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Gert Rosenthal

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Carlos Massad

Director of the Review
Aníbal Pinto

Technical Secretary
Eugenio Lahera



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WORLD BANK

Reorientation of Central American integration

*Rómulo Caballeros Otero**

The Central American countries promoted a vigorous integration process which gave rise to valuable experience. The increased trade furthered industrialization and stimulated investment, modernization of production and economic growth. However, the exhaustion of the past growth model based on agricultural exports and the persistence of the system of over-protection of substitution industry, which was continued longer than was necessary, led to a profound crisis in the economies and in the integration programme itself.

On the basis of a review of that experience and reflections on the present conditions and the role that community action can play in a new development strategy, this article presents some proposals for rethinking the process. It is proposed to move from a demand-based approach to one based on the complementation of supply, as an essential means of achieving a new and effective form of insertion in international trade and thus regaining the path to development in Central America.

*Head of the Economic Development Section of the ECLAC Subregional Headquarters in Mexico.

Introduction

In the mid-1940s, the governments of the Central American countries began to move towards closer mutual relations, which were achieved in 1951 with the signing of the Charter of the Organization of Central American States.

In the 1950s, there were many initiatives which reflected the political will to progress in various aspects of these links. It was only in 1960, however, that the countries signed the General Treaty on Central American Economic Integration, which was to be, for a number of years, one of the most important factors in the growth and industrial development of the economies of the region.

In spite of the spectacular results achieved with regard to intra-regional trade during the first decade of application of the Treaty, unfortunately timely action was not taken to correct some shortcomings of the system, such as the lack of mechanisms to avoid the benefits of the increased trade being concentrated in a few countries. This led to one of the parties suspending its integration commitments in 1971. In the 1970s, intra-regional trade continued to grow and the institutional system was further consolidated, albeit against the background of an abnormal legal situation tolerated by the parties, since one of the countries was only participating partially in the commitments originally entered into.

In the early 1980s, the region suffered the effects of the international economic crisis. The exhaustion of the growth model based on agricultural exports and import substitution, which had facilitated the integration process in the past, now became evident. First the depletion of the international reserves, and then the scarcity of external resources obliged the governments to seek greater national financial stability. This led to the almost complete abandonment of the integration instruments and commitments, and hence to a systematic decline in intra-regional trade. This was yet another element which depressed the national economies by weakening regional demand, and this tendency lasted throughout almost the whole of the 1980s.

In mid-1990, the Central American Presidents met in Antigua (Guatemala) to redefine the future role of integration as an important element in a new strategy of openness to the exterior and modernization of production.

In the context of this renewed impulse for integration, expressed at the highest regional political level, this article presents some reflections based on various studies carried out at the ECLAC Subregional Headquarters in Mexico (ECLAC, 1991a, b and c) regarding two processes which it is considered must be simultaneous and must be initiated as soon as possible: i) the preparation and negotiation of a new

legal and institutional scheme to back up progress towards a Central American economic community, and ii) the normalization of the legal aspects of the present scheme and the application of measures designed to reactivate trade, together with other measures in respect of mutual economic relations designed to boost national efforts to return to the path of development.

I

A retrospective view

In order to understand the outlook for a new integration process, it is worth recalling the experience built up by the region over the last 30 years. This section therefore seeks to draw up a general balance-sheet of the process in order to draw lessons from this and identify the aspects which could be improved. The following analysis distinguishes between four stages corresponding to the marked changes in trends observed over the period 1960-1990: i) buoyant growth and normality, ii) institutional abnormality, iii) emergence of the crisis, and iv) deepening of the crisis.

1. The period of growth and normality (1960-1969)

In 1960, after various attempts to work out an economic cooperation scheme, the Central American Common Market (CACM) was finally set up with the purpose of achieving faster and more autonomous regional development: the General Treaty on Central American Economic Integration was signed in Managua and formally came into effect in four countries in June 1961, with Costa Rica entering the system in July 1962.

Once the free trade area and the common external tariff (which eventually covered 96.7% of the regional tariff universe) had been established, the new integration process rapidly gave rise to steady growth in trade. Thus, trade rose from a little over US\$30 million in 1960 to nearly US\$300 million in 1970, and the common market's share in the total external trade of the region rose from 6.7% in 1960 to 20% in 1966 and 26.1% in 1970. The industrial sector expanded, and productive activities in general

were boosted. A Central American highway system was built, fleets of heavy transport vehicles were established, a Central American telecommunications system was set up, and an interconnected electricity grid was constructed. In addition, regional financial support was mobilized for important infrastructural works and for the main production sectors.

The common external tariff consolidated the creation of a regional space by eliminating distortions in competition and in the allocation of investments caused by the existence of different national tariff systems with clear fiscal orientations. Together with the free trade area, the common external tariff played an important role in Central American industrialization, in the training of new entrepreneurs and in the building-up of management capacity. A particularly important feature was the high share (90%) of industrial products in intra-regional trade. This represented a significant change from the traditional investment model and gave rise to some reallocation of capital for the creation of new production capacity, as well as new jobs offering higher productivity and wages than in other sectors of the economy.

The common external tariff encouraged investment in the manufacturing sector because of the tariff protection given, which was high in some cases. Even so, however, in general it did not reach the level of protection given in other Latin American countries nor that of the non-tariff protection prevailing in some of the industrialized countries.

The regional system of institutions also played a very important role. Within a few years of the signing of the Treaty, the range of functions of the

region's institutions was widened through the establishment of a Central American institutional system made up of the specialized regional bodies and of commissions and committees with specific competence in particular sectors.

Despite the favourable effects of integration on the national economies, however, the process became bogged down at the level of the free trade area, since only trade in goods was liberalized and mobility of factors was never introduced.

Gradually but increasingly, some contradictions in the scheme began to emerge, including the unequal shares of the countries in regional trade, the lack of flexibility of the system for correcting tariff imperfections, the operational difficulties in implementing the Central American Agreement on Fiscal Incentives for Industrial Development, the failure to foresee the difference in national capacities to adapt to the stimuli of the expanded market, and the exhaustion of the easy stage of import substitution.

At the same time, the incorporation of many aspects of integration into the activities of the institutions without having made the necessary modifications in the latter was gradually creating two bottlenecks: i) the increase in the budgetary needs of the institutions, which raised problems of allocation of funds in each of the countries, and ii) the growing difficulty of the organs of the General Treaty in directing Central American integration as the process became more complex and incorporated new sectors of activity (agriculture, transport, etc.). The incorporation of new sectors called for decisions on matters coming within the competence of several ministries, whereas the organs of the General Treaty were made up exclusively of representatives of the economic authorities.

2. *The period of institutional abnormality (1970-1978)*

In 1969, the dissatisfaction of Honduras with the integration process on account of the unequal trade benefits received, and its growing problems with El Salvador, led to an armed conflict between the two countries. Despite the shortness of the war, it had consequences which continued to affect the integration process until only a few years ago. From that

period onwards, the process was carried on in abnormal conditions because one of the members of the CACM withdrew from the organization, which had adverse consequences for trade liberalization and further increased the inequality of the industrialization opportunities.¹

Intrazonal trade –as measured by exports– continued to increase, however, until it reached a peak of US\$1 250 million in 1978, representing around 25% of the total exports of the region.

Since mid-1971, three types of macroeconomic imbalances which threatened to destabilize the economies were identified (ECLAC, 1971): in the balance of payments, in public financing, and in regional trade. The balance of payments of the region *vis-à-vis* the rest of the world had deteriorated with the passage of time, and the import component had become less and less flexible because of the change in the composition of imports: finished goods gave way to capital goods and intermediate inputs used in the process of import substitution.

In general terms, the composition of intra-regional trade did not change substantially between 1970 and 1980, since it continued to be concentrated on manufactures for final consumption, above all textiles, food products, and industrial chemicals. These branches represented over 55% of intra-regional imports in 1970, and in 1980 the figure still stood at 51%.

The two main intra-regional exporters also continued to be the same countries as before. In 1970, Guatemala was the main intra-regional exporter (with 35.6% of sales), followed by El Salvador (25%) and Nicaragua and Costa Rica (around 16% each). The share of Honduras in intra-regional sales went down from 12% in 1968 to 6% in 1970. In 1980, Guatemala continued to generate 35.7% of total exports within the region, and El Salvador, 26.2%. The most noteworthy changes were the growing share of Costa Rica, which almost reached the level of El Salvador (23.9% of regional sales), and the decline of

¹Through decree No. 97 of 31 December 1970, the Honduran Government took the country out of the free trade system by imposing tariffs on intra-regional imports. Because of the conflict with El Salvador, diplomatic relations between the two countries were broken off until 1980.

Nicaragua as an intra-regional supplier to a level (6.7%) even below that of Honduras (which accounted for 7.4% of total exports).

3. *The emergence of the crisis (1978-1984)*

Between 1978 and 1984, the CACM gradually became weaker for various reasons. As from 1979, the Central American countries faced serious difficulties: the decline in the demand for exports to third countries and the further rise in oil prices aggravated the fragile situation of the region's trade. The member States thus encountered increasing difficulty in meeting their obligations and maintaining full freedom of intra-regional trade. The "chronic debtors", as well as sometimes lacking foreign exchange to make their payments, tended to give priority to payments to creditors and financial institutions from outside the region when they did have such foreign exchange. For their part, the creditors took measures to avoid entering into trade transactions when these were not backed up by immediate payment in foreign exchange.

Intra-regional trade slumped in this period to a little over half the amount registered at the end of the 1970s, and there was no indication that this decline was likely to stop (see table).

Nicaragua and El Salvador suffered from heavy deficits in their trade with the other countries, and in 1982 Costa Rica adopted restrictive trade measures against Nicaragua. The Central American Clearing House became in practice a credit mechanism for financing the debit balances between pairs of countries, thus weakening the multilateral nature of the payments system. The result was a form of intra-regional trade settled bilaterally through payments in foreign currency, or characterized by the adoption of barter or bilateral credit procedures.

The economic crisis in the region also gave rise to a constant decline in the effectiveness of the institutional framework of the integration process. On the one hand, governments adopted resolutions aimed at revitalizing the process, but on the other they cut down the budgets for the regional institutions –especially the Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA) and the Central American Economic Integration Bank (BCIE)– whose capacity

to cope with the various problems of integration was thus reduced.

The delays by member countries in paying off their debts with the BCIE became chronic, and this limited the Bank's capacity to finance new projects. This situation was further complicated by problems of organization and administrative management in the institution. The Central American Monetary Stabilization Fund (FOCEM) was exhausted, and on top of this there were the countries' needs to change their exchange and monetary policies, so that the regional impact of the CACM was reduced, and there was growing disharmony in this field.

4. *The deepening of the crisis (1985-1990)*

The integration crisis became even worse during the period 1985-1990 on account of the persistent lack of a political definition on the importance and desirable features of intra-regional links, in view of the continuing irregular nature of the CACM. In addition, there was the problem of the abnormal external relations of Nicaragua. Because of the weakening of integration as an institution and as an "idée-force", national strategies to meet the crisis did not give a central place to integration. On the contrary, in this period the application of adjustment and stabilization programmes at the national level became more generalized and more intensive, leading to the almost complete abandonment of the integration instruments. As the programmes were defined individually by the countries –in some cases in line with programmes negotiated with international financial institutions– it was virtually impossible to coordinate rates of action, time limits and degrees of implementation at the regional level.

In 1986, intra-regional trade reached its lowest ebb (US\$417.6 million, or only 10.4% of total exports), because of the serious imbalances in intra-regional trade and the collapse of the regional payments system due to the accumulation of intolerable debit balances between pairs of countries.

As from 1988, however, the integration process showed its intrinsic vigour: intra-regional trade stopped falling and began to recover slowly but surely. Although the number and value of the transactions carried out within the framework of

Table

**CENTRAL AMERICA: VALUE OF INTRA-REGIONAL TRADE AND ITS
RELATIVE WEIGHT IN TOTAL EXPORTS OF GOODS (FOB)**

	1970	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989 ^a	1990 ^b
Value of exports to the rest of Central America (thousands of Central American pesos)													
<i>Total</i>	286 304	536 380	1 129 157	936 790	765 455	766 623	719 182	487 816	417 567	506 141	548 991	651 679	638 900
Costa Rica	46 091	107 227	270 328	238 023	167 196	198 184	192 913	142 904	100 507	109 612	129 800	144 575	123 100
El Salvador	73 768	141 759	295 795	206 483	174 229	164 894	156 217	95 728	90 984	119 598	139 801	182 548	154 000
Guatemala	102 345	168 227	403 727	355 501	320 068	308 689	285 238	205 127	192 005	232 200	236 441	261 290	287 600
Honduras	18 044	26 593	83 888	65 911	51 876	61 380	47 722	19 893	18 836	25 931	23 800	38 324	37 800
Nicaragua	46 056	92 574	75 419	70 872	52 086	33 476	37 092	24 164	15 235	18 800	19 149	24 942	36 400
Value of exports to the rest of Central America, as a percentage of the value of total exports													
<i>Total</i>	25.5	22.8	23.1	21.4	20.0	20.0	18.1	12.9	10.3	13.3	13.8	15.4	14.4
Costa Rica	20.0	21.7	27.0	23.8	19.2	23.2	19.3	15.2	9.3	9.9	11.0	10.8	9.1
El Salvador	31.3	26.6	27.5	25.9	24.7	21.8	21.5	14.1	11.7	20.2	23.0	36.7	26.5
Guatemala	34.5	26.2	26.6	27.5	27.4	28.3	25.2	19.3	18.3	23.7	22.0	22.8	23.1
Honduras	10.1	8.6	9.9	8.4	7.7	8.8	6.5	2.5	2.1	3.1	2.7	4.0	4.0
Nicaragua	25.7	24.7	16.7	14.0	12.8	7.8	9.6	8.0	6.2	6.4	8.1	8.6	11.3

Source: ECLAC, on the basis of official figures and data provided by the Permanent Secretariat of the General Treaty for Central American Economic Integration (SIECA).

^a Revised preliminary figures.

^b Preliminary figures.

the Central American Clearing House tended to be close to zero, mutual trade found ways of offsetting this state of affairs. On the one hand, agreements were reached between pairs of Central Banks, and on the other, enterprises made arrangements to accept payment in their respective national currencies.

Intra-regional trade continued to be restricted to the "traditional" products traded between the countries in the past, while because of the opening up to supply by third countries, a reverse form of substitution took place, with intra-regional sources of supply being replaced by external suppliers. In the case of agricultural products, the limitations persisted on free trade in basic grains and other food items such as edible oils, dairy products and poultry products.

In short, although the process displayed great vitality in its first phase, since a system of integration actions was kept in effect and mutual trade

machinery was established, numerous internal and external factors acted to check this dynamism and maintained the integration process at an incomplete stage. The programme gradually flagged because of the disputes over its real beneficiaries, the exhaustion of the easy stage of import substitution, the inability to put into practice initiatives such as those concerning integration industries, and the deterioration of the multilateral payments system because of growing problems of liquidity.

At present, even though the strong links of interdependence built up in recent decades still exist, and there is still a political will to take advantage of integration as one of the motive forces for resuming the path of development within the framework of a growth model, the legal anomalies still persist and the process still suffers from the weakness of an institutional framework designed for an outmoded integration model.

II

Elements conditioning a new development strategy

The changes which have taken place in the international environment, together with the new situations which have arisen in Central America, form a set of conditions and challenges that must be faced in defining a new Central American development strategy. It is clear, however, that economic integration continues to be just as necessary as it was in the past, although now in a different context.

1. The international environment

The tasks of stabilization, adjustment and economic recovery facing the Central American countries must now be carried out in an international economy which tends towards the regionalization of markets and the emergence of new trade barriers.

The first of these tendencies is reflected in the formation of great economic and political blocs polarized around North America, Western Europe and the Pacific, which mean a realignment of world economic power. Clearly, the formation of these subsystems calls for changes in traditional styles of bilateral and multilateral negotiation and cooperation. Agreements and conflicts within a multipolar international structure involve an interaction of interests which is not foreign to national policies but goes beyond them. The logic imposed within each expanded economic and political space and the degree of coordination with other blocs filter and subtly influence the interests of each country.

In this new institutional framework which may be expected to govern international relations in the future, it must be borne in mind that the countries or zones which are not as yet aligned with those international subsystems cannot avoid taking a stand on their own linkages with them. The definitions of the links with these international blocs –in terms of forms, preferences and rates of change– will decisively influence national development strategies and even regional development proposals.

The second trend connected with the process of regionalization is reflected in the propensity to intensify protectionist policies within each bloc. In contrast with the paradigm which is supposed to

be in force, and in view of the foreseeable incidence of recessionary conditions, the possibility of consolidating policies for the liberalization of trade in goods and services and movements of labour between countries still seems far off. The persistence of protectionist practices, such as those defended in the Uruguay Round of GATT, augurs frequent friction between the macroeconomic policies of the industrialized countries and the blocs which each of them are forming.

2. The regional framework

In this last decade of the twentieth century, Central America has largely overcome the regional political crisis, but the economic crisis persists.

The end of the regional political crisis was the result of a great effort at consensus building among the five Central American governments, dating from the Esquipulas Declaration of 25 May 1986.

It is now hoped that, within a reasonably short space of time, it will be possible to put an end to the domestic political tensions in some countries of the region, without which it will not be possible to restore the conditions needed for economic and social development.

At the same time, resuming the path of development after the situation of profound deterioration in the productive and financial fields suffered by the economies of the region is a task which is much greater than any challenge Central America has faced in the past. This deterioration became even more marked because of the dispersion of the efforts made by the Central American countries to cope with the crisis, and although they are aware of this, they have not yet managed to co-ordinate their macroeconomic policies.

The difficult situation just described is further complicated by the growing social demands, which have long been put off but naturally tend to become more pressing in periods of greater political openness. It is therefore urgently necessary to resume the path of sustained growth in order to be able to respond to these demands and consolidate the democratic processes in the region.

III

The role of integration within a new development strategy

In the face of the changes which have taken place in regional and international conditions and the incorporation of the concept of integration into a new development strategy in Central America, what is needed is not to reconstitute the original integration scheme, but to redesign it and bring it up to date in order to broaden its scope and enhance its objectives.

1. *Redefining the scope of integration*

Expanding the scope of integration does not mean giving up the idea of a regional economic identity, but rather achieving greater weight in external relations through a more effective form of openness and firmer cohesiveness *vis-à-vis* the outside world.

In its day, the CACM was an expanded market of its member countries. This is because the integration process itself placed limits on it by restricting the mutual relations fundamentally to the area of trade. Unfortunately, this market suffered a marked decline because of the preference for using tariff-based policies, the excessive persistence of which gave rise to a type of protectionism which prejudiced competitiveness and efficiency.

The concept of integration outlined here differs both from that which amounts to the mere aggregation of demand and from that which involves the creation and restructuring of economic blocs in the developed world.

The formation of these great economic spaces is a response to the multipolarity now prevailing in the industrialized world, which has given rise to disputes or alliances aimed at gaining supremacy in production, trade, finances, technology and international politics itself. These blocs tend to be homogeneous in their interior and maintain strong similarities between themselves in terms of competitiveness.

The processes of association in Latin America, and above all in Central America, have opposite characteristics to these. There is no question of hegemony involved, their international insertion is one-sided, and the regional structure is heterogeneous. Nevertheless, there are possible points of cooperation or relationship between the two processes which

should be explored in order to see how they can contribute to the changes in production patterns required by the Central American countries.

A form of integration which goes beyond the limits of the Central American region will undoubtedly lead to greater links with the new economic spaces and permit a more decisive form of openness to the rest of the world; the study of the options for integration or cooperation agreed with other Latin American countries—as well as with nations of North America, Europe or Japan and the Pacific—is associated with the need to gain a greater share in world trade.

International openness of this type must be understood as a willingness to accept criteria of greater competitiveness and benefits in trade flows, together with a policy of market diversification. It is not a synonym for unrestricted liberalization or deregulation, since the more developed countries continue to apply high margins of protection, without taking account of criteria of productivity and competitiveness.

This is of great importance for the less developed countries, where global liberalization would cause ill-effects that could not be offset or checked in other areas of economic activity. This means that while we should support a process of openness, this should be one which is linked with gradual and selective liberalization, and which eliminates from the start the evils of excessive protectionism and the obstacles which hold back productivity and hinder better use of resources in economic and social terms.

The aim of this new approach to integration is to avoid the restriction of agreements and concertation mechanisms solely to the area of trade. Integration must cease to be the pedestal for a belated process of import substitution, or the prop of a traditional agricultural export model. Likewise, it must leave behind it the image of a mere expanded internal market, in order to become instead a platform for community investments with international projections.

2. *Enhancing the purposes of integration*

Integration understood in this way will help to promote productive activity and its restructuring by

taking advantage of the benefits deriving from concentration of resources and economies of scale. This is particularly important for Central America because of the small size of its economies, the low levels of domestic saving, the serious external financing problems, and the increasing difficulties in operating individually in international capital markets.

The obstacles standing in the way of projects such as integration industries indicate that a firm political will is needed in order for initiatives of this type to result in dynamic poles of development incorporating technical progress and for production activities to be diversified and placed on a more solid basis.

In the agenda defined by the Presidents themselves, most of the points of which are contained in the Economic Action Plan for Central America, valuable initiatives are proposed which will undoubtedly help to enhance the new integration

scheme, especially in the areas of physical infrastructure and the generation of new community projects: transport corridors, communications, customs, ports and energy production; schemes for concerted negotiations on activities and measures connected with the external sector; agricultural and agroindustrial complementation programmes; scientific and technological cooperation policies aimed at promoting innovation, and finally the selective incorporation of new production, management and marketing techniques designed to conquer extra-regional markets.

Among these proposals, the governments will assuredly carry out those based on the most suitable economic and political criteria. It will be of fundamental importance, however, for the execution of the programme, project or policy finally selected to be undertaken on a regional basis, thus giving Central American integration a new and more dynamic turn.

IV

Some elements for restructuring the integration process

The Declaration of Antigua, adopted by the Central American Presidents on 17 June 1990, placed on record the governments' commitment to "re-structure, strengthen and reactivate the integration process, as well as the Central American regional bodies, by adapting or redesigning their legal and institutional framework in order to give them renewed dynamism and facilitate their readaptation to the new strategies of external openness and modernization of production being undertaken by the Central American countries, with the objective of the formation and consolidation of the Central American Economic Community".

For its part, the Economic Action Plan for Central America, which forms part of the Declaration of Antigua, provides for "the initiation as soon as possible of the analysis and study of the legal and institutional instruments of integration in order to establish a new legal and operational framework for it".

In order to fulfil this commitment, adjustments could be made to the General Treaty on Central American Economic Integration, which is the main

instrument currently in effect. However, this does not seem to be the best option: firstly, because the General Treaty was prepared 30 years ago, in a different conceptual framework and against a background of national, regional and international situations very different from those of the present day, and secondly, because the idea of keeping the Treaty in being in a modified form is not politically viable, particularly for some of the States.

It would be better to prepare a new and very brief legal and institutional framework limited to the establishment of the bases for the normative and institutional structure of the new scheme. In this way, the creation of community law would remain the preserve of the States and regional organs in all the areas where they have been endowed with regulatory and policy-setting powers.

A legal instrument of this nature would have the dual advantage of being easier to approve, while reserving for the signatory States and the integration organs the possibility of directing the process in a flexible manner, in accordance with

the situations which may arise, without losing sight of the essential objectives of the path thus traced out.

1. Some basic principles of the new scheme

Since it is essential to prepare a suitable legal and institutional framework for a renewed integration scheme—without prejudice to continued efforts to reactivate the present system—, it seems appropriate to reflect on some of the fundamental elements that such a scheme should contain.

Whatever the institutional form or scope that the new integration process may have, it must be based on certain basic criteria, including the following:

i) The proposed economic community must pursue the economic and social development of its member States and of the region as a whole, in order to raise the standard and quality of life of the Central American people;

ii) Regional integration is complementary to national development efforts, which means that it must contribute to the success of national policies, while the latter must take maximum advantage of the possibilities provided by the expanded region;

iii) Regional integration and participation in the international economy are likewise complementary. Internal and external resources together are the source of the dynamism of the Central American economy;

iv) The interest of the countries in the different fields that may form part of the integration process will vary according to circumstances; development, as an objective, must give coherence and stability to the whole. Consequently, the integration process must not be subject to a succession of stages that must be completed in a predetermined sequence.

The new integration scheme should be guided by some fundamental principles which should form basic standards for the decisions of the States and of the integration institutions. It should provide for geographical expansion and the incorporation of the most varied economic and social activities. In this way, the globality of the integration process would be in keeping with the fundamental purpose of development, since both of

these can only be achieved gradually. The decisions on the areas to be incorporated and the time of their incorporation would be sovereign acts by the States, in response to domestic problems or external situations.

In every case, before signing agreements or entering into commitments it will be necessary to make a careful evaluation of the real possibilities for fulfilling them. Entering only into commitments for what is really possible, and not necessarily what is desirable, will avoid subsequent disappointments that could reduce the credibility of the integration process.

In selecting the areas to be incorporated in the process and laying down priorities, certain criteria must be taken into account. Above all, the programmes, projects and activities must correspond to needs which are recognized by all the countries. Secondly, priority must be given to the projects which have the greatest possibility of being extended to other areas or activities, in order to reconcile short-term objectives with the creation of longer-term forms of interdependence. Finally, it is desirable to select a considerable number of programmes and projects, so that the success of some of them will make up for the lesser benefits obtained in others. The integration process also involves two situations which must be tackled in line with these basic principles. One is the different capacity of the countries to progress in the integration process, and the other is the distribution of the costs and benefits of that process.

With regard to the first of these, while it is desirable that the integration process should be very flexible and that the commitments entered into should be shared by all the parties, sometimes there are countries which cannot progress at the same rate as the others. Consequently, it is necessary to define the different forms and degrees of execution, together with the measures that should be taken to back up countries with difficulties and the measures that these countries themselves should take in order to overcome them.

With regard to the costs and benefits of integration, it may be noted that in the various integration schemes an attempt has been made to define the concept of balanced development, but no general agreement has been reached on this matter. Frequently, balance is equated with the

absence of a deficit on intra-regional trade, which could perhaps only be achieved if trade were based on barter. In more general terms, the problem of using the concept of balanced development in an integration process is that the notion of balance corresponds to a static comparison of situations, whereas development is essentially dynamic.

The ultimate aim of the Central American economic community should be that integration should promote the development of all the member countries, so that for each country the total benefits of integration exceed its total costs.

This is better reflected in the concept of reciprocity, which does not mean ensuring benefits in all areas for all countries, but rather achieving as a general balance suitable compensation of the costs when, in particular areas, these are not equivalent to the benefits.

2. A new institutional scheme

The proposed Central American Economic Community must have a new set of organs to direct it, and redesigned institutions to manage the process.

In the light of the experience of recent years, the supreme organ of the Community should be the Meeting of Central American Presidents, which should be responsible for outlining Community policies.

There would be two other main organs: one which would direct the implementation of the Community's policies and ensure the fulfilment of the obligations laid down in the treaty of association, and a technical and administrative organ of the Community.

The directive organ would be made up of the incumbents of the ministries responsible, according to the internal legal order of each State, for the matters to be dealt with at each meeting. As indicated by both Central American and international experience, this is desirable in order to be able to handle not only specialized issues in the administrative field, but also political issues which demand that the national spheres of competence should be taken into account in dealing with them.

This scheme leaves open the problem of the continuity which should be observed in the direction of the process. So far, this continuity has been guaranteed because the integration bodies have been made up of the Ministers of the Economy.

One solution would be that these Ministers could form a permanent part of the directive organ: this would not be at variance with Central American experience.

This solution might be difficult to put into practice, however, since it is not easy to bring together a very large number of ministers at once. They could, however, be represented by other officials fully authorized to take decisions, thus achieving both of the objectives pursued: that of competence to take sectoral decisions, and that of continuity.

The technical and administrative organ of the Community, for its part, should be endowed with some capacity for taking initiatives or decisions. It would be of an authentically Community nature, since its members would not represent individual countries, in contrast with the members of the organ made up of Ministers and, of course, the supreme organ of the Community.

As a body which would be responsible for preparing projects and presenting them to the decision-making organs, the technical and administrative organ should have machinery for consultation with non-governmental sectors, so that the economic and social interests of the latter could be properly reflected in the exercise of its capacity for taking initiatives.

Before the projects thus prepared are put forward for a decision to be taken on them, active work to seek consensus is indispensable. This work could be carried out by the technical organ (as has been done in the past, although to an insufficient extent). Alternatively, a body of permanent representatives of the countries could work together with the technical organ with the specific task of maintaining direct contact with governments and passing on in both directions the information which could facilitate the search for consensus.

The Community would also have a Central American Parliament. Its functions would be defined in the Treaty of Association, which should be in keeping with the new institutional structure.

Finally, there would be another body – the Tribunal – which would interpret and apply the treaty setting up the Community in a uniform manner, together with its complementary or subsidiary instruments.

V

Elements of a strategy for the transition

Passing over to a new integration scheme will involve a transitional period during which the new treaty will be negotiated, signed, approved and ratified. In this period, it will be essential to ensure basic legal continuity. For this reason, it is considered indispensable to temporarily restore the full validity of the General Treaty, and it will also be necessary to adopt a set of measures designed to return the integration process to a state of normality, so that the stage can begin in better circumstances.

Up to mid-1990, it seemed clear that in the state of deterioration to which the CACM had declined it would not be viable to put into effect a restructured scheme without first of all taking measures for reactivation, that is to say, measures to restore as far as possible a state of normality under the prevailing legal framework.

The Declaration of Antigua represented a radical change. In view of the political will to restructure and reactivate the integration process, there cannot be a division between these two elements, since the measures to reactivate the process cannot be of a short-term nature, and consequently they must be combined with the restructuring measures. In reality, they form two parts of a single short and medium-term strategy for regional integration.

The measures included in a transitional programme could reactivate those integration mechanisms which are inactive or suffering from problems in their operation, and put into effect projects which all the countries consider necessary and which have both short and long-term effects. These projects could be incorporated in the programmes approved by the Community when it comes into operation.

In view of the foregoing, it is proposed that the transitional programme should at least include measures and projects² aimed at:

²Most of these measures are included in the Economic Action Plan for Central America. Although these measures have been discussed and studies have been begun on them, however, the executive decisions needed to put them into practice are still lacking.

i) Restoring free trade among the five Central American countries. The aim would be to recover and surpass the previous levels of trade. The main measures for this purpose were laid down in the agreement signed in September 1989 between the Central American governments and the Central Banks of the area, on the one hand, and the Commission of the European Communities on the other, and in the agreement signed on 13 December of the same year by the Ministers responsible for Central American Economic Integration and Regional Development and the Presidents of the Central Banks;

ii) Keeping in being the Central American Clearing House, which, under the above mentioned agreement with the Commission of the European Communities, would now be responsible for establishing a Central American payments system;

iii) Strengthening the process of regional coordination in the fields of exchange, monetary and credit policy in order to reduce exchange and price instability, which have had such serious effects on regional trade. Cooperation in this field would obviate the adoption by the countries of unilateral compensatory measures that would militate against the restoration of free trade;

iv) Strengthening the Central America Monetary Stabilization Fund, which gave important support in the past to the balance of payments of the Central American countries;

v) Making the Central American customs tariff system uniform again³ at levels compatible with the objective of making regional production internationally competitive. Future changes in the tariff system, if considered necessary, would be subject to the rules of the Agreement on the Central American Tariff and Customs Regime;

vi) Coordinating economic policies aimed at modernizing Central American industry, without however neglecting other sectors of the economy;

³In this respect, the Meeting of Central American Presidents (Puntarenas, Costa Rica, 15-17 December 1990) reached an agreement of great importance for whose implementation definite time limits were set, and at the San Salvador Summit the main parameters of the new tariff system were established.

vii) Modernizing Central American transport and rehabilitating, reconstructing and extending the regional road network. A good deal of progress has already been made in this field thanks to the work of the Meeting of Ministers of Transport and of the Central American Bank for Economic Integration;

viii) Defining the positions to be adopted in negotiations within the framework of the Enterprise

for the Americas, Europe 1992, and negotiations with the Far Eastern regional bloc and with other Latin American countries or blocs, especially the Group of Three (Mexico, Colombia and Venezuela);⁴

ix) Strengthening the regional institutions, which have had to assume a large number of responsibilities. For this purpose, it is necessary to create a mechanism for the automatic financing of the regular budgets of the regional institutions.

VI

Possible areas of integration

As already noted, the new scheme should be sufficiently flexible to cover all the fields where Community action is desirable and possible. By way of illustration, some of these fields are mentioned below.

An area of high priority is that of *trade integration*, the formal objective of which continues to be a Customs Union, and the economic objective of which is to create a regional space which makes possible economies of scale, stimulates investments, and facilitates the creation of new linked production systems. Trade integration paves the way for the region to project itself onto the international market.

In the future, efforts should be made to strengthen *agricultural integration* by consolidating the possibilities for intra-regional trade in agricultural products, especially basic grains. It would be important for the Community to attain food security at the regional level, and this would call for joint efforts in the production, technology and distribution of basic grains. Joint efforts will also have to be made to raise the international competitiveness of agricultural production in general and to present a common front in forums which are negotiating the adoption of agreements on the regulation of production and exports of agricultural goods.

Particular importance should be given to *industrial integration*. Its specific objectives should be to modernize established industry, to expand the production capacity of the sector, and increase its productivity and international competitiveness.

The substitution process should be brought into line with criteria of regional efficiency, and it should be selective. At the same time, intensive efforts should be made to export manufactures to the international market.

In the new integration scheme, particular importance will be assumed by *cooperation and integration in the field of external trade*, with the aim of gaining a much larger share of trade in new agricultural products and, in particular, industrial products in the region's international trade. There is still a great deal of dispersion of effort in this field, even though the existence of great economic blocs makes it increasingly necessary for the Central American countries to act in a joint and co-ordinated manner. The Community should give high priority to the coordination of its external trade policy, because of the changes taking place in the international environment and, in particular, the trends shown by foreign investment in Central America and the difficulties of access to sources of external credit.

Physical integration, for its part, is one of the most effective ways of creating a regional-scale economy.

Finally, among many other areas which are suitable for complementation and integration, particular attention should be given to *monetary and*

⁴ On 10 and 11 January 1991, a meeting of Presidents of Central America and Mexico was held in Tuxtla Gutiérrez, Chiapas, and it was agreed to work out arrangements for a free trade area within a period of five years.

financial cooperation and integration. In this field, it will be necessary to consolidate the substantial progress already made and, in some cases, ensure that commitments are effectively fulfilled. With regard to financial integration, there is still a great deal of room for Community action, such as the development and consolidation of a re-

gional capital market and the strengthening of Central American capacity to obtain external financing. In view of the profound and apparently irreversible changes which have taken place in the international financial field, joint action by the region could improve its possibilities of gaining access to sources of external credit.

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