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Review

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UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
SANTIAGO, CHILE, DECEMBER 1992

CEPAL

Review

Santiago, Chile | December 1992 | Number 48

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CEPAL REVIEW No. 48

Industrial policy in Central America

Larry Willmore[*]

The Central American countries have a 40-year tradition of cooperation based on bilateral and multilateral treaties, the most important of which is the General Treaty on Central American Economic Integration, under whose terms the Central American Common Market (CACM) was established in 1960. Nevertheless, the industrial policies pursued by these countries since that time are notable for their lack of uniformity.

This article provides a concise description of the policies in effect as of mid-1992 in five countries –Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua– regarding foreign investment, the registration of new investments, tariff protection and extra-zonal export incentives, all of which influence the relative competitiveness of the subregion's industrial enterprises. Other factors affecting these countries' competitive positions, such as labour, power and water costs, are also discussed.

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Introduction

The Central American governments have traditionally maintained an open-door policy on foreign investment and, in fact, have competed against one another to attract such investment.[1] Today, however, there are important differences in the ways they treat foreign capital. Of the five countries studied, Guatemala is the only one that draws no distinction between domestic and foreign investment. In El Salvador and Honduras, small-scale foreign investment is prohibited. Nicaragua places some restrictions on all types of foreign investment, while Costa Rica, El Salvador and Honduras encourage it by providing preferential access to foreign exchange at the official exchange rate.

Bureaucratic red tape can be a stumbling block for both foreign and domestic investment. In Central America, it takes between 2-3 months (Costa Rica) and 12 months (Honduras) to register a new company. In New York, the same process takes four hours.

In small economies such as those of Central America, external tariffs often play a more influential role than market structure does in determining the type of competition that takes place because the prices of imports –whether real or potential– are what dictate the prices of local manufactures. No matter how concentrated production may be in a given industry, the possibility of importing serves as a regulatory mechanism by curbing the exercise of producers' market power.

In the 1960s, these five countries maintained a joint external tariff to protect the industries of the Central American Common Market (CACM). In the late 1970s, Honduras withdrew from CACM, negotiated bilateral treaties in its stead, and established its own external tariff. In the mid-1980s, the other four countries jettisoned their common external tariff and embarked on a unilateral tariff-reduction effort. Recently, however, all five countries have agreed to re-establish a common external tariff starting in early

[1] Two decades ago, Gert Rosenthal said that "a kind of competition has arisen among the countries as they vie to attract such capital in an effort to enlarge their share of intraregional exports of manufactures. Hence, at the national level an open-door policy on foreign direct investment is pursued, and cases in which such investment is regulated or controlled are extremely rare". (Rosenthal, 1975, p. 273; the original article was published in 1972.) See also Willmore, 1976.

1995. The new tariff will be of a less protectionist cast than its predecessor, with a 5% *ad valorem* floor and a 20% *ad valorem* ceiling.

Import restrictions and taxes generate an anti-export bias, since the incentives to produce for the domestic (or subregional) market then outweigh the attractions of exporting to other countries. All the countries in the subregion have tried to offset this bias, at least in part, by promoting non-traditional exports, especially manufactures.

The form of export promotion varies a great deal from one country to another within the subregion, but four of the five have temporary importation systems and all have customs-free manufacturing zones as well as incentives for exporters producing primarily for protected local markets. Both the differences and similarities of the five countries' policies in this field will be discussed in greater detail later on in this article.

Not only do the Central American countries have differing policies on foreign investment, company registration, tariff protection and export incentives; their labour, energy and water costs vary as well. Costa Rica has the highest wages –in fact, they are nearly twice as high as they are in the other countries; the price of electricity is fairly uniform, but gasoline is considerably more expensive in Nicaragua and Guatemala, diesel fuel is higher in Honduras and Guatemala, and drinking water costs more in Costa Rica and Honduras.

I

Foreign investment

Guatemala has no laws dealing specifically with foreign investment in the manufacturing sector, and Guatemalan-owned and foreign-owned companies therefore receive the same treatment before the law. There is, however, a voluntary register of United States-owned firms which wish to avail themselves of the guarantees provided under an agreement concluded between the Governments of Guatemala and the United States.

Costa Rica's laws do not distinguish between domestic and foreign enterprises in the manufacturing sector either, but the Central Bank does maintain a roster of foreign investors. Companies which voluntarily register their foreign capital are given access to foreign exchange at the official rate for the following purposes: (i) loan payments (on both interest and principal), provided the loan's term is not less than five years; (ii) repatriation of capital (usually after four years, although it can be done earlier); (iii) repatriation of profits, upon submission of an income tax statement; (iv) payments of royalties, subject to a 20% tax; and (v) payments for technical assistance, subject to a 30% tax and a 10% commission. Access to foreign exchange at the official rate is an important factor when there is a wide spread between the bank rate and the "black market" or parallel rate. In such instances, registered foreign enterprises have an advantage over unregistered foreign firms –as well as over Costa Rican companies, since the latter do not have the option of registering their investments. Consequently, Costa Rican policy in this area –which is applied by the Central Bank via internal regulations rather than by the Executive through laws and executive orders– is biased in favour of foreign investment and is therefore discriminatory.

In Honduras, a new investment law passed by Congress in June 1992 holds that "foreign investment complements the effect of national investment in promoting economic development and merits non-discriminatory treatment". Two articles of the relevant statute are, however, discriminatory. First, article 20 stipulates that "small-scale industry and commerce are the exclusive domain of Hondurans and wholly Honduran-owned commercial companies". There is as yet no regulation which defines what is meant by "small-scale", but the limitation of foreign investment to large and medium-scale industry is potentially significant. Second, article 4 guarantees that investors will be able to purchase foreign exchange for the following purposes: the "importation of goods and services necessary for the operation of the company, including the payment of royalties, rents and technical assistance"; the "payment of debts contracted abroad to defray corporate operational expenses and of the interest thereon"; and the "payment of dividends and the repatriation of capital on foreign investments registered under this Act".

Although this article is biased in favour of foreign investment, inasmuch as only foreign investors are guaranteed access to foreign exchange for the repatriation (or expatriation) of their capital and profits, the advantage is minimal because the same article also authorizes the "...opening of foreign-currency accounts in banks within the national system" and provides that "national and foreign investors shall be able to withdraw their deposits, either in part or in their entirety, in the same currency in which they were made".

Like the new legislation in Honduras, Salvadorian law contains a mix of foreign-investment restrictions and incentives. The 1950 Constitution states that "small-scale commerce and industry are the preserve of native Salvadorians and Central American natural persons". Executive Order 505 of 15 December 1961 (Small-Scale Commerce and Industry Protection Act) defines "small" as any company with less than US$ 10.000 in capital and prohibits investment by foreigners except in "those industrial activities ... in which native-born Salvadorians or Central Americans are not engaged"; under such circumstances, a 10-year permit may be issued which may then be renewed upon its expiration provided that no Salvadorian companies are engaged in the same activity.

El Salvador's Foreign Investment Promotion and Guarantees Act requires that all foreign investment be registered with the Ministry of Economic Affairs. Registered foreign investment is provided with the following benefits, which are not granted to Salvadorian companies: (i) the right to have foreign-currency bank accounts which may not be converted into the local currency without the authorization of the account holder; (ii) income tax credits, covered by the company in which the investment has been made; and (iii) access to foreign exchange at the official exchange rate for the repatriation of profits, the repayment of external loans, as well as royalties and technical assistance up to a ceiling of 10% of net sales, and the repatriation of capital. These benefits are clearly more generous than those provided in Costa Rica and similar to those granted by Honduras; be that as it may, their actual value to investors depends on there being a difference between the official and parallel exchange rates. No such difference currently exists in El Salvador, but one could arise in the future; if and when it does, then foreign entrepreneurs would have an advantage over Salvadorians.

At the present time foreigners may not legally invest in Nicaragua. A bill has been drafted, however, which would provide for the creation of a foreign investment commission whose job would be to approve or reject investors' applications and to oversee their conduct thereafter. The National Assembly passed a version of this bill on 12 April 1991, but it was then vetoed by the Executive, primarily because it would have given the foreign investment commission nine members rather than the five members desired by the Executive. In the latter's opinion, a commission whose members would include the Minister of Labour, the Director of the Nicaraguan Institute for Natural Resources and the Environment, a member of the Chamber of Industry and the mayor of the municipality in which the prospective investment would be located would make it quite difficult for any investment application to be approved. Under this law, the main benefits for investors, once their investment plan had been approved, would be: (i) "swift, adequate and effective compensation in the event of expropriation" and (ii) access to foreign exchange at the official exchange rate for the repatriation of profits and, after three years, capital. In addition, the foreign investment commission would be empowered to "grant exemptions, either in whole or in part, from the payment of taxes and customs duties". Foreign investors would also, however, be required to convert their foreign-exchange export earnings into the local currency at the official exchange rate.

In summary, then, Costa Rica, El Salvador and Honduras encourage foreign investment by granting preferential access to foreign exchange at the official exchange rate, but El Salvador and Honduras exclude foreign investors from small-scale industry. Guatemala accords foreign investors the same treatment as Guatemalan investors are given, while Nicaragua places some restrictions on them.

II

The establishment of new companies

New investments result in the creation of new companies, or the expansion of existing ones. The State bureaucracy may obstruct this process by making the registration of new companies costly and time-consuming. In a recent work, Hernando De Soto, author of the now famous book *El otro sendero,* cites the fact that "in Peru, it takes 289 days to register a new company, as compared to four hours in New York" as one of the causes of his country's underdevelopment (De Soto, 1992).

In this sense, Central America is quite close to Peru and very far indeed from New York. In Honduras, the minimum amount of time needed to register a new company is 12 months, while in Guatemala it takes from 10 to 12 months. In both of these countries, the steps that a company must take if it wishes to increase its capital take almost as long and are almost as costly as the procedures for founding a new company. The hurdles facing investors in El Salvador and Costa Rica are somewhat less formidable, since these countries permit the registration of open-end companies. The administrative procedures involved in their establishment take "only" four or five months in El Salvador and from two to three months in Costa Rica. Information could not be obtained on the procedures for registering companies or investments in Nicaragua.

Some Central American governments are aware that bureaucratic red tape is discouraging investment and are trying to streamline the system. The Guatemalan Congress has just passed a law which creates a "single window" for investors. Honduras's Investment Act seeks to do the same thing.

III

Protection against imports

For more than three decades the Central American countries pursued an inward-looking development strategy. In line with this strategy, they levied high tariffs on final consumer goods and exempted imports of machinery, raw materials and intermediate goods for use in their manufacturing industries.

Today, the Central American countries have eliminated all tariff exemptions and specific duties (assessed by weight or unit) and are gradually lowering their *ad valorem* tariffs on imported goods that compete with local industry. These tariff reform efforts began in 1986 in Costa Rica, El Salvador and Guatemala, in 1987 in Nicaragua and in 1990 in Honduras. All five countries have taken numerous unilateral steps, but they have pledged to return to a common external tariff within two and one-half years.[2] The new Central American tariff will be less protectionist in nature than its predecessor. It will have only four rates: 5% for machinery, raw materials and intermediate goods not produced in the subregion; 10% for machinery, raw materials and intermediate goods produced in the subregion; 15% for final consumer goods not produced in the subregion; and 20% for final goods produced in the subregion.

Current tariff protection in the five countries and the levels planned for 1993, 1994 and 1995 are shown in table 1. The top rate, which would be 20% in 1995, does not preclude the application of higher excise taxes for fiscal or health reasons. Cigarettes and perfumes, for example, could be subject to a

[2] In section 28 of the San Salvador Declaration of 17 July 1991, the Central American presidents pledged to implement a uniform Central American tariff with a "20% ceiling and a floor of no less than 5%" on 31 December 1992; the countries may, however, formulate "a short list of products to which the agreed levels will be applied no later than 31 December 1994, for which purpose a tariff-reduction programme shall be established".

Table 1

CENTRAL AMERICA (FIVE COUNTRIES): IMPORT DUTIES

(Percentages)

	1992	1993	1994	1995
Costa Rica	5 - 46 [a]	5 - 40	5 - 31	5 - 20
El Salvador	5 - 30	5 - 25	5 - 20	5 - 20
Guatemala	5 - 30 [b]	5 - 20	5 - 20	5 - 20
Honduras	5 - 35 [c]	5 - 20	5 - 20	5 - 20
Nicaragua	5 - 60 [d]	5 - 20	5 - 20	5 - 20

Source: Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA), *Políticas económicas vigentes en los países centroamericanos a enero de 1992,* Guatemala City, February 1992, and information supplied by the Ministry of Economic Affairs of each country.

[a] A temporary 2% surcharge on imports from outside the subregion was discontinued in March 1992. The Central Bank of Costa Rica required advance deposits until the end of 1991.

[b] Includes a 3% surcharge on imports from outside the subregion.

[c] Includes a 5% across-the-board surcharge (except for machinery and equipment) and an additional 10% surcharge on final goods.

[d] Includes excise taxes at rates of up to 40% which function much like import duties.

100% tariff rate, but if these items are produced locally for the domestic market, they will be subject to an 80% tax on their factory gate value. This measure will ensure that high customs tariffs do not become highly protective tariffs. [3]

Costa Rica currently has tariffs ranging from a 5% rate on machinery and parts to a 46% duty on "sensitive items" (textiles and footwear). For fiscal reasons, the Government maintains a tariff floor of 10% on imports of raw materials and intermediate goods. This puts Costa Rican industry at a disadvantage in competing with other Central American producers, but at least it is better off than it was in 1991, when the 10% floor also applied to machinery and parts and a 10-percentage-point surcharge was levied on all imports from outside the subregion. By the end of 1994 the country hopes to have its target tariff structure in place, which would be composed of *ad valorem* rates of between 5% and 20%.

El Salvador's present import duties range from 5% to 25%, with the exception of textiles and leather footwear, which are subject to rates of up to 30%. In mid-1993 the tariff ceiling is to be lowered to 20% (25% for textiles and footwear), and by June 1994 all tariff rates are to be between 5% and 20%. The Salvadorian Government does not impose quotas, surcharges or advance deposit requirements on imports and maintains a single, free-floating exchange rate.

Guatemala's tariff structure is very similar to El Salvador's. At the present time its rates go from 5% to 30% (including a three-percentage-point surcharge), but the Minister of Economic Affairs has slated a reduction of the top rate to 20% for early 1993.

Under Honduran law, tariff rates have already been brought down to a range of 5%-20%. However, five-percentage-point surcharges are applied to imports of all goods (except capital goods) and another 10 percentage points are added to final consumer goods. Thus, in effect, Honduran producers are in the same position as Costa Rican producers in that they pay a minimum tariff of 10% on imports of raw materials and intermediate goods. It is not yet certain when these import surcharges will be discontinued, but it is supposed that they will be eliminated some time in 1993.

A number of past Honduran administrations, like some of their counterparts in other countries of the subregion, have on occasion made use of import licenses and export permits to protect certain producers or to help out consumers. It is therefore of

[3] Section 28(2) of the San Salvador Declaration permits the preparation of "a limited list of exceptions comprised of products of a fiscal nature on which a tariff above 20% may be levied". If such goods' locally-produced (whether actual or potential) counterparts are exempted from the payment of these special tariffs, this provision could end up promoting the production of these "products of a fiscal nature", which would entail a loss of tax revenue.

interest to note that, under article 4 of the Investment Act, the current administration guarantees entrepreneurs "freedom to import and export goods and services without being required to obtain prior authorization or administrative permits" and pledges to uphold "the principle of free determination as it applies to the prices of the products or services they offer".

Nicaragua lowered its tariff ceiling to 20% in 1990. At the same time, it introduced a number of selective consumption taxes (excise taxes). Many of these taxes, such as those levied on liquor, cigarettes, soft drinks and beer, really are consumption taxes, because they apply to both locally-produced and imported products. Others, however, are actually selective tariff surcharges, since locally-produced goods are exempted. These "hidden" tariffs are charged on imports from any source (even within Central America) and can add up to 40 percentage points (as in the case of fancy biscuits and crackers) to the legally-established tariff. In any event, this is only a temporary measure, since these excise taxes are being lowered every six months and will have been phased out entirely by January 1993.

IV

Export incentives

The protection of the countries' or the subregion's markets creates two types of anti-export biases. The first stems from the fact that machinery, equipment, raw materials and intermediate goods are purchased at prices higher than the going rate on the international market; the higher the tariff floor is, the higher the cost of such inputs to the actual or potential exporter. The second bias arises out of the fact that a given product brings a higher price on the protected local market than it does on competitive export markets, thereby making import substitution more attractive than exporting. For these two reasons, the volume of exports is less than it would be under a free trade system.

1. *Customs-free zones*

The creation of customs-free zones for manufacturing activities is a way of eliminating much of this anti-export bias, at least for the industrial concerns located within them. Such zones exist in each of the five countries, although Honduras calls them by a different name ("export processing zones" (EPZs)). Nicaragua has passed no new legislation on this mechanism nor has it seen any recent investment of this type, but a customs-free zone which pre-dates the Sandinista Revolution does exist and is now run by a government agency called the People's Industrial Corporation (COIP).

The companies in these special enclaves generally operate under a free trade system whereby they have the right to buy inputs anywhere in the world, manage their accounts in whatever currencies they wish, and export their products to other countries. They also enjoy other privileges, such as lower taxes and freedom from the regulations applying to industry in the rest of the country. The key to success for a customs-free zone is authorization of duty-free importation of inputs on condition that they will subsequently be re-exported or used in manufacturing products for export. As one specialist in such customs-free zones has explained (Warr, 1989, p. 34), "Although the details of these provisions vary, a universal feature is the almost complete absence of either taxation or regulation of imports of intermediate goods into the zones".

Costa Rican law does not fit in with this "universal feature" because the government protects the producers of inputs by permitting them to register complaints with the Bureau of Industry. If the Bureau finds that Costa Rican producers can match such imports in terms of price, quality and delivery times, then companies in the customs-free zones must "give priority" to locally-produced inputs.

These restrictions set Costa Rica apart from the rest of the world insofar as legal provisions pertaining to customs-free zones are concerned. Entrepreneurs who choose to set up shop in a zone of this sort do so primarily because of the possibility of becoming more competitive by remaining outside the country's customs jurisdiction and being able to buy raw materials and intermediate goods of the desired quality at the best possible price by seeking them out in any part of the world whatsoever. If Costa Rica were to enforce its laws strictly, these firms' competitive positions would suffer. And if the intention is not to apply the law, then it would be better to amend it so as not to discourage investors. What is more, the above-mentioned provision is entirely superfluous, since no firm is going to import inputs if it can acquire them locally on the same terms.

All the governments of the subregion grant 100% exemption from profits taxes to enterprises in the customs-free zones (see table 2). Many of them place a 10- to 12-year limit on these exemptions, but this is usually not enforced. The firms that set up operations in such customs-free zones are internationally mobile, or "footloose". Firms that shut down their operations in one country generally migrate to another country's customs-free zone where conditions are better. Thus, the profits tax exemption is almost always renewed when its initial term expires. These footloose firms are also given at least partial exemption from other lesser taxes, such as land taxes and taxes on installed capacity.

Companies in the customs-free zones are given such privileges on condition that they export what they produce, that their output is used within the zone itself or that all imported products are re-exported. The laws of the Central America countries do, however, permit such companies to sell a portion of their output to buyers within their territories provided, of course, that all the corresponding duties are paid. In Guatemala up to 20% of such firms' output may be sold on the local market, and in Costa Rica the figure is 40%. In El Salvador and Honduras the law sets no limit in this respect, but all prospective sales on the domestic market must first be approved by the Government (see table 2).

One condition which makes customs-free zones less attractive to footloose companies is the requirement that they be physically located within a certain area. The countries have shown themselves to be flexible on this point, however. At present, two-thirds of the nearly 100 firms operating in Costa Rica's customs-free zones have built "satellite plants" outside the physical boundaries of the zones as a way of dealing with labour-recruitment difficulties or, in some cases, with problems of environmental pollution that make it advisable for them to move away from other industrial plants. In El Salvador, Executive Order No. 461 of 15 March 1990, which in effect constitutes a law on the country's customs-free zones and fiscal precincts, is more explicit in this regard; it states that "firms which export the whole of their output ... and which for technical reasons are not located within a customs-free zone may request that their premises be declared a fiscal precinct ..." (article 20) and specifies that exporters operating within fiscal precincts shall enjoy the same tax incentives as those operating within customs-free zones (article 22).

2. *Temporary importation*

Temporary importation systems have some advantages over customs-free zones in that they permit plants which assemble imported inputs for subsequent exportation ("*maquiladoras*") to locate their facilities anywhere in the country. This allows them to make use of existing infrastructure and thus to avoid costly investments in new industrial complexes. This system is similar to El Salvador's "fiscal precincts", but is much more flexible. The entrepreneur must guarantee that these temporarily imported inputs will be exported within a specified time span, usually one year. No other restrictions are placed on such imports in the subregion. With the exception of El Salvador, the countries also permit duty-free importation of machinery and equipment. As in the case of firms within customs-free zones, each country exempts these assembly plants from profits taxes (see table 3).

Plants operating under the temporary importation system are prohibited from selling their products on the local market in Costa Rica and Honduras. El Salvador and Guatemala permit unlimited sales on the sole condition that the corresponding duties on the final product are paid. *Maquila* activities in El Salvador also receive a drawback equivalent to 8% of the value added, but only once the products have been exported to markets outside the subregion. For the time being Nicaragua has no specific laws on the subject, nor has any bill regarding such activities been drafted.

As a rule, temporary importation mechanisms have been devised as a way of assisting exporters who use many imported inputs and add little value to them within the national territory, but the laws of the Central American countries do not clearly set out the system's eligibility requirements. One way of deciding whether a given concern is or is not a *maquiladora* is to determine how much value the activity adds to the product in question. In Guatemala, Executive

Table 2

CENTRAL AMERICA (FOUR COUNTRIES): CUSTOMS-FREE INDUSTRIAL ZONES

	Costa Rica	El Salvador	Guatemala	Honduras
Tax exemptions				
Imports of machinery and inputs	100%[a]	100%	100%	100%
Profits	100%, 8 yrs 50%, 4 yrs	100%, 10 yrs renewable	100%, 12 yrs	100%
Sales on local market	Up to 40%, subject to approval	Unlimited, subject to approval	Up to 20%, subject to approval	Unlimited "when the same sort of product is not produced in the country", subject to approval

Source: The relevant legal provisions of each country.
[a] No restrictions are usually placed on imports going into the zone, but imports of raw materials or inputs can be restricted if the Bureau of Industry finds that Costa Rican producers can meet the importing companies' requirements in terms of price, quality and delivery times.

Table 3

CENTRAL AMERICA (FOUR COUNTRIES): TEMPORARY IMPORTATION SYSTEMS (MAQUILA ACTIVITIES, DRAWBACKS)

	Costa Rica	El Salvador	Guatemala	Honduras
Tax exemptions				
Imports of machinery	100%	-	100%	100%
Imports of inputs	100%	100%	100%	100%
Profits	100%[a]	100%, 10 yrs, renewable	100%, 10 yrs	100%, 10 yrs
Sales to local market	No	Unlimited, with payment of corresponding taxes	Unlimited, with payment of corresponding taxes	No
Export incentives	No	Drawback of 8% of value added	No	No

Source: The relevant legal provisions of each country.
[a] In the case of registered foreign investments, a 15% tax is levied when profits are repatriated.

Order No. 29-89 defines *maquila* activities "as those devoted to the production and/or assembly of goods ... containing at least fifty-one per cent (51%) foreign merchandise", or, in other words, a maximum of 49% national value added. The distinction between *maquila* and non-*maquila* activities is irrelevant in Guatemala, however, since any company can make use of the temporary customs-clearance system.

3. *General incentives*

Companies operating in customs-free zones or under temporary importation systems export almost all of their output. Even in cases where they are allowed to sell their goods on the local market, they must pay the same tariffs as those levied on firms located abroad. The vast majority of Central American manufacturing firms produce goods for the

Table 4

CENTRAL AMERICA (FIVE COUNTRIES): INCENTIVES FOR EXPORTS OF NON-TRADITIONAL MANUFACTURES

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Tax exemptions					
Imports of machinery and inputs	100%	-	100%	100%	100%
Profits	100%[a]	-	100%, 10 yrs	100%, 10 yrs	80%
Taxes on exports	-	-	1.5%	1%	-
Tax credit certificates (CATs)	Up to 12% of FOB value[b]	-	-	-	15% of FOB value[c]
Cash drawbacks	-	8% of FOB value	-	-	-
Requirements	Minimum 35% national value added	-	-	Provide at least 25 jobs directly	Export at least 25% of output

Source: The relevant legal provisions of each country.

[a] In the case of registered foreign investments, a 15% tax is levied when profits are repatriated.

[b] Annual decreases will have phased out the CATs entirely by 1997.

[c] To be lowered to 10% in 1993, to 5% in 1995 and to zero in 1997.

protected local market, but some of them are in a position to export at least a portion of what they produce. All the countries in the subregion have more flexible legislation regarding these "part-time" exporters.

Table 4 provides an overview of the incentives for exports of non-traditional manufactures in each of the five countries. These incentives do not apply to exports going to other countries within the subregion, but they do apply to sales to companies in customs-free zones. Salvadorian law in this area is surely the most straightforward; it simply directs that a cash payment equivalent to "8% of FOB value [is to be granted] to offset import duties and other indirect taxes on export activity" (article 3 of Executive Order No. 460 of 15 March 1990). The law's simplicity is its main virtue, since it thus streamlines the corresponding administrative procedures. Furthermore, this system enables El Salvador to provide incentives to exporters without exempting them from import duties, thereby encouraging the use of locally-produced inputs. The system does have a disadvantage, however: since not all inputs are subject to the same tariff rate and not all products face the same anti-export bias, the across-the-board drawback may be too much for some activities and too little for others.

The rest of the countries offer various sorts of incentives to exporters. All permit duty-free importation of machinery, equipment and inputs used in the production of goods for export. All the countries also provide these firms with exemptions (although to differing extents) from taxes on the profits they realize from their export activities. Nicaragua provides them with exemptions from 80% of such taxes only, while Guatemala and Honduras place a 10-year limit on such allowances.

Since 1972 Costa Rica has issued tax credit certificates, or CATs, which originally were worth 15% of non-traditional exports' FOB value (the value of the merchandise once on board the ship or airplane, not including freight or insurance charges). As this incentive has proven to be very costly to the government, however, it has decided to phase out CATs over the next few years.[4] Costa Rica currently offers CATs equivalent to 8% of the FOB value of exports containing 35%-40% national value added, and an additional 1% for each five additional points of value added up to a maximum of 12% for exports incorporating 55% or more national value added. In Nicaragua, CATs equal to 15% of exports' FOB value are provided regardless of the amount of national value added. This may be an over-generous incentive for assembly or *maquila* activities, but it will be a short-lived one, since the rate is to be lowered to 10% in 1993, to 5% in 1995 and to zero in 1997.

Guatemala and Honduras are the only countries in the subregion which do not give either cash drawbacks or tax credit certificates to exporters of manufactures. They are also the only ones that tax such exports. The tax is a small one (1.5% and 1% of their value, respectively), but the fact that it exists at all does nothing to help eliminate the anti-export bias, since it leaves open the possibility of a rate hike at some future date.

Two of the countries –El Salvador and Guatemala– offer incentives to all exporters of non-traditional manufactures, no matter how small their export volumes or percentage of national value added. El Salvador's Export Reactivation Act even offers incentives to exporters of traditional products (defined as coffee, sugar and cotton), provided that they process the goods enough to generate at least 30% added value. Costa Rica requires that exports have at least 35% national value added in order to be eligible for CAT incentives. Honduras limits these benefits to relatively large companies by requiring that the exports directly create at least 25 jobs. In Nicaragua, some potential exporters do not receive any encouragement whatsoever because existing incentives are only for firms that export at least 25% of their output.

V

Labour, energy and water costs

The minimum wages and workers' benefits in effect in each Central American country are shown in table 5. It should be noted that the minimum wages cited in the table refer to the manufacturing sector as a whole rather than to specific companies. Many firms, especially the larger ones and those that export most of their output, pay higher wages, but they also hire people who are more highly skilled or who have greater training potential.

The range of wages and benefits in Central America is very wide. Wages are highest in Costa Rica; in fact, they are about double what they are in the other four countries. Legally-mandated annual vacation leave is fairly generous in Nicaragua (30 days), as is the number of public holidays (17 days). Total benefits, measured as a percentage of the base wage, are greater in Nicaragua (64%) than in any of the other countries, partly because of the custom of giving workers a basket of staple foods for their families each month; the lowest levels are found in Honduras and El Salvador (27%).

The additional costs incurred by a company when it dismisses a person for reasons other than misconduct are not included in table 5. This legally-guaranteed severance payment is equivalent to one month's wages per year of employment in all five countries.

Energy and water costs affect the competitiveness of the manufacturing sector in Central America, in addition to labour costs. Electricity rates do not vary a great deal from one country to another, but are highest in Guatemala, followed by Costa Rica and Nicaragua. Firms which are heavy consumers of electricity pay less per kWh, while those who use very little pay much more than the average amounts shown in table 5. It is also important to note that these prices do not include the cost of blackouts, which occur frequently in El Salvador and Nicaragua. Gasoline prices are substantially higher in Nicaragua and Guatemala, diesel fuel is costlier in Honduras and Guatemala, and drinking water is more expensive in Costa Rica and Honduras.

[4] Hoffmaister (1992) estimates that between 1984 and 1989 each dollar's worth of CATs generated US$ 1.34 in *gross* exports and US$ 0.80 in imported inputs which were then incorporated into the goods to be exported. Thus, on average, each dollar's worth of subsidy generated only US$ 0.54 in net exports. During this period most non-traditional exports received 15% CATs, subject to the requirement that the products contain at least 35% national value added.

Table 5

CENTRAL AMERICA (FIVE COUNTRIES): COSTS OF LABOUR, ENERGY AND WATER [a]

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Minimum monthly wage (dollars)	153.31	83.00	68.00	85.00[b]	76.00
Social security (%)	14.0	13.25	10.0	7.0	12.0
Other taxes (%)	8.0	-	1.3	1.0	2.0
Paid public holidays (days/year)	6	11	12	11	17 [c]
Paid vacations (days/year)	15	15[d]	15	10[e]	30
Year-end bonus (days)	30	10[f]	30	30	30
Food basket (%)	-	-	-	-	26.3
Total benefits (%)	36.7	26.6	28.5	27.3	64.2
Total cost per month (dollars)	**209.57**	**105.08**	**87.38**	**108.20**	**124.79**
Work week (hours)	48	44	44	44	48
Total cost per hour (dollars)	1.02	0.56	0.46	0.57	0.60
Exchange rate for the dollar	138.30	8.10	5.09	5.40	5.00
Electricity (dollar/kWh) [g]	0.06	0.05	0.07	0.05	0.06
Regular gasoline (dollar/gallon)	1.29	1.45	1.76	1.32	1.90
Diesel fuel (dollar/gallon)	1.09	0.87	1.17	1.19	1.10
Drinking water (dollar/m^3) [h]	0.60	0.08	0.11	0.31	0.10

Source: Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA), *Precios que inciden en los costos de producción del sector industrial de los países del istmo centroamericano a enero de 1992*, Guatemala City, February 1992, and research by the author.

[a] The figures shown in this table correspond to early 1992.

[b] Legal minimum wage for firms having over 15 employees; the minimum wage is 14% lower for firms having 6-15 employees and 30% lower for those with 5 or fewer employees.

[c] Managua only; workers in the rest of Nicaragua are legally entitled to 15 paid holidays per year.

[d] For annual vacation leave an additional payment equal to 30% of the worker's wage is required.

[e] For persons who have been employed for less than two years; workers who have been employed for two years receive 12 days of paid vacation; those with three years receive 15 days; those with four years or more receive 20 days.

[f] For workers who have been employed for less than three years; workers employed for 3-10 years receive a bonus equivalent to 15 days' wages; persons who have been employed for 10 years or more are legally entitled to a bonus equivalent to 18 days' wages.

[g] Approximate average for industrial use.

[h] Cost in the capital city of each country.

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