

CENTRAL AMERICA: INDUSTRIAL POLICY PROBLEMS*

INTRODUCTORY NOTE

During the fifth extraordinary session of the Central American Economic Council, held at Guatemala City in August 1963, the Ministers for Economic Affairs, after discussing questions related to the industrialization policy that has been followed within the Common Market, decided to devote a meeting early in 1964 exclusively to consideration of the main problems facing economic integration in this sphere. The present text presents some background data and criteria on which such an analysis could be based.

It seems the right moment to examine the form and measure in which economic integration objectives are materializing in so far as industrial development is concerned, and the extent to which the Common Market is being provided with its own bases of production capacity that will make the most of the incentives and opportunities created by free trade, customs tariff equalization and the other instruments established for that purpose. Such a study would make it easier for Governments to formulate guiding principles as to the best way of consolidating what has already been achieved, overcoming difficulties and forging ahead to the attainment of new goals.

In this context, reference is first made to the chief legal and institutional instruments on which Central America's industrial policy rests, and the most important of the principles and objectives that shape this policy

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are formulated, on the basis of the texts of the treaties that have been signed.

Secondly, consideration is given to the five countries' more pronounced industrial growth trends during the fifties and to the significance of the Central American Common Market for their future development. On this basis, general lines are laid down for industrialization within the regional economic unit, with emphasis on the need for specialization and modernization of the traditional industries and, primarily, for the promotion of basic industries manufacturing capital goods and intermediate products.

Attention is then drawn to the necessity of applying the existing instruments of Central America's industrial policy in new ways, through the organization of a promotional effort of completely regional scope. Initially, this effort should pursue the establishment of basic industries for the expansion of the Common Market on the manufacturing side, to which end a series of measures is suggested in connexion with the determination of these branches of industry, the presentation of projects by private enterprise, feasibility studies and the preparation of specific projects, while proposals are also put forward regarding the various activities that should be undertaken, on a co-ordinated basis, by ICAITI, the Central American Bank and SIECA.

Lastly, as a special case, the problems affecting the assembly industries are analysed, including the conditions that should be sought for their establishment and the different kinds of provisions it would be well to include in the additional protocol contemplated in the Central American Agreement on Tax Incentives to Industrial Development.

I. INDUSTRIAL POLICY IN CENTRAL AMERICA

The Central American countries have made an appreciable effort, under the economic integration programme, to promote the industrialization of their economies. At the same time, advantage has been taken of this effort to embark on the formulation of a policy of regional scope, embodying clear guiding principles as to the industrialization pattern it is sought to promote, and supported by a set of legal and institutional instruments for putting it into effect. The aim is to remedy shortcomings in national industrial policies, relating particularly to their lack of standardization, their want of clearly-defined objectives and the indiscriminate way in which they have been applied, as well as to the limitations of the instruments hitherto in existence—especially tariff protection and tax exemption—and the scantiness of the resources channelled into industrialization.

1. *Principal instruments*

The principal legal instruments of Central America's industrial policy thus far established by the Governments are the agreements providing for free trade, a common tariff in respect of imports from the rest of the world, a uniform régime of tax incentives, and the régime for integration industries (and the first Protocol thereto); the tariff provisions relating to milk products contained in a Protocol to the Central American Agreement on Equalization of Import Duties and Charges; and the special tariff system for the promotion of industrial activity. Free trade, tariff equalization and the integration industries régime are already in force, but not the uniform régime of tax incentives, the special tariff system and the first Protocol to the Agreement on the

Régime for Central American Integration Industries. Moreover, an additional protocol on the tax incentives and trade system that are to be applied to products of the assembly industries within the Central American Common Market is envisaged, and is awaiting negotiation, formulation and adoption.

The Central American Research Institute for Industry (ICAITI) and the Central American Bank for Economic Integration (BCIE) are likewise two basic institutions for the implementation of industrial policy in the area. The former has been in operation since 1955, and the latter since 1961.

2. Principles and objectives

Through this series of legal and institutional instruments the Central American Governments are pursuing the joint industrialization of their economies in the form of a single system of regional scope. They all furnish important incentives whereby the action of private enterprise can be usefully oriented towards manufacturing activities that need to be established, strengthened or expanded. The general instruments—providing for a free-trade area and a uniform import tariff—create a favourable climate for industrial progress in various directions. Those of a selective nature—the Agreement on the Régime for Central American Integration Industries and the BCIE—within the framework of the Common Market, provide powerful incentives for transforming the existing industrial structure through the establishment of industries with considerable capacity and advanced and complex technology, and by adapting the established lines of manufacture to the possibilities opened up by economic integration as regards larger-scale production, specialization, and modernization in respect of machinery and equipment.

(a) Structure of industry

Step by step, the existing Central American treaties have defined the structure of industry it is sought to establish in the area. As a general principle, the criteria followed in the formulation of a uniform tariff aim at encouraging domestic production, and at facilitating purchases abroad of the raw materials, intermediate products and capital goods that are needed for industry and cannot be produced in the area. The régime for Central American integration industries, for its part, is designed to promote the installation of branches of industry whose technical characteristics and minimum plant size are such that they require access to the Central American Common Market in order to become firmly established and operate on an economic footing. Under the Central American Agreement on Tax Incentives to Industrial Development, in turn, State action mainly favours industries producing capital goods and raw materials, and those utilizing a high proportion of labour, raw materials, semi-manufactured products and containers of Central American origin. Lastly, the fact that

BCIE's operations may be concerned only with integration projects or projects of direct regional interest decisively channels Central American financial resources precisely into the type of manufacturing activities mentioned above.

(b) *Balanced development*

The uniform import tariff and the Central American Agreement on Tax Incentives to Industrial Development also provide for equalization with a view to preventing productive activity from being located in certain countries in response to disparities stemming from artificial factors—for example, varying levels of tariff duties and different tax rates and benefits—rather than because of disparities in real costs. The régime for integration industries, for its part, is designed to ensure that the basic industries at least are always located in such economic conditions as will guarantee the viability and profitability of investments, which will be so distributed that each of the five countries takes a share. In addition, BCIE's action is calculated to help reduce the disparities now existing between them as regards the relative stage of development of their economic infrastructure. As far as industrialization itself is concerned, a similar purpose is served by the provision contained in the Central American agreement on tax incentives which empowers two countries to extend certain benefits over longer periods than the others.

(c) *Competitive conditions*

The purpose of the Central American Governments in forming the Common Market has been to lay the foundations for a broadly competitive economic system within the area that will establish conditions making for technical progress, increased productivity, improved quality, and lower costs and prices. On the other hand, in the case of industries which, owing to their technical and economic characteristics and the as yet relatively small size of the Common Market, are likely to install only one plant, or very few, such instruments as the industries régime and the customs tariff itself afford means of safeguarding the interests of the consumer. Thus it should always be possible to obtain satisfactory conditions as to price, quality and supply, even where the structure of production is not competitive. What is more, the Central American Economic Co-operation Committee, in resolution 115 (CCE), declared "practices, arrangements or agreements among commercial or industrial enterprises tending to restrict competition or limit trade among the Central American countries" members of the Common Market to be at variance with the aims of economic integration, and requested the ECLA secretariat and SIECA to undertake the necessary research and studies for the formulation of a draft protocol to the General Treaty defining the practices in question and establishing the penalties and measures applicable in such cases.

II. GENERAL FEATURES OF INDUSTRIALIZATION WITHIN THE COMMON MARKET

1. *Industrial development and economic integration in 1950-1960*

The economic integration measures adopted by the Central American Governments during the previous

decade, coupled with the favourable conditions under which the purchasing power of exports to the rest of the world developed in the early post-war years, helped to bring about an industrialization process presenting sat-

isfactory characteristics in several respects. In so far as the first factor is concerned, the market expansion achieved through the system of bilateral free-trade treaties and the raising of import tariffs at the national level led to a sustained rate of growth of industrial investment which consistently exceeded that of total investment, while at the same time the idle production capacity in this sector decreased.

Industrial production was thus able to expand at an appreciably higher rate than the economy as a whole, and trade in manufactured goods became the most dynamic element in a process of inter-Central American trade which, in the aggregate, likewise grew rapidly. These two factors kept the percentage share of the value of imports in the area's total consumption of industrial products at a fairly steady level, and probably also helped to stave off the even heavier pressures which demand for imports would otherwise have exerted on the balance of payments.

However, up to 1960 the stimulus deriving from the expansion of the available market through free-trade treaties had not yet been sufficient to promote a change of the manufacturing sector which, by its nature and scope, could lay the bases of an economic development process founded on industrialization.¹ Throughout the period in question the internal structure of industry registered no important changes, and continued to rest mainly on a few traditional activities—foods, beverages, tobacco, clothing, textiles, wood and furniture—which represented a virtually unvarying proportion (approximately 85 per cent) of the sector's total value added. Moreover, there was practically no increase in the industrial sector's share in Central America's total production, notwithstanding the growth recorded; nor was there any appreciable reduction in the percentage of total consumption of manufactured goods covered by imports. The explanation of this lies in the initial smallness of the manufacturing sector within the economy as a whole.

The absence of any over-all import substitution process is therefore clear, if this is taken to mean satisfying demand with increasing proportions of domestic production. Save in the textile industry—where the share of production in domestic supply rose from 30 to over 50 per cent—in almost all the other branches manufacturing final consumer goods the proportion of imports remained at practically the same level, increasing slightly in the case of durable consumer goods, intermediate products and capital goods.

2. *The Common Market as the base for transforming national industrialization patterns*

The existing structure of industry in the Central American countries owes its formation to the development of manufacturing activity within the context of domestic markets which are narrow on account of both low per capita income levels and numerically small populations. In this respect, the bilateral treaty system had the effect of considerably broadening the individual country markets, without, however, succeeding in giving them a different and completely regional dimension. Thus

the main branches of activity in existence are in fact the only ones it has been possible to establish on the basis of such markets. Moreover, the degree of import substitution achieved is probably the most that can be expected within that pattern of industrial development. The narrowness of the markets often meant that the limited production possibilities were utilized in plants of less than economic size, besides giving rise to duplication of investment and the existence of idle capacity.

With the Common Market, however, the Central American Governments have given available demand that regional dimension which the very nature of the bilateral treaties precluded, and have thereby created the conditions necessary for beginning the transformation of five circumscribed structures of manufacturing industry into a unified industrial system within the framework of the Central American economy as a whole. These new conditions now make it possible to organize the traditional industries on more economic bases, and thus to eliminate the unfavourable characteristics resulting from their establishment at a mainly national level. Furthermore, they permit the development of a series of new productive activities whose installation had previously not been feasible for want, *inter alia*, of a sufficiently wide market.

Some of these changes have already begun to take shape. A new spirit of enterprise is evident within the Common Market, actively directed towards making the most of the trade opportunities and the favourable conditions for industrial investment which it offers. Thus, a start has already been made, or is about to be made, on such non-traditional lines of production as tires, metal structures, copper cable and wire, caustic soda and chlorine, insecticides and fertilizers, petroleum products and other raw materials for the chemicals industry.

Nevertheless, Central America's industrialization process is dependent not only upon the Common Market but also upon a network of measures, likewise of regional scope, which will have to be implemented on the supply side, inasmuch as exploitation of the industrial development possibilities that have been created calls for a good deal of co-ordination, technical assistance and financing which may or may not materialize spontaneously within the Common Market. The satisfaction of these requirements should therefore be sought by supplementary means, in order to ensure the early realization of the development aims pursued.

To these requisites must be added the demands made by economic development on industrialization, in view of the none-too-favourable outlook for traditional export activities. According to a number of studies, the immediate prospects for the expansion of these exports to the rest of the world are limited on the whole, whether intrinsically or in relation to development needs, since their rates of growth will probably fluctuate between 2 and 4 per cent annually. On this basis, provisional estimates indicate that even the attainment of the comparatively modest annual growth rate of 2.5 per cent in the per capita gross product—as laid down in the Charter of Punta del Este—would entail the expansion of the industrial sector at a rapid and sustained rate, and the share of domestic production in internal supply would have to be substantially increased, by

¹The cumulative growth rate of the per capita gross domestic product in the fifties was barely 0.6 per cent annually.

means of a net industrial investment of some \$1 000 million over a period of ten years.²

3. *Development of industries manufacturing consumer goods*

The production of manufactured consumer goods will have to play a major part in the development of the Central American Common Market. The provisional estimates based on the above-mentioned calculations indicate that of the increase of nearly \$980 million that industrial output would have to achieve between 1960 and 1970, approximately two thirds of \$658 million would correspond to this type of product. The attainment of such large increments would necessitate, *inter alia*, taking the maximum advantage of the opportunities afforded by the recently established regional market base. In the case of traditional industries, this would involve plant specialization, modernization of machinery and equipment, and expansion of plant capacity to more economic dimensions. Productivity could thus be improved, and consumers could be guaranteed prices more in line with their income levels. At the same time, available capacity could be more efficiently utilized, and the import substitution process could be intensified.

Such tasks pose problems of an eminently regional nature, whose solution calls for the co-operation both of member Governments and of producers already established in the different countries. Plant specialization in any given country, for example, will clearly depend on the decisions adopted in that field by enterprises situated in the rest of the Common Market area. Furthermore, investment in additional production capacity within the industries in question should also be determined from the standpoint of the area as a whole, in the light of requirements that could not be met through specialization and modernization programmes. Thus, the future growth of these activities, instead of resulting in wastage of the substantial investment already placed in them, would have to be founded on the transformation, modernization and expansion of the available production base.

Demand for consumer goods could not be satisfied on the basis of the existing industrial structure, owing to its under-diversification and its concentration in a limited number of light industries. Moreover, the satisfaction of such demand will necessitate giving continued impetus to direct import substitution in respect of all those additional items where it may prove feasible because of the size of the market and because prevailing conditions justify it from the standpoint of supply. It should be stressed that the limitations noted so far in the industrialization process are related to the lack of dynamism of its principal components, imputable not only to the fact that they are directed towards satisfying

the needs of the lower income sectors, but also to the circumstance that, having succeeded in covering large proportions of domestic supply in certain cases, they find few additional incentives to expansion in import substitution.

Production of consumer goods not currently manufactured in Central America would help to modify the trends towards balance-of-payments disequilibrium deriving from the conditions under which traditional exports must continue to develop, and from the growing import requirements generated by the economic development process itself. The same would be true of specialization and the introduction of new techniques in traditional industries, since such a process would enable Central America's production to meet a higher proportion of its needs.

4. *Need to diversify Central America's industrial base*

Were industrialization to continue to concentrate on the production of consumer goods, unilaterally maintaining the traditional pattern, its development possibilities would be somewhat restricted. Except where demand increases as a result of cost and price reductions due to the modernization of established industries, unless radical changes are effected in the distribution of wealth and income such branches of activity will expand comparatively slowly in relation to population growth and the income generated by agricultural exports.

Moreover, the basic conditions of industrialization in the confines of the individual country markets have given rise to an incomplete import substitution process, which is unquestionably inadequate in its response to regional demand, and within which there has been considerable need for external purchases of raw materials, intermediate products and capital goods. This partly explains the sector's inability to provide the necessary impetus for an integrated economic development process. Even when traditional exports were developing along favourable lines, the income increments that derived, for instance, from higher prices or bigger sales abroad resulted in proportionally larger increases in imports than in purchases of goods produced in Central America, both to meet the demand for consumer goods not produced locally and to satisfy the input requirements of established industries. If this situation were to remain unchanged in Central America, the limitations of the capacity to import—which, as noted above, are bound to continue in evidence—might well obstruct even the growth possibilities of consumer goods industries.

Obviously, therefore, in order to attain the rate of industrialization required, investment would have to be channelled towards the establishment of activities distinct from those producing consumer goods, and, in so far as the latter are concerned, towards the creation of supply conditions in respect of the requisite production factors different from those hitherto characterizing their development. These two questions are closely related, since such new branches of industry are none other than those manufacturing capital goods and intermediate products—for example, caustic soda, sulphuric acid, pulp and paper, rayon fibre, insecticides, fertilizers, tires, cement, rubber, steel, glass, petroleum products and plastics—and the element of difference in the new growth pattern of industries manufacturing consumer goods would in fact be the use of inputs of Central American

² This means, on an average, net annual investment in the manufacturing sector—which in 1960 reached the figure of \$45 million—will have to be doubled, or in other words, that its annual amount will have to be increased until a sum in the neighbourhood of \$140 million is reached by the end of the ten years. The foregoing estimates are based on projections of industrial demand derived, branch by branch, from the over-all growth target and from the relevant income-elasticity coefficients of demand. On the basis of these projections, and of the import capacity envisaged, the increment required in domestic production was calculated residually. The amount of net investment was then estimated with the aid of coefficients applicable to the product-capital ratio, by branches of industry.

origin, in addition to the processes of specialization and improvement of techniques referred to earlier.

Production of capital and intermediate goods in Central America will provide a source of such inputs, enable better advantage to be taken of the incentives to domestic production deriving from increased demand, and facilitate the expansion of import substitution, which thus far has been limited to final consumer goods and will now also include the products used in their manufacture. No less important are the growth prospects opening up for these industries in terms of the use of their products in such other sectors of the economy as agriculture, the building industry and public works. The studies carried out to date suggest that these possibilities may be even more significant for Central America in the ensuing stages of its development.

All these factors—specialization and modernization of traditional industries, the establishment of new industries manufacturing consumer goods and the impetus to production of capital and intermediate goods—would make substantial contributions to the gradual linking-up of the existing domestic manufacturing sectors in a system of regional scope and would provide the production base needed for the continued growth of inter-Central American trade. As regards this second point, it is clear that once the additional demand for consumer goods created by free trade and tariff equalization is exhausted, any rapid expansion of trade would have to be accompanied by diversification of its present composition.

5. Development of basic industries

It is the activities producing capital and intermediate goods that are referred to here as basic industries: basic in the sense that they create material conditions conducive to the development of the manufacturing sector and that, properly founded upon utilization of the area's own natural resources, they free economic activity in other fields, such as those mentioned above, from the handicaps that might stem from a limited capacity to import the industrial inputs required.

The basic nature of these industries derives from relations of interdependence that link them with one another and with other branches of industry and sectors of production. Their products are utilized in a series of allied and collateral activities, from which they themselves obtain a considerable proportion of the factors of production they need. Thus, the growth of any one component will have favourable repercussions on the rest, through an increase in demand for their products or lower prices and better supply conditions in respect of their input requirements. Instead of petering out in a single phase, the industrialization that might be achieved as the result of an expansion of demand—whether this were due to increased export earnings or, as in Central America, to the establishment of the Common Market—would become a much longer process, and would branch out into new phases and other productive activities.

Just as important as these industries' entry into production is their establishment in satisfactory conditions as to size, location, techniques and the composition of output itself. In practice, these conditions are determinants of the pattern to be followed by the industrial sector's subsequent growth. For example, the adoption of relatively out-of-date processes or the selection of unduly small plant sizes in the basic branches of industry

might result in low levels of efficiency and in increases in costs that would tend to hinder the establishment of collateral activities, to reduce the expansion possibilities of those already in existence and to weaken the competitive position vis-à-vis other countries.

Accordingly, it is necessary to select groups of industries in which the installation of a factory will create conditions favouring the emergence of others, which in turn will tend to strengthen the position of those preceding them, thus forming a nucleus of vigorous growth. The separate evaluation of an individual technique or production process may, therefore, lead to mistaken conclusions, if account is not taken of the whole combination of advantages deriving from a series of complementary activities. Industrial complexes provide a clear illustration of this point. Thus, for example, while the decision to install a refinery of a given capacity, based on certain technical processes, may seem unimportant if considered unilaterally, the outlook might change radically if the project were analysed as a possible focal point for the growth of a range of allied activities geared to the Common Market.

Industrialized areas whose structure of production has reached a high level of diversification and complementarity are in a good position to facilitate the investment process by virtue of the fact that the new plants or projects established can benefit forthwith from the favourable conditions created by earlier investment. The situation is different in the developing countries, where a predominant feature is the weakness of the links between different sectors and branches of activity. Hence it is that the promotion of complementary enterprises and activities is of major importance, often an essential requisite for the placing of investment. This is particularly valid for the Central American industrial sector, since the characteristics of the individual country markets have precluded the establishment of a number of basic industries and, in general, the forging of solid interconnections between the various branches of the sector.

6. Relation between Central America's industrial and trade policies

The expansion of the manufacturing sector during the next ten years will derive its main impetus from import substitution within the Central American Common Market. Nevertheless, if the regional economy is to attain a growth rate capable of raising the population's level of living and absorbing the manpower surplus in primary activities or in unproductive services, industrialization policy cannot be based solely on the possibilities afforded by the Common Market. The reason is that the Central American market is not broad enough to support certain basic industries for the development of which the area offers plenty of natural resources, such as forest and fish resources and certain mineral deposits. Even in the case of industries producing consumer goods, Central America's demand will tend to set limits to the degree of specialization necessary for the achievement of substantial increases in productivity.

If to these considerations is added the need to strengthen the external sector of the Central American economies, it becomes obvious that industrialization policy will have to be grounded in future on an active trade policy aimed at promoting exports of manufactured

goods to other countries or groups of countries. In this respect, Central America's policy would not be confined to the conclusion of trade agreements for the opening-up of additional export markets. An equally important step would be the establishment of agreements with third countries or groups of countries on capital investment and the transmission of techniques that would contribute to the industrial sector's growth.

An attempt would thus be made to expand the structure of industry on a selective basis so that, through exploitation of the advantages offered by modern technology and efficient use of the area's natural resources, at least a certain group of industries could be assured of a competitive position in external markets. Concurrently, a pattern of foreign trade specialization would

gradually be established which was less dependent on exports of primary commodities and increasingly oriented towards manufactures in which satisfactory levels of productivity could be attained. An industrialization policy of this nature would not be directed towards import substitution merely for the sake of achieving a maximum of self-sufficiency. On the contrary, it would be necessary to induce a structural reform in domestic production and in foreign trade that would open up new or better growth prospects. Neither would it be solely a matter of increasing external income by expanding exports of manufactured items. An equally or even more important aim of the policy described would be to encourage the development of further investment projects and the establishment of other productive activities.

III. NEED FOR INDUSTRIAL PROMOTION ACTIVITIES IN CENTRAL AMERICA

There are certain important requirements for the establishment, under suitable conditions, of basic industries in Central America, and, in general, for the transformation of the pattern of industrialization in the countries of the area. To meet them, it is essential first to implement thoroughly all the basic treaties establishing the Common Market. This implies expediting the complete liberalization of trade and the full application of the uniform import tariffs; giving effect, as soon as possible, to treaties—such as that on tax incentives and the first protocol to the Agreement on the Régime for Integration Industries—which have not yet been put into practice; and drawing up and signing those that are still lacking, such as the protocol on assembly industries.

It is equally clear that another indispensable requisite is to improve the procedures for applying the treaties and other instruments that have been adopted and established. The passive nature of the existing agreements, by reason of which the possibility of their incentives' materializing is dependent on moves that may or may not be undertaken or carried through, and the absence of any regional measures for applying the instruments in question in the interests of an entirely Central American industrial development programme, might in practice detract from their efficacy. This would mean that investment efforts would tend to be concentrated at the national level, and no advantage would be taken of the potential force and dynamism of a combined effort by all the countries.

A distinction must be drawn between general integration instruments and those covering specific fields and objectives. Application of the general instruments—those providing for free trade and the uniform import tariff—is automatic and coercive. Their function is to create a suitable climate for regional development, and they establish conditions—also of a general nature—calculated to foster the expansion of productive activities. From this point of view, their application has had significant repercussions which, even during the brief period they have been in force, have been reflected in relatively satisfactory increments in industrial production and, above all, in inter-Central American trade in manufactured goods.

However, it is likewise clear that these instruments fail to provide sufficient inducement for industrial investment to be made on the necessary scale or in the fields that need to be covered. Obviously, the attainment of this objective will depend on many other factors as well, i.e., financing, availability of technical resources, organization and knowledge of the market, etc.

In its turn, the use of the specific instruments is in every case subject to submission of the relevant application. As regards both the integration industries régime and the agreement on tax incentives, for example, the granting of benefits and the very possibility of their influencing the actual economic situation are dependent upon the action that industrial enterprise takes to that end. Similarly, ICAITI's activities and the BCIE credit programmes are at present determined by the level and nature of the signs of demand for their resources exhibited by Central America's still incipient industrial groups.

The foregoing considerations suggest that the area's industrial policy might not be sufficiently efficacious if, relying solely on its existing legal and institutional instruments, it continued to depend on their passive application. They also show that to eliminate this risk does not necessarily entail the conclusion of additional treaties, or the setting-up of new institutions.

The solution must be sought elsewhere, and specially—given the body of instruments existing at present—in such methods of applying them as will ensure effective fulfilment of their aims. It would consist in making them really operative by means of a deliberate effort to channel a sufficient volume of Central American savings and capital funds from abroad into industrial investment, and in due course to establish productive activities that would bring about a sweeping change in Central America's industrialization pattern.

In actual fact, this idea has been under consideration virtually since the inception of the integration programme, and has lain behind some of the measures taken by Governments in this field. The question would now be to develop it completely and, above all, to convert it into an integrated effort in terms of specific objectives.

Therefore, the first step would be to decide which industries should be established within specific periods of time and with specific priorities and to organize concerted efforts for their promotion, enlisting the co-operation of the private industrialists in whose hands they would be, and, where appropriate, establishing suitable links with industrialists and investors outside the area; collaborating in the setting-up of the enterprises in question; ensuring the preparation of projects under satisfactory technical conditions; raising and allocating the financial resources needed, both credit and capital (including working capital); in due course forming teams of trained and specialized personnel; and supplementing all these measures by the prompt granting of all benefits existing under the law, both at the national and at the regional level.

There is a close relationship between executive promotional measures and this mode of procedure as regards the implementation of treaties and the operation of institutions, which should find expression in a united effort to further and accomplish regional industrialization. Once the necessary treaties and mechanisms are established, their existence obviously acquires its full significance—their possibilities gaining in depth and scope—only in relation to the promotional measures taken to give effect to their constitutive clauses and statutes.

This type of effort involves important requirements which would have to be formulated and met under national industrial development programmes, whereby greater efficacy would be lent to the activities now being carried out at that level. But this would not be enough to give the necessary impetus to industrialization, or to bring the structure of industry into line with economic development needs. The development of basic industries and the introduction of specialization and up-to-date methods in the traditional branches at least would call for the pooling and organization of all the resources at the disposal of the five countries in the performance of a joint task.

In the Central American countries, the small size of their commodity markets is not the only obstacle to development on a national base. Their capital and entrepreneurial resources are also limited. Logically, therefore, an organic relationship exists between domestic market possibilities, on the one hand, and the capacity—also domestic—to exploit them, on the other. With the conversion of the five individual country markets into a single regional market, and the ensuing multiplication and improvement of investment opportunities, the capacity in question must also expand so that they can be turned to account.

With a view to the establishment of a new relationship consistent with the possibilities offered by the Common Market, the technical, legal, institutional and financial resources must also be pooled to provide it with the appropriate production base, the first step being to channel the scanty national resources into a single regional flow.

This requirement relates both to specialization in the existing traditional industries and to the establishment of the new branches of activity that will provide the basis for future industrialization, but it is particularly marked in connexion with the latter. Consideration will show that a groundwork of knowledge on production, processes and possibilities in the traditional industries already exists in Central America, and will in some degree facilitate regional efforts to expand the installed capacity of the larger plants, and to specialize production, replace out-moded equipment and introduce the most up-to-date techniques. The picture is very different, however, as regards the basic branches of activity, since in their case it is a matter of establishing in Central America unfamiliar forms of industrialization, which involve complex technology and make heavy demands in respect of specialized and skilled personnel; whose investment requirements are far greater than entrepreneurs in these countries are accustomed to meeting; and which pose new marketing and market problems.

It must not be forgotten that the multilateral economic co-operation movement in Central America, as distinct from others elsewhere, does not pursue trade aims alone. Another objective—which is in fact an essential requisite for ensuring the viability of a process of sustained growth in the member countries—is to turn five economies that are precariously founded on national bases into a system of production with broader possibilities. As regards industrialization, the Common Market may lead to some measure of development and improvement of the existing manufacturing sectors. But the result is hardly likely to be full exploitation of their most important opportunities, owing partly to the dispersion of the efforts made, and partly to their probable tendency to cancel one another out. In this sense, a development process organized on the basis of keen competition between countries conflicts with the essential aim pursued: the economic unification of Central America.

The reorganization of industrial promotion in the two fields indicated above would make it possible to judge the different projects on their own merits and from a Central American standpoint, that is, viewed not by one of the parties only but by all five member countries. Thus, superimposed on the idea of each individual country's taking advantage of the opportunities offered by economic integration in the national interest and by means of national efforts, would be the other idea of turning them to account in the interests of the whole area, on the basis of broader and more vigorous promotional activities of regional scope. This would be conducive to a greater community of interests, and narrow aspirations for industries to be established in certain countries would then be over-ridden by a unanimous desire to locate them in the most appropriate places and under the requisite conditions, since on this will ultimately depend, in large measure, the nature and pace of future economic development.

IV. PRINCIPAL FACTORS FOR THE PROMOTION OF BASIC INDUSTRIES

1. *Nature and scope of industrial promotion in Central America*

The industrial promotion activities envisaged in section III are conceived as a joint effort on the part of the agencies concerned with integration, in which the Common Market instruments are brought into play with a view to encouraging private investment and channelling it into those economic activities that are most vital to Central America's development. If this work is to be effective, clearly the promotional machinery adopted should not be restrictive, with rigid procedures tending to hinder or impede action by investors. On the contrary, what is required is to pave the way for private enterprise, pointing out investment possibilities, providing the financial and technical support needed for the execution of its projects, promoting external financing, etc.

The impetus to industrial development at a completely Central American level would have to be confined to the establishment and development of basic industries on a regional scale, and to the specialization and modernization of the main traditional industries. In the broad field represented by import substitution in respect of consumer goods and by the expansion of production of such items in terms of industries of sub-regional size and of those exporting to the rest of Central America but based primarily on a national market, the promotion effort would continue to be incumbent on each individual country.

On the other hand, as the national industrial development plans that are being drawn up on a co-ordinated basis in the five countries, with the advisory assistance of the Joint Central American Programming Mission, are gradually completed, it will be possible for the regional aspects of industrialization to be formulated more precisely and to be incorporated in Central America's promotional effort, for which they will provide guidelines.

It would fall to the industrial development banks and institutions of the individual countries to perform a key role in this regional promotion effort, besides the important part they have been playing, and must continue to play, in this connexion at the national level.

The following pages deal with the measures that could be taken in relation to basic industries. The question of specialization and improvement of techniques in the traditional industries could be considered later, in the light of the relevant studies being carried out by SIECA, the ECLA secretariat and the Joint Mission.

2. *Schedule of promotional measures*

(a) *Definition of basic industries*

A first step in the task of industrial promotion would be to decide which branches of activity are destined to play a strategic part in the ensuing phase of Central America's industrialization process and would be given the strongest support by existing regional bodies, in order to ensure their establishment during the coming decade.

The studies on which the ECLA secretariat has been engaged since 1955, with the help of United Nations technical assistance experts, have made it clear that such

branches of activity would correspond mainly to the chemical and metal-transforming industries; they would produce raw materials, intermediate products and containers for other manufacturing industries, agriculture and the building industry, and lay the foundations for the first Central American industrial complexes. Industries producing mainly for export would also be included, as well as some of the assembly industries which—as will be seen in section V—would in certain cases constitute a preliminary phase in the establishment of basic industries on a regional scale.

Such studies would make it possible to draw up a list of basic industries together with the relevant data and criteria, supplementing the studies already carried out by the ECLA secretariat with those that the Joint Central American Programming Mission is preparing, and others made in the different member countries. In view of the data and information already available, this task could be completed within the space of a few months, and still cover the principal branches of industry to be established, say, over the next ten years.³ Upon completion, the project in question would be subject to examination and revision by the Executive Council of the General Treaty, and would then be submitted for consideration and final approval, where appropriate, by the Central American Economic Council.

The Economic Council's approval of the list of basic industries would commit the Governments to the continued adoption of a joint approach to any projects presented and of joint decisions in connexion therewith, and likewise to giving calculated impetus and top priority to the establishment of such branches of industry on the lines best suited to Central America.

This does not mean that only projects for industries included in the list would be the object of promotion. Undertakings which, in the light of exactly the same criteria, are of equal importance to the region obviously merit the same treatment. The list would therefore serve as a frame of reference for co-ordination of industrial development policy at the Central American level.

(b) *Presentation of projects by private enterprise*

Once the list had been approved, it would be circulated as widely as possible for the purpose of guiding interested parties in the preparation of projects. At the same time, an active and vigorous promotional campaign would be launched in the sphere of private enterprise. Initial dead-lines could also be set for the presentation of projects, with due regard both to the characteristics of each industry, and to the progress achieved in feasibility studies for given branches of industry.

Projects would be submitted directly at the Central American level and would be dealt with jointly by the Governments through the economic integration institutions. Similarly, any applications presented to national authorities would be transmitted by them to the regional agencies, so that decisions were always adopted in relation to the Common Market as a whole. This would tend to eliminate the current practice of many investment

³The ECLA secretariat, for its part, in compliance with resolution 121 (CCE), will embark in 1964 on a new programme of research on Central America's industrial sector.

promoters of travelling through the five countries, often with the aim of selecting the most suitable site, not from the point of view of regional development, but from the angle of where the maximum profits might be obtainable.

It is vitally important that no time should be lost in making an evaluation in depth of the projects presented, and in furnishing them, where appropriate, with every available means of support to ensure their prompt execution. To that end, once the stipulated periods had elapsed and the relevant studies had been completed, the Economic Council, aided by the Executive Council and other integration agencies, would select those best adapted to conditions and requirements in the region, and, also within pre-determined time limits, would in due course adopt the pertinent decisions, indicating the economic integration benefits and instruments applying in each case. In so far as the rest of the projects are concerned, it should be made clear that their non-selection did not imply that their establishment would be prohibited, but merely that they would not be promoted by the Central American Governments.

(c) *Studies by branches of industry*

The adoption of a list of basic industries by the Economic Council would further establish an order of priority for the allocation of resources and for all other measures taken by the Central American integration agencies to promote manufacturing industry. It might sometimes happen that the projects submitted were limited at first as to number and stage of preparation. In that case it would be suggested that the said agencies should encourage their completion and, where appropriate, the preparation of any additional projects needed. For that purpose, the agencies in question would need to possess basic information on the existing industrial structure in Central America, on the lines along which its development should be channelled in the future in terms of the present and potential size of the market, and on supply conditions in respect of the region's natural, technical and human resources. This would entail embarking on a series of studies, by branches of industrial activity, in order to acquire the necessary criteria for estimating the number and capacity of the plants it would be expedient to establish during specific periods, and in relation to similarly specific market dimensions. A fund of detailed information would also be built up with respect to raw materials, containers, semi-manufactured products and capital goods of Central American origin which could be utilized as being readily available, or whose production might well be undertaken as a result of the installation of these industries. Furthermore, conclusions would be drawn as to the necessary criteria for selecting techniques and estimating investment needs, cost and price conditions, and predictable effects on the balance of payments.

(d) *Studies on the feasibility, preparation, financing and execution of projects*

Research by branches of industry would supply data for the proper evaluation of the projects submitted.⁴ In

⁴ None the less, there is clearly no reason to delay the promotion of certain industries that are obviously viable and of direct and urgent importance to Central America, until such time as the findings of this research are available.

addition, however, it would serve as a basis for the furtherance of the promotional effort, primarily through the preparation of comprehensive feasibility studies and the formation of groups of interested investors, and, later, through the formulation of plant design and engineering projects, the constitution and financing of enterprises, the construction of plant and the initiation of the production and distribution activities concerned. Once the analyses by branch of industry and the feasibility studies were available, it would be essential for national development banks and institutes to take an active part in this whole process, side by side with the regional integration agencies.

In this way, the promotion of basic industries would be established in the form of a complete process, beginning with the assessment of investment possibilities and continuing uninterruptedly until it culminated in the execution of the projects.

3. *Institutional machinery and technical and financial resources required*

In order to put into practice in its entirety this effort to promote basic industries in Central America, the Governments would have to focus their action on three main points. It would be necessary in the first place to co-ordinate the activities of the regional development and integration institutions; secondly, to form a nucleus of high-calibre technical experts, duly supplemented and reinforced by technical assistance services from abroad; and, lastly, to have sufficient funds to cover the costs incurred in the work of preparation and evaluation of projects, and to back their execution with contributions from the Central American countries themselves. In relation to these three focal points, the activities of private enterprise, both regional and foreign, would have to be encouraged, as well as those of national industrial development bodies, while at the same time advantage would be taken of the experience of other countries, through close co-operation with technical and financing institutions similar to those already existing in the area.

(a) *Institutional machinery*

One favourable factor is that the necessary elements for establishing an institutional base such as that required already exist in Central America, in the form of the various economic integration agencies which the Governments have set up over the past few years. ICAITI, BCIE and SIECA, guided either directly by the Economic Council, or, respectively, through the Board of Directors of the Institute, the Board of Governors of the Bank and the Executive Council of the General Treaty, would be called upon to play a decisive part in all the tasks referred to, the first two within their particular spheres of activity, and SIECA by virtue of its functions in respect of the administration and application of the treaties and agreements in force.

In this connexion, it would be expedient to set up a committee composed of the Director of ICAITI, the President of BCIE and the Secretary-General of SIECA, which, operating both directly and through technical working groups, would establish proper co-ordination among the three bodies, as well as between them and national industrial development institutes, at the operational level of their respective programmes of work, and

would lay the foundations for effective implementation of the promotion programme. Its immediate tasks would also include studies designed to indicate the basic industries that should be promoted, whence it would proceed to the evaluation of projects, the orientation of studies on individual branches of activity, and the other measures that make up the whole complex of the technical, economic, legal and financial aspects of industrial promotion.

In ICAITI's case, the formulation of specific objectives as regards the types of industries it is intended to establish and the priority to be assigned to them would clearly demarcate its immediate specialized personnel requirements in its capacity as an advisory agency concerned, in addition, with the evaluation of projects,⁵ and would also determine the magnitude and nature of the technological and industrial research services that should be sought abroad. Similarly, it would serve to define the content of the Institute's natural resources research programme, which would be parallel or complementary to the longer-term studies included in the cadastral project sponsored by BCIE. ICAITI could likewise determine the needs of the basic industries to be established, in so far as specialized technical and administrative personnel and skilled labour were concerned, and on that basis could formulate and duly implement the necessary training programmes.

BCIE, for its part, could then quantify the financial resources needed during specific periods for the establishment of basic industries, and analyse and estimate the possibilities of internal financing. It could also make recommendations for the channelling of Central American savings into such industries on the necessary scale; examine the sources of external financing and draft the most appropriate procedures for obtaining the amount required; and, in general, decide what part the institution itself would have to play in the whole process.

In this respect, BCIE could serve to cement Central American capital, by helping to organize groups of local investors,⁶ encouraging their participation in terms of specific targets for each industry, contributing out of its own resources to the capital formation of certain enterprises and granting them credit facilities, acting as an intermediary in the sale of bonds and other securities, and devising the financial organization and other features of the enterprises that would have to be set up. BCIE could further serve as a catalyst in the process of obtaining the necessary foreign capital, arranging credit from different sources, attracting non-Central American investors and promoting their association with local groups.

(b) *Technical personnel requirements*

The formation of a regional nucleus of technical personnel and of appropriate supplementary services is perhaps the fundamental requirement to be fulfilled in

⁵ Moreover, this is one of the most important functions that ICAITI will have to fulfil in the future, in order not only to facilitate the dissemination of present-day technology in Central America, but also to discharge in full the duties laid upon it in this field under various economic integration treaties.

⁶ This is one of the major requisites that would have to be met in any attempt to secure the participation of local capital in new industries on a regional scale. Experience shows that, in view of the magnitude of the investments required, such participation can be brought about only through the fusion of national interests in stronger groups at the regional level.

any effort to promote industry. ICAITI has made some headway during the past few years in training technological and industrial research workers. BCIE, during the brief period it has been in existence, has already succeeded in forming its first teams of specialists, and the national development institutes in some countries have made satisfactory progress in the same direction. The question would be to establish, on the basis of these achievements, on the one hand, a minimum groundwork of technical assistance resources in the Central American agencies themselves, and, on the other, to procure what was lacking—which would be a major proportion—from external sources.

This task would be facilitated in the case of ICAITI if the recommendation formulated by the recent United Nations survey mission to the effect that Special Fund technical and financial assistance be extended for a further five years as from 1965 were approved. As regards BCIE, it would be worth while considering the immediate setting-up of an industrial promotion department as a specialized instrument to help the Bank to fulfil the function assigned to it in this field under the agreement establishing it. This department would be endowed with financial resources, both of the Bank's own and of foreign origin, distinct from and supplementary to the funds already available for BCIE's existing credit programme. In line with the concept of a rational division of labour, the best course would be to staff this department with specialists in finance, credit, organization and promotion of enterprises, assigning to ICAITI experts on the technical aspects of industry as such. Working groups from both agencies and from SIECA could then pool their efforts and take joint action in relation to specific projects of their own or emanating from other sources.

While the teams of technical experts of the economic integration agencies would necessarily be larger than at present, they would still be small, both intrinsically and in relation to actual needs, owing to financial and other limitations. As stated above, they would constitute a minimum nucleus, whose activities, except in a few cases, would be concerned in general with the evaluation of investment projects and not with the carrying out of detailed studies by branches of industrial activity,⁷ or with the preparation of projects. Obviously, this last task would require additional human resources which the agencies in question would not have at their disposal, because of the number of experts and wide range of specialities needed. It is precisely these services that would have to be secured from abroad, through the negotiation of contracts with well-reputed firms of consultants, the establishment of working relations with other technological and industrial research institutes, and the conclusion of co-operation agreements with development institutions and international and foreign financing agencies. In the case of development institutions in the Latin American countries, this type of agreement might have the advantage of facilitating the expansion of the regional market base, and might possibly lead to the creation of favourable conditions for

⁷ The relevant studies being carried out under the auspices of the Joint Central American Programming Mission should supply comprehensive data on various basic branches of industrial activity.

the establishment of Central American industries producing manufactured goods for export to some of the countries concerned.

(c) *Legal instruments*

The agreements already adopted by the Governments of the area in the context of economic integration, in particular those relating to a uniform import tariff, tax incentives, the integration industries régime and the special tariff system, are the legal instruments that would be used in promoting the development of basic industries in Central America. The question of which particular instrument or combination of instruments should be applied would be for the Economic Council to decide,

in each individual case, during the initial phase of the promotion campaign.

It should be stressed that, as far as the integration industries régime and special tariff system are concerned, the specification of the basic industries to be established within the Common Market would afford a good opportunity for Governments to demarcate once and for all their sphere of application, which should be confined exclusively to these branches of activity, though not necessarily covering each and all of them, as has been suggested. It would thus be made clear that neither the industries régime nor the special tariff system would apply to all other manufacturing activities, which would be subject only to the general integration agreements.

V. A SPECIAL CASE: ASSEMBLY ACTIVITIES

Viewed as the initial phase in a gradual process of transformation into manufacturing industries, activities concerned with the assembly of certain industrial products are of importance for the economic development of Central America. In so far as they became an integral part of the structure of production for the common market, they might provide incentives for the installation and development of other industries, facilitate significant technological progress in the countries of the area, and make an appreciable contribution to import substitution and to the industrialization of the Central American economic unit in general. Considered from this standpoint, some of the activities in question might be classified in the group of industries considered to be of basic importance for the growth of manufacturing activities in the area, appearing as a special case within that category. Central American policy in respect of assembly industries would not then be conceived solely in terms of the creation of conditions which would permit their establishment. It would also take the shape—just as in the case of basic industries—of an effort of regional scope, aiming at their installation in accordance with the needs of Central American economic integration.

In the seventh transitional article of the Central American Agreement on Tax Incentives to Industrial Development, the five contracting parties undertook to sign an additional protocol specifying (a) the system of incentives to be applied to assembly activities; (b) the trade régime to which the various assembled articles should be subject within the Central American Common Market; (c) the requirements and obligations to which assembly enterprises should be subject as regards the production or use of parts of regional origin; and (d) the producer activities to which the régime might apply. Until the protocol comes into force, assembly activities to which the above-mentioned transitional article is applicable will enjoy privileges and immunities for three years in respect of imports of machinery and equipment.

Assembly activities constitute a starting-point for the pursuit of specific objectives of Central American industrial policy, whose attainment will in practice depend upon whether the activities in question are established in such a way that they can be gradually absorbed into the production base of the common market, and upon the conditions laid down for their incorporation from the outset.

The background material presented below may facilitate the formulation of the additional protocol within the broad outlines stipulated in the seventh transitional article. It has been prepared on the assumption that the structure of the protocol will be similar to that of the Agreement, and that there will be a basic relationship between the provisions of the two texts. In that sense, the protocol would seem to be essentially a supplementary instrument.

1. *Field of application*

The protocol would relate solely to such assembly activities connected with the metal-transforming industries, and with any other branches of industry comprising similar assembly operations, as might be established in Central America with a view to their gradual transformation into manufacturing activities. Accordingly, a distinction would have to be drawn between these enterprises and assembly operations pure and simple on the one hand, and, on the other, manufacturing proper. It would also be necessary to stipulate that the relevant regulations should in each case include quantitative criteria for making this differentiation. Strictly speaking, these criteria would relate to what minimum proportions of the total manufactured inputs used by the plants concerned were represented by inputs they themselves manufactured. But in the present case, they would obviously refer to minimum proportions of inputs produced in Central America.

The establishment of quantitative criteria would facilitate the administration of the protocol and would avert difficulties that might otherwise derive from the application of its provisions in the case of those same industries, either to assembly activities pure and simple, which are of much less importance to the area, or to manufacturing industries, which merit more support. It would thus be made clear that assembly operations pure and simple, and manufacturing proper, were both outside the scope of the protocol.

2. *Scheduling of enterprises*

In the light of criteria established in defining the field of application of the protocol, it would seem that the conditions laid down in article 4 of the Agreement on Tax Incentives would be equally applicable to assembly activities. These conditions are as follows: (i) use of

modern and efficient technical processes, compatible, in this case, with high employment levels; (ii) production of articles required for the development of other productive activities, or to meet the basic needs of the population; (iii) generation of a value added by the industrial process that is substantial in absolute or percentage terms; and (iv) furtherance of increased use of national or regional raw materials or semi-manufactured products and, in general, of Central America's natural, human or capital resources.

As specific criteria for the scheduling of assembly enterprises, the protocol should stress the technological enrichment of the Central American economy, the prospects for rapid conversion into manufacturing industry and the stimulus given to the development of other productive activities.

3. *Classification of enterprises*

Since not all assembly activities are of equal significance for the economic growth of Central America, it would be necessary to differentiate between them with a view to graduation of the benefits obtainable, so as to give sufficient encouragement to those whose importance was greatest. Consideration should be given to the establishment of two categories, on the basis of the nature and use of the goods assembled: the first would comprise capital goods and intermediate products, and the second, durable consumer goods.

This classification would be consistent with two criteria that are important for Central America: (i) the relation of the assembly industry to the development of other productive activities; and (ii) the importance of the products assembled from the standpoint of the defence of the balance of payments.

In the latter connexion, it should be borne in mind that the Central American countries' requirements in respect of capital goods and intermediate products are likely to continue to expand at a rapid rate. In these circumstances, it would be feasible, provided that the resultant cost and price levels did not exceed given limits, to start the encouragement of domestic production by beginning with assembly operations, since imports, either of parts or of finished articles, would still have to be effected in any event.

The situation is different as regards durable consumer goods, inasmuch as the industries concerned, by definition, do not produce articles on whose existence the efficient operation of other branches of activity depends. Similarly, their products are typically for consumption by the high-income groups, and imports might be restricted in case of need without the infliction of undue hardship on the bulk of the population.

4. *Integration of assembly industries*

Under the provisions of the above-mentioned transitional article, the assembly enterprises covered by the protocol will be subject to requirements and obligations as regards the production or use of parts of regional origin, which would have to be specified for each industry, and would be applicable to producers both of capital goods and intermediate products, and of durable consumer goods. Similarly, they would relate not only to the initial proportion of parts produced in Central America, but also to the increase of that proportion

and the progressive use of other products likewise of Central American origin, deadlines being specified for the completion of the various phases into which this process was to be divided. Neither the initial proportion of locally-manufactured parts nor the higher percentages subsequently reached would necessarily have to be obtained through the activities of the assembly plant itself, but could be covered, in part at least, with the output of other Central American industries. Certain advantages would attach to this policy, inasmuch as it would foster a wider diffusion of industrial ownership, and at the same time would open up new possibilities for private enterprise in the area. Moreover, in the case of assembly activities already established, whose limited capacity might make it difficult for them to meet the requirements of the protocol directly, the use of parts manufactured in other plants might facilitate their compliance with its stipulations and enable them to enjoy the benefits of larger-scale production.

If parts manufactured in other Central American plants are to be used by assembly industries, several conditions must be fulfilled. In the first place, programmes would have to be established for the standardization and typification of parts that could be produced within the area, as a means of guaranteeing their quality and specifications. Secondly, it would have to be decided in each case which parts were to be made by the assembly enterprise itself and which were to be purchased from other Central American sources. Lastly, with reference to the latter, industrial promotion programmes would have to be formulated in order to ensure timely supplies of the manufactures concerned.

An aspect of the problem closely linked to the foregoing is that of the number of makes of products assembled, the range of models within each make, and the frequency with which their designs are changed. In view of the characteristics of the Central American market, the existence of even a small number of makes might seriously obstruct the subsequent development of the industry, by splitting up demand and making it difficult to reap the benefits of large-scale production. Working on the basis of a great many models, or changing them faster than was warranted by the duration of the useful life of the basic equipment involved, would also tend to increase investment costs per unit of output. Accordingly, the protocol should contain provisions to ensure that assembly activities would be established on the most economic lines possible with regard to the number of makes and models. This might be achieved, for instance, by granting concessions for the establishment of assembly activities on a competitive basis, the interested parties submitting the relevant projects so that the Central American authorities might select the one which would best serve the interests of the area.

5. *Tax benefits*

The exemptions granted to assembly enterprises under the protocol might be the same as those established in the Agreement on Tax Incentives, including the deduction for reinvestment in machinery and equipment. This would be justifiable inasmuch as the protocol—envisaged on the lines described—would embody selective criteria analogous to those adopted in the formulation of the Agreement, and would include supplementary provisions

designed to ensure the attainment of exactly the same objectives.

With regard to the amount and duration of the various exemptions, it would not seem advisable to accord the same treatment to assembly activities as to the corresponding manufacturing industries. Moreover, in view of the priority criteria indicated above, the tax incentives applicable to assembly enterprises would have to be graduated in accordance with the importance of the various assembly activities for the development of the Central American economic unit. To that end, the protocol should contain provisions by virtue of which the enterprises first established to assemble capital goods and intermediate products should be granted the benefits established under the Agreement for new industries in group B, while those for group C should be extended to plants assembling durable consumer goods. Consideration would also have to be given to the conditions applicable in the case of activities associated with the establishment of any additional assembly industry complying with the terms of the protocol, and to the incentives they were to be granted, where appropriate.

Thus, enterprises engaged in the assembly of capital goods and intermediate products would be granted total exemption from customs duties on imports of machinery and equipment, during a period of eight years; exemption from customs duties on imports of fuel (other than petrol) for the manufacturing process, raw materials, semi-manufactured products and containers, including assembly parts (say 100 per cent for the first three years and 50 per cent for the next two); and total exemption from taxation on income and profits, assets, and net worth, for six years. Enterprises assembling durable consumer goods would be granted exemption from customs duties on imports of machinery and equipment for three years.

Once the tax exemptions conceded under the protocol had run their term, imports effected by assembly enterprises would be subject to the same tariff duties as the corresponding finished products. This might have an unfavourable effect on the activities concerned as it might prove difficult for them to develop their substitution programmes on the basis of Central American production. To overcome this difficulty, the temporary tax incentives might be complemented from the outset by the adoption of differential margins in the common import tariff, by virtue of which the duties established be higher for the finished product and lower for its component parts. The width of these margins would have to be defined in each individual case, with due regard to the characteristics and requirements of the various industries, but in conformity with the general principle that the more privileged industries should be those assembling capital goods and intermediate products, and that proportionately lesser tax benefits should be enjoyed by assembly activities producing durable consumer goods. To that end, assembly enterprises would have to furnish complete information on the costs of imported parts and units. The authorities responsible for the administration of the protocol, on their part, should carry out detailed studies on these aspects of the problem.

Periodically, and preferably at intervals coinciding with the different phases of the substitution programmes, tariff margins would have to be revised and, where nec-

essary, adjusted to the variations observable in costs and prices of assembly materials of Central American origin in relation to reliable data on their imported counterparts.

The existence of different duties for finished products and component parts would mean that enterprises both manufacturing and assembling parts, assembly activities pure and simple, and the importation of spare parts, all enjoyed the same benefits. To prevent this, various alternative possibilities should be considered in respect of supplementary clauses to be added to the protocol. On the one hand, it might be stipulated that tariff differentials should be applied only to products assembled in conformity with the provisions and regulations of the protocol. For that purpose, the duty applicable to the assembly material would have to be adopted in each individual case. It should be partly *ad valorem* and partly specific, the specific proportion being established with the aim of maintaining a minimum level of tax revenue. The *ad valorem* element, on the other hand, would serve to ensure that the duties payable by the assembly enterprise really did tend to decrease as its substitution programmes were put into effect, and more use was made of parts of Central American origin. The tariff differential would be fixed in relation to the duty on the finished product and the average incidence of the official values (*aforos*) assigned to its component parts in the standard import tariff. The scale of these values would have to be based—with whatever additional break-down was necessary—on the establishment of appropriate tariff levels for parts included in substitution programmes and for those that would always have to be imported. The tariffs would likewise be applicable to imports of parts for assembly activities pure and simple and of spare parts.

6. Regional distribution of customs revenue

Some of the products of assembly industries are important from the standpoint of the revenue at present accruing from Central America's imports of such goods. To prevent considerable losses—and irrespectively of the internal taxation that might be established in accordance with the legal provisions in force—it would be worthwhile to consider the possibility that, in cases where external purchases of finished products were superseded by imports of parts for assembly operations, the customs revenue accruing from the latter might be distributed among the member Governments proportionally to the sales registered in each country. To begin with, the Government of the country in which the assembly plant was situated might assume responsibility for collecting the revenue in question, managing it like a trust fund and distributing it to the other Governments in accordance with suitable registers that would have to be established. Subsequently, as the number of assembly industries in the various member countries increased, and while the Central American customs union was still in process of formation, these functions might be handed over to a regional office set up expressly for the purpose.

7. Application of the protocol: regional regulations

Since the characteristics and requirements of assembly activities vary from one industry to another, the protocol

should be confined to the establishment of a series of regulatory provisions and criteria, which would be formulated in specific terms in an additional set of regulations to be drawn up in each individual case by the Executive Council and the Economic Council of the General Treaty. In line with the principles laid down in the protocol, these regulations would specify, *inter alia*, the minimum proportion of Central American parts to be used by assembly plants on first entering operation, the amount by which and the time limits within which that proportion should be increased, tariff differentials, and questions relating to the number of makes and models. The regulations would serve as a framework for the formulation of agreements or decrees in respect of classification.

Obviously, for all these purposes comprehensive studies on the various technical and economic aspects of the establishment and development of assembly activities would be required. Within the regional approach described in earlier sections of the present note, it would be incumbent upon ICAITI, BCIE and SIECA to carry out these studies. Since various projects for the installation of assembly plants in Central America are already being urged, an immediate start should be made on this research, to which end advantage might be taken of the present opportunity to draw up the pertinent schedule and adopt appropriate measures with regard to procedures and deadlines.

With the creation of the body of instruments constituted by the protocol and its regulations, not only would a proper legal and administrative framework be set up for channelling the activities of private enterprise in the field of assembly industries, but an appropriate basis would also be provided for Governments to promote, through the regional economic integration mechanisms, the establishment of those industries which might play a key role in the development of Central America's manufacturing sector. As a part of this effort, to supplement the guiding principles already indicated, in

the formulation of the above-mentioned regulations due account should be taken of the practical possibilities of promoting assembly activities on the basis of industrial complementarity agreements with other countries and groups of countries. The market-size limitations which might militate against the efficient operation of the enterprises concerned could thus be mitigated or eliminated, and better conditions would be created for the conversion of their activities into complete manufacturing processes at an earlier date.

Lastly, both the protocol and its regulations should be applied through decisions by the Executive Council establishing the terms of the contracts to be signed in each case between the national authorities and the beneficiary enterprise. Only thus, through the application of the said instruments on a completely regional basis, could assembly activities be installed in conditions suited to Central America's requirements. As has been shown, the initial production capacity of such plants is particularly important, not only from the standpoint of the proper satisfaction of available market demand, but also from the angle of the existing possibilities for their gradual transformation, in due course, into manufacturing industries. Moreover, pursuant to the principle of economic integration, better advantage could thus be taken of the possibilities for the production of parts in member countries other than that in which the assembly enterprise concerned was located.

3. *Other provisions*

In addition to the points already touched upon, the protocol should contain provisions establishing procedures in all respects necessary to supplement those already laid down in the Agreement on Tax Incentives, as well as stipulations as to the securities that enterprises would have to offer in respect of implementation of their integration programmes, quality and prices of products, and supply conditions.