CEPAL

Review

Director
RAUL PREBISCH

Technical Secretary
ADOLFO GURRIERI

Deputy Secretary
GREGORIO WEINBERG

UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA

SANTIAGO, CHILE/APRIL 1984

CEPAL

Review

Number 22	Santiago, Chile	April 1984

CONTENTS

CEPAL REVIEW No. 22

The Crisis in Central America: its origins, scope and consequences*

About two years ago, the ECLA Mexico Office prepared a note in which a warning was given that the Central American economies were beginning to suffer rapid deterioration on account of factors of both external and internal origin, and that if nothing was done to deal with this situation it could imperil the level of economic interdependence reached through the integration programme. In order to lessen or even reverse these depressive tendencies, it was proposed that machinery should be set up to heighten international collaboration, with a view to strengthening the activities which the countries of the region would have to carry out themselves.

Since then, it has been observable that the situation of the Central American economies has been eroded to an even greater extent than was foreseen in that note, that international co-operation has not played the role which was expected of it, and that the degree of economic interdependence previously reached has undergone a decline.

Given the seriousness of the situation, in which are combined an economic and a political crisis that are without precedents in recent times, and in view of the widespread confusion as regards the way to tackle these crises, it has seemed appropriate to go more deeply into their causes, characteristics and consequences, and to put forward some suggestions regarding possible policy options which governments might adopt.

The present article makes no claim to offer global solutions or set models for solving problems of such great complexity; rather does it emphasize the novel nature of the present crisis and formulate some guidelines which could facilitate these countries' adaptation to the changed circumstances inside and outside the region. Within these guidelines, particular stress is laid on the activities which could be embarked upon jointly in order to check further economic deterioration and even, if possible, reverse the negative trends of recent years.

*Prepared by the ECLA Mexico Office

I
Introduction

Central America is passing through a profound crisis in both the economic and the political and social spheres: areas so closely interlinked that it would be idle to try to determine whether one took causal precedence over the other. The fact is that since the beginning of the 1980s the region has been simultaneously sunk into the deepest economic depression and racked by the most serious political upheavals of the last fifty years, so that it is living through a climate of instability and confusion. It is hard to find viable solutions on the political, economic or social level.

The origin, scope and possible consequences of the crisis cannot be understood without analysing the main features of the evolution of the economies and societies of Central America since the war. The first aspect which strikes one is the dynamic growth achieved over a 30-year period —naturally with differences from one country to another— within an atmosphere of financial and monetary stability. A second notable aspect is the decisive influence of external factors, which have been essential determinants not only of economic behaviour, but also of the mutual influence of many political factors. Herein lie the historical roots of the repeated propensity of Central Americans to look abroad for explanations and solutions of the problems that beset them. Furthermore, the fragmentation of Central America —since the short-lived federation broke up— has also contributed to the fact that each of the countries has resigned itself historically to having scant room for manoeuvre with regard to its own destiny, owing to the preponderance of factors beyond its control.

A third remarkable feature is that, in the thirty years since the end of the Second World War, most of the considerable changes undergone by the economies of the region have been simply juxtaposed to the economic and social structure which already existed before, and have made no essential difference to a process referred to in the present article as 'superimposed development'.

Lastly, the fruits of the long period of economic expansion which took place after the Second

World War were distributed in a flagrantly inequitable manner among the different population strata within the framework of a concentrative —or at least exclusive— process which precluded any significant relief of the extreme poverty that persists in the region.

In addition to the foregoing constants, mention must be made of more recent phenomena of internal and external origin which might well herald a break with the development model and with former patterns of political interaction. Thus, there are new challenges to the development of the Central American economies and dangers to political coexistence at the national and even the regional levels by which all the countries are affected. The crisis could itself give rise to opportunities for improving the situation, however, if innovative responses to the region's economic and social problems materialize.

In the following pages, first and foremost, the features of the period after the war are analysed, and more recent phenomena are then examined. Consideration is next given to short-term prospects and to a number of possibilities for at least reducing the negative effects of the crisis or even seeking to reverse them within the framework of a development model different from that which has prevailed in the past.

II

Features characterizing Central America's development style since the war

1. *Economic dynamism*

The first special feature of the development of the Central American countries during the last three decades was undoubtedly its sustained dynamism. The gross domestic product of the region as a whole grew at an annual rate of 5.3% in real terms between 1950 and 1978, with differences of degree among the various countries (the highest rates corresponding to Nicaragua and Costa Rica and the lowest to Honduras). As a result, per capita real income practically doubled during this period. Even between 1970 and 1978, when the region had to face exceptionally grim problems —the rise in hydrocarbon prices, imbalances in the international financial market, shortages of raw materials and of some foodstuffs in 1974-1975, several droughts and three large-scale natural catastrophes—, the real annual growth rate averaged more than 5.6% per year.

Some other features of this growth may also be noted (see figure 1). First of all, during the 28 years in question negative growth rates were recorded only on a very few occasions, almost always associated with some natural disaster (twice in Honduras and once in Nicaragua and Costa Rica). Secondly, while there were frequent —almost annual— cyclical fluctuations, these took place against a background of notably stable growth. The cyclical downturns were brief; only exceptionally did the product fall for two years running in any of the countries. Lastly, the cyclical evolution of the gross domestic product of the five countries showed great similarity, reflecting both their common form of insertion into the international economy and the high degree of economic interdependence achieved through the integration commitments of the 1950s and 1960s.

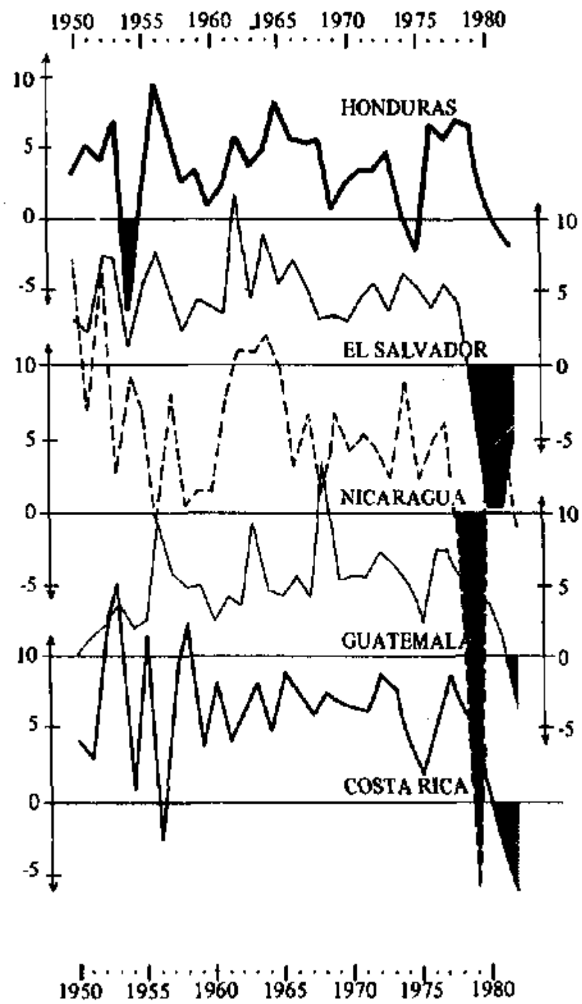
The most dynamic sector was generally manufacturing, to which impetus was given by the expanded market and the industrial development policies created as part of the integration process. As a result, the region's degree of industrialization rose from 12.3% in 1960 to 16.8% in 1978.

2. *The decisive influence of the external sector*

The steadiness with which the Central American economies grew largely reflected the long boom in the international economy which followed the Second World War. During that period, the industrialized countries grew at a cumulative

Figure 1

CENTRAL AMERICA: EVOLUTION OF GROWTH RATES OF THE GROSS DOMESTIC PRODUCT



annual rate of 5.0%, while the volume of world trade expanded at a rate of 9.0%. Albeit in different degrees, all the countries of the region managed to take advantage of this situation: the value of their exports of goods and services to countries outside the region increased by a factor of thirteen between 1950 and 1978, rising from US$ 250 million to US$ 3.2 billion, while the export sector was significantly diversified, as regards both the composition of its products and their geographical destination[1]. The boom in the traditional export sector also created conditions easy enough to facilitate the bold decision to adopt reciprocal free trade in virtually all products originating from the region within a space of not more than five years. This was responsible for the industrialization drive which eventually became a second source of dynamic growth, although this never ceased to depend ultimately on the evolution of the traditional external sector. The easy economic situation referred to, together with the region's intensive modernization process, likewise helped to create consumption patterns in certain strata of the population which imitated those of more advanced societies and accentuated demand for imported goods.

During the 1960s and 1970s the external sector of the Central American countries underwent significant changes. The relative importance of foreign trade tended to increase —the export and import coefficients for the region as a whole rose from 18.6% and 16.3%, respectively, in 1950 to 30.4% and 33.6% in 1978—;[2] the structure of exports and imports changed radically —the former included a growing proportion of non-traditional articles, while within the latter the proportion of intermediate and capital goods increased—; intra-Central American trade expanded rapidly until it accounted for a high and mounting percentage of the total exports of each of the countries, inasmuch as it became a more and more important source of the total imports of each; and movements on the capital account acquired progressive significance as the gap in current transactions widened and

[1]For the region as a whole, in 1950 the main export product of each country contributed 70% of the total foreign exchange generated by exports of goods. This proportion went down by practically half in 1970 (36.1%), thanks to the diversification of the export sector, although it rose again to 45% in 1978 because of the high prices prevailing that year for coffee, which carries a great deal of weight in the total value of exports. Furthermore, in 1950 80% of Central America's external trade was conducted with a single country (the United States), but this share dropped to 35% in 1978.

[2]If reciprocal trade is excluded from these figures, the export coefficient for the region as a whole evolved as follows: in 1950, 1960 and 1978, respectively, it was 18.5%, 16.7% and 23.5%; while in the same years the coefficient of imports from outside the region was 16.2%, 19.8% and 27.3%, respectively.

new sources of international financing, both public and private, became available. As a result, the servicing of the external debt began to absorb an increasingly large proportion of the foreign exchange generated by exports of goods and services.

Even so, throughout this period of growth, diversification and change in the external relations of the region, the essential feature of those small agricultural-export economies persisted: the evolution of the external sector largely explained the global economic behaviour of the economy, while the constraints originating in that sector set a limit to the rate of domestic economic activity. A direct relationship is thus observable between the level of exports on the one hand, and the rates of economic expansion, capital accumulation, investment, procurement of fiscal revenue, level of employment and import capacity, on the other.

External financing acted as a shock-absorber during periods of contraction, preventing drops in the value of exports from being reflected automatically in a limitation of the capacity to import (and hence on the growth capacity of the economy), and at the same time it also facilitated the process of 'superimposed development' referred to below. But when a weakening of external demand coincided with a restriction of the flow of external financing (which served at least partly to make up for the fall in exports), the constraints originating in the external sector had the effect of inhibiting economic growth and even bringing about a contraction in economic activity in real terms.

The influence of external factors on events in the countries of the region was not confined to the economic sphere. Some of the consequences of Central America's dependence on exports profoundly affected the shaping of its societies and the political order prevailing in them. It is common knowledge, for example, that the cultivation of one or two basic export products had a decisive influence on the division of labour, because of the intensive and seasonal nature of manpower requirements for the crops concerned. The availability of labour has thus played a vital part in the economic development of the region as well as in determining the dual and interdependent nature of export and subsistence agriculture, and these facts largely explain, in their turn, the inequitable income distribution structures.

The organization of the Central American economies around one or two export products has also profoundly influenced the 'patterns of authority': the symbiotic relation between dominant economic groups (agricultural exporters and traders) and governments, the legacy of corruption from colonial times, and the historical use of repressive methods to ensure the availability of labour have helped to consolidate the authoritarian and non-participative systems, characteristic of the period since the war, which have taken different forms from one country to another, or within a single country at different times (the main exception being Costa Rica).

Furthermore, factors of external origin have also decisively influenced political interaction in the countries of the region. The virtual hegemony exercised by the United States since the signing of the Clayton-Bulwer treaty in 1850 has taken a new form in the period since the war because of the latent conflict existing between the two leading superpowers of the world. This is not the place to go into detail about the role of United State foreing policy in Central America —a topic which has been the subject of many studies in recent years—,[3] but it is worth stressing

[3]While it must be admitted that reference to a to-and-fro movement between 'realism' and 'idealism' in the foreign policy of the United States represents an oversimplified description, it is nevertheless backed up by some searching analyses. See, for example, the description given by Dexter Perkins of cycles of 'quietism' and 'activism', in *The American Approach to Foreign Policy,* Cambridge, Mass., Harvard University Press, Revised edition, 1962, chapter VII, pp. 136-155. In other cases it is grounded on what Stanley Hoffmann describes as the 'dualism' of the United States style of foreign policy, one of whose manifestations is that of speaking two different languages, neither of which is entirely convincing, and which are difficult to reconcile, the first being the language of power and the second the language of community and harmony. Or, as Hoffmann himself puts it even more graphically, only a symbolic eagle can easily hold both arrows and an olive branch at the same time (see *Gulliver's Troubles or the Setting of American Foreign Policy,* New York, McGraw-Hill Book Company for the Council on Foreign Relations, 1968, pp. 177-178). Finally, the alternation between 'realism' and 'idealism' in foreign policy is also substantiated by Samuel P. Huntington's recent description of the United States' political system, one of whose essential features, in his view, is the gap between political ideals and political realities. Huntington recognizes that such a gap exists in all societies, but asserts

the considerable influence which the United States has acquired in the region. There is no question, of course, of ascribing to the United States an omnipotent role, or of insinuating that Central American events depend entirely on the designs of one or the other of the superpowers, since interaction between the national political actors has its own dynamics; but it may nevertheless be maintained that the United States has shown a capacity for fixing the limits of political interaction in the countries of the region by throwing its umbalancing weight on the side of the national actors whose position is closest to the postulates of its own foreing policy.

Of course the preferences of United States policy have not always formed a coherent set of objectives: some administrations have been mainly concerned with security —above all the 'containment of communism'— while others have been more interested in gradual orderly change towards more pluralistic and equitable societies. In this connection, United States governments have sometimes supported national actors who advocate orderly and peaceful changes, within the framework of a foreign policy *vis-à-vis* the Latin American countries which some authors have called 'idealistic'. This happened, for example, when the United States favoured the heterogeneous alliances which overthrew dictatorships in Guatemala, El Salvador and Honduras in the period following the war, or the governments which promoted changes under the 'Alliance for Progress' in the 1960s, as well as when possibly somewhat reluctant support was given to the similarly heterogeneous alliance which assumed power in Nicaragua in 1979. On other occasions, the United States Government has preferred to help national actors who, in its opinion, have the best qualifications for ensuring a minimum of stability in the face of radical challenges to the *status quo*. The best example of this more 'realistic' policy might perhaps be the support given by the United States administration to the forces which overthrew the elected government in Guatemala in 1954.

At all events, when contradictions have arisen in United States foreign policy —as has happened fairly often— between the objective of promoting orderly change and that of avoiding threats to security, United States governments have invariably preferred to support those actors in each country whom it has considered most capable of defending their own interests. It is in this way that the governments in question have managed to fix the geopolitical limits referred to earlier.

3. *Superimposed development*

Of course the economies and societies of the Central American countries are very different from what they were thirty years ago, not only in quantitative respects —the gross domestic product rose from US$ 1.95 billion to US$ 7.52 billion (at 1970 prices) between 1950 and 1980, while over the same period the population increased from eight million to over 20 million inhabitants— but also because important qualitative changes have taken place. The societies are much more segmented and pluralistic; a noteworthy feature is the appearance of middle-income strata attributable partly to the progressive urbanization (only 16% of the population lived in urban areas in 1950, compared with 43% in 1980); the importance of secondary sector activities in the economies has increased (their relative participation climbed from 14.6% to 24.1% between the two dates mentioned) and in general the system of production has been modernized and diversified year by year. The different geographical regions within the countries are now much better integrated, thanks to the heavy investments made in the physical transport and communications infrastructure, and advances have even made in the supply of education and especially health services. These changes are to be attributed essentially to the 'spill-over' caused by the style of development which has predominated in all the countries

that the United States is distinguished by its manner of approaching it: namely, through four responses differing from one another but all forming part of a 'cyclic pattern' that begins with 'moralism', which seeks to eliminate the gap; falls into 'cynicism', which tolerates it; moves on to 'complaisance' which contrives to ignore it; and ends with 'hypocrisy', which denies its existence. And after that the cycle begins all over again with 'moralism'. See *American Politics: The Promise of Disharmony* (Cambridge, Mass., The Belknap Press of Harvard University Press, 1981), pp. 3, 42, 64 and 68.

—albeit with specific characteristics varying from one to another— over the whole period under analysis. It may be considered that these changes have generally speaking been the only ones permitted by those who have had the possibility of keeping changes within certain limits, outstanding among these actors being those who obtained their economic power under the aegis of the agricultural export pattern which is so vital to the region's historical development style. Consequently, it may be said that the considerable changes which have taken place in the three decades since the war are characterized essentially by the way in which the new economic and social strata were gradually juxtaposed with those already existing, in the course of a process of change and modernization which did not in essence threaten the pre-existent economic structure.

The foregoing is simply another way of explaining an evolutionary process of peaceful change: as long as the pre-existent structures are not eliminated, then all the changes occurring in development patterns must, by definition, be of an additive or superimposed nature, although they need not necessarily be scorned on that account.

What it is desired to stress here, however, is that when these changes have seriously threatened the existing structures and vested interests, they have almost invariably found the way ahead barred, above all when the interests of the dominant groups have been identified —as has frequently (but not always) occurred— with those of the leading international actor in the Central American political arena, in the terms already referred to in previous paragraphs. Thus, peaceful and orderly changes or reforms have had to keep within very tight limits in most of the countries of the region. To put this another way, economic progress has caused an important social change, with many groups rising in the income scale and with the formation of middle classes, but the maintenance of the historical pattern of development has determined a slow and halting advance by the political institutions. The gap between economic change and strengthening of the political practices and institutions required by a more complex society is part of the background of instability in Central America.

This essential characteristic of 'superimposed development' has frequently obliged governments to seek substitutes for changes which perhaps might run the risk of exceeding the limits aforesaid. Thus, for example, recourse was had to external financing partly in order to postpone or take the place of increases in the tax base; State land was distributed in what were called 'land settlement' programmes, in preference to a restructuration of land tenure systems; and external saving was used as a substitute for (instead of a complement to) the inadequate machinery for tapping domestic saving.

By the same token, the tax burden came to be an interesting indicator of the constraints which 'superimposed development' had to face in Central America. Although important changes took place within the taxation system in all the countries —as a reflection of the changes which were coming about in the system of production— it is curious that tax revenue, as a percentage of the gross domestic product, remained constant in some countries or grew at only a dawdling pace in others (see table 1). Furthermore, this coefficient of taxation was extremely low compared with that of other countries of similar economic and social structure, a circumstance which should not be considered merely accidental: entrepreneurial and labour organizations in all the countries —albeit in different degrees— stubbornly resisted rises in levels of taxation, especially taxation on production and income. The financial constraints due to the scanty procurement of fiscal revenue severely limited the capacity of the public sector to play a more active role in development, while a growing proportion of the modest increases achieved in the coefficient of public expenditure (see table 2) was financed through borrowing, especially from external sources.

The public sector's limited participation in the gross domestic product, as measured through procurement of tax revenue and central government expenditure, also fitted in with the 'anti-dirigisme' position of the dominant groups in Central American societies. In the 1950s and 1960s, the public sector was gradually taking control of such public services as the generation and distribution of electricity, telephone communications, rail transport and port and harbour management, while State activity was also

Table 1

CENTRAL AMERICA: COEFFICIENT OF TAXATION, 1955 TO 1982

	1955	1960	1965	1970	1975	1980	1981	1982[a]
Central America	*9.5*	*9.3*	*9.4*	*9.7*	*11.3*	*11.4*	*10.7*	*10.8*
Costa Rica	10.1	10.0	11.8	12.1	12.7	11.4	12.1	11.6
El Salvador	10.8	10.9	9.9	10.3	12.0	11.1	11.3	10.9
Guatemala	8.5	7.8	7.6	7.8	9.5	8.6	7.5	6.9
Honduras	7.3	10.1	9.7	11.2	12.1	14.0	13.2	12.5
Nicaragua	10.8	9.4	10.2	9.4	10.6	18.4	16.6	20.1

Source: ECLA, on the basis of official data.
[a]Provisional figures.

Table 2

CENTRAL AMERICA: COEFFICIENT OF TOTAL CENTRAL GOVERNMENT EXPENDITURE, 1955 TO 1982

	1955	1960	1965	1970	1975	1980	1981	1982[a]
Central America	*10.6*	*11.2*	*11.3*	*11.6*	*15.8*	*19.3*	*19.5*	*20.3*
Costa Rica	11.2	13.3	13.8	13.7	17.9	20.0	15.5	15.3
El Salvador	10.9	12.2	10.9	10.3	13.4	17.2	19.8	20.1
Guatemala	9.5	9.3	10.6	9.9	12.5	15.2	16.9	14.7
Honduras	10.0	12.2	10.8	14.7	21.0	24.9	23.7	23.6
Nicaragua	12.4	11.1	11.2	11.8	19.4	29.5	28.1	39.0

Source: ECLA, on the basis of official data.
[a]Provisional figures.

strengthened with the establishment of public development banks and institutions for regulating commodity prices. In all countries, however, the public sector scrupulously avoided participating in activities of interest to private enterprise, the main exception to this rule being perhaps the Costa Rican financial intermediation system.

Another example of the persistence of pre-existent structures in the processes of change under discussion was the low level of backward or forward integration of traditional agricultural export activities, in the sense that the sectors depending on these have not tried to diversify systematically in order to invest in more complex activities. The appearance of new agricultural export lines (cotton, sugar and meat) meant no more than a repetition of the pattern of traditional basic commodities, with their scanty linkages with other productive activities. In other words, traditional producers diversified but little, and the State shared only slightly in the surplus generated by them. This gives an idea of the way in which the traditional economic and social structures were perpetuated and of how the changes so often mentioned were simply juxtaposed with them without altering them in essence. That is to say, the changes occurred only within relatively narrow limits (although these varied somewhat from country to country). Thus, despite the considerable expansion and change wich took place in the Central American economies and societies in the thirty years following the war, that change was, paradoxically, not sufficient to meet the growing expectations of large sectors of the population. Furthermore, the instinctive desire to preserve vulnerable social systems led in most of the countries to the maintenance of the existing economic patterns —which were able to take advantage of the boom in the international economy— based on political institutions that were of an exclusive nature, at least as regards the distribution of power and of the fruits of economic development. Consequently, the social mobilization and spill-over effects which accompanied the postwar boom were not able to offset, in a comparable sense, the backwardness of some political structures.

4. *The exclusive nature of development*

Hence, despite their economic dynamism, the countries of the region were not capable during the thirty years after the war of significantly improving income distribution or of reducing the number of Central Americans living in a state of extreme poverty. According to household surveys carried out in recent years, the poorest 20% of the population has less than 4% of the national income at its disposal, while at the other extreme the most affluent 20% obtains more than 55%. There are considerable differences from one country to another, the most dissimilar features corresponding once again to Costa Rica (see table 3). In countries where surveys were carried out at different times, the available evidence —albeit the methodologies used were not always comparable— indicates that the gap between the groups at the two extremes of the scale widened, even though the relative share of the intermediate strata may have tended to increase (see table 4). In the case of Guatemala and Costa Rica, the per capita real income of the poorest 20% of the population actually went down.

Table 3

CENTRAL AMERICA: STRUCTURE OF INCOME DISTRIBUTION AND PER CAPITA INCOME LEVELS, BY COUNTRIES, TOWARDS 1980

(Dollars at 1970 prices)

Strata	Costa Rica		El Salvador		Guatemala		Honduras		Nicaragua	
	%	Average income	%	Average income	%	Average income	%	Average income	%	Average income
Poorest 20%	4.0	176.7	2.0	46.5	5.3	111.0	4.3	80.7	3.0	61.9
30% below the mean	17.0	500.8	10.0	155.1	14.5	202.7	12.7	140.0	13.0	178.2
30% above the mean	30.0	883.8	22.0	341.2	26.1	364.3	23.7	254.6	26.0	350.2
Richest 20%	49.0	1 165.2	66.0	1 535.5	54.1	1 133.6	59.3	796.3	58.0	1 199.8

Source: ECLA, on the basis of official data from the countries.

Table 4

CENTRAL AMERICA: EVOLUTION OF FAMILY INCOME DISTRIBUTION IN THE 1970s

(Dollars at 1970 prices)

Strata	Guatemala[a]			Costa Rica			Honduras		
	1970	1980	Growth rates (annual averages)	1971	1977	Growth rates (annual averages)	1968	1979	Growth rates (annual averages)
Poorest 20%	1 088	996	−0.9	572	528	−1.4	85	287	6.4
30% below the mean	2 014	1 962	−0.3	1 167	1 495	3.7	206	564	5.8
30% above the mean	3 702	3 865	0.4	2 269	2 639	2.3	522	1 055	4.6
Richest 20%	9 098	12 393	3.1	5 756	6 465	1.8	2 476	3 958	3.4
Richest 10%	12 081	12 970	4.0	7 874	8 737	0.9	3 649	11 395	6.2
Average income	3 752	4 426	1.7	2 297	2 639	1.3	731	1 338	4.1

Source: ECLA, on the basis of official data from the countries.

[a] Urban sector.

In absolute figures, out of a total of over 20 million Central Americans in 1980, some 13.2 million (64%) were living in a state of poverty —in the sense that their income did not cover their basic needs— while over 8.5 million (41%) did not even have sufficient income to pay for the minimum shopping-basket of food considered necessary to meet their biologico-nutritional requirements (see table 5). The situation was much more serious in rural than in urban areas, and there were considerable differences from one country to another (in Costa Rica, less than 25% of the population lived below the threshold of poverty, whereas in Guatemala the corresponding proportion was over 70%). Moreover, although in all likelihood the percentage of Central Americans living in a state of poverty nowadays is less than it was 30 years ago, it is nevertheless true that in absolute terms, because of population expansion, there are now more poor people (and also more people who are not poor) than in the period immediately after the Second World War.

In short, the region's characteristic development style has been concentrative, or at any rate of an exclusive nature in the sense that it has favoured the different strata of the population in a flagrantly inequitable manner, accentuating the degree of income concentration in some countries. Likewise, although 30 years of rapid and sustained economic expansion have gone by, over half the population of Central America —and three-quarters of those living in rural areas— do not have sufficient income to cover their essential needs as regards food, housing, clothing and basic services.

It should be noted that the exclusive pattern of development is not confined to the economic and social sphere. If it were possible to speak of a truly typical characteristic of political interaction in most of the Central American countries, then this characteristic would be the absence of broad popular participation, reflected in the virtual exclusion of the masses, and specially the rural masses, from political activity. Neither the industrialization nor the urbanization which have taken place since the end of the war have been able to bring about a decisive change in the still essentially agricultural nature of these societies. With a few exceptions, the masses working in rural areas continue to be passive observers instead of organized actors in the evolution of the political systems. This exclusive feature has had a decisive influence both on the characteristics and on the scope of the various modernization projects undertaken in the region.

Thus, with one exception, the lack of effective participation by the emerging social classes meant that they were not in a position to counterbalance the weight of the traditional power groups in the handling of public affairs, and this sometimes increased the tensions between the rapid social development and the slow institutional development in the political sphere.

To put this in another way, except in the case of Costa Rica, political interaction in Central America has generally been of an elitist nature and has not been able to include the region's most numerous population groups in the projected modernization of its societies. To do this would have meant perhaps eliminating, possibly by degrees, the factors of authoritarianism referred to above, and undertaking the consistently postponed reforms aimed at fulfilling the legitimate aspirations of the groups which have so far been virtually excluded from the benefits of development.

III

Recent events and the current economic crisis

1. *The break with historical trends*

In 1977-1978 the trends briefly described above reached a turning-point, at least as regards sustained economic growth. Since that two-year period, a progressive slowdown has occurred, culminating in negative rates in all the countries (1982) (see figure 1). The duration, intensity and peculiar characteristics of this situation have no

Table 5

CENTRAL AMERICA: ESTIMATED INCIDENCE OF POVERTY TOWARDS 1980

	Whole of Central America			Costa Rica			El Salvador			Guatemala[a]			Honduras[b]			Nicaragua		
	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural
	Thousands of persons																	
Total	*20 696*	*8 315*	*12 381*	*2 213*	*1 011*	*1 202*	*4 747*	*2 119*	*2 678*	*7 262*	*2 485*	*4 777*	*3 691*	*1 229*	*2 462*	*2 733*	*1 471*	*1 262*
In a state of poverty	13 178	3 738	9 440	549	138	411	3 267	1 221	2 046	5 166	1 168	3 998	2 515	540	1 975	1 681	671	1 010
Extreme poverty	8 647	2 130	6 517	300	75	225	2 427	943	1 484	2 879	418	2 461	2 092	376	1 716	949	318	631
Basic needs not satisfied	4 531	1 608	2 923	249	63	186	840	278	562	2 287	750	1 537	423	164	259	732	353	379
Not in a state of poverty	7 518	4 577	2 941	1 664	873	791	1 530	898	632	2 096	1 317	779	1 176	689	487	1 052	800	252
	Percentage breakdown																	
Total	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
In a state of poverty	63.7	45.0	76.2	24.8	13.6	34.2	68.1	57.6	76.4	71.1	47.0	83.7	68.2	43.9	80.2	61.5	45.6	80.0
Extreme poverty	41.8	25.6	52.6	13.6	7.4	18.7	50.6	44.5	55.4	39.6	18.8	51.5	56.7	30.6	69.7	34.7	21.6	50.0
Basic needs not satisfied	21.9	19.4	23.6	11.2	6.2	15.5	17.5	13.1	21.0	31.5	30.2	32.2	11.5	13.3	10.5	26.8	24.0	30.0
Not in a state of poverty	36.3	55.0	23.8	75.2	86.4	65.8	31.9	42.4	23.6	28.9	53.0	16.3	31.8	56.1	19.8	38.5	51.4	20.0

Source: ECLA, Central American Basic Needs Project, on the basis of data from the countries and CELADE, ***Boletín Demográfico***, Vol. XIV, No. 28.

a Urban/rural population breakdown corresponds to figures from the 1979/1980 family income and expenditure survey.

b Urban/rural population breakdown corresponds to figures from the 1978/1979 family income and expenditure survey.

precedent in the period since the war. Suffice it to say that, after 30 years of expansion in the five countries' per capita income (with only sporadic interruptions), there has been a sharp and pervasive decrease during the last five years. In Costa Rica, Guatemala and Honduras the absolute level in late 1982 barely equalled that recorded in 1976. In El Salvador and Nicaragua the situation was even more dramatic, since real per capita income had slipped back to the levels of the first half of the 1960s.

In addition, the process of economic integration, which had earlier allowed the downward fluctuations in the international economy to be offset, changed direction and became a factor which magnified the crisis. Due to the depth of the crisis, together with political circumstances and the lack of a strategy of regional scope, the economic interdependence of the five countries has tended to become a mechanism that transmits recessionary economic forces.

The fact that the pronounced deterioration in the evolution of the economies has coincided with a period of increasing political upheaval may be functionally related to some of the characteristics of Central American societies mentioned before. Some of the many manifestations of those characteristics led to a questioning of the social order which involved violent challenges to the *status quo*, and these, in turn, gave rise to similarly violent responses which contributed to a rapid polarization of positions in some countries, especially Guatemala, El Salvador and Nicaragua. There are many complex and mutually-reinforcing interrelationships among the local political and economic factors and the way in which both intermix with external influences. These phenomena will be briefly examined below.

2. *The impact of exogenous phenomena*

It is not by chance that the economic crisis has affected all the countries, regardless of the degree of social peace or upheaval prevailing in them, the economic policy objectives pursued, or the differences in relations between the public and private sectors. All have been seriously affected by factors of external origin. This has been inevitable because the common denominator affecting them all has been the profound recession in the international economy which, as already noted, to a great extent determines the overall behaviour of the Central American economies and even imposes a limit upon their ability to grow. Now, in addition to the world recession, the economic effects of the political crisis —discouragement of private investment, flight of capital, difficulties in attracting external financing— have combined and have reinforced one another to the point where they have produced an economic breakdown unlike any seen in Central America since the 1930s.

With respect to the effects of the disarray in the international economy, it may be recalled that, in addition to the industrialized countries' difficulties in 1978-1979 —low growth rates, high rates of inflation, decreased savings, lags in the application of technological innovations— hydrocarbon prices went up again in 1979. Still greater importance could perhaps be attributed to the attempts to modify economic policy made by some industrialized countries which have stressed the fight against inflation —with some success— and have resorted, *inter alia*, to restrictive monetary measures that have been reflected in high interest rates. These policies have undoubtedly contributed to the slowdown of economic activity in the countries where they have been implemented, as well as in the world economy in general, with the resulting repercussions on the levels of international trade. This situation has weakened demand for the Central American countries' traditional exports. Given the persistent international inflation (although recently it has begun to decline), the weakness of demand produces a marked deterioration in the terms of trade. What is more, in the financial sphere, the Central American countries have been adversely affected by the high interest rates on their massive foreign debt and by their recent difficulties in gaining access to new external financing.

The figures in tables 6 and 7 speak for themselves. With the decline in the prices of virtually all the products exported by Central America and the continued upward pressure on the prices of its imports —especially hydrocarbons in 1979-1980—[4] the region's terms of trade have deterio-

[4]For the region as a whole, the relative share of petroleum in total imports rose from 4.4% in 1970 to 10.7% in 1976, 18.7% in 1980 and 21.6% in 1981.

rated by almost 50% since 1977, while the purchasing power of its exports has fallen by 30%. In general terms, this means that if the 1977 purchasing power of exports had been kept up, the total value of exports in 1982 would have been 40% greater than it was, whereby approximately 2.0% would have been added to the gross domestic product in the latter year.

Table 6

CENTRAL AMERICA: MAIN FOREIGN TRADE INDICATORS, 1976 TO 1981

	1976	1977	1978	1979	1980	1981
			Growth rates			
Exports of goods						
Value	29.7	35.3	−1.3	14.9	2.3	−7.2
Volume	5.9	−0.9	2.6	13.6	−3.3	3.0
Unit value	22.4	36.5	−3.8	1.2	5.9	−4.5
Imports of goods						
Value	20.1	27.0	8.9	6.3	15.5	−4.6
Volume	14.5	19.8	1.9	−7.0	0.5	−11.4
Unit value	4.9	6.0	6.8	14.3	14.8	6.7
Terms of trade (goods)	16.7	28.8	−9.9	−11.5	−7.8	−11.5
			Indexes			
Terms of trade	93.4	120.3	108.4	95.9	88.4	78.2
Purchasing power of exports of goods	132.6	169.3	156.5	157.3	140.1	120.4
Purchasing power of exports of goods and services	141.1	172.0	162.3	164.5	149.2	130.5

Source: ECLA, on the basis of official data.

Since 1978, the terms of trade have been negative each year in all of the countries. In addition, there has been a decline in the volume of the exports of some countries (including product lines, such as nickel in Guatemala, which have actually ceased to be exported because of lack of demand) as well as increasing difficulties in incorporating new export items because of market constraints and the protectionist measures which some industrialized countries have put into effect, and a considerable decrease in certain exports of services, such as tourism, due not only to the world economic recession but also to non-economic factors in Central America.

On the other hand, productive activity in the Central American countries required imports, in spite of the recession, especially in order to meet the demand created by the increased public spending which the governments promoted, partly in order to counteract the sluggishness of private investment. As a result, the trade deficit of the five countries jumped from US$ 432 mil-

Table 7

CENTRAL AMERICA: TERMS OF TRADE, 1976 TO 1981

	Growth rates					
	1976	1977	1978	1979	1980	1981
Total	*16.7*	*28.8*	*−9.9*	*−11.5*	*−7.8*	*−11.5*
Costa Rica	11.3	28.1	−6.8	−4.0	−6.1	−15.2
El Salvador	29.9	24.5	−15.7	−3.2	−11.5	−14.3
Guatemala	10.5	40.0	−11.4	−11.8	−6.4	−8.2
Honduras	8.2	15.4	−0.4	−12.3	−1.8	−17.6
Nicaragua	17.7	27.4	−11.3	−11.9	0.9	−9.7

Source: ECLA, on the basis of official data.

Table 8

CENTRAL AMERICA: BALANCE-OF-PAYMENTS TRADE ACCOUNT POSITION AND ITS RATIO TO GDP, 1975 TO 1981

	1975	1976	1977	1978	1979	1980	1981
				Millions of dollars			
Total	*−570*	*−427*	*−432*	*−887*	*−653*	*−1 323*	*−1 411*
Costa Rica	−166	−146	−164	−269	−425	−460	−107
El Salvador	−79	−12	29	−234	2	−51	−169
Guatemala	−77	−227	−99	−354	−291	−216	−548
Honduras	−101	−60	−74	−89	−99	−197	−126
Nicaragua	−147	18	−124	59	160	−399	−461
				As a percentage of GDP			
Total	*6.0*	*−3.5*	*−2.8*	*−5.4*	*−3.5*	*−6.4*	*−6.8*
Costa Rica	−8.7	−6.1	−5.3	−7.6	−10.5	−10.1	−3.2
El Salvador	−4.4	−0.5	1.0	−7.6	0.1	−1.5	−5.0
Guatemala	−2.4	−5.2	−1.8	−5.8	−4.2	−2.8	−6.3
Honduras	−9.7	−4.7	−4.8	−4.9	−4.6	−7.7	−6.2
Nicaragua	−9.5	1.0	−5.5	2.9	7.7	−17.1	−18.2

Source: ECLA, on the basis of official data.

Table 9

CENTRAL AMERICA: BALANCE-OF-PAYMENTS CURRENT ACCOUNT POSITION AND ITS RATIO TO GDP

	1975	1976	1977	1978	1979	1980	1981
				Millions of dollars			
Total	*−700*	*−455*	*−573*	*−1 088*	*−880*	*−1 690*	*−1 965*
Costa Rica	−218	−203	−226	−364	−554	−654	−382
El Salvador	−95	−11	21	−249	−24	−117	−239
Guatemala	−65	−79	−37	−271	−180	−178	−560
Honduras	−125	−115	−139	−170	−212	−334	−285
Nicaragua	−197	−47	−192	−34	90	−407	−499
				As a percentage of GDP			
Total	*−7.4*	*−3.7*	*−3.8*	*−6.6*	*−4.7*	*−8.1*	*−9.5*
Costa Rica	−11.4	−8.4	−7.4	−10.3	−13.7	−14.3	−12.0
El Salvador	−5.3	−0.5	0.7	−8.1	−0.7	−3.4	−7.1
Guatemala	−2.1	−1.8	−0.7	−4.5	−2.6	−2.3	−6.5
Honduras	−12.0	−8.9	−9.0	−9.3	−9.8	−13.1	−14.1
Nicaragua	−12.7	−2.5	−8.6	−1.7	4.3	−17.4	−19.7

Source: ECLA, on the basis of official data.

lion in 1977 (equal to 2% of GDP) to more than US$ 1.4 billion in 1981 (6.8% of GDP) (see table 8). In addition, there was a spectacular increase in debt servicing, attributable not only to larger-scale borrowing but also, and in particular, to soaring interest rates. External factor payments rose, for example, from US$ 268 million in 1977 to US$ 700 million in 1981 for the region as a whole. This accounts for the fact that the current account deficit grew from US$ 573 million to almost US$ 2 billion during the same period (3.8% and 9.5% of the GDP, respectively) (see table 9).

During 1979-1980 Central America had considerable access to public and especially to private international financing. External support for Nicaragua's reconstruction programmes contributed significantly to this phenomenon, and these resources partially took the place of domestic saving, which tended to be depleted rapidly by reason of public-sector deficits and the flight of private capital. In 1977 only 13.0% of total saving came from external sources, but that figure had increased to 46.4% in 1981 (see table 10). During the same period, the region's external public debt mounted from US$ 2.4 billion to US$ 7.7 billion, and factors limiting several countries' capacity for additional borrowing were thrown into relief. This last circumstance, combined with the constraints on the availability of new resources (the commercial banking system considers the region to be a high financial and political risk, while official sources have tended to diminish due to the austerity policies of

Table 10

CENTRAL AMERICA: EVOLUTION OF INVESTMENT AND SAVING, 1977 TO 1981

(Million of Central American pesos)

	1977		1978		1979		1980		1981[a]	
	In absolute terms	%	In absolute terms	%	In absolute terms	%	In absolute terms	%	In absolute terms	%
Central America										
Gross domestic product at market prices	7 949	100.0	8 231	100.0	8 221	100.0	8 301	100.0	8 213	100.0
Gross domestic investment	1 728	21.7	1 717	20.9	1 492	18.1	1 539	18.5	1 431	17.4
Gross fixed investment	1 603	20.2	1 664	20.2	1 582	19.2	1 443	17.4	1 363	16.6
Public	536	6.8	506	6.1	501	6.1	587	7.1	665	8.1
Private	1 067	13.4	1 158	14.1	1 081	13.1	856	10.3	698	8.5
Changes in stocks	125	1.5	53	0.7	−90	−1.1	96	1.1	68	0.8
Global saving	1 728	21.7	1 717	20.9	1 492	18.1	1 539	18.5	1 431	17.4
External saving	196	2.5	324	4.0	232	2.8	580	7.0	559	6.8
Domestic saving	1 532	19.2	1 393	16.9	1 260	15.3	959	11.5	872	10.6
Costa Rica										
Gross domestic product at market prices	1 518	100.0	1 605	100.0	1 683	100.0	1 693	100.0	1 632	100.0
Gross domestic investment	424	27.9	453	28.2	506	30.0	450	26.7	306	18.8
Gross fixed investment	382	25.2	437	27.2	502	29.9	445	26.3	330	20.2
Public	106	7.0	121	7.5	150	8.9	154	9.1	122	7.4
Private	276	18.2	316	19.7	352	21.0	291	17.2	208	12.8
Changes in stocks	42	2.7	16	1.0	4	0.1	5	0.4	−24	−1.4
Global saving	424	27.9	453	28.2	506	30.0	450	26.7	306	18.8
External saving	27	1.8	71	4.4	128	7.6	124	7.4	5	0.3
Domestic saving	397	26.1	382	23.8	378	22.4	326	19.3	301	18.5

(concl.)

Table 10 (conclusion)

	1977		1978		1979		1980		1981[a]	
	In absolute terms	%	In absolute terms	%	In absolute terms	%	In absolute terms	%	In absolute terms	%
El Salvador										
Gross domestic product at market prices	1 477	100.0	1 542	100.0	1 517	100.0	1 372	100.0	1 241	100.0
Gross domestic investment	362	24.5	376	24.4	336	22.1	198	14.5	162	13.1
Gross fixed investment	323	21.9	356	23.1	322	21.2	203	14.8	175	14.1
Public	112	7.6	111	7.2	113	7.4	97	7.1	83	6.7
Private	211	14.3	245	15.9	209	13.8	106	7.7	92	7.4
Changes in stocks	39	2.6	20	1.3	14	0.9	−5	−0.3	−12	−1.0
Global saving	362	24.5	376	24.4	336	22.1	198	14.5	162	13.1
External saving	73	4.9	153	9.9	63	4.2	24	1.8	27	2.2
Domestic saving	289	19.6	223	14.5	273	17.9	174	12.7	135	10.9
Guatemala										
Gross domestic product at market prices	2 891	100.0	3 036	100.0	3 171	100.0	3 290	100.0	3 323	100.0
Gross domestic investment	494	17.1	544	18.0	477	15.0	405	12.3	460	13.8
Gross fixed investment	463	16.0	497	16.4	462	14.6	419	12.7	434	13.1
Public	128	4.4	124	4.1	134	4.2	169	5.1	216	6.5
Private	335	11.6	373	12.3	328	10.4	250	7.6	218	6.6
Changes in stocks	31	1.1	47	1.6	15	0.4	−14	−0.4	26	0.7
Global saving	494	17.1	544	18.0	477	15.0	405	12.3	460	13.8
External saving	48	1.7	102	3.4	83	2.6	77	2.3	154	4.6
Domestic saving	446	15.4	442	14.6	394	12.4	328	10.0	306	9.2
Honduras										
Gross domestic product at market prices	938	100.0	1 004	100.0	1 072	100.0	1 089	100.0	1 084	100.0
Gross domestic investment	192	20.4	240	23.9	263	24.5	264	24.3	213	19.6
Gross fixed investment	190	20.3	237	23.6	250	23.3	251	23.0	213	19.6
Public	67	7.2	88	8.7	82	7.6	87	8.0	65	6.0
Private	123	13.1	149	14.9	168	15.7	164	15.0	148	13.6
Changes in stocks	2	0.1	3	0.3	13	1.2	13	1.3	–	–
Global saving	192	20.4	240	23.9	263	24.5	264	24.3	213	19.6
External saving	1	0.1	28	2.8	32	3.0	61	5.6	61	5.6
Domestic saving	191	20.3	212	21.1	231	21.5	203	18.7	152	14.0
Nicaragua										
Gross domestic product at market prices	1 125	100.0	1 044	100.0	778	100.0	857	100.0	933	100.0
Gross domestic investment	256	22.7	104	9.9	−90	−11.6	222	25.9	290	31.1
Gross fixed investment	245	21.8	137	13.1	46	5.9	125	14.6	211	22.6
Public	123	10.9	62	5.9	22	2.8	80	9.3	179	19.2
Private	122	10.9	75	7.2	24	3.1	45	5.3	32	3.4
Changes in stocks	11	0.9	−33	−3.2	−136	−17.5	97	11.3	79	8.5
Global saving	256	22.7	104	9.9	−90	−11.6	222	25.9	290	31.1
External saving	47	4.2	−30	−2.9	−74	−9.5	294	34.3	312	33.4
Domestic saving	209	18.5	134	12.8	−16	−2.1	−72	−8.4	−22	−2.3

Source: ECLA on the basis of official data.

[a] Provisional figures.

the donor countries), has created serious difficulties since 1981 in obtaining net financing, and in 1982 external saving —far from offsetting the downward movement in national savings— contributed to the trend.

In 1980-1981 the level of economic activity in the region would have been even lower if it had not been for public and private net external financing (this rose from US$ 864 million to US$ 1 728 million between 1977 and 1980) and if some countries had not used the international monetary reserves which they still had available. Nervertheless, this latter source was quickly exhausted, and by the first quarter of 1982 all the countries, without exception, had negative net reserves.

There was also an intense and persistent flight of capital throughout the region (in some countries more than others), owing to economic and especially non-economic factors which aggravated each country's external position and thus decisively influenced the drop in economic activity.

Furthermore, exogenous factors not only had an impact on the evolution of the economies; they also influenced political events. As noted below, significant changes occurred towards the end of the 1970s in the political interaction of the region, especially in Nicaragua. Just as the long period of postwar economic expansion had reached a turning-point, the social and political structures too had had to undergo a major shift. These events gave rise to a heterogeneous alliance which challenged the ruling regime in Nicaragua. It was not by accident, however, that the changes in Nicaragua —like those in Guatemala, El Salvador and Honduras in the 1940s— occurred at a time when United States foreign policy was aimed at promoting orderly change based on principles which that country recognizes as valid. Thus, during a brief interlude the geopolitical boundaries referred to earlier were extended, and the challenge launched in one of the countries against the traditional development model became viable.

3. *The challenge to the 'superimposed development' model*

The programme adopted by the National Reconstruction Government of Nicaragua deviates from the well-known traditional norms. In a different context, the events in El Salvador also diverge from the model of 'superimposed development' in so far as they have led to changes which, in one way or another, alter the pre-existing structures. It could even be said that, under the twofold onslaught of the economic crisis and the threat to the *status quo*, it is unlikely that the pre-existing structures will be able to survive in some countries without fundamental adjustments. This in no way predetermines the nature of the social organizations which might eventually replace the preceding ones, nor their ideological leanings; it only means that the post-war model which has been in effect for more than 30 years may have run its course.

Some of the economic phenomena which are at once the object and the subject of the crisis clearly illustrate what has just been said. One such phenomenon is capital accumulation. Investment has been shrinking considerably since 1978 both as a result and as a cause of the reduction in economic activity, the drop in domestic savings, the flight of capital and the reaction of the private sector to the political and social tensions by which the region is shaken. Table 10 shows that the domestic saving of the five countries fell from 19.9% to 9.3% of the gross domestic product in 1981 —a serious situation for countries which are attempting to develop. Private investment also suffered a marked reverse: it diminished in all of the countries. The regional coefficient of private investment dwindled from 14% in 1978 to less than 9% in 1981, while in the countries disturbed by civil unrest, the coefficient of private capital formation has plummeted by 50% in the last five years. The public sector made an effort to counteract this decrease —thereby accentuating another long-standing imbalance in the Central American economies: the public finance deficit— but it was not enough; the coefficient of total investment declined in all the countries and tended to create bottlenecks in areas where public spending cannot serve as a substitute for private investment.

The deliberate efforts made by governments to counteract the reduction in economic activity, at a time when there was a downward trend in tax revenues, raised the proportion of the regional GDP represented by public spending from 17.7% in 1977 to 21.3% in 1981, while the coefficient of taxation fell from 12.9% to 11.6% during the same period. As a result of the asymmetry in the patterns of expenditure and income, the aggregate deficit of the five governments increased from 460 million Central American pesos in 1977 (3% of GDP) to more than 1.6 billion pesos in 1981 (7.8% of GDP) (see table 11). In view of the lack of sufficient external financing to cover the deficits, domestic financing was used, but this expedient indirectly exacerbated the disequilibrium in the balance of payments —through the imported component of expenditure— and, in some cases, absorbed most of the expansion in domestic credit, thereby taking away resources from the national private sectors. Thus forces came into play which are tending to destroy, or already have destroyed, the traditional stability of prices in the countries of the region —yet another manifestation of the gradual functional impoverishment of the pre-existing structures.

4. *Effects on intra-Central American co-operation*

The external sector constraints —reflected in the shortage of foreign exchange— have worsened to such an extent that, as from 1981, the countries with deficits in intra-regional trade have even had difficulties in covering their debit balances. At first, the central banks of the countries with surpluses extended bilateral credit lines, and later a regional mechanism was established to deal with the same problem multilaterally (the Central American Common Market Fund). However, when these expedients were exhausted[5] —and when sufficient backing from the international community was not forthcoming— the lack of foreign exchange began to limit intra-Central American trade.

The response of some countries to the constraints on their external sector was to adopt exchange measures (variations in parity, adoption of multiple rates or of controls on the movement of foreign exchange) which affected the terms of trade at the inter-Central American level and, in some cases, limited the volume of

[5]At the end of December 1982, the debts contracted by the countries in order to keep up their trade in previous months came to over US$ 240 million: a debt so large that it exhausted the financing capacity both of the countries enjoying a trade surplus and of the multilateral mechanisms mentioned.

Table 11

CENTRAL AMERICA: CENTRAL GOVERNMENT DEFICITS, 1976 TO 1981

	1976	1977	1978	1979	1980	1981[a]
	Millions of Central American pesos					
Total	*−579*	*−459*	*−789*	*−910*	*−1 470*	*−1 614*
Costa Rica	−150	−136	−211	−324	−418	−184
El Salvador	−27	60	−52	−36	−198	−232
Guatemala	−225	−98	−138	−254	−446	−667
Honduras	−84	−102	−150	−140	−243	−248
Nicaragua	−93	−183	−238	−156	−165	−283
	As a percentage of GDP					
Total	*−4.7*	*−3.0*	*−4.8*	*−4.9*	*−7.1*	*−7.8*
Costa Rica	−6.2	−4.4	−6.0	−8.0	−9.2	−5.8
El Salvador	−1.1	2.1	−1.7	−1.0	−5.7	−6.9
Guatemala	−5.2	−1.8	−2.3	−3.7	−5.7	−7.7
Honduras	−6.5	−6.6	−8.2	−6.5	−9.5	−12.3
Nicaragua	−5.0	−8.2	−11.7	−7.5	−7.1	−11.2

Source: ECLA, on the basis of official data.

[a] Provisional figures.

commercial transactions. As a result of all these phenomena, intra-regional trade ceased to play its traditional role as a factor capable of offsetting cyclical lows in extra-regional trade and became one more victim of the crisis in the external sector. Thus, in 1982 it was estimated that the value of this trade would lessen by almost 20% (from 925 million Central American pesos in 1981 to 750 million pesos in 1982) and that its relative share of the region's total exports would shrink from 21.1% to 19.3%.

One of this situation's innumerable effects on the productive apparatus was that the degree of industrialization (which, as already noted, had increased consistently between 1950 and 1978) stagnated, decreasing from 17.1% in 1978 to 16.2% in 1982. In other words, industrialization, whose expansion had been more dynamic than that of the economy as a whole during the boom, has turned out to be less dynamic than the economy as a whole during the recession.

Despite the fact that the Central American governments have traditionally been, and continue to be, successful in keeping the sphere of economic co-operation separate from the sphere of political relations, the growing ideological heterogeneity now poses a latent threat that political differences will spill over into the sphere of economic co-operation precisely at the time when intra-regional co-operation is most needed in order to mitigate the effects of the external sector problems. In addition, the danger of internationalization of intra-regional conflicts could lead to a greater fragmentation of the Central American Isthmus and a repetition of painful historical episodes.

5. *Summary*

In short, the region is living through a critical situation of unprecedented magnitude and depth. Economic activity has been diminishing, and this has been accompanied by growing external imbalances as well as by a sharp downturn in the levels of public sector saving and investment, together with an ever-narrowing radius of action for overcoming these disequilibria.

The high and rising levels of overt unemployment and underemployment suggest that the long-standing inequalities of the Central American economies will tend to worsen. The prolonged depression and the limited capacity of some of the countries for external borrowing have required the adoption of adjustment programmes —some in accordance with commitments to the International Monetary Fund— which involve the adoption of unpopular economic policies.

Moreover, the region is experiencing an intense political upheaval which is closely related to the above-mentioned economic phenomena, and all this may be the prelude to a breakdown of 'superimposed development' at a time when it is still not possible to glimpse the features of any alternative development model. What is more, given the unpromising economic prospects already described, not even the most optimistic view of things could counsel embarking on social transformations, yet without them the political stability of various countries in the region is in danger.

The intensity of the crisis has given rise to an atmosphere of demoralization which no one knows how to tackle and overcome. Unanswered questions, and even bewilderment, arise out of the realization that many problems surpass the constituted governments' capacity for action and are beginning to erode the very foundations of the process of Central American integration.

IV

Short-term prospects

1. *Alternative scenarios and the need to adapt the Central American development style to the new circumstances*

If the international economy had retained the characteristics which it had at the end of the Second World War, there can be little doubt that for economies with small markets such as those of Central America, the best and perhaps the only way of raising the levels of well-being of their population would have been to seek their dynamic incorporation into external trade flows, although not necessarily in the same forms as in the past.

In effect, because of the scale and characteristics of the markets of the Central American countries —even when considered as a whole— there can be no doubt that, regardless of whatever set of economic policies may be adopted in each country to stimulate its own economy and promote more equitable distribution of the fruits of development, external demand would have to continue playing a decisive role in determining levels of production, while external supply would perform an equally vital function in meeting the needs of the region. In other words, regardless of the development style which each country might select, it would be absurd to think of any possibility of Central American development in isolation from international trade flows.

It would be equally mistaken, however, to pin all the region's hopes on a development strategy oriented towards external markets whose evolution depends on many imponderable factors. At the very least, it must be taken into account that the industrialized economies —and the international economy in general— may have to cope with far-reaching structural changes whose consequences are impossible to predict. Is the world facing a prolonged period of recession or very slow expansion, with only limited possibilities of reactivating international trade and even with the danger that trade flows may continue to shrink? Or may it perhaps be possible, in contrast, to achieve rapid and sustained reactivation of the main industrial powers, as some authors maintain, on the basis of highly advanced technological activities such as genetic engineering, microelectronics and robotization? If the industrialized economies were reactivated on these new technical bases, then what consequences could result from this for the Central American countries, whose capacity of adaptation to new circumstances is much smaller? In spite of the many studies on the topic published recently both in academic circles and by international and intergovernmental organizations, the complex set of factors intervening in the international crisis means that any forecast which is made can only be mere speculation.

It might, however, be assumed as a realistic hypothesis that the prolonged boom period of the industrialized economies in recent decades has reached its turning-point, and that the period of adjustment to a new situation whose features are still to be defined must necessarily be relatively long. Furthermore, during this period the developing countries in general and the Central American countries in particular will not be in conditions similar to those which prevailed in recent years. In particular, the possibility of procuring large amounts of external financing is likely to be constrained not only by the limitations associated with the countries' own capacity for borrowing or for attracting direct investment, but also by the contraction in the availability of public and private international resources as a result of the drop in the oil-exporting countries' surpluses, the austerity policies forming part of the adjustment process in the industrialized economies, the debt problems of the developing countries, and the difficulties experienced by the official multilateral bodies in replenishing their capital.

Even if the international economic crisis subsequently turned out to be a mere depressive cycle —albeit the most serious since the war—, followed by a recovery phase (which apparently has already begun in the United States), the positive effects of the latter on the Central American countries could only be very limited during the next two years in view of the considerable burden represented for almost all of them by their accumulated external debt, the depletion of their international monetary reserves, and the profound maladjustments —difficult to set right in the short term— which the recent recession must have caused in their production capacity and social structure.

Nor is it possible to think of an economic reactivation based on the recovery of domestic levels of saving and investment until such time as the reigning climate of instability can be dispelled. This, in its turn, calls for significant changes in the pattern of political interaction in most of the Central American countries. As long as the present degree of polarization of political tendencies, which have boiled over into situations of violence, is maintained, and until a way is found to improve the real and full participation of the broad masses in political life, it is difficult to see how it can be possible to restore social stability and thus enable attention to be turned to the attainment of objectives connected with material well-being. It has already been noted that the challenges to the traditional structures in some countries foreshadow a break with the past, but the characteristics of the social order which may emerge in each of the countries as a consequence of the complex phenomena described are still far from clear.

Be that as it may, unless the indispensable corrective measures are adopted soon, the present situation —which is already critical— will inevitably tend to deteriorate still further, with unforeseeable and even unmanageable consequences. In the economic sphere of each individual country, nothing can be foreseen at present but rising unemployment, a drop in real per capita income, declining levels of saving and investment, and persistent flights of capital. At the regional economic level, the important advances in intra-Central American co-operation achieved in 30 years of resolute effort could crumble in face of the dual problem of the shortage of foreign exchange (which has led to the adoption of national measures whose consequences include restrictions on reciprocal trade) and the tensions arising from the increasing internal division of some countries or their likewise increasing ideological heterogeneity.

In the political sphere, the events of recent times have aroused the interest of the international community and led to an increased presence of external actors on the Central American stage. The entrance of new international forces on this stage and the depth of the economic crisis form a potentially explosive combination. The great risk attendant on the search for external allies on the part of the different actors confronting one another in the arena of Central American domestic policy lies in the probable internationalization of national conflicts along the split down the middle of the international political system.

In short, the domestic and external, economic and extra-economic circumstances which gave rise to the evolution of the Central American economies and societies in the thirty years after the end of the Second World War are now totally altered.

The Central American governments, both individually and collectively, must obviously do all they can to prevent such unfavourable tendencies from getting the upper hand. Otherwise, the future awaiting the Central American countries —subject to differences of degree between one and another— would be to pass from the relatively dynamic economic progress of the last 30 years to a downward path which would virtually lead back to the subsistence economy, while the growing political polarization foreshadows an increasing degree of authoritarianism and even the risk of violent conflicts extending beyond the purely national sphere. These future prospects could also include the ruin of the economic co-operation efforts carried out so enthusiastically in past decades.

2. *Requirements of a development style fitted to the new circumstances*

Recognition that the circumstances now faced are markedly different from those prevailing in the period following the war would constitute the first step for governments in moving towards a qualitatively different policy. In recent years, the international economy, instead of being a reliable source of support for the growth of the countries of the region, has become a source of instability, and as has happened so many times in the history of Central America, it has set a limit —and a strict one— to the expansion of their economies. The recent changes in the political sphere, for their part, together with the traditional tendency to look abroad for explanations and solutions, constitute new risks, especially for intra-Central American co-operation.

The countries of the region would do ill to resign themselves to meekly suffering the consequences of an adverse external environment. Rather should they seek to expand their room for manoeuvre with the aim of gaining some degree of autonomy —no matter how modest it may be— without of course sacrificing the possibility of taking advantage of such dynamic impulses as the international economy may continue to generate. The ultimate objective pursued should be Central America's continuous advance towards greater control of its own destiny, both in the economic and in the political field.

In the first of these fields, it is not a matter of proposing utopian solutions such as, for example, trying to partly isolate the countries from the international flows, but neither is it a matter of passively accepting with folded arms, the cost of adaptation to the uncertain and adverse situation of the international economy. A realistic but more active approach would require that the countries, besides taking advantage of the opportunities offered by the international economy, should seek ways of reducing the vulnerability of their economies through the creation of alternative poles of development and modification of the traditional patterns of consumption and accumulation. In the second of these fields, what would be called for would be an explicit recognition by the Central American governments of the fact that international circumstances make it necessary to draw a distinction between economic aid proper and aid which may imply the interference of external actors seeking to internationalize national and intra-regional conflicts.

No claim is made here to spell out in detail the characteristic of a Central American development strategy in keeping with the new economic circumstances. Unfortunately, there are no set economic policy models for tackling the problem of the reduced opportunities in the international economy or the uncertain situation prevailing in each of the economies of Central America and in the region as a whole. A first approximation, however, could be to identify the essential requirements of a more active approach to adjustment and to ways of offsetting the dominant recessive trends. These requirements would come to form part of a development style whose concrete expression, in view of the non-existence of theoretical solutions, would have to be gradually perfected through successsive approximations as a function of each country's current and particular demands.

i) *Definition of the structure of production desired.* The first requisite in a development style qualitatively different from that prevailing in the past would be to define with some precision the sectoral and subsectoral priorities of an economic policy aimed at selective reactivation of production. In this respect, the countries of the region could adopt a pragmatic approach consisting in taking maximum advantage of the possibilities which the international market might continue to offer, while at the same time giving a vigorous impulse to efficient import substitution. In effect, the region as a whole represents a sufficiently large resource base for appreciably expanding and diversifying the present production capacity without incurring disproportionate costs.

As regards production for external markets, for example, there is no reason why Central America should resign itself to limiting its exports to five or six basic products; thanks to its resource endowment and its geographical location there are, in spite of the uncertainty of international market prospects, obvious possibilities for expanding and diversifying sales of a whole range of products derived from the agricultural sector. These include fruit, vegetables, meat, dairy products, marine products and chemical inputs of vegetable origin, all capable of being subjected to increasing degrees of processing. The exploitation of forest resources, too, represents an important potential for some countries. In this respect, the specialized evolution of the manufacturing sector in the Scandinavian countries during the present century could provide some useful lessons for Central America, as could the progress made by some Asian economies in the export of highly labour-intensive manufactures.

In anticipation of the probable tendencies towards industrial redeployment at the international level, the skills of the region's labour force should be developed with a view to participation —among other possibilities— in the expansion which will characterize the different branches of the electronics industry, both as regards products and as regards the development of systems. All this would be a complement to —not a substitute for— the traditional export activities in which the Central American countries have had experience for decades and which would assuredly more than maintain their ability to compete on the world market.

In short, the present limitations of international demand should not lead Central American governments to give up their efforts to increase the generation of foreign exchange through exports; on the contrary, these efforts should be redoubled and new measures should be taken in the fields of fiscal and exchange rate practices and of organization of production and marketing so as to gain access to the markets of third countries.

As regards production for domestic consumption, top priority should be given to the supply of food —a branch in which Central America has achieved virtual self-sufficiency in the past and can do so again— and the promotion of relations between agriculture and industry which will make it possible to sustain and guarantee this self-sufficiency and also to generate exportable surpluses. In the second place, there is still ample potential in the region for industrial import substitution in reasonably efficient conditions, especially if industry takes advantage of the economies of scale implicit in the regionsl market. Among the branches which offer the best prospects are industrial development in connection with agriculture, construction and articles to meet essential needs.

In selecting the activities which ought to receive support from economic policy, a criterion of special importance could be based on their capacity to generate productive employment, in view of probable trends in labour supply and demand. In this connection, it would be possible to select labour-intensive techniques in the agricultural sector and to support manufacturing activities of the same nature.

ii) *Realism and pragmatism.* One of the biggest problems that arise when formulating an economic policy is the uncertainty which largely stems from factors traditionally beyond the control of the governments of the region. Reference has already been made to the doubts which exist regarding the future evolution of the international economy, the changes to which the industrialized economies must face up, or the result of the relatively untried policies being implemented in some of the main industrialized countries. It is not yet known what influence these factors may have on the developing countries in general and those of Central America in particular, nor does anyone know what the final outcome of the grave political and social tensions present in some countries of the region will be.

All this means that the economic policy of the Central American countries must be designed and applied with flexibility and realism so that it can be progressively adapted and adjusted to changing, unpredictable and essentially unprecedented circumstances. Flexibility and effective responses would imply breaking with the past to some extent, because traditionally policies have tended to react passively or with considerable delay to the vicissitudes of the international economy. Today, in view of the risk that what will have to be faced is not so much a recessive cycle as a structural change in the world economy, it will be necessary to build a response capacity which will make it possible to take advantage of even the slightest opportunities and reduce as far as possible the constraints on the development of the countries of the region: questions which have particularly important implications for the conception and role corresponding to the State in guiding the future economic evolution of Central America.

In the same order of ideas, the current uncertainty and the want of solutions of proven worth mean that a new development style must adapt itself conceptually to a resolutely pragmatic approach. This is not the moment to be trying out particular economic doctrines, as recent experience in Latin America has so eloquently shown. One of the results of the disorder reigning in the international economy, for example, is that it is just as risky to throw the entire weight of economic policy behind a strategy oriented towards dynamic insertion into world trade as it is to adopt a strategy which prevents a country from taking advantage of the potentialities of such trade. Economic policy must undoubtedly be planned with sufficient flexibility to enable it to be adapted without difficulty to all the changing conditions of external and internal markets.

In a situation of general lack of confidence on the part of some of the main economic agents, it seems completely inappropriate to leave adjustment programmes exclusively at the mercy of international economic trends and exposed to the play of market forces. Thus, for example, in view of the acute shortage of foreign exchange which characterizes all the economies of the region, it would be quite unsuitable to rely precisely on foreign exchange supply and demand for the fixing of exchange parities, since repressed needs and speculative pressures tend to value 'hard' currencies far above what they are really worth. It would be equally foolhardy to depend only on administrative controls and on exaggerated centralization of the application of economic policy when dealing with maladjustments of external or internal origin. It must be stressed once again that what is needed is a pragmatic approach making it possible to achieve certain objectives and mitigate the effects of the crisis on employment.

iii) *Austerity.* The international depression has been reflected in a number of restrictions attributable to the need to reduce imports and ultimately levels of economic activity. The resulting austerity, however, has by no means had an equal impact on the different strata of the population. The shortage of foreign exchange and the necessity of increasing the mobilization of domestic saving in view of the constraints on external financing, as well as that of satisfying the population's most basic needs, call for much more selective and careful use of export earnings and, in general, for an impartially strict pattern of expenditure. In short, the structures of expenditure and saving will also have to be adapted to the new economic circumstances, and this will be reflected in austerity consumption patterns in both the private and public sectors.

Austerity has a dual aim: to save foreign currency through the reduction of consumption of non-essential goods and services which either are imported or have a high imported content, and to increase the coefficient of saving.

As regards the first of these objectives, the countries of the region must use the foreign exchange they manage to obtain from their exports with the greatest care and the strictest selectivity, and as already noted, this will necessitate considerable changes in traditional consumption patterns and in the characteristics of investment. With respect to consumption, governments will need to discourage the consumption of non-essential goods and services of external origin, and to take maximum advantage of national and regional potential for supplying demand. This may result in a life style different in quality from that of the past, above all in the middle and upper income strata of Central American societies. Of course there is no question of reducing still further the standards of living of the masses who are already living below the poverty line. On the contrary, as stated below, what is envisaged is a redistributive effort which, *inter alia*, will give greater support to the satisfaction of the population's basic needs.

Where investment is concerned, everything points to the advisability of reviewing the possibilities of using more labour-intensive technologies, not only because of the pressing need to create jobs, but also because of the necessity of reducing the imported component in new fixed capital.

The foregoing guidelines are of use for all the different types of governments, regardless of the economic policy objectives pursued or the means adopted to attain them. Some governments will place emphasis on exchange and taxation policy in order to achieve more effective use of their foreign exchange; others will adopt administrative systems designed to ration the allocation of such resources; while still others will resort to a combination of mechanisms designed to secure selective discouragement of imports. In the final analysis, what is needed is to bring about the rational and careful utilization of scarce foreign exchange in order to reduce as far as possible the adverse repercussions caused by the international economic situation.

Improving the selective utilization of the foreign exchange generated by exports means that the governments of the region must maximize the rationalization of public expenditure and reorient it towards truly essential activities. This is particularly important because, on the one hand, the persistence of the international crisis and other factors of a domestic nature are heralding a recrudescence of social pressures on governments to fulfil their responsibilities for economic development and the well-being of the population, while on the other hand the markedly open nature of the Central American economies imposes strict limits on deficit financing of public expenditure because of its domestic effects and its repercussions on the balance of payments. In this connection, it will be necessary to supress luxury or non-essential spending and above all to advance in political détente in the region, so that part of the resources now devoted to military purposes can be transferred to the promotion of development.

Furthermore, public expenditure itself could help to reduce the external imbalance if, in selecting investments, preference is given to projects which require a high proportion of national or regional inputs. At all events, the public sector will have to increase its procurement of revenue in keeping with its expenditure, in order to prevent financial deficits from contributing to inflationary demand for imported goods.

iv) *Efficiency*. Another basic requirement of a strategy appropriate to the new circumstances is that is should ensure that growth is based on increases in efficiency and productivity. In the present circumstances, improving efficiency is absolutely essential, from the macro- and microeconomic standpoints alike, in order to increase the multiplier effects of saving and investment, to undertake import substitution on reasonably competitive terms, or to maintain and expand exports to international markets. It is the duty of the State to improve the efficiency of the services which it provides and to encourage the productivity of enterprises by making reasonable use of fiscal and credit instruments.

A significant increase in efficiency and employment in the region can be achieved without resorting to imports of capital goods, simply by making full use of the existing installed capacity. As is common knowledge there is a considerable amount of idle capacity, above all in almost all branches of manufacturing. There is also an ample margin for appreciably stepping up the productivity of the area under crops in the case of most of the region's agricultural products, even those where the countries have had the greatest success with their exports.

v) *Defence of the minimum requirements of the masses*. If it did not prove possible to bring about any significant reduction in extreme poverty even during the 30 years of dynamic expansion of the Central American economies, then it is inevitable that this situation should grow worse as the economic crisis persists, since there is a direct interrelation between levels of employment and degrees of poverty. In the last two years, overt unemployment and underemployment have increased, and unless some means of prevention is found, this tendency will be aggravated in the immediate future.

Unless the State takes clear measures in favour of the masses, the depressive effects of the crisis —and of the austerity policies accompanying it— will tend to have a disproportionately severe impact on these groups, which are the least well organized to defend themselves, and among other consequences this will widen the gulf between the governing and the governed.

The spread of absolute poverty is unacceptable from any point of view. It must be understood, however, that it is hard to implement a policy aimed at satisfaying the basic needs of the masses even in periods of rapid economic expansion, and harder still in times of severe constraints, including those affecting the public finances. At all events, reducing poverty is an essential part of the needful development approach. Without it, all efforts to overcome the crisis would be meaningless, since the spread of social discontent could render social tensions unmanageable and make it impossible to retain savings; i.e., it would adversely affect the whole process of investment and development. Thus, in economic policy top priority should be given to food-and-agriculture systems, especially in respect of labour intensive activities. The provision of low-cost housing and of health and educational services would also call for priority attention.

It will be necessary to find some way of satisfying the basic needs of the population which involves a relatively modest imported component, in consonance with foreign exchange restrictions. At all events, and quite apart from considerations of equity, the political crisis in many countries of Central America has reached a point at which it is absolutely indispensable to restore a minimum of peaceful understanding among the population. Otherwise, social instability will inevitably be reflected in economic instability, by paralysing, for example, the process of capital formation and leading to a kind of State-dominated expenditures which would be of little help in expanding productive activities.

3. *Implications for economic policy lines*

A development style different from that prevailing for the last three decades would probably have to be rather more inward-looking than the historical model, at least in the next few years. Thus, if the international economy does indeed turn out to suffer from a prolonged period of stagnation or if, even in a recovery phase, it does not give rise to sufficiently dynamic impulses for the Central American countries, it is logical that these countries should place the major emphasis on domestic demand in order to provide the impulses required. Stress must be laid on the critical importance of co-operative action at the regional level in support of an effort of this type, in order to overcome obstacles implicit in the narrowness of the markets which cannot be surmounted at the purely national level. At the same time, the gradual restructuring of consumption in a context of austerity and of a policy deliberately aimed at satisfying the basic needs of the population would reactivate domestic and regional demand, at least for certain types of goods and services.

There would be no question of having to face the dilemma (which would in any case be completely false) of stimulating domestic demand at the expense of an eventual reactivation of external demand. A flexible and selective economic policy would enable the countries to take better advantage of the incentives afforded by the national and regional markets, while it would not preclude their availing themselves of any opportunities that the international economy might offer.

It has already been noted that there is no set of models which can guarantee the efficacy of new policies embodying the requisites mentioned above. However, it will be essential —quite apart from the specific economic policy objectives which each country pursues and the mechanisms adopted in order to achieve them— to encourage saving, promote growth, and defend the basic needs of the masses. In some countries, the fulfilment of such diverse requirements would call for the adoption of reforms which are long overdue, above all in the area of agrarian reform and taxation, and every growth strategy would have to pay marked attention to the satisfaction of the needs of the masses, on the basis of the creation of opportunities for productive employment.

Adherence to the historical growth model would mean that far from its being possible to put into practice minimum programmes for the expansion of job opportunities, all that could be expected in Central America would be a progressive increase in overt unemployment and underemployment. One of the essential aspects of the approach proposed here would therefore be to take maximum advantage of the resource most abundant in the region —its labour— in order to prevent the international recession from being reflected in still more critical levels of poverty.

Much has been written on this subject, and to recapitulate arguments would be out of place here. It is worth emphasizing, however, that the main criterion which should guide economic policy in the coming years should be that of its impact on employment, with the precise aim of contributing one of the basic ingredients for a kind of new social consensus to deal with a crisis which is difficult to resolve with traditional instruments.

The foregoing guidelines would find more concrete expression in the application of exchange, credit, taxation and public expenditure policies, and in the selection of techniques for implementing investment programmes. At the same time, it should be reiterated that placing emphasis on a more inward-looking approach than that historically adopted would not mean that there should be any slackening of efforts to take advantage of any opportunities that external demand might continue to afford. In this connection, the non-reciprocal preferences recently made available by various countries, including the United States of America and to a lesser extent Mexico, might offer a new potential well worth exploring.

Finally, little could be expected from the adoption of the economic policy criteria and guidelines sketched above unless a way out of the social and political tensions which have arisen in some of the countries of the region is discovered. This is an extremely complex problem which does not admit of simple, much less of standardized solutions. The intention is not to enter into any discussion whatever on this subject in the present note, but certainly to emphasize that a minimum of stability and peaceful and harmonious coexistence —both within each individual country and in the subregion as a whole— is a prerequisite for any serious attempt at development and at the reactivation of private investment. A way must therefore be found to make economic, social and political demands give place to a participation model in which these demands are sifted and ordered in open processes of political negotiation so that they can subsequently be incorporated in concrete form in government programmes. It will also be necessary for the peoples of Central America to gain the fullest possible control over their own destinies, not only in economic affairs, as already stated, but also in the political sphere and in that of international relations.

4. *The role of intra-regional co-operation*

Beyond all doubt, intra-regional co-operation offers the best possibility of loosening the constraints imposed by the external sector on the Central American economies. Today, more than ever, it is needful to press on in greater depth with the programme which was begun in Central America nearly 30 years ago and which has left behind it such valuable fruits and experience. It is necessary to do this not only in order to take advantage of the more dynamic impulses which could be expected from domestic demand (understood on a regional basis), but also in order to face up jointly to certain specific features of the region's relations with the rest of the world. This aspect has been dealt with in ECLA documents on repeated occasions in the past, but it acquires fresh interest in the present circumstances.

The aim would be, through intra-Central American co-operation, to enlarge the scanty room for action available to each of the individual countries of the region, in order to mitigate the effects of the external-sector depression. In the short term, the only effective way of expanding local demand seems to be that connected with co-operative efforts at the regional level. There is nothing new about such a procedure, since as long ago as the 1950s it was successfully put into practice in order to overcome the same obstacle, namely, the narrow limits imposed on growth by international demand. Now, however, it would be adopted in a different situation. If it proved possible to increase intra-regional trade to the maximum, the requisites for the new development style mentioned earlier would gradually be fulfiled as more rational use was made of installed capacity, the influence of adverse external-sector phenomena was reduced, efficiency was stepped up —both in import substitution and as regards improving the ability to compete on international markets— and even joint advantage was taken of any opportunities that the international market might continue to offer.

All this is hindered at present by the barriers standing in the way of intra-regional trade. Clearly, it would not be realistic to defend unrestricted free trade which did not take account of the greater or lesser importance of the goods being traded, but it would be desirable at all events to keep restrictions to a minimum and even to adopt mechanisms giving preference to reciprocal trade over similar trade flows with third countries. Only in this way would it be possible to make optimum use of the region's installed capacity, and even to promote some new activities based on regional demand. For this purpose, the countries would need to adopt new procedures for financing the intra-Central American trade debit balances, to do away with certain constraints at present resulting from the exchange controls adopted, and, in general terms, to give essentially the same treatment to products from any other Central American country as to those domestically produced.

Furthermore, as already noted, regional co-operation is the best way of improving the use made of the opportunities offered by international trade, both in order to increase exports —on the basis, for example, of common marketing systems— and in order to obtain additional external financing for projects and initiatives which are of interest to all. The strengthening of the Central American Bank for Economic Integration and of the machinery available under the Central American Monetary Council are examples of some measures which would give real force to this latter idea. Another initiative of great topical significance at present is that adopted by the Central American governments in 1981 whereby they propose to approach the international financial community jointly to seek an increase in the transfer of resources to the region. It should be remembered that lack of intra-regional co-ordination in such a vital area as external financing not only has a high opportunity cost —if the possibilities for joint mobilization of a flow of resources which could not be obtained through individual negotiations are lost— but also represents a risk for the survival of intra-Central American co-operation. It has been noted that various actors on the international scene seem to be interested in providing co-operation to the Central American countries on a selective basis, with the exclusion of one or more countries from their programmes. This type of external co-operation, far from uniting the Central American countries around a topic, would tend to separate them.

There would be no question, of course, of seeking to promote instant integration of the economies of the region, since the obstacles standing in the way of such an ambitious initiative are well-known. Rather would the aim be to make integration an effective instrument for helping each country, internally, to adapt itself to the circumstances so often mentioned here. Making intra-regional co-operation one of the pillars of this effort would simply mean demanding, in the first instance, the preservation of the degree of economic interdependence already reached, while subsequently promoting joint action to rectify or mitigate common problems.

In this connection, some ideas could be put forward for reactivating intra-regional economic co-operation in the short term on the basis of concrete action in six respects: a) maintenance of the degree of economic interdependence already reached on the basis of reduction of the barriers erected to intra-regional trade and the adoption of financial machinery to ensure the smooth operation of such trade; b) revision of the Central American common tariff —on the basis of the technical advisory studies already prepared— in support of the economic policy guidelines discussed earlier; c) regional co-ordination of short-term policies such as exchange policies, or those connected with the processes of cyclical adjustement d) joint activities *vis-à-vis* the international community, above all in order to increase the mobilization of external finance and improve the access of Central American products to the markets of third countries; e) implementation of joint projects of multinational interest, such as for example the interconnection of electricity systems and co-operation in the exploitation of marine resources; and f) strengthening of the Central American integration institutions so that they can help to carry out the policies in question.

5. *The renewed role of the State*

In periods of intensive change, when it is necessary to transform styles of growth, modify consumption patterns and defend minimum levels of well-being of the masses, it is essential in modern societies for the State to assume an active and leading role in the orientation of development, because otherwise society would become fragmented or it would be necessary to cover excessively high social costs.

Furthermore, the renewal of the role of the State is indispensable, regardless of differences of political inclination, because of the need to mobilize the population in a participative effort without which development and social stability would be seriously imperilled, quite independently of the scope and objectives of whatever economic policy each government may prefer and of the greater or lesser significance assigned to that policy. In other words, the need to adapt to new circumstances makes it essential to bring economic policy into line with different demands. Likewise, it is the responsibility of the State to help to resolve a series of conflicts which are bound to arise when a development style is in the making which is qualitatively different from that prevailing in the past.

It may seem an exaggeration to assert the need for the State to assume a more active role in the present critical situation. But analysis of the features of this situation shows that the public sector still has a certain amount of room for action, and this should be utilized not only in order to cushion the negative impact of the crisis, but also in order to orient its effects on constructive lines. Thus, for example, the shortage of foreign exchange makes it necessary for some-one to lay down an order of priorities for the different importer sectors, and also to require that export earnings really be devoted to essential imports. It seems natural that this role should be assigned to the Central Banks and the government departaments concerned with foreign trade. At all events, the need to rationalize the use of foreign exchange calls for greater intervention by the State than that which would be needed in situations of normality as regards external relations.

Furthermore, this shortage gives rise to conflicts of interest and consequent pressures on the part of the various importer and exporter groups. The disputes which invariably take place in these situations can only be settled through the arbitration of a higher authority. In this respect, regardless of the combination of exchange, credit or tax formulas resorted to in order to face the crisis, the shortage of resources does in fact exacerbate the struggle between the various interest groups, thus opening up —due to the fragmentation of demands— a larger room for manoeuvre which the public sector can use to advantage.

Another qualitative change in the role played by the public sector derives from its lesser degree of dependence on international trade as a direct source of fiscal revenue. The decisive role historically played by the exporter groups has been reflected in the considerable weight of foreign trade taxes in the public sector income, but This situation will tend to change as the external depression limits the possibilities of exporting and, accordingly, of importing too. As a result, there will be financial problems until new domestic tax sources are found, but at the same time the vulnerability of the State *vis-à-vis* certain pressure groups will be reduced.

As already noted, nothing said in this study prejudges the degree of intentionality of public action in each country; the role of the 'Monitor State' is considered to be perfectly compatible with a strong and vigorous private sector. On the other hand, what it is desired to emphasize is the unavoidable need for the State to assume a more decisive role in order to orient the development style in the light of certain objectives, connected with the vital common imperative of overcoming the adverse factors currently predominating in the economies of the region and threatening their social and political stability.