>36.9%</td>
</tr>
<tr>
<td><strong>Central America</strong></td>
<td>21.3%</td>
</tr>
<tr>
<td>Mexico</td>
<td>7.2%</td>
</tr>
<tr>
<td>China</td>
<td>5.6%</td>
</tr>
<tr>
<td>Colombia</td>
<td>3.4%</td>
</tr>
<tr>
<td>United States</td>
<td>44.3%</td>
</tr>
<tr>
<td><strong>Central America</strong></td>
<td>22.9%</td>
</tr>
<tr>
<td>Mexico</td>
<td>5.6%</td>
</tr>
<tr>
<td>China</td>
<td>4.7%</td>
</tr>
<tr>
<td>Colombia</td>
<td>3.0%</td>
</tr>
<tr>
<td><strong>Central America</strong></td>
<td>20.5%</td>
</tr>
<tr>
<td>United States</td>
<td>18.0%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>13.4%</td>
</tr>
<tr>
<td>China</td>
<td>9.6%</td>
</tr>
<tr>
<td>Dutch Antilles</td>
<td>9.2%</td>
</tr>
<tr>
<td>United States</td>
<td>50.6%</td>
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<tr>
<td>China</td>
<td>8.4%</td>
</tr>
<tr>
<td><strong>Central America</strong></td>
<td>7.2%</td>
</tr>
<tr>
<td>Mexico</td>
<td>6.8%</td>
</tr>
<tr>
<td>Japan</td>
<td>3.2%</td>
</tr>
</tbody>
</table>

Source: SEC-SIECA
As for Panama, the new sub-system member, the foreign trade balance in 2012 showed a USD 508.4 million surplus in relation to the other sub-system countries.

Only 8.2% of all Panama exports went to the subregion, and only about 3% of Panama imports originated in the subregion's countries. This percentage is similar to Panama's importance as a destination and origin for Central American trade. Among Central American countries, Costa Rica is the main exporter to the Panamanian market, and Guatemala is the biggest buyer of Panamanian products. Although both import and export flows are relatively diversified, medicines figure prominently in bilateral trade.
II. Institutional and legal framework for the defence and promotion of competition in Central America

At present no regional system for the defence of competition exists to deal with business conduct that produces cross-border anti-competitive effects, or to advocate for overcoming the legal, technical and administrative barriers blocking the development of intra-regional trade. In 2006, the Central American Network of Competition Authorities was created to serve as a forum, but its competencies do not include legally binding powers.

The legal framework for regional integration provides, however, for establishing a competition system. In fact, the Guatemala Protocol contains a provision obligating the region’s member States to adopt common provisions for preventing monopolistic activities and promoting free competition (Article 25). In the Second Panama Declaration, the Presidents of these same States agreed to push for a gradual and progressive transition to regional competition standards and a regional competition authority. Finally, Chapter XI of the Framework Agreement for the Establishment of a Central American Customs Union states that “the party States will develop a regional set of standards for competition policy.”

In addition, the European Union Central American Association Agreement signed on June 29, 2012 also contains provisions for competition under Title VII. In Article 278 of this Agreement the parties recognize the importance of free and undistorted competition in their trade relations, and acknowledge that anti-competitive practices have the potential to impede or block the proper functioning of markets and the benefits of trade liberalization. They agree that anti-competitive agreements, abuse of a dominant position or substantial market power, and concentrations between undertakings which significantly impede effective competition are incompatible with the Agreement, in so far as they may affect trade between the parties. Article 297 of this Agreement then establishes the obligation of the parties to adopt and maintain in force comprehensive competition laws and to establish competition authorities appropriately equipped to effectively and transparently enforce such laws. Specifically, any party that still lacks a law and an authority when the Agreement goes into effect must adopt a law and designate an authority within three years. Moreover, within seven years after the Agreement goes into effect, the Central American parties must have a regional competition law and a regional competition authority. The Association Agreement entered into effect on August 1, 2013 in all countries in the region except Guatemala, where it took effect on December 1, 2013.

Although the region can be expected to adopt a regional competition law and designate a regional competition authority within a relatively short time span, right now we are interested in analysing the characteristics of the national systems for the defence of competition currently in effect in order to determine their suitability and efficacy for combating anti-competitive practices and obstacles to the intra-regional trade of goods and services.

It is worth noting that Guatemala still lacks a competition law and authority, despite the fact that its Constitution expressly confirms the government’s obligation to “impede the functioning of excessive practices that may lead to the concentration of

10 In the context of the 19th Central American Presidential Summit Meeting on July 12, 1997
11 Signed on December 12, 2007 by the Republics of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua
goods and means of production to the detriment of the community” (Article 119, Section H and to protect the market economy and impede associations “that tend to restrict market freedom or harm consumers” (Article 130). In addition, Article 361 of its Commercial Code establishes that “all undertakings have an obligation to contract with anyone requesting the goods or services they provide, observing equal treatment of the different categories of consumers.” Articles 340 and 341 of the Criminal Code typify market monopolization as a crime and prohibit, among other behaviours, the hoarding of goods, production-limiting agreements, sale of goods below cost price, and “any act or procedure that impedes or seeks to impede free competition in production or trade.”

The lack of a general competition law in Guatemala raises the question of whether the country’s sectoral laws contain appropriate provisions for combating competition-restricting conducts in their respective areas of operation. Firstly, the Guatemalan regulators of the sectors studied here – the Directorate General of Civil Aeronautics, the Ministry of Public Health and Social Assistance, and the Bank Superintendent – are not empowered to hear cases of anti-competitive practices. Although the Bank Superintendent must authorize concentrations in its sector, it bases its authorization on an analysis of solvency and liquidity but not competition. Finally, the Commercial Code (Decree 2-70) establishes the legal requirements for corporate mergers but is limited to regulating strictly formal aspects without taking into account competition considerations.

A competition bill has been presented to the Guatemala parliament and has received the go-ahead from the Economy Committee, but voting on it has been paralysed since June 2012.12 It must be concluded, therefore, that until a competition law is adopted, Guatemala’s current laws do not enable it to control anti-competitive conducts; this constitutes, without a doubt, an additional problem that could have repercussions for the rest of the region’s national jurisdictions.

In general, the competition laws in the region’s countries recognize greater economic efficiency and/or greater consumer well-being as their fundamental goals.

Substantively, these laws include the customary provisions of competition rules: (1) prohibition of anti-competitive practices – competition-restricting horizontal agreements, vertical constraints and abuse of market power; (2) control of concentrations under an ex-ante notification system (except in Panama); and (3) the ability to issue opinions or recommendations on laws or bills and administrative acts and to issue market studies, in addition to the authority’s mission to improve the country’s culture of competition (competition promotion or advocating).

In some texts the difference between vertical constraints and abuse of market power is blurred, there being some doubt that vertical constraints on competition can be prohibited when there is no market power or position of dominance involved, if it is necessary to be able to intervene in exclusive or selective distribution contracts or non-competition obligations included in those contracts, which can lead to market compartmentalizing even when the companies participating in the agreements lack market power.

12 Decision of the Economy and Foreign Trade Committee of the Parliament of the Republic of Guatemala 2-2012 on Competition Bill of Law 4426
Major differences are found between the different national jurisdictions with respect to the following, among other matters:

- The material scope of the law’s enforcement: In some cases, specific areas of economic activity are excluded, as in the case of activities reserved for the government (El Salvador, Honduras and Panama) or those aimed at ensuring food security, health and nutrition (Nicaragua).

- Application of the rules for analysing suspicious conducts (per se rule, rule of reason, admission of efficiency criteria, etc.).

- The authority’s investigative powers: surprise domiciliary inspections, obligations to respond to the authority’s requests for information, etc.

- Application of negotiated procedures (clemency programs, early resolution of cases through compromises or transaction agreements).

- The remedies and punishments that can be imposed.

In the control of concentrations, although protection goals and transaction notification thresholds may vary from one system to another, it should be emphasized that all but Panama (in Costa Rica only just recently with the 2012 reform of its competition law) provide for ex-ante obligatory notification of concentration transactions that exceed certain thresholds. In Panama the Consumer Protection and Free Competition Authority (ACODECO) has a three-year period for challenging non-notified consummated transactions.

Institutionally, it could be said that all the region’s competition authorities have an advantageous autonomy to act and make decisions on the basis of technical arguments, without any obvious political interference.

In addition, in all but the Panamanian jurisdiction, the systems for enforcing competition law are “administrative”; that is, the competition authorities decide in first instance on cases, although these decisions are later subject to appeal in the courts. These administrative systems have not provided for separation of the instruction and decision phases of the cases into two different bodies, a solution that has been adopted by many other countries in the world, though it has been criticized because the authority would act as both judge and party to the cases. In some countries, however, mechanisms have been provided that attempt to ensure independence between the instruction and decision phases. Thus, in El Salvador the Superintendent handles instruction, while decision-making and sanctions, if necessary, are carried out by the Executive Board. In Costa Rica, Coprocom has delegated the instruction of cases to the Technical Support Unit.

In Panama, though, the system is “judicial”; ACODECO carries out the relevant investigation, after which it decides whether to take it to the competent courts. Once the courts have analysed the case and have determined the existence of anti-competitive conduct, ACODECO dictates the respective remedies or punishments. The court does not intervene in voluntary concentration notification procedures except in case of appeal. To this respect, a third party has the possibility of opposing a concentration transaction by filing a legal challenge at a competent court.
The competition authorities’ decisions (the decisions as to whether to take cases to the courts, in the case of Panama, and the decisions for resolving cases, in the rest of the jurisdictions) are made by collective bodies, except in Nicaragua and Panama. In Nicaragua, the decisions are made by the President of Procompetencia, although they can be appealed to the Executive Board consisting of the same president and three directors. In Panama, the ACODECO administrator has the authority to decide whether to continue with the process and take the matter to court.

With respect to the scope of enforcement of competition laws, throughout the region these laws generally apply – in principle – to all economic sectors and agents, although some major exceptions do exist. Thus, in Costa Rica exceptions are granted to government monopolies and public service concessionaires by virtue of a specific law, and to anyone performing acts authorized by special laws (pre-2012 reform exceptions were broader). In Panama exceptions are granted for acts, meetings, agreements, arrangements, accords, formulas or any other mechanism or modality promoted by the government with economic agents for the safeguarding of the public interest (this interest must be declared by the Cabinet), and for collective labour agreements, exercise of intellectual and industrial property rights, and the State’s constitutionally reserved economic activities that are not subject to a concession regime.

In El Salvador, exceptions are granted to economic activities reserved exclusively for the State and municipalities by the Constitution or municipal governments. In Nicaragua, exceptions are granted to efforts promoted by the State for the purpose of ensuring public food security, health and nutrition, and to agreements between national and foreign agents that recognize more favourable conditions for national producers. In Honduras, no sector is exempted, not even State companies, although a legal exemption would be recognized and granted to “temporary privileges conceded to inventors, discoverers or authors as scientific, literary, artistic or commercial property rights, invention patents and trademarks” by virtue of Article 339 of the country’s Constitution.

Territorially, all jurisdictions have provided competition law enforcement for conducts originating abroad when they produce or potentially produce anti-competitive effects in the national territory.

With respect to the application of competition laws to regulated sectors, all of the region’s competition laws, except that of Nicaragua, grant exclusive power to the competition authorities to enforce them in all sectors. In Nicaragua, Article 15 of Law 601 provides, as interpreted by the Supreme Court of Justice, that the sectoral regulators should hear anti-competitive practices in their respective sectors, after Procompetencia issues an opinion that must be taken into consideration by the regulators. This ruling by the Supreme Court of Justice came after an appeal of a Procompetencia decision in a credit card case that Procompetencia had sanctioned. Since Article 15 falls within the chapter on anti-competitive practices, a feasible interpretation is that the control of concentrations is within the Procompetencia’s scope of authority.

However, in some cases the division of competencies or form of collaboration between competition authorities and regulators may not be very clear. In Honduras, the fact that some regulators also have the power to examine concentration transactions may be a potential source of problems. Thus, as a preventative to avoid future conflicts, the Commission for the Defence and Promotion of Competition
(CDPC) has signed cooperation agreements with the National Banking and Insurance Commission (CNBS) and the National Telecommunications Commission (CNT). CNBS first requires a favourable opinion from CDPC, which would reveal a strong degree of coordination between the two authorities; in fact, several concentration transactions have been reviewed in the banking sector without any problems arising between CDPC and CNBS. The Competition Secretariat (SC) in El Salvador has also signed cooperation agreements with sectoral regulators.

The OECD-IDB’s report to the 2010 Latin American Forum on its peer review of competition law and policy in Panama states that the sectoral regulators’ perception of ACODECO’s role has improved to the extent the agency has promoted its institutional relations with them, and to this end ACODECO has availed itself of both formal and more informal mechanisms, such as the exchange of officials between ACODECO and the regulators, to create valuable contact points. This same report emphasizes that the joint oversight of the banking sector – the Bank Superintendent is also authorized to evaluate concentrations in this sector – had led to “some minor confrontations” between ACODECO and the Superintendent.

In competition advocacy or promotion, and particularly in the competition authorities’ power to issue opinions and recommendations on bills of law, it would be very useful for the law to make it compulsory for legislators to ask for the competition authority’s opinion. Accurate mechanisms would also have to be enabled so that notification of the preparation of a new law, and the draft of the same, arrive sufficiently in advance for an adequate report to be prepared. This would allow the competition authority to react in time and ensure considerations regarding the new law’s impact on market competition are included in the analysis. A cooperative relationship between the competition authority and the ministerial departments, regulators and legislative branch could be quite helpful for this purpose.

In Honduras, this timely communication would be more or less guaranteed, since information is sent to CDPC when bills are submitted to Congress, and one of the commissioners is required to participate in the National Congress to facilitate communication and coordination.

With regard to the Central American competition authorities’ issuing of opinions on regulations and recommendations resulting from sectoral studies, the experiences have varied greatly, even within the same jurisdiction. Such is the case in El Salvador, although SC’s opinions have in practice been taken into account in various cases, including the amendment to the law on medicinal drugs. By way of illustration, in Honduras, CDPC was able to get the prices of medicines deregulated and entry barriers lowered with regard to minimum distances between pharmacies.¹³

III. Three chosen sectors

III.1. Banking sector

III.1.1. Notes for Characterizing the Sector

The Central American banking sector is very heterogeneous and has undergone major transformations as a result of the political and economic storms it has had to weather. In El Salvador and Nicaragua, banks went from predominantly private to public and back again to private. In Costa Rica, though, public banking has predominated almost immutably, despite the fact that private banks have been increasing their participation and the industry as a whole has been modernizing. The most stable banking cases are those of Guatemala and Honduras, although in these countries banking is more behind the times. Panama, with its financial district, has the most advanced banking in the region.\(^{15}\)

The Director of BICSA, a private financial institution in Costa Rica, recently remarked on the difference between the Panamanian banking sector and that of the rest of Central American countries, stating that the Panama banking sector is more nimble and flexible. Setting up a bank in Panama can be accomplished within six months, where it would take two years in other countries, and the greater competitive pressure leads to larger credit flows than in other countries – not only for consumption, but also for productive investment – and credit conditions are better. Along this line, a source at the Nicaragua Bank Superintendent explained that Panama excelled in the flexibility of its laws and business start-up speed, to which a Nicaraguan economist added that the Panamanian banking sector prioritized productive investment, unlike in Nicaragua.\(^{16}\)

The CAPARD\(^{17}\) regional banking system handled approximately USD 180,396 million (24.3% of the region’s GDP) in 2012. The banking systems of the six study countries had some USD 171,100 million in assets at June 2013.

In June 2013, the largest of the region’s banking systems was Panama (USD 77,900 million in assets), and the smallest was Nicaragua (USD 5,000 million). The Costa Rica and Guatemala systems are very closely matched in size if the offshore banking assets of the latter are included. Though somewhat smaller, the El Salvador and Honduras systems are also similar to each other in size.

El Salvador stands out for the strong participation of foreign banks (93% of the assets), and Costa Rica for that of State banks (53.1% of assets). With the exception of Panama, the region’s countries have a low degree of financial depth (loans/GDP), especially Guatemala (even including offshore banking credit) and Nicaragua.

\(^{14}\) The current data referred to in this section comes from reports by the Executive Secretariat of the Central American Monetary Council (SECMCA) ([http://www.secmca.org/](http://www.secmca.org/)) and Fitch Ratings ([http://www.fitchca.com/default.aspx](http://www.fitchca.com/default.aspx)).

\(^{15}\) Competition and Regulation in the Banking Systems of Central America and Mexico: A Comparative Study. Eugenio Rivera & Adolfo Rodríguez for the ECLAC. Mexico D.F., February 2007

\(^{16}\) From a series of interviews conducted in November 2013

\(^{17}\) The 5 Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua) + Panama + Dominican Republic
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

### Banking System Assets (Billions of USD) Jun 13

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<tr>
<td>Panama</td>
<td>77.9</td>
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Source: Compiled from Fitch Ratings data

In most of the systems the share of personal loans (consumption and housing) in the loan portfolio is notably large, benefitting the banks’ margins. The bank loan ratio in the Panamanian system as a percentage of the total portfolio would be close to that of the Honduran system if only domestic loans were taken into account.

All the countries maintain controlled default rates. Central American banking has adequate coverage for its 90+ day default portfolio. However, high past-due rates persist in the household portfolio, especially in consumer credit cards.

38.1% of external lending in 2012 by the Costa Rica, El Salvador, Guatemala and Nicaragua banking systems (no information is available for the others) was to residents in the region, especially in Honduras and Panama, while 21.1% went to United States residents. Most of it originated in Costa Rica.

The dollarized banking systems (Panama and El Salvador), or those that are highly dollarized with high levels of local liquidity (Nicaragua), had lower funding costs.

The region's banks are financially very sound. Their capital adequacy and capitalization indicators are higher than the minimums established in regulations. Most of the credit funding comes from residents’ deposits (much higher than 100% of all credit), constituting a strength for the systems.

External funding for CARD was 7.4% in 2012. This source of funds was very important for the Panamanian banking system (36.5% of liabilities) but less so for the Guatemalan system (13%).

The reserve coverage of private banks in Costa Rica (131% in June 2013) is almost double that of State banks (67.4% in June 2013). Panama and Costa Rica still lack a formal system of guarantee funds (or insurance) for deposits, but apparently are working on creating one.

Liquidity levels, which are too high, are dropping in the majority of the region’s banking systems, enabling the stronger credit demand to be met.

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18 For more information on the Central American banking sector, see Appendix 1.

19 CAPARD without Panama
In 2012, the proportion of loans in foreign currency was on average 39.3%, and foreign currency availabilities covered less than 40% of the short-term liabilities in foreign currency (in 2012 Nicaragua continued to record the highest dollarized portfolio proportion in the region). Exchange risk coverage, then, is a major challenge for the region’s banks, especially in countries with more exchange rate risk. Regulators are strengthening controls and capital requirements for foreign currency exposures in the non-dollarized systems in order to mitigate exchange rate and credit risk.

Except for Panama, the level of implicit intermediation spread for the region’s banks is very high, but administrative expenses are also quite high (absorbing more than 40% of financial income and more than 60% of the financial margin), so the region’s efficiency levels remain low. This is explained, according to the Executive Secretariat of the Central American Monetary Council (SECMCA), by the high level of banking concentration (which would appear to suggest a lack of competition), low levels of “bankarization” and low per-capita incomes and other social indicators of development.

The banking systems of Honduras and Nicaragua, together with the State banks in Costa Rica, are the least efficient in the region. For Fitch Ratings, operating efficiency will continue to be driven by business-oriented banks and by the reinforcing of technological platforms for e-banking.

In 2013, SECMCA was expecting the region’s banking system to maintain the recovery trend that had begun in 2010, with stepped-up lending and stronger financial soundness indicators. It was also expecting monetary and oversight authorities to continue with regulatory framework improvements, incorporating macro-prudential measures, and to move forward with implementing risk-based supervision, consolidated cross-border supervision, and systemic risk identification and measurement.

If the “regional banks” – that is, those with a presence in more than one country in the region – are analysed separately, it is found that their share of all bank assets in the region was 43.9% in 2012. In 2012, the regional banks of Costa Rica, Guatemala and Nicaragua significantly increased their lending, and those of Honduras and the Dominican Republic somewhat less so. Of note was the recovery of lending by the regional banks in El Salvador, whose growth rates had been negative. In general, the performance of regional banks improved in 2012; they augmented their earnings, maintained adequate liquidity levels, and improved their loan portfolio quality and allowance coverage. Nevertheless, some regional banks still have high default rates, low allowance coverage and low earnings.

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20 Bankarization describes the financial depth of the economy or market.
21 The SECMCA report on the Central American banking system and its outlook for 2014 are still not available.
Table: Presence of Regional Banks in the Region’s Countries

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Source: Compilation based on data from the SECMCA 2012 report.

The poor efficiency of Central American banking systems despite high intermediation margins could be due, at least in part, to limited competition in the sector. This merits more investigation, given the understanding that a banking system’s efficiency could have a lot to do with the competitive pressures within it.

A Fitch Ratings report²³ holds that, with the exception of Panama, the region’s efficiency has room for improvement and that although there is a growing use in the region of less costly alternate services such as telephone banking, internet banking and automatic tellers, some banks still aspire to a broad geographical coverage through traditional branches despite the fact that not all branches are profitable.

²² An October 2013 Asobancaria report states that “The share of Colombian conglomerates’ assets out of all Central American banking system assets is already 22.4%. The most weight is in El Salvador, with 52.7%, followed by Panama with 25.2%, Nicaragua with 22.6%, Honduras with 21%, Costa Rica with 12.8% and Guatemala with 2.9%.

²³ The following information comes from the Fitch Ratings Special Report, Efficiency across Central American Banking Systems, March 2012.
The Panamanian banking system has the greatest bankarization (132% loans/GDP) and is also, at the same time, the most efficient system in the region. According to Fitch Ratings, this is explained by the fact that Panama is a regional financial hub and has a larger population concentration in urban areas, a less extensive territory, and a relatively high GDP per capita. It also demonstrates, however, that banks make better use of alternative ways to reach customers in a more competitive environment characterized by lower interest rates.

**Bankarization and Efficiency**

![Graph showing bankarization and efficiency across different countries.](image)


Honduras has a larger territory and less population in urban areas. With fewer banks, it has more branches, though the business volume per branch is smaller. Although the use of alternative mechanisms for providing financial services is becoming more popular, the entire system is the least efficient in the region.

In Guatemala, the financial system is geared primarily to corporate finance, with smaller margins than other non-dollarized economies. Some banks have specialized in retail financing and provide the best geographical coverage in the region, but bankarization is still low and the business volume at the branches is smaller compared to that of other countries, due to the country’s extensive area, its highly dispersed population and its modest per-capita GDP. The overall efficiency of the Guatemalan financial system is low.

In response to relatively inferior margins, the Salvadorean financial system has the second best efficiency in the region, with high business volumes per branch, as a
result of a larger population concentration in urban areas, greater geographical penetration, and the use of alternative mechanisms for reaching customers.

In Costa Rica major efficiency differences persist between public banks and banks created by special laws, on the one hand, and private banks on the other. Public banks include bankarization in their strategic objectives (being significantly fewer, they have more than half the country’s branches) and benefit from lower funding costs. Private banks, whose margins are relatively smaller, are more efficient. The private bank branches have a higher business volume in terms of assets, and the public bank branches have a higher volume in terms of loans.

The Nicaraguan system is the smallest and least efficient in the region, with the lowest degree of bankarization. With the lowest per-capita income in the region and the largest area, the banks need to use alternative channels for providing their services.

Banking and financial sector regulation is broad and complicated, and a detailed analysis of what applies in each of the six Central American countries exceeds the scope of this paper. However, the Matriz de Políticas Básicas para la Integración de los Sistemas Financieros de la Región CAPARD (Basic Policy Matrix for Integration of CAPARD Financial Systems) posted by SECMCA on its website\(^\text{24}\) combines information from all the countries (the six and the Dominican Republic) on some of the more important regulatory provisions: nature and degree of independence of the regulator from the financial sector in each country;\(^\text{25}\) number and type of financial institutions overseen by each; minimum capital requirements; risk management instruments and rules, including limits on open foreign exchange positions; treatment of offshore banking; consolidated supervision; transparency, auditing and corporate governance practices; institution intervention and liquidation; banking secrecy; credit limits; deposit insurance; and taxation.

Regionally, the Central American Monetary Council (CMCA) and the Central American Council of Superintendents of Banks, Insurance and Other Financial Institutions (CCSBSO) are an attempt to harmonize the region’s regulations and integrate its financial and banking systems.

The Central American Monetary Council (CMCA) was created by the Agreement for the Establishment of the Central American Monetary Union\(^\text{26}\) signed by the central banks of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua on February 25, 1964. The Dominican Republic Central Bank joined on June 22, 2002.

CMCA is a SIECA body acting as a sectoral council of ministers with functional autonomy in the exercise of its responsibilities; its members being the Presidents of the central banks of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua and the governor of the Dominican Republic Central Bank.

\(^{24}\) [http://www.secmca.org/DOCUMENTOS/matriz/MATRIZSBREDUCIDA_ACTUALIZADAFINALFINSROIDC2013.pdf](http://www.secmca.org/DOCUMENTOS/matriz/MATRIZSBREDUCIDA_ACTUALIZADAFINALFINSROIDC2013.pdf). The Matrix has been recently updated (December 2013) as a result of an inquiry of ours (the previous version was dated March 2009). Our thanks to SECMCA.

\(^{25}\) The General Superintendent of Financial Institutions (SUGEF) in Costa Rica, the Financial System Superintendent (SSF) in El Salvador, the Bank Superintendent (SB) in Guatemala, the National Banking and Insurance Commission (CNBS) in Honduras, the Superintendent of Banks and Other Financial Institutions (SIBOIF) in Nicaragua, and the Bank Superintendent in Panama.

\(^{26}\) For the status of the monetary integration project, see [Nota Económica Regional de la SECMA](http://www.secmca.org/NOTAS_ECONOMICAS/articulo55JUL2012.pdf), Jorge Barboza, July 2012.
The legal basis for CMCA and its attributes is found in the Guatemala Protocol\(^{27}\) and in its own founding agreement, the Central American Monetary Agreement.\(^{28}\)

CMCA’s vision is “to be the leading institution for regional monetary and financial integration”, and its mission is “to promote monetary and financial policies that drive monetary and financial integration and regional macroeconomic stability.”

Its strategic objectives for the 2011-2015 period are as follows: foster member country cooperation on monetary and financial policies, help strengthen regional financial stability, encourage the harmonization and dissemination of regional economic statistics, foment economic research with a regional focus, promote central bank cooperation among members, reinforce coordination with other regional and international institutions, and build the technical, financial and administrative capacities of the Executive Secretariat (SECMCA).

It has a series of support committees: (1) Monetary Policy Committee; (2) Capital Market Committee; (3) Legal Studies Committee; (4) Payment System Technical Committee, whose objective is to develop a regional communication platform for national payment systems and recommend principles, designs and methods for strengthening national payment systems; (5) Regional Standards Technical Committee, which was initially charged with defining and presenting for approval the Minimum Standards for Harmonizing the Region’s Public Debt Markets and recommend complementary actions to guide the creation of a regional market for discounted internal public debt, and then later given the task of following up on the implementation of the Guide to Standards, once it was approved; and (6) Information Technology Committee.

It also has a series of ad hoc groups: (1) Ad Hoc Monetary Statistics Group; (2) Ad Hoc National Accounts Group; and (3) Ad Hoc Balance of Payments Group, charged with the Harmonization of Macroeconomic Statistics Project.

The Central American Council of Superintendents of Banks, Insurance and Other Financial Institutions (CCSBSO) was created by an agreement adopted at the Third Meeting of Superintendents of Banks, Insurance and Other Financial Institutions held in San Pedro Sula on July 28, 1976.

At its inception the Council was comprised by the superintendents of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, with the entry of Panama and the Dominican Republic being approved on February 18, 1999. The Council’s Executive Secretariat, a permanent body since 2011, is located in Panama.

The Council has several committees: (1) Standards Committee, charged with drawing up an action plan for adapting the regulatory framework and supervisory procedures to New Capital Agreement guidelines; (2) Liaison Committee, for the effective and coordinated supervision of financial conglomerates; (3) Financial and Accounting Standards Committee, for developing a standard form for presentation of financial statements and standard rules on accounting and prudential criteria, with which national supervision policies must concur; and (4) Technology Committee, which proposes the necessary information technology and telecommunications actions.

The Council’s strategic plan for the period 2010-14 emphasizes the strengthening of consolidated and cross-border supervision of regional groups, risk-based supervision,

\(^{27}\) http://www.secmca.org/LEGISLACION/REGIONAL/Protocolo%20de%20Guatemala.pdf

\(^{28}\) http://www.secmca.org/LEGISLACION/REGIONAL/AcuerdoMonetario.pdf
and banking security networks, as well as the adoption of international reporting standards.

However, Central American financial integration would be better if it were produced spontaneously, or in a de facto manner, as international banks set up in the region’s different countries and try to operate as if they were a single market.29

The benefits of financial integration would be a larger market, enabling financial institutions to operate at a larger scale, and more competition, obligating financial institutions to modernize, become more efficient, reduce finance costs, improve the quality and diversity of their products and services, and explore new ways to capture savings and investment. Financial integration also entails obligations for the governments, essentially the ceding of national sovereignty in financial regulation and supervision in order to control systemic risk, regulatory arbitration and destabilizing flows. It also requires monetary stability, efficient payment systems, harmonized policies and regulations, etc.

The first efforts towards achieving financial integration in Central America involved the Central American Clearinghouse, which closed at the beginning of the 1990s. After the Guatemala Protocol, CMCA and the Council of Superintendents approved a set of harmonized minimum standards in the form of recommendations. Thus progress was made on harmonizing the rules and on consolidating cross-border financial supervision of financial groups. The Multilateral Memorandum on Information Exchange and Mutual Cooperation for Consolidated Cross-border Supervision among Members of the Central American Council of Superintendents of Banks, Insurance and Other Financial Institutions.30

However, governments have not done enough to promote integration (there has not been enough regional harmonizing, so regulation and supervision remains fragmented, at risk of regulatory arbitration). Their major achievement, however, has been the 2006 Central American and Dominican Republic Treaty on Payment Systems and Securities Settlement and the construction of the Regional Payment Interconnection System of Central America and the Dominican Republic (SIP), making low-cost, safe inter-regional payments possible.31

Another initiative was set in motion, with the help of the Inter-American Development Bank (IDB), for developing national public debt markets in order to gradually integrate them in the future. A set of regional standards was prepared for

29 Regional Economic Report by the SECMCA, August 2012. Jorge Barboza
30 http://www.ccsbso.org/informacion/multilateral
31 From http://www.secmca.org/Leg_Reg.html, http://www.secmca.org/SIP.html and the SECMCA 2012 Work Report. The SIP enables customers of the banks and financial institutions affiliated with the system to make low-cost USD electronic funds transfers between those countries quickly and safely. The fee for each transfer is USD 5. Transfers can be made from 9 a.m. to 3 p.m. in Central America, and from 10 a.m. to 5 p.m. in the Dominican Republic. To use SIP services, interested parties have to go to the banks and financial institutions. Participating in the SIP are 22 banks in Guatemala, 6 in Honduras, 3 in El Salvador, 6 in Nicaragua and 17 in the Dominican Republic. The SIP was created to facilitate trade and intra-regional investment. Its pillars are: modernization of national payment systems, a regional legal framework that ensures the legal security of the payment cycle, and an interconnection design that meets international standards. The system was inaugurated and started operations in 2011. In 2012, 626 transactions were made through SIP for USD 74.2 million. The SIP is in the consolidation phase and is expected in the next few years to become the main infrastructure for intra-regional payments.
Initiatives were taken – also with the IDB’s help – for the Central American Market Alliance (AMERCA) and the Regional Strategy for Regulation and Supervision of the Central American Stock Market (ERSMB).\footnote{Oportunidad para la integración bursátil centroamericana. Regional Economic Report N° 66, July 2013. Jorge Barboza. \url{http://www.secmca.org/NOTAS_ECONOMICAS/articulo66JUL2013.pdf}}

The AMERCA initiative was announce in August 2007 by the Costa Rica, El Salvador and Panama stock markets as a project for standardizing the trading rules of the three markets and making it easier for brokerage firms in the three markets to operate in any of them using a single trading platform. The stock exchanges of the rest of the Central American countries and the Dominican Republic were expected to join later to form a larger market. The idea for the medium term was to link AMERCA with other initiatives in the Americas, such as the Integrated Latin American Market (MILA), where the stock markets of Chile, Peru and Colombia operate.

ERSMB was implemented between 2011 and mid-2013, with the goal of harmonizing rules and regulations in three specific areas: the public offering of securities; the trading, clearing and settling of securities; and the actions of stock operators (including brokerage firms and stock markets). Various national diagnostics were conducted for this, the best international practices were identified, common regional reference standards were defined, and national action plans were established for implementation of those standards.

The project was concluded, and in July 2013 the beneficiary oversight bodies were specifying the content of their action plans and the timeline for implementation of the strategy. The integration of Central American stock markets is still to this day a dream waiting to be realized. For SECMCA, the first step would be to indefinitely renew the 2007 Multilateral Memorandum of Understanding between the Countries of Central America, Panama and the Dominican Republic for the Exchange of Information and Mutual Cooperation\footnote{https://www.ssf.gob.sv/images/stories/descarga_convenios/memo_centropanama-repdominicana.pdf} and implement ERSMB with the duly needed political drive.

### III.1.2. Competition Problems

In 2007, ECLAC published a series of studies on the status of competition and regulation in the Central American banking sector. The one entitled Competition and Regulation in the Banking Systems of Central America and Mexico: A Comparative Study\footnote{Eugenio Rivera & Adolfo Rodríguez. Mexico D.F., February 2007} set forth a series of conclusions that could be summarized as follows:

- The contestability faced by the sector has been increasing, particularly from abroad. The development of telecommunications and the fluidity of capital bring local banks into intense competition with foreign banks and brokerage firms. On the liability side, many large- and medium-sized investors manage their portfolios abroad, and on the asset side, many corporations receive loans from foreign banks.
- Economies of scale, along with other factors such as customer loyalty, have enabled local banks to maintain their control over medium- and small-sized customers, but all indications are that this barrier will gradually disappear. In these market niches, in particular, banks may face contestability from internal sources such as credit cards issued by non-banking operators, the public debt, or investment funds.

- Increased concentration in the sector does not seem to have reduced competition. On the one hand, the relative symmetry between leading banks maintains a workable degree of competition. On the other, the exposure to foreign contestability has forced banks to maintain relatively competitive dynamics. Moreover, concentration has occurred within the framework of a regionalization process with positive consequences for competition in this sector.

- After having basically focused on domestic business, local banks are increasingly participating in more a regional market. The major banks operate in most of the countries, and the regional nature of their operations is becoming a competitive advantage that will gain in importance as public policies institutionalize the headway made by the private sector on integration.\(^{35}\) The regional nature of the industry seems to be helping to intensify competition and improve banking quality. In Honduras, the effect of large regional bank activities is positive (regional bank performance indicators are substantially higher than those of domestic banks), while in Guatemala the impact is minimal due to a low level of regional bank penetration.

- It cannot be said that the contribution of extra-regional banks has been equally beneficial for consumers, however. The entry of foreign banks has not brought improvement, either in the cost or the quality of services (private sector lending and coverage), although it has improved profitability.

- There is no guarantee that by taking control over local banks foreign banks will improve competition in the banking system or the services provided to users. For the moment, local banks have demonstrated strong dynamism and ability to adapt. However, various factors outside of these local banks, mostly originating in outdated public policy, threaten their ability to compete with foreign banks.

This same report breaks down the regulatory and possibly structural problems that are blocking the development of competition in this sector. Central American markets are facing relatively limited contestability, in some cases, due to poorly developed infrastructure (Internet, payment infrastructure, etc.), related markets (interbank, public debt, securities, etc.) or other savings products (investment funds, pension funds, etc.). In other cases, it could be regulations that impose restraints on

\(^{35}\) Note here also the implied recognition that the reality of integration has exceeded – or has occurred faster than – the regulators’ efforts to achieve integration.
intensified competition, although sometimes regulatory reasons also underlie the underdevelopment of specific markets or financial products.

When entering the sector, interested banks face specific minimum capital requirements. Rivera & Rodríguez (2007) argues that the gradual increase in capital requirements since the 1990s (to meet Basel prudential standards) has played an active role in driving mergers and concentrations. Also coming out of Basel are specific regulations affecting the banks’ competition strategies, such as the ones setting constraints on portfolio concentration and lending to related parties, which would be perfectly justified in Central America, especially if we take into account that many of the problems that have afflicted the region’s banks have had to do with credit risk.

Although there are no absolute barriers to entry in any of the countries in the region, in some countries foreign banks face constraints for opening offices or branches. Panama is the most open to the entry of new players. The 1970 banking law authorized the execution by offices set up in Panama of operations that are carried out and effective abroad; it also authorized the establishment of representative offices in Panama. Combined with a deregulatory process that liberalized interest rates and eliminated obligatory cash reserves, this gave rise to the development of the so-called “financial district”, which became a major offshore destination for the region's banks and some of the world’s largest banks. In the case of El Salvador, Herrera (2007) does not notice any significant legal entry barriers for new banking institutions and found that entry provisions were in line with regulatory and supervisory objectives. According to the paper, the ease with which Central American capital, especially Nicaraguan, had entered the system is an indication of this.

At any rate, small domestic market sizes and modest population income levels, depending on the case, could discourage the entry of new agents into the market, rather than it being so much a question of regulatory barriers.

Some regulations involve a discriminatory treatment of private and public banks. In Costa Rica, several measures give public banks an advantage over private ones: an unlimited government guarantee on public bank deposits (this also occurs in Guatemala), an obligation for private banks to deliver 17% of their current account deposits to public banks, a tax exemption for public banks on earnings from foreign currency transactions, an exemption for public banks to the minimum capital requirement for operation, or the fact that government agencies can only deposit in public banks.37

There are also cases, though, where regulations impose burdens on public banks that do not apply to private banks, in the form of provisions imposing specific uses for their profits or constraints on employment and administrative procurement.

Regulations also treat offshore banking differently. Monge González & Rosales-Tejerino (2007) explains that offshore banking was losing ground in the Costa Rica system due to the gradual elimination of certain distortions that had favoured its creation, although in 2007 it still had relatively significant weight. Offshore banking operates outside SUGEF’s supervision, insofar as this regulator has no legal mandate for supervising consolidated private bank operations. It is also exempt from the obligatory reserve established by the Central Bank.

In addition, El Salvador (since 2001) and Panama (since 1904) are dollarized economies, and the rest of the region’s countries (except Guatemala) have some type of exchange rate commitment that limits the room for manoeuvre in monetary policies. Combined with public debt management and payment infrastructure weaknesses, this makes the main instrument of monetary policy the obligatory reserve, which is costly for the banks (as it is not remunerated) and gets passed on to consumers. This is a strong disadvantage of local banks compared to foreign banks and a driver for relocation of their operations.

The absence of efficient interbank markets compromises the competitiveness of local and small banks. In effect, lacking efficient mechanisms for managing their liquidity, banks are forced at great financial cost to maintain excessive liquidity and to take out credit lines on foreign banks in order to deal with potential contingencies. This favours foreign banks over local ones, since liquidity management is less costly for the former, and large banks over small ones, since many of the latter are unable to get adequate credit lines at foreign banks or can only do so at a much higher cost than their competitors pay.

Efficient mechanisms are also lacking in the region for making cross-border payments, which must be made through a costly chain of foreign correspondent banks, increasing transaction costs and making portfolio management more expensive. The regionalization of banking groups helps overcome these constraints, putting them in a position of advantage for capturing customers with intra-regional business, though there is always a loss of efficiency.

For Rivera & Rodríguez (2007), local bank activity is subject to intense competition from foreign banks, although some “transaction costs” still persist. Thus the perception predominates that it is very easy for investors to invest in foreign markets, but local companies are held captive by local banks, relatively speaking, for getting financing.

Efforts to capture savings made by offshore banks within the national territory are prohibited in all countries in the region except Guatemala. No foreign-domiciled bank can capture savings from the public, although in countries with more open regulations the branches of foreign-domiciled banks can do so. There are no restrictions, however, keeping domestic banks from investing in foreign-domiciled banks or carrying out business transactions with them.

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38 This disadvantage is added to other difficulties faced by small banks as compared to large ones, as noted by Herrera (ECLAC 2007). Large banks have greater risk analysis capacity than small ones and can thus choose their customers better, leaving the “bad customers” for small banks. Small banks therefore face higher reserve requirements for risk and fixed equity, as well as lower returns.

39 This limitation is one of the reasons for regionalization, according to Rivera & Rodríguez (ECLAC 2007), which also suggests that countries in the region have not had a clear intention of favouring regional integration and competitiveness in their regional banking system.
Other sources of market contestability, this time internal, are, in principle, the alternatives to bank deposits as ways of capturing savings from the public: public debt, investment funds and pension funds.\footnote{40} Local public debt is an alternative for medium and large investors, who buy it on the primary market (auctions and windows) or the secondary market (through banks and brokerage firms). According to Rivera & Rodríguez (2007), this is a market segment in which banks are unable to compete because their funding costs would increase appreciably (public debt returns are generally higher than those offered by term deposits at banks), and at any rate they already have a captive segment for at-sight or term deposits of small investors without access to public debt, due to the lack of a distribution network for these securities, their limited liquidity and the issuance cost of physical securities.

The battle for capturing small investors has been set off by the development of pooled instruments, especially investment funds. However, stock markets have had practically no relevance for most of the countries in the region. In Panama, stock market activity is almost non-existent and is basically used for purely tax-related reasons – company-issued bonds are a mechanism for getting bank loans with very favourable tax conditions for the debtors. In the case of Honduras, the banking sector accounts for 95% of the financial system’s transaction volume, the stock market’s influence being minimal and practically imperceptible – the little existing activity is geared to the trading of public debt securities.\footnote{41} In Costa Rica, the stock market is essentially for bank and public debt and has played some role in the development of banking.\footnote{42}

The stock markets and brokerage firms have had disproportionate weight in the organization of the Central American securities market, given the fact that all countries in the region legally require all transactions with securities, whether stocks or bonds, to be made on the stock market or through brokerage firms or brokers. This has made it difficult to develop interbank markets and has forced banks to create brokerages to handle the bank’s own liquidity needs, at least. Laws have forced financial groups to set up companies for the groups’ different activities, creating independent companies within the same holding company. These brokerage firms provide securities brokerage services to the banks’ customers and in some cases have

\footnote{40} Competition and Regulation of the Banking Sector in Guatemala (Edgar Balsells, ECLAC, January 2007) states that “a modern framework of competition and competitiveness is associated with the emergence of a strong non-banking financial sector, operating with stock market investments and in a consolidated capital market, that can enable new ways to finance companies and contribute to financial competition.”

\footnote{41} This limited development of stock market activity does not help in the least to lower funding costs, expand the service offering, or increase the returns that savers and investors can get from their deposits. From Competition and Regulation of the Bank: The Case of Honduras. Marlon Ramssés Tábaro. ECLAC. Mexico D.F., November 2007.

\footnote{42} The development of Costa Rica stock market activities is interesting from the point of view of competition. Originally developed by non-banking financial groups, investment funds have become quite important, and financial groups are gradually being forced to set up fund management firms in order to offer them to their customers. Most financial groups let their group’s fund management companies compete openly with the bank for capturing savings, so much of the competition pressure on banks is from investment funds, including those managed by companies belonging to their same financial groups. Thus the development of investment funds gave rise in Costa Rica to improved banking services and higher interest rates for deposits. It is no coincidence that in other Central American countries, where financial development has been determined more by the banks, the development of stock markets, and particularly investment funds, has been much more limited. From Rivera & Rodríguez (ECLAC 2007).
agreements with foreign brokerage firms to handle the accounts of those customers, for whom they obtain lower fees than customers would be charged in dealing directly with the foreign firms.

Costa Rica pioneered in providing pension and investment funds. However, foreign banks, in general, have not entered the investment fund business, just as banks specializing in corporate customers have not entered the pension fund market.

Despite the fact that the size of the Central American market does not lend itself to the emergence of highly specialized banks, a certain pattern of specialization can be detected. The general trend, however, has been for financial groups to enter into all businesses, even though, as has already been noted, laws have forced them to do so through independent companies belonging to a holding company. For example, the segment of small savers and credit demanders is starting to be targeted by banks that had previously specialized in higher income segments and are now counting on the technical and financial support of international organizations, such as the IDB, interested in promoting the provision of banking services for the rural world.43

Beyond regulatory and/or structural questions, competition problems can come from the behaviours of market agents, who could eventually distort competition through anti-competitive agreements, abusive behaviours or concentrations that endanger the competitive process.

Some anti-competitive conducts that could occur include agreements over interest rates, fees or charges for credit card use, the tying of goods and services, and practices for blocking the entry of new competitors, among other possible practices.

Regarding concentrations, for Rivera & Rodríguez (2007) concentration moves by banks have not reduced competition in the sector. On the contrary, the mergers and acquisitions have been accompanied in many cases by improvements in the quality of competition by creating large players who can compete with each other while taking advantage of the economies deriving from their larger size, all to the benefit of consumers.

Accordingly, Paredes & Morales (2007) states that the economic concentrations in the International Banking Center (CBI) of Panama were not negative for competition, given the existing rivalry and absence of entry barriers; at the same time a wave of mergers was taking place, new banking licenses were also being issued. Likewise, Monge González & Rosales-Tijerino affirm that the mergers and acquisitions in the Costa Rica banking sector have not necessarily reduced competition.

For Herrera (2007), the effect of mergers in El Salvador has not been negative in terms of competition. To the contrary, the system has gained in efficiency and solvency by ridding itself of inefficient banks with credit default and insolvency

43 Morales & Paredes (2007) suggests that in Panama the banks adopt two types of strategies to deal with competition. Some aim at market niches, and some seek consolidation through economic concentration to increase their equity (improving their risk rating and funding costs) and lending capacity. In Competition and Regulation of the Bank: The Case of Panama. Gustavo Adolfo Paredes & Jovany Morales. ECLAC. Mexico D.F., September 2007. A March 11, 2013 article at panamerica.com.pa states that since 2000 eight banks have opened their doors “with a focus on competing in the niche segment. Making customers feel that going to the bank is a pleasant experience is the strategy followed by some banks here.”
problems. Moreover, increased concentration resulted not just from mergers but also from the closing of problem banks following intervention by the regulator.

This does not mean, however, that new concentration transactions will not pose problems for competition, especially considering that some markets already have very concentrated structures. In addition, Rivera & Rodríguez (2007) warns that some regulations could have been encouraging the sector’s concentration, capital requirements being cited in some reports.

### III.1.3. Actions of Competition Authorities in the Region

#### Studies, Reports and Opinions

The SC in El Salvador issued an opinion on the *bill of law for supervision and regulation of the financial system* in 2010, and on the *bill of law for the credit card system* in 2009. The Panama authority issued an opinion in 2000 on the *draft of Law 68, providing for measures to be taken to protect consumers from potential excesses in the handling of credit, and modifying several articles of Law 20 of 1986*, and in 1998 on *Law 9 of 1998, by means of which the bank system was reformed and the Bank Superintendent was created*.

In addition, Coprocom in Costa Rica commissioned a study, *Promoting More Competition in the Costa Rican Banking Sector* in December 2007; SC published a study on the *Conditions of Competition in the El Salvador Credit and Debit Card Sector* in August 2011; CDPC carried out an *Analysis of the Credit Card Market in Honduras*, which it published in May 2007, and has publication pending for a *Sectoral Study on Competition in the Honduras Retail Banking System*, and ACODECO (and before that, the Commission for Free Competition and Consumer Affairs, or CLICAC) of Panama has issued various Technical Notes or Technical Reports on the sector.

SC gave the go-ahead for the supervision draft law, which would integrate several superintendents to strengthen oversight of the financial system, and proposed various modifications to the draft law for the credit card system, such as eliminating the ceiling on effective interest rates charged on debt balances, including an obligation to publish fees for credit card services, giving the Central Reserve Bank the power to require information on interchange fees to be made known to consumers and affiliated merchants, and recognizing the right of merchants to establish differentiated pricing by payment method.

The study on the Costa Rican banking sector reviews financial liberalization in Costa Rica and its impact on the degree of competition in the banking sector, attempts to

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44 Germán Coloma for the Regional Competition Center for Latin America (CRCAL) and the CDPC, June 2013

45 The law was passed at the beginning of 2011; its last amendment was in August 2012. [http://www.asamblea.gob.sv/eparlamento/index-legislativo/busador-de-documentos-legislativos/ley-de-supervision-y-regulacion-del-sistema-financiero](http://www.asamblea.gob.sv/eparlamento/index-legislativo/busador-de-documentos-legislativos/ley-de-supervision-y-regulacion-del-sistema-financiero)
identify the obstacles to greater competition, and proposes public policy recommendations to that respect.

The payment card sector study in El Salvador (2011) found that the sector had already reached a significant level of maturity there, although the combination of permanently high returns, a highly concentrated market, and strategic and regulatory entry barriers led to the conclusion that competition was not working efficiently. The study gave recommendations to improve competition: establish mechanisms for improving the accountability of public authorities for the sector, expressly add card system oversight to the duties of the public agencies charged with their supervision, grant merchants the right to differentiate end consumer pricing depending on the payment method used, regulate a new interchange fee schedule based on cost and fraud risk, promote measures to reduce change-of-provider costs for users, publish transaction statistics to improve transparency, and expand the financial education program for consumers, with special emphasis on small and micro-enterprises.

The study on the credit card market in Honduras (2007) concluded that it was concentrated, encouraging collusion among providers, and that in fact an agreement (tacit) among the banks was the only possible explanation for the interest rates observed.46

The study on the retail banking sector in Honduras (which has not yet been published, though some information has come out of it) found an intermediate degree of concentration, with no bank having higher than a 20% market share (so positions of dominance cannot be assumed), and a tendency to behave like a competitive market – though CDPC should not let down its guard and should closely monitor the sector to detect eventual competition problems.

ACODECO has studied the stock brokerages (Technical Report of May 2013) and the microcredit market (Technical Report of September 2011), apparently without finding any competition problems, and has issued various notes and reports on lending interest rates in Panama, questioning in Technical Note No. 31 of September 2004 whether the fact that no bank had lowered its loan interest rates in two years could be due to a lack of effective competition. ACODECO also publishes periodic reports on credit card and other finance card interest rates.47

Cases of Anti-competitive Practices and Analyses of Economic Concentrations

The Costa Rica competition authority investigated a case of tied selling (the interested party was forced to take out an insurance policy or pension plan as a condition for getting a loan),48 Nicaragua49 and Honduras50 authorities have investigated various cases of alleged collusion for fixing credit card interest rates, and the El Salvador

46 CDPC’s investigation of the credit card market may have been derived from this study. The investigation concluded that there was no anti-competitive practice.
48 Expediente No D-03-08
49 Case No. 0003-2010
50 Case No. 024-PIO-8-2007
authority is investigating a case of potential collusion for increasing loan interest rates.\textsuperscript{51}

The Costa Rica case was shelved, as the accused institution was felt to lack a position of dominance in the loan market. A punishment was dictated for the case in Nicaragua, but the Supreme Court of Justice annulled the decision, considering that authority over the case rested not on Procompetencia but on the Bank Superintendent (SIBOIF). The Honduras case ended positively for the accused parties when CDPC found that the agreement did not refer to fees to be charged to merchants but rather to the interchange fee (and here the agreement was necessary).

In the field of economic concentrations, the El Salvador, Honduras and Panama authorities have analysed several transactions, none of which has been prohibited (or none of which has received an unfavourable opinion, in the case of Panama) or conditioned, except in two cases in Panama (the merger of Banco General and Banco Continental, and the acquisition of Banistmo by HSBC Asia Holding). The authorities’ analyses took into account the shares of the institutions being concentrated in the markets that would be affected by the concentration, and if they coincided, the existing degree of competition in those markets prior to the concentration, and whether the transaction significantly changed the situation. In addition, they studied the degree of market contestability to keep in mind potential competition, as well.

**III.1.4. Recommendations**

Some measures can be deduced from the foregoing that would help improve competition in the Central American banking sector.

Reference has been made to certain regulatory measures that may be obstructing the market entry of potentially new competitors or limiting the ability of some to compete with others (discriminatory treatment). It would be worth revising those regulations, taking into account at all times that although security and solvency are extremely important, competition is also something worth protecting.\textsuperscript{52} Collaboration between competition authorities and sectoral regulators could give good results to this end.

Where similar regulatory problems are found, competition authorities could consider coordinating their advocacy efforts in order to magnify their impact. The ability of competition authorities to join forces would be especially useful for influencing regulatory decisions being made in regional organizations, such as CMCA or the Council of Superintendents. This would ensure that competition is taken into account in Central American financial integration.

Certain structural weaknesses have also been found that could be putting a ceiling on the contestability of the markets in which commercial banks operate. Thus the development of related markets – such as the interbank, debt and stock markets – and alternative financial products to deposits – such as investment or pension funds – would improve the ability of banks to obtain funding, manage their liquidity and offer

\textsuperscript{51} The banks had apparently increased their interest rates to offset elimination of the management fee. Press release by the El Salvador Competition Superintendent, June 12, 2013

\textsuperscript{52} Tábora says in *Competition and Regulation of the Bank: The Case of Honduras* (ECLAC, Mexico D.F., November 2007) that regulations need to look for a balance of three aspects: market-generating incentives, regulatory framework rigidity, and adequate preventive oversight.
better conditions to their customers, and the ability of users to choose among more savings and credit options. In addition, the development of infrastructure for facilitating telephone, mobile, and Internet banking, etc., could boost competition and open up new possibilities for banks and financial service users (and new users who could be brought into the market, thus also improving the indices of bankarization or financial depth). These alternative channels make it possible to reach a scattered population where branches would not be profitable.

Institutionally, the sector’s evolution has forced regulators to build capacities and strengthen their inter-cooperation. A relevant question is that of the independence of those regulators from their government administrations and from private interests (also of vital importance for competition authorities). We have seen how financial integration in Central America has outstripped the efforts of regulators to create favourable conditions for it. It seems that quite a lot of progress has been made on the consolidated supervision of financial groups, but a stronger commitment is needed for harmonizing and coordinating policies and regulations.

Concern for industry stability has perhaps led some regulators until recently to neglect the issue of competition in the sector, but this must change. Intensification of the relationships between regulators and competition authorities is highly recommended for raising the regulators’ awareness of the relevance and benefits of competition and for giving competition authorities a better understanding of the banking sector (or the broader financial sector). Initiatives to this end could include mutual training.

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53 In *Competition and Regulation of the Banking Sector in Guatemala* (Edgar Balsells, ECLAC, January 2007): Although it is important to ensure the “autonomy” of regulators from the central government and its economic cabinet, autonomy from large corporate groups, especially banking ones, is also important.

54 *Herrera* (2007): Consolidated oversight makes common sense for the system’s regulatory and oversight authority. The formation of conglomerates involves intrinsic risks, moral risk and regulatory arbitration. It is important to intensify supervision and information transparency and strengthen coordination between supervisory institutions in the different countries, as this is a multinational phenomenon. To this respect the SSF has proceeded appropriately by signing agreements with peer organizations.

55 Practically all the works referenced have some recommendation along this line. *Morales & Paredes* (2007): The Panama competition authority has in the past had difficulties in getting the Bank Superintendent’s cooperation in its investigations of restrictive competition practices, so it would be worth recommending a strengthening of the relationship between the two organizations in order to understand the scopes of their respective functions and make their tasks more efficient. In the review of banking sector economic concentrations, although the Bank Superintendent and the competition authority have dual administrative competence, there should not be any conflicts since the bank regulator is charged with analysing financial solvency (Decree-Law 9 of 1998) and the competition authority is charged with analysing competition. Experience has shown, though, the need for greater cooperation between the two institutions so that the concentration verification analyses in the banking sector can be coordinated and speeded up. *Tábora* (2007): In Honduras, adequate and effective coordination and communication mechanisms need to be created between the CNBS and the new National Competition Commission in order to ensure adequate support between the two and minimize any conflicts or differences that might arise over the fields of action of the two institutions, especially in the analysis of concentrations and the definition of relevant markets for the evaluation of operators with significant market power. *Herrera* (2007): In El Salvador the Competition Law fills an enormous void. However, the structure that needs to accompany it is still not ready. The challenge is to generate regulations and mechanisms of coordination with other regulatory agencies. *Monge González & Tijerino* (2007): The coordinated efforts of the competition authority and the regulator are indispensable for pro-competition measures to be in line with the sector’s stability. Banking regulation and oversight objectives should be linked to pro-competition objectives. Institutional mechanisms should be set up to facilitate joint and coordinated efforts of regulators and Coprocom.
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programs, staff sharing, and joint seminars, among other possibilities. Training sectoral regulators on issues related to the defence and promotion of competition will be especially important when these regulators have some authority for enforcing competition rules, as occurs in Nicaragua.

With respect to regulations and structural aspects, we must continue to insist on the importance of setting up a good system for the defence of competition that could apply to this and all sectors of the economy. Guatemala is the only study country that has still not adopted a competition law or an independent competition authority.

As has already been noted, though, beyond regulations and structural or institutional issues, some business practices or behaviours could distort competition in the sector. It is essential, then, for regulators and competition authorities to work efficaciously at detecting and punishing, when necessary, anti-competitive conducts (collusive agreements, abuse of market power, etc.) and at speedily and competently analysing concentration transactions.

It should be kept in mind that oligopolistic structures favour the occurrence of anti-competitive conducts, so competition authorities should be especially on the alert for markets with this characteristic. Anti-competitive conducts originating in one country can also make their effects felt on another country in the region. Cooperation, therefore, is important between Central American competition authorities in the investigation of cases and, eventually, in the imposition of remedies. Even if the scope of the practice does not go beyond the domestic arena, the sharing of information is of interest, since conducts can be replicated in different countries among different players (in the same or different economic groups).

With regard to concentrations, perhaps up to now bank concentrations may not have spoiled the competitive game and may even have benefitted competition and users of bank services, but this is no reason for sectoral regulators and competition authorities to pay less attention to new concentration transactions that could occur in the sector, especially considering that some markets already have quite concentrated structures.

When studying concentrations it is essential to adequately define the relevant affected markets and consider potential competition, so the sector must be studied from a dynamic point of view. Mario Cuevas (2008) warns that although market concentration could facilitate specific anti-competitive behaviours, other factors that also affect the quality of a market’s competition should not be overlooked. One factor that invites a reinterpretation of high concentration indices is potential competition. Relevant markets can also be very extensive, geographically, for specific products (as in investment banking when the offering is extra-regional). In other cases, though, the relevant market may be narrower than was thought at the beginning (as in the case of a single automatic teller located in a specific place). Finally, the quality of competition can improve when there are fewer competitors, as has already been noted, since a few large competitors can operate at a larger scale and with lower costs.

should be institutionally strengthened to make better use of proactive mechanisms for promoting competition.

Nicaragua authorities (Procompetencia and the regulator) should be especially alert, since the sector is already very concentrated and links exist between banks and large companies in other productive sectors, in some cases forming a single economic group.

Strengthening cooperation among the region’s competition authorities will become more and more important, since as the financial and banking markets become increasingly regionalized and internationalized the need and importance of sharing information will also increase in order to shed light on the potential cross-border effects of concentration transactions and to coordinate any remedies imposed by the authorities.

57 In a November 2013 interview, Nicaragua Bank Superintendent sources explained that the banking sector is extremely concentrated, with three banks holding 80% of the market – two domestically owned and the other Colombian-owned.

58 In *Competition and Regulation of the Bank: The Case of Nicaragua*. Claudio Ansorena. ECLAC. Mexico D.F., July 2007: Financial liberalization in Nicaragua did not lead to a competitive banking structure, with easy access to credit in a well-regulated and transparent free market regime. On the contrary, it consolidated an oligopolistic structure that made access to credit difficult for small and medium-sized enterprises and specific productive sectors – especially agriculture – to the point where, in a country dominated by families or small groups with little foreign bank participation, a dual economy model was established in which the dominant banking sector and its related activities expanded internationally to develop business and make their capital produce while the vast majority of the population had no access to credit. Limiting credit for new and independent domestic firms also limits competition in other segments of the economy. And banks linked to large business groups exercise entry barriers for new competitors who might threaten the dominance of companies connected to the financial group in other sectors. Competition policy in the sector requires profound institutional and legal changes that can ensure neutral enforcement of the laws and protection of regulatory agencies from the potential influence of politically and economically powerful sectors.

59 In October 2013, the Nicaraguan Foundation for Economic and Social Development (FUNIDES) published a report on *Availability and Use of Medium- and Long-term Credit in Nicaragua* (Political document series. No. 1) that gives an account of the country’s credit restrictions and sets forth recommendations for improving the situation. The recommendations include strengthening the country’s macroeconomic stability and legal security, as well as the interbank market and the Central Bank’s function as lender of last resort, developing the stock market, revising the nation’s credit regulations and standardizing regional regulations, developing risk capital and institutions for promoting new undertakings, improving the transparency of domestic and regional loan transactions, adopting the International Financial Reporting Standards and international auditing standards in large companies, training and providing accounting technology and financial management services to MSMEs (apparently there are two parallel initiatives to this respect, one by the EU and the other by the Central American Bank for Economic Integration), and encouraging alternative forms of risk coverage.
III.2. Medicine sector

III.2.1. Notes for Characterizing the Sector

Market Size and Importance

In June 2010, the region’s market was USD 1,353 million (USD 34 per capita), while the world market was USD 808,000 million (USD 129 per capita). Guatemala was the largest national market (26%), followed by Costa Rica (21%), Honduras (17%), Panama and El Salvador (14%) and, lastly, Nicaragua (8%). The ethical market (prescription drugs) accounted for 80% of unit sales and 92% of sales value. The rest corresponded to the popular market (or over-the-counter (OTC) drugs). The regional market grew 15% on average between 2005 and 2009.60

Petrecolla (2011) argues that the sector’s direct effect on the economy is small, since production is marginal and net imports account for only 1% of the GDP, but recognizes that the sector plays a key role in economic growth, due to its impact on the population’s life expectancy at birth and as it is an essential provider for the health sector, which in turn has relatively major economic importance.

Although sales volume in the region is quite small compared to the world total, the region has lately become the focus of interest for the global industry due to its potential size, the Central American population having already surpassed 41 million inhabitants, the aging of the demographic pyramid, and the population’s growing purchasing power.61

Health Systems and Regulation

<table>
<thead>
<tr>
<th></th>
<th>Total Health Spending in 2011, in % of GDP</th>
<th>Total Per Capita Health Spending in 2011, in USD</th>
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</thead>
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<tr>
<td>Costa Rica</td>
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<td>1330</td>
</tr>
<tr>
<td>El Salvador</td>
<td>6.8</td>
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</tr>
<tr>
<td>Panama</td>
<td>8.2</td>
<td>1284</td>
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Compiled with data from the World Health Organization (WHO)62

Appendix 2 gives some notes on the health systems of the study countries. To summarize briefly, it could be said that the public health systems of Costa Rica and Panama seek to guarantee universal coverage, though the social security system is facing problems of financial sustainability, while the health sector is segmented in the rest of the region’s countries, with poor coordinating of the public and private subsystems and a high proportions of the population lacking access to health services.

60 Figures taken from Petrecolla (2011) - GPR Economía S.A., Estudio Regional de las Condiciones de Competencia en la Cadena de Distribución Mayorista y Minorista de Medicamentos en Central America y Panamá. January 2011. For the Central American Group on Competition Policy and the IDB.
61 In Petrecolla (2011), factors indicated by Rivera (2009)
62 http://www.who.int/es/
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The main source of financing for medicinal drugs in Central America in 2010 was out-of-pocket spending by the population at pharmacies (69%). Public insurance absorbed the remaining portion, the importance of private insurance being practically marginal. The largest institutional market was Costa Rica (39%) while the smallest was Nicaragua (12%). The free medications basket is small compared to total medications on the market. It consists of no more than 400 products (the list of the Costa Rican Social Security Institute (Caja) contains 400 products), with the WHO's list of essential medicines serving as a guide.63

Authorization is needed in all countries in the region to manufacture, import, export, distribute or market drugs. When a drug meets national quality, safety and effectiveness standards it is authorized for marketing and registered in the national health registries, generally for a renewable 5-year term.

In order to register drugs, the following information is required: the certificate of free sale in the country of origin, or certificate of pharmaceutical product as recommended by the WHO (in the case of imported drugs); identification of the manufacturer and certificate of Good Manufacturing Practice compliance; formula and methods for making and validating its analysis (pharmacopeia in which it is registered) and delivery of samples; and safety and effectiveness data (test data: preclinical and clinical trials), or data showing equivalence with registered drugs. Registration of drugs in the national registries is apparently automatic if the drug is already registered in a developed country.

It appears that drug registration in some countries in the region is takes longer than desirable. In Costa Rica, registration of a new drug takes close to one year, and the government has obtained the cooperation of the Georgia Institute of Technology in the United States for a study on the development of a new health registry system.64 Due to registration backlogs and the elevated index (close to 80%) of applications rejected on defects of form, the Health Ministry has agreed to prepare specific guidelines.65

In Panama the registration of generic drugs could take 6 months (8,000 applications are received annually), and that of a new drug 9 months. A project had been implemented for digitalizing the health registration of drugs and cosmetics that will foreseeably reduce times by 50%.66 In El Salvador, certain practices related to the official medicine list had led to the exclusion of specific generic drugs.67

The regulations for authorization of drugs are complemented by oversight on medicines and procedures for the authorization and control of laboratories, pharmacies and pharmaceutical wholesalers (for compliance with good manufacturing practices and other requirements).

It seems that the authorization of new establishments may not always have been a quick and peaceful matter. Controversy has accompanied the delayed authorization for the opening of pharmacies in Nicaragua by Kielsa, a new Honduran entrant. The government claims that the delay has been due solely to the paperwork, but the pharmacy association, AFUN, has strongly opposed the authorization, arguing that the

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63 From Petrecolla (2011)
64 nación.com, January 14, 2013
65 nación.com, July 21, 2011
66 panamaamerica.com.pa, February 18, 2013
67 Interview with El Salvador government sources, November 2013
The Nicaraguan market is already saturated with pharmacies. Procompetencia is currently investigating a complaint filed recently by Farmacias Gurdián against Kielsa for alleged predatory pricing practices.

Note should be made of the regional efforts in this sector within the framework of SIECA, which include Central American Technical Regulations (RTCA) on such diverse matters as health registration requirements, drug stability testing, and drug quality assessment and verification. Also, since September 2002 (Resolution No. 93-2002 of the Council of Ministers for Economic Integration, COMIECO-XXIV) there has been a mechanism for mutual recognition of drug registrations by El Salvador, Honduras and Nicaragua (Guatemala joined in December of that same year) with annexes on Procedures for the Mutual Recognition of Drug Registration, Single Product Certificate Form, Regulations for Good Manufacturing Practices in the Pharmaceutical Industry, List of Pharmacopeias and Scientific Literature, Alphanumerical Coding for Drug Registration, List of the Number of Samples Required for Quality Assessment for Registration, Inspection and Self-inspection Guide to Good Manufacturing Practices, and Reasons for Derecognition of Drug Registrations.

Counterfeit drugs also appear to be a cause of concern in the region. Proof of this is the recent enactment in Guatemala of the Law against Production and Marketing of Counterfeit Medications, Counterfeit Pharmaceutical Products, Adulterated Medications, and Counterfeit Surgical Material and Medical Devices, which provides for sentences of up to 10 years for these crimes (charges of homicide in the event of death). It also provides for license revocation for establishments, disqualification of professionals, and stronger sentences for the public officials involved. In 2010, a Nicaraguan newspaper stated that the trafficking of counterfeit drugs had become a serious public health problem and that a clandestine market had been consolidated in Nicaragua of medications manufactured without any institutional control. This market, moreover, was controlled by violent groups associated with drug smuggling.

In El Salvador, the National Framework Policy for Medications, adopted on September 20, 2011 and published in the official journal on October 24 of that same year, notes that the circulation of fraudulent, counterfeit or contraband medications is a serious problem for the country, “since this type of product is found to varying degrees in most of the countries in the region and few countries have implemented energetic measures to reduce the problem.” The El Salvador government has taken energetic measures to guarantee the quality of the medications being marketed in its...
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territory by inaugurating a laboratory with which it seeks to ensure within three years the effectiveness and safety of all drugs marketed in the country.  

The diverting of State medications to the private market also seems to be a concern. The draft General Medications Law being debated in the Honduras National Congress proposes measures for putting a halt to the problem: prescriptions at public institutions will be issued from special prescription books subject to special control to prevent the transfer of prescriptions for getting medications at public hospitals, and State-purchased medications will be labelled as such on their containers.

There are significant reserved activities in all the study countries, such that the wholesale distribution of medications can only be done by pharmaceutical wholesalers, laboratories cannot sell directly to pharmacies or participate in tenders, and pharmacies cannot import medications without intermediation. In addition, in many countries the minimum distance between pharmacies is regulated. Reserved activities together with exclusivity relationships between manufacturers or importers and pharmaceutical wholesalers are seriously limiting the possibilities of free competition in the medications market.

In most of the region’s countries, drug prices and marketing margins are subject to some type of regulation. In Nicaragua, the formula for calculating drug prices is as follows: CIF price + 3% for customs clearance expenses; + 34% for the distributor, if the product was classified as a brand item by the Ministry of Health, or 28% if it was classified as generic; and + 30% for the pharmacy, if the product was classified as a brand item, or 32% if it is generic (in addition to an exchange rate and an increment factor, etc.).

In El Salvador the new Medications Law, passed by Congress on February 22, 2012, took effect on December 29 of the same year. This law prohibits the street trade of drugs and cosmetics and provides for the setting of maximum prices for medications on the basis of the active ingredient (not the product) and average international (Central American) prices. It establishes an adjustment period for stocks to the new maximum prices once they are published. Finally, a medication’s maximum price for sale to the public would be given on its label, together with the price at which it is effectively sold.

Laboratory and pharmaceutical wholesaler associations (FEDEFARMA and DIPROFA) opposed the regulations for the new medications law and the list of maximum prices published by the government, arguing that the consequences would be higher prices for generic drugs, the closing of many pharmacies, a loss of jobs and

75 El Salvador government press release, December 4, 2013
76 Diario La Tribuna de Honduras, February 5, 2013
77 For Petrecolla (2011), laws or usages that prohibit laboratories from selling directly to pharmacies, social security institutions and the government, and laws that prohibit pharmacies from importing medications directly, constitute an unnecessary entry barrier. Note that Petrecolla (2011) does not refer only to laws but also to “usages and customs”.
79 Decree No. 1008
81 Decreto Nº 245
market shortages.\textsuperscript{81} FEDEFARMA even decided to withdraw 38 medications from the domestic market, though it reversed its decision after meeting with the government. The government and manufacturers apparently coincided in pointing out wholesale distribution margins (28\%) as the reason for the high prices and proposed the possibility of allowing pharmacies to buy directly from laboratories to save on that margin and thereby adjust to the maximum prices. Other reactions to the law included the withholding of medications by the pharmaceutical wholesalers, as in the case of the Santa Lucía Pharmaceutical wholesaler, against which the government acted by accusing it of civil disobedience and the crime of hoarding.\textsuperscript{82}

The savings achieved by the new price regulations had already reached USD 31 million by October 2013 and was expected to reach USD 60 million by the end of the year. In addition, there was an increase in both drug purchases (the lower prices were enabling consumers to finish their treatments) and the number of active pharmacies in the country (56 new pharmacies).\textsuperscript{83} Ministry of Health sources say that as a result of the new law they have seen a drop in prices of innovative drugs but a rise in prices of generic drugs, and a mechanism is under study to limit the marketing margin in order to prevent prices from always reaching ceiling prices.\textsuperscript{84}

In Honduras, \textit{Executive Decree 139-97 of July 28, 1997} regulates marketing margins. The draft \textit{General Medications Law} apparently includes, among other reforms, empowerment of the State to set maximum drug prices based on international pricing, and the creation of the Superintendent General for Medications as the regulatory and oversight body, responsible as well for State purchases of drugs.\textsuperscript{85}

In Costa Rica, draft \textit{Law 17.738} proposes drug prices be regulated by having the Health Ministry set a maximum margin.\textsuperscript{86} Panama has a market price monitoring system that was provided by Law 1 of 2001.\textsuperscript{87}

\section*{Generic Drugs}

In 2010, name-brand generic drugs accounted for 54\% of sales, non-name brand generic drugs accounted for 7\% (12\% of unit sales), and innovative drugs accounted for 39\%. Non-brand generic drugs sold at a mean price equal to 10\% of the mean price in the medications market. The country with the largest share of non-brand generic drugs was Nicaragua (11.4\%), followed by El Salvador (8.7\%), Honduras (7.3\%), Costa Rica and Panama (6.5\%), and Guatemala (5.5\%). Name brand and non-brand generic drugs had an almost 60\% share of the ethical market, but more than 50\% were name-brand generic drugs, which may be due to a lack of sufficient information on the quality, safety and effectiveness of non-brand generic drugs, weakening their strength as competitors.\textsuperscript{88}

\begin{flushleft}
\textsuperscript{81} elsalvador.com, March 1 and March 8, 2013
\textsuperscript{82} El Salvador government press release, April 22, 2013
\textsuperscript{83} http://www.transparenciaactiva.gob.sv/tag/medicamentos/
\textsuperscript{84} Interview conducted in November 2013
\textsuperscript{85} Diario La Tribuna de Honduras, February 5, 2013
\textsuperscript{86} elfinancieroncr.com, May 21, 2013
\textsuperscript{87} apps.who.int/medicinedocs/documents/s18242es/s18242es.pdf
\textsuperscript{88} Data taken from Petrecolla (2011) and from IMS Health MAT, June 2010
\end{flushleft}
A 2006 study by Vacca et al. on the definition of generic medications in 14 countries, including Costa Rica, Guatemala, Nicaragua, and Panama, found the following information of interest:

- Equivalency testing has been provided for in Costa Rica and Panama (but not in Guatemala or Nicaragua). Short lists have been established in Costa Rica of the medications requiring this testing (due to their clinical and health risk).
- In some countries, any medication can be produced as a generic once the patent rights have expired, but in Nicaragua and Panama the health authorities prepare lists of medications that can be produced as generics.
- In Panama there is the possibility of presenting in-vitro tests applied in artificial media as an alternative to in-vivo studies.
- Test quality is the reason for “major differences” between innovative laboratories and those producing generic drugs.
- The governments of some countries, such as Costa Rica, Guatemala, and Nicaragua, encourage the production of generic drugs. The most obvious example of government encouragement for generic drugs would be Brazil, with 6 public laboratories engaged in producing generics to support its universal coverage system. Costa Rica finances the production of generic drugs.
- In Nicaragua and Panama, the use of international common denomination (ICD) is restricted to doctors.

Regarding this last fact, Petrecolla (2011) writes that in Panama prescription by generic name is obligatory, in Honduras the obligation only exists for national hospitals, and in Guatemala it exists for the institutional market; in “some of the remaining countries” the generic name is optional or accompanied by the trade name.

In Panama, moreover, the health authority is obligated to publish a National List of Therapeutic Equivalents, and since September 2003 pharmacies are obligated to post the Basic Medications Basket (CABAMED) in plain sight for customers, within the framework of a joint initiative of the Health Ministry, the Gorgas Commemorative Institute for Health Studies, the Social Security Institute, and ACODECO. CABAMED is updated monthly and gives, for 40 active ingredients chosen on the basis of the epidemiological profile, the average prices of innovative drugs and the minimum prices of their generic equivalents found from a survey of pharmacies. Together with these prices, each pharmacy must give the price of the cheapest generic drug they sell and the laboratory that makes it.

Nicaragua’s National Strategic Plan for Promotion of the Rational Use of Medications, 2011-13, adopted in May 2011, expresses a concern for household spending on medications (in 2009 it was up to USD 131 million, more than 65% of

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90 Decree 16-2003 on the value-added tax establishes the obligation of including the generic name on prescriptions along with the original name of the medication. http://portal.sat.gob.gt/sitio/index.php/component/docman/doc_download/648-decreto-16-2003-del-congreso-de-la-republica-
91 http://www.minsa.gob.pa/destacado/autoridades-de-salud-y-acodeco-lanzan-en-conjunto-canasta-basicade medicamentos
92 http://apps.who.int/medicinedocs/documents/s18991es/s18991es.pdf
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Total public and private sector spending on drugs) and adds that one problem is that although generic name prescriptions are almost the rule in the public sector, brand-name prescriptions – and frequently the most expensive ones – predominate in the private sector, where more prescriptions are written. Furthermore, it notes that pharmaceutical advertising has adverse effects on the habits of drug prescription, dispensing and use, and that despite drug information centres in various public organizations, information is limited to this public setting and to essential medications. Another problem is the population’s elevated index of self-medication (in 2005, 95%).

In Honduras, the draft General Medications Law proposes a definitive replacement of the drug name by the active ingredient name and a prohibition against offering donations, commissions, gifts, bonuses, cash payments or any other type of perk to doctors and other sector professionals with the idea of promoting product exclusivity (a common practice among innovative drug manufacturers). In Guatemala, Decree 16-2003 exempts the buying and selling of generic drugs from payment of value-added tax.

In Vacca et al. (2006), Costa Rica appears as an example of a flexible policy for encouraging generic drug production without neglecting medicine quality. Costa Rica’s Decree 28466-S\(^93\) establishes that non-interchangeable generic drugs cannot be prescribed as interchangeable generics,\(^94\) but the tests to which they are submitted are not as strict and they have easier access to the market. The regulations also provide for ICD labelling on medication containers, and for preparation by the Technical Council for Drug Registration of a list of pharmaceutical products with health risks to be published in the official journal.

Elías Mizhari Alvo (2010)\(^95\) argues that some Central American countries have focused on regulating the domestic marketing of drugs produced in other places, rather than the manufacturing of drugs; this could be favouring generic drugs produced by innovative manufacturers once the patent expires, to the detriment of generics produced by other manufacturers. In El Salvador no clinical testing or procedures for determining the interchangeability of generic drugs have been established.

**Intellectual Property Rights and Parallel Imports**

The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement) granting 20 years of protection on patented products applies in all the countries in the region. The TRIPS Agreement obligates the granting of patents as of 2005 (extended to 2016 for several developing countries) and includes flexibilities such as obligatory permits in cases of health emergencies, after negotiation with the patent holders.\(^96\)

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\(^93\) http://www.pgr.go.cr/scij/Busqueda/Normativa/Normas/nrm_repartidor.asp?param1=NRTC&nValor1=1&nValor2=43444&nValor3=86941&strTipM=TC

\(^94\) The decree differentiates between pharmacologically and therapeutically equivalent medications. A medication is interchangeable only when it is both pharmacologically and therapeutically equivalent.


\(^96\) It should be highlighted that the law in Costa Rica gives the State the power to grant obligatory licenses if anti-competitive practices can be proven, such as excessive or discriminatory price-setting for patented products, failure to supply the market under reasonable business conditions and obstruction of commercial or productive activities (Article 19).
Free trade agreements with the United States, such as the CAFTA-DR, have broadened the TRIPS Agreement (made it stricter) by prohibiting the registration of generic drugs whose components are protected by a current patent, introducing compensation for delays in the processing of patents and marketing permits, and protecting undisclosed information on test data (preclinical and clinical trials) for 5 years after patent expiry.

The TRIPS Agreement establishes that none of its provisions can be used to determine the patent expiry regime in each country; each one must freely decide if it wants the regime to be national, regional or international. The intellectual property rights expiry regime is very relevant for medication-importing countries, because the legality or illegality of parallel imports depends on it. A national rights expiry regime implies that only imports from licensees authorized by the patent holder are legal. This is the same as saying that parallel imports are illegal under this regime. The EU has adopted a regional rights expiry regime such that parallel imports among member States are permitted and are legal, as long as the medication has been sold with the patent holder’s authorization in the member State of origin. In an international patent expiry regime, parallel imports are admissible once the product has been sold in any country.

In El Salvador, Guatemala, Honduras and Nicaragua, parallel imports are prohibited. El Salvador empowers the patent holder to authorize imports and exports of its legally manufactured products, and Guatemala’s Decree 57-2000, Honduras’s Law 12.99, and Nicaragua’s Law on Invention Patents, Utility Models and Industrial Designs all prohibit the importing of patented products without the consent of the patent holder. For its part, Costa Rica (Law 6867 on Intellectual Property) has adopted an international patent expiry regime, admitting parallel imports once the drug has been sold in any country. This is also the case with Panama.97

There could also be barriers to imports of generic drugs into the region and between countries in the region. These trade barriers are limiting the attainment of economies of scale by national manufacturers due to each country’s small market size and inter-brand competition in the Central American medication markets.

The UNCTAD document serving as a basis for discussion on the drug sector at the second annual meeting of the UNCTAD-SELA Working Group on Trade and Competition (WGTC) in Lima in June 2012 explained the concern of Panama’s ACODECO over barriers to the international trade of medications, one of which is the drug registration system itself.

Costa Rican government sources have mentioned that Costa Rica has suggested the creation of a Central American Drug Agency, within the framework of SIECA, which would help achieve effective free circulation of medications in the region.98

Manufacturing, Wholesale Distribution and Retail Distribution

Some 630 pharmaceutical laboratories operated in the region in 2010 (CR30=66%, CR20=57%).99 The leading manufacturers are transnational laboratories operating at a global scale, with most of their R&D activities and manufacturing concentrated in

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97 “Some countries, such as Costa Rica and Panama, have regulated parallel imports of medications in their health registration rules.” Petrecolla (2011)
98 Interview conducted in November 2013
99 IMS MAT 2009 and 2010
developed countries, though with some industrial plants located in other regions. There are a few relatively new domestic firms manufacturing name-brand or non-brand generic drugs, in general, with very little regionalization. They export intra-regionally, but their degree of penetration in domestic markets is very low; they fail to position among the top 20 laboratories in each country, and their market shares in each country fail to exceed 2.5%. Innovative medications are generally already divided up and readied for distribution and consumption when imported into the region.

Industry concentration at the laboratory level is moderate. In 2010 the four largest firms had 23% of total sales, and the top 12 had 51%. Generic manufacturers would not face significant entry barriers in the Central American region in terms of tariffs or other taxes, insurance and shipping costs, or distribution and marketing costs.

Pharmaceutical wholesalers are primarily domestic firms and are exclusively responsible for distributing all drugs to both private and institutional markets. The wholesale distribution sector is concentrated. In Costa Rica the Health Ministry recently registered 202 pharmaceutical wholesalers, with three of them dominating 87% of the market (Cefa with 39%, Cofasa with 20% and Farmanova with 28%).

A University of Costa Rica study noted that one company controlled the distribution of 80% of the drugs, which were being marketed with margins of up to 1,000%. The study denounced the sector’s low competition, as four-fifths of all registered medications were being handled with exclusivity.

In retail distribution, two types of establishments market medical prescription drugs: traditional pharmacies and pharmacy chains. With over-the-counter drugs, other retail sale channels such as large department stores, supermarkets and shops join in. Out of close to 8,500 pharmacies in the region in 2010, 15% are part of a pharmacy chain.

In Panama, pharmacies almost seem to be turning into convenience stores in the manner of the large United States chains, as a reaction to the country’s opening of its doors to these with the United States-Panama Trade Promotion Agreement. This would seem to be the trend as well in other countries in the region.

Petrecolla (2011) notes the competitive advantages of large pharmacy chains over traditional pharmacies: greater capacity and solvency for buying larger quantities, better-trained personnel, better facilities, greater variety of brands, products and prices, and additional services such as home delivery.

Small pharmacies be react to the greater presence of large chains, forming associations to obtain better prices from the pharmaceutical wholesalers. This is the
case of 700 of these small pharmacies, most of them members of the UNPROFA trade association in Panama. In Costa Rica, KPO Alpha supplies medications to more than 200 small and medium-sized pharmacies at the same price the large pharmacies get for buying large volumes, and in 2011 Condefa already had more than 100 local independent pharmacy members for negotiating large volumes with pharmaceutical wholesalers and laboratories.

With respect to integration, some domestic laboratories have set up pharmaceutical wholesalers for marketing their own and third-party medications, and pharmacy chains are sometimes integrated with pharmaceutical wholesalers that control imports. In general, the top pharmaceutical wholesalers are linked to small laboratories and large pharmacy chains.

Mention has already been made of the restrictions on parallel imports, which make it necessary to import patented drugs through a single importer authorized by the patent holder. Also of potential significance is the existence of exclusivity agreements between laboratories or importers and wholesale distributors.

**Prices and Marketing Margins**

Petrecolla (2011) finds that the effect of the pharmaceutical wholesaler margin on the end price of the drugs is greater in this region than in developed countries, with Costa Rica, El Salvador and Guatemala having the highest laboratory prices and Nicaragua the lowest. The paper also finds lower laboratory prices in Panama, Nicaragua, Costa Rica and Honduras than the import parities, which could be explained by the greater presence of domestically manufactured drugs, at a lower price, in these markets. In pharmacies, the highest prices were in El Salvador and Guatemala, and the lowest were in Tegucigalpa (Honduras) and Managua (Nicaragua).

A 2011 IDB study found that the country where medicines are sold at the highest prices is Costa Rica, followed by El Salvador. A 2009 study by the Central American Council of Consumer Protection (CONCADECO) placed Guatemala in first place, followed by El Salvador.

El Salvador’s *National Framework Policy for Medications*, mentioned above, states that “the distribution chain has an influence on the high prices of medications…. The cumulative margins of original brand medications reach, on average, 5,200%, and imported generic medications are up to 2,800% over the international reference price.”

In Guatemala and El Salvador, a tariff is applied to retail-sale-ready imports of drugs for human use, though in El Salvador the tariff is lower for some countries (1% for Panama and 1% to 3% for CAFTA-DR), and in Guatemala non-brand generics are exempt. The general value-added tax (VAT) also applies in El Salvador and Guatemala (except for generic drugs and HIV medications).

The inequalities among countries of income levels and distribution and demand purchasing power (private and institutional) could be one of the main factors behind the differences (Petrecolla, 2011). As there is practically no arbitration between domestic markets due to trade barriers that block parallel imports, domestic markets operate very independently from each other, with national distribution channels,

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109 elfinancierocr.com, May 21, 2013
110 nacion.com, October 6, 2011
price-setting strategies and regulatory frameworks. This gives sellers leeway to implement third-degree price discrimination policies.

The base document for the medications sector meeting at the second annual meeting of the UNCTAD-SELA WGTC mentioned earlier expressed the suspicion of Costa Rica’s Coprocom that the country’s high prices of drugs compared to the rest of the region might be due not only to trade barriers and higher per capita income in Costa Rica but also to exclusivity relationships between pharmaceutical firms and wholesale distributors, the way the products are advertised (through medical sales representatives), and discounts promoting large volume purchases.

Foreign Trade and Parallel Imports

Between 2005 and 2009, the region imported an annual average of USD 1,119.6 million. Exports were about one-third of imports. Only 29% of imports were intra-regional, with growth between 2005 and 2009 (36%) less than the figure for extra-regional imports (46%). On the other hand, the destination of most exports was within the region (74%), but extra-regional exports have been more dynamic (53% growth between 2005 and 2009). The volume share of intra-regional imports is greater (34%), in line with the lower average price of medicines manufactured in the region.\(^\text{111}\)

**Table: Foreign Trade in Medications by Country**

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<tbody>
<tr>
<td>Costa Rica</td>
<td>401.834</td>
<td>453.156</td>
<td>427.572</td>
<td>456.766</td>
<td>436.909</td>
<td>424.198</td>
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<td>El Salvador</td>
<td>218.317</td>
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<td>252.881</td>
<td>272.349</td>
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<td>306.012</td>
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<td>325.659</td>
<td>360.711</td>
<td>349.698</td>
<td>355.528</td>
<td>401.128</td>
<td>418.106</td>
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<tr>
<td>Honduras</td>
<td>333.773</td>
<td>405.192</td>
<td>329.376</td>
<td>370.758</td>
<td>425.847</td>
<td>417.940</td>
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<tr>
<td>Nicaragua</td>
<td>206.949</td>
<td>272.958</td>
<td>278.484</td>
<td>314.399</td>
<td>283.328</td>
<td>306.297</td>
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<tbody>
<tr>
<td>Costa Rica</td>
<td>280.554</td>
<td>314.367</td>
<td>321.833</td>
<td>279.471</td>
<td>231.394</td>
<td>124.593</td>
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<tr>
<td>El Salvador</td>
<td>97.246</td>
<td>108.679</td>
<td>97.769</td>
<td>104.988</td>
<td>104.640</td>
<td>107.102</td>
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<td>Guatemala</td>
<td>138.405</td>
<td>156.398</td>
<td>151.515</td>
<td>161.667</td>
<td>190.138</td>
<td>196.500</td>
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<tr>
<td>Honduras</td>
<td>6.434</td>
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<td>3.433</td>
<td>3.849</td>
<td>4.573</td>
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<td>Nicaragua</td>
<td>4.142</td>
<td>4.297</td>
<td>3.311</td>
<td>2.355</td>
<td>1.797</td>
<td>1.556</td>
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Source: SIECA

Contraband medicines seem to be a source of concern in the region. In 2012, 7,323 units of contraband medicine were seized going from Nicaragua to Costa Rica, and in

\(^{111}\) From Petrecolla (2011)
the first five months of 2013, 67,381 units were seized. The Panamanian press highlighted the fact that Panama had become a transit as well as distribution point for illegal goods.

**Public Procurement**

Public procurement of medicines in the region’s countries faces weaknesses in planning, selection of the purchase method (direct, through tenders, etc.), design of bidding procedures, and detection of anti-competitive practices. It also faces problems of public funds shortages and/or high costs of medications, with significant delays in paying suppliers.

The August 2009 sectoral market study of specialized private health sector services in Honduras found that 38% of the institutional market was monopolized, that only 30% of the country’s registered pharmaceutical wholesalers sell pharmaceutical products to the State, that major barriers to participation in public medication tenders existed – in the form of cumbersome paperwork, delayed and expensive health registration, late payments (averaging 1.5 years late), and lack of transparency – and that the purchasing public institutions lack systematized, automated bidding and direct purchase files. The study recommended a profound reform of the tendering processes.

The *base document for discussion of the medications sector at the second annual meeting of the UNCTAD-SELA WGTC* expressed the concerns of CDPC over poor planning in the public health sector, which had resulted in the authorization of “at least 4 emergency decrees in the last 7 years for making direct purchases”, which “facilitates coordination between the State and certain companies”.

The *National Framework Policy for Medications* in El Salvador states that “the chronic shortage of medications in the public sector, together with high domestic pharmaceutical market prices, directly affects the household economy (…), making it necessary to explore other alternatives for improving efficient supply management and cost containment, such as direct imports, price negotiation, reference pricing, incentives for innovation and domestic production or specific imports of high-cost orphan drugs from limited production sources.”

The Framework Policy also recognizes that “institutional weaknesses make proper drug supply management difficult in the public sector – the government budget does not cover the real cost of drugs”, and that “the public procurement law delayed the purchase process up to 251 days, but the direct purchase mode introduced with the June 2011 amendment speeded up the process.”

In Guatemala, the government has apparently awarded contracts several times, arguing an emergency or situation of disaster. It could be that the bidding for drug purchases in this country is being side-stepped. Procurement awarded through bidding is only 18% of the total, direct purchase or purchasing exception formulas are abused, and there is evidence of divided purchasing in order to avoid bidding.

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112 laprensa.com.ni, July 8, 2013
113 pa-digital.com.pa, July 18, 2011
114 See further below.
115 prensalibre.com, December 6, 2013 and December 2, 2011
116 sigloxxi.com, April 9, 2012
In El Salvador as of May 2012, delays in paying suppliers could be as long as 6 months, and in Honduras the government debt to medication suppliers may have been more than USD 30 million at the start of 2013, with pharmaceutical wholesalers claiming USD 33 million from tenders and direct sales since 2010. Arguing that the million-dollar credit their industry granted to the government had drained them of capital, the companies threatened to boycott 2013 tenders. In fact, the Honduran government did find it difficult to obtain medications during 2013. No company responded to the call for bids by the Hospital Escuela Universitario, so the procurement procedures for 19 medications were declared void and alternatives had to be found, such as buying from international suppliers. Procurement tenders for 123 drugs remained void, and the Secretary of Health’s Drug Committee proposed the drugs be purchased with the help of international organizations, such as the United Nations or the Central American drug procurement mechanism.

In Guatemala, some contract awards have been controversial; the Finance Minister was questioned by the opposition over the award of four drug supply contracts at the beginning of 2012 with cost overruns varying from 25% to 2,000%. There are also those who suspect that the supply of medications has been used to repay a political favour. The second vice president of Congress has alluded that many administrations rewarded their campaign financiers by awarding them drug supply contracts, sidestepping the procurement law.

In El Salvador, the bidding bases may have been adapted to the usual suppliers, thus excluding potential new competitors.

Some governments appear to be reacting. The Guatemala government has sent two bills to Congress for improving competition in the institutional medications market by including foreign suppliers, facilitating imports, opening up the possibilities for generics, and excluding open contracts. The Honduras government has modified the medication procurement mechanism to save up to USD 12 million in 2012 (its medications budget was USD 31.49 that year), with reverse auctions (e-tendering where the best price obtained the previous year is given as the maximum) and the sending of supplier and price catalogues to the health regions and hospitals to help guide them and prevent differences.

The Thirtieth Regular Meeting of the Council of Ministers of Health of Central America and the Dominican Republic (COMISCA) held in Managua on June 16-17,

117 elsalvador.com, May 7, 2012
118 laprensa.hn, February 21 and January 17, 2013
119 laprensa.hn.com, August 1, 2013
120 elheraldo.hn, March 14, 2013
121 Margins of 15% are established in Honduras for the national basic services industry. This is not the case in Costa Rica (Elías Mizhari Alvo, 2010).
122 elperiódico-com.gt, December 21, 2012
123 elperiodico.com.gt, January 13, 2013
124 El Salvador government sources in an interview in November 2013
125 elperiódico.com.gt, January 25, 2013
126 Tiempo Digital, March 12, 2012
127 The Council of Ministers of Health of Central America (COMISCA) is the policy body for the Central American Integration System (SICA), the goal of which is to oversee the regional health sector – that is, to identify, address and solve regional health problems, which are treated jointly through the Agenda and the Mesoamerican Health Plan and other forums and meetings in order to guarantee the Central American population’s right to health. http://www.sica.int/comisca/. COMISCA is not the only regional cooperation initiative for health. Links can be found at the COMISCA website to RESSCAD.
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

2009, approved the Regulations for Joint Negotiations on Prices and Purchase of Medicines.\textsuperscript{128}

Prior to this, in 2007, the COMISCA had also approved the Medicines Policy for Central America and the Dominican Republic, which the countries represented in COMISCA agreed to include in their health policies.\textsuperscript{129}

The antecedent to this policy was Resolution CD45/10 of October 1, 2004, of the Directing Council of the Pan American Health Organization (PAHO), which identified four lines of action to expand the public's access to medicines: formulating consistent generic drug policies, adopting cost-containment strategies, strengthening procurement systems, and implementing regional mechanisms for joint purchasing.

The Medicines Policy for Central America and the Dominican Republic is justified by: (i) the lack of a government policy that transcends the moment; (ii) the population’s limited access to medicines; (iii) the incorporation by the CAFTA DR of more restrictive rules on intellectual property than the TRIPS; (iv) weaknesses in procurement management; (v) poor oversight and control of medicine quality; (vi) sectoral objectives out of line with public health interests, resulting in the shortages of certain medicines and marketing of others without therapeutic evidence, few suppliers of medicines for treating some prioritized diseases, excessively high prices, “altered State procurement processes”, and “prescribers influenced by unethical promotional practices”; and (vii) weak education in pharmacotherapy.

The policy’s goal is to foster the population’s timely access to safe and effective quality drugs, in line with health needs and at affordable cost for individuals and health institutions. Its strategic objectives are to guarantee quality and access (including encouraging the use of generics and joint negotiating of prices with suppliers), manage supplies properly, and promote rational use.

At least two countries have adopted national framework policies for medications: Panama, through Ministry of Health Resolution No. 632 of June 30, 2009, published in the Official Gazette on October 6 of that same year,\textsuperscript{130} and El Salvador, through a decision on September 20, 2011, published in the Official Journal on October 20 of that same year. In May 2011, Nicaragua adopted a 2011-2013 Strategic National Plan for Promoting the Rational Use of Medicines.

The national framework policies present very similar problems and proposed solutions in various areas:

\textsuperscript{128} http://negociacionconjunta.org/sites/default/files/documentos/Reglamento%20para%20la%20Negociacion%20Conjunta%20y%20Compra%20de%20Medicamentos.pdf The first award appears to have been in July 2010 (the information is not very clear on the website for the Central American Observatory for Medicines http://www.sicasalud.net/ocamed/, where there is a portal for joint negotiation for Central America and the Dominican Republic http://negociacionconjunta.org/). The last one could have been in 2013 (the deadline for the receipt of documents for prequalification was April 29, 2013). Guatemala apparently has not been participating in the regional joint negotiations (prensalibre.com, July 10, 2012).\textsuperscript{129} http://apps.who.int/medicinedocs/documents/s19010es/s19010es.pdf

\textsuperscript{130} http://www.sicasalud.net/ocamed/sites/default/files/documentos/Politica_Subregional_Medicamentos.pdf
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

(1) Access: Preparation and/or harmonization of lists of medications (revised in a timely manner), promotion of generic drugs, and improvement of supply systems (public procurement).

(2) Quality, safety and effectiveness: Improvement of the regulatory framework for registration, laboratories, pharmacovigilance, etc., capacity-building of authorities (preventing conflicts of interest), and development of strategies for preventing and combating counterfeit, adulterated or contraband drugs, etc.

(3) Rational use: Good prescribing and dispensing practices, educational campaigns for professionals and the general public, fostering of professional ethics, audits, and advertising control.

(4) Human resource development.

The Panama and El Salvador plans propose the creation of a national drug committee, and the Panama plan also proposes a national drug observatory.

The Panama plan proposes joint regional negotiation to contain costs and the use of a regionally established drug observatory to follow up on prices and improve the transparency of the joint negotiations. It also expressly mentions competition: “Modification of the relevant legal provisions (…) can ensure competition in the pharmaceuticals market with the entry of new, safe and quality products as soon as the current patents expire.”

The El Salvador plan proposes the regulation of medicine prices and preparation and implementation of an entire set of good practices for manufacturing, pharmacovigilance, and purchasing, storing and distributing of medicines (public procurement).

III.2.2. Competition Problems

From the foregoing we can deduce some of the competition problems that may be afflicting the medicine sector in the Central American region.

One is the existence of regulations that are somewhat unfavourable for competition. Administrative procedures for authorizing medicines or establishing drug production or distribution businesses may be overly slow or too demanding.

Undoubtedly, authorization procedures for drugs that will be introduced to the market should exist to ensure their disease-treating efficacy and consumer safety. It is also necessary to require certain conditions to be met by players who seek to intervene in drug production, distribution or sales. However, it is unjustified to demand conditions, requirements or administrative barriers that exceed these public interest objectives, and introducing unnecessary or disproportionate obstacles to free competition – which is another public interest meriting protection.

The mutual recognition system for drug registration and the development of regional good practice documents could potentially speed up the paperwork for bringing medicines into the different national regions and facilitating intra-regional trade.

In addition, reserved activities – such as the ones enjoyed by pharmaceutical wholesalers, making them the only ones that can import and sell to pharmacies and the public sector, thus impeding pharmacies from directly importing drugs or
purchasing them directly from domestic manufacturers, and impeding domestic or international manufacturers from selling directly to pharmacies without their intermediation – could be putting up unnecessary barriers to entry and the development of free competition.

Although some players in the production and distribution chain have reacted by integrating vertically, Petrecolla (2011) argues that it is not always convenient for manufacturers to establish their own domestic pharmaceutical wholesaler due to the reduced demand in each country. In cases where vertical integration does occur, this kind of a move could lead to overly concentrated markets on the supply side, with overly large agents and individual or collective market power that could eventually be abused. Oligopolistic market structures also facilitate anti-competitive agreements for dividing up markets or setting prices.

An eye must also be kept on exclusivity relationships established in the distribution chain (between a domestic or international manufacturer and a pharmaceutical wholesaler), as they introduce restrictions on intra-brand competition that could be found unjustified.

Of course, restrictions on parallel imports also limit intra-brand competition by blocking the import of patented innovative drugs by players other than those strictly authorized by manufacturers. In addition, obstacles to the international trade of generic drugs could be limiting inter-brand competition in domestic markets and keeping manufacturers from achieving production economies of scale.

It would be worth revising regulations, as well, that dictate minimum distances between pharmacies, although the environment appears to be more competitive at the retail distribution level.

The development and marketing of generic drugs is usually blocked by the conduct of innovative pharmaceutical firms with medicines whose patents have expired. These firms frequently try to deposit new patents on the same active ingredient, provoke disputes, or arrange for delays in the arrival of generic drugs with the laboratories that produce them. Central America is essentially an importer of innovative drugs (and producer of generic drugs), but although this type of anti-competitive practice originates outside the region, it could be causing undesirable effects within it, as in the rest of the world.

Moreover, for some time now policies have been imposed to encourage consumption of generic drugs, especially for medicines covered by social security systems. These policies seek to create favourable regulatory frameworks for the market entry of generic medicines.\footnote{In Spain, for example, doctors are obligated to prescribe generic medicines when they exist, and can only prescribe brand-name drugs when there is a reason to justify doing so. At present this obligation, which in the beginning concerned doctors, will be complemented with the obligation of pharmacists to dispense generics when they exist, regardless of whether or not the doctor has prescribed a brand-name medicine. In France, the responsibility of promoting the use of generics falls directly on the pharmacist, who is obligated to give preference to the dispensing of generic drugs, and, in addition, a discriminatory margin system is applied that favors the use of generics and penalizes the use of brand-name medicines. From 	extit{Base Document for the Second Annual Meeting of the UNCTAD-SELA WGTC (Lima, June 2012)}.}

There appears to be room in the Central American region for encouraging competition between innovative and generic medicines, improving regulations for the
authorization of generic drugs, and implementing policies to actively promote them – such as policies requiring doctors to prescribe active ingredients rather than brand names and pharmacists to inform consumers of the existence and efficacy of generic medicines, or policies that put an end to specific manufacturer practices, through medical sales representatives, that encourage the prescription and sale of innovative medicines.

However, regulations more conducive to the introduction of generic medicines may not be enough, since on occasions innovative laboratories resist competition of their medicines with other manufacturers’ generics and condition the supply of specific patented medicines to the purchase of other, unpatented, medicines already in competition with cheaper generics, or establish loyalty policies that could have the effect of excluding competition. The laboratories also, on occasion, establish predatory pricing policies in places where they have maintained a monopoly, or they denigrate generics with doctors and pharmacists.

A trend has been seen in this region for regulating the prices of medicines. Most recently, the country to do this is El Salvador, with the result, apparently, that innovative drug prices have dropped while generic prices have risen, with a still uncertain effect on general consumer well-being. Perhaps the reform was an improvement for those who only used innovative medicines, but it was not so for those who already used generics, trusting in their comparable quality. In any case, the competitive pressure exerted by the cheaper generic prices on innovative drug prices could have disappeared. Price regulation – of medicines or any good or service – is an extremely delicate matter in which many factors must be taken into account. If adopted, an in-depth analysis should first be made, at least, and periodic revisions should be made.

Governments are major purchasers of medicines. As such, public procurement of medicines should follow strict rules and oversight to guarantee free competition among potential suppliers, so that government coffers get the most for their resources and can ensure supplies. The region has competition obstacles in the purchase of medicines, however, ranging from a lack of planning or transparency and advertising to exclusion of potential bidders (when manufacturers or direct importers are banned from bidding, to the benefit of pharmaceutical wholesalers) to unequal treatment (of domestic and foreign bidders or of innovative and generic medicine suppliers) and even potentially corrupt practices.

III.2.3. Actions of Competition Authorities in the Region
Studies, Reports and Opinions

Costa Rica’s Coprocom has resolved two queries, one on price discrimination (May 2011) and the other on parallel imports (January 2013). In the first, it was noted that the practice by an exclusive drug distributor of granting different sales conditions to different customers could be deemed anti-competitive behaviour if it could be proven that the accused distributor had substantial power in the relevant market and that the purpose or effect of the practice was to displace other market agents, substantially impede access, or establish exclusive advantages in favour of one or several parties.

See the reservations of the SC with respect to drug price regulation in its April 2010 Opinion.
In the second, it confirmed that parallel imports are legal and that no regulations exist in Costa Rica to limit or restrict them, as the courts have acknowledged. In the case of medicines, a special rule, Regulation 28466-S, regulates the procedure and requirements for import authorization. It lists the requisites required of importers, adding one more for parallel importers, who must also meet “approved labelling and insert conditions for registration of the product, for which a sample must be submitted of the medicine to be imported.”

El Salvador’s SC has issued several opinions. In its *February 2013 Opinion on special regulations for recognition of foreign health registries*, the SC favourably evaluated the contents of the proposed regulations, which recognize the validity of specific foreign health registries and health certificates, specifically those issued by United States, Canadian, Australian and the European Agency authorities or authorities meeting PAHO level IV health standards (Argentina, Brazil, Cuba and Colombia).

Regarding the new Medicine Law, which was finally passed on February 22, 2012, the SC’s *April 2010 Opinion* favourably evaluated provisions for improving medicine quality and oversight, provisions obligating the prescription of generics and use of the generic name on containers and prospectuses and obligating pharmacy employees to inform consumers of the existence and prices of generics, and provisions banning certain commercial practices that promote the prescription of innovative products at the expense of generics. However, it found that other provisions – those on the minimum distance between pharmacies, import exclusivity, and parallel imports, bans on doctor consultations or clinical laboratory sampling at pharmacies, and the obligation to have a permanent professional pharmacist at pharmacies – needed improving as they were deemed insufficient to eliminate barriers.

It also found room for improvement with pricing regulations, arguing that medicines are not homogenous products and that it would be too expensive for regulations to take into account such diversity and establish optimum prices for each medicine. Instead, the SC proposed to foment competition in the sector by improving the quality of generics, eliminating import barriers and commercial practices promoting the prescription of innovative drugs, and banning vertical price-fixing practices (*Resale Price Maintenance, or RPM*). Only exceptionally, for specific medicines and in a fully justified manner, would price regulation be feasible.

In an analysis from the *market competition point of view of medicines for treating cardiovascular, respiratory and gastrointestinal diseases* in El Salvador, Jorge Bogo (2008) finds that the fundamental problems in the El Salvador medicine sector were the quality and perception of quality (poor reputation) of domestic products, entry barriers – especially obstacles to parallel imports – and unfair and medically unethical business practices (incentives to doctors and pharmacists for prescribing and dispatching innovative products rather than generics); measures are recommended for combating these problems. The SC based its *August 2008 Opinion* on this report, recommending promoting generics and ensuring their quality, removing trade barriers, eliminating commercial practices that benefitted innovative medicines over generic ones, promoting generics in public procurement, and obligating pharmacies to inform about generics.
Honduras’s CDPC conducted an economic analysis of the pharmaceutical market in May 2007, followed in September of that same year by policy recommendations for competition in the pharmaceutical sector. Here it gave the administrative and legal regulations – especially in retail marketing – that generated distortions for competition: pharmacy operating permits, pharmacy authorization by the governing body, minimum distances between pharmacies, health permits night-time pharmacy hours, and import permissions for pharmaceutical wholesalers only. It also highlighted the economic entry barrier posed by the significant investment required for laboratories and pharmaceutical warehouses in terms of market knowledge and advertising.

Furthermore, CDPC found that the addition of large-format and other retail distribution developments are good for competition, but that the sector needs continuous monitoring to prevent or detect anti-competitive practices (such as agreements between pharmacies on discounts to be applied on regulated prices). It recommended eliminating unnecessary constraints on competition (including laws that set prices and marketing margins) and permitting pharmacies to import medicines, exercising stricter control over drug quality, safety and efficacy, implementing policies to encourage generics, and overseeing the treatment of pharmacies by pharmaceutical wholesalers to prevent discriminatory practices.

We have already referred to the CDPC’s August 2009 Sectoral Study on the Specialized Private Health Services Market on the institutional medicine market.

Nicaragua’s Coprocom requested a study of the sector entitled The Medicines Market in Nicaragua: Analysis of the Market from a Competition Point of View (Delgado et al., 2008, funded by UNCTAD/COMPAL), which deplored the weakening of domestic manufacturing, since domestic generic drug prices act as an anchor that pulls down innovative drug prices. It also expressed concern over misleading advertising of spectacular discounts, the lack of promotional policies for generics, and the fact that margin regulation was encouraging the distribution of higher cost, imported drugs rather than local and generic drugs.

It recommended revising marketing margins, putting alerts in place for anti-competitive practices (including discriminatory policies practiced by distributors) and potentially harmful economic concentrations (for competition), promoting generics (including a consumer information campaign), and withdrawing ineffective and harmful medicines from the market.

A 2010 UNCTAD/COMPAL Market Statement for Nicaragua expressed concern over pharmaceutical wholesalers’ discriminatory policies and distribution exclusivities and questioned whether price regulation effectively promoted efficiency and consumer well-being.

An April 2000 Technical Report by Panama’s CLICAC included a proposal for a draft medicine marketing law. CLICAC met with all the stakeholders and then presented a report with recommendations for promoting “a comprehensive solution to the complex problem of medicines.”

Their recommendations included: implementing a decisive policy for promoting generics; revising the procedure and requirements for drug registration; publishing pharmacy prices to inform consumers; publishing the list of registered drugs as a guide for pharmacies to prevent the marketing of unregistered drugs; revising the list of essential medicines; creating a national health surveillance system for pharmaceutical products; enforcing the laws obligating every pharmacy to have a
registered pharmacist, limiting the sale of drugs to registered pharmacies, and banning doctors and surgeons from owning or holding shares of pharmacies; evaluating the possibilities of establishing a special regime for “small pharmacies” in consideration of the social function they fulfil; revising the implementation of retiree and pensioner discounts to prevent abuse, and ensuring that the State rather than the pharmacies cover the cost; educating consumer to keep them from self-medicating and help them use medicines appropriately; and creating a drug fund for people of limited means.

It also proposed automating public procurement processes, clarifying qualification and award criteria, and revising the possibility of partial deliveries during the term of the contract.

In addition, ACODECO publishes drug price statistics, and as stated above, participates jointly with several organizations in an incentive that seeks greater transparency in generic and innovative drug pricing at pharmacies in Panama through the monthly publication of prices for a basic medicine basket (CABAMED).

**Cases of Anti-competitive Practices and Analyses of Economic Concentrations**

In Costa Rica there have been two cases – one on an alleged strategic partnership between pharmacies, and the other on public tenders in which the authority found no evidence of anti-competitive practices as typified in the Competition Law; and at present there is an investigation underway on relative monopolistic practices.

In El Salvador, one public tender case was found where there were no indications of anti-competitive practices (the SC recommended consulting with it on the bidding specs, as it could issue an opinion on them), and another was found on collusive practices that is now under investigation.

In Honduras, CDPC found evidence of a collusive practice among pharmacies regarding discounts on regulated prices and punished the pharmacies, pharmacy and pharmaceutical wholesaler associations and the Professional Association of Pharmacists with fines of between 40,000 to 7.1 million lempiras. The trade associations and the Professional Association of Pharmacists were forced to revoke regulations on marketing margins, exclusive import rights, on-duty pharmacies, and minimum distances between pharmacies. CDPC also ordered pharmaceutical wholesalers to independently negotiate discounts with retailers and to define and publish the conditions and mechanisms for governing sales, promotions, benefits, credit, guarantees and other discounts and sales conditions in order to eliminate price discrimination, increase transparency and foment competition among the wholesalers.

In Nicaragua, as mentioned earlier, a case is now under investigation on alleged predatory practices of Kielsa pharmacies, a new market entrant.

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134 No. 016-2010
135 Case No. D-038-11
136 Case No. 37-11
137 SC-034-D/PA/NR-2009
138 SC-009-D/PS/R-2010
139 Case No. 013-PIO-2-2007
140 Case No. 0002-2013
In the realm of economic concentrations, El Salvador’s SC and Honduras’s CDPC each received a transaction notice, which they did not study in depth as neither of the two transactions reached the respective notification thresholds.
III.2.4. Recommendations

Some recommendations can be derived from the abovementioned problems that could improve competition conditions in the Central American medicine sector.

Regulations that set limits on the development of free market competition should be reviewed to see if they are necessary and proportionate to the public interest goals they seek to achieve (ensuring drug quality and efficaciousness and the professionalism of the establishments operating in these markets), keeping in mind that free competition is also a public interest that merits protection. This review should culminate in the elimination of any barriers found to be unnecessary or disproportionate, replacing the regulations, as relevant, with ones that are less restrictive of competition. As experts on the promotion of free competition, competition authorities would play an important role in this process.

It would also be worthwhile revising the regulations and procedures for public procurement of medicines in the region, in order to prevent abuse of formulas that sidestep bidding and to promote truly competitive procedures. The necessary mechanisms should also be put into place for detecting any anti-competitive practices by bidders. In addition to the timely revision of public procurement regulations, there should be, where needed, capacity-building of public procurement agencies in the pro-competitive design of public tenders and the detection of bid rigging, which should be reported accordingly to competition authorities. Effective formulas for this could be agreements between procurement agencies and competition authorities.

It has already been mentioned that there is still room in the region for promoting active policies and regulations that boost generic medications, also within the framework of public procurement. The competition authorities’ advocacy work in this area could also be fundamental.

However the competition authorities’ important advocacy task in this sector should not distract from the work of overseeing markets to detect and punish anti-competitive practices – cartels (especially, perhaps, in public procurement), vertical constraints (exclusivity agreements with unfavourable effects on competition, for example), unilateral conducts or abuse of positions of dominance (tied sales, predatory behaviour, loyalty discounts, etc.) – and analysing potentially dangerous concentration transactions for maintaining effective market competition.

In all areas of potential activity regarding this sector, regional cooperation among competition authorities is essential. In effect, the competition agencies of countries facing similar regulatory problems would get better results if they coordinated their advocacy work. Together they could promote the strengthening of regional integration projects that would be potentially beneficial for competition, such as the mutual recognition of drug registrations and joint negotiation of drug prices.\(^{141}\)

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\(^{141}\) *The Health Agenda for Central America and the Dominican Republic, 2009-2018*, approved at the Twenty-fourth Meeting of the Council of Ministers of Health of the Central American Integration System (COMISCA) in Tegucigalpa in January 2009, recognized the relevance of strengthening regional integration of medicine policy: “It is necessary to support and strengthen the Regional Drug Policy that has begun to be implemented in the region. The regional policy should include negotiations and consolidated procurement of drugs and technologies (including family planning), the development of regional quality-control mechanisms, studies on drug quality, guidelines for the introduction of new drugs, the development of basic treatment regimens in line with procurement, and accountability systems for social control of expenditures in this category. Regional laboratories are urgently needed, as well as cooperation with an international entity that can certify and support the maintenance of*
Cooperation among competition agencies is also crucial in the investigation and analysis of practices with cross-border effects, practices with domestic effects that are repeated in different jurisdictions (if there are regional players these will be more likely), or concentration transactions with transnational effects.
III.3. International Air Passenger Transport Sector

III.3.1. Notes for Characterizing the Sector

Introduction

Air transport is traditionally highly regulated by Governments, though recently the global trend has clearly been to deregulate and liberalize the services.

International air transport is by definition a cross-border service. Multilaterally, traffic rights and those directly related to traffic were left out of the General Agreement on Trade in Services (GATS), which only included auxiliary services such as maintenance and repair and those of Computerized Reservation System (CRS) operation. The 1944 Convention on International Civil Aviation, also known as the Chicago Convention, acknowledged the principle of national treatment, so each signatory State must treat domestic operators and operators from other nations equally favourably.

However the degree of openness of domestic markets, and the degree of liberalization of services, depends wholly on national laws and bilateral agreements between States on international air transport.

In effect, the possibilities of international air transport depend essentially on the so-called “air liberties”, which are negotiated between States. The most liberalizing agreements between States are the so-called “open skies” agreements, which nevertheless tend to maintain restrictions on domestic transport and cabotage services. Some States have unilaterally adopted open skies policies (such as Guatemala).

National Regulations and International Transport Agreements

National civil aviation laws regulate, with varying degrees of thoroughness and liberalizing intent, the entry and operation of service providers (capacity limits, number of flights or seats, route designations, price approvals, etc.) and matters of safety and environmental protection. They also usually establish sectoral regulatory agencies charged with ensuring compliance with the law.

The regulatory agencies of Costa Rica, Guatemala and Honduras report directly to the President, while those of Panama, Nicaragua and El Salvador are more autonomous, with their own legal entity status and administrative and technical independence.

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142 First liberty: Fly over a country without landing in it. Second liberty: Land without a commercial reason (technical stopover). Third liberty: Transport passengers from the country of origin to another country. Fourth liberty: Transport passengers from another country to one’s own. Fifth liberty: Transport passengers between two different countries in a flight originating in one’s own country. Sixth liberty: Transport passengers between two different countries making a stopover in one’s own country. Seventh liberty: Transport passengers between two different countries in a flight that does not pass through one’s own country. Eighth liberty: Transport passengers between two destinations in another country in a flight originating in one’s own country. Ninth liberty: Transport passengers between two destinations in another country in a flight that did not originate in one’s own country. The eighth and ninth liberties are associated, therefore, with cabotage. From Aldo González. Estudio sobre el mercado aéreo de transporte de pasajeros en Latinoamérica. Initial Version. CRC Latin America, June 2013.

143 Some of the information here derives from the work of Victor Hugo Valdés’s Regulación económica de aerolíneas en el Istmo Centroamericano. ECLAC Subregional Headquarters in Mexico. Mexico D.F., October 2009.
Some regulators function as regulators and service providers at the same time, which could be a source of conflict of interest. Some regulators have insufficient resources to adequately perform their functions.

The most open system for the granting of operating licenses is that of Guatemala, with its unilateral open skies policy. Very recently, through D.L. 509 of October 10, 2013 in El Salvador “established an open skies policy on the basis of the principle of real and effective reciprocity. After this amendment the application of said principle is optional.”

Honduras, Nicaragua and Panama reserve domestic service for domestic airlines. In Costa Rica, the legal barrier that restricted access to domestic service by non-Costa Rican airlines was removed, but it is argued that some processes, such as that of a public hearing, may eventually make entry difficult. In El Salvador, there is no domestic market.

With international transport, market entry depends on agreements between States, though the civil aviation laws of some countries already specify the air liberties they grant to other States under the principle of reciprocity. Thus Honduras would grant the first to the fifth air liberties, and Guatemala would grant all of them. In El Salvador, there are at least two cases on record (COPA and AEROMÉXICO) where authorizations for operating an international service were delayed for administrative reasons. A 2009 CDPC study on the Honduras air passenger transport sector described the difficulties met by the entrant airline, Solair, for operating routes to or from El Salvador (it apparently also had problems in Nicaragua), which were suspected to be due to the desire of Salvadoran authorities to protect TACA.

El Salvador, Honduras and Guatemala provide for the free setting of rates by operators, save for reasons of public interest, while Costa Rica, Nicaragua and Panama have introduced some regulation in the form of criteria for determining said rates – which in some cases may be ambiguous or somewhat subjective. In practice, the countries in the region do not set international transport service rates.

Central American countries have developed their international air transport relationships on the basis of reciprocity. Only Panama has signed explicit agreements with other countries in the region. The agreements between Panama and Nicaragua.
and Panama and Guatemala,\textsuperscript{149} then, grant the rights corresponding to the first through the fifth air liberties, designate one airline for each party, and provide for mutual approval of the rates set by each airline and mutual recognition of airworthiness and release to service certificates and issued or validated licenses.\textsuperscript{150} Some Central American countries are currently negotiating bilateral agreements, including El Salvador and Nicaragua, and El Salvador and Panama.\textsuperscript{151}

Regionally, the 2006 \textit{Cooperation Agreement for Facilitating and Developing Airline Operations between the Governments of the Republic of Guatemala, the Republic of Honduras, the Republic of El Salvador, and the Republic of Nicaragua}\textsuperscript{152} seeks to encourage the subregion’s social and economic development by facilitating tourism, both domestic and foreign, and trade flows by positioning the subregion as a unique geographical area with low transportation costs, air safety and quality service. In reality, the agreement tries to facilitate the flow of people between some countries in the region by using a "standard flight plan" and eliminating administrative, customs and migratory paperwork, but it is not an open skies agreement. In addition, it establishes that the provisions of bilateral or multilateral agreements between the countries will prevail over the ones it contains.

\textit{Resolution RC-AE-05/2013} of the SC in El Salvador states that though this agreement grants the eighth liberty and introduces a Central American air operator certificate that helps reduce the administrative load for a new entrant, “by itself, this provision does not have the potential for promoting greater opening of air passenger transport services in the region.” It also notes that the agreement does not include all the countries in the region.

For its part, the \textit{Multilateral Open Skies Agreement for Member States of the Latin American Civil Aviation Commission (CLAC)}\textsuperscript{153} of November 5, 2010, signed at the time by Chile, Uruguay and later, in 2011, by the Dominican Republic, Guatemala, Paraguay and Panama (ratified in 2013) and in 2012 by Honduras and Brazil, grants maximum liberties for developing air transport in Latin America. Nevertheless, there are still only a few signatory countries, with only two from Central America.\textsuperscript{154}

\textsuperscript{149} Accuerdo entre la República de Panamá y la República de Guatemala, sobre Servicios Aéreos entre sus respectivos territorios y más allá de los mismos, signed in Guatemala City on November 26, 1998. Ratified by means of Law Nº 30 of June 19, 2002, Gaceta Oficial Nº 24,579 of June 21, 2002.

\textsuperscript{150} The relations between Panama and Costa Rica are founded on the principle of reciprocity. Documents: Minutes of the Costa Rica–Panama Aeronautical Consultation Meeting, signed in San José (Costa Rica) on May 13, 2011; and Minutes of the meeting held by representatives from the Costa Rica and Panama civil aviation offices, signed on October 13, 2005. The relations between Panama and El Salvador are founded on the principle of real and effective reciprocity; no written document exists. Between Honduras and Panama there is an administrative Memorandum of Understanding between the aeronautical authorities signed in Panama City on October 15, 1987.

\textsuperscript{151} Resolution RC-AE-05/2013 of the SC in El Salvador.

\textsuperscript{152} The text of the agreement is available at \url{http://www.aac.gob.sv/archivos/acuerdoCA4.pdf}.

\textsuperscript{153} \url{http://clacsec.lima.icao.int/2011-MAcuMOU.htm}

\textsuperscript{154} The Latin American Civil Aviation Commission (CLAC) “is an international body with the goal of providing the member States’ civil aviation authorities with an adequate structure for discussing, planning and managing all the measures required for the cooperation and coordination of civil aviation activities, and for fostering efficient, sustainable and safe, protected, orderly and harmonized development of Latin American air transport for the benefit of all its users. At present the CLAC consists of 22 States in Latin America and the Caribbean.” (\url{http://clacsec.lima.icao.int/2011-MQS-Objetivos.htm})
In the El Salvador presentation of his *study of the air passenger transport market in Latin America*, expert Aldo González explained that Latin America was lagging in regional liberalization (and consequently, price reduction) of air transport service, although locally some countries are more liberal and more open.\(^{156}\)

**International Route Operators in the Central American Region**

The main operators are COPA and TACA/AVIANCA.\(^{157}\)

COPA Airlines was founded in 1947 as the Compañía Panameña de Aviación. It initiated flights to three cities in Panama and by 1966 it had three weekly flights to San José (Costa Rica). In 1969 it began to fly to Kingston (Jamaica), Managua (Nicaragua) and Barranquilla (Colombia), and in the 1970s it added the cities of Medellín and Cartagena (Colombia), San Salvador (El Salvador) and Guatemala (Guatemala). In 1980, it withdrew from the domestic market to focus on the international market, and in the following decade it expanded its destinations to Miami (US) and various cities in the Caribbean. In 1992, with the start of operations at the Tocumen International Airport (Panama) of the first Latin American airline hub, the “Hub of the Americas”, COPA began adding more destinations in South America, the Caribbean and Mexico. In 1998, it formed a strategic partnership with Continental Airlines, and in 1999 it launched its new image as COPA Airlines and adopted the OnePass frequent flyer program. In 2005, through COPA HOLDINGS, S. A., the airline was listed on the New York Stock Exchange, and in 2010 it announced that Aero República would operate under the trade name COPA AIRLINES SALVADOR COLOMBIA. In 2011, it expanded its “Hub of the Americas” from 4 to 6 flight banks, and in 2012 it announced its new MileagePlus frequent flyer program in conjunction with United, and its formal entry, in June, into the global airline network, Star Alliance.

In 1980, the Salvadoran company, TACA, initiated a process of international expansion – primarily through the acquisition of other airlines – and has become the TACA Group. It thus purchased AVIATECA and REGIONAL (Guatemala), LACSA and SANSA (Costa Rica), LA NICA and LA COSTEÑA (Nicaragua), LA ISLEÑA (Honduras) and AEROPERLAS (Panama), adopting in principle more of a point-to-point than a hub-and-spoke model. At the end of 2009, TACA Group announced its partnership with AVIANCA.\(^{158}\) The TACA Group included TACA INTERNACIONAL in this partnership, along with its shares in LACSA, TACA


\(^{156}\) laprensa.com.ni, July 1, 2013.

\(^{157}\) The following information has been taken from the airlines’ websites.

\(^{158}\) On June 14, 1940, Aerovías Nacionales de Colombia S.A. (Avianca) was incorporated; the corporation resulted from the integration of SCADTA and Servicio Aéreo Colombiano (SACO). In 1994 a strategic partnership was formed that linked the three largest companies in the Colombian aeronautical sector, Avianca, SAM (Sociedad Aeronáutica de Medellín) and HELICOL (Helicópteros Nacionales de Colombia), giving birth to the Avianca System. On May 20, 2002, Avianca and SAM formed, together with ACES (Aerolíneas Centrales de Colombia), the Summa Alliance. In November 2003 the shareholders decided to start liquidation of the Sociedad Alianza Summa and direct their efforts at strengthening the Avianca brand. In line with their goal of achieving leadership in the region, the company changed its trade name in 2005 and registered itself as Aerovías del Continente Americano S.A. In 2009, the airline returned to the stock market through a large placement of bonds issued in June. [http://www.avianca.com/es-otr/](http://www.avianca.com/es-otr/)
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PERU, AVIATECA, SANSA, LA COSTeña and LA ISLEÑA. AVIANCA included AVIANCA, TAMPA CARGO and AEROGAL. In 2011 it launched the unified LifeMiles frequent flyer program, which at the end of that year already had 4 million members. On March 28, 2011, AVIANCATACA issued shares for 500,000 million Colombian pesos. During 2011 it inaugurated 12 new routes and added 155 flight frequencies, reaching more than 100 destinations in the Americas and Europe, with more than 4,000 flights per week. On June 21, 2012, AVIANCA and TACA AIRLINE El Salvador officially joined Star Alliance. On October 10 of that same year, it announced the adoption of the AVIANCA name as the sole trade name for the subsidiary airlines of AVIANCA HOLDINGS S.A. (AVIANCA, TACA, TACA INTERNACIONAL, TACA REGIONAL, TAMPA CARGO and AEROGAL) as of 2013.

In 2012, AVIANCATACA transported 23 million passengers (13% more than in 2011), and COPA transported 10.1 million (17% more than in 2011). COPA has its hub in the Tocumen International Airport (Panama), and it could be said that AVIANCA’s hub is at the El Salvador International Airport, with a secondary hub at the Juan Santamaría International Airport (Costa Rica).

In 2014, three new airlines with Central American capital could start operations: TICOS AIR and TICAS AIRLINES, both with Costa Rican capital, and VUELOS ECONÓMICOS CENTROAMERICANOS (VECA), with Salvadoran capital. Only the last is seeking to make international flights in the region, for which it would use three Airbuses with capacity for 144 passengers each. Its strategy would be that of a low-cost airline, with ticket prices of around USD 150 plus taxes. VECA plans to offer 10 flights daily from the El Salvador International Airport to Guatemala, Tegucigalpa, Managua, San José and Panama, with 50% cheaper rates than the ones on the market, and will have the financial support of Alba Petróleos (a loan) in its exploratory studies.

It should be noted, finally, that AVIANCA is working with Central American tourism ministries (and with the support of tourism chambers in FECATUR and tourism service providers) on the Discover Central America campaign, which was initiated in 2012 and re-edited in 2013. The airline made 22,000 seats available at a single Central American rate for travel to and from any Central American destination for USD 269, tax included (for purchases made April 18-30 and for travel from April 22 to May 31). In addition, tourism service companies joined efforts to make accessible packages available for Central American travellers (between USD 365 in Guatemala and USD 399 in Costa Rica, Belize and El Salvador, including air ticket, lodging, tours and transportation). The campaign required a total investment of USD 200,000 – up to USD 50,000 for each Ministry and Avianca – with the arrival of more than 10,000 new travelers foreseen for the region.

In 2012, the airline provided some 26,000 seats with discounts of around 40%, the single Central American rate being USD 229. The Costa Rica Tourism Institute

159 elconomista.net, June 12, 2013
160 elfinancierocr.com, November 18, 2013, and VECA for EF, November 15, 2013
161 elmundo.com.sv, September 5, 2013
162 elsalvador.com, June 27, 2013
163 AVIANCA may announce more operations in El Salvador, precisely in reaction to VECA’s plans to enter the market – 60 additional flights arriving in the country, which would mean a 9% increase in arriving passengers (elmundo.com.sv, July 25, 2013).
reported that the campaign had meant the arrival of 3,300 Central American tourists to the country, who stayed on average six days and spent some USD 1,200 during their stay; it stated that “part of the goal was to capture more pleasure visits in a market that up to then had been in the business segment.”

**Essential Infrastructure**

The main international airport in the Central American region is the Tocumen International Airport (PTY) in Panama, followed by the Juan Santamaría International Airport (SJO) in Costa Rica, the El Salvador International Airport (SAL) in El Salvador, and the La Aurora International Airport (GUA) in Guatemala. In 2012, PTY recorded almost 7 million passengers, SJO somewhat more than 3.2 million, and SAL and GUA a bit more than 2 million. The international airports in the other two Central American countries, Honduras and Nicaragua, are substantially smaller in terms of the passengers they handle.

Tocumen International Airport (PTY) has the most traffic in Central America and is considered the region’s best international airport. In 2006, reforms were begun to enable it to handle up to 10 million passengers per year. More than 56,000 scheduled international flights leave every year from Panama to 73 destination airports in 31 countries. Given the increase in Panama air operations, and thanks to Panama’s steady growth as a tourism and business destination, PTY is set for new remodelling and expansion. With an investment of close to USD 100 million, Tocumen S.A. started construction of the North Dock project, a complete two-story terminal that increases the current airport infrastructure by 21,000 square meters and 12 aircraft positions, entailing the construction of new apron areas and taxiways for aircraft, passenger departure lounges, shops, service roads and airline and Tocumen S.A. offices.

Juan Santamaría International Airport (SJO), located in the city of Alajuela 18 km from the city of San José, provides service to airlines flying to Central, North and South America and Europe. It also houses a NASA hangar from where an experimental cartography aircraft flies. Aeris, the airport’s administrator, reported almost 23,000 operations per year. In December 2012 the airport inaugurated a performance-based navigation (PBN) system for landings, making Costa Rica the region’s first country to have this technology. Airlines, such as TACA and COPA, who loaned their aircraft for the testing, reported savings of up to USD 4,500 in fuel on each flight, and the new system is calculated to increase the airport’s air traffic by 20%. Jean-Marc Bourreau, a Costa Rican Tourism Institute airline advisor, is of the

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164 elfinancierocr.com, April 19, 2013, and revistamyt.com, April 17, 2013
165 IATA airport codes
166 Other international airports in the region include the Daniel Oduber (Liberia, Costa Rica), Mundo Maya International (GUA), Ramón Villeda Morales (San Pedro Sula, Honduras), Golosón (La Ceiba, Honduras), Juan Manuel Gálvez (Roatan, Honduras), and Enrique Malek (David, Panama).
167 The information given below has been taken from the websites of the airports and regulatory authorities, unless otherwise indicated.
168 http://www.tocumenpanama.aero/
169 Benefits of Aviation, Panama, Oxford, 2013
170 http://www.fly2sanjose.com/
171 There are 3 other international airports in Costa Rica, but of these only the Daniel Oduber International Airport in Liberia, Guanacaste, receives international flights from America and Europe.
opinion that SJO is a competitive airport because it can handle high passenger volume with just a few gates.\textsuperscript{172}

El Salvador International Airport (SAL)\textsuperscript{173} is half an hour from San Salvador by highway. It has a 3,200-meter long, 60-meter wide main runway (07-25) with a 45-meter effective taxiing surface and 7.5-meter shoulders. Parallel to the main runway, and just as long, is the “Alpha” taxiway with six exits to the runway. An 800-meter long secondary runway (18-36), built for small aircraft, is currently used for long-term aircraft parking. The passenger terminal building apron has sixteen aircraft parking positions, fourteen of which have boarding gates that connect the aircraft directly with waiting areas; with a total construction area of 34,380 square meters, it has departure lounges and hallways, immigration and customs areas and shops. American Airlines, Continental Airlines, Delta Airlines, Mexicana de Aviación, COPA and AVIANCA offer service at SAL.

A recent study commissioned by El Salvador’s SC\textsuperscript{174} noted that in operating terms (take-off and landing capacities), none of SAL’s three flight banks or peak traffic hours are saturated, although during those hours there is certain evidence of saturation in the terminal building (document counters and security and immigration checkpoint areas), which could complicate the entry of new airlines.

The growth of AVIANCA’s hub has pushed the El Salvador’s executive airport commission (CEPA) to speed up the work for increasing the capacity and halting the deterioration of SAL. The investment will apparently be USD 78 million.\textsuperscript{175} CEPA might also have felt pressured by AVIANCA’s announced intention to build its own airport terminal\textsuperscript{176} or set itself up in another Central American capital.\textsuperscript{177} In 2007, Aeropuertos de París had already developed a master plan for the SAL expansion, which CEPO hopes to update for receiving proposals from United States, French and Japanese firms.\textsuperscript{178}

La Aurora International Airport (GUA)\textsuperscript{179} was remodelled in 2010 and has a master plan for expansions and actions to cover demand for the next 25 to 30 years. At present it has a capacity of 4 million passengers annually, 22 boarding gates, 160 weekly flights and direct connections with cities in the United States, Mexico, Central America, Peru and Spain. With its new facilities, GUA has attained a category 1 rating from the United States Federal Aviation Administration and its runway is the safest in Central America. Toncontín International Airport (TEG), which handled 556,000 passengers in 2011, has one runway and a terminal with three boarding gates and two boarding gates for international flights. It receives between 20 and 30 domestic and international flights

\textsuperscript{172} nación.com, November 16, 2013
\textsuperscript{173} http://www.aeropuertoelsalvador.gob.sv/
\textsuperscript{174} RC-AE-05/2013, de 27 de noviembre de 2013
\textsuperscript{175} eleconomista.net, October 3, 2013; and elsalvador.com, September 27, 2013
\textsuperscript{176} elsalvador.com, September 27, July 25 and June 20, 2012
\textsuperscript{177} elsalvador.com, June 20, 2012
\textsuperscript{178} elsalvador.com, May 28, 2012
\textsuperscript{179} Apparently the airport does not have its own website. http://www.dgac.gob.gt/ is the website of Guatemala’s Directorate General of Civil Aeronautics.
every day. A key infrastructure project is the transfer of the Toncontín airport in Tegucigalpa to Palmerola in Comayagua.\textsuperscript{180}

Ramón Villeda International Airport (SAP), located 21 km from downtown San Pedro Sula, handled 782,000 passengers in 2011. It has one runway and three boarding gates plus a boarding gate for international flights. It is presently being remodelled; more than USD 45 million will be invested to add 5 jet bridges, furnish the old terminal, expand the parking areas and build the perimeter fence.\textsuperscript{181}

Augusto C. Sandino International Airport (MAN), located 11 kilometres to the east of downtown Managua, handles an average of 100 flights daily with destinations in the United States, Central America, Mexico, and Panama, in addition to connections and domestic flights to the Nicaraguan Atlantic coast. The Empresa Administradora de Aeropuertos Internacionales reported that it had executed the development projects and plans for modernizing and expanding MAN, allowing it “to position the airport as one of the most modern in the Central American region, helping to raise Nicaragua’s rating to category one.”

Overall, infrastructure spending appears to be the basic challenge for international airports in Central America – and in Latin America, in general.

The Executive Director of the Latin American and Caribbean Air Transport Association (ALTA) affirmed that “until airport expansion projects are undertaken, the region will have put a ceiling on growth in this area. There are airlines that don’t offer more flights because ‘I can’t land when I want to land.’” In Central America, the only airport prepared to absorb present and future demand is PTY.\textsuperscript{182}

At the Americas Competitiveness Forum held in Panama in October 2010, the CEO of COPA affirmed that Latin American countries need to increase spending on airport infrastructure, since one out of every three flights in the region takes off from airports considered extremely congested. Panama does not have the same congestion problems and thanks to this, COPA has been able to grow and place Panama “at the vanguard of the air movement, which has had a positive impact on the country’s economic development in tourism and the arrival of multinational firms.”\textsuperscript{183}

\textsuperscript{180} On January 8, 2014, the contract for the design, financing, construction, maintenance and operation of the new Palmerola International Airport was awarded to the Honduran firm, Constructora de Servicios Aeroportuarios Integrados S.A. (SAISA); the airport will be located in the Comayagua municipality along the highway between Tegucigalpa and San Pedro Sula, one hour from the capital city. In the framework of an international tender developed by COALIANZA with the help of the Spanish consulting firm, ALG, SAISA was prequalified along with a Colombian company; but in the end only SAISA submitted a bid. The project will be developed under a public-private partnership scheme. The contract will have duration of 30 years from initiation of operations, and upon termination the airport will be returned to the Honduran government. The estimated investment for developing the project is USD 107 million. Construction work will begin in the first semester of 2015 and the airport will be ready in the second semester of 2016. By 2045, the Palmerola International Airport is predicted to have achieved 1.8 million passengers, in a conservative scenario, and 2.1 million passengers, in the base scenario (press release by the Commission for the Promotion of the Public-Private Partnership, COALIANZA). The president of the Association of Air Transport of Latin America and the Caribbean (ALTA) warns that the success of Palmerola could depend on the use made of Toncontín, since if this is kept as an international airport it would be preferred over the Palmerola one due to its closer proximity to the Honduran capital (eleconomista.net, June 10, 2013).

\textsuperscript{181} \url{http://www.interairports.hn/}

\textsuperscript{182} eleconomista.net, June 10, 2013

\textsuperscript{183} prensa.com, October 10, 2013
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

The passenger flow in Latin America has increased by 80% in the last ten years, from 95 to 170 million, and “30% of all Latin American flights take off or land at saturated airports, and this is one of the main hurdles for development of the air sector.”

III.3.2. Competition Problems

In the international air transport sector, relevant markets are often defined by city-pairs, although airport-pairs are also used – when the airports serving the same city are not sufficiently close substitutes – and sometimes include other alternative means of transportation, such as high-speed trains, when the service they provide is a sufficiently close substitute to the one provided by air transport. On occasions, stopover flights may be considered close substitutes for direct flights, in terms of ticket price, time between origin and final destination, and passenger characteristics (business or tourists).

In the Central American international transport sector, the relevant markets should seemingly be defined by city-pairs rather than airport-pairs, without including other alternative means of transportation (there being at this time no true rail-highway intermodal transportation competition) and considering only direct flights (the distances are too short to make it worth the while for passengers to make a stop, so connecting flights do not put sufficient competitive pressure on direct flights to be considered part of the same relevant market).

Taking intra-regional international route pairs (between cities of different Central American countries), it appears that the vast majority are operated as a monopoly by COPA or AVIANCA, or as a duopoly by the two.

The aforementioned study in El Salvador found that all the international routes between El Salvador and other Central American cities had a single provider in 2011 – AVIANCA – with the exception of the SAL-PTY route, which was served by AVIANCA (with 14% of the market share) and COPA (with the remaining 86%).

Also, the SJO-MAN (also served by NATURE AIR, though this is a premier airline), SJO-TEG, SJO-SAP, SJO-MAN, SJO-PTY, GUA-SJO, GUA-MAN and TEG-SJO routes served as a duopoly between AVIANCA and COPA. AVIANCA is serving the TEG-GUA route in a duopoly with the Honduran CM Airlines, in addition to serving the GUA-TEG and GUA-SAP routes in a duopoly with the Honduran Aerolíneas Sosa.

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184 elconomista.net, June 12, 2013
185 To this respect, the study for El Salvador (RC-AE-05/2013, of November 27, 2013) agrees, reporting that in 2010 and 2011 connecting flights did not account for even 1% of all passengers.
186 NATURE AIR is a San José (Costa Rica)-based premier airline offering flights to 13 destinations in Costa Rica, Bocas del Toro in Panama and Managua in Nicaragua (http://www.natureair.co.cr).
187 In October 2013, the press (prensalibre.com) picked up on the news of the partnership between the Guatemalan airline, TRANSPORTES AÉREOS GUATEMALTECOS (TAG) (http://www.tag.com.gt), CM AIRLINES (http://cmairlines.com/) and TROPIC AIR of Belize, which had started operating flights from Monday through Friday between GUA and TEG, SAL and Belize. These were direct flights leaving in the morning and returning in the afternoon, to give passengers a round trip on the same day. TAG had purchased three 34-seat capacity Saab aircraft. Each round trip ticket could cost around USD 400.
188 With the information that could be found on the websites of the Central American airports and the Airlines providing international passenger transport services in the Central American region; at some of these websites it is not easy to find specific information.
189 http://www.aerolineasosahn.com/
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

It could be that the high prices of intra-regional international routes in Central America are a consequence – at least partially – of this weak competitive dynamic: the installed airlines are trying to obtain the highest possible revenue from the monopoly/duopoly, and if the entry barriers to potential new competitors are perceived as being sufficiently high there is no pressure to improve their performance by reducing costs, innovating, or being more efficient and providing better services to consumers at more economical prices. On the other hand, it is worth considering that, depending on the route, there may not be sufficient demand for more than one or two companies to provide the service, especially taking into account the low average income in Central American countries. However, in this case it may be that lower prices wouldn’t generate greater demand while at the same time making it possible for new providers to enter the market, triggering new price and demand adjustments until a certain balance is reached.

Of course, there is the perception that the Central American market is dominated by AVIANCA and COPA, that prices of intra-regional international flights are high and impossible for the majority of the population (making this an elitist sector with low passenger flows), and that this, together with the lack of an intermodal (rail-highway) alternative, is blocking regional integration, for which the movement of people is essential.\(^{190}\)

The El Salvador study on the sector discovered that the load factors of the intra-regional international routes served by AVIANCA were quite low – under 30% in all cases – and that none of them was operating at a profit. On the SAL-PTY route, the only one where AVIANCA faced competition with COPA, the load factor was especially low for AVIANCA (12%) and higher for COPA (59%), with COPA’s tickets being on average more expensive than those of AVIANCA. COPA was operating at a profit on this route, while AVIANCA was not.

An analysis of each of the intra-regional international routes in Central America goes beyond the scope of this report. In any case it must be considered that keeping open the possibility of new operators entering the markets (in other words, making sure the markets are contestable) guarantees that said potential entrants enter when they find a business opportunity and discipline the incumbent operators, who will make an effort to improve prices and the quality of the services they provide to consumers when they feel threatened by potential new entrants.

It is therefore important to eliminate unnecessary or disproportionate measures or regulations that introduce market entry roadblocks or delays, as well as the strategic behaviours of the installed companies designed to impede the entry of potential competitors, resulting in anti-competitive practices. Another fundamental question for market contestability has to do with access to the essential infrastructure for providing the service: the airports.

The resolution of El Salvador's SC on the results of the same study reveals some domestic regulatory issues that could cause unnecessary or disproportionate entry barriers, such as the public hearing required in the procedure for obtaining operating permits. This process, which is not necessary for the goals sought by the regulation, is subject to use by installed operators to obstruct the entry of potential competitors, as apparently has indeed occurred. The resolution also highlights the little sense it makes

\(^{190}\) Sources from the El Salvador Ministry of Economy and the Costa Rica Civil Aviation Authority, in addition to economist Manuel Novoa of Nicaragua, interviewed in November 2013.
to punish anti-competitive behaviour by cancelling the violator’s operating permit, since this further reduces competition in the affected market.

In addition, the intervention of the regulatory authorities in setting the prices of services is undesirable from an economic standpoint (when prices are determined in the market by supply and demand they become indicators of demand preferences and shortages). Such intervention, if deemed necessary, should be reserved for very exceptional and fully evaluated cases.

Perhaps the most important regulatory constraints for entry into international air transport services are those imposed by bilateral agreements between countries wherein, depending on the air liberties, airlines and origin/destination routes are designated and capacity limits are set on frequencies or number of seats. The El Salvador study also emphasizes the harm caused to competition by designated airline nationality restrictions, making the eventual sale of the business to foreign capital difficult by endangering the airline’s acquired rights by a change of nationality. This increase in exit costs also has inevitable repercussions on entry costs.

Airports are an essential infrastructure for the provision of air transport services, and congestion or anti-competitive management, or vertical integration with airlines, could seriously limit the market entry chances of new providers (routes originating or arriving at each airport).

As has already been stated, one of the biggest challenges facing the sector in Central America is to improve and expand the capacity of its airports. More important still is to establish clear and fair rules for allocating the existing capacity – spaces and services – at those airports. The most obvious of these spaces and services are the slots, or aircraft take-off and landing schedules, at the airports. None of the Central American international airports has a true slot allocation policy.

The El Salvador study found no evidence that the airport manager (CEPA) had employed discriminatory practices or any other type of anti-competitive practice in its slot allocations, not even when Spirit and Aeroméxico began operating in 2011 and 2012, respectively. It seems both entrants were given their requested schedules since they were not the ones with the highest demand. In any case, the lack of a defined slot allocation policy gives discretion to the awarding authority and consequently leads to greater uncertainty for potential new entrants and discourages efficient management of the installed capacity.

Accordingly, the sector study in Honduras warns that slot allocation should not be taken lightly, even in airports that are far from congested, since the criteria used (or the absence of a definition of said criteria) are susceptible to creating entry barriers for potential market competitors. It also complained that no defined framework for slot allocation existed in Honduras, so allocations are made “empirically and there are surely losses of efficiency in their fairly informal and undetermined process.”

The Coprocom in Costa Rica criticized in its Decision of October 5, 2010, that there was no guarantee of equal treatment for access to the airports by users, since an objective slot regulation system has not been established.

Regarding the essential infrastructure needed for provision of the service, vertical integration (whether in the shape of coincidence in properties or long-term contracts) among airports and airlines would inhibit competition. Other than the case where investment is needed in airport capacity and risks exist for the later operational phase,
vertical integration is not easily justified. At present, it is usual to have public-private partnerships for infrastructure investment projects such as airports. If the only willing investors are those that already operate within it, the potentially adverse effects of vertical integration on competition could be limited through mechanisms such as fair durations for the airport operating agreements and, during the agreement, the establishment of rules for non-discrimination among operators in the allocation of slots, boarding gates, fingers, document counters and other spaces or services in short supply at an airport – perhaps under the supervision of the regulator and/or competition authority.

Other types of barriers are the strategic behaviours of installed operators, some of which may infringe the laws defending competition (these must be discouraged and, if relevant, punished).

To this respect, agreements between airlines merit the scrutiny of competition authorities, paying special attention to the effects they have on the routes where the agreeing or partnering airlines compete or could potentially compete. In principle, code-share agreements allow airlines to expand their routes and/or frequencies, and the partnerships offer better services to travellers (protection against missed/cancelled flights by means of the other economic agent, preferential attention at the other airlines’ hubs, standardization of frequent flyer plans, etc.) and even, under certain circumstances, make service possible on specific routes that they would not otherwise possess. However these same advantages could translate into entry barriers for new competitors, who are not able to offer the same level of service.

Aldo González (2013) explains that airline partnerships tend to include four types of agreements: (1) Interlining: An agreement that enables the different airlines to coordinate a trip where each participates by operating a leg. The coordination makes it possible for passengers to buy a single ticket and not be affected by the frictions involved in a change of service provider. Aside from operational coordination, the airlines must agree on payment methods or the sharing of income for the passengers transported by each. (2) Common use of access areas: A business agreement that enables airlines to share infrastructure and/or services at different international airports, such as departure lounges and boarding gates. (3) Agreements on frequent flyer plans: Under this agreement, the airlines group together their points and rewards. Passengers can accumulate flight miles regardless of the partner airline on which they fly, and can exchange them at any of the airlines in the agreement. (4) Code-share: An agreement whereby an airline can sell another airline’s flights as if they were their own. As in interlining agreements, the airlines have to agree on income-sharing mechanisms based on the tickets sold and passengers transported.

The paper emphasizes that the benefits of partnership include more and faster brand recognition and quality for the airlines (which is particularly important for new airlines partnering with ones that already have worldwide prestige); better service and business conditions for offering to corporate customers; and facilitation of the undertaking through joint project financing.

However it also warns of the risks of these agreements for competition. In interlining agreements the main concern is the existence of exclusivity clauses, and in code-sharing agreements, the impact they can have on the legs where both airlines compete, since there the interests of the airlines might not agree with those of consumers (if the airlines jointly set the reciprocal ticket price they will tend to maximize their joint profits, the end price coming close to that of a monopoly). The Honduras study on the
sector highlighted the intense level of information-sharing among competitors that generally leads to partnerships, facilitating the coordination of their behaviours.

In Central America, the recent incorporation of AVIANCA and COPA into the Star Alliance, one of the world’s largest along with Sky Team and OneWorld, should be cause for concern. The sector study in El Salvador found that passengers in the SAL-PTY route might especially be adversely affected and recommended its review by the SC prior to its coming into force.

Other types of entry obstacles for new operators may derive from the relationship between the airlines and travel agencies. In order to improve ticket sales through travel agencies, airlines offer the agencies incentive programs that might eventually be considered abuse of a dominant position. The risk is that these programs could become exclusivity agreements and lead to the market closing of sales channels for other competing airlines. The larger the share of total ticket sales of these channels, the more important the effect of a market closing.

The El Salvador sector study estimates that 57% of tickets are sold in that country through travel agencies, but does not find any indication of exclusivity agreements between AviancaTaca and said travel agencies. The airlines with smaller market shares offer more attractive commissions and less restricted programs. AviancaTaca’s agreements require higher targets to be met for collecting overrides, and where AviancaTaca faces competition its competitors offer more attractive commissions.

Finally, the El Salvador study includes a comment on hub and spoke systems with reference to AVIANCA’s hub at SAL. Although the decision to opt for this system may be due to business and market strategies and not constitute anti-competitive behaviour, what is true is that this system makes it possible for whoever adopts it to best exploit the economies of scope and density inherent to air transport networks, giving them an advantage over other operators who seek to operate routes from that airport. The same arguments are valid for COPA’s hub at PTY.

Another potential source of competition problems are the State aid policies for airports or airlines. AVIANCA’s International Director of communications and corporate affairs referred to the issue in December 2013 with respect to the market entry of new airlines: “We have no problem new airlines coming in, as long as they meet the requirements and regulations for operation and enter the market under equal conditions, without subsidies or privileges.”

III.3.3. Actions of Competition Authorities in the Region

Studies, Reports and Opinions

In April 2010, AEROMÉXICO asked Costa Rica’s Coprom for its opinion on the difficulties it was facing for entering the Costa Rican market. In June 2009 AEROMEXICO had applied for an exploitation certificate to operate the México-San José-México route; in February 2010 it had already obtained its second provisional operating permit from the Technical Council on Civil Aviation (CTAC), but in April MEXICANA requested a public hearing to lodge its objections.

In its October 5, 2010 Decision (Case No.008-10-OP), Coprom denounced strong market entry barriers in the form of access regulations and administrative procedures.

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In its opinion, CETAC has great discretion in the granting of exploitation certificates, and the public hearing procedure is used by established operators to make entry difficult for new ones (citing the example of TACA’s opposition to COPA’s entry). It recommended the participation of consumer organizations and business chambers at these public hearings. The market is concentrated, largely due to legal barriers and the fact that the laws have been used “as an industry policy tool to support national carriers and prevent the entry of new competitors.”

With respect to airports, essential facilities for the provision of services by any operator in this market, Coprocom criticized the fact that there was no guarantee of equal treatment for access since there was no objective slot allocation system established “based on the willingness to pay for a resource in short supply, so that expansion needs can be indicated by the airlines on the basis of expected demand, and in order to offset the difficulties arising from vertical control and horizontal coordination between airlines and the major airports”, citing Guillermo Jiménez (2009).

In its May 3, 2011 Decisions (Cases C-005-11 and C-10-11), Coprocom found no incompatibility of: the Costa Rica - Panama agreement; the Costa Rica - Arab Emirates agreement; and with the competition law. It did recommend expanding on and refining the articles dealing with this issue, so that the parties would agree to guarantee an environment of free competition within the framework of their respective laws, eliminate any airline operation procedures that may be discriminatory or constitute market entry barriers, and fight anti-competitive practices “common to the commercial air transport market” – whether these are competition-limiting agreements (such as code-sharing, at times), or abuses of a position of dominance (“the spurious use by an economic agent with power in one or several routes of common and legitimate market strategies in the commercial air transport market whose ultimate goal or effect is to impede or limit competition or competitors’ access to that route, or to encourage them to leave”, “predatory pricing”, or “any other discriminatory, predatory or anti-competitive practice”).

The SC Board of Directors in El Salvador commissioned the consulting firm ADHOC CONSULTOREI Salvador Y ASOCIADOS S.C. to prepare a report on competition conditions in the air transport of passengers in El Salvador; it then used its conclusions in its Resolution RC-AE-05/2013 of November 27, 2013. The main findings of the study are as follows:

- AviancaTaca is the main provider of air passenger transport services in El Salvador. In 2011, AviancaTaca handled 56% of all passengers, American Airlines 14%, United (Continental) Airlines 12%, and Copa and Delta 6%.
- In 2011, AviancaTaca offered direct flights from San Salvador to Guatemala, Tegucigalpa, San Pedro Sula, Roatan, Managua, San Jose, Liberia and Panama in Central America, and COPA only offered flights to Panama.
- In 2011, the destinations from San Salvador with the strongest demand were North America – Canada, the United States and Mexico (71%) – and Central America (21%).

193 In its November 2, 2010 Decision (Case 025-10-OP), the Coprocom took advantage of a query on the Air Transport Service Agreement submitted by the Brazilian aeronautics authorities to insist on the same arguments it had given in its October 5, 2010 Decision.
- Panama City was the fifth largest for traffic (after four cities in the United States).
- Travel to Central America was motivated primarily by business and secondly by tourism.
- A survey of one thousand people who made at least one flight in the two previous years concluded that ticket price was the main limiting factor for airplane travel.
- Intra-regional routes were all monopolized by Avianca, except for the SAL-PTY route, where COPA had only 14% of the market share (versus AviancaTaca with 86%).
- AviancaTaca served the same route with an average load factor\(^{194}\) between 2008 and 2011 of slightly more than 12%, and COPA with slightly more than 59%. In the rest of the intra-regional routes, AviancaTaca’s load factor was less than 30%, with the exception of the SAL-SJO route (slightly over 56% between 2005 and 2011).
- For the SAL-PTY route, the average ticket price was USD 380 (between January 2010 and November 2011) for AviancaTaca and USD 470 for COPA.
- COPA turned a profit on this route; AviancaTaca did not.
- In most of the markets the trend was for higher prices.

The study revealed the obstacles to competition interposed by the legal framework for the industry – the public hearing procedure, the possibility of competition law violations leading to cancelled permits, and the limitation of the air liberties granted unilaterally by El Salvador – in addition to the limited comprehensiveness of El Salvador’s bilateral and multilateral agreements and its nationality requirement.\(^{195}\)

Other obstacles include those posed by the saturation of the airport infrastructure, Avianca’s hub, the way document spaces are allocated in the airport, and the lack of definition of a slot allocation policy. The study also warns of the risk of allowing, or of not overseeing, the vertical integration of airlines and the airport.

In addition, the market may be feeling the effect, or may potentially be affected, by airline override policies for travel agencies and a lack of regulation of partnerships and code-share agreements among airlines.

With respect to intra-Central American traffic, the study found that AVIANCA operated all lines as a monopoly, and that only the Panama run was being served as a duopoly by AVIANCA and COPA, with the latter occupying a dominant market position.

The resolution issued recommendations for improving competition in the sector: (i) If SAL is expanded, limit vertical integration of the airport and airlines; (ii) Amend the Organic Law of Civil Aviation to include the approval of partnerships and code-share agreements by the Civil Aviation Authority after a binding opinion by SC, eliminate the possibility of operating permit cancellations as punishments, and eliminate public

\(^{194}\) Passengers transported / capacity

\(^{195}\) The SC advises that the recent amendment of the Organic Law of Civil Aviation has already overcome some of the problems noted in the study.
hearing as part of the procedures for obtaining operating permits; (iii) Establish a slot allocation policy favouring competition; (iv) Promote the negotiation of an open skies agreement in the Central American region (among the six countries) and later the joint negotiation of the entire bloc of new agreements with third parties; (v) Amend the Organic Law of CEPO to improve legal certainty and revise the method for setting airport rates; (vi) Amend the Organic Law of CEPO to enable it to manage international airports; and (vii) Optimize the use of SAL facilities.

In SC-011-O/PN/R-2013 of June 26, 2013 on the amendment of the Organic Law of Civil Aviation, the Salvadoran authority took a positive view of some of the proposed changes, such as that of regulating rates only for reasons of national interest or public necessity (intervention will be based on the existence of market distortions that merit regulation, after the SC’s binding opinion), or that of eliminating the privilege enjoyed by incumbent airlines of not having to deposit a bond. It took a negative view, however, of other proposed changes, such as eliminating the obligation for airlines to register their rates (SC recommends maintaining the obligation for statistical, public policy and regulatory purposes) or that of unilaterally adopting an open skies policy (SC feels that although it would add to competitive pressures, at the same time it would limit the State’s ability to negotiate with other States according to the principle of reciprocity and to support the domestic industry).

In SC-047-O/PN/R-2013 of February 6, 2013, the authority decided in favour of some aspects of the Air Transport Agreement between El Salvador and Nicaragua, such as the freedom of each State to designate airlines to benefit from liberalization, the non-discriminatory treatment of airlines in airways, airports and other infrastructure, the freedom of airlines to set their own rates, with State intervention limited to very specific cases, the recognition of the duty to protect corporate rivalry, and the States’ mandate to minimize administrative procedures and validate permits and certificates. On the negative side, the agreement granted the designated airlines the right to enter into code-share agreements. Aware that on occasion they can significantly restrict competition, SC recommended adding the power of the regulator and SC to issue opinions on these types of agreements.

The Sectoral Study on Air Passenger Transport in Honduras of June 2009 covers domestic routes and international routes to and from Honduras. Its recommendations include the following: Oversee the market, especially the airlines’ pricing strategies and their relationships with travel agencies; detect potential indications of anti-competitive practices; and study whether there is effective competition between COPA and TACA in terms of route openings and ticket prices, as they are the two most important regional airlines and may be motivated to protect their market power through coordinated behaviours. The study also recommends tightening ties between CDPC and the Directorate General of Civil Aeronautics, considering the opening up of cabotage services in the country, and advocating for a procompetitive slot allocation policy at airports.

Cases of Anti-competitive Practices and Analyses of Economic Concentrations

To date there have not been many cases investigated by the region’s competition authorities with respect to the air passenger transport sector.

In Costa Rica, cases of Airlines and Code-Sharing have been investigated. In the first, Coprocom punished several airlines, including those with intra-regional international routes such as LACSA, TACA and COPA, for agreeing to lower travel agency
commissions. Two escaped punishment in the first instance when it was found that they had reduced their commissions after the others had published their cuts, and in an appeal for reconsideration all were exonerated under the argument that the issue had been discussed at an IATA meeting. In the second case, Coprocom alerted the Technical Council on Civil Aviation (the authorizing authority) of the anti-competitive effects of one of the affected routes in the code-share agreement that was about to be signed by LACSA and American Airlines. The Council authorized the agreement but imposed a set of conditions.\footnote{196}{The description of these cases has been taken from Mario Cuevas’s paper, Las condiciones de competencia en las principales rutas de aerolíneas nacionales e internacionales, y los mercados domésticos en cada país del Istmo Centroamericano, ECLAC Subregional Headquarters in Mexico. Mexico D.F., December 2009}

In Panama, CLICAC investigated a similar case on an agreed commission cut for travel agencies and filed suit against the respective airlines, including COPA and TACA, for having come to an agreement within IATA. In another case, also regarding a code-share agreement, this time between three airlines (COPA, AVIANCA and SAM), CLICAC filed suit on the understanding that the agreement was an anti-competitive practice affecting consumers.\footnote{197}{From Mario Cuevas’s paper for ECLAC (see above)}

At the end of 2009, El Salvador's SC monitored the relationships between travel agencies and airlines (SC-018-MT/NR-2009: Monitoring of Relationships between Travel Agencies and Airlines) without finding any evidence of anti-competitive practices. It did recommend, however, that the Civil Aviation Authority should obligate airlines to notify it of the commissions paid to travel agencies and the criteria they use to determine them.

In 2009, CDPC in Honduras investigated (Case No. 070-D-07-2009: Restrictive Competition Practices in the Air Passenger Transport Sector) a complaint by American Airlines against the Corporación Centroamericana de Servicios de Navegación Aérea (Cocesna), which is charged with controlling air transit in the region. Cocesna had stopped providing service to the airline due to a dispute over its new rates, forcing the airline to go around Cocesna’s areas of operation, with a resulting economic loss and weakening of its ability to compete with its rivals. CDPC declared the complaint without merit, deeming that it concerned a contractual dispute.

In the control of economic concentrations, only one case has been found, analysed by El Salvador’s authority in 2009 (SC-027-S/C/R-2009), wherein SC resolved to deny the request for authorizing a "contribution agreement" between TACA and AVIANCA, since AVIANCA was not participating in the Salvadoran market. The applicants’ brief disclosed that AVIANCA was offering tickets over the Internet with El Salvador as the final destination, by virtue of an agreement with LÍNEAS AÉREAS CONSTARRICENSEI Salvador S.A. (LACSA), a TACA affiliate. It argued, though, that the tickets to El Salvador were not an AVIANCA sale and that the passengers making the Costa Rica-El Salvador run and vice-versa were TACA, rather than AVIANCA, passengers.
III.3.4. Recommendations

Recommendations can be derived from the foregoing that may help improve the conditions for the development of competition in the international air passenger transport in Central America.

First, the elimination of regulatory aspects that unnecessarily or disproportionately impose obstacles to effective market competition should be promoted. Indeed, a certain amount of regulation is needed to maintain sufficiently high standards of service quality and safety, but those provisions that are unnecessary or disproportionate (because they are excessive in the protection of the public interest they seek to safeguard to the detriment of another public interest, which is the protection of competition) should be eliminated or reformulated.

The possibility should be considered of simplifying and speeding up the procedures for obtaining permits, licenses or certificates for airlines to operate, that is, their entry to the market, and of limiting the cases where the regulatory authorities can set the prices of services (and, where they establish criteria for guiding price-setting by the airlines themselves, of preventing discretionary or ambiguous criteria).

With regard to the concession of air liberties between States and the limitations to competition set out in agreements between States in terms of designated airlines, routes, frequency and seat numbers, etc., the competition authorities should advocate for the reduction of obstacles.

Along this line, a true Central American open skies agreement would improve conditions for the development of competition in Central America. The resolution of SC’s Board of Directors, RC-AE-05/2013 of November 27, 2013, advocates for the construction of a “Central American common market in air passenger transport” that would require two components. The first is an open-skies agreement among all the countries in the region, with concession of the first to the seventh air liberties, without frequency restrictions or airline nationality restrictions (where the main offices are located should be the prevailing criterion), with multiple designations and the freedom of airlines to set rates. The second is the joint negotiation by the Central American bloc with third parties for standardizing the concession of liberties and other rights to airlines from outside the region, thus reducing the regulatory obstacles to entry for regional route service provision. In addition, for foreign airlines to enter the competition for regional routes they should have the possibility of setting up a hub in one of the countries in the region (and if that hub is set up in El Salvador, Salvadoran consumers should benefit the most). A unification of regulations among the countries would also be desirable to facilitate greater competition throughout the region.

Within this framework, it would be advisable to ensure the participation of competition authorities in the regulatory process and in negotiations of agreements between States – and in sensitizing and training regulators on the benefits of competition and how they can effectively promote it.

Obviously, when seeking to promote Central American integration, the joint or coordinated action of the competition authorities will most certainly be more effective than the individual efforts of each authority.

With respect to essential airport infrastructure, it has been seen that investment projects must be promoted in Central America to increase the capacity of airports that are becoming too small, or to modernize those that are becoming obsolete. These
investment projects should allow for the entry of firms that can later provide services (it might even be desirable for interested airlines and airport authorities to coordinate in planning airport expansions on the basis of foreseen activity), with due precautions: limited contract durations and rules for non-discrimination among operators in the allocation of slots and terminal spaces and services.

The vertical integration of airports and airlines should not be permitted in the case of consolidated airports, and attention should be paid to the issue of the financial dependence on specific airlines of airports serving as their hubs, as the airlines may eventually be able to influence the decisions of the airport authorities to the detriment of actual or potential competitors.

Of course, pro-competitive policies should also be encouraged for the allocation of slots. The El Salvador study suggests that slot allocation policies that incorporate "acquired rights" as an allocation criterion favour incumbent airlines and are not conducive to the entry of new competitors. Instead, market mechanisms should be introduced for the allocation such as auctions, secondary markets for the sale and purchase or leasing of slots, and “use it or lose it” rules that discourage hoarding for anti-competitive ends. Consideration should also be given to differentiating rates according to peak or off-peak hours and optimizing the use of boarding gates and counters through the concession of common-use spaces. The study also suggests the possibility of using slot allocation to favour the entry of low-cost airlines. Finally, it recommends developing the slot allocation policy at SAL within the framework of an inter-institutional committee consisting of the Civil Aviation Authority, CEPO as the manager of SAL, and SC. The study on the sector in Honduras recommends evaluation of the slot allocation policy by CDPC and training of the airport authorities on competition issues.

This training, which we feel is essential, would seek to give airport authorities an understanding of the importance of stimulating competition in the sector and of how they can do this as part of their work (in the allocation of slots and other airport spaces and services, for example). The training would also promote efficient management of the essential infrastructure in order to be able to adjust airport fees.

In addition, competition authorities should oversee markets as part of their task of discouraging, detecting and punishing the anti-competitive behaviours of air passenger transport service providers.

Competition is already very limited on some routes and practically non-existent on many others (in many city-pairs, as has been seen, the service is provided by a single airline, generally COPA or AVIANCA), so competition authorities should be especially alert to the evolution of this sector, especially now that several new airlines (such as the low-cost VECA airline) appear to be completing the procedures for providing service on some routes. With respect to the chapter on anti-competitive practices, the authorities could be facing cases of strategic partnerships between airlines, airline and travel agency agreements (which could be a concern as long as the agencies are the main marketing channel for tickets), or practices qualifying as abuse of a dominant position such as predatory pricing or other behaviours for obstructing the entry of competitors to the market. Obviously, the scrutiny by competition

198 Aldo González (2013) deals fairly exhaustively with slot allocation policies, including specific experiences and cases in Latin America.
authorities of concentration transactions with potentially damaging effects on competition is also necessary.

Cooperation among the region’s competition authorities will be essential when investigations involve anti-competitive behaviours with cross-border effects and concentration transactions between companies with a presence in the region. Mario Cuevas (2009) refers to the need for cooperation among the region’s competition agencies as follows: “Since the air transport market cannot be viewed in an isolated manner in each country, the competition agencies in the subregion should coordinate when hearing cases, since many of the cases will probably involve more than one country. The importance of including the issue of competition in the Central American integration process also needs to be emphasized. To this end, the working group on competition policy in Central American economic integration can be used as a point of departure for facilitating subregional coordination and collaboration among national competition entities.”

IV. Proposal for stronger Central American integration for the defence and promotion of competition

Our analysis here of the working of these three sectors clearly shows the existence of numerous hurdles and restrictions impeding the development of regional trade and healthy and effective competition. These obstacles slow the pace of economic integration and harm consumers, who fail to benefit from the advantages otherwise gained under an integrated and effectively competitive system – advantages they would foreseeably perceive in the form of better products and services offered at lower prices.

Completing the integration requires not only taking measures for the technical harmonization of laws, reduction of tariff, tax or administrative barriers, establishment of a common tariff, and improvement of transportation infrastructures, etc., but also implementing policies for the promotion and defence of region-wide competition that can act as drivers and guarantors of free competition and the free circulation of goods and services.

There is a sufficient and adequate legal basis within the Central American integration system for building a system of regional competition. In fact, the Tegucigalpa and Guatemala Protocols give community agencies the ability to adopt rules and regulations that promote and guarantee free competition among companies, thereby fomenting an efficient market that can drive the region’s economic development. By virtue of the institutional structure of Central American integration, the responsibility for eventually issuing and approving regional competition rules and regulations lies with the Meeting of Presidents as the supreme governing body of SICA, at the

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199 Mario Cuevas. Las condiciones de competencia en las principales rutas de aerolíneas nacionales e internacionales, y los mercados domésticos en cada país del Istmo Centroamericano. ECLAC Subregional Headquarters in Mexico. Mexico D.F., December 2009

200 According to the El Salvador Ministry of the Economy’s Trade Policy Director, Carlos Moreno, competition practices have to be observed in the entire region, not just in an isolated manner in each country, such that the nations cannot apply anti-competitive measures to prevent the entry to the market of new players.
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In view of the importance of aiding the process of Central American integration by establishing a regional system for the defence of competition, below is a concrete proposal to that end. As shall be seen, this proposal has the advantage of being able to be implemented relatively quickly and at a minimum cost, taking advantage of structures already established by national competition authorities.

IV.1. Referential analysis of regional systems for the defence of competition

An effective regional set of competition rules should contain, at the least, an institutional model appropriate to the region’s characteristics, and specific rules (substantive and procedural) for prohibiting and punishing collusive agreements and abusive conduct, establishing control over regional concentrations, facilitating coordination for implementing policies for competition advocacy or promotion, intervening in the realm of State aid, and coordinating cooperation with judicial bodies and sectoral regulatory bodies.

For an institutional model design to be effective in practice, all the aspects that define and characterize the region’s status quo must be taken into consideration: each State’s institutional organization, the existing competition culture, the economic situation and structure, the needs and political will of the governments involved, and the results of integration efforts, etc. All this is necessary when designing a regional competition model that entails another ceding of the member States’ sovereignty to a community or regional organization.

At present there are various regional competition models in the world. Each model responds to a specific reality and pursues more or less ambitious goals, but the common characteristic of all is that they create mechanisms that make it possible to investigate, and if necessary punish, anti-competitive conduct in intra-regional trade. Although these systems serve as a reference and source of inspiration for the Central American model, none of them can or should be fully copied.

To this respect, the EU’s decentralized implementation model offers quite interesting aspects, as does that of UEMOA (currently under revision) and that of the Andean Community.

IV.1.1. The EU System for the Defence of Competition

The founding treaties for European integration already contained specific provisions for implementing a Community competition policy, needed for complementing and helping to achieve the fundamental freedoms in the common market. Indeed, so that competition is not restricted in the common market, Articles 101-109 of the Treaty on the Functioning of the European Union, or TFEU (former Articles 85-94 of the Treaty establishing the European Economic Community, or TEEC) establish a set of rules to control both conducts of undertakings (prohibition of collusive and abusive conducts, Articles 101 and 102) and member State relationships with public undertakings and undertakings with special rights (Article 106), and at the same time provide a system to control the State aid granted by member States to their

201 Article 119 of the TFEU (former Article 3 of the TEEC).

For the Community antitrust law to apply, the conducts of undertakings and/or member States have to affect trade between two or more member States. This condition implies a need to maintain – parallel to the Community Law – national competition laws for controlling conducts whose effects are felt in only one member State. For this, a dual level of competition law enforcement (double barrier) is maintained within a procedural framework where coordination between national competition authorities (NCAs) and the European Commission is essential.

By virtue of the principle of the predominance of Community Law, national laws cannot authorize anti-competitive conducts that are prohibited by the European law, though they can prohibit other types of conducts not prohibited by said Community Law. Also, traditionally the Community competition law was applied exclusively by the European Commission until Regulation 1/2003, which took force on May 1, 2004, eliminating the Commission’s enforcement monopoly and establishing a decentralized system of enforcement. This has led to an exponential increase in the number of cases resolved – mostly by NCAs – and greater coordination of the Commission and NCAs through the European Competition Network (ECN).

The system of concurrent powers established by the new Regulation implies that in practice issues are handled by the best suited authority (NCA or Commission), which is determined on the basis of objective criteria in the Notice on the ECN. The Commission retains a preeminent position of primus inter pares that lets it initiate a case and take on the authority to handle it, even if in principle the case has been handled by an NCA.

On the other hand, operation of the network has allowed for greater coordination of NCAs in applying the Community law, allowing, therefore, for a more consistent and increasingly standardized application of national laws.

This, then, signifies the importance of the Community Law as a coordinating, innovative and driving force for European and national competition policies.

Initially, TEEC did not give the Commission any powers for controlling concentrations. However, the effect of several international concentrations on the market structure spurred the Commission to enforce Articles 102 (former Article 86 of TEEC) and 101 (former Article 85 of TEEC) of TFEU for specific

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202 The rules for control of concentrations date from the end of the 1980s, when the Council approved the now-revoked Regulation (EEC) 4064/89 of December 21, 1989, by means of which the European Commission was given specific powers for the control of business concentrations in order to ensure that competition was not distorted by this type of transaction. To this end a uniform body of material and procedural regulations was adopted that evaluated the compatibility of concentrations with the common market and connected all operators engaging in economic activities in Community territory. The Commission became the sole competent authority for enforcing the rule on concentration transactions with a Community dimension.


204 Commission Communication on Cooperation in the Competition Authority Network (2004/C 101/03).

205 On December 9, 1971 the Commission applied Article 86 of TEEC to a concentration transaction, deeming the purchase by the American company Continental Can of TDV, its only competitor in Europe, an abuse of a dominant position. This decision was annulled by the review court in Ruling 21
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concentration transactions. This was prior to 1973, when the Commission sent to the Council a draft regulation to establish true control over community-wide concentrations. After 16 years of comings and goings, the proposal came into existence with the approval of the first regulation on the control of concentrations between undertakings, a regulation that has since been modified into the current Regulation 139/2004.

This regulation establishes an ex-ante system of control by the Commission of concentration transactions with a Community dimension when they exceed certain thresholds. Nevertheless, the regulation provided referral mechanisms to enable the Commission to delegate control of a transaction with a Community dimension to an NCA when the effects of the transaction are concentrated in a single member State and the NCA is better situated to analyse its effect on the market. In the opposite direction, another mechanism allows NCAs to refer a concentration transaction without a Community dimension to the Commission when it falls under the jurisdiction of three or more member States. The experience of recent years has shown that a control of concentrations with a Community dimension is useful and essential for preventing harm to competition. In practice, most concentrations are approved, although on occasion this approval is subject to conditions (divestment, sale of patents, etc.).

Control of State aid is an essential aspect of European competition policy. Granting of State aid can undoubtedly help drive the economy under certain conditions, but the corrupting and distorting effect of certain types of aid on competition calls for control. For this reason, the authors of the Treaty introduced specific provisions to regulate the granting of State aid, with a system of prior notification and ongoing control by the Commission (exclusively).

The policy developed by the Commission on this matter during the first few years lacked transparency and attracted strong criticism, so for the next few years the Commission acted on the basis of soft law (communications, frameworks, guidelines and letters to the member States). Without downplaying the work of the Commission in the previous period, it can be said that it has only been in the last fifteen years, and especially since the approval of the 2005-2009 Action Plan, that the Commission has developed a more transparent policy on State aid aimed at channelling the granting of this aid towards commendable goals from a Community of February 1973, although it admitted the possibility of applying Article 86 to certain concentration transactions.

On March 22, 1984, the Commission decided to apply Article 85 to a partial concentration consisting of the share takeover by the Philip Morris Company of stock in the Rothmans Tobacco Company. The review court annulled the decision for inadequate statement of reasons, but it admitted the possibility of applying Article 85 to this type of transaction.

From September 1, 1990 to January 31, 2014 there have been notifications of 5,449 transactions, of which only 24 have been prohibited.

Articles 92 to 94 of the TEEC established the principles applicable to control of State aid and the prior notification procedure. At present the provisions are regulated in Articles 107 through 109 of the TFEU.

Indeed, the Council’s inactivity on this matter could be seen up to 1998, when it adopted Regulation (EC) No. 994/98 of May 7, 1998, on the application of Articles 92 and 93 of the TEEC to specific horizontal State aid categories, giving the Commission power to regulate the granting of certain aid through regulations for exempting by category. Note should be made to this respect of Regulation (EC) No. 800/2008 of the Commission on aid for SMEs, jobs, the environment, training, R&D, and regional aid.
standpoint (regional development, job creation, training, support for small and medium-sized enterprises, environmental protection and innovation), seeking maximum efficiency and transparency (with limitations in terms of type of investment) and a clearly motivating effect on economic activity. At present the Commission is developing its State aid modernization plan.

With respect to promoting competition, the Commission’s efforts have been innumerable, almost all aimed at making its policies more transparent and analysing the competitive situation of basic sectors of the European economy through sectoral studies (energy, telecommunications, distribution, etc.). In addition, emphasis must be placed on the power given to the Commission by the Treaty to bring before the Court of Justice any member State that adopts or maintains laws in violation of the Treaty, especially those liable to block the free play of competition.

However, competition promotion has greater impact when the efforts are made by NCAs. Indeed, efforts within the regulatory framework of public administrations over public procurement procedures or business and professional association activities are clear examples of how NCAs are better situated to act, no matter the degree to which their actions may derive from guidelines adopted at the Community level. For this reason, the Commission’s work here is more that of coordinating and guiding NCAs to solve European problems than engaging in advocacy, in the strictest sense of the word.

IV.1.2. UEMOA’s Regional Competition System Reform Project

UNCTAD is currently helping UEMOA (West African Economic and Monetary Union) to design a new regional system for the defence of competition that will be based on close coordination between NCAs and the regional authority (the Commission). At the core of the model is inter-institutional cooperation, coordination of activities and sharing of competencies between NCAs and the Commission. Thus both will participate in handling cases brought against restrictive competition practices with a regional scope (affecting trade between member States or the Community’s general interest). In addition, the model establishes criteria for cooperation and sharing of competences in the control of concentrations, for State aid, and for the regulatory activity of member States, as well as for cooperation with judicial and sectoral bodies.

The Competition Law enforcement system in UEMOA was established in the Dakar Treaty. The rules coming out of the Treaty were complemented by regulations and guidelines, as well as by jurisprudence as of 2002. However, after ten years a need has arisen to reflect on the usefulness of a system that has seen very little enforcement of the laws against anti-competitive practices in the region.

Many factors have led to the failure of the initial system, from the lack of means or lack of a competition culture in some member States to ambiguity in the sharing of competencies between Community and national authorities and the manifest lack of cooperation between authorities at different levels. The volunteer peer review report on UEMOA, Benin and Senegal, coordinated by UNCTAD in 2007 and presented at the meeting of the Intergovernmental Group of Experts on Competition in July of that

year, revealed the system’s weaknesses and recommended its modification to make it more effective.

The reform that was later initiated revolves around four basic axes. First, it was necessary to decide between having a single community law for all the member States and having the regional law coexist with national laws. The Treaty rules do not require – as a condition for their application – that conducts must affect trade between two member States, so they can be applied at the national level.

Secondly, a system had to be established for the effective sharing of the punitive procedure’s different phases: investigation and decision. Thirdly, an institutional system had to be designed that took into account Community authorities as well as national competition authorities, along with other sectoral authorities with competence on the matter. And fourthly, it was necessary to establish appropriate procedures for articulating the relationships between Community and national authorities in order to guarantee proper working of the system and provide legal security for companies.

The experts have opted for the establishment of a single Community law to pursue conducts that restrict competition, control concentration transactions and the granting of State aid, and engage in competition advocacy. This option of maintaining a single law constitutes an essential divergence from the European model, despite the fact that in the EU, laws of member States have reached a high degree of convergence.

On the other hand, UEMOA’s current system, based on the allocation of exclusive authority to the Commission, has not worked, so the new regulatory texts should seek a balance of authority-sharing and proper coordination between the Commission and NCAs in order to guarantee uniform enforcement of the Community Law throughout the region. The proposal is as follows:

In the realm of anti-competitive conduct, both the Commission and NCAs will be empowered to make decisions for prohibiting and punishing – the Commission in cases of conducts affecting trade between member States, and NCAs (if operative) in cases of conducts with effects confined within their respective territories. Nevertheless, the Commission will have the authority to intervene in cases posing problems that are novel or of Community interest. Fact-finding and investigations of cases brought by the Commission will be handled by NCAs under the Commission’s guidance and supervision.

At the same time, procedures will be established for reciprocal reporting and referral between the national and Community authorities so that the Commission will have knowledge of the cases brought before the different national courts.

The Commission will have exclusive authority over concentration transactions with a Community dimension, and NCAs will have the authority to analyse transactions with a national dimension. A system of notifications and information-sharing among the authorities has been provided to facilitate coordination.

Another important and differentiating aspect of this system will be that decisions made by NCAs may be appealed before the Commission in the first instance, and later by UEMOA’s Court of Justice, in the second instance, in order to guarantee consistency and uniformity in the application of the rules.

To prevent conflicts of interest, the Commission will maintain exclusive authority over the control of State aid and restrictive practices attributable to member States.
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The Treaty has provided for ex-ante control of aid granted by member States to their companies, which must be reported to the Commission following a procedure regulated by a new regulation. The regulation will provide some crucial exceptions to the prohibition and establish a specific compatibility analysis procedure for aid granted illegally – that is, aid that has been granted without prior notification of the Commission or without waiting for authorization.

The respective NCAs must first be notified of draft laws that may affect the workings of competition, upon which they will issue an opinion. These NCAs will be obligated to inform the Commission of the notifications they receive so that, within one month, the Commission can issue an opinion.

Finally, the new regulation will establish specific provisions to regulate relationships between NCAs, the UEMOA Commission, judicial bodies and sectoral regulators. Cooperation with judicial bodies is necessary to make sure competition laws are enforced consistently by all bodies (administrative and judicial) with authority for their enforcement. The figure of amicus curiae has been provided, so that any national jurisdiction can ask the Commission for a report on the application of competition rules in the private cases submitted to their jurisdiction, and the Commission can intervene of its own accord before the courts to offer information or present written or oral comments, pursuant to each country's procedural rules.

The relationship with sectoral regulators will be established by each NCA, following a set of principles set out in the draft regulation that basically state that NCAs are the only bodies authorized to investigate and punish violations of competition rules in all regulated sectors, without prejudice to the establishment of adequate cooperation channels with the sectoral bodies so that the latter can intervene in procedures involving companies in regulated sectors.

IV.1.3. The Andean Community System for Defence of Competition

The States of Bolivia, Colombia, Ecuador, Peru and Venezuela (in 2006, Venezuela withdrew from the Community) decided to come together on the basis of shared interests and form a community of nations with an expanded market. Supranational public power was achieved through a transfer of competences with no effect on the States’ legal status and through the establishment of common authorities. These common authorities have adopted Decision N° 608 and are charged with its application. At the substantive level the Decision provides rules to prohibit and punish conducts that restrict free competition and affect the subregion, whether in the territory of one or more member States or in the territory of a non-member of the Andean Community when the effects are felt in one or more member States of said Community. Practices originating in and affecting a single member State are excluded and will be subject to the respective member State’s national laws. The Decision

211 According to the Cartagena Agreement, the Andean Community pursues the objectives to “promote the balanced and harmonious development of the Member Countries under equitable conditions, through integration and economic and social cooperation; to accelerate their growth and the rate of creation of employment (…)” for the purpose of “bringing about an enduring improvement in the standard of living of the subregion’s population.” The objective of forming a common market is not in the Cartagena Agreement but has been expressed by the Andean heads of State at various summits.

212 Decision No. 608 has three main attributes: i) pre-eminence or supremacy, since in the event a conflict should occur with national laws it prevails over them in its application and for the specific case overrides the national laws regulating the same set of facts or establishing an opposite legal effect; ii) immediate application, that is, from the moment it becomes effective due to its publication it produces
does not establish any regulatory provisions for the control of concentrations or State aid, but it does give the Andean Committee authority to promote competition (Article 36).

The Secretariat General of the Andean Community has authority when a conduct occurs or its effects involve the territory of more than one Andean Community member State, and in these cases it is charged with instigating and conducting the investigations and issuing a decision. The Secretariat General is vested with powers to obtain and record information, summon and question the agents involved, visit the respective locales, obtain records and recordings, and require regional market agents to present any and all documents regarding their business activities and corporate structures.

Another of the functions of this office is to impose the necessary precautionary measures ex officio or at a party’s request, after the NCA of the State in which the measure would apply has given its opinion. It can also call the parties to a public hearing to argue their claims, and can accept or reject the voluntary agreements of parties for early conclusion of cases.

The Secretariat General requests the cooperation of NCAs, and in fact it is these NCAs that conduct the relevant investigations according to an “investigation plan” determined by the Secretariat General. It is important to note that NCAs apply their national rules and regulations as to procedure, the authority’s power, and probatory acts, among other actions not specified in Decision 608. Nevertheless, in its capacity as leader of the procedure, the Secretariat General will be able to conduct its own determinations and probatory acts and ask NCAs for complementary information.

Prior to resolving, the Secretariat General prepares a report on the results of the investigation and sends this to the parties and the Andean Committee for the Defence of Free Competition, a technical body formed by representatives from each of the member States that serves to guide the Secretary General. If the Secretariat General deviates in its resolution from the Committee’s opinion it must expressly state the grounds for the discrepancy.

### IV.2. A model regional system for the promotion and defence of competition in Central America

There is no doubt about the need to set up a regional system for the defence and promotion of competition in Central America in order to deal with the problems of competition in the region. The existence of NCAs in five of the six member States is already a major advantage, but Guatemala must adopt national rules and regulations comparable to those of the other countries in the region.

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213 The Secretariat General is the technical, executive and administrative body of the Andean integration system. It is under the leadership of a Secretary General named by the Andean Council of Ministers of Foreign Relations.

214 The process can be initiated ex officio by the Secretariat General of the Andean Community or at the request of a qualified applicant: i) NCAs, ii) national integration organizations in each Member Country; iii) consumer associations; and iv) individuals or legal entities subject to public or private law.
Though the aforementioned regional competition systems offer items of interest that can serve as a reference when proposing a specific model for Central America, they cannot be replicated or transposed in their entirety. It is essential to start on the basis of the region’s legal, political, social, economic and cultural reality in order to avoid building on a basis that cannot support the system’s structure over the medium and long term.

In the EU model, the European Commission drives the development of regional competition policy and has set its evolution and objectives over time, while member States have been progressively adapting their policies to the guidelines set by this Commission. Since 2004, ECN has been a valid platform for reaching greater consensus and coordinating application of the proposals launched by the European executive.

In the Central American region, on the contrary, NCAs have been the ones to develop competition policies in their respective territories, and the path followed by each NCA constitutes input, know-how and an investment that should be taken advantage of in creating a regional system. This leads us to conclude that the regional competition system in Central America should be driven by NCAs, and by the network of Central American competition authorities, and that its structure should be rooted in the national structures already in place – which vary in their regulations and how those regulations are applied – and in their different experiences and case histories. Acting jointly under clear principles of coordination, cooperation and consistency, NCAs can confront the competition problems faced by regional markets.

Regional competition rules would thus contain provisions for establishing the following (and this would be the proposal):

a) **An institutional model adapted to the region’s characteristics.** The new institution would seek to obtain the general goals of economic integration, and would operate on the basis of an effective system of coordination of the region’s NCAs, so that having a fully functional NCA would be the *sine qua non* for participating in the regional institutional system. The new institution would have the following bodies:

   - An executive body, the *Regional Executive Commission*, comprised by the heads of NCAs, rotating the presidency, with competence for deciding on cases of anti-competitive conducts and control of concentrations (based on proposals submitted by the fact-finding and investigation body), as well as State aid and competition promotion (based on proposals submitted by the body responsible for promotion).

   - An investigative body, the *Regional Investigation Office*, formed by the heads of the NCA investigation departments, each case being directed by the head of the NCA investigation department in the best position, who would have sufficient power and the cooperation of the other NCAs involved in the matter at hand. The regional rules and regulations would clearly establish the principles of relevant information sharing among NCAs in order to prevent legal problems with regard to confidential information.

   - A body responsible for the promotion or advocacy of competition, the *Regional Advocacy Office*, comprised by the advocacy officers of the
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respective NCAs, which would make proposals to the Regional Executive Commission and undertake promotion, prepare reports and sectoral studies and maintain relations with the media, pursuant to decisions adopted by the executive body.

- A permanent Secretariat General, whose members, functions and headquarters would be regulated in the regional rules and regulations. This Secretariat would carry out the tasks of coordinating and overseeing adherence to procedures, guaranteeing compliance with the terms prescribed in the rules and respect for the rights of defence. Its structure would be simple, with a Secretary General assisted by a minimum body of technicians and administrative staff.

This simple, austere institutional design trusts to NCAs, under the Secretary General’s coordination, the task of building a regional competition policy from the combination of national policies. It would produce synergies in the efforts of NCAs, which would progressively coordinate their national efforts, adopting the best practices they would discover in their joint work with other NCAs, while still respecting their own laws.

By adopting a model of inter-institutional cohesion such as the one being proposed, very positive effects can be achieved for competition and trade in the region:

- Coordination will take place at all levels and in all aspects of the application of the rules, giving as a collateral result a more consistent and uniform application by NCAs of their respective national rules, as common objectives and similar methods of acting are progressively established. The regional rules and regulations could include provisions obligating the States to harmonize specific substantive and procedural aspects.

- The system would improve the efficacy and efficiency of NCAs, as they would act in coordination on cases of anti-competitive practices and control of concentrations (with joint investigations), and on cases of inefficient regulations or anti-competitive State aid (with coordinated advocacy, with which they would have greater impact).

- Information-sharing problems would be avoided, since NCAs would act under the cloak of a regional set of rules that would obligate them to transmit all relevant information to the investigative body.

- By joining the efforts of all NCAs, the number of matters handled and efficacy in obtaining evidence would presumably increase.

- The cost of the system would be minimal, since no new institutional structure needs to be created with replication of management positions or technical and administrative staff, except for the Secretariat General.

b) Prohibition of anti-competitive business conducts affecting trade among member States. An exhaustive list of anti-competitive conduct should not be sought, as this would reduce the authority’s room for action in applying the rules. In addition,
exemptions should be provided for conducts that might lead to market efficiencies, following the European scheme.

**c) Procedures for application of competition rules to anti-competitive behaviours**, which should always guarantee the rights to due process and defence. The rules must at least provide the following:

- The ways procedures are initiated (ex officio and by complaint).
- NCAs’ obligation to inform the Secretariat General of complaints and investigations being undertaken.
- The Secretariat General’s duty to coordinate every phase of disciplinary proceedings or the implementation of joint competition promotion efforts.
- The criteria for determining which NCA is best situated for taking charge of an investigation, with the collaboration of the remaining NCAs’ investigative bodies.
- The powers of investigation and inspection (minimum rules or remission to national law).
- Procedural phases and time periods.
- The obligation of all NCAs to cooperate in the investigation and transmit all relevant information to the leading investigative body.
- The presentation of the investigated case to the deciding authority.
- The procedures for negotiated conclusion, with or without punishment.
- The punishments and remedies.

**d) The procedure for ex ante control of economic concentrations with a regional dimension.**

**e) The power to undertake competition promotion or advocacy efforts.** A formal competition advocacy strategy is an essential instrument for safeguarding markets from inefficient regulations and preventing unnecessary or disproportionate barriers to market entry. NCAs’ coordinated efforts could be more effective for introducing competition to sectors that have traditionally been protected, and for helping to offset pressure groups that induce administrations or governments to maintain obstacles to market entry.

**f) The control of State aid.** Under certain circumstances, State aid can become a distorting factor for intra-regional competition or contribute to artificially maintaining inefficient undertakings, transferring their problems to the rest of the undertakings in the sector. To this respect, it needs to be ensured that aid goes to cover market deficiencies (funding for SMEs, research and development efforts, ongoing training, job creation, etc.), encourage private investment, and serve as a counterbalance in the public interest. In brief, competition authorities should seek to have State funds used rationally and to the benefit of the public interest. To do so, they should provide their governments with guidelines or recommendations as to the criteria to follow in granting State aid. The proposal is not to establish *ex ante* control for the granting of State aid as in the EU, but rather to install a coordinated system of recommendations based on soft law documents that would help redirect the efforts of national
governments towards procompetitive goals, within reasonable margins of discretion. A policy that qualitatively and quantitatively improves the granting of State aid not only prevents distortions of competition but also helps reinforce budgetary discipline and improve public finance.

Finally, the regional authority should have active legitimacy for challenging before the CCJ any laws or acts of public administrations that set up hurdles for intra-regional competition or that involve the granting of State aid to the detriment of competitive trade between member States without justifiable compensation for the public interest.

**g) The scope of application of the rules.** The rules should apply to all sectors of the economy and all undertakings (public or private), without distinction of nationality. They should also apply to public administrations when they act as economic operators in the market (buying or selling goods or services).

Starting the system will essentially require a consensus among NCAs, which would commit to acting under the new regional competition system in addition to the work they already do within their jurisdictions.

Putting into operation an inter-institutional system, with participation of authorities with knowledge and experience in applying national competition rules and regulations, would be foreseeably quicker, cheaper and more suitable for dealing with regional challenges than creating a whole new authority that would have to start from scratch. A new authority would have to dedicate enormous efforts to learning and to figuring out how to coordinate with NCAs, not to mention the problem of funding sources. To sum up, the proposal is being made in the firm conviction that the best system for regional competition in Central America is one that is buttressed by NCAs of the countries in the region (trusting in Guatemala’s adoption of its own competition law in the short term), working jointly, in a coordinated manner and under a set of common, clear and consensual operating principles.
V. Conclusions and recommendations

The Central American integration system is at a critical juncture and needs a new boost. The data on Central American economic growth and trade with its primary trading partners shows that the region has quite significant development potential and can attract foreign investors and companies. The recent trade agreements with the United States and the E.U. are evidence of this attractive force which, well managed, could re-launch the region’s development to levels exceeding expectations. However, this potential will not be realized if it is not accompanied by suitable public decisions and measures for creating the necessary climate of security and stability.

Central American integration suffers from the typical problems of every economic integration process, with trade liberalization measures at the community level (elimination of customs and tariff barriers, harmonization of regulations, etc.) leading, as a counterpart, to trade practices aimed at re-establishing protection systems and re-stricting trade and competition in the intra-regional market. The lack of coordinated action for preventing or eliminating these trade practices can be felt.

In banking, regulatory problems have been found that may block market entry for potential new competitors or limiting the ability of some to compete with others by imposing discriminatory treatment. Specific structural weaknesses (lack of market development, related financial instruments or alternative technologies) that could be restricting the contestability of the markets in which commercial banks operate were also found. The work of the competition authorities in this sector is essential. Firstly, they should be advocating for regulatory changes to improve competitive conditions. Secondly, they need to be attentive to anti-competitive practices in the sector, such as the coordinated setting of bank fees or interest rates, especially where the supply structure for bank services is already concentrated. Thirdly, they have to watch over markets and foresee concentration transactions that might be harmful for competition.

In the pharmaceutical sector, specific national regulations concerning the authorization of drugs or drug production and distribution, and others that restrict activities or limit parallel imports and intra-regional trade in generic drugs, may be placing constraints on the development of free competition in these markets. With respect to public procurement, direct purchase abuse should be prevented and truly competitive tenders should be promoted (joint Central American price negotiating is a good initiative), and the necessary mechanisms need to be put into place for detecting bid rigging practices. In addition, competition authorities have to be alert to eventual anti-competitive practices in this sector, which could show up in the form of price fixing or market sharing agreements, exclusivity contracts in vertical relationships, or practices such as bundled pricing, predatory behaviours, and loyalty discounts, etc., by companies with market power. They also need to analyse potentially harmful concentration transactions from an intra-regional market perspective in order to maintain effective competition in this sector.

In the air passenger transport sector, international air fares between Central American countries are out of reach for most of the population, significantly impacting the ability of people to move around the region since there is no comparable travel alternative with other means of transportation. The sector is clearly dominated by two major companies (Avianca and Copa), which operate routes between the region’s cities as a monopoly or duopoly. Although the problem may be partially structural, regulations and administrative practices do tend to “protect” the installed operators from potential entrants. Moreover, the airports – essential facilities for the activity –
need investment for expanding and modernizing, along with clear, pro-competitive policies for allocating existing capacity. Other types of entry barriers may come from the strategic behaviour of the incumbent operators. Competition authorities need to pay special attention to agreements between airlines (Avianca and Copa have recently joined the same alliance) or between airlines and the travel agencies marketing their tickets, and to business concentration moves in the sector.

The problems of competition found in each sector, and the remedies proposed for resolving them, require the joint and coordinated efforts of NCAs, so regional cooperation on competition needs to be strengthened. To this respect, it does not seem essential, or even recommendable, to create a new institutional structure for the defence of competition at the regional level, independent of NCAs. Instead, this study recommends a structure formed by the sum of NCAs in operation – to take advantage of their own structures, knowledge, experience and know-how – on the basis of a new set of regional rules and regulations for setting up the necessary coordination mechanisms. The model, which proposes the region’s NCAs to jointly address problems with a regional scope, would improve the efficacy and efficiency of NCAs’ work to the benefit of Central American consumers and could be adopted in a relatively short space of time with limited financial investment.
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4. **Interviews Conducted in November 2013 in Costa Rica, El Salvador and Nicaragua**
# ANNEX 1: Central American banking system statistics

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<tr>
<th></th>
<th>No. of Banks</th>
<th>No. of Foreign Banks</th>
<th>% of Foreign Banks</th>
<th>Foreign Bank Share (% of Assets)</th>
<th>Shares of the 5 Largest Banks (% of Assets)</th>
<th>Inhab/Bank</th>
<th>Km²/Bank</th>
<th>Bank Assets (% of GDP)</th>
<th>Assets in Foreign Currency (% of Total Assets)</th>
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<td>Costa Rica</td>
<td>16</td>
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<td>292</td>
<td>3,194</td>
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<td>42.9</td>
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<td>11</td>
<td>84.6</td>
<td>91.6</td>
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<td>1,619</td>
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<td>11.9</td>
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<th></th>
<th>Loans (% of GDP) Dec 2012</th>
<th>Loans in Foreign Currency (% of Total Loans) Dec 2012</th>
<th>Borrowing Interest Rate (Domestic Currency) Dec 2012</th>
<th>Average Capital Adequacy Solvency (%)</th>
<th>Past Due Portfolio / Total Portfolio (%)</th>
<th>ROA Dec 12</th>
<th>ROE Dec 12</th>
<th>Underlying Intermediation Spread</th>
<th>Cash in Banks + Short-term Investments (% of Total Deposits) Dec 12</th>
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<td>8.9</td>
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<tr>
<td>Honduras</td>
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<tr>
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<tr>
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<td>0.7</td>
<td>1.7</td>
<td>9.1</td>
<td>4.2</td>
<td>50.9</td>
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</table>

Annex 2: Notes on the healthcare systems of countries in the Central American Region\textsuperscript{215}

Costa Rica

| Total spending on health per inhabitant in 2011: USD 1,330 |
| Total spending on health as a percentage of GDP in 2011: 10.9% |

For the purpose of achieving universal access, public health services have been provided since the 1990s by a single institution, the Costa Rican Social Security Institute (CCSS).

Funding comes from contributions by insured workers, employers and the State. Those who contribute to the system, their dependent family members, retirees and their dependents, and those who are not insured all have access to the public health system. In 1984, a modality was created for State-sponsored insurance that covers people who are too poor to pay for insurance under the other modalities. In 2011, the public health system covered 92\% of the population.

Costa Rican social security covers the immigrant population, especially with respect to emergency services, primary care and hospitalization for emergencies and childbirth (in 2011 the immigrant population accounted for 9\% of the total population). In 2010, a new immigration and alien affairs law took effect that established affiliation with the national health system as a requirement for regularization of immigration status.

The Advisory Commission for Drug Quality is charged with reviewing and proposing drug quality regulations and following up on enforcement of the Central American Technical Regulation on pharmaceutical products. Since 1982, CCSS has maintained an official list of medicines in accordance with the National Therapeutic Form.

The main challenge to the Costa Rican health system is the financial sustainability of CCSS. Waiting lists constitute one of the biggest inconveniences for users of the health services.

\textsuperscript{215} Information taken basically from:
- The WHO and PAHO websites
- The websites of the competent authorities in the countries, including National Health Models or Plans
- \textit{The Health Agenda for Central America and the Dominican Republic, 2009-2018}, approved at the Twenty-fourth Meeting of the Council of Ministers of Health of the Central American Integration System (COMISCA), Tegucigalpa, Honduras, January 30-31, 2009
El Salvador

| Total spending on health per inhabitant in 2011: USD 467 |
| Total spending on health as a percentage of GDP in 2011: 6.8% |

The public health system in El Salvador consists of the Ministry of Health (MINSAL), the Salvadoran Social Security Institute (ISSS), the Solidary Health Fund (FOSALUD), the Military Health Command (CSM), the Salvadoran Institute for Teachers’ Welfare (ISBM) and the Salvadoran Institute for Comprehensive Rehabilitation (ISRI). The private sector has both for-profit and not-for-profit institutions (hospitals, clinics and NGOs).

The country has 30 hospitals and a total of 747 USs (Health Units for outpatient care) and UCSFs (Community Family Health Units). MINSAL covers 74% of the population, ISSS 24%, ISBM 1.4%, CSM 1.3% and private health insurance less than 1%. In 2010, it is estimated that 40.9% of population were without comprehensive access to health care.

Private and out-of-pocket spending for the system has decreased significantly and public spending has increased, although public spending is still considered insufficient. In fact, the argument is that public health spending needs to increase in order to expand and consolidate the community and family care model in the Integrated Comprehensive Network of Health Services (RIISS) and move towards universal healthcare coverage.

Regarding the status of the health sector reform, government sources emphasized in October 2013 that there had been significant improvement of “public access to free medical services in rural areas, since in the last four years 5,000 doctors, nurses and other kinds of specialized personnel had been hired (…) and the number of health units had doubled from 377 to 692.” There has also been elimination of “voluntary payments”, which led to a 40% increase in the demand for medical services.”

The National Framework Policy for Medications, adopted on September 20, 2011 and published in the official journal on October 20 of that same year, highlights the main limitations of the Salvadoran health system, and more specifically, in public access to medications:

- The El Salvador national health system reform seeks to reduce the effects of highly fragmented services and population segmentation according to capacity of payment and insertion in the formal labour market, which leave a large group of the population excluded from social protection for health (…). 41.7% of the population has limited access to health services, and 78% have no public or private health insurance (…).
- A chronic shortage of medications in the public sector, together with high prices in the domestic pharmaceutical market, directly affect the household economy, considering that out-of-pocket expenditures in 2006 accounted for 62% of health spending. (…) exploration is needed of other alternatives for improving supply management and cost containment, such as direct imports, price negotiation, reference pricing, incentives for innovation and domestic production or specific importing of high-cost orphan drugs from limited sources of production.

- (...) weaknesses in (...) defining a single list of essential medicines.
- (...) The distribution chain affects the high prices of drugs (...). The cumulative margins of original brand medications reach, on average, 5,200%, and imported generic medications are up to 2,800% over the international reference price.”
- Institutional weaknesses make proper drug supply management difficult in the public sector – the State budget does not cover the actual need for drugs; the laws have weaknesses with respect to drug price regulation; the public procurement law was slowing the procurement process to up to 251 days, though the direct procurement modality introduced by the June 2011 reform will speed up the process; the Pharmacotherapy Committee has weaknesses; suitable staff are lacking; rational use of medications is lacking; there are weaknesses in information technology and the mechanisms for obtaining information; drug storage and distribution conditions are inadequate; operating standards are lacking; and a generalized “drug culture” exists where there is a drug for every symptom.
- Weaknesses in the regulations for evaluating documents submitted to the Registry and for evaluating drug safety and efficacy, and technological limitations for overseeing the quality of marketed drugs.
- Circulation of fraudulent, counterfeit or contraband medications, “since this type of product is found to varying degrees in most of the countries in the region and few countries have implemented energetic measures to reduce the problem.”
- The Health Code regulates the dispensing of medications with prescriptions, but prescriptions are not required for their purchase at pharmacies. Prescriptions have trade names rather than generic names. 39.3% of the population self-medicate or do not see a doctor when sick.
- There is no education on the responsible use of medications and the importance of sticking with the treatments.
- The staff at pharmacies are not suitably trained, either in the private or the public sector.
- Drug promotion and advertising is regulated, but there is no oversight of compliance.
- There is a practice of unethical incentives for the sale of medicines (office visitors, etc.).
- Official lists of medicines are used in public sector procurement, but to a lesser extent for prescribing and consuming.
Guatemala

<table>
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<tr>
<th>Total spending on health per inhabitant in 2011: USD 334</th>
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<tr>
<td>Total spending on health as a percentage of GDP in 2011: 6.7%</td>
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Different health subsystems exist with different finance models, aimed at different sectors of the population. The different subsystems and health units are not duly integrated; this has kept services and service quality from being standardized and resources from being efficiently allocated. The more sophisticated services have been concentrated in urban areas, where the percentage of wage earners is higher, to the detriment of more vulnerable, rural populations.

The Ministry of Public Health and Social Assistance (MSPAS) is the authority in control of the provision of health services. In 2011, a total of 31,829,903 doctor visits were made. 49.6% of healthcare corresponded to MSPAS, 15.7% to the Guatemalan Social Security Institute, which handles subscribers and retirees, 34.3% to the private sector, and 0.4% to the Ministries of Government and Defence.

Traditional indigenous medicine plays a pivotal role outside the health system, much more so than in other countries in Central America.

Public health funding is insufficient and focuses on the department of Guatemala and urban areas where living conditions are better, fuelling and maintaining the inequity between city and rural living. To increase coverage of the population, improve the infrastructure, maintain the current network and implement the projected network, and make the necessary investments in technology and research, MSPAS calculates three times its current percentage of the GDP and a narrowing of the gap between public and private spending on health will be needed.

The Ministry of Public Health is saddled with a huge debt, corresponding to 50% of the budget lines for drugs and surgical and medical equipment.

In December 31, 2011, 21% of the health areas were at drug supply levels of less than 65%, and 31% were below 85%. In 26 hospitals in the network (60%), the supplies of drugs and surgical and medical equipment were below 85%.
Honduras

Total spending on health per inhabitant in 2011: USD 351
Total spending on health as a percentage of GDP in 2011: 8.6%

The Honduran public health system includes the Secretariat of Health (SS) and the Honduran Social Security Institute (IHSS), as well as other public institutions that manage special insurance regimes (Armed Forces) or handle specific populations.

SS provides care to the entire population at its own facilities and with its own doctors and nurses; 60% of Hondurans are estimated to make regular use of these services. IHSS covers 40% of the economically active population employed in the formal sector and their dependents, that is, 18% of the total population. This institute is funded with worker and employer contributions and provides services to members, spouses and children under the age of 11 at private facilities, their own facilities, and those of the Secretariat of Labour and Social Security. The private sector handles some 5% of the population, particularly those with payment capacity. It is estimated that some 3% of the population has private insurance. An estimated 17% of Hondurans have no regular access to health services.

In 2010, the budget allocated to SS was slightly more than USD 530 million, with 76% coming from the national treasury, 11% from outside loans, 9% from donations and 4% from national debt relief. In that same year, IHSS was funded with USD 193.5 million from contributions by employers (between 2% and 5% of wages), employees (between 1% and 2.5%), and the State (0.5%).

In 2009, with the ILO’s support, a special progressive regime was set up for autonomous or independent workers or the voluntarily insured.

The 2010-2014 National Health Plan proposed an ambitious reform of the system that included the universalization of insurance and establishment of an integrated, pluralistic health system where SS would operate as the governing and regulating institution, with national public health insurance for the poor, and IHSS would operate exclusively as an insurer, contracting services for its members from public and private providers.

Through the General Office for Health Regulation, SS regulates the manufacturing, importing, marketing, distribution and consumption of medications and other health-related items. It also defines the maximum percentage of gross profit in the sale price of domestically produced drugs and an essential medicines list (CBM) for public institutions, which in 2011 included 397 active ingredients and 365 pharmaceutical preparations.

In 2002, the Office of the National Human Rights Commissioner reported that despite the 2001 Medications Law some 15,000 medications were circulating in the Honduran market in 2002, of which only 8,374 were registered.

SS’s purchase of medications is handled according to CBM by the Inter-institutional Medications Commission, created in 2006. IHSS, for its part, purchases medications in a centralized manner, separately from SS, according to its own list but in accord with SS’s CBM.

In 1991, SS implemented the Community Medications Fund for the purpose of achieving lower prices for people in outlying areas, with the support of various civil society organizations.
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

The drug regulations have been reformed and supervision of pharmaceutical establishments has notably improved. However, few pharmaceutical producers fully comply with Good Manufacturing Practices and problems persist in the supply of drugs for SS establishments that have led to reorganization of the entire system and particularly of inventory control and storage.

Nicaragua

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<tr>
<td>Total spending on health per inhabitant in 2011:</td>
<td>USD 296</td>
</tr>
<tr>
<td>Total spending on health as a percentage of GDP in 2011:</td>
<td>10.1%</td>
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The goal of the National Health Plan (2004-2015) is to guarantee the right and free, universal and equitable access to public health services.

The public health sector consists of the Ministry of Health (MINSA), the medical services of the Nicaraguan Army and the National Police, and the Nicaraguan Social Security Institute (INSS). The public and private sectors are poorly integrated and articulated. The Ministry of Health governs the health sector and is the main service provider. 65% of the population is covered by the Ministry of Health, 18% (members and their families) by INSS, 6% by the Ministry of the Interior and the Army, and 11% by private institutions. According to the National Institute of Development Information (INIDE), however, one-fourth of the population lacks access to any health system and probably spends out of pocket and/or uses traditional medicine.

The public health service network consists of 1,275 units, of which 32 are hospitals (acute- and chronic-care), 178 are health centres and 948 are health posts. 78% of these units have already had a useful lifetime of more than 40/50 years and sustain serious structural damage. 56% of the country’s homes are at least two hours away from the nearest health unit (6% are more than 5 hours away).

According to Badillo et al. (2009), health in Nicaragua is financed primarily through private funds, representing 53% of all expenditures. Public funds provide 36% and international cooperation provides 11% of total health spending.

In 2010 the public budget allocated to health was USD 211 million, 64.2% coming from treasury coffers, 11.8% from donations, and the rest from international donors such as the WB and the IDB.

INSS has tripartite funding: the State contributes with 0.25% of the wages of those actively insured in the comprehensive regimes, employers with 10% to 16% of the workers’ wages, and those actively insured with between 6.25% and 4.24% of their wages.

In 2010, INSS had 534,881 affiliates. The recipients (the directly insured, their children under the age of 12, and spouses – pregnancy and childbirth) represent 22% of the economically active population. INSS is the social security institution. In Nicaragua it is compulsory for wage earners to be insured for disability, old age and death, in addition to workers’ compensation. Health insurance affiliation is only compulsory for wage earners who live where INSS offers health services. INSS does not have its own medical infrastructure network but rather contracts services from both the public and private sectors and offers a basic basket of services to recipients.
Towards a Mechanism for Regional Enforcement of Competition Policy in Central America

The health sector's organization and operation is highly fragmented, with a network of establishments that are seriously limited in terms of structure and processes and an information system that consistently suffers from underreporting, all of which affects the Ministry of Health’s capacity and limits the exercise of its leadership.

Law 292 on medications and pharmacies, published in 1998, regulates the manufacture, distribution, importation, exportation, storage, promotion, experimentation, marketing, prescribing and dispensing of medications for human use, cosmetics and medical devices. This law also regulates the selection, evaluation and advertising of these products, in addition to their quality control, health registration and rational use. It also gives specific rules for the operation of pharmaceutical establishments, describes the owner and manager's responsibilities and defines the respective violations and punishments.

The medications market is characterized by a lack of controls over the importing, prescribing and retailing of drugs, influenced by the aggressive promotion of distributors and manufacturers, profit margins out of the control of the regulatory authority, and a lack of true competition in market prices, since the Ministry of Finance, Industry and Trade (MIFIC) sets the prices of each medication individually on the basis of the CIF price reported by the importer rather than in reference to the prices of equivalent products.

In addition, cultural factors and misinformation lead to the irrational use of medications by the public, encouraging the uncontrolled appearance of pharmacies and other points of sale in markets, supermarkets and corner stores. The national medications policy promotes free access to essential medications and the use of generics, according to the National Strategic Plan for the Rational Use of Medications. In this context, MINSA has developed CIMED for promoting the proper use of medications. CIMED focuses its efforts on producing and disseminating independent scientific, therapeutic and pharmaceutical information among decision-makers and prescribers and on strengthening their capacities and skills for identifying, evaluating and applying the best available biomedical evidence.

MINSA has a list of essential medications that it reviews every two years and publishes by the generic names. INSS has a basic obligatory list of medications that EMPs must provide to insured individuals.

Regulating the procurement and distribution of essential medications in MINSA are the Purchasing Unit, the CIPS and the Office for Health Supplies.

In 2010 there were 1,563 pharmacies. MINSA enforces the Law for Medications and Pharmacies.

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217 Some public hospitals in the MINSA network (in addition to the other two public hospitals, that of the Army and that of the Ministry of the Interior) have created what is known as Social Security Medical Companies (EMPs) for selling services to the Social Security Institute and the general public.
Panama

<table>
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<th>Total spending on health per inhabitant in 2011: USD 1,284</th>
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</thead>
<tbody>
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<td>Total spending on health as a percentage of GDP in 2011: 8.2%</td>
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Public health services are provided by the Ministry of Health (MINSA) and the Social Security Institute (CSS). CSS beneficiaries include the contributors and their spouses, parents and dependents up to the legal age (18 or up to 25, if they are duly shown to be students, as long as they have not become independent and are registered in the country's formal education system).

The demand for medical care exceeds the supply for certain specialized services, and there is a deficit of human resources in rural areas and various specialized areas of hospital care, which they are trying to correct with performance incentives and outsourcing. Initiatives are underway for modernizing management systems with more use of automation and communication technologies in CSS and MINSA services.

MINSA has been delegated a leadership role, but there is an overlap of functions among several institutions that act separately.

Some 33% of all health spending in 2011 is estimated to come out of the public's pocket, either for direct purchases (27%) or paying insurance (6%). The rest of the money comes from the social security system (24%) and MINSA (43%).

MINSA’s expenditures are basically financed by general taxes, while the CSS is financed by State funds (0.8% of wages and other bases for contributions from contributing affiliates), employees (9.25% plus a payment equivalent to 7.25% of one of the three items of the payment they receive for the thirteenth month pay), employers (12.25% plus 10.75% of the thirteenth month pay paid out plus payment for workers’ compensation), and independent workers and voluntary affiliates (8.5% of their declared monthly earnings for health and maternity insurance and 22% for the complete package that includes health and pension), in addition to revenue from the CSS’s own efforts.

CSS covered 80% of the population in 2011. The remaining 20% is the responsibility of MINSA, although MINSA also provides care for insured individuals, a total of 53% of the country's population.

At present the Official Medications List has more than 604 lines of medications for addressing the problems of those who are insured and 382 lines of medications for all those in the country who are not insured. In 2010, 75.14% of MINSA’s medications were in supply. In CSS, the medication shortage was reduced to 5-6% in September 2010.