

**PERSPECTIVES OF A FREE TRADE AGREEMENT BETWEEN GUATEMALA
AND CHINA**

By

Joel Delgado

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfillment of requirements

for the degree of

MASTER OF PUBLIC POLICY

2011

**PERSPECTIVES OF A FREE TRADE AGREEMENT
BETWEEN GUATEMALA AND CHINA**

By

Joel Delgado

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfillment of the requirements

for the degree of

MASTER OF PUBLIC POLICY

2011

**PERSPECTIVES OF A FREE TRADE AGREEMENT
BETWEEN GUATEMALA AND CHINA**

By

Joel Delgado

THESIS

Submitted to

KDI School of Public Policy and Management

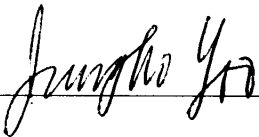
in partial fulfillment of the requirements

for the degree of

MASTER OF PUBLIC POLICY

Committee in charge:

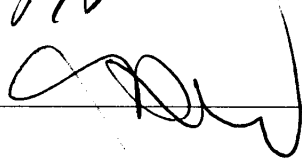
Professor Yoo, Jungho, Supervisor



Professor Ahn, Byung-Joon



Professor Lee, Sung-Joo



Approval as of December, 2011

Abstract

China is an emerging major player from which Guatemala could benefit by entering a free trade agreement to enjoy a preferential access to this important economy. However, it is important to consider that Guatemala has diplomatic relations with Taiwan, which is a thorn in China's eye, and supports the island's sovereignty.

Another of Guatemala's international trade priority is to complete the Central American regional economic integration. The region's integration efforts have led the Central American countries to engage in a joint negotiation process with prospective partners outside the region. But this requires Guatemala to perform a delicate balancing act in her trade negotiation with the Republic of China.

Before Guatemala engages in a negotiation with China, it has to consider the possible advantages and disadvantages that this decision could represent and how this would affect some key elements of Guatemala's trade and foreign policy like: the country's foreign policy principles; Guatemala's commitment with the Central American economic integration; the historical relation with Taiwan and Costa Rica's experience on their negotiation of a free trade agreement with China.

There could be another option for Guatemala and the key is the Economic Cooperation Framework Agreement that China has established with Taiwan, it might very well be the tool that Guatemala could use to improve its trade conditions with China without having to abandon Taiwan.

Acknowledgment

I want to thank God for the opportunities that he gave me all this year, especially the opportunity to meet wonderful people and friends, the opportunity to travel to this beautiful country and see more of this world.

I also want to thank my parents for their patience and their sacrifice of supporting my decisions even when this meant to be apart for a year.

I thank also the KDI School for the opportunity they gave me a chance to study in this wonderful institution and learn important lessons that, without any doubt, will help me to make a change in my country.

TABLE OF CONTENTS

I.	Introduction	1
II.	Guatemala's trade regime	4
	A. Guatemala's economic profile	4
	B. Guatemala's international trade policy	6
	C. The Central American Integration process	9
	D. Economic relation with China	10
	E. History of the diplomatic and economic relations with Taiwan	15
	F. Costa Rica's experience	18
III.	Guatemala's Policy Options	20
	A. Advantages	20
	B. Disadvantages	24
IV.	The Third Option: The establishment of relations with the economic zone created by the Economic Cooperation Framework Agreement between China and Taiwan	29
V.	Conclusions	30
VI.	Recommendations	34
VII.	References	36

LIST OF TABLES AND CHARTS

1. Table 1: The most important imports of Guatemala	5
2. Table 2: The most important exports of Guatemala	5
3. Table 3: Imports and Exports between Guatemala and China	11
4. Table 4: Guatemala's exports to China in detail	13
5. Table 5: Imports and Exports between Guatemala and Taiwan	17
6. Chart 1: History of Imports from China to Guatemala	22
7. Chart 2: History of Exports from Guatemala to China	23

I. Introduction

One of the priorities of Guatemala's trade policy, (Foreign Affairs Ministry 2007) is to engage in as many negotiations of free trade agreements as possible to improve its international trade. So far, Guatemala has signed free trade agreements with the United States, Mexico, Colombia, Chile, Panama, Taiwan and the European Union. At present, it is currently closing the negotiation with Canada, Peru and Ecuador.

As noted before, Taiwan is the only Asian country that has a Free Trade Agreement with Guatemala. However, in the rapidly developing international trade scene, China is emerging as a major player from which Guatemala could benefit by entering a free trade agreement, and thereby gaining preferential access to the latter's market.

Although a free trade agreement with China will definitely be beneficial in terms of economic transactions, the international political situation is much more complex. China is not like any other trade partner because of the conflicts the country has had with Guatemala in the past. In addition, Guatemala has no diplomatic relations with China. Currently, Guatemala has diplomatic relations with Taiwan, which is a thorn in China's eye, and supports the island's sovereignty. Guatemala is one of the 23 countries that have diplomatic relations with Taiwan. China is adamant in entering diplomatic relations with the countries that support Taiwan. This means that if Guatemala were to initiate negotiations for a free trade agreement with China, it may need to rethink its diplomatic relations with Taiwan.

Concomitantly, Guatemala's international trade priority is to complete the Central American regional economic integration. The region's integration efforts have led the Central American countries to engage in a joint negotiation process with prospective partners outside the region. This strategy has been used on the negotiations of the free trade agreement with

the United States and the European Union. The joint negotiation is the preferred method, but individual countries retain the right to negotiate separately with their prospective trade partners.

This dual mechanism —joint and individual— requires Guatemala to perform a delicate balancing act in its trade negotiation with the Republic of China.

What is equally complicating is the fact that of the 23 countries that support Taiwan, five of them are the countries from Central America. Historically, this situation has stirred a great deal of political stress not only to Guatemala but for the rest of the countries of Central America. Thus far, these Central American nations stand by their diplomatic commitment to Taiwan and historically have supported it all together (with the exception of Costa Rica).

The question that this thesis aims to answer is: Is this is a good time to think about negotiating a free trade agreement with China given the international, regional and national context in which Guatemala is conducting its national foreign trade policy?

In this study, I evaluate the pros and cons to give the reader an idea on some elements that have to be considered evaluating if Guatemala should negotiate a Free Trade Agreement with China at the present time, and face the consequences that this decision would signify such as: abandoning Taiwan´s side and supporting China´s claim to the Island; improving the trade conditions and benefiting from preferential treatment based on a free trade agreement but at the same time increasing the negative trade balance.

Or it could be better for Guatemala to wait a little longer and continue to support Taiwan while improving the economic and trade framework that could allow Guatemala to benefit in a greater extent when a Free Trade Agreement could be a reality.

And finally, explore the possibility of considering another option that will allow Guatemala to have a mixed position.

To analyze how the elements will affect Guatemala's international trade and foreign policy, it would be necessary to revise the current trade statistics between Guatemala and China, Guatemala's foreign policy objectives, the Central American integration process, the historical relation with Taiwan, and Costa Rica's experience on their negotiation of a free trade agreement with China, and finally to revise the possibility to use the existence of the Economic Cooperation Framework Agreement between China and Taiwan in Guatemala's favor.

II. Guatemala's Trade Regime

To identify the pros and cons of a possible free trade agreement with China, this section will describe the larger context of Guatemala's current trade regime to be able to understand the elements that inform a decision as important as this.

A. The Economic Profile of Guatemala

Guatemala is located to the south of Mexico, and to the west of El Salvador and Honduras. It has a population of over 14 million from which more than 11 million is economically active (National Statistics Institute 2010).

Guatemala has a GDP of approximately 37 billion dollars (International Monetary Fund 2010), and a commercial balance of more than \$10 billion US dollars, consisting of \$4,998,645,132 in exports and \$5,077,104,709 in imports (Secretaria de Integracion Economica Centroamericana 2010).

Guatemala had an economic growth of 4% in 2009, but it has a negative growth of -0.5% in 2010, owing largely to the current global financial crisis and global economic depression. (Guatemala's Central Bank 2009)

In 2009, the most important exports were coffee, sugar, coconuts, Brazilian nuts, combustible, water, pork grease, and bird grease.

The most important imports were solid combustibles, motors and electric generators, small nuclear reactors, tractors, and ethylene polymers. (Secretaria de Integracion Economica Centroamericana 2010)

The ten most important trade partners in 2009 in terms of imports (Secretaria de Integracion Economica Centroamericana 2010) were:

Table 1

COUNTRY	Imports 2009 (P)
	Valor
UNITED STATES	3,754,782,590
Mexico	1,069,504,704
El Salvador	543,051,459
People´s Republic of China	493,129,289
Costa Rica	389,493,901
Panamá	347,811,904
Aruba y Curazao,	329,773,606
Colombia	304,541,068
Honduras	240,454,480
Brasil	206,761,200
Total Selección	7,679,304,201

The ten most important trade partners in 2009 in terms of exports (Secretaria de Integracion Economica Centroamericana 2010) were:

Table 2

COUNTRY	Exports 2009 (P)
	Valor
UNITED STATES	1,271,385,861
El Salvador	766,600,371
Honduras	563,531,698
México	303,172,373
Costa Rica	283,126,544
Nicaragua	253,736,537
Panamá	143,189,888
Canadá	104,799,727
Japón	103,116,413
Netherland	96,234,076
Total Selección	3,888,893,488

It is important to highlight that the People´s Republic of China is among the 5 more important countries from which Guatemala imports goods as shown in the imports table.

B. International Trade Policy:

The International trade policy of Guatemala is structured on the basis of three key principles. All trade decisions have to be consistent with these principles (Ministry of Economy, Guatemala 2007).

1. **Competitiveness:** This is considered one of the most important elements for the country in order to improve the productive structure and the institutional framework that gives certainty to the business and attracts foreign investment. According to the World Bank Report Doing Business, Guatemala ranks number 100 on the ease of doing business, and that is one of the difficulties that the country faces to attract foreign business, and to have a competitive export sector (World Bank 2010).
2. **International Negotiations:** This has two objectives: access to international markets and the improvement of preferential conditions to the exports of the country.
3. **Consolidate the Central American Economic Integration.** The Central American Economic Integrations aims to establish a customs union between the countries of Central America to facilitate the trade between these countries. As part of these efforts, the Central American countries have established a joint procedure to negotiate free trade agreements as a region.

Guatemala also has established a set of goals that govern its international trade policy (Foreign Affairs Ministry 2007):

- **Free Trade Agreements** as tool to attract investments and improve the international trade.
- **The Central America Integration Process** which has led Guatemala to plan and execute its policies jointly or in consultation with other Central American countries.

Some critics against the current International Trade Policy:

As of today, Guatemala has a free trade agreement with Chile, Colombia, United States, Mexico, Panama, Dominican Republic, and Taiwan, consecutively. In addition, free trade negotiation is underway with Canada. A re-negotiation is also under way with the government of Mexico to renegotiate the free trade agreement.

Guatemala also has concluded a free trade agreement with the European Union in concert with other nations of Central America. This trade agreement was negotiated on a region-to-region basis (acan - efe 2010).

Despite the logic and usefulness of free trade agreements, the expected economic growth has not been realized yet.

For some analysts, much of the negotiation and approval of these free trade agreements have not been conducted with an economic goal in mind but with a political interest instead, especially neglecting the fact that the country is not fully prepared to reap the benefits that these free trade agreements present. (Centro de Investigaciones Nacionales 2008).

The reason for the lack of economic growth despite opening and liberalizing the trade through free trade agreements is the impediments that the country faces on taking advantage

of the opening. According to Ricardo Spross, (2007) the main impediments are weak negotiation position and the inefficiency of its implementing institutions.

To understand some of the weaknesses let us consider the superintendence of tributary administration which is in charge of the tariff collection and the application of the preferential conditions agreed on the treaties. As an example, it has been calculated that Guatemala's government is losing approximately \$886 millions in contraband and fiscal evasion (Prensa Libre 2009) and this represents a real harm to Guatemala's industries as well as a big threat to the national economy.

Even with the current demand of Guatemalan products, the country is not ready to respond to that demand. The Director of the Guatemalan association of exporters stated in a recent interview that there is not enough "exportable supply" (Bolaños 2011). She continued saying that among the possible exportable products, all of them are scarce. She noted that all of the demanded products come from the traditional offer of agricultural products, wood, and light industry. She describes one case in which the demand was of 30 to 40 tons and the export offer only reaches 10 to 15 tons which is not acceptable. Guatemala is currently losing these important business opportunities, something that will not improve by the simple fact of signing a free trade agreement.

Despite these weaknesses on the implementing institutions, there is a strong consensus that Guatemala has to still engage in the negotiation of free trade agreements that can be beneficial to expand its exports and diversify its export markets.

As earlier mentioned, Guatemala's government considers the international trade negotiations as part of the key elements for the economic development of the country (Foreign Affairs Ministry 2007).

C. The Central American Integration Process

The Central American integration process is another priority of the current government of Guatemala. Guatemala has historically supported the idea of a united Central America, and its efforts to accomplish this, has remained constant since the creation of the Central American Common Market in 1960.

Trade statistics show that the most important trade partners after the United States are the other Central American countries, with a combined export value of over US\$200 million and an import value of US\$150 million; while trade statistics that show positive trade balance (Secretaria de Integracion Economica Centroamericana 2010).

One of the important objectives of Guatemala's trade policy is the construction of the Central American economic integration (Foreign Affairs Ministry 2007) as a tool to diversify trade activities, to have better opportunities for economic growth, and to use the advantages presented by the trade facilitation provided by this regional integration.

The foreign policy outlined for the period 2007 – 2012 (Foreign Affairs Ministry 2007) considers the Central American integration process as one of the priorities for the country, and the main objectives of the process according to the vice minister of economy are the suppression of all restrictions to the regional trade, the distribution of tariffs paid by external trade partners, and the coordination of policies and institutions.

Guatemala, which is the biggest economy in the region, is one of the most active promoters of the integration and has tried to remain always in line with this desire (Foreign Affairs Ministry 2007). The foreign policy outline states that “The competent authorities are compelled to strengthen the Central American economic integration.”

This constitutes a foreign policy mandate that requires the country to promote and deepen the process in order to take advantage of this regional dimension to be able to open jointed opportunities with the rest of the world.

In October 2010, Guatemala's Congress approved an agreement that creates the Central American Custom Union, which shows Guatemala's real commitment to the integration process. Still pending is the approval of this agreement by Nicaragua and Costa Rica. Costa Rica has completed this procedure, but has not implemented the instrument to this date (Gramajo 2010).

In its foreign policy, Guatemala has set forth specific cornerstones by which to promote the Central American integration process, one of which is the resolution to promote and support the mechanism of joint international negotiations with the countries of Central America. This means that the members in the Union will present a unified front in external trade negotiations. Also, the outline affirms that the Central American countries will design and apply their foreign trade policies in consultation with the other member states of the Central American custom union.

D. Economic Relation with China

Guatemala does not have diplomatic relations with China, but that has not hindered the economic relations with the latter. This economic relationship is based primarily in trade transactions which have been conducted before 2001, according to the international market conditions and then improved by the addition of China to the World Trade Organization in 2001; thus the bilateral trade nowadays is conducted under the multilateral rules.

Since 1997 the trade relation with the people's Republic of China has been growing considerably.

The trade statistics (Secretaria de Integracion Economica Centroamericana 2010) are as follows:

Table 3.

Trade relations between Guatemala and the Republic of China between 1997 and 2009

Year	Imports in dollars	Exports in dollars	Trade balance
1997	5,919,544	282,010	5,637,534
1998	7,690,229	65,618	7,624,611
1999	9,695,001	140,613	9,554,388
2000	44,231,208	3,010,426	41,220,782
2001	46,287,419	452,583	45,834,836
2002	77,952,942	136,478	77,816,464
2003	85,452,237	3,516,840	81,935,397
2004	149,465,481	19,359,540	130,105,941
2005	218,235,363	35,833,952	182,401,411
2006	453,225,875	29,920,386	423,305,489
2007	590,849,991	54,173,829	536,676,162
2008	689,610,443	30,344,899	659,265,544
2009	493,129,289	28,781,977	464,347,312

China is becoming one of the most important trade partners to all the countries in the world, and consequently, it is also the case for Latin America.

China represents a market of 1.3 billion people and the second biggest economy in the world - an economy that is rapidly growing with an average annual growth of nearly two digits. China presents a strong economy even in the midst of the global economic recession - it has maintained an average economic growth of 8.7% in 2009 (Economic Commission for Latin America 2007).

China has a trade balance in its favor characterized by exports from Guatemala that consist mainly in natural resources or manufactures based on natural resources.

Even when the trade transactions have grown, Guatemala’s share in the Chinese market is still small. The total value for Guatemala’s exports, as seen in the previous table, to China is almost 29 million US dollars.

The most important products that Guatemala exports to China are products from the alimentary industry, vegetables and steel and its derivatives (Secretaria de Integracion Economica Centroamericana 2010).

Table 4
Guatemala’s exports to China

Cane sugar or beet sugar and chemically pure sucrose in solid state.	19,200,904
copper mattes, cement copper (precipitated copper)	3,042,836
Raw Aluminum	2,548,256
Motors and generators, electric, except electric	847,899
Polymer of ethylene in primary forms	795.694
Brute casting iron and spiegel in blocks or other primary forms	702,080

Articles of leather for all animals	193,079
Coffee, whether or not roasted or decaffeinated; shell coffee and skins; coffee substitutes containing coffee in any proportion.	184.037
Synthetic filament cables	181,323
Tractors	1401,088

Guatemala imports from china represent primarily manufactured products, especially those from the electronic sector; but there are other types of products as well, especially those that require low and intermediate technology. The total value for Guatemala ´s imports from China is more than 493 million of US dollars.

The most important products that Guatemala imports from China are products from the chemical sector, products derived from plastic and rubber, textiles, and the most important of all are electric machinery and small nuclear reactors (Secretaria de Integracion Economica Centroamericana 2010).

The WTO legal frame work since 2001 has allowed the trade relation with China to grow, though this growth has been characterized by a trade balance in favor of China Nevertheless, there are some disadvantages with the current conditions.

Disadvantages of the Current Framework

The present conditions of the multilateral trade system have improved over the years, and after eight successful negotiating rounds, the international trade has been clear of almost all tariff-based obstacles. This has helped to promote economic growth and prosperity to those who have been able to take advantage of this process of liberalizing the global trade.

However, things changed in the latest round; there was a realignment on the part of the members as the underdeveloped members started to question some of the multilateral rules and started to insist on including other issues like agriculture and better conditions for manufactured goods. The Doha Round has yet to be finalized and the perspectives for a conclusion are generally regarded as improbable.

Any improvement on the multilateral rules has to overcome this stall and in the case of the trade relations of Guatemala and China, it will have to be regulated under these conditions until the international trade system agrees on a new set of rules.

Another aspect that could affect the current trade conditions is the fact that Guatemala and China do not have diplomatic relations which presents a challenge in their bilateral trade relations because there is no possibility to establish diplomatic meetings in order to resolve any conflict that could arise between the parties.

The dispute settlement mechanism gives an opportunity during the consultations stage of the process, for the involved countries to answer any consultation that is given to them. In normal conditions, these consultations are answered through diplomatic channels, without them the communications become harder between the countries and have to establish other mechanisms with the intervention of the WTO.

This difficult the celerity of the procedures and in the case of Guatemala it raises the costs of the procedure in a way that is not affordable for the country and this in turn can make the dispute resolution a costly option and discourage the usage of this procedure, with the eventual consequence of affecting the trade relation between China and Guatemala.

E. History of the Diplomatic and Economic Relations with Taiwan

Guatemala's relation with Taiwan has been characterized by its support to the island struggle for its sovereignty, and at the same time the continuous tension with China which refuses to establish diplomatic relations with any country that supports Taiwan.

Guatemala has supported Taiwan ever since it has established diplomatic relations in 1960. It has been an ally of the island interests since the beginning of what has been called its unsettled international status.

In 1945, Japan surrendered all rights to the island of Formosa (former name of Taiwan) and left the island. After that, the Republic of China took control of the island and recognized it as part of the territories of China. Once this was done, and after losing the Chinese civil war, the government of the Republic of China moved to Taipei and claimed to be the only legitimate government of China over the Communist Party that ruled the mainland China. (Taiwan Affairs Office and the Information Office of the State Council 2009)

This relation has been maintained even at Guatemala's own cost. For example, in 1996, after 36 years of civil war, the country decided to end the war by signing a peace agreement between the rebel forces and the government to support the establishment of peace in the country. The UN resolved to send peacekeeping monitors that would verify the process of disarming the rebel forces. However, China as a permanent member of the UN's Security Council, exercised its veto right to cancel the UN resolution.

The justification given by the Chinese government as said by Shen Guofang, spokesman for the Chinese Government, was that: "Guatemala cannot expect on the one hand to do something that harms the sovereignty and territorial integrity of China while on the other hand requesting China to cooperate in peacekeeping" (Tyler 2007).

He added that this veto was mainly Guatemala's own fault, but that China could reconsider the veto in exchange for Guatemala's downgrading its relations with Taiwan and ceasing its support for Taiwan's re-entry into the United Nations.

This relation and support has been shared as well with the other countries of Central America, forming a regional support for the island. Nevertheless, in 2007, Costa Rica broke this alliance and cut all ties with the island in pursuit of the negotiation of a Free trade agreement with China (EFE, Costa Rica vuelve sus ojos a China atraído por el comercio 2007).

After this action, Taiwan feared a domino effect leading to a multiple abandonment of Taiwan by the Central American countries, in favor of China (EFE, Costa Rica vuelve sus ojos a China atraído por el comercio 2007). But it did not happen. In the midst of the announcement of Costa Rica's decision, one by one- Honduras, Nicaragua, Guatemala and El Salvador- ratified its support for Taiwan first individually, and after in a joint meeting, but they clarified that they were planning to improve and strengthen its commercial ties with China, on the basis of economic interest.

Today, this is still a concern for Taiwan. In September of 2010, the government of Honduras announced once more its support for the island after it signed an agreement with a Chinese state enterprise which will build a hydro- power plant project in the country. The government of Honduras, however, had to clarify that this does not mean the break of diplomatic relations with the island, and was strong in expressing that the government is not thinking about having diplomatic relations with China any time soon (EFE, Honduras descarta ruptura con Taiwan y relaciones diplomáticas con China 2010).

The commercial relation between Guatemala and Taiwan has existed since before 1995 but the importance of it grew just after signing a free trade agreement in 2005.

The trade statistics since 1994 (Secretaria de Integracion Economica Centroamericana 2010) are:

Table 5
Guatemala´s trade with Taiwan

Year	Imports in dollars	Exports in dollars	Trade Balance
1997	55,729,588	449,980	55,279,608
1998	72,421,636	868,348	71,553,288
1999	70,608,658	639,643	69,969,015
2000	59,104,675	5,604,414	53,500,261
2001	50,844,966	5,381,918	45,463,048
2002	69,624,791	4,665,700	64,959,091
2003	68,897,131	199,149	68,697,982
2004	89,149,558	1,638,629	87,510,929
2005	87,748,609	12,354,277	75,394,332
2006	110,075,013	12,838,480	97,236,533
2007	101,334,798	19,612,282	81,722,516
2008	84,360,316	19,909,550	64,450,766
2009	66,024,071	27,006,224	39,017,847

The free trade agreement with Taiwan was considered to have a strong political component over the possible economic benefits nevertheless the objectives exposed for it were purely economic, among them: To improve Taiwan's investment in Guatemala; to take advantage of both countries strategic geographical position; To increase Guatemala´s export of sugar, coffee and wood products (Ministry of Foreign Affairs 2006).

Guatemala was the second country in Latin America to have a Free Trade Agreement with Taiwan (2005) and the first in Central America then Nicaragua (2006), Honduras (2007) and El Salvador (2007) followed this move.

F. Costa Rica's Experience

Costa Rica as the other Central American country was part of the nations that supported Taiwan in their struggle to participate in the international forum. The relation was established in 1944 being the first among the Central American countries to established diplomatic relations. These diplomatic ties remained until 2007 when Costa Rica decided to cut all diplomatic ties with the island and decided to establish diplomatic relations with China.

In a press release on June 2007, President Oscar Arias explained the reasons that led to the decision by saying: “this is not a made on ideological basis or to geopolitics, it is a decision strictly based on a realist thinking, it’s a recognition of the importance of China as one of the most strong and important economies of the world.” (El nuevo diario 2007)

Taiwan’s reaction to this decision was to increase precautions in order to avoid China to woo more of its allies, the foreign minister said, he order all the embassies to “extreme precautions in that region to exercise intense against any further pressure by the Chinese communists” (New York times 2007)

It was feared by Taiwan that the other Central American countries would follow Costa Rica. But as the former Minister of Foreign Affairs of Nicaragua pointed in an interview, Costa Rica has always taken its decisions without consulting with any other country, in the interview he said: “The decision of Costa Rica won’t produce a domino effect on the other Central American countries. The decision was unilateral and hasn’t being consulted with the other central American countries... .. it has been common for Costa Rica to act in a separate way, it is not a surprise that (Costa Rica) this country takes a different road than the rest.” (AFP 2007)

After a year of that decision it was disclosed that Costa Rica and China will start the negotiations for a Free Trade Agreement. The idea of Costa Rica was to increase their share in the Asian market, as it was said by Costa Rica's ministry of commerce "We would make all efforts to improve our free trade agreement with the U.S and we will conclude an agreement with the EU but we recognize that the future lays in Asia" (La Nacion 2008).

It took six rounds of negotiation and in the year 2010, the Free Trade Agreement was signed by the countries in a meeting held in Beijing. Now the next step is to get the agreement approved by their national legislative bodies.

In the case of Costa Rica, the arguments in favor and against the agreement started as the agreement were presented to the national congress. For some, this agreement only satisfies the interest of the previous government and it does not represent generalized benefits for the entire sectors but only for a few of them, specially the "Intel factory". They argue that the economy was open having only one thing in mind, and that this agreement will stop the growth of the local industry. (Araya 2010)

For some, this agreement is just the door that opens the Costa Rican economy to China's influence. In 2010, it was planned that an agreement would be finalized that will allow the China National Petroleum Corporation to participate in the united exploration, fining and cooperation in the exploitation of oil which of course is one of the special needs of China--sources of energy is one of their national priorities.

According to the president of the chamber of commerce, 90% of the current trade between China and Costa Rica is being carried only by INTEL, and apart from that the trade relation is minimal. And from the 95% of the products included in the Agreement are under special labor laws which are under minimum standards that would force the Costa Rican enterprises to go into the informal sector.

III. Guatemala's Policy Options

In order to take advantage of the potential benefits of a trade relation between Guatemala and the People's Republic of China, Guatemala should evaluate the perspectives of negotiating a Free trade Agreement with China, or keep the trade relations under the multilateral rules of the World Trade Organization, which would mean that there still would not be a diplomatic relation between China and Guatemala. All the trade exchanges would be made under the general principles of the World Trade Organization, and in case of conflict, the countries would have to resort to the Dispute Settlement mechanism directly.

In this section, I will examine the advantages and disadvantages in negotiating a Free Trade Agreement between China and Guatemala. This analysis would be based on how the principal elements of Guatemala's Trade and Foreign policy would be improved or affected by this decision, specifically: the Central American Economic Integration process, the International Trade Agenda, the capacities of the International trade related institutions and the diplomatic relation and support to Taiwan. Finally this analysis will consider the experience of Costa Rica and what precautions Guatemala's might need to take in light of Costa Rica's experience and the fundamental differences between these countries motivations.

Decision to Negotiate a Free Trade Agreement with China.

A. Advantages

- **There can be preferential conditions for the trade of goods between Guatemala and China, allowing an increment in the imports and exports between the 2 countries.**

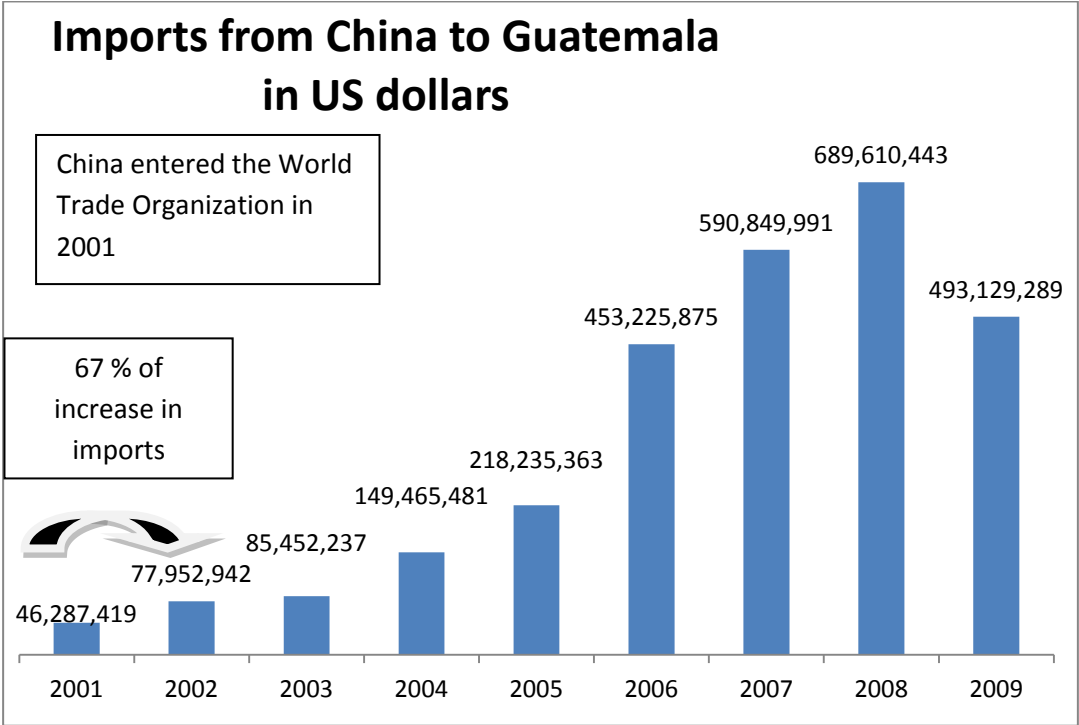
Applying a simple economic analysis, the perspectives of establishing a free trade agreement with China seems very attractive for Guatemala since this instrument can allow the country to have a preferential treatment for its products to access the biggest market of the world. So far the trade has been growing by reciprocally opening the market even more will facilitate the trade exchanges between the two countries.

The minimum that Guatemala has to target in the negotiation of a Free Trade Agreement with China should be the gradual and progressive liberalization of the trade on goods between the two countries, but with a consideration of asymmetries between the two economies. Apart from reducing tariffs, the free trade agreement should look to reduce non tariff barriers to the bilateral trade, the liberalization and improvement of the trade of services between the two countries, the improvement of the rules that can facilitate mutual investment between the two parties at the same time it has to include rules than can protect the investors of both parties as well as the promotion of Foreign Direct investment.

The benefits of a Free Trade Agreement will depend on what will be the result of the negotiation, but Guatemala would have to have at least a calculated improvement on its imports and exports to China of at least the one experienced after the entrance of China to the World Trade Organization.

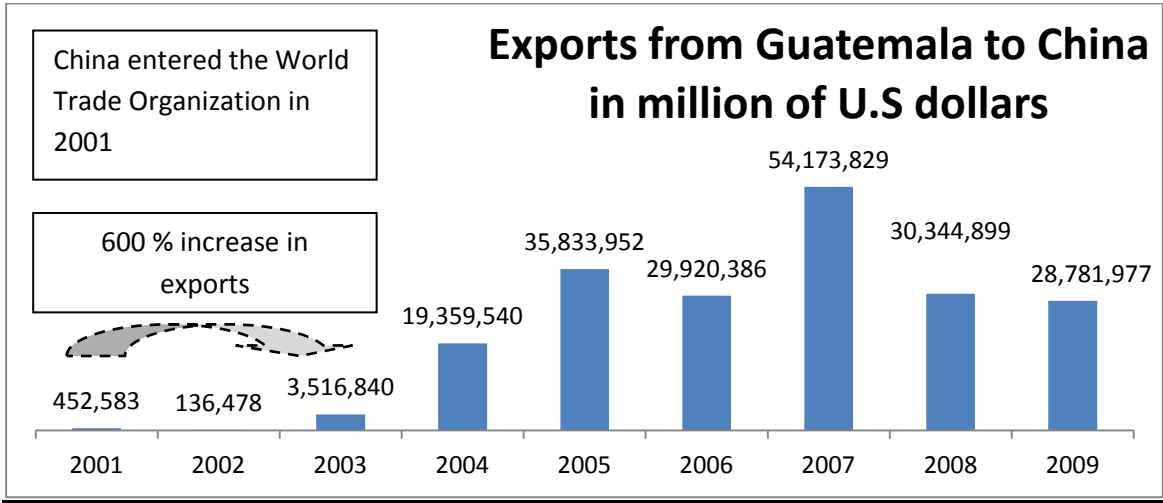
China entered the World Trade Organization in 2001 and with that, the general rules of trade applied; as it can be noted from the Table 2 of this work, the year before China entered the World Trade Organization 2001, the imports from China to Guatemala were of 46 million of US. Dollars. In 2002 it grew to 77 million and has grown in the years after that, the initial grow was of 67%.

Chart 1



In the case of the exports from Guatemala to China something interesting happened, in 2001: the exports were of 452,583 and in 2002 the exports were reduced to 136,478 and it wasn't until the year 2003 that the real benefit was felt. The exports rose all the way up to 3 million US dollars which meant an increase of more than 600%. It is important to notice that it has been growing since, peaking in 2007 at 54 million dollars but it has reduced again in 2009 with only 28 million dollars.

Chart 2



Applying this tendency of liberalization, the minimum that Guatemala could expect in the establishment of a Free Trade Agreement (considered as a second wave of liberalization of the bilateral trade), would be a starting increase of imports of 67%. In the case of the exports Guatemala could expect to benefit with a starting increase of at least 600%.

- **Guatemala could establish official diplomatic relations with China.**

As the experience of Costa Rica proves, one of the requirements that China asked to engage in the negotiations was that this country should cut all diplomatic ties with Taiwan, and formalize diplomatic relations with China.

The same requirement can be expected the same for Guatemala.

There are plenty of benefits to obtain by creating a diplomatic relation with China. This would mean the establishment of proper diplomatic channels for the bilateral communication in order to have a better mutual understanding and supporting mutual interests in different areas.

This way. Guatemala can create a good environment to set the necessary tools for a cooperative relation with China, in order to substitute the cooperation lost with cutting the diplomatic relations with Taiwan.

China could be a good source for official development assistance but the exact benefits are not clear at the moment. A better understanding of this can come after analyzing the aid received by Costa Rica and other countries years from now.

Another benefit of establishing a diplomatic relation with China is that Guatemala would enjoy the support of China as a permanent member of the United Nation´s Security Council.

B. Disadvantages

- **The preferential trade relation could exacerbate the trade imbalance between China and Guatemala.**

If the export structure and the capacity of the export sector doesn´t improve and develop, the current deficit in the trade with China could grow even bigger.

A free trade agreement between China and Guatemala could result in a more unbalanced trade. This would mean that this agreement would mostly represent benefit to the Asian country and the opportunity of opening the trade to this important partner could prove to be harmful to Guatemala´s economy or an opportunity wasted at the minimum.

For this agreement to represent clear benefits to Guatemala, the country must improve the nature of the bilateral trade in a way that can diversify the possible exporting offer; Guatemala has to offer to China some other products different than just raw materials, the trade offer from Guatemala has to be aiming to become part of the productive chain of China and stop basing the trade in just inter-trade products to participate in intra-trade exchanges.

- **The management of the free trade agreement could prove unrealizable for Guatemala's institutions pressuring an already deficient system.**

There is a continuous argument that affirms that one of the main reasons why the Free trade agreements have not produce enough positive results, is because the institutions in charge of managing and implementing the Free Trade Agreements are regarded as weak, corrupted and inefficient to manage the agreements.

Among those institutions two of them are in need of the most restructuring, the Department of Foreign Trade Administration and the Superintendence of Tax Administration.

According to Ricardo Spross a beneficial implementation of the free trade agreements in Guatemala, will require an upgrading of the following aspects in the Department of Foreign Trade Administration (Spross 2007): The implementation of a data base system in order to help the general public access the requirements for imports and exports; strengthening the coordination with other entities like the ministry of agriculture and finance; establishing one direct link to the data base of the customs services to be able to take optimal management decisions based on information regarding the balance of trade, quantity of exports, quantity of imports, volume and value of products; cross reference of data bases with the trade partners to identify potentialities on the international markets and real time controls of products at risk or threatened by sudden changes on the imports and exports behavior.

Improvement is also needed in the Superintendence of Tax Administration as well. A restructuring of this institution represents a big and most urgent challenge because nowadays the management of the current trade is proving too much to handle for this institution.

It has been calculated that Guatemala's government is losing approximately \$. 886 millions in contraband and fiscal evasion (Prensa Libre 2009) and this represents a real harm to Guatemala's industries as well as a big threat to the national economy.

Some measures that have to be taken according to Spross relates to: managing the preferential tariffs accordingly to the various regimes like, WTO, the central American integration and the rest of the Free trade agreements; Strengthening controls and response capacities to eliminate disloyal commerce practices that relates to exemptions and returns of customs tariffs; Publication of all measures that apply to imports and exports and the necessary complementing services in order to let the common citizen know their rights and obligations and fully use the preferential treatment; establish simplified but more efficient custom procedures (Spross 2007).

Without strengthening the institutions related to the implementation of free trade agreements, the signing of a free trade agreement with China could represent the total collapse of the system because not only of the importance of it but because the huge amounts of imports that could come by the liberalization.

- **Guatemala would have to follow the pressure of China into supporting their initiatives in the International arena.**

According to (Jiang May 2010) China's FTA policy making is based on their "good neighborly foreign policy" and their "economic diplomacy" which falls at the same time in between their global foreign policy agenda and foreign economy agenda.

He continues to say that it's a strategy of economic diplomacy which uses economic means to achieve foreign policy objectives, as well as the use of diplomacy to pursue economic benefits. "China's economic diplomacy consists of FTAs, foreign aid and investment, financial cooperation, resource diplomacy and other measures...."

As it happened with the experience of Costa Rica and Malawi (Jiang 2010) the cited author affirms that before engaging in a free trade agreement, the Chinese Ministry of Foreign Affairs assesses if the possible trade partner could or has offered a bilateral relation with

enough political trust. This political trust is often evaluated by the potential trade partner's view on some concerning issues for China like the tensions between China and Tibet, China and Taiwan or China's political system.

There is no reason to believe that China's approach on the negotiations for a Free Trade Agreement with Guatemala could be any different.

Based on these previous experiences and arguments, it is safe to say that Guatemala would have to cut the diplomatic relations with Taiwan and establish official diplomatic relations. But not only that, with these new channels and the economic relation becoming more entangled than before, China can always demand Guatemala's support to other initiatives in the international forum and advanced their political agenda by means of using economic pressures.

This would present a dilemma for Guatemala's foreign policy because some of the interests of China can contradict the interests of the United States which has been a historical and natural ally for Guatemala, and ally that has had considered the American continent as his exclusive influence area.

- **A decision like this taken unilaterally will distort the relation with Central America, affect the Central American economic integration process or cause a domino effect against Taiwan.**

Guatemala cannot take this decision in the same way Costa Rica did. It is not a unilateral decision to take. If Guatemala acts accordingly to its foreign policy principles it has to prioritize the jointed negotiations method and enter the negotiation of a free trade agreement with China only if the other Central American countries agree to do it.

But this would represent that Guatemala will have to lead the way for four countries (El Salvador, Honduras, Nicaragua) to leave the side of Taiwan and in this way turning from

being one of the historical supporters to practically initiate the domino effect against Taiwan's interests. This is also supported by the historical evidence of how the Central American countries decided to have a free trade agreement with Taiwan. First it was Guatemala and then the rest of the Central American countries.

If the other central American countries decide not to negotiate a free trade agreement with China and Guatemala goes through with the decision to do it; This decision without a doubt would be harmful for the regional efforts that Guatemala is trying to make and the natural consequence would be that the other central American countries will regard Guatemala as a country not interested in the regional integration therefore it can produce the interruption of this important process.

IV. Economic Cooperation Framework Agreement between China and Taiwan, a possible third option for Guatemala

This agreement seeks the establishment of beneficial conditions of trade between Taiwan and China improving the conditions of the multilateral rules therefore creating bilateral rules between the parties.

It has an overall view to serve as a cooperative mechanism that could help to improve the economic relations of Taiwan and China setting aside any political differences that could affect the trade flow.

The main goal it envisions is the reduction of the trade barriers and liberate the trade in goods between the parties.

Guatemala would have to try to get advantage exactly of the willingness of China to improve the bilateral relation with Taiwan even if the diplomatic conflict remains. Therefore Guatemala could explore the possibility to find another way to get into a beneficial bilateral relation with China, so instead of looking for a free trade agreement with China it might as well look to negotiate to enter as a party within this Agreement and propose that the three parties could benefit from this mechanism for economic cooperation. Another option Guatemala could explore it is the possibility to negotiate with the liberalized area this agreement is building, not entering as a party of this agreement but negotiating with the partners forming this area, being that Guatemala already has a free trade agreement with one of them (Taiwan) it could use this as a base to negotiate with China and Taiwan at the same time. Both of these options have to be more substantially explored.

The exact possibilities of this option would be better assessed years from now, for the moment, it appears to be another option that Guatemala has to evaluate, economically and diplomatically.

Conclusions

A. Guatemala has among its priorities in the international trade agenda, the negotiation of free trade agreements with its principal trade partners. In that sense Guatemala has successfully negotiated free trade agreements with Chile, Colombia, United States, Mexico, Panama, Dominican Republic and Taiwan and its closing negotiations with the EU and Peru.

B. China and Guatemala have a meaningful trade relation that is based on the multilateral rules of the World Trade Organization; trade that has been growing since 1997.

In the current conditions, the trade with China has surpassed the obstacle that is presented by the lack of diplomatic relations between Guatemala and China. With the increasing importance of China in the international economy Guatemala is faced with the option to negotiate a free trade agreement with this country that would certainly be beneficial.

C. If Guatemala would negotiate a Free Trade Agreement it could expect at least the increase in trade that enjoyed when China entered the World Trade Organization, therefore Guatemala could benefit from a starting increase in imports of at least 67% and a starting increase of 600%, these approximation is based on what happened with the former liberalization; a more precise figure has to be the result of a particular study of the economic benefits that could result after the negotiation.

D. The research question that this thesis aimed to answer was: what are the pros and cons of Guatemala's decision to pursue a free trade agreement with China? This was a necessary question to ask because although economically, the decision is regarded as beneficial, is not a simple decision to take, because of particular elements that have to be considered.

In order to establish the pros and cons of this decision, the thesis begins by looking at

elements such as: the country's foreign policy principles; Guatemala's commitment with the Central American Economic Integration; the historical relation with Taiwan and Costa Rica's experience on their negotiation of a Free trade agreement with China.

- E.** Guatemala's foreign policy principles include the evaluation of the country's competitiveness, international negotiations and primordially, the Central American Economic Integration. With respect of the competitiveness, Guatemala is deemed to have a weak institutional and export structure which is blamed in part for the lack of economic growth despite having free trade agreements already in force with very important trade partners.
- F.** Historically the Central American Economic Integration has been a permanent desire for Guatemala; today more than ever Guatemala is fully committed to this process, this principle is part of the foreign policy and is one of the priorities of the international trade policy. So far the countries members of the Central American region are the most important trade partner for Guatemala and the trade statistics reflect a continuous growth of this economic relation.

With this process in mind Guatemala has preferred the jointed procedure of negotiations between Central America and other trade partners outside the region like the EU and the United States instead of trying to negotiate alone; also Guatemala has stated that in taking any decision in the international arena, she will consult with the other Central American countries.

- G.** Guatemala has supported Taiwan struggle for sovereignty ever since they established diplomatic relations in 1960. Guatemala is one of 23 countries that support Taiwan and it is the relative biggest economy among its allies. Guatemala also has a free trade agreement with Taiwan but the trade relation has not grown or given enough benefits as it was expected.

The relationship that Guatemala has with Taiwan is the main reason why Guatemala does not have diplomatic relations with China. This is a sensitive topic for Guatemala and the foreign policy of China, having caused tense episodes between them especially in the United Nations. Fortunately that has not impede the growth of the bilateral trade to an extent that ironically has positioned China –without a free trade agreement – as an economically more attractive trade partner than Taiwan –with a free trade agreement-.

H. In 2007, Costa Rica decided to cut its diplomatic ties with Taiwan after a diplomatic relationship of more than 60 years in order to pursue the negotiation of a free trade agreement with China. The reasons for this decision were: To recognize the importance of China´s economy; to improve the growing and positive trade balance in favor of Costa Rica; to consolidate an energetic agreement between the Costa Rica´s National oil monopoly and China national Petroleum corporation.

Costa Rica took this decision without consulting the other Central American countries who are members of the Central American Economic Integration that together are trying to build. But that´s a behavior that doesn´t surprise anyone, and also doesn´t made anyone follow, as it was feared by Taiwan in that moment.

I. If Guatemala takes the decision to negotiate a free trade agreement with China the pros of this decision could be:

- i. The possibility to negotiate preferential conditions for the trade of goods between Guatemala and China. And the opening of Guatemala´s market to imports from China.
- ii. The trade conditions between the two countries can be improved even if the multilateral rules of the WTO don´t.
- iii. There can be a bilateral dispute settlement mechanism to settle any conflict that could arise between the two countries.

- iv. As a requirement previous to the negotiation Guatemala must establish official diplomatic relations with China.
- v. Guatemala will have the support of China especially in the United Nations as China is another of the permanent members of the Security Council.

J. There are some cons that Guatemala has to consider before taking this decision:

- i. The possibility that the preferential trade relation could exacerbate the trade imbalance between China and Guatemala.
- ii. The management of the free trade agreement could prove unrealizable for Guatemala's institutions pressuring an already deficient system.
- iii. Once the diplomatic relation is established, Guatemala would have to follow the pressure of China into supporting their initiatives in the International arena.
- iv. If the decision is taken unilaterally, this will distort the relation with Central America, affect the Central American economic integration process or cause a domino effect against Taiwan.
- v. In terms of the cooperation and aid received from Taiwan, Guatemala would lose all the benefits and the current projects would be left uncompleted.
- vi. The Economic Cooperation Framework Agreement between China and Taiwan could be a third option that Guatemala can explore because this agreement represents and improvement of the multilateral rules, and is a way to enter into a more beneficial economic relationship with China by entering this agreement as a party or negotiating with both Taiwan and China based on this Agreement, and all of this could be done if possible, without having to tackle the diplomatic issue and therefore having to choose between China and Taiwan.

Recommendations:

- a.* Before proceeding further with an ambitious international trade agenda based on the negotiation and signing of more free trade agreements, Guatemala should focus on improving the competitiveness of the export and institutional structure, in this way the country can be ready to take advantage of the trade opportunities given by the openness negotiated on the free trade agreements.

- b.* This thesis have gone through the research posing the question over the possibility of Guatemala negotiating a free trade agreement with China with the presumption, as it happened with Costa Rica, that the prerequisite is to cut diplomatic ties with Taiwan and end the support. But there can be a more advanced study that can contemplate the possibility of having the free trade agreement and still support Taiwan, all of this based on the following:
 - i.* Establishing a case study applying the tools of game theory to describe what can be the policies and tradeoffs that Guatemala has to exercise in order to enjoy the relation with both countries.
 - ii.* When the Central American Economic integration is more mature the negotiating power of these countries will increase.
 - iii.* Evaluate the possible strategies that Guatemala or Central America would have to apply in order to have an international stand similar to the one that the United States is exercising known as “active ambiguity” (Bush 2007) by which the United States adheres herself to the “one china principle” but doesn’t elaborate on her understanding of the concept and at the same time maintains diplomatic relations with China and cultural, economic and even military ties with Taiwan.

- iv. With the signing of a Economic Cooperation Framework Agreement between China and Taiwan there is a generalized belief (Chang 2010) that this will free the way to have negotiations of free trade agreements with the island without stressing China, so the countries that to does not have diplomatic relations with Taiwan can negotiate FTA´s without been concerned that by doing so they would offend Beijing, which opens another phase to a possibility of engaging in parallel economic relations with both China and Taiwan.

References

acan - efe. «SICA considera un hito historico acuerdo entre Europa y Centroamerica.» *Prensa Libre*, 18 de 05 de 2010: 45.

Araya, Jorge. «Costa Rica : Sectores industriales: TLC con China se condiciono a decisiones desafortunadas del gobierno.» *Bilaterals*, 2010.

Australian exporters assistance. «austrade.» may de 2010. <http://www.austrade.gov.au> (último acceso: 25 de november de 2010).

Bolaños, Rosa Maria. «"La oferta exportable es insuficiente".» *Prensa Libre*, 11 de june de 2011: 33.

Bush, Richard. «US - Taiwan relations - What is the problem?» *brookings.edu*. 03 de december de 2007. www.brookings.edu/speeches/2007/1203_taiwan_bush.aspx (último acceso: 25 de octubre de 2010).

Centro de Investigaciones Nacionales. *En busca de una agenda de comercio exterior*. Guatemala: CIEN, 2008.

Chang, Mike. «Bilaterals.org.» 21 de August de 2010. <http://www.bilaterals.org/spip.php?article17972&lang=en> (último acceso: 25 de october de 2010).

Economic Commission for Latin America. *Latin America, China and India: Towards a new economic coallition*. Santiago de Chile: United Nations, 2007.

EFE. *Costa Rica vuelve sus ojos a China atraido por el comercio*. San Jose, 07 de 06 de 2007.

EFE. *Honduras descarta ruptura con Taiwan y relaciones diplomaticas con China*. Tegucigalpa, 09 de 09 de 2010.

El nuevo diario. «Costa Rica breaks its relation with Taiwan.» *Arias establece relaciones con china*, 07 de junio de 2007: 25 .

Foreign Affairs Ministry. «Outline of Guatemala´s External policy 2007 - 2012.» Public Policy, Guatemala, 2007.

Gramajo, Urrias Moises. «The Costum Union advances.» *Prensa Libre*, 05 de 10 de 2010: 37.

Guatemala´s Central Bank. *Study of the national Economy 2009*. Guatemala: Banco de Guatemala, 2009.

International Monetary Fund. *International monetary fund*. 2010. www.imf.org (último acceso: 05 de october de 2010).

Jiang, Yang. «China's pursuit of free trade agreement: Is China exceptional?» *Review of International Political Economy* 17:2, May 2010: 238 - 261.

La Nación. «Ronda de negociaciones con China .» diciembre de 2008.

Ministry of Economy, Guatemala. «International Trade Policy.» Public Policy, Guatemala, 2007.

Ministry of Foreign Affairs. «Gobiernos de Guatemala y Taiwan suscriben documentos de ratificación de tratado de libre comercio.» *Comunicado 062 - 2006*. Guatemala: MINEX, 2006. 1 - 2.

New York times. «Taiwan cuts ties with Costa Rica over recognition for Taiwan.» 9 de June de 2007.

Prensa Libre. «Contrabando y defraudación le costarán al fisco de Guatemala.» 13 de October de 2009.

Secretaría de Integración Económica Centroamericana. *Secretaría de Integración económica centroamericana*. 2010. www.sieca.int (último acceso: 05 de October de 2010).

Spross, Jose Fernando. *CAFTA: Proposal for an effective application in Guatemala*. Seoul: KDI School, 2007.

Taiwan Affairs Office and the Information Office of the State Council. «Taiwan Affairs Office of the State Council.» 2009. www.gwytb.gov.cn (último acceso: 05 de 10 de 2010).

Tyler, Patrick E. *China Asserts Taiwan's Ties To Guatemala Led to Veto*. New York, 12 de 01 de 2007.

World Bank. *Doing business*. Report, International Finance Corporation, 2010.