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SITUATION OF THE CENTRAL AMERICAN  
INTEGRATION PROGRAMME

### Introduction

By the middle of 1965, the General Treaty on Central Economic Integration will have been in force for four years. By means of this instrument, the signatory countries consolidated various bilateral and multilateral agreements that had been negotiated and signed during the fifties and undertook to establish a free trade area within a period of five years (a period which will end in mid-1966) and at the same time to adopt a common tariff for third countries as provided for in the Central American Agreement on the Equalization of Import Duties and Charges, signed in September 1959. In addition, the Central American Bank for Economic Integration (CABEI) was established, as well as the organs required to put the General Treaty into effect and to direct the work of economic integration: the Economic Council, the Executive Council and the Permanent Secretariat.

Over the last three years, the Central American economy has been making a steady recovery from the relative stagnation registered from 1957 to 1961. During the three-year period 1962-64, the gross product of the region as a whole increased at an average annual rate of more than 6 per cent in real terms, which is equivalent to an annual increase of 3 per cent in the per capita product.<sup>1/</sup>

This recovery has been due substantially to the rapid expansion of exports to countries outside the area, and particularly to the fact that in three countries - El Salvador, Guatemala and Nicaragua - the regional output of cotton almost tripled between 1961 and 1964. The promotion of expanded intra-regional trade was equally important, for it resulted in a decisive increase in the rate of growth in those three countries, and in the others, it offset the depressive effects of the stagnation in agricultural production.

<sup>1/</sup> For a more detailed analysis of the recent development of the Central American economy, see Economic Survey of Latin America, 1964, (E/CN.12/711), vol. I, chapter II, pp. 57-90.

On the basis of the available figures, it can be said that the value of regional trade rose to at least \$95 million in 1964, which is more than three times the figure for 1960 (\$30 million). In relative terms, the value of trade within the free-trade area rose from 7 to 15 per cent of the value of the total foreign trade of the region as a whole for the same period.

The expansion of intra-regional trade in the last two years reflects large increases in the exports of Nicaragua and Costa Rica, whose contribution to regional commodity trade has previously been rather marginal.

Over the same period, the upward trend of trade in manufactures was maintained, which led to the expansion of the area's traditional industries and, more recently, to the installation of new industries of regional importance. It is estimated that investment in these new industries had risen to \$65 million by 1963. This process was intensified in 1964, with the result that private investment in the region as a whole rose by 18 per cent compared with the previous year. At the same time the requirements of the common market speeded up government investment in the regional highways network, harbour works and communications.

Thus, the economic integration of Central America is in full swing. The intensification of trade between the five countries has created problems connected with the adaptation of existing industries to the new competitive conditions in the regional market and also to fiscal repercussions deriving from free trade and the common tariff. The solution of such problems has forced the bodies responsible for regional integration to make decisions of different kinds, to govern and supplement the machinery of the common market. The Central American Bank for Economic Integration has devoted a large part of its funds to the expansion and modernization of existing industries.

As regards practical results, it has already been possible to undertake highly important regional programmes such as those relating to communications, transport and electrification. Some progress has been

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made, although not so rapidly as was expected, towards the formulation and execution of a regional policy for the development of production and the regulation of trade in staple foodstuffs.

The Central American Clearing House, established in 1961 as the first regional body for monetary co-operation, has also facilitated intra-regional trade. In February 1964, the Central Banks laid the bases for the progressive establishment of a Central American monetary union and instructed the Central American Monetary Council, which was established at the same time, to make the necessary preparations. The Ministers of Finance and the Ministers for Economic Affairs - the latter forming the Central American Economic Council - met in April 1965 to consider what had to be done to concord domestic taxes and, in general, to co-ordinate the fiscal policies of the five countries.

In addition, studies have been undertaken to determine the bases for a joint trade policy aimed at establishing increasingly strong economic links with neighbouring countries or groups of countries in the Latin American market. It is necessary to link the Central American economy with larger markets because the regional market is not big enough to sustain certain industrial activities, particularly those which would ensure the optimum use of Central America's forest and mining resources. Bearing in mind also the shortage of savings and of technical know-how in the area, the trade links might be supplemented by agreements on investment and the transfer of technology in certain branches of industry.

The trend towards integration necessitated a recasting of the Organization of Central American States (OCAS) in accordance with the interim provisions of the General Treaty. The new charter of the Organization, which came into force on 30 March 1965, states that the five countries constitute an economic and political community aiming at Central America integration (article 1), and establishes the machinery for this purpose, including the Meeting of Heads of State,

the Central American Court of Justice, the Conference of Ministers for Foreign Affairs, and the Executive, Legislative and Economic Councils. The organs of the common market become part of the Central American Economic Council,<sup>2/</sup> which continues to be responsible for the planning, co-ordination and implementation of economic integration.

#### 1. Free trade régime

On 4 June 1965, the Central American Free Trade Area will begin its fifth year of operation, the last year of the transitional period during which restrictions may still be applied by pairs of countries to specific commodities produced in the countries which are signatories of the General Treaty on Central American Economic Integration. By that date the free trade régime will cover over 85 per cent of all the items in the Central American Standard Tariff Nomenclature (NAUCA).<sup>3/</sup> The remaining items - except for the twenty-four sub-items referred to below - will gradually be incorporated into the free trade régime as follows: 93 by a year later (4 June 1966) and 72 as certain regulatory agreements come into force or when certain requirements are met.

The commodities subject to exceptional transitional arrangements which will be incorporated into the free trade system in 1966 include, inter alia textiles, oils and fats, and foodstuffs. The group which is subject to special agreements includes mainly petroleum products, paper, clothing, tobacco and wheat flour. One of these agreements, equalizing customs duties on textiles made of artificial and synthetic fibers was signed in February 1965. When it comes into force, probably this year, 25 sub-items of clothing now subject to restrictions between certain pairs of countries will be automatically incorporated into the unrestricted free trade régime.

<sup>2/</sup> This regional body had already been established by the General Treaty on Central American Economic Integration.

<sup>3/</sup> The NAUCA contains 1,276 tariff items and sub-items.

The 24 remaining items, which are excluded from the free trade régime for an indefinite period, are basically the principal exports (coffee and coffee extracts, cotton and cane sugar) and certain articles which are subject to special State monopoly regulations (for instance, alcohol and sugar cane spirits).

## 2. Tax policy

With the ratification of three additional protocols to the Convention on the Equalization of Import Duties and Charges in 1963 and 1964, the Central American common tariff system was virtually established. At the present time uniform duties and charges apply to 98 per cent of the NAUCA items.<sup>4/</sup>

Some of the products on which equalization tariffs are still pending are specially important as sources of tax revenue; petroleum derivatives, motor vehicles and electrical equipment. The equalization of the tariff duties on these articles is linked to regional agreements regarding the concordance of domestic taxes on consumer goods, the granting of free trade, and the development of assembly activities.

A substantial advance was achieved with regard to equalization in the first quarter of 1965, when a special agreement was signed laying down uniform duties and charges for textiles of artificial and synthetic fibres; the agreement covers 16 NAUCA items for which progressive equalization arrangements had been adopted, to be completed by the end of the year.

There was also an advance in tariff legislation when the Central American Customs Code came into force, in February 1965, establishing the legal limits of the regional customs arrangements required for

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<sup>4/</sup> Except for Honduras and Nicaragua, where the proportion is slightly lower (95 per cent) owing to the fact that these countries have not yet deposited the instrument of ratification of one of the above-mentioned protocols.

the common market. The Executive Council of the General Treaty is carrying out a final revision of the regulations of the Code with a view to giving greater flexibility to customs operations.

The renegotiation of uniform duties has been started; this work will become specially important in the future, as it will be necessary to adapt the standard tariff continually to the needs that will arise as industrialization progresses and the Central American Governments adopt new economic policies. For this reason, formulas are being considered for giving greater flexibility to the procedure for the revision of the common tariff system, from the negotiation stage up to the entry into force of the new duties.

### 3. Industry

Thanks to favourable conditions on the markets of each of the Central American countries and the possibilities of regional trade, there has been an improvement in the productive capacity of Central America and the volume of investment in Central American industry has increased.

Intra-regional trade in manufactures rose at an annual rate of more than 30 per cent over the last three years and now represents more than 70 per cent of the total value of such trade.

Besides promoting better use of the installed capacity, the economic integration programme has encouraged the expansion and modernization of the traditional industries and, in the last few years, the installation of new industries which are regional in scope for the production of intermediate goods and some capital goods.

It has therefore been possible to replace, to a very large extent, regional imports of non-durable consumer goods and building materials. The following new industries, inter alia, have started operations: petroleum refineries and plants for the production of fertilizers, sulphuric and nitric acid, welded steel tubing, electric light bulbs, copper wire and cables, raw materials for detergents, steel rods, tyres and inner tubes. Plans are far advanced for the installation of /plants for

plants for the manufacture of caustic soda, chlorine and insecticides, glass containers and sheet glass, and for the distillation of turpentine oils. Preliminary studies have been made for the establishment of an iron and steel industry and for developing the forest resources of the region for the production of pulp and cellulose and, as a longer-term project, kraft paper. A start has been made also with the assembly of motor vehicles and refrigerators and other electrical equipment.

In February 1965, the first protocol to the Agreement on the Régime in Central American Integration Industries came into force. The tyre factory now operating in Guatemala and the caustic soda and chlorinated insecticide factory which is to be installed in Nicaragua are the two first projects to have been treated as Central American integration industries. In view of the rapid growth in regional demand for tyres, it has been agreed to assign another factory of this type to Costa Rica; it will start production in about two years' time. Negotiations are under way also for applying the integration régime to a glass-container factory which is to be installed in Honduras.

In February 1964, the Central American Governments laid down general criteria as guide-lines for the industrial policy of the Common Market. They specify the need for programming and promoting dynamic industries at the Central American level. In this connexion, the Joint Programming Mission for Central America has prepared a preliminary study on industrial development prospects for the decade 1965-1974, indicating certain lines of action and methods which could be adopted to achieve balanced and coordinated development at the regional level.

#### 4. Agriculture and livestock

Intraregional trade in agricultural and livestock products grew from 1961 to 1963 at a cumulative annual rate of 25 per cent, reaching a total value of \$29 million in the latter year. Raw materials, staple grains, fruits and vegetables, products of animal origin and vegetable and animal oil and fats account for 80 per cent of this trade.

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In June 1965, the restrictions on the grain trade between Costa Rica and the other Central American countries will be automatically abolished, which will be a further step towards complete liberalization of trade in agricultural products. In addition, progress is being made in the establishment of a regional network of grain silos, a programme which was approved in 1963. The projects have reached the construction stage in some countries, and the pre-investment study stage in others. A regional board has been established to co-ordinate marketing and price stabilization policies for the principal items (maize, rice and beans). Through the board, support prices for maize have been agreed upon by all member countries and a maize purchasing system has been established to regulate the prices to the producer. Negotiations have been started on similar agreements for beans and rice.

In October 1964,<sup>5/</sup> the Central American Governments decided that it was necessary to speed up the removal of obstacles to regional free trade in certain agricultural products. They also considered it urgently necessary to proceed with studies on selected products, in order to encourage the production and sale on the world market of tobacco and meat. In addition, they reaffirmed the desirability of establishing as soon as possible a joint organ for negotiations with the third countries on specific products.

In January 1965, the United Nations Special Fund approved financing for a project to investigate the region's fishery resources and to lay the groundwork for a common policy on the development and exporting of these resources. This project would take six years and the total investment planned amounts to \$4 million.

5/ At the first meeting of the Sub-Committee on Agricultural Economic Development, held at San José, Costa Rica.

## 5. Transport and communications

Intraregional trade relies mainly on the road transport system. It is estimated that over 90 per cent of the goods are conveyed by road. In order to facilitate such trade, work has continued on the construction of missing sectors, the surface has been improved and improvements have been made in the Central American road network. The basis for the establishment of this network is a programme consisting of thirteen projects and entailing an investment of over \$73 million. It is to be completed by 1969.

The steady growth reflected in the regional trade figures has brought out the need for more adequate road transport facilities. Studies on this matter are approaching completion and will be submitted to the Governments for their consideration in the course of the year. The main idea is to devise institutional measures which will make the services more flexible and regular, give the enterprises greater stability and encourage effective co-operation among them at the regional level. Among the studies under way, mention should be made of one by the Central American Bank for Economic Integration on the present transport situation and of those by the United Nations Special Fund on ports, railways and roads in Costa Rica and Nicaragua.

As far as air transport is concerned, the Central American Air Transport Services Corporation, which was set up in 1964 to improve the telecommunication systems needed for air transport, has established a regional flight telecommunication network among the five Common Market countries. Consideration is being given to the possibility of forming a Central American air consortium, which would make it easier for the enterprises of the different countries to purchase modern equipment and make it possible to operate international services jointly, with consequent savings in operating and administrative costs.

Since 1964 a programme has been under way to modernize telecommunication systems in Central America, for which the United Nations Special Fund has contributed a study. This will involve expanding the various national networks, which will affect the international service.

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In this connexion, the Governments have prepared a draft agreement on the establishment of a regional telecommunication system entailing an investment of about \$7 million, which would be administered by a Central American corporation. The possibility of incorporating the planned regional network into the inter-American continental network is also being studied.

## 6. Electrification

Special attention has been given in the last two years to investigating the possibilities of interconnecting national electrical systems and of promoting the joint development of their water resources. Three studies have been made during this period and another will be completed in 1965.

The first project relates to the interconnexion of the central systems of Honduras and El Salvador. It is estimated that this joint project will lead to a net saving in investment of \$30 million during the first seven years, starting from the time when the systems are interconnected, as compared with the cost of developing each system independently. The feasibility studies carried out by private consultants in 1964 confirmed the technical and economic advantages of interconnexion and outlined the general basis for a possible agreement. The Governments concerned have decided in principle to negotiate such an agreement, under which they would also undertake to investigate the possibility of joint exploitation of the water resources of their countries, with a view to making better use of them.

The second project could mean a net saving of some \$9 million and relates to the interconnexion of the electrical systems of the frontier areas of Panama and Costa Rica. Studies are at present being made on the feasibility and financing of this project with the assistance of the United Nations Special Fund. These studies are to be completed in the third quarter of 1965.

The third study investigated the possibility of interconnecting the central systems of Nicaragua and Costa Rica, which could mean a reduction of \$21 million in the investment planned and a cumulative economic gain of \$28 million over the period 1968-1975. Officials from the two countries

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met in December 1964 to consider the study and decided to set up a permanent working group to investigate the technical and financial aspects of the project in detail and to determine its short-term feasibility.

The fourth project, at present in preparation, is concerned with the interconnexion of the central electrical systems of El Salvador, Guatemala and Honduras. In addition, the possibility of making a survey of the region's water resources is under study. In this connexion, the Central American Governments approved in 1963 a project to establish a network of hydrometeorological and hydrographical stations, which the United Nations was asked to help finance.

7. Financing of development and  
monetary co-operation.

On 31 May 1965, the Central American Bank for Economic Integration will have been in operation for four years. From its establishment until 31 March 1965, it effected 91 credit transactions totalling \$34 million for the purpose of establishing and expanding 66 industrial enterprises, 21 feasibility studies and 4 loans for infrastructural and housing projects. It has approved in principle four additional loans totalling \$22 million for new infrastructural projects.

In the course of 1965, the Central American Fund for Economic Integration will become a reality. This will lead to a substantial increase in the financial resources available to meet the additional needs of investment in the public sector which will promote and strengthen the economic integration and the balanced development of Central America. The Fund will presumably be constituted by a grant from the United States Government and contributions from the five Central American Governments and will be administered by the Central American Bank. The countries of the region will be able to draw on the Fund's resources to cover the total cost - including local costs - of the projects undertaken in pursuance of national policy and national economic and social development plans.

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As a start, each of the Central American countries was expected to contribute \$1 million and the United States Government \$20 million, in the form of long-term low-interest loans. Some increase in the initial contributions is being considered with a view to raising the Fund's resources to a total of \$35 million.

The agreement to establish a Central American Monetary Union, approved by the central banks on 25 February 1964, is designed to bring about the co-ordination and concordance of the monetary, exchange and credit policies of the member countries and gradually to lay the foundation for this monetary union. So far as the institutional aspects are concerned, the agreement relies on the system of Central Banks, and establishes a Central American Monetary Council composed of the presidents of the Banks as the senior organ. In addition, four committees have been set up to deal with the following specialized technical activities: monetary policy, exchange and compensation policy, financial operations, and juridical studies. A secretariat is responsible for preparing technical studies and co-ordinating the work of the committees. Under the agreement, the Clearing House, which started operations independently in October 1961, has become a part of the monetary union as a subsidiary body of the Committee on Exchange Policy and Compensation. The average total monthly volume of compensated operations rose from 2 million in the first six months of 1962, to 7 million in the second half of 1964. It is estimated that approximately 90 per cent of the payments made in respect of intra-regional visible trade are already negotiated in local currencies.

The Central American Central Banks, in conjunction with the Bank of Mexico, adopted a special agreement on compensatory payments in September 1963, under which the parties set themselves a limit of \$3 million for regular liquidation and of an additional \$2 million for special liquidation.

### 8. Planning

In recent years, the Central American countries, with the technical advisory services of the Joint Central American Programming Mission have been actively promoting the establishment of organic planning systems which would guide public and private activity in a joint effort designed to facilitate and rationalize the economic development process. There have been significant advances as regards, the establishment of the central planning organs, co-ordination machinery in the public sector, and the preparation of basic surveys and over-all and sectoral programmes. However, in addition to the establishment and operation of internal machinery, planning in Central America calls for the adaptation of the machinery to and its co-ordination with the process of economic integration.

In all the countries of the region, there has been a strengthening of the central planning offices as technical and advisory bodies at the highest executive level and sectoral planning offices of greater or lesser scope are being organized to deal both with the strictly economic aspects and with those related to the programming of the social aspects of development.

The organization, co-ordination and preparation of basic surveys, on which programming is based, will be the first responsibilities of the central planning offices. Uniform systems of national accounting and statistics have been organized and analyses of the economy have been prepared, in most cases broken down by main sectors.

The establishment of institutional machinery and the carrying out of surveys, referred to above, have made it possible to begin with the actual preparation of economic and social development plans covering the period 1965-1969. Most of the Central American countries have already completed or are about to complete their own over-all programmes and have made considerable progress in drawing up sectoral programmes and co-ordinating them with existing machinery and general development policy. The system of programme budgeting has been

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incorporated in the operative machinery relating to the execution of plans in all the countries of the region and plans have been drawn up for short-term public investment in some countries.

Finally, reference should be made to the problems of co-ordinating the national plans and setting regional goals related to the needs and potentialities of the Central American Common Market. In 1962, the Governments agreed to work for close co-ordination of the respective country programmes in order to expedite the formulation at a later stage, of a single regional plan which would enable all the countries to benefit fully from the advantages of the regional market and lead to the complementarity established productive activities. Apart from the work of co-ordinating national plans, permanent relations have already been established among the national planning offices, which act as an advisory body to the Central American

Economic Council.