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El Salvador: industrial policy, business attitudes and future prospects

Roberto Salazar Candel

This article analyses the interaction between changes in the domestic and external economic environments, industrial policies and business attitudes in El Salvador. The 1960s were a time of rapid import substitution-based industrialization, which was spurred forward by the expansion of the domestic market through the creation of the Central American Common Market (CACM). During this period, institutions devoted to the promotion and support of CACM-oriented industrial activities were founded and developed, and policies on trade, tariffs, the exchange rate and other matters were implemented that contributed to the import-substitution process. During the 1970s, the style of industrial development which had been adopted by the country began to exhibit a number of structural problems. Armed conflict with Honduras, along with a CACM-wide crisis and the oil shock, heightened the need for new markets and activities. In the 1980s, the critical situation in Central America was exacerbated by armed conflicts; in the case of El Salvador, these conditions were compounded by Statist-oriented measures and policies arising out of a polarized political-military situation which had a strong impact on business activity. The 1990s saw a change in the direction of economic policy within the context of a radically different international climate and expectations of an imminent peace settlement. The conclusions presented in the article offer a basis for examination of the industrial sector's prospects in the new environment created by an open economy and greater social cohesiveness.
1. Trends in economic activity

Along with the rest of the Central American countries (Guatemala, Honduras, Nicaragua and Costa Rica), El Salvador embarked upon a rapid industrialization process in the 1960s as a direct result of the creation of the Central American Common Market (CACM). This heightened the country’s expectations of obtaining access to markets of a size that would allow it to produce some types of manufactures with a reasonable degree of efficiency.

We will not delve into this subject here, since a great deal has already been written about it, both in regard to El Salvador specifically and in relation to the Central American countries as a group, whose industrialization processes have been similar. It is necessary, however, to provide some idea of the dimensions of this phenomenon and a number of statistics are therefore presented below.

In the 1960s, El Salvador’s manufacturing sector marked up a growth rate of about 1.5%, 1 and this was accompanied by high rates of increase in its gross domestic product (GDP) as well (see table 1). This rapid expansion of industrial output served to satisfy the needs of El Salvador and the demand generated by the rest of the Central American countries (SIECA/IDB/INTAL, 1974).

The value of the manufactures exported to the CACM—‘the country’s main and virtually only external market at the time—jumped from US$12.7 million to US$73.6 million between 1960 and 1970. 2 However, this figure is a poor indicator of the growth of exports during the decade as a whole since, as a consequence of the country’s armed conflict with Honduras (1969), manufacturing firms (in particular) sustained enormous losses and were deprived of their main (net) market in Central America. 3

Major changes were also seen in the composition of industrial output (see table 2). The proportion of food products shrunk, while the shares of textiles, furniture, chemicals and electrical machinery expanded. Japanese investment in the sub-region’s largest yarn and fabric plants (USASA and INSINCA) was heavy during this period, when the textile industry was experiencing a wave of euphoria thanks to the lines of credit, grace periods, preferential interest rates, technical assistance and other incentives provided by the Salvadorean Institute for Industrial Development. Textile plants operating in the country included Izalco, Tazumal, La Estrella and other smaller business concerns. This was also the period in which Hilandería Salvadoreña (HILASAL), a spinning mill, became established. Ever since the 1970s, this firm has maintained a leading position in the “towel niche” within the international market.

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2 According to figures compiled by the Central Bank and the Salvadorean Foundation for Economic and Social Development (FUSADES), the average annual growth rate was 11.9% in the 1960s, 3.4% in the 1970s and 0.1% in the 1980s. This last figure was influenced by the 1989/1990 recovery, since up to 1988 it had been -0.6% (Central Bank and FUSADES).

3 For example, CAPRI, a company which exported furniture and mattresses to all the Central American countries and which used Honduran lumber to make its products, registered a loss of approximately US$400,000 in 1969. After losing its main supplier of raw materials and its second-largest market, it had to cease its participation in subregional trade due to the deterioration of its competitive position.
### TABLE 1

**El Salvador: Level, trend and structure of gross domestic product, 1960-1990**

<table>
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<tbody>
<tr>
<td><strong>Level in millions of 1962 colones</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>200.5</td>
<td>322.9</td>
<td>438.3</td>
<td>578.0</td>
<td>586.2</td>
<td>515.4</td>
<td>591.6</td>
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<tr>
<td>Agriculture</td>
<td>426.2</td>
<td>517.2</td>
<td>627.2</td>
<td>787.3</td>
<td>841.1</td>
<td>742.8</td>
<td>785.5</td>
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<tr>
<td>Other</td>
<td>756.0</td>
<td>1075.5</td>
<td>1328.1</td>
<td>1757.6</td>
<td>1862.0</td>
<td>1735.4</td>
<td>1907.9</td>
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<tr>
<td><strong>Total</strong></td>
<td>1382.7</td>
<td>1925.6</td>
<td>2393.6</td>
<td>3122.9</td>
<td>3289.3</td>
<td>2993.6</td>
<td>3285.0</td>
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<td><strong>Structure (%)</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Manufacturing</td>
<td>14.5</td>
<td>17.3</td>
<td>18.3</td>
<td>18.5</td>
<td>17.8</td>
<td>17.2</td>
<td>18.0</td>
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<td>Agriculture</td>
<td>30.8</td>
<td>26.9</td>
<td>26.2</td>
<td>25.2</td>
<td>25.6</td>
<td>24.8</td>
<td>23.9</td>
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<tr>
<td>Other</td>
<td>54.7</td>
<td>55.9</td>
<td>55.5</td>
<td>56.3</td>
<td>56.6</td>
<td>58.0</td>
<td>58.1</td>
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<tr>
<td><strong>Total</strong></td>
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<td>100.0</td>
<td>100.0</td>
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<td>100.0</td>
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</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>66.0</td>
<td>31.7</td>
<td>31.9</td>
<td>1.4</td>
<td>-12.1</td>
<td>14.8</td>
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<tr>
<td>Agriculture</td>
<td>21.4</td>
<td>21.3</td>
<td>25.5</td>
<td>6.8</td>
<td>-11.7</td>
<td>5.7</td>
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<tr>
<td><strong>Total</strong></td>
<td>39.3</td>
<td>24.3</td>
<td>30.5</td>
<td>5.3</td>
<td>-9.0</td>
<td>9.7</td>
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<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>11.9</td>
<td>3.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4.7</td>
<td>3.4</td>
<td>-0.7</td>
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<tr>
<td><strong>Total</strong></td>
<td>7.3</td>
<td>3.7</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Salvadorian Foundation for Economic and Social Development (PUSADES)*

### TABLE 2

**El Salvador: Structure of manufacturing output, 1960-1990**

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<tr>
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<th></th>
<th></th>
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<tr>
<td>Food products</td>
<td>41.3</td>
<td>33.7</td>
<td>39.9</td>
<td>48.3</td>
</tr>
<tr>
<td>Beverages</td>
<td>14.5</td>
<td>11.2</td>
<td>16.4</td>
<td>14.2</td>
</tr>
<tr>
<td>Tobacco</td>
<td>6.0</td>
<td>4.8</td>
<td>5.0</td>
<td>3.8</td>
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<tr>
<td>Textiles</td>
<td>6.1</td>
<td>12.2</td>
<td>4.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Footwear and wearing apparel</td>
<td>11.9</td>
<td>6.8</td>
<td>3.7</td>
<td>2.6</td>
</tr>
<tr>
<td>Wood products</td>
<td>0.6</td>
<td>0.5</td>
<td>0.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Metal and wooden furniture</td>
<td>1.0</td>
<td>2.4</td>
<td>2.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Paper, cardboard and related products</td>
<td>0.2</td>
<td>1.7</td>
<td>2.0</td>
<td>1.1</td>
</tr>
<tr>
<td>Printing and publishing</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td>1.1</td>
</tr>
<tr>
<td>Leather products</td>
<td>1.1</td>
<td>0.6</td>
<td>0.8</td>
<td>0.4</td>
</tr>
<tr>
<td>Rubber products</td>
<td>0.6</td>
<td>0.4</td>
<td>0.3</td>
<td>0.1</td>
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<tr>
<td>Chemicals</td>
<td>3.4</td>
<td>5.6</td>
<td>2.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Petroleum products</td>
<td>-</td>
<td>3.9</td>
<td>6.0</td>
<td>5.1</td>
</tr>
<tr>
<td>Non-metallic products</td>
<td>4.3</td>
<td>3.4</td>
<td>4.5</td>
<td>4.8</td>
</tr>
<tr>
<td>Basic metals industries</td>
<td>0.2</td>
<td>0.5</td>
<td>1.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Metal products</td>
<td>1.1</td>
<td>1.6</td>
<td>0.7</td>
<td>0.4</td>
</tr>
<tr>
<td>Machinery other than electrical machinery</td>
<td>0.7</td>
<td>1.0</td>
<td>1.0</td>
<td>1.2</td>
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<tr>
<td>Electrical machinery</td>
<td>0.5</td>
<td>3.2</td>
<td>3.6</td>
<td>2.4</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>2.3</td>
<td>0.6</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Miscellaneous industries</td>
<td>2.2</td>
<td>3.9</td>
<td>2.0</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Non-durable consumer goods</td>
<td>75.5</td>
<td>59.5</td>
<td>68.1</td>
<td>73.4</td>
</tr>
<tr>
<td>Intermediate goods</td>
<td>13.3</td>
<td>26.3</td>
<td>18.4</td>
<td>13.9</td>
</tr>
<tr>
<td>Capital goods</td>
<td>11.2</td>
<td>14.2</td>
<td>13.6</td>
<td>12.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source: Central Reserve Bank of El Salvador*
2. Business groups and development banking

In the 1960s Salvadorian industrialists grouped together to form the Salvadorian Industries Association (ASI). The membership base for this organization, which was founded and developed during this period, was made up primarily of entrepreneurs in the textile and chemicals (pharmaceutical laboratories) industries, the food, beverage, footwear and garment industries, and the metal products and machinery sector. It was a response to the CACM policy of import substitution-based industrialization.

At the governmental level, the former Salvadorian Institute for the Development of Production (INSAFOP) was transformed into the Salvadorian Institute for Industrial Development (INSAFI) and began to function as such early in 1962. This institution was the executing agency for the industrial policy embodied in the Industrial Development Act enacted by the Civico-Military Council (1961-1962). INSAFI was created as an autonomous agency governed by an executive board made up of representatives of the Central Bank, Ministry of Economic Affairs, the private banking system and the industrial sector, with a Chairman designated by the President of El Salvador.

INSAFI, which was equipped with departments responsible for promotion, industrial services, technical services and credit, was entrusted with the implementation of industrial policy during the decade and was the agency for channeling resources to industry. Virtually without exception, all the country's industrial enterprises — large and small alike — operated through INSAFI.

In addition to the scheme of fiscal incentives for industrial development (REIFALDI) established by the Industrial Development Act—which was emulated in a subregional version—credit incentives were provided in the form of special repayment periods, interest rates and grace periods. INSAFI also provided technical assistance, especially to small and medium-sized firms, as well as aiding in the promotion of joint ventures on the part of Salvadorian and foreign companies (e.g., those launched by INSINCA and IUSA with Japanese investors and by CONELCA with Phelps Dodge of the United States).

In addition to the funds made available by the development banking system, represented by INSAFI, resources were also mobilized by the commercial banking system—especially short-term funds for use as working capital— and made available through the Central Bank in the form of “lines of development credit”. In the private sector, the Financiera de Desarrollo e Inversiones played an important role in the provision of industrial financing. The United States Agency for International Development (USAID) also set up special lines of credit that were channeled through that development finance company; this served as the foundation for the creation of a highly dynamic industrial/financial group which came to be known as the “development group”.

3. Policy

The key policy in this industrialization process was that regarding tariffs; the Standard Central American Tariff Nomenclature (NAUCA) was established in 1964 and remained in force until 1985. In 1986, it was modified as NAUCA II. The differences between the two versions are irrelevant in terms of the policy aspects of interest to us here, i.e., the nomenclature’s impact on the level of effective protection and its anti-export bias. Under both systems, the effective protection provided to the import-substitution sector was nearly twice as high as the average nominal level. This was accomplished at the expense of the export sector, which was subject to a negative effective level of protection that exceeded the export tax rate.

Another consideration is the role played by exchange policy in attaining the central objective of maintaining a fixed exchange rate for the dollar and in providing preferential access to the foreign ex-

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4 El Salvador launched its fiscal incentive policy in 1952 with the Processing Industries Development Act, which was reformulated as the Industrial Development Act in 1961. In 1969, within the framework of the subregional integration scheme, the Central American Agreement on Fiscal Incentives entered into effect.

5 Genberg, Rodríguez and Sjaastad (1985) undertook a comparative study for the Ministry of Planning in which they analyzed the nominal and effective levels of protection associated with each of the two nomenclatures and proved that there was no difference between them.

6 A recent study conducted by FUSADES (1992a) clearly demonstrates that the “overprotection” of the segment of the manufacturing sector that was oriented towards the internal (Central American) market worked to the detriment of the export sector.
change market for industrial activities (another key factor in intensifying the anti-export bias of this industrialization process). 7

These incentives and policies fulfilled their purpose of transferring resources to the manufacturing sector at the expense of other branches of activity (particularly the export sector). At the same time, however, they proved to be ineffective in launching an industrial development process, as became evident when these temporary measures turned into permanent policy fixtures. In 1986, when the amendments to the subregion’s standard nomenclature entered into force (NAUCA II), these incentives were discontinued.

We may conclude that entrepreneurs did what they might be expected to do: i.e., take the greatest possible advantage of the array of perquisites and incentives which the import-substitution model made available to industrial activities offering “easy” opportunities for substitution. This eventually gave rise to powerful business associations in the textiles, food, chemicals (pharmaceuticals), footwear, garment, and metal products and machinery industries. As it grew and came to play a dominant role as a trade association in the country’s economic decision-making processes. Meanwhile, the more dynamic entrepreneurial groups used their leadership position among financial institutions as a platform for the formation of industrial conglomerates (the above-mentioned “development group” or the “Catalan group” as La Popular called it).

By the end of the 1960s, the 1969 war with Honduras, the continued development of business activity and the evident limitations of the model associated with the subregional market had made the business community aware of the need to penetrate markets outside the Central American area.

II

The 1970s: the crisis in the CACM, the oil shock and the appearance of the maquila industry

The fact that the average annual growth rate of manufacturing output dropped from 11.9% in the 1960s to 3.4% in the 1970s (the total GDP growth rate being 3.7%) signalled the deceleration and stagnation of the process begun in the 1960s (see table 1).

The structure of the manufacturing sector (see table 2) reflected something of a turnaround in the process begun during the preceding decade, and the sector’s composition reverted practically to what it had been in the 1960s, in that most of the activities that improved their position in the 1970s saw that position deteriorate in the 1980s, and vice versa. The recovery of the food and beverage industries and the decline of the textiles and chemicals sectors were particularly noteworthy in this connection. If we examine the manufacturing sector’s structure in terms of the use made of the goods produced, we find that, following a considerable expansion of the shares accounted for by intermediate and capital goods and a contraction of consumer goods during the 1970s, this trend was abruptly reversed in the 1980s. (This trend has continued, and now, in the 1990s, the situation is virtually identical to what it was in the 1960s; thus, after 30 years, the sector is back where it started.)

This deceleration-stagnation-reversal process probably manifested itself earlier in El Salvador than in the other Central American countries as an immediate result of the country’s armed conflict with Honduras (1969). Honduras’s response was to withdraw immediately from the CACM and conclude bilateral agreements with the other member countries. This not only caused El Salvador to lose the second-largest market for its manufactures, but also reduced the competitiveness of Salvadorian products in Nicaragua, Costa Rica and Panama, since the fact that El Salvador had

7 The exchange rate was 2.5 colones to the dollar from 1936 until the Salvadorian currency’s first official devaluation in 1986. In other words, the same exchange rate was maintained for 49 years. This degree of exchange stability was the usual policy of the central banks in the subregion; in fact, it came to be regarded as a national objective and mark of sovereignty, and as such was a taboo subject that was not questioned in any shape or form.
to use ferries in the place of land routes through Honduras increased its transport costs and delivery times. The impact on Honduras was much less noticeable since, in addition to the fact that its transport routes were unaffected (Honduras shares borders with Guatemala, Nicaragua and El Salvador), its level of industrial development was substantially lower than those of the other CACM countries.

Ultimately, however, this deplorable conflict adversely affected the entire subregion, since it constituted the first tangible evidence of just how fragile the subregional integration system and the CACM were. Thus, it set a dangerous precedent by revealing the vulnerability of integration organizations and mechanisms in situations where one country (in this case, Honduras) unilaterally decides to withdraw “halfway” from the system, and the other countries (with the obvious exception of El Salvador) not only fail to oppose such a step but actually stand ready to sign bilateral treaties or even actively promote such a course of action. This marked the beginning of the deterioration of the system and of its integration mechanisms, which have subsequently come under heavy fire because of their ineffectiveness in preventing the breakdown of the CACM.

The second event that dealt a blow to the Salvadoran manufacturing sector—and affected the rest of the countries as well—was the across-the-board increase in the prices of its imports caused by the first oil shock (1973). This revealed the fragility not only of integration per se, but also of the development model then in use or, in other words, the extreme weakness and premature exhaustion of a (belated) industrialization process based on the “easy” phase of import substitution. This brought out the fact that one of the main objectives of the current model of industrialization—that of reducing the country’s dependence on external factors as the production process moved on from consumer goods to intermediate and capital goods—had not been achieved and that the country was actually more dependent than ever in

the areas of energy, raw materials, capital goods, technology, finance and markets. It also demonstrated the fact that this type of industrialization process had already run its course in the 1970s. This argument is reinforced by the fact that CACM-related industry was founded, according to a survey conducted by the Ministry of Economic Affairs in 1990, during the period between 1960 and 1979 (Buitelaar, 1992).

In the early 1970s the serious situation in which Salvadorian industry found itself had a corollary in its first trade deficits with the CACM, which continued throughout the decade and are still being recorded today. However, this deterioration of the sector’s competitive position in its principal market—the CACM—was counterbalanced by a renewed effort on the part of entrepreneurs, the Government and workers to seek out and penetrate new markets, either unilaterally or by forming groups or developing joint proposals for that purpose.

These efforts were reasonably successful, for example, the OECD market (see table 3). The competitiveness and market shares of the more dynamic types of products improved substantially. An improvement was also seen in the category of activities on the decline; although the products in this category are less dynamic, some of them have a strong sectoral impact (e.g., coffee products) and therefore make an important contribution at the national level.

These advances were made possible, on the one hand, by the efforts of an enterprising business community that managed to win a foothold in this highly competitive market by utilizing certain comparative advantages (location, inexpensive labour), but on the other hand the firms within this sector were also absorbing technical progress and incorporating training and efficient organizational structures. Examples include HILASAL (towels and the like), ADOC (footwear), Productos de Café (freeze-dried and instant coffee) and some producers of chemicals and pharmaceuticals. This was the entrepreneurial sector which had begun to recognize the limitations of the CACM and the potential of new markets as far back as the late 1960s.

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8 The Estudio Centroamericano de Transaportes (BCIE/IDB/UNDP/SIECA, 1976) shows how the cost involved in (and obstacles to) the transport of Salvadorian manufactures played a substantial role in inverting its trade balances with Nicaragua and Costa Rica. Moreover, Guatemala not only covered the portion of the Honduran market that had been supplied by El Salvador’s manufacturing sector but also took advantage of the diseconomies of scale and external problems faced by Salvadorian firms in order to improve its position in the markets of the other Central American countries (including El Salvador itself).

9 This fact is brought out in the annual economic surveys prepared by ECLAC in the 1970s. In the 1980s, these deficits were attributable to other reasons which will be discussed in a later section.
### TABLE 3

**El Salvador: Competitive position in relation to OECD countries**

*(Percentages)*

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<tbody>
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<td>Composition</td>
<td>-</td>
<td>0.12</td>
<td>0.09</td>
<td>0.05</td>
</tr>
<tr>
<td>Contribution</td>
<td>0.02</td>
<td>14.13</td>
<td>4.40</td>
<td>12.08</td>
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<tr>
<td>Specialization</td>
<td>-</td>
<td>1.54</td>
<td>1.89</td>
<td>2.24</td>
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<tr>
<td>Sectoral share</td>
<td>5.39</td>
<td>9.16</td>
<td>2.32</td>
<td>5.39</td>
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</table>

<table>
<thead>
<tr>
<th>2. Declining activities</th>
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<tbody>
<tr>
<td>Composition</td>
<td>0.57</td>
<td>0.76</td>
<td>0.12</td>
<td>0.04</td>
</tr>
<tr>
<td>Contribution</td>
<td>66.19</td>
<td>75.05</td>
<td>8.17</td>
<td>2.67</td>
</tr>
<tr>
<td>Specialization</td>
<td>4.64</td>
<td>10.03</td>
<td>2.42</td>
<td>1.73</td>
</tr>
<tr>
<td>Sectoral share</td>
<td>14.26</td>
<td>7.48</td>
<td>3.37</td>
<td>1.55</td>
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<table>
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<th>3. Activities with missed opportunities</th>
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<th>4. Receding activities</th>
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<td>Contribution</td>
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<td>74.23</td>
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<td>Specialization</td>
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<td>Sectoral share</td>
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<td>0.92</td>
<td>2.78</td>
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Source: ECLAC, Division of Production, Productivity and Management.

* The table shows the loss of competitiveness sustained by dynamic products (in the market and in terms of their share of domestic production) and the specialization taking place in declining or receding activities.

Mention must also be made of the in-bond assembly, or *maquila*, industry. Ever since the late 1960s, foreign business groups (especially from Japan, the United States, Taiwan and South Korea) which had set up operations with a view to doing business with the CACM had been aware of the following potentials: a clear comparative advantage in manpower; some degree of work skills acquired during the substitution-based industrialization process (in the manufacture of clothing, leather products, chemicals, sporting goods), together with adequate infrastructure which had also been developed during that process; an enviable geographic location due to its proximity to the United States; and the fact that—owing to the disadvantageous situation of the CACM—the Government, local entrepreneurs and workers all saw the need to promote the labour-absorbing maquila industry. Thus began the “maquila craze” of the early 1970s.

By the late 1960s, INSASI was already advocating the passage of the first non-traditional exports promotion act, which, like the Industrial Development Act which had led to the founding of INSASI, provided for the creation of its own main executing agency: the Salvadorian Foreign Trade Institute (ISCE).

At the same time, INSASI was developing the first free trade zone, known as San Bartolo. This zone was set up near the old Ilopango Airport, the idea being that this terminal could later be used exclusively for air cargo, and especially for transporting the products assembled in the maquilas to the United States.

As textile mills oriented towards the domestic or Central American markets were going bankrupt (La Estrella, Tazumal), maquila plants were being opened in which clothing was made up from fabric cut in the United States. One example of this type of operation is CONVESA, a firm in which Japanese investors hold a majority interest which is located in the Santa Ana industrial zone and employs over 2,000 workers.

Ilopango and the surrounding area became the home of the maquila industry. This is the site of San Bartolo, whose facilities (now filled to the brim) employ more than 12,000 persons. Texas Instruments, with over 3,000 workers, set up a plant in Colonia Santa Lucia, while other factories producing gloves, baseball equipment, nets, etc., were set up in nearby Soyapango.

In the late 1970s, when violence broke out in the cities, especially San Salvador, these firms began to move to the Dominican Republic and Haiti, and Salvadorian workers began their exodus to the United States.
III

The 1980s: the civil war and the wartime economy

The year 1979 was an extraordinarily agitated period of confrontational politics. Extremely violent acts were frequent (armed confrontations, kidnappings, assassinations). Business enterprises, workers and the citizenry at large began to think seriously about emigrating or actually to do so. The military government then in office had come to power by means of election fraud, while the Sandinistas had recently come to power in Nicaragua by force, which encouraged revolutionary groups within El Salvador. The United States was deeply concerned about the “spread of the Sandinista revolution” in a densely populated country having a greater capability for expansion, and finally, whether for domestic or external reasons, the military saw with serious preoccupation how grassroots organizations expanded, the guerrilla movement continued to make inroads, and both the military as an institution and the country’s security forces were falling into discredit. This, in combination with the country’s deepening economic and social crisis and the loss of support from (or repudiation by) the international community, including the United States, put the military in a very difficult confrontational situation. Their response to these circumstances was to mount a coup d’état (October 1979) while calling for the democratization of the country and pledging to undertake certain “revolutionary” reforms that were needed in order to transform Salvadorian society.

Many people staked everything on this reformist, democratizing agenda for El Salvador as an answer to the rise of armed insurgency and as a way of preventing the country from following in Nicaragua’s footsteps. The opposing bands—with substantial external support—chose to gain power, or hold on to it, by force. The result was more than ten years of civil war; over 75,000 dead; plummeting economic and social indicators (including an increase in poverty and extreme poverty, a steep rise in the number of refugees, displaced persons, widows and orphans, mounting unemployment and a change in the structure of the population); devastation of the environment and the destruction of basic infrastructure; an exodus of Salvadorians from the country (including skilled workers, investors and businessmen); massive capital flight; and an increase in corruption. These are just some of the negative effects directly related to the war.

As for the country’s economic activity, manufacturing output dropped by something over 12% in 1980-1985 and total GDP was down by 9%. For the decade as a whole, despite the recovery made during its final years, the growth rate of manufacturing output (0.1%) was such that it remained at virtually the same level as in 1980, while total GDP actually showed a slight decline (see table 1).

The external trade balance showed a growing deficit throughout the entire decade, except in 1986, when it improved considerably thanks to a steep devaluation early in that year. By 1989, the trade deficit amounted to US$698 million, which was equivalent to nearly 80% of the country’s total exports. The situation in El Salvador’s trade with Central America was similar, with a deficit of around US$550 million (the equivalent of about 30% of its exports to that market). 10

Trade in manufactures with other markets, including those produced by the maquiladora industry, exhibited a similar deterioration. The trends observed in trade with the OECD countries (see table 3) during earlier periods changed appreciably. For example, between 1979 and 1985 the share of dynamic product categories shrank both in the market and in terms of the sectoral contribution, and yet another cause of concern is the fact that goods occupying a very important place in the sector slipped into the category of products that are receding from the market.

The downturn continued in 1985-1989, when the slight increase in the sector’s share of dynamic products, which was due to the drop in manufacturing

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output, was more than offset by the decrease in these products' market share. The competitiveness of Salvadoran manufactures in the various markets thus declined even further.\(^{11}\)

However, the country has been able to withstand this long string of deficits because of two major sources of external finance: the foreign aid received in connection with the war and—equally important—the private remittances sent by Salvadorans living abroad, especially in the United States (ECLAC, 1991 and 1993).

The conditions that can be described as wholly attributable to the civil war were compounded by the policies which the authorities implemented, especially in the economic sphere, in an attempt to deal with the problem. The economic measures applied at the start of the decade had been of an essentially political nature and were designed to score points against the “enemy”, which was identified with the Left and with guerrilla groups. Accordingly, the new Government’s development policy focused on three major reforms: agrarian reform, the nationalization of foreign trade (coffee, sugar cane) and the nationalization of the banking system. The State thus acquired a set of tools for stimulating the country during wartime and, as if this were not enough, it also took over the reform programmes which the Left had traditionally advocated as being of strategic importance for overcoming the country’s underdevelopment and position of dependency. This was the era of Statism as a strategy for coping with the war.

Paradoxically, however, in the external sector public policy moved in the opposite direction, i.e., towards economic liberalization, privatization and a more open economy. In this sphere, it was an era of orthodox neoliberalism. Thus, on the one hand, the Government of El Salvador was applying Statist programmes of an interventionist/populist stripe which involved tremendous economic costs but were not delivering the hoped-for political benefits (guerrilla activity was on the rise) and were producing alarming results in terms of inefficiency and corruption in key sectors (foreign trade and finance), while on the other hand it was under pressure from international agencies (International Monetary Fund, World Bank) and USAID to modify its macroeconomic policies, particularly in the area of finance, in order to avert unmanageable imbalances in the fiscal, monetary and external sectors that would call for still further external financing. Above all, it had become clear that the war was having a destabilizing effect on expenditure, business expectations, production costs and planning.

The outcome of this situation of diametrically opposed policies applied during a civil war with outside involvement, of forces capable of influencing decisions but having different objectives and spheres of action, and of a manifest lack of administrative capacity on the part of the public sector is what we have termed a wartime economy. A typical feature of a wartime economy is that it becomes a question of merely “managing the crisis”, as some have described the efforts of the administrations of the 1980s (up to mid-1989): a situation which we regard as tantamount to anarchy in terms of economic rationality.\(^{12}\)

The reaction of entrepreneurs, especially those with links to the industrial sector, was the same as that of most Salvadorans: those who could leave did so, taking their businesses or assets with them (maquilas, Phelps Dodge, ADOC, Hilandería Salvadoreña, etc.); those who stayed either kept the lowest possible profile or switched over to more speculative or lower-risk activities, such as commerce or services. Small and medium-sized businesses, which are the main support for employment levels during times of crisis, diversified: some firms began to export to other markets (handicrafts and similar products); others ran their businesses at a loss, taking advantage of the fact that the nationalized banking system took a very permissive and flexible attitude to arrears (over US$1 billion in accumulated arrears); still others went bankrupt (El Salvador, Chamber of Industry and Commerce, 1987).

\(^{11}\) It is worth noting once again that this group of products includes goods produced by the maquila industry, which, due to difficulties of classification, have been categorized as manufactures (especially what we have called “dynamic” products). The reader will recall that the maquila industry began to be dismantled at the first signs of conflict (in the late 1970s).

\(^{12}\) There are a number of documents which reflect the trade associations’ views regarding this “economic policy anarchy” (El Salvador, Chamber of Industry and Commerce, 1987; FUSADES, 1989). In the light of these types of documents, and with the direct participation of trade associations such as FUSADES, the party which is now in office drafted a manifesto entitled “Hacia el rescate nacional: Programa económico social” (ARENA, 1989).
According to a 1990 survey, the majority of Salvadorian manufacturing concerns (linked to the CACM) had been founded between 1960 and 1979, and given the loss of competitiveness occasioned by the above situation, most of these (small and medium-sized) industries channeled their products to the domestic market.

In summary, the attitudes adopted by Salvadorian entrepreneurs reflect the central features of their survival strategies. Some—the most enterprising—launched themselves into the competitive external market, finding niches where they had some sort of competitive edge or could engage in activities into which technical progress could readily be incorporated. Most, however, simply used a survival strategy involving the diversification of their activities and their supplementation with other businesses (services, imports) or the fullest possible utilization of the “state of emergency” and the perquisites it afforded.

IV

The 1990s: the end of economic anarchy, the reorientation of economic policy, the reaction of the business community and the peace process

1. A brief baseline analysis of the manufacturing sector

After 30 years of industrialization, it may be helpful to review the status of El Salvador’s manufacturing sector, its potentials and its limitations as they appeared at the time the structural adjustment programme was launched (during the second half of 1989).

In the preceding sections we looked at the different phases of the industrialization process: rapid expansion, stagnation and regression. Let us now look at the sector’s situation and prospects at the start of the 1990s.

First of all, we see a rather diversified (heterogeneous) manufacturing sector with few production linkages (vertical integration), producing primarily for the domestic and Central American markets.

Manufacturing output accounted for a hefty 18% of GDP, but the sector’s share in employment was small (it provided jobs for less than 5% of the economically active population), its firms lacked training programmes for their workers and there were very few links between academic or research institutions and the production sector, which was part of the reason why businesses were not innovating or appropriating new technologies.

Despite all this, the process did produce a small group of companies—or entrepreneurs—with a greater willingness to assume risks and with the kind of mentality and practices needed to penetrate competitive markets and to maintain their position in such markets once it was established.

The public sector suffers from two main problems. First, the (inherited) public apparatus that takes care of “uncompetitive, protected, import-substituting industries” is too large; this is true both of the portion of this apparatus located within the central government (Ministries of Economic Affairs and Foreign Trade, Finance, Foreign Affairs and Planning) and of its decentralized agencies (BANAFI, CORSAIN, CEPA, CEL, the Central Bank, government-run agroindustrial enterprises, etc.). Second, the public sector lacks the skilled personnel and the institutional framework it needs to fulfil the new role it is called upon to play in regulating the various agencies’ responsibilities and in helping the private sector and its leadership to meet the challenge of changing production patterns (in this case, those of the manufacturing sector) with social equity. The result is obvious: if the efforts made are headed in the wrong direction and nothing is done to move the country

\[13\] All the reports prepared by the experts of Project ELS/90/004 on different manufacturing activities (leather and footwear, textiles and the metal products and machinery industry) identify the lack of investment in human capital as one of the chief constraints affecting the growth and competitiveness of these firms. To take just one example: a single recommendation regarding one aspect of the production process made it possible for a metal products and machinery factory to save US$50 000 per month.
in the right direction, then government intervention is bound to be ineffective and inefficient. 14

It is worth emphasizing that, within the new parameters of authentic competitiveness, Salvadorian industry generally fails to comply with minimum standards of environmental protection. The national and subregional environments have suffered a great deal of destruction and pollution as a result of the industrialization process. Because of the national and external restrictions now in place, however, it is no longer possible for industry to continue to plunder the environment.

The pacification and democratization of the country will have a strong influence on its systemic competitiveness. These changed circumstances will permit an improvement not only in the competitiveness of individual firms, branches of activity or industries, but in the overall competitiveness of the country as well because they will facilitate consensus-building among the different actors (the business community, workers and Government) involved in the various phases of production, not in respect of short-sighted, conflictive objectives but instead—we hope—in relation to major national goals.15

Finally, it should be noted that, within Project ELS/90/004, a study on indicators of competitiveness found that the activities with the highest coefficients of competitiveness are: i) sugar mills and refineries and the processing of various food products; ii) the production of yarns, fabrics and finished textiles; textile articles other than wearing apparel; knitted goods; and making-up of wearing apparel other than footwear; iii) the production of footwear made from materials other than vulcanized rubber or plastic; and iv) the production of articles from pulp, paper or paperboard not specified in another category. The firms that have managed to penetrate and survive in competitive markets belong to these groups (the same situation is described by Buitelaar and Fuentes, 1991).

2. The Structural Adjustment Programme: principal measures and results

The Structural Adjustment Programme proposed by the new administration was based on two key considerations: the need to adjust income and expenditure at the aggregate level (short-term stabilization) and the need, in conjunction with the changes to be made in the country's economic and social structures, for measures and programmes whose results would make themselves felt in the medium and long terms.

Naturally, some results were seen in the short term. Inflation, for instance, was brought down from 23.5% in 1989 to 17.8% in 1990 and then to 9.8% in 1991 (although in 1992, with the application of a 10% value added tax, the inflation rate rebounded to 19.8%).

The achievements have not been comparable in other spheres of the economy. For example, in an effort to avoid creating upsets or generating inflationary pressures, the Central Bank has interfered in the exchange market. The results are debatable: reserves have been built up, but the Bank has been unable to sterilize the heavy inflow of remittances from abroad; moreover, the nominal exchange rate is stable but the real rate is not, and this has reduced the competitiveness of exports (FUSADES, 1989, chapter 2).

The results of the fiscal and monetary policies applied have been even worse. In the area of fiscal matters, for example, efforts to lower the deficit by cutting expenditure have been unsuccessful, and it therefore became necessary to introduce the value added tax (VAT) quite suddenly—with the whole of its effect being transferred over to prices—in order to boost revenues. To compensate for this, a tight monetary policy has been applied that keeps interest rates at fairly high levels in international terms, and this, together with a fixed nominal exchange rate, attracts inflows of speculative capital, thereby pushing the exchange rate even lower. Both of these (i.e., monetary and exchange) policy outcomes have affected the economy's reactivation, especially in the export sector.

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14 Two examples may be cited: the implementation of an 8% drawback for exporters fell months behind schedule and, in some cases, was never applied at all, and the formalities needed to comply with all the legal requirements for registering a company take an average of six months or more.

15 ECLAC/UNESCO (1992) pursues the argument formulated by K. Ohmae, who contends that, following its devastation during the Second World War, Japan became convinced that it was impossible for it to expand by means of military force and, through the basic educational system of society as a whole, has put across the message: "export value added or starve". According to Ohmae, the society's internalization of this value constitutes the underpinnings of the system of social and commercial organization which has been so successful in conquering the world market. In El Salvador, albeit on a smaller scale, we too are emerging from a devastating war and are in a position to send out a similar message. We believe that all the various social forces are now ready to take it to heart.
This has led to another imbalance: the trade deficit. It must not be forgotten that El Salvador's neighbours have aggressive exchange policies designed to stimulate exports. International lending agencies as well as national economic authorities consider this problem of the deficit to be the most serious of all, despite the fact that it is a consequence of the country's economic policy management. 16

Steps have been taken to carry forward structural changes, but, as noted earlier, their results will only become evident in the medium and long terms. Furthermore, some reforms have yet to be initiated and others need to be applied more intensively. There are also problems of timing and of shifting priorities which hamper the implementation of the Programme and its effectiveness, even in such important areas as the conclusion of peace agreements and efforts to formulate a national reconstruction plan. Let us take a moment to examine the measures provided for in the Programme while bearing in mind their impact on the realignment of the manufacturing sector.

Briefly, the Government has proposed the following measures: i) an economic liberalization programme to include tariff reductions, the elimination of (State) export monopolies and less control of the exchange rate by the monetary authority; ii) the elimination of price controls in the market for goods and services, especially agricultural products; iii) tax reform; iv) a programme designed to modernize and restructure the civil service, including those components relating to the public investment process; v) measures to put the financial system on a sound footing in preparation for its privatization; and vi) a macroeconomic policy capable of holding the basic balances (fiscal, external and production) to manageable levels.

The main reforms proposed in the business sector, particularly manufacturing, are summarized below.

First, there are the proposed changes in fiscal management and the civil service. Tax reforms are being advocated which, in broad outline, will broaden the tax base, reduce the number of taxes, eliminate taxes on foreign trade, create a single income tax and permanently establish the value added tax (VAT), which began to be applied at the rate of 10% in September 1992.

At the same time, reforms are to be made in the area of tax administration. These include the amalgamation of the agencies administering direct and indirect taxes, the funding of the Government's and quasi-autonomous State enterprises' debts, the proposal of measures to correct the administrative and financial problems of State-run enterprises, and the creation of a single nationwide taxpayers' register.

Reforms in the civil service include the strengthening of the National Public Investment System in order to make the administration and execution of expenditure more efficient.

In addition, programmes have been proposed for the privatization of State-owned enterprises and the modernization of the civil service. Although these programmes are essential for changing the country's production patterns, they have not moved forward as expected and are in fact the two main reforms that still remain pending (FUSADES, 1992b).

Major reforms are also proposed in the external sector. These include a quite ambitious (in Central American terms) trade reform programme that would cut tariffs (to rates of between 5% and 20%), reduce the number of tariff categories (from 20 to 7), eliminate price controls and excise taxes, do away with quantitative restrictions (tariff exemptions, advance deposits on imports) and repeal existing promotion acts, set up the Export and Investment Promotion Programme, and seek the entry of El Salvador as a member of the General Agreement on Tariffs and Trade (GATT).

Other important modifications in this respect relate to the area of exchange policy, which achieved a short-lived success by establishing a single exchange rate and reducing the currency's overvaluation. Foreign-currency exchange houses are to be legalized and their operations are being promoted as a means of liberalizing the foreign exchange market and increasing its transparency, and a law is being promulgated that will prohibit the Central Bank from directly setting the exchange rate.

Another key area of reform is the financial system. The first reform measures, which are designed to place the system on a more solid footing, include audits for the purpose of rating and assessing arrears, the merging of banks and savings and loan associations (S&Ls), and a law aimed at strengthening the financial status and reinforcing the position of banks and S&Ls. A programme is also being developed to strengthen and provide training services to the Super-

16 Statements made to the press by the Chairman of the Central Bank in March 1993 indicated that existing trends in inflation and the exchange rate were manageable but that the same could not be said of the country's trade balance, which even at that time had become untenable.
intendency of Banks and Financial Institutions so that it may become completely autonomous and develop a strong capability for controlling the system. Measures to attract international banks are currently also being promoted.

On a purely sectoral level, a package of measures or programmes is being put into effect that will have a particularly appreciable effect on industry. These measures include amendments to the Export Incentives Act, an overhaul of the CACM 17 (with the inclusion of Panama and Belize as observers), and trade agreements with Mexico, Colombia and Venezuela (the aim being to organize a free trade area with a population of over 170 million persons by 1995).

Liberalization of the labour market is being proposed along the following lines: productivity-linked wage increases, the relaxation of regulations regarding minimum wages for young people and apprentices; restrictions on workers' benefits; regulation of the length of strikes; and authorization to hire temporary workers until labour disputes are settled.

In order to promote the formation of appropriate linkages between the manufacturing sector, the educational system and human resources training, the public sector and the rest of the production system, the National Council for Science and Technology (CONACYT) is being created.

Progress in the privatization of manufacturing or agroindustrial enterprises has been negligible, but it is reasonable to suppose that peace may bring better results in this regard. Currently, efforts are being directed towards the privatization not only of export agribusinesses (sugar, coffee) or import-substituting industries (textiles, cement) but also of basic services (energy, telecommunications and transport).

The business community’s response, though somewhat reserved, is promising in view of the widespread climate of uncertainty which has existed thus far during the 1990s, especially before the peace settlement. In terms of actual results, table 4 indicates that the growth rate of exports accelerated in 1989 and 1990, with annual rates of 12% and 16% respectively. In addition, according to figures compiled by ECLAC, the growth rate of manufacturing output rose

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17 This includes, inter alia, the strengthening of the Permanent Secretariat of the General Treaty on Central American Economic Integration (SIECA) and the Central American Bank for Economic Integration (BCIE); the implementation of a regional payments system; progress in the harmonization of fiscal, monetary, trade and exchange policies; advances in the elimination of barriers to the free movement of goods and services, capital and individuals; and the harmonization of foreign investment regulations, health standards and transport and intra-customs transit regulations.
from 2.5% in 1989 to 3.0% in 1990 and to 4.9% in 1991. A similar situation is reflected in surveys regarding the business climate (FUSADES, 1992b), whose indicators point to the existence of some degree of optimism.

Business attitudes also reflect the greater relative importance of today’s new markets (see table 5). The manufacturing sector’s efforts are directed towards those markets, where it has already won a share of nearly 40%. All the survey results on hand indicate that it is in these new markets where there is potential for growth, and the business community sees these markets as offering the only path to a sustained and sustainable form of development in the long term.

### TABLE 5

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<td>Value</td>
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<td>Food, beverages and tobacco</td>
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<td>Textiles and textile manufactures</td>
<td>68 640</td>
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<tr>
<td>Footwear and related products</td>
<td>15 246</td>
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<tr>
<td>Paper, cardboard, and paper and cardboard products</td>
<td>33 905</td>
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<td>Chemicals, rubber and plastics</td>
<td>45 302</td>
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<td>Non-metallic mineral products</td>
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<td>Metals and metal manufactures</td>
<td>29 326</td>
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</tr>
<tr>
<td>Machinery, electrical materials and appliances</td>
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<td>Other products</td>
<td>20 369</td>
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<td><strong>Total</strong></td>
<td>273 976</td>
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Source: Central Reserve Bank of El Salvador.

\[ V \]

**Conclusions: a critique of what has been done so far and the outlook for the maquila industry**

1. **What has been done and what remains to be done**

First of all, we must acknowledge that the current administration has laid down clear-cut, credible ground rules that will permit the country to begin the process of changing its production patterns; a manageable form of stabilization strengthens market mechanisms, restores the preeminence of the private sector\(^{18}\) and redefines the role of the public sector.

At the same time, this is clearly not enough. The private sector must assume its responsibilities and, in

\(^{18}\) It may be recalled that past administrations –even as far back as the 1950s, and to an extraordinary degree in the 1980s– took a flagrantly Statist line.
order to do so, it will presumably expect definite signals and measures at the sectoral level. High-priority sectoral policies include: i) with regard to infrastructure, an energy plan (for the short, medium and long terms), the upgrading of transport facilities, and the modernization and expansion of communications systems; ii) in sectors producing internationally tradeable goods (agriculture and manufacturing), the definition of sectoral policies and programmes and their coordination with trade policy (microeconomic studies); and iii) in the public sector, the programme for restructuring the civil service already mentioned earlier. In addition, there are programmes relating to subjects that are not of a sectoral nature because they cut across all sectors but which are clearly of high priority: the programme on science and technology and its linkages with the restructuring of the educational and production systems, and an environmental protection and reclamation programme in keeping with the process of changing production patterns with social equity.

2. A critique for further consideration

If the 1980s were a “lost decade” for Latin America, then for El Salvador they were a veritable descent into Hell. Expectations were running high when the new Government took office, and it had to act fast. Like most of the Latin American countries, El Salvador subscribes to the orthodox views of the World Bank and IMF.

Because Chile was regarded as a concrete example of a successful country, it was felt that the most expeditious route was to reproduce the 1980s version of the “Chilean model”. The first result of this decision was that the civil service became filled to the brim with Chilean advisers (followers of the above-mentioned orthodoxy in its purest form), who found excellent job opportunities in El Salvador just when, with the advent of a democratic Government in Chile, they were leaving their own country’s civil service.

In addition, for a variety of reasons (having to do with finances, technical staff, business relations) a great deal of importance was given to the views of FUSADES.

This mixture resulted in a package of formulas for the country’s macroeconomic management (which was fairly successful), for institutional and legal changes, for the restructuring of the civil service, for the privatization process and other purposes and, to a marginal extent, for the promotion of social equity. These sporadic forays into the realm of public policy on the part of external interests having differing objectives but no strong commitments have given rise to problems of timing and consistency in the corresponding projects or programmes.

The results of the application of these formulas, as might be expected, have been shaky in terms of economic stability (a large fiscal deficit, instability of the real exchange rate and real interest rates—which are currently negative—and widening trade deficits). Moreover, given the absence of adequate compensatory social programmes, the adjustment has hit the most vulnerable groups in the population hard, and this effect constitutes an obstacle to the proposal of a further adjustment.

Even so, in all its documents, forums and advisory missions FUSADES advocates devaluation. If this proposal had been accepted, the result would probably have been runaway inflation, without any corresponding improvement in non-traditional exports. We have already shown that as of October 1992 the export sector had not declined in competitiveness in terms of costs, since although the real effective exchange rate (considering domestic inflation as compared to international inflation) had fallen, the decline in real wages made up for that decrease, so that the export sector was just as competitive as it had been in 1980 (Mussi, 1992).

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19 To make an analogy: It is not enough for the water to be calm (i.e., that there be macroeconomic equilibrium and clear-cut rules): in order for a boat to stay on course (follow the development path) it needs to be steered (through sectoral plans or programmes). Intervention at the sectoral level helps to ensure the private sector’s participation, without which—under the new development pattern that has been adopted—the entire plan will fall apart. The greatest challenge is to motivate this sector to take part in the (environmentally sustainable) production activities that offer significant national development potential in the long run.

20 FUSADES is made up of private businessmen and receives most of its financing from the United States Agency for International Development (USAID). Some of the technical experts on the Government’s economic team have ties with this organization.

21 For example, following the implementation of a package of measures affecting consumers (deregulation, tariff reductions), a consumer protection law was proposed. The version of this bill put forward by FUSADES, which had been drafted by a Chilean lawyer during flying visits to the country, was a transcription of Chile’s consumer protection law. Fortunately, the then Minister of Economic Affairs presented a version which was more in keeping with national realities.
The public sector, for its part, is heavily indebted and is running a hefty deficit; a devaluation would only exacerbate this situation. This has happened in the majority of the countries in the region, except Chile and Mexico, where a considerable portion of exports (copper and oil) are in the hands of the State. Perhaps the weakest link of all is at the sectoral level. Macroeconomic policies need to be supplemented with sectoral policies and microeconomic studies. Since the former policies are not enough in and of themselves, the country runs the risk of having its adjustment processes lose credibility and of incurring larger, long-lasting deficits. (An example: although the manufacturing sector was affected by tariff reductions, no programme was implemented to soften their impact on employers or workers).

Another important aspect that has been neglected by macroeconomic policy-makers – and in the policy recommendations made by FUSADES and others – is the effect of this policy on the distribution of income and wealth. We should not lose sight of the fact that when, for purposes of stabilization, a tight money policy is pursued that includes cuts in public financing, the use of an exchange-rate anchor (which means overvaluing the currency) and a downturn in real wages, this will bring about major changes in the distribution of income, property and power (Sáinz and Calcagno, 1992). Thus, for example, those groups that have access to credit or that control the foreign exchange market will be at an advantage; the State transfers assets (through privatization) or sets rates and charges in ways that strengthen private groups, and at the same time there is speculation in financial or currency markets, services or trade which works to the detriment of the manufacturing or agricultural sector.

All these effects must be taken into consideration when applying such policies, especially if they hurt the weakest groups in the population or the hardest-hit sector (in this case, manufacturing). There is no doubt that in the present process small and medium-scale industry has been adversely affected.

In reviewing the institutional reforms (deregulation, liberalization, privatization) aimed at downsizing the State – reforms upon which the success of the structural adjustment programme hinges – we see that, due to the problems of timing referred to earlier, they are falling short of their goals and that sometimes, paradoxically, they also fail to achieve their objectives even when they are stepped up. For example, the objective of privatizing the banking system is to liberalize the financial market, i.e., to strengthen competition in that market in order to improve the allocation of resources, but the modality adopted and the pace of the process have been such that it has generated a concentrated, oligopolistic system. This invalidates competition as an element for optimizing resource allocation, which is the ultimate objective of the privatization process. (Nationalizing is easy; privatizing is difficult.)

3. Guidelines for changing industrial production patterns and large-scale development of the maquila Industry

A review of the recent course of events at both the sectoral and global levels can serve as a framework for proposing a series of guidelines and measures for reactivating and redirecting Salvadoran industry on the basis of a competitive form of development. 22 Because of the lack of microeconomic studies and research on specific branches of industry, the recommendations presented below are based on studies conducted at the Ministry of Economic Affairs of El Salvador as part of Project ELS/90/004.

a) General recommendations

i) Promote the establishment of an organizational structure of the type proposed by Project ELS/90/004 with a view to the formulation of a selective industrial realignment programme in which industrialists, universities, research centres, workers, the Central Bank and the Government would all participate (Salazar, 1992).

22 In this connection, Porter (1991) defines the competitive stages of development as follows: i) factor-led development; ii) investment-led development; iii) innovation-led (intelligence-led) development; and iv) wealth-led development (decadence). If we accept this frame of reference, then El Salvador – like the majority of Latin American countries (with the exception, to some extent, of Mexico and Brazil) – is on the verge of entering into the first stage (with the aggravating circumstance, in comparison to some other nations such as Chile, that it suffers from a shortage of natural resources and skilled human resources; its resource endowment consists of a supply of unskilled manpower). Buitelaar and Fuentes (1991) arrive at the conclusion that gains in competitiveness are based on the use of existing sources of comparative advantages (unskilled manpower and natural resources).
ii) Step up the pace of the programme for the modernization of the civil service. The report of Project ELS/90/004, as well as subsequent studies conducted under the same project, contain proposals for the restructuring of the Ministry of Economic Affairs.

iii) Restructure, in accordance with the proposals cited above, the institutions involved in the design and implementation of trade policy, which needs to be harmonized with industrial and agricultural policies. The form of organization should, as in the above cases, involve all the main actors in this area (business, trade unions, professionals, etc.).

iv) Consolidate the National Council for Science and Technology (CONACYT). As a first step in this process, the Programme for Science and Technology should be carried forward; guidelines have been set forth by the Project for this purpose (Hodara, 1992).

v) Strengthen non-formal training and instruction programmes. An important step in this regard is the approval and establishment of the Salvadorian Occupational Training Institute as an autonomous agency that will operate in close cooperation with the business community (Macario, 1992).

vi) Reinforce the institutional structure for export promotion, with the active participation of the private sector, outside the bounds of the traditional bureaucratic system. To this end, the trade promotion offices of the Ministry of Foreign Affairs in the countries of the subregion should also be strengthened.

vii) Update the legislation on company registration, patents, royalties and foreign investment in order to smooth the way for investors who will contribute not only capital but also technology, organizational capabilities and markets (examples of such measures might include the elimination of minimum capital requirements, restrictive regulations on the repatriation of capital or the slow, complicated procedures involved in registering a company). 23

viii) Implement the programme proposed by Project ELS/90/004 for the development of leasing activities in El Salvador (Shulz, 1992).

ix) Carry forward and further intensify efforts to promote integration. From the standpoint of competitiveness, the market provided by such integration provides an opportunity to gain experience in certain types of activities before moving into more competitive markets, to take advantage of the relevant countries' complementarity, and to improve external negotiation capabilities.

x) Implement a package of specific policy measures to boost the competitiveness of those activities offering the greatest potential in the Central American, Latin American or world markets (Motles, 1992; Pivel, 1992).

b) Specific recommendations for certain branches of industry

i) For the metal products and machinery industry: Limit efforts to expand the market to the whole of Latin America; investigate and undertake the manufacture of electrodes for use in arc welding; form a consortium for the importation of inputs; establish a training and assistance centre for this sector of activity.

ii) For the textile industry: Implement the proposal for setting up a sizing and dyeing industry and for creating a technical assistance and training centre.

iii) For the leather and footwear industry: Make use of vegetable-based (non-polluting) tanning techniques for poor quality hides; import high-quality hides and process them into semi-finished goods; create a technical assistance and training centre for the leather and footwear industry (or use the centre in Costa Rica).

iv) For the pharmaceutical chemicals industry: Promote the development of quality-control laboratories; update the legal provisions pertaining to this industry; take advantage of the framework provided by CONACYT to conduct long-range research into the agrindustrial potential for sweeteners, essential tropical oils and preservatives.

v) Food: Research on the food industry was not conducted due to limitations relating to the scope of the project, and specific recommendations concerning that industry cannot therefore be presented. Nevertheless, according to the available indicators of competitiveness, this is definitely the branch of activity that holds out the greatest potential.

c) Recommendations for the maquila industry

i) An aggressive development programme should be undertaken in this sector, with broad-based participation by the private sector. The relevant legislation should be flexible, should create competitive conditions and should offer clear advantages over other countries (temporary importation provisions, for

23 Willmore (1992) says that the formalities involved in registering a company take four hours in New York, six months in El Salvador, four months in Costa Rica and a whole year in Honduras.
example). Whereas for some countries the maquila industry is just one of various options to be explored, in the case of El Salvador, because of the country’s tremendous limitations, it is the option. To recall the argument made by Porter, we should optimize our use of the only resource which the country has in abundance (unskilled manpower) and then use that as a platform from which to move on, over a space of time that will not necessarily be very short, to the subsequent phases of the process (capital formation and the development of skilled human resources).

ii) The above measures should help to attract private and public investment to the maquila industry (the private sector is already working on the creation of in-bond customs-free zones). Infrastructure should be developed for this purpose; the country’s position in expanded regional markets should be strengthened; and its geographic location should be used to advantage. Meanwhile, for its part, the Salvadoran manufacturing sector should give priority to developing and supplying these activities. In addition to the fact that such a scheme would create jobs, its financing would be viable in the short term (there is a huge demand for facilities in customs-free zones) and it might also enable local manufacturing concerns to gear up as suppliers and thus find a shortcut to operating as exporters (in the textile industry, there are already some highly developed firms which act as suppliers for the maquila sector).

4. A brief summation

In 1991-1992 El Salvador made substantial progress in relation to macroeconomic variables and made some headway in improving the country’s institutional framework, but a great deal remains to be done in the sectoral and microeconomic areas. It is not enough to reach financial balances or to adopt models that have had good (and bad) results in other countries: the actual situation is much more complex and changeable. The challenge is a formidable one, but by that same token, there is also a very strong motivation for developing the manufacturing sector of a country that has recently proven that it is capable of great sacrifices and great accomplishments, of withstanding a devastating war, and of undertaking an exemplary peace process.

(Original: Spanish)

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24 At the behest of President Duarte, in 1984 Sergio Molina and Carlos Massad prepared a confidential study in which they concluded that, given the urban make-up of the country, its stocks of human and natural resources and the tremendous pressure being exerted on the environment, the best option was to follow the example of Taiwan by using the maquila industry as the starting point for a long-range initiative.
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