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THE CENTRAL AMERICAN COMMON MARKET
AND ITS RECENT PROBLEMS

Note: The English text of this document has not been revised and is therefore subject to changes in substance and style.

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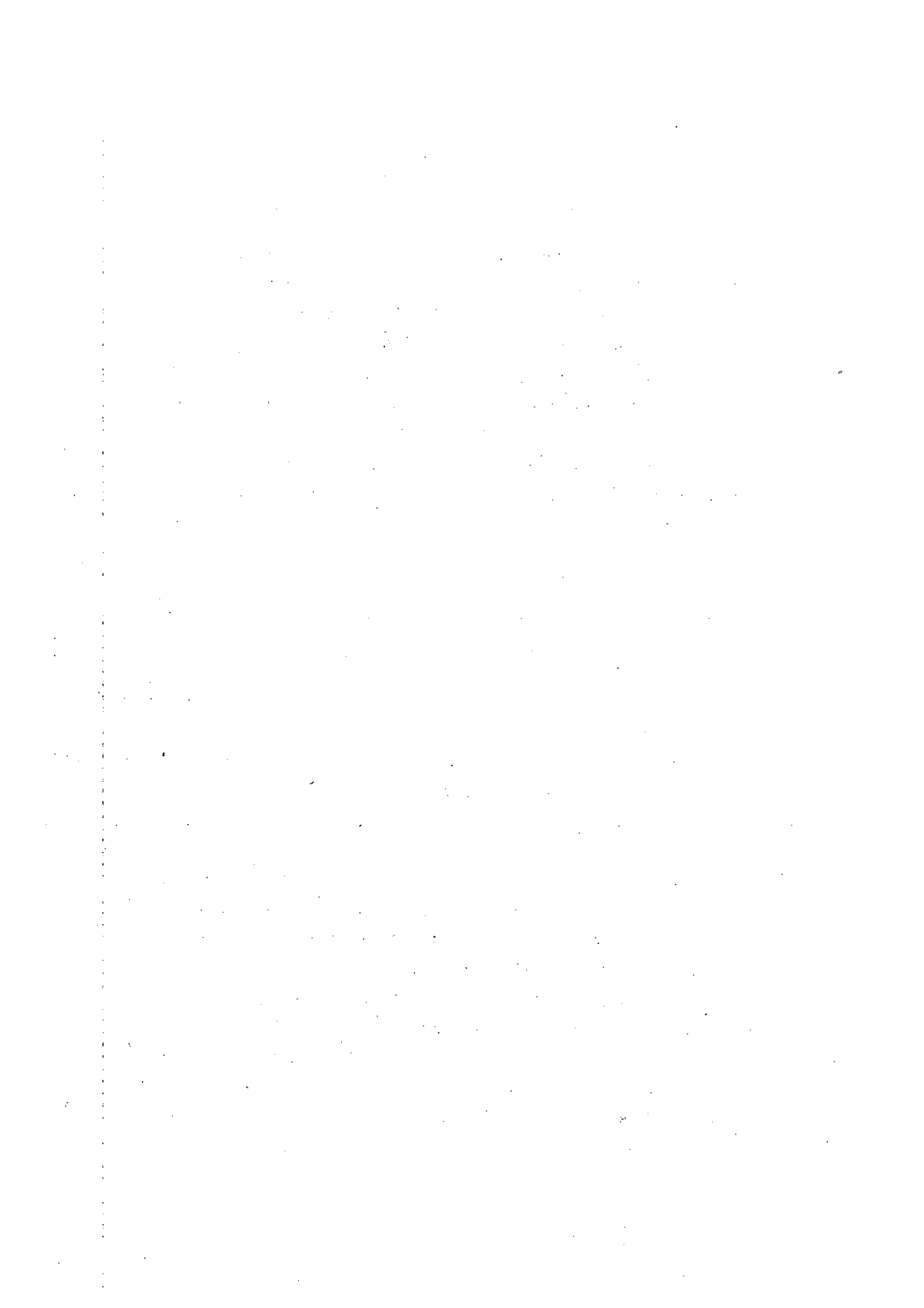
FOREWORD

The present document is one of the studies undertaken by the ECLA secretariat on regional economic integration movements in the region and has been prepared for submission to the Economic Commission for Latin America at its fourteenth session.

The central objective of the study is to examine the main characteristics of the integrated development of the Central American countries, and to identify the major problems faced by the Central American Common Market. The study begins by looking at the special features of regional development and some of the reasons for the slackening of the growth rate in recent years; continues with an examination of the status of the integration programme before the hostilities in 1969 and some of the economic implications of the hostilities; and concludes with a description of the measures taken by Governments to restore the Common Market and its organs to normal operation and with a number of reflections on the current status of the integration movement.

No attempt was made to cover every one of the economic and social aspects that have a bearing either directly or indirectly on the integration process; some important aspects, such as employment and income distribution, have not been discussed. Similarly, the study does not attempt a comparative evaluation of the benefits and costs of integrated development for individual countries on the basis of the probable trend of their economies under different assumptions of economic co-operation.

The main emphasis in the study is on identifying the major components involved in the operation of the regional economy that hamper or prevent the perfecting of Central American economic unity. In adopting this approach, account has been taken of the need for a general frame of reference that will, at a later stage, be of use in designing strategies for remodelling and expanding the scope of integration agreements, and the need for a clearer idea of the nature of the disequilibria that might ensue were the bonds joining the Central American countries together ever to loosen.



1. Introduction

Since the early 1950s the Governments of the Central American countries have seen economic integration as a process whereby a productive structure, regional in scope, could gradually be established as a complement to, and support for, the main centres of dynamic growth.

This has led, through successive stages, to the formation and perfecting of the Central American Common Market. During the research period from 1951-1958 areas of common interest were selected and the first regional machinery was established. Between 1958 and 1962 the principal agreements establishing the Common Market were signed, and the battery of regional organizations was set up to direct its operation and propose ways of expanding the programme under way. The next phase, between 1961 and 1965, showed considerable progress backed by favourable conditions in the external sector: progress was made towards the full establishment of the free trade area and the adoption of the common external tariff, and there was a consolidation of the organs of the General Treaty on Central American Economic Integration. The phase starting in 1966 saw improvements in the procedures and regulations for the administration of the Common Market and in its basic instruments, and the signing of new agreements, the most outstanding being those concerned with laying joint bases for the co-ordination of economic policy, the defense of the balance of payments, and balanced development. During this phase also new formulas were studied for bringing the individual national economies into line with the new expanded market and adjusting them to meet the requirements of interdependent economic development.

Another distinctive feature of the latest phase is the occurrence of problems and disputes stemming from the complexity of the regional programme which has occupied a great deal of the integration agencies' time, without, however, holding up the regional programme. Some of these difficulties have been due to the rapid increase in the activities and transactions generated by the Common Market, which have absorbed much of the energies of Government technical staff and overburdened the regional institutions. Other problems have arisen because the progress made has

/inevitably affected

inevitably affected important interests in each country, and it is therefore more difficult than it was in the past to reach an agreement, in line with feasible criteria for development and integration. Nevertheless, it would be wrong to think that the integration agencies should have maintained a passive stance vis-à-vis all the long-term problems and the crises in individual countries. As indicated below, although it did not prove possible to complete the formulation of a new strategy for integrated development, a series of studies were prepared and many meetings were held to examine guidelines for action extending beyond the confines of purely administrative or short-term considerations. But, the regional decision-making machinery was slow to act and not very flexible, and this made it impossible to take suitable corrective action early enough.

Added to these factors, the war in the middle of 1969, although short, created an atmosphere of uncertainty which has restricted the expansion of trade and investment currents and delayed the signing of the agreements needed to improve the running of the programme. Since then numerous efforts have been made to re-establish the normal functions of the Common Market, so as to bring about its eventual reorganization in order to deal with the new circumstances in which it is developing. At the end of 1969 there was a meeting of Ministers of Foreign Affairs at which a Joint Declaration was approved, restating the principles of regional economic solidarity and suggesting plans of action to end the crisis which has arisen. Upon the basis of these agreements the Ministers of Economic Affairs held a series of meetings in 1970 in order to decide upon a plan of action to find a solution to the disagreements and distortions in trade and production and to ensure the resumption of activities by the agencies governing the integration movement. No specific agreements were signed at those meetings, but each country made its position clear, and measures were examined which can be applied subsequently on a regional scale. The results of the work carried out were placed before the Ministers of Foreign Affairs, who are now trying to find new ways of assuring the maintenance and progress of the Central American Common Market.

2. The structural background of recent integration problems

Some reflection upon the traditional pattern of development, the changes tried out lately and the differences caused by the regional integration process are needed for a satisfactory explanation of the origin of the Central American Common Market problems and recent events there in. The worst delays are due mainly to two parallel growth patterns which have developed at a different speed and have given rise to temporarily divergent demands.

Various strategic factors must be analysed in order to give a brief definition of the main features of the present development pattern in Latin America - bearing in mind the distinguishing features of each country.

The first and most important factor is external demand. Trade with third countries continues to be the most important influence upon growth or decline in the region as a whole and in all the Central American countries. This is because it comprises the most developed and modern sector, because it is the source of the main bulk of savings and because it controls the most intensive multiplying factors with regard to demand, or because it is the largest source of public revenue. It could also be said, although it may be obvious, that these economies were organized over a long period of time to deal exclusively and effectively with such activities, as is evident from the transport system and the specialization of financial institutions in credit for agricultural products for export, and from the relation of prices which generally favour the production of articles for external markets rather than those for domestic use or consumption.

The external sector, as a dynamic factor in Central American development, (at least within the range of traditional exports), lost the ability to sustain sufficient continuous development. Apart from the constant fluctuations in the world economy, the growth rate in the production of coffee over a long term started to fall, in fact from the beginning of the century; the banana industry started to feel the effects of pests and soil exhaustion from 1915 onwards, and mineral extraction

/had practically

had practically lost its impetus by the mid-1920s.^{1/} At the time of the Depression in the 1930s, the Central American countries had to all intents and purposes exhausted their potential for growth within the pattern which included them in the world economy as exporters of raw materials. This was reflected in the characteristic lack of stability in their economic systems and the inability to absorb the labour force productively and to improve the standard of living of the mass of the population to any significant degree.

Two efforts to rectify the situation through exports - the first in the postwar years ^{2/} and the second between 1960 and 1965 - greatly facilitated the first serious attempts at forming new centres for promoting development.

The second element which is typical of the development pattern is the expansion of state functions in the economic and social field, and the formation of a series of agencies, institutions and programmes aimed at growth. Since the end of the 1940s and especially during the 1950s, central banks were set up and banking systems were modernized; development agencies were established; the specialized ministries, production and services sectors were expanded. At the same time there was a certain increase in current expenditure and capital expenditure by governments and especially a marked rechanelling of their use, which later appeared as substantial expansion of infrastructural works (roads, electrification, ports) and other social services (education, health, housing, etc.)

The public sector is therefore undergoing considerable changes and strengthening previously weak technical cadres whose main preoccupation is to reach the development targets. This should not be taken to mean

1/ Evaluación de la integración económica en Centroamérica (United Nations Publication, Sales N° : 66.II.G.9), p. 5.

2/ In addition to an improvement in prices and external demand, cotton was added to the main items for export during those years.

/that government

that government expenditure in Central American economies would have reached the same degree of autonomy and play the same role as in the developed countries; such autonomy is seriously restricted by the structure of production, the tremendous dependence upon external supplies and the peculiarities of the tax systems. In spite of all this, however, neither the quantity nor the quality of the recent advances made by Central American economies can be explained without taking into account the contribution of the public sector, which is particularly large in peak periods for external demand. It should also be noted that during the same period efforts have been made to institute protectionist policies - with some exceptions - and the effects upon industrialization have scarcely been noticed because of the insignificance of the domestic markets.

A third point can be added to the factors already mentioned, although it is of a completely different type, and that is the impact of the formation of the Common Market on each of the Central American countries. The creation of the free trade area and the equalization of import duties and changes established an important autonomous centre of growth. In a very short space of time regional trade gained ground within the ensemble of external trade, until in 1968 it accounted for about 25 per cent of external trade. However the main reason for its importance is the decrease in the limitations in size of domestic markets, which came about as a result of better utilization of surplus capacity in the majority of industries, and this opened up possibilities for development which would never have occurred in other circumstances. The process of import substitution, which had scarcely begun to take effect in some countries, has grown in importance and has expanded lately to include the production of inputs and some durable consumer goods and capital goods.^{3/}

^{3/} The influence of integration upon industrial development can be illustrated by a simple comparison. The period from 1950 to 1955 and from 1960 to 1965 both show a rapid rise in exports and product, but the rate of increase in added industrial value is appreciably lower during the first period (6.1 per cent compared with 8.7 per cent in the second period). There is a similar relationship between the periods from 1958 to 1961 and 1965 to 1969 (5.9 per cent and 9.1 per cent respectively), although both the growth of general economic activity and the growth of the external sector slow down. (See table 1.)

Table 1

CENTRAL AMERICA: GROSS DOMESTIC PRODUCT AND ADDED VALUE OF THE
MANUFACTURING INDUSTRY, 1950-1970a/

Year	Central America	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
<u>Gross domestic product at factor cost</u>						
<u>Millions of Central American pesos at 1960 prices</u>						
1950	1 655.9	668.7	330.8	247.1	206.3	203.0
1955	2 045.2	749.0	413.2	272.4	307.8	302.8
1958	2 401.8	903.6	480.0	324.7	334.7	358.8
1959	2 499.4	948.2	501.1	338.4	339.7	372.0
1960	2 584.2	971.3	521.4	342.6	344.4	404.5
1961	2 699.2	1 013.1	539.8	355.3	369.7	421.3
1962	2 889.6	1 048.9	604.3	380.6	408.7	447.1
1963	3 084.0	1 149.0	630.4	384.4	434.7	485.5
1964	3 276.7	1 202.2	689.1	391.3	485.0	509.1
1965	3 500.2	1 254.6	726.1	431.0	533.3	555.2
1966	3 713.0	1 323.7	778.1	463.1	549.7	598.4
1967	3 905.6	1 378.1	820.4	493.4	578.7	635.0
1968	4 122.2	1 457.2	847.0	528.0	606.1	683.9
1969	4 321.4	1 539.1	876.0	544.4	632.5	729.4
1970 ^{b/}	4 543.1	1 617.3	914.0	566.4	661.3	784.1
<u>Annual percentage growth rate</u>						
1950-55	4.3	2.3	4.5	2.0	8.4	8.3
1955-60	4.8	5.3	4.8	4.7	2.3	6.0
1960-65	6.2	5.3	6.9	4.7	9.1	6.6
1965-69	5.4	5.2	4.8	6.0	4.4	7.1
1969-70	5.1	5.1	4.3	4.0	4.6	7.5

/Table 1 (continued)

Table 1 (continued)

Year	Central America	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
<u>Value added in the manufacturing industry ^{c/}</u>						
<u>Millions of Central American pesos at 1960 prices</u>						
1950	176.6	66.6	41.4	21.4	16.7	30.5
1955	237.4	75.6	55.3	31.7	26.6	48.2
1958	286.5	95.3	63.7	37.9	32.5	57.1
1959	295.7	99.9	64.0	40.0	32.5	59.3
1960	315.8	104.2	70.6	41.8	33.6	65.6
1961	339.6	110.2	77.0	47.8	37.6	67.0
1962	363.9	116.2	85.0	49.6	40.6	72.5
1963	400.0	127.6	92.4	51.8	45.6	82.6
1964	436.5	135.7	104.1	53.6	52.8	90.3
1965	478.8	146.7	117.2	58.4	59.4	97.1
1966	532.9	162.0	130.5	64.2	68.0	108.2
1967	580.6	175.6	141.4	71.2	73.5	118.9
1968	631.3	191.6	147.6	79.4	82.5	130.2
1969 _{b/}	679.4	208.8	151.5	85.4	92.8	140.9
1970 _{b/}	726.3	225.5	154.7	89.8	103.6	152.7
<u>Annual percentage growth rate</u>						
1950-55	6.1	2.5	6.0	8.2	9.8	9.6
1955-60	5.9	6.6	5.0	5.7	4.8	6.4
1960-65	8.7	7.1	10.7	6.9	12.0	8.2
1965-69	9.1	9.2	6.6	10.0	11.8	9.8
1969-70	6.9	8.0	2.1	5.2	11.6	8.4

Table 1 (Conclusion)

Year	Central America	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
<u>Relative percentage share in the gross domestic product of value added in manufacturing c/</u>						
1950	10.7	10.0	12.5	8.7	8.1	15.0
1955	11.6	10.1	13.4	11.6	8.6	15.9
1958	11.9	10.5	13.3	11.7	9.7	15.9
1959	11.4	10.5	12.8	11.8	9.6	15.9
1960	12.2	10.7	13.5	12.2	9.8	16.2
1961	12.6	10.9	14.3	13.5	10.2	15.9
1962	12.6	11.1	14.1	13.0	9.9	16.2
1963	13.0	11.1	14.7	13.5	10.5	17.0
1964	13.3	11.3	15.1	13.7	10.9	17.7
1965	13.7	11.7	16.1	13.5	11.1	17.5
1966	14.4	12.2	16.8	13.9	12.4	18.1
1967	14.9	12.7	17.2	14.4	12.7	18.7
1968	15.3	13.1	17.4	15.0	13.6	19.0
1969	15.7	13.6	17.3	15.7	14.7	19.3
1970 ^{b/}	16.0	13.9	16.9	15.9	15.7	19.5

Source: ECLA, on the basis of official statistics.

a/ i.e. gross domestic product at factor cost.

b/ Preliminary figures.

c/ In the case of Costa Rica, the value added in manufacturing includes mines and quarries.

It is true that between 1961 and 1965 the stimulus of free trade increased and benefited from the growing development of exports, which made it easier to adopt far-reaching joint commitments in all fields and to channel public and private capital into numerous activities or programmes of a regional kind.

Nor can it be denied that integration has increased autonomy - although still on a modest scale - and brought new dimensions to Central American development. Installations for the production of paper and pulp, plastics, petrochemical products and steel are no longer an impossibility in the Central American context. Furthermore, joint action itself has helped a great deal to attract and absorb foreign capital and the capacity for trade with third countries or other groups of countries has improved.

All the points mentioned - external demand, strengthening of the public sector and expansion of the regional market - pushed the Central American economy upward during the period from 1961 to 1965, by creating innumerable investment opportunities which were well used in an interdependent process of complementary stimuli, practical realization and progress in the opening up of new areas of regional co-operation.

3. Tension and weakening of the development pattern

A more detailed analysis of the development pattern prevailing in Central America shows symptoms of weakness and tension which are only to be expected in the adjustment of forces which arose from the process of integration and import substitution at regional level. The weakening factors are not only connected with external bottleneck or the limited space for manoeuvring government finances to bring about development and offset the action of depressive forces, they are also connected with the impact of intra-regional disagreements and other problems which increase the structural defects in the economies in the region.

(a) The balance of payments

During the first half of the 1960s there was a marked come-back in traditional exports, after a period of sharp decline starting in 1956. The purchasing power of sales of goods and services rose in real terms to an average rate of 11.6 per cent annually, and dropped to 6.6 per cent during the next five years, in spite of a sharp rise in the price of some articles (coffee, bananas and meat) in 1970. (See table 2.) However these difficulties arose, not only as a result of the decreasing rate of expansion of exports to third countries, but also because there were significant changes in the structure of the balance of payments.

Imports, which had been practically at a standstill between 1957 and 1961-62 as a result of the low levels of economic activity prevailing during the period, began to rise again at a rate which was equal to or exceeded the expansion of import capacity.^{4/} In other words, at the outset of a period of rising economy the typical mechanism of adjustment of export economies comes into play and balances the growth of demand and a slightly diversified supply, by increasing purchases in foreign markets. The repercussions of this process - if not for every country in Central America, at least for the region as a whole - could hardly be softened by deflecting trade and the subsequent import substitution brought about by the formation of the Common Market.

^{4/} Between 1962 and 1965 the purchase of goods at current prices rose by 17.6 per cent per year, or by 11.0 per cent per year for the period from 1962 to 1970. (See table 3.)

Table 2

CENTRAL AMERICA: PURCHASING POWER OF EXPORTS OF GOODS
AND SERVICES, 1960-1970

Year	Total	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
<u>Millions of dollars at 1960 prices</u>						
1960	504.0	131.5	116.9	71.9	79.2	104.5
1961	516.2	125.8	125.7	80.3	83.8	100.6
1962	586.0	134.0	146.2	89.1	106.2	110.5
1963	655.0	174.7	152.6	88.1	127.9	111.7
1964	756.2	194.0	174.3	103.8	147.5	136.6
1965	871.0	213.4	204.6	137.2	179.0	136.8
1966	947.3	241.0	201.3	155.9	182.4	166.7
1967	952.6	217.5	213.6	168.9	182.4	170.2
1968	1 075.9	249.3	227.9	192.6	203.1	203.0
1969	1 089.0	280.7	213.2	182.5	196.0	216.6
1970 ^{a/}	1 198.0	304.0	229.2	190.1	219.8	254.9
<u>Annual percentage growth rate</u>						
1960-65	11.6	10.2	11.9	13.8	17.7	5.5
1965-70	6.6	7.4	2.3	6.7	4.2	13.3
1969-70	10.0	8.3	7.5	4.2	12.1	17.7

Source: ECIA, on the basis of official statistics.

a/ Preliminary figures.

/Table 3

Table 3

CENTRAL AMERICA: BALANCE OF PAYMENTS, 1950 - 1970

(Millions of dollars)

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969 ^{a/}	1970 ^{b/}
1. Total exports of goods and services (not attributable to factors)	325.4	369.8	394.1	422.1	442.0	467.8	502.2	527.0	523.5	502.2	504.0	524.7	591.1	677.0	776.9	886.1	959.7	987.8	1 098.0	1 132.6	1 276.5
Goods (f.o.b.) ^{c/}	300.2	343.5	366.3	392.8	411.3	425.6	450.9	463.3	460.8	436.8	433.8	460.0	523.6	589.5	684.9	771.2	840.9	858.9	957.0	984.0	1 111.0
Services	25.2	26.3	27.8	29.3	30.7	42.2	51.3	63.7	62.7	65.4	70.2	64.7	67.5	87.5	92.0	114.9	118.8	128.9	141.0	148.6	165.5
Freight, insurance and other transport services	3.9	4.7	5.4	6.0	7.5	11.7	14.3	14.2	13.6	14.3	14.4	15.4	17.4	21.6	22.3	26.5	26.4	27.6	31.0	35.1	38.2
Travel	6.9	6.9	7.0	6.7	6.4	12.4	14.0	17.7	19.9	22.0	22.3	21.8	22.5	23.5	26.5	30.2	37.2	43.7	48.8	50.0	54.6
Other services	14.4	14.7	15.4	16.6	16.8	18.1	23.0	31.8	29.2	29.1	33.5	27.5	27.6	42.4	43.2	58.2	55.2	57.6	61.2	63.5	72.7
2. Total imports of goods and services (not attributable to factors)	269.9	324.1	360.3	382.5	426.3	469.6	532.8	592.2	578.1	547.8	580.3	560.3	624.4	747.5	877.8	1 012.2	1 094.2	1 168.5	1 204.8	1 232.0	1 415.8
Goods (f.o.b.) ^{c/}	215.3	266.2	294.0	303.8	344.3	374.0	423.2	473.8	460.1	426.1	459.0	442.5	493.3	583.3	688.3	801.4	855.2	929.9	964.1	903.8	1 137.3
Services	48.6	57.9	66.3	78.7	82.0	95.6	109.6	118.4	118.0	121.7	121.3	117.8	131.1	164.2	189.5	210.8	239.0	238.6	240.7	248.2	278.5
Freight, insurance and other transport services	29.2	34.5	38.2	43.1	48.9	54.5	59.9	65.6	67.9	67.3	65.1	61.9	69.7	82.5	94.7	106.3	116.1	125.3	115.7	122.2	134.7
Travel	11.7	13.2	14.8	16.8	16.7	21.0	23.4	26.1	24.5	28.3	26.1	27.7	30.9	42.1	50.3	60.0	72.1	62.6	63.3	64.2	80.3
Other services	7.7	10.2	13.3	18.8	16.4	20.1	26.3	26.7	25.6	26.1	30.1	28.2	30.5	39.6	44.5	44.5	50.8	50.7	61.7	61.8	63.5
Intra-regional trade (o.a.f.)	(8.6)	(10.2)	(10.8)	(11.9)	(14.0)	(13.1)	(13.7)	(16.9)	(21.1)	(28.7)	(32.7)	(36.8)	(50.8)	(72.1)	(106.2)	(135.5)	(174.7)	(214.0)	(258.3)	(249.0)	(304.2)
3. Net remittance of profits and interest	-44.8	-38.8	-28.6	-30.2	-18.1	-17.4	-22.9	-16.5	-25.5	-17.0	-6.3	-17.7	-29.3	-27.5	-41.4	-58.3	-72.3	-86.3	-102.3	-105.8	-120.2
4. Net private transfer payments	-0.8	-0.8	-0.4	-0.2	-0.3	-0.2	0.5	1.3	0.5	1.2	0.7	4.0	3.1	12.1	18.7	21.0	20.7	23.1	24.8	32.2	36.8
5. Balance on current account (1 - 2 + 3 + 4)	15.9	6.1	4.8	9.6	-2.7	-19.4	-53.0	-80.4	-79.6	-61.4	-81.8	-49.3	-59.5	-85.9	-123.6	-163.4	-186.1	-243.9	-184.3	-173.0	-222.7
6. Government transfer payments	0.8	1.5	3.0	2.3	4.9	17.2	22.3	31.6	26.6	22.9	24.5	30.0	19.5	14.6	18.9	18.4	18.3	17.5	16.1	16.5	16.0
7. Total balance (5 + 6)	16.7	7.6	7.8	11.9	2.2	-2.2	-30.7	-48.8	-53.0	-38.5	-57.3	-19.3	-40.0	-71.3	-104.7	-145.0	-167.8	-226.4	-168.2	-156.5	-206.7

Source: IMF, SIECA, Central Banks and ECLA estimates.

a/ Preliminary figures.

b/ Estimates.

c/ Including non-monetary gold.

/In fact,

In fact, in spite of the intensity and the speed with which supplies from abroad were replaced by non-durable consumer goods, raw materials, building materials and other articles, the upward trend of imports from third countries could not be controlled sufficiently.^{5/} The reasons for this are easy to explain. When the integration programme started, the low production capacity of each of the Central American countries could be used to a far greater degree and it was possible to take far greater advantage of the complementary economies, but this made extension of the substitution process impracticable on a shorter period. It should also be emphasized that, with the advent of this process on a regional scale, the difficulties which frequently arise from the existence of conflicting interests and factors of uncertainty - which do not occur when a single country starts to put into practice an inward directed development strategy - have to be overcome. In this last case, unity of decision, discussion of projects and definition of criteria concerning the treatment and localization of new investments, raises a problem of a different kind, and it is simpler to deal with than the problem which occurs when efforts are made to make progress simultaneously in production promotion and the formation of a multinational unit of integration comprised of countries which are comparatively slow in developing and have a limited market. Under these conditions it is understandable that an immediate need arose to import intermediate goods and capital goods in increasing quantities in order to meet the advance in diversification of manufactures and other products.^{6/}

Disregarding the influence of the short period available for putting the regional substitution policy into practice, a superficial analysis of the present import content gives a clear indication of the phenomena mentioned. Purchases of consumer goods - especially non durables - from

^{5/} Under the same conditions, very general estimates show that the rate of expansion of purchases outside the region would have been 12.2 per cent per year if the Common Market had not existed, whereas the figure registered between 1962 and 1968 was 8.1 per cent; and that the annual growth rate of domestic product would have been one or two per cent lower during that period.

^{6/} As shown by Latin American experience, this phenomenon also occurs in individual economies which embark upon inward directed development strategies and the smaller the market or the more limited the scope of the substitution process, the more noticeable the effect.

the rest of the world are expanding slowly, during the 1958 to 1968 period the proportion dropped from 33.6 to 23.2 per cent, and similar trends are registered for construction materials and capital goods for agriculture. The acquisition of raw materials and capital goods for industry and transport rose, by contrast, and together accounted for 49.0 to 66.6 per cent of the same total. (See table 4.)

Thus Central America as a whole has followed a relatively intensive pattern of substitution of simple consumer manufactures which is now expanding to cover a fairly wide range of production goods. This does not mean that the process is already showing signs of exhaustion, because the possibilities for continued replacement of intermediate and finished industrial articles are still extensive. It is however, an indication of the limited room available for manœuvring over a short space of time to reduce imports in periods of low external inflow, in the same way as with increasing frequency, the bulk of purchases from third countries are articles essential to development (raw materials and capital goods).

Other factors of a different kind should be mentioned in connexion with the new inflexibility in the balance of payments. The net balance on the account for freight, insurance and other transport expenditure has continued to deteriorate in spite of investments and improvements in long shore terminals and other transport services, as is shown by the rise in deficits from 54.3 to 84.7 to 96.5 millions of dollars in 1958, 1968 and 1970 respectively. (See table 3.) A special study would be needed to discover the exact causes of the trends shown for these items in the balance of payments. It is sufficient here to note that some of the reasons for this situation are the absence or deficiency of national or regional transport services, the insufficiencies in some long shore installations, and particularly the rise in maritime freight charges brought about by unfavourable treatment of the region by international shipping conferences.

Table 4

CENTRAL AMERICA: COMPOSITION OF IMPORTS, BY ECONOMIC GROUP AND REGION OF ORIGIN, 1958, 1965 AND 1968

(Percentages)

Economic group	1958			1964			1968		
	Total	Rest of world	Central America	Total	Rest of world	Central America	Total	Rest of world	Central America
<u>Total</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Consumer non-durables	20.2	19.2	44.8	23.9	19.7	49.8	20.3	12.3	45.5
Consumer durables	13.9	14.4	3.3	9.8	10.8	3.6	9.7	10.9	6.0
Fuels and lubricants	6.6	6.9	0.4	6.2	6.4	4.7	1.9	2.1	1.5
Raw materials	33.7	33.6	35.3	31.1	30.8	33.1	42.1	43.8	36.5
Construction materials	6.7	6.7	6.0	6.2	6.3	5.9	5.5	4.9	7.4
Capital goods for agriculture	3.2	3.2	2.3	3.7	4.1	0.8	2.5	2.9	1.2
Capital goods for industry	13.0	13.3	5.5	13.6	15.6	1.1	13.4	17.1	1.6
Capital goods for transport	2.1	2.1	1.2	5.1	5.9	0.3	4.4	5.7	0.3
Miscellaneous	0.6	0.6	1.2	0.4	0.4	0.7	0.2	0.3	0

Source: ECLA, on the basis of official statistics.

/Furthermore, the

Furthermore, the economic crisis of the late 1950s forced the Central American countries to obtain compensatory credit internationally on a long-term basis and this led to a phase in which external debts increased rapidly. Subsequently, as capital inflow became more flexible and accessible, opportunities for development in the Common Market expanded, thereby attracting foreign capital, and the gaps in the current account between the real formation of capital and domestic saving are covered increasingly by small loans and the expansion in international investment. During the period from 1958 to 1968 the net inflow from credit rose from 22.8 to 112.0 million dollars per year and net income from direct investment rose from 13.9 to 78.3 million; that is to say the inflow of external resources over this period increased five-fold. (See table 5.)

The problem would be less serious if exports and other entries on the current account had grown faster than imports, or if domestic saving had increased sufficiently fast to maintain the contribution of external resources in the formation of capital within reasonable bounds and keep it as a complementary factor. Neither the first nor the second condition occurred. The expansion of both private and public saving in the region, far from keeping pace with investment, fell from 88 to 75 per cent of global financing between 1958 and 1968. (See table 6.)

In these circumstances, net service payments rose sharply from 25.5 to 120.2 million dollars between 1958 and 1970 and now account for about 10 per cent of the inflow on the current account. If the distributions in capital account are added that percentage would fluctuate between 17 and 20 per cent over recent years. (See table 3.)

Thus a situation is beginning to develop in Central America - with appreciable differences from one country to another - in which the utilization of external finance, far from remedying the instability in the balance of payments, has paradoxically become a factor for increasing that instability which has, until now, only been relieved by the fact that the debt at the beginning of the 1960s was quite low.

Table 5

CENTRAL AMERICA: NET INFLOW AND SERVICING OF NON-COMPENSATORY FOREIGN CAPITAL, 1958-1968

(Millions of dollars at current prices)

	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968
1. Net movements of direct investment	13.9	26.1	17.8	17.1	33.2	27.8	38.5	36.3	58.4	66.7	78.3
2. Inflow of direct investment	23.6	13.9	3.1	12.9	22.7	20.1	33.6	49.1	60.9	70.0	70.4
3. Difference (1 - 2)	-9.7	12.2	14.7	4.2	10.5	7.7	4.9	-12.8	-2.5	-3.3	7.9
4. Other net movements of foreign capital	22.8	3.5	32.8	23.1	44.7	120.1	122.3	161.6	92.2	135.1	112.0
5. Other influses of foreign capital	4.0	5.8	5.6	7.1	9.5	11.1	13.5	17.7	21.5	24.7	40.4
6. Difference (4 - 5)	18.8	-2.3	27.2	16.0	35.2	109.0	108.8	143.9	70.7	110.4	71.6
7. Total net movements of foreign capital (1 + 4)	36.7	29.6	50.6	40.2	77.9	147.9	160.8	197.9	150.6	201.8	190.3
8. Total inflow of foreign capital (2 + 5)	27.6	19.7	8.7	20.0	32.2	31.2	47.1	66.8	82.4	94.7	110.8
9. Difference (7 - 8)	9.1	9.9	41.9	20.2	45.7	116.7	113.1	131.7	68.2	107.1	79.5

Source: ECLA, on the basis of official statistics.

Table 6

CENTRAL AMERICA: INVESTMENT FINANCING, 1953-1970

Year	Investment	Domestic saving	External saving
<u>Millions of Central American pesos at 1960 prices</u>			
1953	275.2	287.0	-11.8
1954	267.6	267.8	-0.2
1955	302.0	300.8	1.2
1956	372.2	340.4	31.8
1957	401.7	351.4	50.3
1958	356.8	300.2	56.6
1959	368.8	325.4	43.4
1960	364.8	296.1	68.7
1961	351.5	332.8	18.7
1962	404.5	364.8	39.7
1963	450.1	381.2	68.9
1964	512.3	410.6	101.7
1965	584.5	441.0	143.5
1966	625.0	455.8	169.2
1967	656.5	436.8	219.7
1968	667.6	502.0	165.6
1969	719.4	567.5	151.9
1970 ^{a/}	784.7	594.4	190.3
<u>Percentage structure of investment financing</u>			
1953-57	100.0	95.6	4.4
1958-62	100.0	87.7	12.3
1963-68	100.0	75.2	24.8
1968-69	100.0	77.2	22.8
1969-70 ^{a/}	100.0	75.7	24.3

Source: ECLA, on the basis of official statistics.

a/ Preliminary figures.

/In short,

In short, the deficit on the current account has shown a tendency to rise it has now exceeded 200 million dollars, whereas in the period from 1958 to 1962 it remained around 66.3 million. This lack of adjustment, originating from the disparity between exports and imports of goods, is increasingly due to instability in the service payments account at the present time (remittance of profits and interests, freight and transport). The three years from 1968 to 1970 show an average annual deficit of payments of 177.1 million dollars corresponding exactly to a vertical rise in net expenditure on service payments which could not counteract foreign loans totalling on average 47.1 million dollars. (See again table 3.)

(b) Public finances

As noted above, one of the factors which has most influenced the changes in the Central American economies since the early post-war period is the reorganization of the public sector and internal financial systems. It should be added that the main effects of this reorganization have been of a qualitative rather than a quantitative nature. In fact, the most striking changes are connected with the adoption of certain approaches along the lines that the State must participate in and is mainly responsible, directly or indirectly, for broadening the productive base and improving the population's living conditions. It was therefore necessary to introduce important changes in the government machine, and to reorientate economic policy instruments with a view to establishing measures to promote production and provide more investment opportunities for the private sector. At the same time as Governments were expanding their activities in the economic sphere, their responsibilities in the social sphere were increasing enormously, whether as the actual reflection of internal tensions or as a result of the soaring hopes and expectations of the broad masses throughout the developing world.

Although the State has increased its sphere of competence through the gradual acquisition of additional powers, and it has made development its main objective, however, its capacity to tap resources has lagged behind or, at least, has failed to expand sufficiently. The public sector's share of the gross domestic product fell from 12.6 to 12 per cent between the periods 1958-1961 and 1967-1969, which is representative of the situation in all the Central American countries except, in recent years, Nicaragua and Honduras (see table 7).

Table 7

CENTRAL AMERICA: COEFFICIENTS OF STATE PARTICIPATION, 1950-1969^{a/}
(Percentages)

	1950-1957	1958-1961	1962-1966	1967-1969
<u>Central America</u>	12.4	12.6	11.9	12.0
Guatemala	11.3	11.1	8.7	9.1
El Salvador	14.1	13.5	12.2	11.9
Honduras	11.1	12.0	12.0	13.0
Nicaragua	12.8	13.1	14.1	15.3
Costa Rica	13.9	15.0	16.4	14.7

Source: ECLA, on the basis of official statistics.

a/ The coefficient of State participation is the ratio of consumption plus public investment to the gross domestic product.

An immediate result of the insufficient growth of government resources has been a decline in their contribution to capital formation and saving, at a time when the expansion of the infrastructure, basic services and social works are becoming an inescapable need. If the period 1958-1962 is compared with 1963-1968, it will be noted that public investment declined from 25 to 23 per cent of total investment, and that the share of real investment (which represented about 60 per cent of the central governments' capital expenditure) fell by one-third (see tables 8 and 9).^{7/} Nor did public saving follow a favourable trend, since the differences between current government income and expenditure shrank from 61 to 23 million dollars between 1953 and 1961. Although a certain recovery set in later - due to the boom resulting from the Common Market - the figure stood at barely 51 million in 1968 (see table 10).

The steady deterioration of government finances can hardly be ascribed to an excessive increase in current expenditure. The Governments' consumption expenditure, while appreciable differences exist between countries, remained at the same level throughout the period 1958-1962, and if it subsequently grew fairly rapidly (7 per cent annually from 1962 to 1968), this must be considered a natural effect of the recovery from the previous low level, state of the expansion of public services, transfers in support of the private sector or semi-public enterprises, and higher interest payments on the public debt (see table 10). Expenditure on current account is, in fact, inflexible, and any attempt to reduce it would, in the best of cases, do little towards improving the government finances. This inflexibility is due to the low levels of government income, the pressures exerted by rises in the wages and salaries of government employees, which are chronically low, but above all merely to the growth of the administration and of the economic and social services of developing economies which are experiencing a rapid population growth.

^{7/} Real investment by Governments amounted to 89.6 million dollars in 1958, and this absolute figure had not been exceeded ten years later, although the economies had grown appreciably (see table 10).

Table 8

CENTRAL AMERICA: PRIVATE AND PUBLIC FIXED INVESTMENT, 1958-1970

Year	Total	Private	Public
<u>Millions of Central American pesos at 1960 prices</u>			
1958	356.8	245.7	111.1
1959	368.8	273.9	94.9
1960	364.8	289.2	75.6
1961	351.5	266.1	85.4
1962	404.5	311.2	93.3
1963	450.1	354.0	96.2
1964	512.3	397.4	114.7
1965	584.5	446.5	138.0
1966	625.0	468.4	156.6
1967	656.5	509.9	146.6
1968	667.6	523.1	144.5
1969	719.4	553.5	165.9
1970 ^{a/}	784.7	635.8	148.9
<u>Percentage structure of total fixed investment</u>			
1958-62	100.0	75.1	24.9
1963-68	100.0	77.2	22.8
1968-69	100.0	77.6	22.4

Source: ECLA, on the basis of official statistics.

a/ Preliminary figures.

/Table 9

Table 9

CENTRAL AMERICA: COMPOSITION OF CENTRAL GOVERNMENT CAPITAL EXPENDITURE, 1953-1968
 (Millions of Central American pesos)

	Annual averages			Relative percentage structure		
	1953-1957	1958-1961	1962-1968	1953-1957	1958-1961	1968-1969
Capital expenditure	112.6	117.6	156.5	100.0	100.0	100.0
Investment	75.9	71.9	70.0	67.4	61.1	44.7
Real investment	71.3	67.3	64.9	63.3	57.2	41.5
Financial investment	4.6	4.6	5.1	4.1	3.9	3.3
Amortization of the public debt	22.0	28.3	55.9	19.5	24.1	35.7
External	4.4	7.0	22.0	3.9	6.0	14.1
Internal	17.6	21.3	33.9	15.6	18.1	21.7
Transfer and other payments	14.7	17.4	30.6	13.1	14.8	19.6

Source: ECLA, on the basis of official statistics.

Table 10

CENTRAL AMERICA: CENTRAL GOVERNMENT CURRENT AND CAPITAL
INCOME AND EXPENDITURE FOR SELECTED YEARS

(Millions of Central American pesos)

	1953	1958	1961	1962	1968
<u>Current income</u>	209.9	276.8	280.2	294.3	466.8
Tax revenue	185.7	252.9	251.1	266.3	420.3
Non-tax revenue	24.2	23.9	29.1	28.0	46.5
<u>Capital income</u>	36.5	66.4	81.3	87.5	135.9
Public credit	22.4	41.4	59.0	69.7	117.9
External	1.8	12.0	13.3	18.9	52.2
Internal	20.6	29.4	45.7	50.8	65.7
Transfer payments	3.4	18.9	16.3	11.0	5.1
Sale of assets, etc.	10.7	6.0	6.2	6.8	13.0
<u>Current expenditure</u>	148.4	224.4	257.6	265.3	416.3
Consumption expenditure	125.1	185.2	207.3	209.9	315.4
Transfer payments	20.7	33.5	41.8	42.4	80.3
Interest on the public debt	2.6	5.7	8.4	13.0	20.5
<u>Capital expenditure</u>	85.6	125.9	114.0	117.6	184.1
Investment	53.1	96.0	65.0	52.9	76.8
Real investment	50.7	89.6	59.0	50.3	73.3
Financial investment	2.4	6.4	6.0	2.6	3.5
Amortization of the public debt	21.3	18.9	25.0	40.5	72.9
External	6.3	5.0	8.7	14.0	35.0
Internal	15.0	13.8	16.3	26.5	37.9
Transfer and other payments	11.2	11.0	24.0	24.2	34.4

Source: ECLA, on the basis of official statistics.

/The solution

The solution to the problem is not therefore to rely on credit or to reduce expenditure, although experience in the last few years has shown that the two measures can temporarily help to mitigate budgetary imbalances.

This does not mean that nothing has been done to remedy the situation or that no changes have been introduced in the structure of the tax systems, tax collection and public revenue. Admittedly, the average tax burden has not altered much (about 9 per cent in relation to the product), but the composition of the taxes has changed appreciably (see table 12). The share of taxes on foreign trade declined from 54 to 41 per cent between 1958-1963 and 1963-1968, while that of income tax and other direct taxes rose from 15 to about 21 per cent. While the proportion of indirect taxes on sales and domestic production increased, but of indirect taxes on imports declined (see table 13).

These variations were partly due to the changes that took place in production. Needless to say, the expansion and diversification of import substitution activities undoubtedly had the effect, even without any changes in tax legislation, in increasing tax revenue, through many internal taxes and as a result of the general acceleration of the growth rates with the establishment of the Common Market.

The reforms introduced by nearly all the Governments of the region with a view to gradually modernizing the tax and tax collection systems should not be overlooked either. To sum up, through the changes deliberately introduced in tax policy and those brought about by the actual economic development of the region, the governments' long-standing dependence on export earnings was in some degree lessened and their internal revenue stepped up. It will be noted, for example, that tax collections over the period 1963-1968 increased by 7.7 per cent annually at current prices, which compares favourably with the rates of 2.8 and 6.4 per cent recorded in 1958-1963 and 1953-1958, respectively (see table 14).

Table 11

CENTRAL AMERICA: FINANCING OF PUBLIC SECTOR CAPITAL EXPENDITURE,
FOR SELECTED PERIODS, 1953-1968

(Percentages)

	1953-1957	1958-1961	1962-1966	1967-1968
Capital expenditure	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Current saving	64.9	31.5	33.3	23.3
External credit	7.4	12.3	22.4	29.1
Domestic credit	23.0	29.3	41.5	37.5
Transfer payments	10.2	12.2	3.8	2.7
Sale of assets	1.0	0.1	-	0.1
Other	4.5	4.8	3.7	5.2
Variations in cash reserves	-10.9	9.8	-4.7	2.1

Source: ECLA, on the basis of official statistics.

/Table 12

Table 12

CENTRAL AMERICA: GROSS DOMESTIC PRODUCT AND TAX REVENUE, 1953-1968
(Million of Central American pesos)

Year	Gross domestic product	Tax revenue	Percentage
1953	2 026.3	185.7	9.2
1954	2 141.2	211.7	9.9
1955	2 261.2	225.6	10.0
1956	2 399.4	235.5	9.8
1957	2 524.9	262.7	10.4
1958	2 610.3	252.9	9.7
1959	2 688.6	247.9	9.2
1960	2 758.1	259.6	9.4
1961	2 865.6	251.1	8.8
1962	3 105.5	262.2	8.4
1963	3 345.6	290.1	8.7
1964	3 521.1	328.9	9.3
1965	3 798.6	357.8	9.4
1966	4 000.0	370.8	9.3
1967	4 232.1	385.2	9.1
1968	4 520.9	420.3	9.2

Source: ECLA, on the basis of official statistics.

Table 13

CENTRAL AMERICA: STRUCTURE OF TAX REVENUE ^{a/}, 1953-1968

(Percentages)

Year	Total tax revenue	Direct taxes			Taxes on foreign trade			Taxes on consumption, production, etc.
		Total	Income tax	Patents and inheritance tax	Total	Imports	Exports	
1953	100.0	13.1	9.9	3.2	60.6	45.7	14.9	26.3
1954	100.0	12.5	8.4	4.1	60.1	44.8	15.3	27.4
1955	100.0	13.6	11.2	2.4	61.1	41.5	19.6	25.3
1956	100.0	12.9	9.9	3.0	59.5	42.2	17.3	27.6
1957	100.0	13.6	10.3	2.8	57.4	41.0	16.4	29.0
1958	100.0	13.8	10.7	3.1	55.4	43.5	11.9	30.8
1959	100.0	14.3	11.2	3.1	56.2	46.0	10.2	29.5
1960	100.0	13.8	10.6	3.2	56.0	46.4	9.6	30.2
1961	100.0	14.8	10.9	3.9	53.9	45.3	8.6	31.3
1962	100.0	17.2	13.6	3.6	52.3	44.9	7.4	30.5
1963	100.0	16.6	12.6	4.0	49.6	42.9	6.7	33.8
1964	100.0	18.2	14.0	4.2	44.1	37.0	7.1	37.7
1965	100.0	19.8	15.4	4.4	44.9	37.1	7.8	35.3
1966	100.0	21.2	16.6	4.6	42.0	34.6	7.4	36.8
1967	100.0	24.0	18.7	5.3	36.7	30.8	5.9	39.3
1968	100.0	25.6	19.3	6.3	30.9	26.3	4.6	43.5
1953-58	100.0	13.3	10.1	3.1	59.0	43.1	15.9	27.7
1958-63	100.0	15.1	11.6	3.5	53.9	44.8	9.1	31.0
1963-68	100.0	20.9	16.1	4.8	41.4	34.8	6.6	37.7

Source: ECLA, on the basis of official statistics.

^{a/} i.e. Central Government income.

Table 14

CENTRAL AMERICA: TAX REVENUE ^{a/}, 1953 - 1968

(Millions of Central American pesos)

Year	Total tax revenue	Direct taxes			Taxes on foreign trade			Taxes on consumption, production, etc.
		Total	Income tax	Patents and inheritance tax	Total	Imports	Exports	
1953	185.7	24.2	18.4	5.8	112.6	84.9	27.7	48.9
1954	211.7	26.4	17.8	8.6	127.3	94.8	32.5	58.0
1955	225.6	30.7	25.3	5.4	137.7	93.5	44.2	57.1
1956	235.5	30.4	23.3	7.1	140.0	99.4	40.6	65.1
1957	262.7	35.5	28.3	7.2	150.8	107.8	43.0	76.3
1958	252.9	34.8	27.0	7.8	140.1	110.1	30.0	78.0
1959	247.9	35.4	27.7	7.7	139.4	114.1	25.3	73.1
1960	259.6	35.7	27.5	8.2	145.4	120.5	24.9	78.6
1961	251.1	37.1	27.2	9.9	135.5	113.8	21.7	78.6
1962	262.2	45.2	35.8	9.4	137.2	117.7	19.5	79.9
1963	290.1	48.1	36.6	11.5	143.9	124.5	19.4	98.1
1964	328.9	59.9	46.0	13.9	145.0	121.7	23.2	124.0
1965	357.8	70.7	55.0	15.7	160.8	132.8	28.0	126.3
1966	370.8	78.7	61.6	17.1	155.8	129.5	27.3	136.4
1967	385.2	92.5	71.9	20.6	141.3	118.5	22.8	151.4
1968	420.3	107.5	81.0	26.5	130.0	110.7	19.3	182.8
Growth rate								
1953-58	6.4	7.5	8.0	6.1	4.5	5.3	1.6	9.8
1958-63	2.8	6.7	6.3	8.1	0.5	2.5	-8.4	4.7
1963-68	7.7	17.5	17.2	18.2	-2.0	-2.4	-0.1	13.3

Source: Guatemala: Planning Office
 El Salvador: Planning Office.
 Honduras: 1953-1957, Planning Office; 1958-1968, Budget Office.
 Nicaragua: 1953-1959, Planning Office; 1960-1968, Budget Office.
 Costa Rica: Planning Office.

^{a/} i.e. Central Government income.

Nevertheless, the

Nevertheless, the measures adopted and the advances made were not far-reaching or intensive enough to offset, or sufficiently reduce, the forces that have been determining the trend towards a bottleneck in government finances, or to prevent their association with the external disequilibria. They are, in fact, maladjustments which are rooted in the actual structure of developing export economies, and which had been resolved in the past by the simple expedient of deflating the internal levels of economic activity and public expenditure whenever external demand was depressed.

The process tends to be followed initially by a reduction in exports and an immediate depression of the whole economy. This, in its turn, has a primary unfavourable effect on tax collections, followed by a secondary effect associated with the readjustment of imports. In attempting to maintain the levels of expenditure, the Governments are compelled to incur heavier budget deficits, increase the public debt and, lastly, when the pressures are too intensive, adopt increasingly restrictive measures.

It may be affirmed that this recurring process, which is typical of small developing countries, has operated intensively in Central America. This is because - apart from the obvious fact that its tax systems are still based to a great extent on taxes on foreign trade - import substitution and the construction of a new and dynamic export sector have not gone far enough to protect the economy, in relative terms, from fluctuations in the demand for traditional products in world markets. Moreover, the money and capital markets are undeveloped and the financial capacity of the public sector and semi-public agencies is limited.

Since Central America is in a transitional phase of its economic development and, moreover, the Governments' objective is to maintain the rates of growth, the readjustments to which this process gives rise are particularly difficult to effect. They no longer exclusively affect the import and trade sector, but also many other activities which have gradually been established at great internal sacrifice and which help to intensify the social pressures on the economic decision-making centres that have very little room for manoeuvre over the short term, as was noted above.

(c) Integration, and fiscal and payments disequilibria

Therefore, it must be recognized that, either separately or together, the Central American countries could not have avoided the fiscal and payments disequilibria deriving from the level of development of the production structure and the tax systems which, early in the 1960s were the point of departure for a regional inward-directed development policy. In more than one sense, the tensions observable are typical of the stage of change in the development pattern and stem from social aspirations that cannot be satisfied on the basis of the possibilities of progress offered by maintaining the traditional export sector as the hub of productive activity.

Thus, it would be useful to analyse whether the integration agreements have helped to mitigate or have accentuated the structural disequilibria, in order subsequently to evaluate whether or not the measures adopted at the regional level to correct those disequilibria have been effective. Such an analysis presents no particular difficulties if the question is examined from the standpoint of long-term development. On this point, the Common Market has undoubtedly created real and potential opportunities for economic progress which would not otherwise have existed. Nor can there be any doubt about the positive contribution of the integration programme from the standpoint of the expectations that have already been fulfilled, i.e., the raising of growth rates, import substitution and the region's bargaining power to attract external resources.^{8/}

^{8/} The results of research show that intra-regional transactions are responsible for raising Central America's rate of economic growth by 1 or 2 per cent (see, for example, Phillip Allan May, Panama and the Central American Customs Union: Estimates of Union-induced Changes in the Value of Central American Output, Ann Arbor, Michigan, University Microfilms Inc., 1965), and similar conclusions are inferred from a comparison of rates of growth over different periods in the past. During the period 1956-1961, which was characterized by the contraction of the external sector and by relatively few intra-regional transactions, economic growth was barely 4.5 per cent annually. In contrast, during the years 1962-1965 when exports and intra-regional trade boomed, the growth rate rose to 6.6 per cent. Lastly, from 1969 to 1970, external demand increased by 10 per cent (a figure which could not be called critical or excessively unfavourable), but the rate of growth of regional trade declined and the average growth of the product slowed to 5.1 per cent (see tables 15 and 16).
/Table 15

Table 15

CENTRAL AMERICA: GROSS DOMESTIC PRODUCT AT MARKET PRICES, 1956-1970

Year	Central America	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
<u>Millions of Central American pesos</u>						
1956	2 353.3	878.0	485.5	324.5	335.1	330.2
1957	2 506.7	927.5	511.3	346.2	363.4	358.3
1958	2 615.2	970.8	522.4	354.6	364.6	402.8
1959	2 721.3	1 018.8	545.9	368.9	370.1	417.6
1960	2 816.0	1 043.6	568.0	375.4	375.1	453.9
1961	2 941.4	1 088.5	588.0	389.3	402.8	472.8
1962	3 149.4	1 127.0	658.3	417.1	445.2	501.8
1963	3 360.7	1 234.5	686.6	421.2	473.6	544.8
1964	3 570.6	1 291.7	750.6	428.7	528.3	571.3
1965	3 815.2	1 348.0	791.0	472.2	580.9	623.1
1966	4 047.7	1 422.3	847.6	507.4	598.8	671.6
1967	4 258.0	1 480.7	893.7	540.5	630.4	712.7
1968	4 494.6	1 565.7	922.6	578.6	660.2	767.5
1969	4 712.5	1 653.6	954.7	596.6	689.0	818.6
1970	4 954.7	1 737.7	996.0	620.6	720.4	880.0
<u>Average annual percentage growth rate</u>						
1956-1961	4.5	4.4	3.9	3.7	3.7	7.5
1962-1965	6.6	6.2	6.3	4.2	9.3	7.5
1965-1968	5.6	5.1	5.3	7.0	4.4	7.2
1968-1969	4.8	5.6	3.5	3.1	4.4	6.7
1969-1970	5.1	5.1	4.3	4.0	4.6	7.5

Source: ECLA, on the basis of official statistics.

Table 16

CENTRAL AMERICA: AGGREGATE SUPPLY AND DEMAND, 1960-1970
(Millions of Central American pesos at 1960 prices)

Item	1960	1965	1966	1967	1968	1969	1970 ^{a/}	Average annual growth rate			
								1960-65	1965-68	1968-69 1969-70 ^{a/}	
Gross domestic product at market prices	2 816.0	3 815.2	4 047.7	4 258.0	4 494.6	4 712.5	4 954.7	6.3	5.6	4.8	5.1
Imports of goods and services	579.6	992.4	1 079.8	1 123.9	1 178.1	1 210.6	1 322.7	11.4	5.9	2.8	9.3
Aggregate supply	3 395.6	4 807.6	5 127.5	5 381.9	5 672.7	5 923.1	6 277.2	7.2	5.7	4.4	6.0
Terms-of-trade effect	0	15.7	10.4	-23.9	2.0	-19.2	79.0				
Aggregate demand	3 395.6	4 823.3	5 137.9	5 358.0	5 674.7	5 903.9	6 356.2	7.3	5.5	4.0	7.7
Purchasing power of exports	492.8	851.2	925.3	929.8	1 049.8	1 063.5	1 169.6	11.5	7.2	1.3	10.0
Gross fixed capital formation	364.8	584.5	625.0	656.5	667.6	719.4	784.7	9.9	4.5	7.8	9.1
Public	75.6	136.0	156.6	146.6	144.5	165.9	148.9	12.8	1.5	14.8	-10.2
Private	289.2	448.5	468.4	509.9	523.1	553.5	635.8	9.1	5.4	5.8	14.9
Increase in stocks	24.9	68.2	30.7	54.6	41.9	38.8	90.0	22.0	-15.0	-7.4	132.0
Consumption expenditure	2 513.1	3 319.4	3 556.9	3 717.1	3 915.4	4 082.2	4 311.9	5.7	5.7	4.3	5.6
Government	262.8	336.8	358.2	385.8	398.6	428.8	451.0	5.1	5.8	7.6	5.2
Private	2 250.1	2 982.6	3 198.7	3 331.3	3 516.8	3 653.4	3 860.9	5.8	5.7	3.9	5.7

Source: ECLA, on the basis of official statistics.

^{a/} Preliminary figures.

/Taking an

Taking an over-all view of Central America's balance of payments, it will be seen that the Common Market has channelled trade flows which represent a gross annual saving in foreign exchange of over 200 million dollars, if 1960 is compared with 1969, although the benefits may not be so evident in the case of a specific country, owing to the fairly persistent imbalances in intra-regional transactions (see table 3). Nevertheless, a more thorough analysis by no means indicates that the net effects of integration on each country's balance of payments would have continued to be consistently negative.

Even in the case of regional debit balances, other factors - which are attributable to the Common Market - no doubt more than compensate for this disadvantage in the over-all payments situation of each economy. On the one hand, integration made it possible for all the member countries to export goods which they would have been unable to sell to third countries, and to effect import substitution investments which would have been very difficult under other circumstances. Moreover, a large proportion of the goods now purchased in Central America itself would have had to be obtained from third countries if the Common Market had not existed. Lastly, at the same rates of income growth, the payments maladjustments would indubitably have been greater without the integration programme, inasmuch as the structural defects which account for the external disequilibrium would have been accentuated and the access to external sources of credit and resources would have been more restricted.

This does not mean that the common agreements have had an equally favourable effect on all the countries' balances of payments. There is no doubt that the economies which were best able to take advantage of the expansion of the market were able to increase their exports to other countries in the area more rapidly, and obtained large surpluses (see table 17), a situation which has been a source of friction despite the great efforts to remedy it.

A similar analysis can be made of the effect of integration on government income trends. As mentioned previously, the faster rate of economic growth, the upsurge of activities associated with production and intra-regional trade, and the raising of the customs tariff caused government revenue to rise.

Table 17

CENTRAL AMERICA: INTRA-REGIONAL TRADE, 1960-1970

Year	Central	Guatemala			El Salvador			Honduras			Nicaragua			Costa Rica		
	America	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
<u>Thousands of Central American pesos c.i.f.</u>																
1960	32 676	7 265	7 504	-319	12 673	13 491	-818	7 435	5 311	2 124	3 446	2 776	670	1 858	3 514	-1 656
1961	36 806	10 315	8 867	1 448	14 448	14 663	-215	8 294	6 353	1 941	1 771	2 877	-1 106	1 978	4 046	-2 068
1962	50 848	13 889	11 228	2 655	18 505	22 058	-3 553	13 799	8 911	4 888	3 229	5 343	-2 114	1 931	3 308	-1 377
1963	72 098	20 773	14 176	6 597	28 684	27 944	740	13 972	13 258	714	4 214	7 353	-3 139	4 455	3 817	-638
1964	106 188	29 971	26 357	3 614	35 178	39 234	-4 056	18 337	18 004	333	6 924	14 308	-7 384	15 778	8 285	7 493
1965	135 503	38 377	31 530	6 847	46 159	42 406	3 753	22 200	25 480	-3 280	9 872	21 395	-11 523	18 895	14 692	4 203
1966	174 735	55 071	33 834	21 237	57 470	52 032	5 438	21 486	34 053	-12 567	14 896	31 659	-16 763	25 811	23 156	2 655
1967	213 958	65 690	42 104	23 586	75 172	54 506	20 666	23 526	40 754	-17 228	18 582	42 373	-23 791	30 988	34 221	-3 233
1968	258 294	77 525	49 444	28 081	84 882	65 161	19 721	31 266	48 671	-17 405	26 942	46 172	-19 230	37 679	48 849	-11 170
1969 ^{a/}	248 973	86 441	51 381	35 060	71 755	60 180	11 575	23 870	43 973	-20 103	30 797	42 219	-11 422	36 109	51 220	-15 111
1970 ^{b/}	304 200	114 800	65 600	49 200	76 800	65 400	11 400	23 100	44 900	-21 800	44 100	56 600	-12 500	45 400	71 700	-26 300
January-October ^{a/}	242 406	85 911	52 244	33 667	61 108	49 722	11 386	14 539	44 901	-30 362	42 485	40 250	2 235	38 364	55 290	-16 926
<u>Percentage annual growth rate</u>																
1961	12.6	42.0	16.9		14.0	8.7		11.6	19.6		-48.6	3.6		6.5	15.1	
1962	38.2	34.6	26.6		28.1	50.4		66.4	40.3		82.3	85.7		-2.4	-18.2	
1963	41.8	49.6	26.3		55.0	26.7		1.3	48.8		30.5	37.6		130.7	15.4	
1964	47.3	44.3	85.9		22.6	40.4		31.2	35.8		64.3	94.6		254.2	117.1	
1965	27.6	28.0	19.6		31.2	8.1		21.1	41.5		42.8	49.5		19.8	77.3	
1966	29.0	43.5	7.3		24.5	22.7		-3.2	33.6		50.9	48.0		36.6	57.6	
1967	22.4	19.3	24.4		30.8	4.8		9.5	19.7		24.7	33.8		20.1	47.8	
1968	20.7	18.0	17.4		12.9	19.5		32.9	19.4		45.0	9.0		21.6	42.7	
1969	-3.6	11.5	3.9		-15.5	-7.6		-23.7	-9.7		14.3	-8.6		-4.2	4.9	
1970	22.2	32.8	27.7		7.0	8.7		-3.2	2.1		43.2	34.1		25.7	40.0	

Source: SIECA, on the basis of official statistics.

^{a/} Preliminary figures.^{b/} Estimates based on trade statistics for the first six months.

In fact, on an average, tax revenue grew faster than the product (7.7 per cent annually compared with 6 per cent) over the period 1963-1968, which is also attributable to certain changes in tax legislation, although, of course, appreciable differences are observable in the different countries (see tables 14 and 15).

The liberalization of trade in goods produced in Central America had an opposite effect, in certain cases through excessive exemptions and reductions in the import tariff, either with the purpose of promoting industry or merely to improve the competitive position of entrepreneurs in the various countries or to attain objectives of secondary importance. To illustrate this point, the exemptions from import duties and charges represent, on an average, a high percentage of total revenue, fluctuating in certain cases from 70 to 150 per cent.^{9/} This should in no way be ascribed to the Common Market, but rather to the delays in implementing the standard system of fiscal incentives and its regulations.

On the whole, the available studies and estimates show clearly that the integration process has had distinctly favourable effects on the over-all finances of most of the Central American countries, although in some it may be considered neutral. In practice, the financial bottleneck which Governments have encountered - and this must be emphasized - is due in particular to the structural factors examined above, which were latent before the signing of the General Treaty and which the changes in the production machinery and in the style of economic policy adopted in the past decade have done little to eliminate.

It is also true that the individual countries have lost some of their independence in dealing with emergency situations and that this loss of individual flexibility has not been replaced by effective regional mechanisms.

Moreover, since the establishment of the Common Market, the pressures on government finances and the balance of payments have been dealt with primarily through measures adopted at a national level, i.e., by having

9/ See Dirección General de Aduanas, Nicaragua, Memoria, 1968, and Dirección General de Estadísticas y Censos, Costa Rica, Comercio Exterior, 1968.

/recourse to

recourse to monetary and credit instruments, increasing internal charges or curtailing public expenditure. At the regional level, although progress has been made in many directions, up to the beginning of 1969 no joint mechanisms had been applied except where national emergency provisions affected intra-area trade.

(d) Regional disequilibria and falling off of trade

Although it has not completely lost its initial impetus, the spectacular growth rate of intra-regional trade during the first five years of the 1960s (33 per cent) dropped to 24 per cent between 1965 and 1968, levelled off in 1969 on account of the conflict between El Salvador and Honduras and began to recover in 1970 (see table 17).

The determinants of the trends in regional trade are very diverse. It is observed that the high growth rates decreased for the simple reason that the initial levels of trade were very low, accounting for 3 per cent of the total exports of the region in 1953, 12.2 per cent in 1963, and 27.4 per cent in 1970 (see table 3). In addition to this secondary factor, there seems to have been other more substantive reasons for the decline in trade over the years.

(i) Import substitution as an indirect strategy. In earlier pages it was said that the economies of the Central American countries are faced with a double standard of development from the moment that their economic development begins to depend to a greater extent on internal stimuli - particularly the impetus provided by the free-trade area -, and as long as their marked dependence on exports of traditional primary products continues.

It is, therefore, necessary to analyse the type of indirect strategy that guided the setting up of the Common Market and to relate it to the scope of the instruments and machinery of regional policy and to the real evolution of trade and the state of interdependence of the Central American countries.

The establishment of the free-trade area and of the common tariff was obviously dictated by protectionist policy, although, at the same time, fiscal and balance-of-payments considerations would have been taken into account. The main objective was to create a base for domestic

/production, taking

production, taking advantage of existing demand that was previously satisfied by imports. The protective measures established are in line with that objective. A relatively liberal system of imports of capital goods and inputs for agriculture was established, since such goods have a limited domestic market and are difficult to replace in the short term, and because it was intended to facilitate investment and prevent a rise in costs in the most important sector of economic activity. Raw materials, intermediate goods for industrial use and construction materials were given greater protection, and the barriers were even higher for consumer goods and luxury articles, with a view to limiting imports of such articles.^{10/} This policy was closely bound up with the internal structure of production and demand, and tended to promote the process of import substitution, by taking advantage of the opportunities that were most obvious or appeared to be attainable at the time.

The adoption of a strategy aimed chiefly at limiting purchases abroad found concrete expression not only in tariff policy and in the creation of the free-trade area, but was also a guiding factor in the conception of other instruments of regional action, such as the agreement on fiscal incentives, the system of industrial integration and the special system for the promotion of productive activities, even though many of those instruments were never or only partially applied.

In contrast, regional agreements and national policy measures are of much more restricted scope in so far as they represent a deliberate attempt to broaden or diversify traditional exports to third countries. There is a noticeable weakness or absence of machinery to achieve that end, such as export subsidies, machinery directed towards achieving specialized output and level of efficiency and costs that ensure a minimum of competitiveness on international markets.^{11/}

^{10/} The document Consideraciones económicas y técnicas para establecer lineamientos sobre la segunda etapa de revisión del arancel de aduanas centroamericano (E/CN.12/CCE/362/Rev.1) contains a more detailed analysis of the features of the Central American protectionist system.

^{11/} Of course, great efforts have been made to protect the prices of traditional export products and to harmonize negotiating positions with third countries, among other things, but such efforts have for the most part been confined to the sphere of trade policy rather than production.

Thus, regional strategy has been mainly in the form of import substitution, to some extent as an extension of the process already initiated by the countries before the creation of the Common Market. The chief instrument used to that end has been the uniform import tariff and the abolition of all restrictions on products from the region.

Despite the limited range of regional policy instruments, this strategy has promoted a fairly intense industrialization process. Between 1963 and 1968, the value added of manufactures grew by more than 9 per cent a year, and the rate was not less than 8 per cent in any of the Central American countries (see table 1). In 1966, intra-regional trade in industrial products already accounted for slightly more than 21 per cent of the same type of trade with third countries. In agriculture, construction materials and trade services, there was a similar boom and substitution of imports also took place although on a much less spectacular scale (see table 18).

It cannot be concluded, on the basis of the progress made in the process of import substitution at the regional level, that Central America has gone beyond the first phase of replacing imports. That hypothesis is not justified, as there is a wide range of non-durable and, in particular, durable consumer goods, and intermediate goods also, that are not produced or are produced in insufficient quantities, and for which there is a sizable market. The same can be said of construction materials and agricultural output, although in that connexion climate and natural resources impose narrower limitations.

(ii) Factors determining the decline in trade. Despite the above, there are signs - as was said before - of a falling off in the upward spiral of regional trade, which are obviously connected with the repercussions of the conflict between El Salvador and Honduras. The above observations on the indirect strategy for developing the integration programme and the policy instruments that have been used, were made in an attempt to clarify this question, albeit only in part.

Table 18

CENTRAL AMERICA: REGIONAL TRADE AS A PERCENTAGE OF TRADE WITH OTHER COUNTRIES,
BY SECTOR OF ECONOMIC ACTIVITY, 1966

(Thousands of dollars at current prices)

ISIC divi- sion or group	Sector	1966				Share of manufacturing sector in the total		
		Total	CACM	Rest of world	Percentage ratio of CACM to rest of world	Total	CACM	Rest of world
		<u>Totals</u>						
<u>Total</u>		<u>942 887</u>	<u>173 915</u>	<u>768 972</u>	<u>22.6</u>	<u>100</u>	<u>100</u>	<u>100</u>
0	Agriculture	44 879	19 681	25 198	78.1			
1	Mining	24 798	758	24 040	3.2			
2-3	Manufacturing	864 375	152 083	712 292	21.4	91.7	87.4	92.6
4	Construction	1 119	278	841	33.1			
5	Electricity, gas, water and sanitary services	11	-	11				
6	Commerce	80	13	67	19.4			
7	Transport, storage and communication	-	-	-	-			
8	Services	-	-	-	-			
9	Activities not ade- quately described	7 625	1 103	6 522	16.9			
		<u>Manufacturing sector</u>						
<u>Total</u>		<u>864 375</u>	<u>152 083</u>	<u>712 292</u>	<u>21.4</u>			
20	Food manufacturing industries, except beverage industries	58 438	21 085	37 353	56.4			
21	Beverage industries	5 203	623	458	136.0			
22	Tobacco manufactures	1 367	1 038	329	315.5			
23	Manufactures of Textiles	83 834	27 104	56 730	47.8			
24	Manufactures of footwear, other wearing apparel and made-up textile goods	24 857	16 949	7 908	214.3			
25	Manufactures of wood and cork, except manufac- tures of furni- ture	7 094	4 962	2 132	232.7			
26	Manufacture of fur- niture and fixtures	5 152	7 601	1 551	490.1			
27	Manufacture of paper and paper products	49 553	6 003	43 550	13.8			
28	Printing, publi- shing and allied industries	7 498	2 352	5 146	45.7			

/Table 18 (concl.)

Table 18 (concl.)

ISIC divi- sion or group	Sector	1966			Percentage ratio of CACM to rest of world	Share of manufacturing sector in the total		
		Total	CACM	Rest of world		Total	CACM	Rest of world
29	Manufacture of leather and leather and fur products, except footwear and other wearing apparel	5 411	2 152	3 259	66.0			
30	Manufacture of rubber products	18 210	6 329	11 881	53.3			
31	Manufacture of chemicals and chemical products	161 085	31 079	130 006	23.9			
32	Manufacture of products of petroleum and coal	26 017	1 830	24 187	7.6			
33	Manufacture of non-metallic mineral products, except products of petroleum and coal	20 239	2 511	17 728	14.2			
34	Basic metal industries	48 311	5 353	42 958	12.5			
35	Manufacture of metal products, except machinery and transport equipment	43 549	5 367	38 182	14.1			
36	Manufacture of machinery, except electrical machinery	116 215	1 455	114 760	1.3			
37	Manufacture of electrical machinery, apparatus, appliances and supplies	59 138	5 504	53 634	10.8			
38	Manufacture of transport equipment	91 976	565	91 411	0.6			
39	Miscellaneous manufacturing industries	31 229	6 221	25 008	24.9			

Source: SIECA, Anexo Estadístico No. 75, Carta Informativa No. 80, June 1968.

/One of

One of the symptoms of decline is the fact that both the initial effects of the deviation of trade and the effects of complementarity agreements and economies of scale in existing plants have decreased with time and fallen into line with the conditions of an expanded market. It is probable that import substitution will have to meet greater requirements in terms of technology, management capacity and capital resources as more complex goods are manufactured or an attempt is made to modernize traditional activities.

One of the most serious factors in the decline is the lack of joint machinery to facilitate, promote and regulate the progress of an import substitution policy in new areas of general interest. And it is not only necessary to rationalize or increase the efficiency of production or the allocation of resources. The lack of suitable agreements may slow down or altogether stop the growth of intra-regional trade. In other words, it must be stressed that the intensification of the import substitution process within the scheme of integration of developing economies does not come about automatically and cannot be achieved exclusively through setting up protective barriers. A set of common rules and policies is also required which, in order to provide guarantees to investors, must eliminate or compensate for the natural elements of uncertainty implicit in a market made up of countries with differing interests, legislation and policies.

The Central American Common Market lacks suitable instruments in some fields, and although nominally it has instruments in other fields, these have not been used. The limited adherence to the system of industrial integration or the special system for the promotion of productive activities, quite apart from the fact that they could be replaced by improved machinery, has doubtless slowed down the installation of plants producing for the regional market, and may also have prejudiced the decisions of investors interested in diversifying the sector and in initiating the production of basic articles. Moreover, the delay in the drafting and approval of a protocol laying down standards for the so-called assembly industries has halted the import substitution of many products at the regional level, especially consumer durables. To complete the picture, it has been impossible to apply the agreement on fiscal incentives at the regional level for a variety of reasons, and this has led to distortions in the placement of investment, duplication of factories and the concession of exaggerated incentives to the detriment of government finances.

/Not even

Not even a wider range of traditional instruments, with more flexible machinery to speed up their implementation, would make it possible to solve all the problems involved. One such problem in particular, namely, the difference in the capacity of the Central American economies to take advantage of the impetus provided by the Common Market, would require specific provisions to guarantee an equitable distribution of benefits. Thus, in order to ensure the continued expansion of regional trade and to eliminate the obstacles to such trade, it will be necessary to establish co-ordinated programmes of industrial output, import substitution and specialized agricultural production, not to mention such important fields as the utilization of natural resources, or provisions to permit the expansion of the purchasing power of the poorer strata of the population. There is no denying that the Common Market has barely arrived at the initial stage of discussion and analysis of these problems and is far from achieving the necessary co-ordination of national plans and regional programmes proper.

At the same time, it must be recognized that the present situation is not due to defects inherent in the Common Market or to the lack of a desire to arrive at suitable decisions. In fact, the boom in regional trade, the difficulties caused by the relative recession in foreign markets, the need to administer the agreements in force, and the repercussions of the football war have necessitated the signing of agreements and the carrying out of real transformations at such a rate that it has been impossible to analyse and provide machinery for the most suitable solutions in the short time available.

Thus, a paradoxical situation arises: the very initial success of the Common Market has helped to solve some problems and at the same time has created others which must be solved if subsequent development and the voluntary participation of the members of the Common Market in this joint undertaking are to be ensured. It is therefore very important to deal with the question of balanced growth and the structural or economic difficulties that have proved a stumbling block to certain countries and which appear to be the principal causes of friction within the Common Market.

(iii) Aspects of balanced development among the countries. Apart from the fact that the countries shared a common historical and socio-cultural heritage, the main idea behind the integration programme was to overcome the limitations inherent in a market composed of small productive units which individually had little potential for economic growth. Far from attempting political consolidation, efforts were focused on achieving economic objectives that would provide a basis for gradual progress towards the formation of bonds of interdependence and development. Against this background, the objective of expanding national markets while promoting import substitution was, naturally enough, made conditional upon certain basic principles regarding the equitable distribution of the costs and benefits of integration. In both spirit and letter, the principal instruments ^{12/} lay down norms for ensuring reciprocity and mutual advantage as a means of safeguarding the complete and willing participation of each of the members of the Common Market. This does not mean that the benefits and costs are distributed equally among all the member countries - obviously, an impossible feat - but that each obtains a net surplus and that all are guaranteed similar opportunities for their future development.

For this reason, it is noteworthy that, although all the members have benefited in general terms, there remain sharp contrasts in their participation in the Common Market, and in the costs incurred and benefits received by each country. The trade flows show a high concentration of trade in two countries and more or less persistent imbalances in two others; some countries have borne the brunt of the process of regional industrialization and the rest have had more enjoyment of the effects of the expansion of investment and of their productive base.

These facts are sources of tension and have hampered the process of integration, but in all justice they cannot be attributed to supposedly inherent limitations in the process itself. It must be recognized that the

^{12/} This objective was also a factor in the establishment of the system of industrial integration, the uniform system of fiscal incentives, the monetary and payments arrangements and the preferential allocation of funds through the medium of the Central American Bank for Economic Integration.

available instruments and machinery are inadequate, and that additional measures are needed, such as a decisive resolve at the national level to make all efforts to narrow the existing gaps and, at the joint level, a more vigorous policy of compensatory investment and agricultural and industrial complementarity agreements. It should also be recognised that the absence of agreements on manpower or capital mobility aggravates the comparatively disadvantageous position of some countries. But this in no way alters the basic differences of structure. When the integration agreements were drawn up, the Central American economies, apart from considerable income disparities, showed serious differences of capacity to utilize the opportunities created by the expansion of the market. The availability of resources, entrepreneurs, plant and other similar factors in some countries facilitated the immediate expansion of production and exports to the rest of the region, while the productive and institutional systems prevailing in other countries prevented an equally rapid and flexible response. Nevertheless, in the long term, the access to regional markets made it possible to make progress in a very short time.^{13/}

The real origin of the disequilibria mentioned above is to be found, therefore, in the development conditions that originally prevailed in each economy, before the creation of the free-trade area, obviously. In 1960, the differences in annual per capita income fluctuated between 203 and 368 dollars; the markets varied in size from 13 to 37 per cent of the total market; similar discrepancies were observed in savings and investment; in some countries the industrial sector accounted for up to 16.2 per cent of the total value added, while the proportion was considerably less in others (see tables 19, 15 and 1, respectively). To claim, therefore, that in less than a decade it was possible to eliminate differences that were built up over many decades of economic isolation, would be tantamount to distorting the true historical perspective and the nature of the processes of transformation of productive structures.

^{13/} To support what at first sight may appear to be mere speculation, mention should be made of the relatively complex industrial projects that have been or are in process of being established in the less developed countries of the region (chemicals pulp and paper, fertilizers, metal articles, etc.) and of the improvement in the intra-regional payments position of Nicaragua, due largely to progress of this type.

Table 19

CENTRAL AMERICA: GROSS PER CAPITA DOMESTIC PRODUCT,
1960 AND 1970(Central American pesos at 1960 prices)

	1960	1970 ^{a/}	Average annual growth rate 1960-1970
Central America	257	330	2.5
Guatemala	270	336	2.2
El Salvador	226	289	2.5
Honduras	203	240	1.7
Nicaragua	250	356	3.6
Costa Rica	368	489	2.9

Source: ECLA, on the basis of official statistics.a/ Preliminary figures.

/This is

This is not to say that the integration process as a whole and also certain efforts at the national level have ceased to have a substantial impact on the transformation of productive structures in Central America. Throughout the 1960s - despite the slackening of tempo at the end of the decade - the growth rate of each of the countries was above 5 per cent a year. What is really significant, however, is that, more than being simply an acceleration of growth, this was accompanied by structural changes of some magnitude. In 1970, the changes in the origin of imports, and the establishment of new trade flows and interdependent relations represented transactions of a value close to 300 million dollars, whose effects were felt chiefly in manufacturing but also in the agricultural and services sectors. The share of the value added by manufacturing in the region's total economic activity moved from 12 to 16 per cent during the period 1960-1970 and in no country, including the relatively less developed countries, did this share rise by less than 3 per cent. Particularly worthy of note is the development of manufacturing in Nicaragua which, owing to the establishment in recent years of a number of plants to supply regional demand, has substantially changed both quantitatively and qualitatively, as is shown by the fact that manufacturing currently accounts for some 15.7 per cent of the gross domestic product, as opposed to less than 10 per cent ten years ago. This is substantial progress by any international yardstick, and it has taken place in differing degrees in other sectors of the Central American economies, such as agriculture, transport and communications, and the formation of basic social capital.

However, this description of the progress achieved in integration and the identification of the real structural roots of the problem of the balanced development of Central America should not cause other factors to be overlooked or lead to complacency or the adoption of a defeatist attitude. As will be mentioned later, in addition to the differences in capacity to take advantage of regional demand, the machinery of development has worked slowly and there has been a limited choice of instruments to moderate or correct the imbalances that began to make themselves felt

/after the

after the signing of the General Treaty. For the above reasons, it would certainly have been difficult to impose a different course on the integration programme, and yet, by proceeding in this manner, intra-regional disequilibria were allowed to get worse.

Nor was it seen with sufficient clarity that the crucial problems experienced by some countries - in the field of external payments, public finance or intra-regional trade -, far from being confined to individual economies, would affect the whole Common Market after a time and would call for joint solutions, since the situation could not be improved as long as a complete economic unit was not created.

Similarly, in national policies there have been divergent patterns in the allocation of resources which have helped to intensify the apparent regional disequilibria. Indeed, faced with the dilemma of having to choose between producing more for the Common Market or more for traditional exports, the countries adopted a variety of measures that subsequently led to a greater or lesser degree of participation in intra-regional trade flows, measures involving an opportunity cost that should not, in principle, give rise to unjustified complaints at a later stage.

Obviously, the prospects for the individual or collective development of the Central American countries are limited in a world where very large markets are required to meet the demands of the technological revolution and modern scales of production, for which reason nearly all such prospects depend on the possibility of increasing - and in no case decreasing - multilateral co-operation links.

The lack of political and economic action to solve the above problems and to channel, energize and speed up the adoption of new agreements and more far-reaching programmes that are required, may paralyse the growth and improvement of regional unity, and favour the proliferation of unilateral measures which, as has been shown, jeopardize the progress that has been made and further weaken intra-area trade.

4. The status of the integration programme before the hostilities

As has been noted earlier, during the first half of the 1960s the Central American countries experienced a period of rapid growth, stimulated to a large extent by the integration process. The regional domestic product grew at an average annual rate of 6.3 per cent and intra-area expanded by 33.1 per cent annually. During the second half of the 1960s the growth of external demand slackened off while at the same time there was tension and conflict within the Common Market which led to a substantial decline in the over-all level of economic activity.

Although the situation was satisfactory up to 1965, distortions were gradually becoming apparent - and this is a point that must be stressed - in the balance of payments, public sector financing, balanced development and intra-area trade. These problems checked the steady growth of trade among the members of the Common Market, initially for short periods and later in more permanent fashion, and also led to the adoption of unilateral measures, to delays in the ratification or deposit of instruments of accession to regional agreements, and, after the hostilities, to the temporary suspension of the activities of the organs of the General Treaty.

The Governments repeatedly endeavoured to place the Common Market on a sounder footing and sought ways and means of overcoming the difficulties encountered and their harmful effects. With a view to expanding the scope of the regional co-ordination machinery and establishing joint guidelines for action extending beyond the confines of trade, meetings were organized of the Ministers of Economic Affairs, Finance, Agriculture and Public Works, and Presidents of Central Banks and heads of planning offices.^{14/} Nevertheless, because of the variety and pressing nature of all the many problems, tensions arose that could not be completely allayed, not because no suitable solutions existed, but because the regional machinery that would have implemented them could not cope with all the tasks it was obliged to undertake.

^{14/} See reports of the joint meetings of Ministers of Economic Affairs with Ministers of Agriculture (no symbol), Public Works (SIECA/MEOP-I/2), Finance (SIECA/RMEH-1) and heads of planning offices (SIECA/REDIP-I and SIECA/REDIP-II/2), and the records of the four joint meetings of the Economic Council, the Monetary Council, and Ministers of Finance.

Certain interesting conclusions can be derived from the experience described in the following sections. It is clear that joint measures are superior to those that had to be or were adopted unilaterally. Apart from the fact that they carry more weight, decisions with regional backing help to retain the advantages of the integration process, while unilateral decisions may jeopardize these advantages and may even lead to retrograde steps that harm the development of the Central American countries, both individually and collectively.

This confirms, of course, that the regional machinery is slow to react to emergency situations. It is noticeable that several years elapse between the submission of the first complaint and the adoption of specific measures to deal with it, marked by a history of friction that is caused precisely by the delay (see table 20).

It is worth considering another aspect of the method and scope of the decisions taken so far. The approach has remained pragmatic, in that no attention has been devoted to problems until they arise. While this may have been a useful approach when the Common Market first entered into operation, because it meant that efforts could be concentrated on priority issues, it is now no longer appropriate because the complexity of the integration process demands that thought be given to problems that may arise over the medium and long term.

The over-all picture shows the effect of a number of vicious circles that it has not been possible to overcome, despite all the efforts made so far. It has been seen that the key problems of certain countries could not be tackled on the basis of flexible arrangements of regional scope. The result was the promotion of unilateral formulas that, in addition to interfering with the operation of the integration programme, in several cases actually moved strictly national issues to the plane of the Common Market. Furthermore, the inflexibility and slowness of the regional decision-making machinery is in part a reflection of the lack of a long-term view of the opportunities of development connected with perfecting the Common Market and anticipating the tensions that are inevitably involved in modernizing and changing inadequate structures. This is to some extent explainable because of the disparity between the scale of State responsibilities and the volume of resources available for fulfilling them.

Table 20

CENTRAL AMERICA: MULTILATERAL ECONOMIC INTEGRATION AGREEMENTS

(As of 31 January 1971)

Title of instrument	Date signed	Date instruments of ratification deposited by	
		Third country	Fifth country
Regional Agreement on the Temporary Importation of Road Vehicles	Nov. 56	Dec. 57	Jan. 68
Multilateral Treaty on Free Trade and Central American Economic Integration	Jun. 58	Jun. 59	Sep. 63
Agreement on the Régime for Central American Integration Industries	Jun. 58	Jun. 59	Sep. 63
Central American Agreement on Road Traffic	Jun. 58	Nov. 59	Sep. 63
Central American Agreement on Uniform Road Signs and Signals	Jun. 58	Nov. 59	Oct. 63
Central American Agreement on Equalization of Import Duties and Charges	Sep. 59	Jun. 60	Sep. 63
Treaty on Economic Association signed between Guatemala, El Salvador and Honduras	Feb. 60	Apr. 60	Apr. 60
General Treaty on Central American Economic Integration	Dec. 60	May 61	Sep. 63
Protocol to the Central American Agreement on Equalization of Import Duties and Charges (Managua Protocol)	Dec. 60	May 61	Sep. 63
Agreement Establishing the Central American Bank for Economic Integration	Dec. 60	May 61	Sep. 63
Central American Agreement on Fiscal Incentives to Industrial Development	Jul. 62	Feb. 64	Mar. 69
Protocol of Accession of Costa Rica to the Managua Protocol on Equalization of Import Duties and Charges	Jul. 62	Dec. 63	Aug. 65
Protocol to the Central American Agreement on Equalization of Import Duties and Charges (San José Protocol)	Jul. 62	Apr. 64	Mar. 65
Protocol to the General Treaty on Central American Economic Integration	Nov. 62	Oct. 63	Jun. 64
Protocol to the Central American Agreement on Equalization of Import Duties and Charges (First San Salvador Protocol)	Jan. 63	Oct. 64	Aug. 65

/Table 20 (cont.)

Table 20 (continued)

Title of instrument	Date signed	Date instruments of ratification deposited by	
		Third country	Fifth country
Protocol to the Agreement on the Regime for Central American Integration Industries	Jan. 63	Feb. 65	
Charter of ODECA	Dec. 62	Aug. 63	Mar. 65
Uniform Central American Customs Code (CAUCA)	Dec. 63	Jan. 65	
Protocol to the Central American Agreement on Equalization of Import Duties and Charges	Aug. 64	Apr. 67	
Special Agreement on Equalization of Import Duties and Charges in respect of Rayon Textiles and Other Man-made or Synthetic Fibres	Feb. 65	Jan. 68	Jul. 68
Special Protocol on Grains (Limón Protocol)	Oct. 65	Oct. 67	Feb. 68
Protocol on the Central American Agreement on Equalization of Import Duties and Charges (Second San Salvador Protocol)	Nov. 65	Oct. 67	
Protocol to the Agreement on Central American Integration Industries (Second Protocol)	Nov. 65	Jan. 68	Mar. 69
Treaty on Telecommunications between Nicaragua, El Salvador, Guatemala and Honduras	Apr. 66	Nov. 66	
Protocol to the Central American Agreement on Fiscal Incentives to Industrial Development (Protocol on Special Treatment for Honduras)	Sep. 66	Oct. 68	Mar. 69
(Third) Protocol to the General Treaty on Central American Economic Integration (Free trade in paper and glass containers between Nicaragua and the other members)	Oct. 66	May 68	
Protocol to the Central American Agreement on Equalization of Import Duties and Charges and to the Agreement on the Régime for Central American Integration Industries (Special system for productive activities) (Second Managua Protocol)	Nov. 67	Oct. 68	Mar. 69
Protocol to the General Treaty on Central American Economic Integration (Emergency measures to protect the balance of payments)	June 68	Oct. 68	Aug. 70

/Table 20 (concl.)

Table 20 (concl.)

Title of instrument	Date signed	Date instruments of ratification deposited by	
		Third country	Fifth country
Central American Agreement for the Protection of Industrial Property	Jun, 68		

Source: ECIA, on the basis of data from the secretariat of the Organization of Central American States (ODECA).

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In the context of the present study, it appears clear that the amount of technical staff and financial resources employed in systematically exploring the development options open to each country and formulating policies ranging beyond the confines of immediate economic problems is still inadequate; moreover, in some cases there have been shortcomings in systems for formulating plans and projects and supplying information. Virtually no studies exist examining the significance of integration as it relates to the economic future of each country or assessing integration within the context of national development strategy. Hence, when emergencies arise, it is not surprising that the short-term approach prevails, and this makes it difficult to place the problems of transforming the traditional pattern of development within a more realistic and less immediate context.

(a) The principal problems encountered

With respect to the question of balanced development, the Government of Honduras repeatedly stated from 1964 onwards that Honduras was not receiving benefits comparable to those enjoyed by other members of the Common Market. It was referring specifically to reciprocal trade flows and to the distribution of investment and productive activities within the region. It also pointed out that although integration had stimulated remarkable progress, its effects in Honduras had been less strong than elsewhere with the result that the gap between the Honduran economy and those of the other members had widened.

The points raised by the Government of Honduras were studied and discussed at length. At the end of 1966, the Central American Economic Council - on the basis of recommendations made by the Economic Co-operation Committee and the ECLA secretariat - ^{15/} approved the establishment of preferential treatment for Honduras. In order to promote industrial development, it was agreed that there should be a special protocol according Honduras fiscal incentives more generous than those approved for the other members, and that, after suitable technical studies, Honduras should be

^{15/} See ECLA, El crecimiento económico de Honduras y el desarrollo equilibrado en la integración centroamericana (E/CN.12/CCE/IX/DT.1), and Evaluación de la integración centroamericana, op. cit.

assigned a number of integration industries in accordance with the provisions of the Regime for Integration Industries. It was further agreed that the BCIE should give priority in its operations to projects of interest for Honduras, and that regional agencies (SIECA, ICAITI and ESAPAC) and international agencies should be requested to give preference to Honduras as regards technical assistance, especially with respect to the preparation and implementation of specific investment projects.

At the time, these measures appeared to be adequate, but subsequently in practice they were found to be inadequate owing to disequilibria in Honduras' trade balance with the interest of the region and other factors. The Agreement on Fiscal Incentives to Industrial Development and its Protocol did not enter into force until 1969 and the uniform regulations for its application have still not been approved. Furthermore, the preparation of technical studies on specific industries - the steel fertilizer, polyvinyl, nylon yarn and filament, pulp and paper industries - was delayed for various reasons, added to which there was competition from projects sponsored by other countries. Genuine progress was achieved only with respect to the infrastructure and financing.

Disequilibria in the balance of payments and government finances which had begun to be a matter for concern from 1965 onwards, prompted the first joint meeting of Ministers of Economic Affairs and Finance at which it was agreed to implement co-ordinated measures to restrict imports from third countries, but it was not possible to put these measures into effect immediately.

By early 1967, the balance-of-payments situation of Costa Rica had become critical. Small harvests and the drop in prices for its major exports had swelled the current account deficit and reduced its reserves considerably. It was estimated that the inflow of external credit would barely cover external debt servicing payments which were soaring, partly because of extraordinary expenditure incurred as a result of earlier natural disasters (1963-1965). Because of this and other factors, the Government was in an extremely delicate financial position: the fiscal deficit had doubled between 1965 and 1967, current saving was a negative balance and the resources available, including credit, barely covered its commitments.

Nicaragua's situation has been roughly similar, although complicated by growing imbalances in intra-area trade. The current-account deficit in the balance of payments with countries outside the region virtually trebled between 1965 and 1967, while the deficit on intra-area trade rose from 12 to 24 million dollars. Furthermore, the government accounts showed increasing disequilibrium. Central government saving virtually disappeared while government finances moved from a surplus position to one of rising deficit, making it necessary to impose very restrictive measures even at the risk of lowering the over-all growth rate.

Although Costa Rica and Nicaragua tackled their problems in different ways, a common denominator was the adoption of positions and measures that affected or might have affected the normal operation of the Common Market. At the same time, moreover, as these events occurred - which were prompted in part by the delay in implementing joint measures and by a failure to understand the regional implications of joint agreements - Costa Rica decided, inter alia, to place restrictions on the use of foreign exchange. At the beginning of 1967, the first joint meeting of the Economic Council and the Monetary Council was held to discuss these measures with a view to ensuring that they did not affect trade within the Common Market and the regional system for the clearing of payments, and a number of agreements were reached which exempted trade originating in the area from all restrictions and laid down guidelines for the establishment of machinery to co-ordinate policies at the Central American level.

Nicaragua initially raised the question of applying the principle of balanced development, owing to the increasing deficit in its trade balance with the other members, and thereafter was obliged to take a number of measures to reduce imports and cut back government spending.

During the following two years, as a result of Costa Rica and Nicaragua's problems, added to the steady decline in the balance of payments the Central American agencies held a number of meetings culminating in the

/signature of

signature of the San José Protocol in 1968, the aim of which was to provide a uniform basis for protecting the balance-of-payments and increasing public revenue. The Protocol, however, did not enter into force until March 1969.^{16/}

The Central American Governments also held a large number of meetings to deal with specific problems hampering the operation of the Common Market, with the advisory assistance of the integration agencies. These meetings brought substantial improvements in the administration of intra-area trade, helped to overcome the crisis caused by unilateral measures, and promoted the ratification and deposit of outstanding instruments (see table 20).^{17/} Work also proceeded on the preparation of uniform regulations for the Central American Agreement on Fiscal Incentives to Industrial Development, the development of machinery to expand the resources and operations of the BCIE, and measures to expand the links between the Common Market and third countries or groups of countries.

(b) Formulation of the immediate action plan

On the basis of the work done on various aspects of economic integration and the problems of the Common Market, the Central American Governments adopted an immediate action plan, which is contained in resolution 54 of the Central American Economic Council, approved in March 1969. The programme was designed not only to eliminate the difficulties that had arisen within the Common Market or were inherent in the economic structure of the individual countries, but also to establish policy guidelines to facilitate the integration process. The main measures related to the establishment of a customs union and the co-ordination and harmonization of national policies regarding monetary matters, industry, agriculture and the infrastructure; the creation of a regional capital

^{16/} The San José Protocol provides for levying a 30 per cent surcharge on the duties on imports from third countries, including imports by enterprises granted exemptions from taxation. It also provides that, at the discretion of Governments, national consumption taxes should be established on two lists of non-essential goods without it being necessary to engage in the ratification procedure laid down in regional agreements.

^{17/} For more details, see records 22-27 of the Central American Economic Council and records 25-39 of the Executive Council of the General Treaty.

market; the improvement of economic relations with countries outside the region; and the preparation of studies to define the scale and characteristics of the geographical distribution of the Central American population.

Customs union was considered to be a fundamental requirement for improving the geographical coverage of the Common Market since it would permit the free movement of goods irrespective of origin. It was thought that it would help to solve economic and fiscal problems relating to the restructuring of links with third countries, the reorganization of customs revenue and the streamlining of transport and distribution systems. In view of the scale of the changes required, the Governments decided to proceed to customs union in stages, the first stage consisting of research and basic studies to evaluate its economic implications and determine how to organize, collect and distribute the fiscal revenue under the customs union. These studies would provide the basis for the conclusion of the appropriate agreements.

The immediate action programme includes a number of specific measures for the harmonization of economic policy designed to strengthen the bonds of economic interdependence by promoting regional industrial and agricultural activities. It was agreed to revise policies governing exemption from taxation, to reduce the social cost of industrialization, to adapt the existing customs tariff to the needs of development, and to intensify efforts to implement the regional instruments for the promotion of manufacturing. Furthermore, machinery was established to make industry and agriculture more closely integrated and to improve the regulations governing trade in basic agricultural commodities, and it was agreed to set up a regional price stabilization fund.

In this connexion, and with a view to facilitating the co-ordination of national production plans and preventing imbalances in the distribution of investment in the region, the Governments undertook to implement a series of projects for the harmonization of domestic consumption and sales taxes, and at a later stage to harmonize taxes on company dividends and profits.

/As regards

As regards financial and monetary policy, apart from stressing that a monetary union should be established as soon as possible, it was decided to promote the creation of a regional stabilization fund, speed up studies on the establishment of a capital market, and support the BCIE in its programmes to expand and diversify its sources of external resources.

It was further decided to initiate studies on the scale and characteristics of demographic problems relating to the geographical distribution of the population.

Special arrangements were made regarding economic relations with countries outside the region, notably the formulation of a common external policy to protect traditional exports, the elimination of restrictions, the expansion of quotas and price stabilization. Efforts were also made to secure more equitable treatment from the shipping conferences, to curb rises in freight rates, and to reduce the weight of transfers in respect of invisibles in the balance of payments.

On the basis of this plan, the Governments and regional agencies set in motion a number of measures, but as a result of the hostilities in mid-1969 they had to be suspended and some of the integration agencies found themselves obliged to deal with other matters in addition to their standing work programmes.

5. Impact of the hostilities on the integration programme

The hostilities between El Salvador and Honduras have had a profound impact on the functioning and prospects of the Central American integration process. Apart from all the human tragedy and the economic damage caused, they have had the effect of changing the order of priorities laid down by Governments and have created doubt as to when and how the integration process can be stepped up, and even whether this is possible. Responsibilities for the critical stage through which the Central American Common Market is passing cannot, however, be laid exclusively at the door of the hostilities. In the integration programme and also in the promotion of changes within countries, a great deal of work still remains undone, and this has added to the tension.

Although the hostilities have opened a breach that may lead to the weakening or dissolution of the economic ties joining the Central American countries, it may be that they have also shown up more clearly the advantages of continuing as an economic unit, as opposed to facing the difficulties involved in development on a purely national scale.

In 1969 and 1970 the growth rate of income fell in virtually all sectors in each country and in the region as a whole, most probably owing to the partial interruption, disruption and readjustment of intra-area trade (see table 15). The countries that felt the impact most keenly were, naturally enough, El Salvador and Honduras, which suspended reciprocal trade indefinitely and ceased to benefit from each other's productive apparatus which was essentially complementary. Despite all their efforts to compensate for this by diverting output to the domestic market or to other countries both inside and outside the region, both have had problems with the accumulation of surpluses, unemployment and internal disruptions. The unfavourable prospects for the future have certainly been the cause of the stagnation of investment and, what is more serious, the possible diversion of investment to purely national projects or to other members of the Common Market. Furthermore, national programmes to replace agricultural imports produced in the region have been growing and are now beginning to cover certain manufactures, to the detriment of economic complementarity and relations of interdependence among the countries of the region.

/The hostilities

The hostilities also had an adverse effect on other Central American countries because not only was there a decline in demand from El Salvador and Honduras and a rearrangement of intra-area trade flows, but there were also the inevitable disruptions in road haulage of goods and uncertainty about what might happen eventually to production for the Common Market and to the new investment projects just starting up. Temporary relief may have been provided by a slight increase in intra-area exports within the Common Market to replace items formerly supplied by El Salvador and Honduras.

Although the economic impact of the hostilities was undoubtedly important, their impact on the legal and institutional framework of integration was even more serious. The organization of the Common Market has been put to its severest test, apart from the fact that some of its basic statutes have been temporarily suspended.

First priority was given to the cessation of hostilities, and then a great deal of work was done to design a modus operandi that would guarantee the continued operation of the Common Market in the current situation and ensure that all members were willing to continue with the joint programmes. Although this stage has not yet been completed, and partly because of this some countries have been obliged to take unilateral measures, activities and negotiations are continuing with a view to defining a common area of agreement that will return matters as far as possible to normal in the Common Market and lead eventually to major reforms to solve the basic problems of integrated development.

(a) Some economic consequences

(i) Intra-area trade. The terms of intra-area trade have suffered most directly from the hostilities between Honduras and El Salvador. For the first time since the conclusion of the General Agreement, trade lost its impetus and contracted in absolute terms. Moreover, the structure of intra-area trade changed substantially (see tables 21-25).

The value of trade within the Common Market in 1969 was only 248.9 million dollars, a drop of 3.6 per cent over the figure for 1968 (see table 17).

Table 21

GUATEMALA: TRADE BALANCE WITH OTHER CENTRAL AMERICAN COUNTRIES, 1963-1970

(Million of Central American pesos)

	1963	1964	1965	1966	1967	1968	1969 ^{a/}	1970 ^{b/}	January- October 1970 ^{a/}
<u>Regional balance</u>	<u>6.5</u>	<u>3.4</u>	<u>7.4</u>	<u>21.7</u>	<u>23.8</u>	<u>28.5</u>	<u>35.1</u>	<u>49.2</u>	<u>33.7</u>
<u>Exports</u>	<u>20.7</u>	<u>29.7</u>	<u>38.9</u>	<u>55.9</u>	<u>65.6</u>	<u>77.9</u>	<u>86.5</u>	<u>114.8</u>	<u>85.9</u>
El Salvador	12.6	16.3	18.5	27.3	29.9	34.8	38.2	47.4	33.7
Honduras	4.6	5.8	8.7	10.6	11.7	14.2	17.8	26.0	23.1
Nicaragua	2.9	4.8	6.4	8.9	12.7	13.0	12.9	17.3	12.4
Costa Rica	0.6	2.8	5.3	9.1	11.3	15.9	17.6	24.1	16.7
<u>Imports</u>	<u>14.2</u>	<u>26.3</u>	<u>31.5</u>	<u>34.2</u>	<u>41.8</u>	<u>49.4</u>	<u>51.4</u>	<u>65.6</u>	<u>52.2</u>
El Salvador	11.5	19.1	22.4	23.9	29.1	30.8	33.3	42.6	32.8
Honduras	2.0	3.6	3.8	3.9	5.4	7.1	6.0	6.6	5.3
Nicaragua	0.2	0.8	1.4	2.1	2.1	3.5	4.6	7.0	6.1
Costa Rica	0.4	2.8	3.9	4.3	5.2	8.0	7.5	9.4	8.0

Source: SIECA, on the basis of official statistics.

a/ Preliminary figures.

b/ Estimates.

/Table 22

Table 22

EL SALVADOR: TRADE BALANCE WITH OTHER CENTRAL AMERICAN COUNTRIES, 1963-1970

(Millions of Central American pesos)

	1963	1964	1965	1966	1967	1968	1969 ^{a/}	1970 ^{b/}	Jan-Oct 1970 ^{a/}
<u>Regional balance</u>	<u>-4.0</u>	<u>-4.3</u>	<u>3.7</u>	<u>5.6</u>	<u>20.4</u>	<u>19.0</u>	<u>15.6</u>	<u>11.4</u>	<u>11.4</u>
<u>Exports</u>	<u>23.2</u>	<u>34.2</u>	<u>46.1</u>	<u>57.5</u>	<u>74.2</u>	<u>84.7</u>	<u>72.8</u>	<u>76.8</u>	<u>61.1</u>
Guatemala	11.5	19.1	22.5	23.9	29.1	30.7	33.3	42.6	32.8
Honduras	7.9	8.9	12.3	15.9	19.9	22.9	12.4	0.4	0.0
Nicaragua	2.2	3.9	6.5	10.0	13.6	14.9	11.9	14.5	12.5
Costa Rica	2.3	3.0	4.8	7.7	12.3	16.2	14.2	19.3	15.8
<u>Imports</u>	<u>27.2</u>	<u>39.2</u>	<u>42.4</u>	<u>51.9</u>	<u>54.5</u>	<u>65.7</u>	<u>60.2</u>	<u>65.4</u>	<u>49.7</u>
Guatemala	12.6	16.3	18.5	27.2	30.0	34.8	38.2	47.4	39.6
Honduras	10.8	13.0	15.7	13.3	12.4	14.8	7.3	0.0	0.0
Nicaragua	2.4	2.7	3.1	5.5	5.3	7.1	6.2	8.4	7.2
Costa Rica	2.1	7.2	5.1	5.9	6.8	9.0	8.5	2.6	3.9

Source: SIECA, on the basis of official statistics.

a/ Preliminary figures.

b/ Estimates.

Table 23

HONDURAS: TRADE BALANCE WITH OTHER CENTRAL AMERICAN COUNTRIES, 1963-1970

(Millions of Central American pesos)

	1963	1964	1965	1966	1967	1968	1969 ^{a/}	1970 ^{b/}	Jan-Oct 1970 ^{a/}
<u>Regional balance</u>	<u>-0.1</u>	<u>0.3</u>	<u>-4.2</u>	<u>-13.7</u>	<u>-17.2</u>	<u>-17.0</u>	<u>-20.2</u>	<u>-21.8</u>	<u>-30.4</u>
<u>Exports</u>	<u>13.2</u>	<u>18.3</u>	<u>22.1</u>	<u>21.5</u>	<u>23.5</u>	<u>31.4</u>	<u>23.8</u>	<u>23.1</u>	<u>14.5</u>
Guatemala	2.0	3.6	3.8	4.0	5.4	7.1	6.0	6.6	5.4
El Salvador	10.8	13.0	15.6	13.3	12.4	14.8	7.3	0.0	0.0
Nicaragua	0.2	0.9	1.3	2.2	2.5	4.1	4.7	7.8	3.9
Costa Rica	0.2	0.8	1.4	2.0	3.2	5.4	5.8	8.7	5.2
<u>Imports</u>	<u>13.3</u>	<u>18.0</u>	<u>26.3</u>	<u>35.2</u>	<u>40.7</u>	<u>48.4</u>	<u>44.0</u>	<u>44.2</u>	<u>44.2</u>
Guatemala	4.6	5.8	8.7	10.6	11.7	14.2	17.8	26.0	23.1
El Salvador	7.9	9.0	12.3	16.0	19.8	22.9	12.4	0.4	0.0
Nicaragua	0.5	1.5	2.3	3.3	3.8	4.8	6.4	9.1	11.7
Costa Rica	0.3	1.7	3.0	5.3	5.4	6.5	7.4	9.4	10.1

Source: SIECA, on the basis of official statistics.

a/ Preliminary figures.

b/ Estimates.

/Table 24

Table 24

NICARAGUA: TRADE BALANCE WITH OTHER CENTRAL AMERICAN COUNTRIES, 1963-1970
(Millions of Central American pesos)

	1963	1964	1965	1966	1967	1968	1969 ^{a/}	1970 ^{b/}	January- October 1970 ^{a/}
<u>Regional balance</u>	<u>-2.9</u>	<u>-6.3</u>	<u>-10.9</u>	<u>-16.4</u>	<u>-23.8</u>	<u>-18.7</u>	<u>-11.4</u>	<u>-12.5</u>	<u>2.3</u>
<u>Exports</u>	<u>4.0</u>	<u>7.0</u>	<u>10.1</u>	<u>15.3</u>	<u>18.6</u>	<u>27.5</u>	<u>30.8</u>	<u>44.1</u>	<u>42.5</u>
Guatemala	0.2	0.8	1.4	2.1	2.1	3.5	4.6	7.0	6.1
El Salvador	2.4	2.7	3.2	5.5	5.3	7.1	6.2	8.4	7.2
Honduras	0.5	1.5	2.3	3.3	3.8	4.8	6.4	9.1	11.7
Costa Rica	0.9	2.0	3.2	4.4	7.4	12.1	13.6	19.6	17.5
<u>Imports</u>	<u>6.9</u>	<u>13.3</u>	<u>21.0</u>	<u>31.7</u>	<u>42.4</u>	<u>46.2</u>	<u>42.2</u>	<u>56.6</u>	<u>40.2</u>
Guatemala	2.9	4.8	6.4	8.9	12.6	13.0	12.9	17.3	12.4
El Salvador	2.2	3.9	6.5	10.0	13.6	14.9	11.9	14.5	12.4
Honduras	0.2	1.0	1.3	2.2	2.5	4.1	4.7	7.8	3.9
Costa Rica	1.6	3.6	6.8	10.6	13.7	14.2	12.7	17.0	11.5

Source: SIECA, on the basis of official statistics.

^{a/} Preliminary figures.

^{b/} Estimates.

Table 25

COSTA RICA: TRADE BALANCE WITH OTHER CENTRAL AMERICAN COUNTRIES, 1963-1970

(Millions of Central American pesos)

	1963	1964	1965	1966	1967	1968	1969 ^{a/}	1970 ^{b/}	January- October 1970 ^{a/}
<u>Regional balance</u>	<u>0.3</u>	<u>6.7</u>	<u>4.2</u>	<u>2.9</u>	<u>-3.2</u>	<u>-11.8</u>	<u>-15.1</u>	<u>-26.3</u>	<u>-16.9</u>
<u>Exports</u>	<u>4.3</u>	<u>15.3</u>	<u>18.9</u>	<u>26.1</u>	<u>31.0</u>	<u>37.7</u>	<u>36.1</u>	<u>45.4</u>	<u>38.4</u>
Guatemala	0.4	2.8	3.9	4.3	5.2	8.0	7.5	9.4	7.9
El Salvador	2.1	7.2	5.1	5.9	6.8	9.0	8.5	9.6	8.9
Honduras	0.3	1.7	3.0	5.3	5.4	6.5	7.4	9.4	10.1
Nicaragua	1.5	3.6	6.9	10.6	13.6	14.2	12.7	17.0	11.5
<u>Imports</u>	<u>4.0</u>	<u>8.6</u>	<u>14.7</u>	<u>23.2</u>	<u>34.2</u>	<u>49.5</u>	<u>51.2</u>	<u>71.7</u>	<u>55.3</u>
Guatemala	0.6	2.8	5.3	9.1	11.3	15.9	17.6	24.1	16.7
El Salvador	2.3	3.0	4.8	7.7	12.3	16.2	14.2	19.3	15.8
Honduras	0.2	0.8	1.4	2.0	3.2	5.4	5.8	8.7	5.3
Nicaragua	0.9	2.0	3.2	4.4	7.4	12.0	13.6	19.6	17.5

Source: SIECA, on the basis of official statistics.

a/ Preliminary figures.

b/ Estimates.

/Exports by

Exports by El Salvador and Honduras to the other Common Market members, which experienced the largest fall, contracted by between 40 and 50 per cent in the second half of 1969 as compared with 1968, almost halving El Salvador's normal surplus and bringing Honduras's deficit to over 20 million dollars. In other words, the cutback in imports from the Common Market countries did not offset drastic decline in exports to those countries. Of greater importance than this setback in the trade figures were the perhaps irreversible consequences of the policies followed by both countries to make up for the interruption in reciprocal trade, because the measures taken to replace basic grains in El Salvador and light manufactures in Honduras may over the long term have an adverse effect on the complementarity of the two economies.

Trade by Guatemala and Nicaragua continued to increase in volume; as a result of the situation in Honduras and El Salvador they gained markets and reduced imports, which brought substantial improvements in their balance-of-payments position vis-à-vis the Common Market.

Costa Rica is a special case. Partly because of the slackening off of the growth of demand in Central America and also because of restrictions imposed in early 1969 by Nicaragua - its major export market - its exports to the Common Market slightly declined in absolute terms. This may also have been due to the problems of transporting goods and to the distribution of recent investment which had been concentrated in projects for trade with countries outside the region rather than with Common Market members. As a result of all this and of the expansion of imports, Costa Rica's trade deficit with the Common Market rose to 15 million dollars in 1969 and an estimated 26 million dollars or more in 1970.

During 1970, the trends described above continued. The balance-of-payments position of Honduras and El Salvador deteriorated and that of Guatemala and Nicaragua improved. The total value of Common Market trade however, recovered somewhat and provisional estimates place it at between 290 and 305 million dollars, although the rate of growth is still below that of earlier years (see table 17).

/Looking now

Looking now at the Common Market as a whole and ignoring differences in individual countries, it may be concluded that the temporary closure of frontiers and the obstacles hampering the free movement of goods considerably affected the trends of intra-area trade. Preliminary estimates by SIECA indicate that 45 million dollars worth of trade was cancelled in 1969 and close to 30 million in 1970.^{18/}

The contraction of trade would probably have been even greater but for the adoption in 1968 of a series of national and regional measures to protect the balance of payments and internal economic activity. The San José Protocol, by raising tariffs and domestic taxes on a fairly extensive range of consumer goods, restricted and diverted a number of imports from third countries, and at the same time had favourable consequences internally because by increasing fiscal revenue it helped -- albeit in modest fashion -- to cover government expenditure. Virtually all countries, in varying degrees, had placed restrictions on imports from outside the area, thus creating incentives for the expansion of imports from within the area and import substitution.

Furthermore, the increase in the prices for some of the major exports and the expansion of domestic demand had favourable effects and made it possible to hold growth rates at the 1968-1969 level and also alleviate some of the tension evident within the Common Market.

The serious disruptions of the past two years appear to have had their most damaging effects already, but they will remain a source of uncertainty and friction until suitable agreements are arrived at. Trade between Honduras and El Salvador is still suspended and there are no signs that it will be resumed in the near future. Intra-area trade as a whole recovered somewhat in 1970 but it may again take a downturn in 1971 as a result of recent events. The fact that it was impossible to conclude a series of multinational agreements at the end of 1970, and the measures taken by Honduras to protect its balance of payments which have

^{18/} See Situación actual del comercio entre los países centroamericanos y sus perspectivas a corto plazo (Nota de la Secretaría) (SIECA/CT-REMECA-III/D.17) (Guatemala, 22 August 1970).

an impact on area trade, may further worsen the situation and make necessary yet another rearrangement of intra-area trade that would have even more serious effects because it would take place within a smaller market.

If the countries refuse to be flexible, this new rearrangement of trade flows might easily cause major problems because of competition from other markets, surplus supply and in general comparatively greater imbalances within the area. It would also tend towards the elimination - either gradually or all at once - of multilateral trade agreements and their replacement - as has been talked about in several countries - with bilateral agreements. Obviously, this sequence of events is not the only possibility and it is to be hoped that it is not the most likely.

(ii) Intra-area transport. Another of the sectors severely affected by the obstacles to trade has been the transport of goods and road and rail transport development in Central America. In this respect, it should be recalled that most Common Market trade is carried by road,^{19/} and that - had past trends continued - the gross income of road haulage would have been slightly more than 8 million dollars higher than it was in 1969 and 1970.

On the basis of the 1968 figures and earlier trends it is estimated that more than half of the freight moved between the Central American countries was adversely affected - in differing degrees - by these problems. Virtually all the normal trade flows from El Salvador and Honduras to Nicaragua and Costa Rica were severely disrupted, and there were similar although less severe effects on the movement of freight from Guatemala to Honduras and the other countries in the south of the area.

^{19/} In 1965, 78.4 per cent of intra-area trade was carried by road and some 20 per cent by sea, the amounts carried by air or by railway being negligible. Subsequently, the tonnage of fuels and lubricants carried - normally by sea - fell off owing to the establishment of a number of refineries. At present virtually all intra-area trade is transported by road, except for a small amount carried in recent years by ferry.

The partial or temporary interruption of road transport checked the flow of intra-area trade and also brought considerable increases in transport costs. Together with the inevitable disorganizations of established systems, and the fact that no regular services were available for moving freight by other means, a coastal shipping service had to be improvised. Fragmentary data indicate that the freight rates for goods which countries were obliged to move by launch or ferry rose by between 1.5 and 2 times (see table 26).^{20/} Moreover, there were also disruptions owing to the changes that had to be made in customs procedures and methods of packing and dispatching goods.

Programmes to improve regional road transport services and the highway system suffered delays and in some cases were modified. In this connexion, it should be noted that the highway construction and improvement programme agreed upon in 1963 which covered thirteen trunk roads has been implemented in only five, while some of the resources have been diverted to projects of national scope.

Justifiable concern has been aroused as a result of the problems caused by the fact that the Common Market depends virtually exclusively on a single means of moving freight, which, moreover, was especially affected owing to the geographical location of the hostilities. Accordingly, several countries have initiated studies to identify alternative means of transport based on coastal shipping which, in addition to complementing land-based services, would make for competition beneficial to both shippers and consumers.

^{20/} The movement of lorries by ferry between El Salvador and Nicaragua has been experiencing some difficulties. Up to March 1970 there was only one barge making the crossing Cutuco-Potosí in up to twenty-four hours, with a freight rate of approximately 24 dollars per ton.

Table 26

CENTRAL AMERICA: FREIGHT RATE FOR REGIONAL TRADE,
1968 AND 1970

(Central American pesos per ton)

	1968 ^{a/}	1970 ^{b/}
San Salvador-Managua	21	41
San Salvador-San José	34	53
Guatemala-Managua	29	51
Guatemala-San José	39	61

Source: ECLA, on the basis of official statistics.

a/ Average rate for overland transport.

b/ Average rate for maritime transport, including overland access.

/(b) Legal

(b) Legal and institutional aspects

The most striking consequences of the hostilities on the legal and institutional framework of the Common Market stem from the temporary suspension of the functions of the main organs of the integration programme. No country denounced the regional agreements because of the hostilities, but some failed to meet their commitments, mainly as regards the free movement of goods. The fact that it was impossible to call a meeting of the Executive Council created additional difficulties which added to the disruption in the regular tasks of administering intra-area trade and arbitrating and resolving the problems that is an inevitable feature of it.

There were also delays in the work of the Economic Council, in particular in the adoption of a number of decisions to perfect and accelerate the integration programme. For example, work was interrupted on the formulation and approval of several sets of regulations (fiscal incentives, origin of goods and balance of payments) and on the implementation or acceleration of measures to harmonize taxation and production policies. Studies were also suspended on a number of new joint decisions on a very wide range of integration activities.

These consequences were not solely due to the fact that the Economic and Executive Councils were obliged to mark time. They were also due, as noted earlier, to the need to focus efforts on returning activity and trade within the Common Market area to normal. SIECA and other regional agencies have had to devote much of their resources to preparing studies, answering inquiries and in general providing advisory assistance to Governments in their search for solutions to the crisis in the Common Market.

/All this

All this necessarily meant changes in the priorities fixed for the 1969 immediate action plan. All research was immediately suspended on the establishment of a customs union and similar projects. Fortunately, however, not all research at the regional level was postponed or interrupted. The BCIE continued to expand its activities with respect to financing, loans and the collection of external resources. Approximately one-third of the loans granted by the BCIE since its establishment were approved in 1969 and 1970, and a similar trend is observable in its programmes to tap external resources (see table 27). The ICATI and ICAP continued to develop and even expand their specialized activities under the integration programme. Significant progress was also made with respect to the infrastructure: a number of meetings were held and agreements were adopted on joint standards and specifications, electricity interconnexion, the evaluation of water and energy resources, and the of a telecommunications network. In the field of maritime transport, the Central American Port Authorities Commission, the Central American Shippers Association and the Central American Shipowners Association were established.^{21/} With respect to trade policy, an export promotion unit was set up and further agreements were reached on promoting exports, obtaining non-reciprocal tariff preferences and protecting markets for commodities.

^{21/} For more detail on these topics see the reports of the eight meetings of the Regional Groups on Electrical Standards, Electricity Rates and Electricity Interconnexion of the Economic Co-operation Committee, and the documents on electrification, water resources and road transport prepared by the ECLA secretariat and United Nations experts.

The Central American Monetary Council and the Central Banks, in close collaboration with other regional agencies, continued to negotiate agreements and to harmonize exchange and monetary policies; a Central American monetary stabilization fund was set up and basic studies were prepared on the formation of a regional capital market.^{22/} Projects and programmes being carried out by integration organs and international agencies proceeded without serious interruption.

The documents prepared for the meetings held in recent months to lay the foundations for returning the activities of the Common Market to normal and for restructuring it in the future, have helped to clarify problems and to make progress towards solving them on a regional basis. They have covered, for example, tariff and industrial policy, and the establishment of flexible machinery for renegotiating tariffs and determining the origin of goods.

The Central American integration movement is still at its most critical stage, but since the end of 1969 steady efforts have been made to establish joint guidelines for action and common bases for negotiation that may eventually lead to firm agreements to strengthen regional economic unity.

^{22/} See the report of the Twenty-Fourth Meeting of the Board of Governors of the International Monetary Fund (Washington, D.C., September-October 1969) and the report of the XXXIII special meeting of the Central American Monetary Council. With respect to the regional capital market, a programme was initiated on 1 April 1970 under the joint sponsorship of the BCIE, the Executive Secretariat of the Central American Monetary Council and SIECA.

6. Formulation of a modus operandi for the
Central American Common Market

(a) Background

The Ministers of Foreign Affairs of the five Central American countries met on 4 December 1969 to establish the institutional bases of the work of solving the differences that had arisen as a result of the conflict between El Salvador and Honduras, to improve the legal and institutional system of the Common Market, to overcome the restrictions on normal economic relations, to revive the activities of the economic integration organizations, and to establish the guidelines for the restructuring of the Central American multinational co-operation movement.^{23/}

The joint declaration approved by the Ministers of Foreign Affairs contains three principal points: (a) the setting up of a bilateral working group, made up of representatives from El Salvador and Honduras, whose mission would be to adopt formulas for the gradual and progressive solution of the differences that have arisen between the two countries; (b) the creation of an ad hoc commission to reorganize the Central American institutional system, composed of two representatives of each of the five Central American governments; and (c) the holding of meetings of the Ministers of Economic Affairs of the five countries agree on a formula for renewing the activities of the agencies of the General Treaty on Central American Economic Integration and, acting as an Economic Council, to adopt decisions on outstanding questions relating to the Common Market, to establish a modus operandi for its current operations, and to review such legal aspects of economic integration as are necessary to complete the restructuring and strengthening of the Market.

^{23/} See the records of the Meeting of the Ministers of Foreign Affairs held on December 1969.

Between 9 January and 2 December 1970, the Ministers of Economic Affairs met seven times in order to draw up the interim standards of operation of the Central American Common Market and to decide when it would be feasible to renew the activities of the economic integration agencies.^{24/}

In order to carry out these tasks it was necessary to undertake action on several fronts: on the one hand, to analyse the joint declaration of the Ministers of Foreign Affairs, to specify the position of the governments on the development problems of the Common Market and to take cognizance of the statements of the representatives of workers and industry; on the other, to identify the scope of, establish machinery and fix priorities for the work of normalizing prevailing economic and institutional interrelationships.

A declaration to the above effect was made to the Ministers of Economic Affairs meeting in permanent session, a working group was set up - made up of Deputy Ministers of Economic Affairs and Integration - to draft practical proposals, and the Central American Monetary Council was requested to help solve some of the financial problems connected with the running of the Common Market. Moreover, priority was given to the design and formulation of a regional modus operandi, the main components of which are as follows: measures to correct the imbalances in the intra-regional trade of the deficit countries; definition of new industrial development and agricultural policies in the Central American context; establishment of a regional fund for the expansion of productive activities; drafting of general safeguard clauses; and formulation or completion of regulations in respect of fiscal incentives, balance of payments and origin of goods. Lastly, it was agreed in a timetable of work that the Economic Council and the other substantive agencies of the General Treaty should be in a position to renew their activities

^{24/} See the records of the second meeting of Ministers of Economic Affairs of Central America (9 January 1970) and the first (21 to 25 July 1970), second (24 to 28 August 1970), third (4 to 9 September 1970), fourth (3 to 6 November 1970) and fifth sessions of the third meeting of the Ministers of Economy of Central America (17 to 20 November 1970 and 25 November to 2 December 1970).

formally before the end of 1970, not only by authorizing and adhering to the agreements, protocols and resolutions establishing the modus operandi, but also by continuing to deal with outstanding questions of administration and operation of the Common Market on a multilateral basis, and by initiating the process or restructuring the regional economic integration programme.

(b) Objectives and structure

The Ministers of Economic Affairs established the following objectives as a guide to the formulation of a modus operandi in the Common Market:

(i) To regulate the operation of the Common Market by interim measures, taking account of the situation faced by the countries with small markets and the development problem of those others that are in a chronic deficit position; (ii) to improve the Common Market system in order to be able to solve the most urgent problems that came to light during the first decade of its existence; and (iii) to achieve, as soon as possible, the normal working of institutions in the integration programme and to ensure the participation of each and all of its members.

In accordance with these objectives, the Ministers of Economic Affairs negotiated on the following fundamental aspects of the modus operandi: financing; industrial and agricultural policy; special safeguard clauses; measures to deal with the irregular situation of intra-regional trade and action to regulate basic provisions of the regional agreements. The main aspects of each of these questions are dealt with below.

(i) Fund for agricultural and industrial development. The purpose of a fund to finance the expansion of agricultural and industrial activities in the region would be to help correct the current imbalances and prevent new disequilibria from arising among the countries in the context of economic integration. The terms of reference state that the fund would help to fix attention on the chronic and persistent trends in the position of the countries in the context of intra-regional trade and on another type of negative trend and development disequilibrium that have an equally adverse effect on the development of regional economic integration.

The fund would be administered by the Central American Bank for Economic Integration and would form part of its organizational structure. The operations of the fund would contribute to the complementary financing

/of industrial

of industrial and agricultural development from internal and external sources. In some cases, such financing would be supplemented by investment out of the Bank's own resources. This would help to promote the regional mobilization of capital and, at the same time, one of the objectives of the programme of economic integration.

The fund would be set up within five years with annual contributions by the countries and would be complemented by foreign funds in the proportion of two to one. The contribution of each member country would be determined on the basis of their individual share of the benefits of the Common Market and of economic integration in general. The ratio of imports to exports to and from the Common Market in 1970, adjusted in accordance with foreseeable trends during the next few years would be taken as a basis for calculation. It was tentatively established that the scale of financing of the fund would be as follows: Honduras, 14 per cent; Nicaragua, 16 per cent; Costa Rica, 18 per cent; El Salvador, 20 per cent; and Guatemala, 27 per cent. The funds would be made available through an investment programme giving preference to the countries that receive a less than proportionate or limited share of the benefits of integration. The distribution of benefits would in general terms correspond to the contributions of the countries in reverse. Thus, Guatemala would receive 11 per cent of available funds, El Salvador 20 per cent, Costa Rica 20 per cent, Nicaragua 22 per cent and Honduras 27 per cent. Bearing in mind the fact that the fund would draw on foreign financing, as was mentioned above, Honduras would receive 5.6 pesos for each peso that it contributes, Nicaragua 4.1, Costa Rica 3.3, El Salvador 3 and Guatemala 1 peso; that is, each country would receive more than or at least the same amount as it contributes.

No agreement was reached regarding the total contribution of the countries. Two proposals were made: one, made by the countries that would benefit least by the fund, that the contribution should be 30 million Central American pesos; the other, for 40 million. Supplementary external financing would increase the size of the fund to a total of 90 or 120 million pesos in five years, according to which of the two systems of participation is adopted by the member countries.

/(ii) Regional

(ii) Regional industrial policy. Industrial policy would be re-drafted according to the following policies: (a) intensified growth of manufacturing output, applying the standards of increased equality and balanced development; (b) the achievement of agreements by industrial sectors, through resolutions of the Central American Economic Council, which promote the rationalization and modernization of industries by ordering their future expansion; (c) to establish, promote and develop basic industries in accordance with regional decisions; (d) to promote the implementation of this policy through the more active participation and collaboration of entrepreneurs; (e) to grant the benefit of regional and national economic policy instruments only to those plants that adhere to sectoral regional agreements and development programmes for basic industries; and (f) to achieve these objectives gradually and progressively, priority being given to the correction of the disequilibria that are currently observed in the sector.

In order to apply the above principles, initial lists would be made of the industries for which sectoral agreements could be drawn up and those that might be considered as basic industries. Others would be identified subsequently taking account of special technical and economic criteria. Similarly, there would be assignment of plants or increases in the productive capacity of countries, priority being given to those with less industrial development, provided that the projects are technically and economically viable. The application of these criteria would ensure the encouragement and strengthening of industrial relations in the context of regional complementarity and specialization, and would provide an impetus to projects under way, speed up the development of the manufacturing industry in the region and stimulate the creation of multinational enterprises.

The initial list of basic industries incorporating this new approach comprised steel; pulp and paper and petrochemicals. The Economic Council is authorized to expand that list. The activities that could be the subject of sectoral agreements are as follows: metal transforming; long vegetable fibres and their synthetic substitutes; pharmaceutical goods; some durable goods for domestic consumption; assembly industries; textiles; oils and

/fats; and

fats; and leather. The Economic Council itself would specify the activities to be placed on the above-mentioned two lists which it would review at least once a year. In the event that a country was not in a position to develop a project or expand a plant, it would decide on its re-allocation to another country.

(iii) Regional agricultural policy. With a view to obtaining common directives for the co-ordinated promotion of agricultural development in the process of economic integration, the Ministers of Economic Affairs of Central America approved a series of guidelines and activities.

The guidelines may be summarized as follows: (a) to ensure the most adequate means of supply, promote economical import substitution, and diversify exports to third countries. An attempt will be made to establish appropriate conditions for the promotion of this activity in all the countries, taking account of the store of natural resources, the growth of employment, balanced development and the plans that are currently being drawn up at the national level; (b) to encourage the extensive mobility of factors of production, increase the volume of production and improve the productivity of the sector; (c) to regulate, stabilize and expand market in order to guarantee adequate supply and suitable prices for both producers and consumers; and (d) to strengthen links between agriculture and industry by promoting the production of agricultural inputs for industry and industrial products for agriculture.

In accordance with the above objectives the need was recognized to add to the current benefits of free trade and tariff protection the commitment to co-ordinate production policy, marketing and industrialization of the goods produced by the agricultural sector; to apply the special protocol on basic grains to the fullest extent; and to strengthen the regional institutions so as to facilitate the provision of instruments for the common agricultural policy. To this end, specific short-term plans in the field of agricultural policy were approved by the co-ordinating committee on marketing and price stabilization of the Permanent Secretariat of the General Treaty on Central American Economic Integration. The specific programmes that these regional institutions should prepare cover - among other things - the perfecting of the Common

Market of agricultural products; the development and training of manpower; the implementation of a common external trade policy towards third countries or groups of countries; and the regional co-ordination of national programmes, taking account of the balanced development of the Central American economy. It was considered that the basic surveys on agricultural division according to region and area should be finished immediately so as to formulate plans to complement production.

In order to strengthen and expand the activities and functions of the Co-ordinating Committee an immediate plan of action would be adopted and, among other short-term targets, it would include the stabilization of prices both at producer and consumer levels; the incentive needed to finalize the regional programme for building farms and obtaining the funds for the programme, and to encourage the setting up of a Central American fund for the stabilization of the price of basic grains. Within the activities of the Committee, top priority would be given to fixing and controlling the annual amount of preferential imports of basic grains that member states could allow; to the setting up of machinery to facilitate forward purchases to cover production deficits; to the implementation of a uniform, co-ordinated programme based on the forecasts for basic grain harvests; and to improving the regional information system on production and marketing conditions and wholesale and retail prices of grain.

(iv) Tariff policy. Revision of the tariff policy in force would cover two points: (a) the adoption of a Central American Tariff policy which would reconcile the interests of the producer, the consumer and the Treasury with those of industrial development under increasingly efficient economic conditions, and (b) revision of the common external tariff on imports in two stages. In the first stage existing protection would be adjusted where it was considered excessive or insufficient and, in the second stage, the common tariff would be revised in detail so as to ensure that the new tariff policy structure is adequate and in keeping with the demands of development reached by Central America.

In order to decide which protective tariffs are too high or too low and are to be examined in the first stage - which would last six months at most - the selection would be made in five phases, each progressively more severe. The items chosen will then be discussed and multilateral agreements will be made on the changes in tariff levels advised.

/The more

The more detailed revision of the tariff would be carried out immediately after the first stage and would cover a maximum period of two years. The second revision would be based on the following criteria: (a) formulation of the economic objectives of the new tariff policy; (b) adoption of the work programme, the technical and methodological criteria and acceptance of the adjustments in the nomenclature to which the revision of the common external tariff on imports would be subject, and (c) multilateral approval of the new tariff policy.

(v) Flexibility in the application of the Central American Customs Tariff. The object of the protocol for flexible application of the Central American Customs Tariff would be to authorize the Executive of each country - and through the Economic Council for the whole region - to modify, the charges applicable to goods imported from third countries, within certain limits. This would not only allow for a more flexible application of the common external tariff, it would also facilitate the implementation of the joint trade policy vis-à-vis the rest of the world, and it would establish the means for achieving a more adequate control of imports. This instrument would also include an authorization to apply tariff preferences in Latin America for those articles produced in the region which, because of their origin, would not be subject to unrestricted free trade between the member states. The Central American Tariff Committee would be set up as an advisory institution for the organs of the General Treaty of Economic Integration in matters governed by the said protocol and those mentioned in article XI of the basic Agreement on Equalization of Import Duties and Charges.

(vi) Origin of goods. The application of stricter criteria for determining the origin of goods in regional trade would be carried out under a regulation conforming to the general provisions on this matter in articles III and V of the General Treaty on Central American Economic Integration. The main aim of this regulation would be to introduce an element of order in the Common Market, without restricting the trade between the member countries, to regulate the treatment of products which are considered to be produced externally, but which are subject to processing or are traded in the area.

The basic criterion used to determine the origin of goods would be the value added to the product in the region, and minimum manufacturing processing would be considered as a subsidiary criterion. The regulation drafted covers the definition of these criteria and goods are considered to be produced locally, if over 40 per cent of the total value of production - at ex-factory prices - is value added in the region, the same applies to goods which do not fulfil the previous condition but which have been made up in the region from a specific phase in production stipulated in the regulation. Furthermore the principle of authorizing regional preferences was accepted for goods made in the region which do not satisfy any of the conditions mentioned above.

(vii) Safeguard clauses. The adoption of measures which are an exception to the legal code of economic integration in cases where one country is faced with situations causing or threatening serious instability in the balance of payments, in the organization of marketing, or in supplies of goods, would necessitate the signing of a protocol containing safeguard clauses of a partial and temporary nature with a maximum duration of one year. The Economic Council would authorize its implementation, in conjunction with the Monetary Council when balance-of-payment problems were involved. If a multilateral agreement were not reached in a maximum of eight days, the governments could adopt unilateral measures which would be adapted once an agreement was reached. In any case, both Councils would take action in their respective fields to overcome problems and their causes.

The instrument considers that when problems involving the regional supply of basic grain or products manufactured by the integration industry arise, resolutions would be passed in accordance with the provisions of the Special Protocol on Basic Grains and the Agreement on the Régime for Central American Integration Industries and its protocols respectively.

As an interim measure it was also provided that until the new protocol was signed and the rules for implementing it formulated, the governments undertook to work together with resolutions to solve the problems affecting some of the Central American states in the fields where safeguard clauses can be applied.

/(viii) Application

(viii) Application of the economic stabilization tax. A regulation would be adopted to govern the application of the economic stabilization charges mentioned in the San José Protocol on measures to protect the balance of payments. The regulation would include common criteria upon which the application of such taxes would be based; it would define the common basis of the taxes, the cases where exceptions could be authorized or received and the procedures for calculation and liquidation. The draft Regulation was examined during the course of the talks between the Ministers of Economic Affairs.

(ix) Fiscal incentives for industrial development. The finalized form of the Regulations for the Central American Agreement on Fiscal Incentives drafted by the Executive Council of the General Treaty, would ensure the uniform implementation of the said Agreement and the Protocol on Preferential Treatment for Honduras. The draft Regulations were also studied at the meetings held by the Minister of Economic Affairs.

The Regulations would include provisions intended to govern and standardize the application of the criteria for classification of enterprises and authorization of fiscal benefits. To this end, the following, among others, would be defined: the value of production added, net benefits in the balance of payments, and the total cost of production. The Regulations would also specify the limits for general application of the Agreement and would state the norms for its co-ordinated application and that of its protocol in each of the countries; they would establish provisions for solving problems which might arise in competition between enterprises whatever their category and the benefits they enjoy; include a specific treatment for imports from outside Central America and cover a set of procedures on how to classify and apply control and sanction systems and to attend to other factors involved in the application of this kind of regional legislation.

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It should be noted that the discussion on fiscal incentives included a complementary agreement whereby an effort was made to extend the status quo agreed to by the Ministers of Economic Affairs for a further seven months, with a view to reclassifying the enterprises established in the region which had to join Group C ^{25/} for fiscal benefits. This agreement would provide for a longer period to perfect the information available and finalize the studies on the economic effects of the acceptance of classification criteria. If these were not available, the protocol for making the Central American Customs Tariff more flexible could be used, by modifying the uniform charges on some raw materials.

(x) Other matters. The rules of procedure for some provisions of the General Treaty on Central American Economic Integration would be drafted. These rules would be made to avoid interruptions in regional trade which might arise from the administration and application of internal consumer taxes; the concession of customs franchises for imports from third countries, on goods which are produced in Central America under adequate conditions, and the application of criteria, procedures and sanctions for cases of unfair trade practices. They would also cover the adoption of the Rules of Procedure for the Executive Committee of the General Treaty, and undertaken to set up Mixed Bilateral Committees to decide upon interim measures to relieve the trading problems in the area resulting from the abnormal situation caused by the events of 1969. The urgent need to enforce the instruments for economic integration in each one of the countries would be recognized, in such a way that the effective implementation of the modus operandi would not be obstructed and would fulfil all the commitments to the regional instruments in entirety, as is

^{25/} Group C includes industries which manufacture non-essential goods or articles which are not considered to be of prime importance for manufacturing development. It also includes activities requiring a low degree of processing.

the need to give the regional agencies for economic integration sufficient special resources to enable them to give adequate attention to the work involved in the implementation of the modus operandi and the following stage of restructuring the economic integration programme.

(c) Problems involved in the implementation of the modus operandi

On 2 December 1970 talks were practically concluded on the ensemble of agreements and commitments constituting the modus operandi of the Central American Common Market. Only two items connected with the Central American Fund for industrial and agricultural promotion remained outstanding and subject to consultation by some of the Governments.^{26/}

At a further meeting of Ministers of Economic Affairs, held a week later, it proved impossible to reach a multilateral agreement on the modus operandi.^{27/} On the one hand, one of the countries stated that it was impossible for its government to sign the parts of the agreement referring to the fund, because they were too closely connected with industrial and agricultural policies. On the other hand, another of the countries made its government's signature conditional upon the full participation of the five countries in the modus operandi.

This situation not only made it impossible to settle for a multilateral arrangement on the modus operandi, it also eliminated the possibility of at least four countries' participating fully and the fifth partially. After over four months the work of the Third Meeting of Ministers of Economic Affairs in Central America was then considered to be at an end, and it was agreed that the results should be passed to the Ministers of Foreign Affairs with the idea of looking for new formulas for agreement.

^{26/} See the Press release issued by the Ministers of Economic Affairs in Central America (2 December 1970).

^{27/} See the final proceedings of the Third Meeting of Ministers of Economic Affairs in Central America (8 to 11 December 1970).

It would perhaps be hardly advisable to attempt to evaluate the content and possible efficiency of the modus operandi had it been signed as a whole or in part in December 1970. The situation prevailing in the Central American Common Market at present, commented on below, does not favour an evaluation. However, everything seems to point to the fact that, if a temporary regime, such as the one suggested, were applied, it might lead to a series of problems which have been worrying the governments for some time and which have become more strong during the years of experience of the Common Market. In fact, new measures have been incorporated in the approaches and proposals mentioned in previous paragraphs, so as to increase regional growth in production and apply the principle of balanced development among integrating countries with greater efficiency. In the same way provisions and regulations were included to re-establish normal trade relations and institutional terms which had been affected in 1969. It should, however, be borne in mind that an agreement on the lines mentioned above did not imply by any means that all the latent difficulties had been eliminated nor all the structural and functional barriers broken. The governments and their regional agencies should if formulas are to be found to right them and arrive at multinational agreements which would represent significant progress in the integrated economic and social development of Central America. It is also possible that the questions raised might become a compulsory part of the process of restructuring the economic integration programme which was mentioned in the Joint Declaration of the Ministers of Foreign Affairs.

7. Measures adopted recently by the Central American governments

The Ministers of Economic Affairs in Central America terminated negotiations for the formulation of a modus operandi for the Common Market in December 1970. During the month of January 1971 the governments took different steps to deal with the prevailing situation as can be seen below.

On 31 December 1970 the government of Honduras enforced a series of measures to stimulate national production and regulate its export trade.^{28/} The following are some of the more important reasons for the adoption of these measures: (a) there are distortions in the original proposals encouraging the Central American countries to pledge themselves to the integration effort, for example those concerning the unnecessary rise in prices for consumers of regional exchange products, which can mainly be attributed to excessive customs tariff protection; (b) the legal standards of the integration programme had undergone a change for two of the member states, as a result of the events of 1969, and this meant that trade had to be diverted to other countries, which had a detrimental effect on development opportunities and led to short-term international liquidity problems for Honduras; and (c) the agreements between the member states on a modus operandi to bring temporary relief to the abnormal situation prevailing had not been signed and the termination of the extension of the status quo agreed to by the Ministers of Economic Affairs in September 1970, whereby no unilateral measures would not be adopted as long as negotiation of the agreements on the said modus operandi continued. As a result, the Honduran authorities considered that the governments of the region "were at liberty to apply any measures they thought fit to protect the economic interest of each one of them while negotiations for restructuring the Common Market continue as long as they kept to the guiding principles of the Economic Integration Programme and ensured that the original pledges and principles would be re-established and respected".^{29/}

^{28/} See Decree N° 97 the National Congress of Honduras (30 December 1970).

^{29/} Ibid.

The measures adopted by Honduras cover the modification of free-trade policies and the equalization of import duties and charges; the implementation of principles and joint actions to increase the import trade and promote exports; the setting of the standards to render action taken by the Executive and the State agencies, on integrated economic development more complete and flexible.

Free-trade in the Central American countries was effectively suspended when it was stated that the common external tariff should be applied "to all imports". Even though the uniform charges in force are maintained, national customs rights are lower on imports of specified essential products, raw materials, intermediate articles and capital goods. In special cases the uniform tariff and nomenclature can be modified in order to "provide adequate protection for national production, to guarantee domestic supplies and promote new productive activities ...",^{30/} for these cases a legislative sanction will be required.

With regard to external trade policy it appears that there is a possibility of making changes in the customs duties upon entering into bilateral negotiations with other countries. At the same time it is stated that if this kind of negotiation is carried out on a reciprocal trade basis with Central American countries with which relations are maintained or with other countries in the world, bilateral trade treaties or deeds may be signed if they include forms of payment, preferably using "the system of assignments of goods" or similar systems. The Executive is authorized to adopt a system of export promotion and internal marketing for new exports or for increasing those which already exist and it is stated that traffic and passenger and cargo transport between Honduras and the countries with which it has trade relations, must be subject to the principle of "equal reciprocal concession", and everything concerned with transport must be standardized while national firms should be fully responsible for the operation of the internal transport system.

The other measures involving general impetus for economic development and for stimulating the action of public entities and making them more flexible are very varied, among the most important are: (a) the creation

^{30/} Ibid.

of a national fund for agricultural and industrial development, mainly financed with 2 per cent of the current tax revenue; (b) authorization for the Central Bank of Honduras to adjust its monetary policy and direct credit policy "with a view to expanding national production, increasing exports, substituting imports and contributing to satisfactory stability in the country's balance of payments"; and (c) Executive revision of the system of fiscal incentives to promote national production, "the corresponding legislative reforms must be proposed and the necessary measures adopted in accordance with the regulations as soon as possible to make the system more effective, dynamic and flexible".^{31/}

As a consequence of these factors, the governments of Guatemala, Nicaragua and Costa Rica started to apply the provisions of the General Treaty on Central American Economic Integration at the beginning of January 1971 after providing a guarantee on products imported from Honduras. This procedure has been used previously in similar cases when there have been regional exchange problems which have not been multilaterally solved. Furthermore, the same three governments stated on 8 January 1971 that economic and trade relations between them would continue to be adapted to the Treaties in force, that they would immediately set up mixed bilateral committees to regulate trade between them "so as to avoid any instability resulting from the measures taken by the Government of Honduras" and that the agreements made by those committees would be maintained as long as the Honduran Government "failed to establish economic and trade relations with the Governments of Guatemala, Nicaragua and Costa Rica in accordance with the spirit of the General Treaty on Integration".^{32/}

^{31/} Ibid.

^{32/} See the Joint Declaration of the Ministers of Economic Affairs of Guatemala, Nicaragua and Costa Rica (8 January 1971).

On 12 January 1971 the Guatemalan, Nicaraguan and Costa Rican chancellors adopted a set of agreements concerning the economic integration of Central America and a uniform position with regard to inter-American relations, and they urged the governments of El Salvador and Honduras to abide by this.^{33/}

As far as the agreements on regional economic integration are concerned, the Chancellors ratified the Joint Declaration of the Ministers of Economic Affairs of their respective governments outlined in the previous paragraph; they recommended the acceleration of the tasks entrusted to the Bilateral Working Group responsible for the peace talks between El Salvador and Honduras; and they nominated the Ad hoc Group, established to draw up projects and surveys on the institutional revision of the Central American Common Market, to recommend activities as from 1 May 1971 and to deal with the following tasks at a permanent sitting: (a) revision of the basic charter of the Organization of Central American States (ODECA); (b) drafting of an agreement to set up a tribunal or committee to settle disputes on economic integration; and (c) drafting a project to reform the institutional side of the Common Market. The Ministers of Economic Affairs were also urged to continue their efforts to re-establish the normal function of economic integration, within the legal bounds in force, and to convene the Economic Council as soon as possible for this purpose. On that occasion the Chancellor of El Salvador, upheld every item included in the Declaration outlined on behalf of his government.

^{33/} See the Declaration of El Alcázar de la Antigua, Guatemala, 12 January 1971.

8. Ideas on the prospects of integration

Trade relations between El Salvador and Honduras have been at a standstill since the hostilities. Inter alia, Honduras adopted protective trade measures which have affected intra-area trade and later Guatemala, Nicaragua and Costa Rica established measures to protect their trade with Honduras and stated, as did El Salvador, that their economic relations would continue to be governed, both by the treaties establishing the Central American Common Market and by the bilateral committees which would be set up to regulate their trade in view of the disruptions following upon the suspension of free-trade with Honduras. That is briefly the position in Central America at the end of January 1971. Once the activities of the main agencies for economic integration had been suspended, the balance of power became unstable and it is difficult to predict what will happen to it in view of the complexity of the political and economic factors at stake.

The efforts of the Central American governments to try and normalize the function of the Common Market have been outlined above. In addition, the Governments, within the existing status quo, are still all agreed on the temporary nature of the present situation and willing to look for more stable formulas for restructuring the economic integration process.

It is worth while making a brief examination of some of the possible repercussions and approaches which might stem from the agreements and talks in the immediate future.

The first part of this report deals with an analysis of the close connexion between the Common Market pressures and the accentuation of the structural and temporary problems which have arisen in some of the Central American economies and which can be expected to recur from time to time. Using the example of just one country, the case of Costa Rica shows instability in the total and intra-regional balance of payments and this will probably call for the adoption of important measures to restrict imports.

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During the period of tension and crisis leading to readjustment of the economic sectors in Central America, as has been noted, a great deal of the friction was due to the disagreements arising from the differing stages of development among the economies when the Common Market was founded. Another cause of friction is instability coupled with a development pattern requiring certain changes to consolidate new growth centres and clear the way for forming a broader economic unit.

It is also evident that the advantages of integration have not been equally distributed and that it has proved impossible to establish multilateral agreements to solve this problem to the satisfaction of all. The difficulty in finding such formulas and the objections preventing agreements from being made on new activities intended to improve the programme of economic and social integration, make it increasingly difficult to overcome the Common Market status quo and solve the structural problems which face the countries at national level. Furthermore, the events of 1969, have made it more difficult to re-establish trade relations between the two opposed countries over a short period. This means that it is materially impossible to reformulate an integration plan in the immediate or near future with the full participation of the five member countries who originally signed the General Treaty,^{34/} and these facts explain to a larger extent why the modus operandi was not signed in December 1970.

The government will find it difficult to escape the repercussions of the adjustment of forces. During the multilateral negotiations held since the Common Market came into being, it has sometimes been found necessary to disregard national interests where they seem to conflict with the long-term aims of integration and development. At the same time, however, limitations of the manouevring capacity needed on a national level to deal with short-term domestic difficulties, is sometimes advocated in the regional agreements. This is why multilateral solutions which take both these

^{34/} The Declaration of the Alcázar de Antigua Guatemala indicates the need for the El Salvador-Honduras Working Group to endeavour to overcome differences which have arisen between the two countries as soon as possible.

needs into account are quite difficult to find at this time. The absence of long-term national programmes, co-ordinated at regional level, makes it difficult to get a realistic balance of what integrated development means to each country as a separate entity, in the way of advantages and costs.

Thus the tensions apparent in integration are by no means extraordinary, they are inherent in the process of change which is under way. This circumstance must be clearly understood if formulas are to be found to safeguard the progress already made, because until solutions and common policies are found and applied to difficulties which only seem to affect one country, it will be impossible for the Common Market to advance, and the same will be true as long as national or group interests take precedence over the interests of all.

This situation would not be so serious if all the member states were in a position to speed up development considerably, exclusively on the basis of their domestic markets and resources; but the price that countries would have to pay, if the opportunities for economic and social progress were to disappear as a result of gradual disintegration of the Common Market, would mean a return to the situation of isolation and material inability to develop further than the size of their individual markets allowed over ten years before the Common Market was established. Furthermore, in a short time the countries would be forced to restructure and readjust many activities and their general development, and in so doing would encounter much greater difficulties than those encountered in the more solid context of the Common Market unit, which is now practically in abeyance.

From the economic point of view alone, it is therefore essential to maintain regional unity with the full participation of the five countries in the process of integration, for the sake of development and trade. The relative influence of the Common Market upon the growth rate of the region as a whole has been increasing, and this proves the importance of the efforts and actions of the public sector and entrepreneurs in strengthening and improving the traditional development pattern within that context.

/If the

If the interests now at stake and the development requirements of the different countries are to be satisfied by maintaining regional economic unity, integration agreements will have to be reached on the following principles and commitments:

- (1) To ensure active participation in the process of integration for the greatest possible number of Central American countries, under conditions which facilitate partial participation or subsequent incorporation of those who, for the time being, decide not to sign or accept the common agreements reached by the rest;
- (2) To form new legal and operative bases to govern economic and trade relations between countries for the time being until restructuring of regional economic integration is achieved;
- (3) To define the scope and content of the gradual and progressive process of restructuring economic integration; and
- (4) To take all suitable measures to guarantee active participation by the five Central American countries in the negotiations arising from the three previous points, and to make a formal pledge not to obstruct the development of restructuring agreements drawn up to benefit each country in particular and all in general, by making unilateral decisions.

The above however, in no sense implies placing the Common Market on the same foundations as hitherto, but stems from a recognition of the fact that circumstances have made it necessary to remodel the operation of the Common Market and adapt some of its machinery, for a time at least, to the abnormal situation prevailing since the hostilities. More specifically, the strategy for integrated development must be redefined on a broader base to include the co-ordination of policies relating to production protection of the balance of payments and the financing of public and private investment, and must also cover a number of new fields, especially certain social questions of regional scope. As has been shown, the growth of the Central American economies and of Common Market transactions is being hindered by the inflexibility and slow reactions of the regional decision-making machinery and by the lack of agreements or the limitations of existing agreements regarding problems that only on the surface appear to be

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confined to individual countries, or regarding expanding the coverage of integration commitments. The need for a restructuring of this machinery is thus closely linked with the conclusion of agreements designed to strengthen and clear the way for import substitution combined with the promotion of complementarity among the member countries, and to seek ways and means of ensuring that the benefits and costs of integration are more equitably shared, as a prerequisite for maintaining the unity of the five economies within the integration movement.

Mention must be made of certain restrictions that were imposed as a result of the crisis in the Common Market and of the measures taken recently by several of the member countries. While it is absolutely essential to implement measures and conclude agreements that will prevent any possible deterioration in the internal relations of the Common Market in the future, it is important not to start off from the point reached prior to 1969. The first consideration must be recognition of the fact that it is impossible to reactivate trade flows between Honduras and El Salvador over the short term. Another restriction is Decree N° 97 enacted by Honduras which, inter alia, has placed Central American products on the same competitive footing as products from third countries. To ignore this Decree would be tantamount to closing one's eyes to the changes that will necessarily take place in intra-area trade or to thinking that a number of questions relating to the restructuring of the Common Market can be forgotten about or modified before the agenda for the Bilateral Honduras-El Salvador Working Group has been settled.

A third limitation is connected with the deterioration in the payments position of a number of countries and the disposal of the regional supplies normally destined for the Honduran market. If the imbalances in intra-area trade persist and given that over-all balance-of-payments disequilibria have grown, it is highly likely that the natural expansion of intra-area trade, and especially the redirection of trade flows, will cause more serious friction because it will occur at a time when surpluses at the national level will have to contend with a shortfall in regional demand.

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On the basis of the above and taking account of the special features of the Common Market, agreements should be promoted as quickly as possible at three clearly differentiated levels. First, it is essential to develop guidelines for restructuring the integration movement that will promote strict compliance with the principles of balanced development; ensure prompt and joint action on national and regional problems affecting or threatening the stability and development of the integration process; incorporate new activities into regional policy that will make possible or facilitate the formation of a stable economic community of mutual advantage and guarantee the willing and multilateral participation of all the Central American countries in the integration programme.

Secondly, it is necessary to take short-term measures to solve the problems caused by the disruption and diversion of intra-area trade, and to find outlets for the surplus in supply that will occur in the near future.

Thirdly it would be advisable to develop a general agreement under which countries would undertake to avoid as far as possible adopting unilateral measures that may create new and greater difficulties both for the balance of intra-area trade and for future negotiations regarding restructuring the multilateral co-operation programme. Such an agreement could provide, inter alia, for recourse to the normal machinery for consultation or could establish ad hoc machinery which would leave Governments free to tackle emergency situations in their own way but would facilitate the search for joint solutions.

All these agreements require that the five countries take part in the discussions and that each and every one of them sign all the sections of the agreements reached of their own free will.

If each country maintains a prudent and accommodating attitude during the negotiations this will create the right kind of atmosphere for a return to institutional normality and full participation by the five Common Market countries within a shorter period.

In any case, the main point is that it is urgently necessary to prevent the negotiations from bogging down and to ensure that they take place under procedures that will give them unity over time and will harmonize agreements designed to solve immediate problems with agreements on

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restructuring the Common Market. Unless such agreements are reached, it will be extremely difficult first to bring the integration programme back to normal and then to reformulate it without the risk of jeopardizing the multilateral system that governs intra-area transactions.

It is thus appropriate to consider the effect of replacing a multilateral approach to area trade with more restricted arrangements, for example bilateral treaties, and the significance of integration in the future development of the Central American countries.

If the deadlock in negotiations continues in the immediate future, making progress towards normalization and restructuring of the integration programme impossible, multilateralism in regional relations will almost inevitably break down. It is therefore appropriate to analyse some of the effects of a possible return to the system of bilateral treaties.

In the first place, bilateral arrangements would eliminate or severely restrict all possibilities for establishing Central American policies for regional promotion of production, balance-of-payments protection, financing, money and credit, etc., to the smaller framework of intra-area trade; and as has already been noted the lack of operative regional instruments in this respect has been the very reason that has prevented a solution being found for many of the problems which have arisen in the Common Market.

In the second place, the process of area import substitution - which is probably the principal dynamic domestic centre for growth - would be badly affected. The entrepreneurs and investors would not only no longer be able to rely upon the stimulus of joint demand, they would also be faced with the difficulty of placing articles made in plants designed for regional demand, and it would become much more difficult to channel external funds to supplement Central American savings. With the breakdown or weakening of the links of economic interdependence and reciprocal trade which ruled the Common Market agreements to a greater or lesser extent, it will be more difficult to meet the costs of industrialization or specialization of production at a regional level and offset the reduction in benefits from an unsuccessful integration programme. In these circumstances, if import

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substitution is achieved, it will be on a national scale and under much more limited conditions and with narrower prospects than before, and it would not be surprising if supplies from the neighbouring Central American countries were replaced in each country.

The effect of these processes in the negotiation of bilateral agreements would obviously be restrictive and would, in addition, facilitate the consolidation of national interests, which will obstruct the re-establishment of multilateralism and regional agreements of far greater importance to the country in the long run.

Finally, a warning should be given to the effect that the structural defects which have appeared in Central American economies, far from being cured by the suppression of the free-trade zone, will continue to cause greater and greater tension as the potential range of development becomes progressively poorer and more difficult to define. Thus as payments and public finances become more and more unstable in a given country, it can be expected to neglect coverage of its bilateral obligations or to prefer to import from third countries where it may get better prices and quality, and this situation would be met by similar measures from the regional exporters affected.

In conclusion, either because of the cost of rechanneling activities towards national markets and confining import substitution to the demand of each country, or because of the larger obstacles restricting exports of manufactures of new products to international markets, the fact remains that bilaterally negotiated agreements would seem to give scant opportunities for an advantageous substitution of the free-trade area and for maintaining the currents of Central American trade without subsequent deterioration. It is not because bilateral treaties are necessarily a step backwards in the advance achieved in economic integration that this solution is so unattractive, it is because they are surrounded by circumstances which are essentially unpredictable and do not provide a satisfactory solution to any of the problems raised.

With more or less reservations, it should be agreed that the return to bilateral agreements or the indefinite continuance of temporary agreements, may make the subsequent task of restructuring the regional economic policy more difficult, and in any case only produces a partial solution to the problems resulting from the present crisis.

/A realistic

A realistic view of Central American economic development clearly shows the obstacles that will have to be overcome in any strategy for growth which relies upon the resources and potential of each country as a separate entity, and at the same time the undeniable advantage of integration for speeding up development and reducing the inherent social sacrifices involved.

This is not to imply that all the development problems of the Central American countries can be solved by strengthening their economic ties, which could not of course replace all the domestic transformations and reforms that would in any case have to take place. There is, however, no doubt that a revised system of integration would be bound to contribute valuably to promoting more advanced studies of economic and social development.

The advantages of larger economic units - wider markets, economies of scale, complementarity of production, shifting of imports and import substitution, new trade outlets and new possibilities of production - are particularly relevant to the Central American context because they have proved to be the best way of sustaining the change in the traditional pattern of development, hitherto dependent upon the sale of a small set of primary export commodities.

With the creation of the Common Market, the region as a whole and each country individually have taken the first steps towards acquiring a minimum of autonomy in their process of economic growth, despite the fact that the domestic nerve centres are not yet sufficiently dynamic to compensate for fluctuations in foreign trade. A basic productive sector has already evolved which is considerably more extensive than would have been feasible without integration and has been established at much lesser sacrifice than would have been required under different circumstances. Substantial strides have also been made in the process of industrialization and there are plenty of possibilities of import substitution within the regional market that could be planned in such a way as to avoid the kind of pitfalls that many Latin American countries have fallen into. The immediate requirement is for a policy which, while avoiding undue protectionist measures or an unnecessary increase in the social cost of industrialization, would help to strengthen the productive centres by means of a certain

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degree of specialization aimed at preventing the development of inefficient manufacturing enterprises or of activities that are ill suited to the size of the market, volume of resources or other economic conditions of Central America.

Even considered as a whole, the region does not have a big enough population or a high enough income to support indefinitely a typical inward-directed growth policy or to produce a series of goods that entail large scales of production. Consequently, the development strategy would have to involve both replacing a specific range of imported goods with domestic production and reorganizing the structure of trade with other countries. Here again, the joint efforts of all the States members of the Central American Common Market should afford greater support for such a policy than could possibly be achieved simply at the national level.

Exports of manufactured goods should be facilitated by the fact that, in addition to affording a minimum guaranteed market, regional demand would make it possible to introduce larger scales of production that generally bring lower costs and greater competitiveness. Similar advantages could accrue from raising the degree of processing of primary commodities, especially of mining resources. Finally, the application of a joint external policy would put the region in a much better bargaining position with other countries or groups of countries, help it to protect the prices of its traditional exports and pave the way to the creation of agencies specializing in the development, marketing and financing of exports.

The progressive improvement of the integration programme would thus contribute usefully, from the standpoint both of import substitution and diversification of exports, towards breaking down the barriers to development arising from the persistent balance-of-payments bottleneck; this in turn would tend in various ways to correct the chronic maladjustment of government finances. It is a typical feature of Central American economies that they depend far too much for their tax revenue on duties and charges on foreign trade, and this is bound to persist until such time as they create domestic centres of economic growth and diversify their production;^{35/} i.e., until they develop more elastic and more dynamic sources of tax revenue.

^{35/} See Hinrichs, H. Harley, A General Theory of Tax Structure Change during Economic Development (Harvard University, 1966).

It therefore seems hardly necessary to stress the setback it would represent for the evolution of the tax systems if the development strategy were replaced by an approach that limited the possibilities of import substitution and diversification of exports to a strictly national context.

A further obstacle to the economic development of Central American countries is the inability of their domestic savings to accelerate capital formation and the growth rate of the product. At the regional level, the policy of integration has, by providing countless opportunities for investment, brought about a more satisfactory distribution of domestic resources that might otherwise have been diverted to projects that were too small or not productive enough. Mainly through the BCIE, it has also made it easier to arrange loans and attract direct investments for a large number of programmes. It is true, however, that no way has yet been found of raising the domestic savings coefficient and that the purchase of Central American enterprises by foreign investors has increased, perhaps unduly. All these considerations point to the need for defining new policies, at both the national and the regional level, but in no way alter the fact that the Central American integration programme has done much to facilitate the financing of the region's economic development. A number of recent achievements may soon be expected to give rise to the formation of capital and securities markets and to the promotion of multinational enterprises financed mainly with Central American capital.

In short, the revitalization and steady improvement of the Common Market appear to be the most feasible and simple method of breaking down the structural obstacles to social and economic progress in Central America. Obviously, the effort required to achieve comparable results and opportunities at the national level would be much greater, and it is doubtful whether the appropriate institutions even exist for promoting the rate of domestic transformation that this would entail, or whether it could be politically feasible to expect the various levels of the population to make still more sacrifices.

/Everything suggests

Everything suggests that the policy of integration is still one of the key elements in Central America's development strategy. Recent problems have derived in the main from structural shortcomings and from the failure to adapt the regional policy to such matters as the stricter application of the principle of equity and reciprocity among member States. Nobody looking at the situation realistically could deny that these difficulties can be overcome without necessarily running the risk of breaking up the economic ties and the sense of solidarity that the countries of Central America have succeeded in establishing over a period of nearly twenty years.