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CENTRAL AMERICA: BASES FOR REACTIVATION AND DEVELOPMENT

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E C L A C

Economic Commission for Latin America and the Caribbean

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/INTRODUCTION

INTRODUCTION

This paper was prepared as part of the background documentation for the expert meeting organized by the ECLAC Secretariat on "Crisis and Development in Latin America and the Caribbean", to be held in Santiago, Chile, from 29 April to 3 May 1985.

This document relates to the particular case of Central America, a region which is experiencing a serious crisis that is having an economic as well as a political and social impact. In view of the fact that these two spheres are so closely interlinked, it would be useless to try to determine if one takes causative precedence over the other. The fact is that since the beginning of the present decade, notwithstanding the slight recoverty which took place in most of the countries during 1984, Central America has been immersed in the deepest economic depression and the most serious political upheavals of the last fifty years. The resulting climate of instability and confusion makes it difficult to find solutions in either the political or the economic and social spheres. Nonetheless, the search for solutions is the greatest challenge facing Central America today and, moreover, it cannot be deferred.

Addressing a subject as complex as this crisis would be impossible without analysing the most outstanding developments in the Central American economies and societies during the postwar period and without ascertaining the reasons why their characteristics changed so abruptly in the late 1970s. This analysis is contained in chapters I and II.1/* Chapter III contains a discussion of some aspects of the short-term outlook for the economies of the region, but without providing any precise quantitative framework. Finally, proposals aimed at serving as the basis for a policy for regional reactivation and development are set forth in chapter IV.

It is not pretended to offer paradigms or global solutions for overcoming the economic crisis in this study. As its title indicates, its scope is a good deal less ambitious. It is simply proposed to formulate some general guidelines which, in the view of the Secretariat, could help in the task of overcoming the depression and building the bases for future development. The underlying aim is to give rise to a debate on a subject of vital importance for the Central American countries.

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* The footnotes appear at the end of the document.

/I. CHARACTERISTICS

I. CHARACTERISTICS OF THE CENTRAL AMERICAN DEVELOPMENT STYLE IN THE POSTWAR PERIOD

The origin, scope and possible implications of the crisis cannot, as already noted, be understood without analysing the main developments in the Central American economies and societies during the postwar period. A first outstanding feature is the rapid rate of growth that was achieved over a span of thirty years --with, of course, differences from one country to another-- in an atmosphere of financial and monetary stability. Secondly, there is the decisive influence of external elements, which have largely determined not only the economic performance but also the mutual influence of many political factors. This is where the historical roots are to be found of Central Americans' repeated propensity for seeking external explanations and solutions for the problems which beset them. Moreover, the fragmentation of Central America --after its fleeting federation disintegrated-- contributed a great deal to each country's historical resignation to having very little freedom of action to determine its own destiny, which is felt to be mainly subject to factors beyond their control.

A third noteworthy factor is that in the thirty years following the Second World War, most of the major changes taking place in the economies of the region have been merely superimposed on the pre-existent economic and social structure without changing it in any basic way: a process which is herein referred to as "additive development".

Finally, the benefits of the long period of postwar economic expansion have been distributed very unequally among the various strata of the population as part of a process of concentration --or, in any case, exclusion-- which has prevented any significant reduction from being made in the extreme poverty that persists in the region.

These four phenomena are discussed in greater detail in the following pages.

1. Economic dynamism

The first outstanding feature of the Central American countries' development during the past three decades has undoubtedly been its sustained dynamism. In the region as a whole, the gross domestic product grew at an annual rate of 5.3%

/in real

in real terms between 1950 and 1978, although there were differences of degree among the various countries (the highest rates corresponded to Nicaragua and Costa Rica, while the lowest was in Honduras). As a result, real per capita income nearly doubled during that period. Indeed, between 1970 and 1978, when the region had to deal with particularly serious problems --rising hydrocarbon prices, imbalances in the international financial and monetary market, a shortage of raw materials and of some foodstuffs in 1974-1975, a number of droughts and three natural disasters of vast proportions-- the real rate of growth, on average, was over 5.6% annually.

There are other aspects of this growth which should be noted. Firstly, during those 28 years, negative rates of growth occurred only on rare occasions and were almost always associated with some natural disaster (twice in Honduras and once in Nicaragua and Costa Rica). Secondly, there were frequent --almost annual-- cyclical fluctuations but growth was nonetheless remarkably stable. Cyclical lows were of brief duration; only in exceptional cases did the product shrink during two consecutive years in any of the countries. Lastly, there was a great deal of similarity among the cyclical trends in the gross domestic products of the five countries, reflecting the fact that their forms of insertion in the international economy are very much alike, as well as the fact that the integration agreements of the 1950s and 1960s led to a high degree of economic interdependence (see table 1 and figure 1).

The manufacturing sector was generally the most dynamic, being fostered by the expanded market and by the industrial promotion policies that were created as part of the integration process. In consequence, the region's degree of industrialization rose from 12.3% in 1960 to 16.8% in 1978.

2. The decisive influence of the external sector

The steady growth of the Central American economies was, to a great extent, a reflection of the long international economic boom which followed the Second World War. During that period, the industrialized countries grew at a cumulative annual rate of 5.0%, while the volume of world trade expanded at a pace of 9.0%. To varying degrees, all the countries of the region were able to take advantage of that situation: the value of their exports of goods and services to countries outside the region grew by a factor of thirteen between 1950 and 1978 (rising from

/Table 1

Table 1

CENTRAL AMERICA: GROWTH RATE OF THE GROSS DOMESTIC PRODUCT a/

(Percentages)

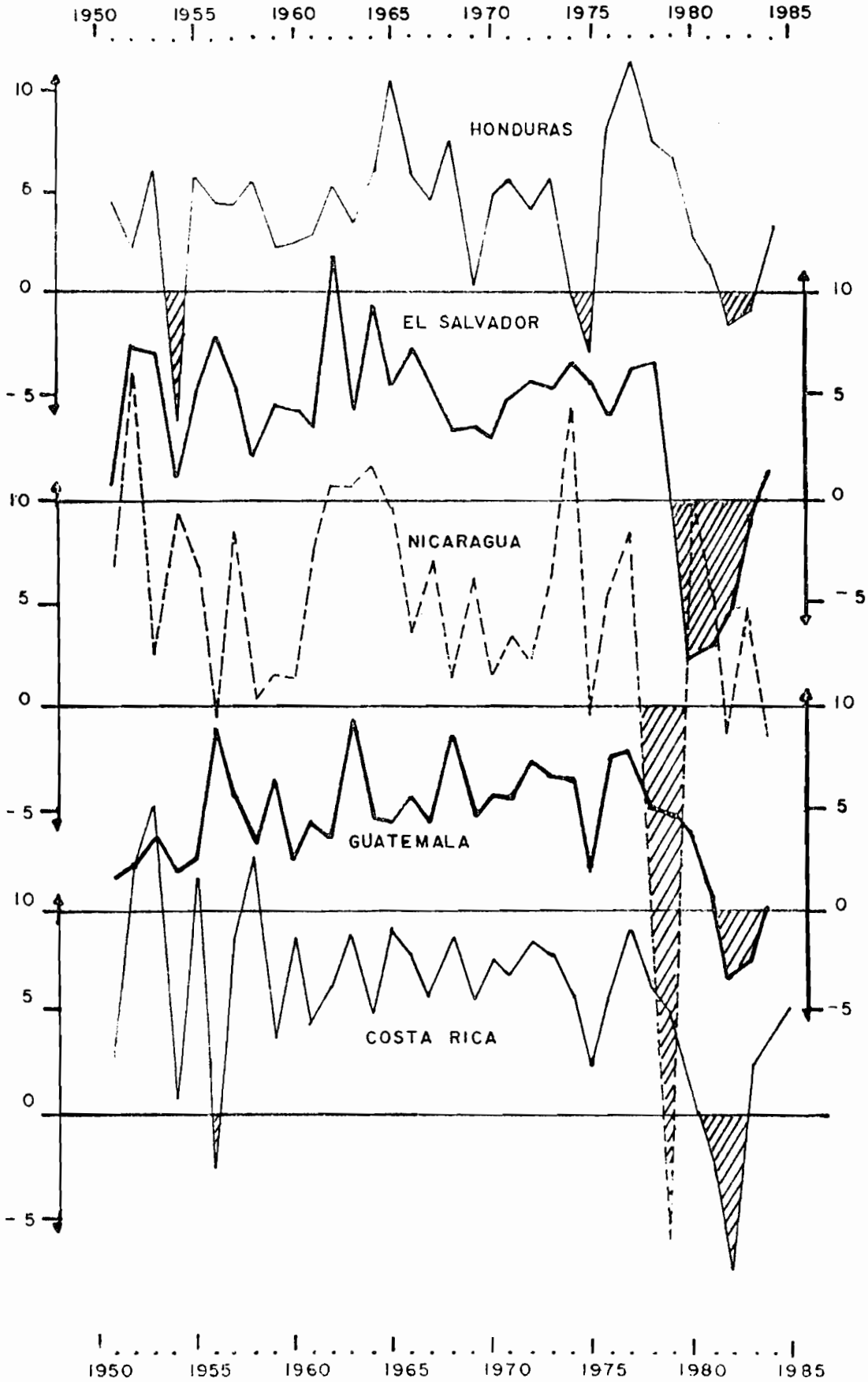
	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Average annual rates					
1950-1960	6.4	4.8	3.7	2.8	5.4
1960-1970	5.9	5.5	5.2	5.0	6.5
1970-1978	6.3	5.4	6.0	4.7	3.9
1978-1983	-0.4	-4.6	0.8	1.7	-2.0
Annual rates					
1970	7.2	3.4	5.5	3.5	-0.2
1971	6.8	4.9	5.5	5.8	3.4
1972	8.2	5.4	7.5	4.4	2.8
1973	7.5	4.7	6.6	5.8	5.3
1974	5.4	6.7	6.1	-0.3	13.5
1975	2.2	5.8	2.4	-3.1	1.5
1976	5.5	3.1	7.6	6.5	5.8
1977	8.5	6.1	7.4	9.6	6.1
1978	6.2	6.8	4.9	9.3	-5.9
1979	5.3	-1.2	4.7	6.0	-24.5
1980	0.9	-8.1	3.8	3.3	8.3
1981	-2.3	-7.9	1.1	0.6	5.4
1982	-7.1	-5.2	-3.3	-0.2	-0.6
1983	2.3	-0.1	-2.0	-1.1	5.2
1984 b/	5.0	1.5	0.2	2.8	-1.5

Source: ECLAC, on the basis of official data.
a/ At constant 1970 prices.
b/ Preliminary figures.

/Figure 1

Figure 1

CENTRAL AMERICA: GROSS DOMESTIC PRODUCT AT MARKET PRICES
(Annual growth rates)



US$ 250 million to US$ 3.2 billion), while the export sector diversified considerably with respect to both its composition and its geographic destination.2/ The upturn in the traditional export sector also provided sufficiently prosperous conditions to facilitate the daring decision to embark on reciprocal free trade in virtually all products originating from the region within a span of not more than five years. This led to the intensive industrialization process which was to become another focal point of dynamism, although growth never ceased to depend, in the final analysis, on the situation in the traditional external sector. This prosperous situation and the region's intensive modernization also helped to create patterns of consumption among some strata of the population which imitated those of more advanced societies, thus increasing the demand for imported goods.

During the last two decades, the Central American countries' external sector underwent significant changes. The relative magnitude of foreign trade tended to increase (the export and import coefficients for the region as a whole increased from 18.6% and 16.3%, respectively, in 1950 to 30.4% and 33.6% in 1978);3/ the structure of exports and imports changed radically, with an increasing proportion of non-traditional items being incorporated into the former and the structure of the latter being altered in favour of intermediate products and capital goods; trade within Central America grew so rapidly that it came to represent a large and increasing proportion of each country's total exports, likewise becoming a more and more important source of each country's total imports; and capital account movements took on a greater and greater importance as the gap in current transactions widened and new public and private sources of international financing became available. External debt servicing consequently began to absorb an increasingly large proportion of the foreign exchange obtained from exports of goods and services.

During this whole period of growth, diversification and transformation of the region's external relations, however, the essential aspect of these small, agricultural-export economies persisted: the situation in the external sector largely determined the economy's overall performance, while the constraints arising out of that sector set a limit on the pace of domestic economic activity. There is thus a direct relationship between the level of exports, on the one hand, and the rates of economic expansion, accumulation and investment, level of fiscal revenue, level of employment and import capacity, on the other.

/External financing

External financing acted as a shock absorber during slowdowns, preventing decreases in the value of exports from being automatically reflected in a restriction of import capacity (and, therefore, of the economy's growth capacity), while at the same time it facilitated the process of "additive development" which will be discussed below. However, when a drop in external demand coincided with a restriction of the inflow of external financing --which otherwise would have at least partially compensated for the drop in exports-- constraints originating in the external sector acted as a brake on economic growth to such an extent that they even caused a real contraction in economic activity.

The influence of external factors on developments in the countries of the region was not confined to the economic sphere. Some of the consequences of Central America's desire to export had a profound effect on societal structure and the political order. It is well-known, for example, that the exploitation of one or two export commodities had a decisive influence on the type of division of labour which was established, due to the intensive and seasonal use of manpower to farm those crops. The availability of human resources,has thus not only played a vital role in the economic development of the region but has also shaped the dual and interdependent nature of agriculture for export and subsistence --a situation which goes a long way towards explaining the structural inequalities in the distribution of income.

The organization of the Central American economies around one or two export products has also had a profound effect on the "patterns of authority": the symbiotic relationship between dominant economic groups (exporters of agricultural products and merchants) and the government, the legacy of corruption from colonial days and the repressive methods which have historically been used to ensure a supply of manpower have contributed to the consolidation of the authoritarian non-participatory political systems of the postwar period, with the particular forms differing from one country to another and within the same country at different times (Costa Rica being the main exception).

External factors have also had a decisive influence on political interaction in the countries of the region. The virtual hegemony exercised by the United States since the signing of the Clayton-Bulwer treaty in 1850 has taken a different form during the postwar period as a result of the latent conflict between the two main world superpowers. This is not the proper place to go

/into detail

into detail about the role of the United States' foreign policy in Central America (a topic which has been the subject of many studies in recent years), but the considerable influence attained by the United States in the region is indeed worthy of note. It is not, of course, a question of attributing an omnipotent role to either of the superpowers or of insinuating that developments in Central America are the result of their designs, since the interaction among national political actors has its own dynamic, but it may nevertheless be maintained that the United States has demonstrated a capacity to set limits on political interaction in the countries of the region by placing its asymmetrical weight behind those national actors whose position is the closest to the postulates of its own foreign policy.

The leanings of United States policy have not always constituted a coherent set of postulates: some administrations have been mainly concerned with security (and, above all, the "containment of communism"), while others have been interested in evolutionary and orderly change leading to more pluralistic and equitable societies. Thus, United States administrations have sometimes supported national actors advocating orderly and peaceful change as part of a foreign policy with respect to the Latin American countries which some authors have termed "idealistic". This was what happened, for example, when it supported the heterogeneous alliances that overthrew dictatorships in Guatemala, El Salvador and Honduras immediately after the war, or those governments which promoted change under the "Alliance for Progress" during the 1960s, as well as the --perhaps reluctant-- support given to the other heterogeneous alliance which took power in Nicaragua in 1979. On other occasions the United States Government has preferred to assist the national actors who, in its opinion, are best able to ensure at least a minimum of stability in the face of radical challenges to the status quo. The best example of this more "realistic" policy might be the support given by the United States administration to the forces which overthrew the constitutional government in Guatemala in 1954.4/

However, when conflicts have arisen in United States foreign policy between the objective of promoting orderly change and that of avoiding threats to security --as has frequently occurred-- the United States Government has invariably supported those groups in each country which it has considered to be

/most capable

most capable of defending its interests. Thus, the administrations of that country have been able to set the geopolitical limits to which reference was made previously.

3. "Additive development"

The economies and societies of Central America are very different from what they were thirty years ago, not only with respect to quantity --while the gross domestic product grew from US$ 1.95 billion to US$ 7.52 billion (1970 prices) between 1950 and 1980, the population increased from 8 million to over 20 million-- but also in terms of major qualitative changes. These societies are much more segmented and more pluralistic; one major development in this respect is the emergence of middle-income strata, due partly to the progressive urbanization (only 16% of the population lived in urban areas in 1950, as compared to 43% in 1980). Furthermore, the importance of secondary activities in their economies has increased (the relative share has grown from 14.6% to 24.1% in that period), and, in general, the system of production has become more modernized and diversified from one year to the next. The countries' various geographical regions are now much more integrated, thanks to large investments in physical transport and communications infrastructure, and progress has also been made in providing educational and especially health services. Basically, these changes are attributable to the "trickle down" effect of the development style that has predominated in all these countries --with specific characteristics varying between one and another-- during the entire period under discussion. In general, these changes have been the only ones which have been permitted by those actors having the capability to keep change within certain limits, particularly those who drew their economic power from the agricultural-export pattern which has been such a vital element for this historical development style in the region. Consequently, the considerable changes that came about during the three decades following the war are essentially characterized by the way in which new economic and social strata were superimposed on previous ones as part of a process of change and modernization which nevertheless did not threaten the basic nature of the pre-existing economic structure.

/This is

This is simply another way of describing evolutionary and peaceful change: so long as pre-existing structures are not eliminated, all changes in patterns of development must, by definition, be "additive", but this does not mean that they are negligible.

What we wish to stress here, however, is that when these changes have posed a serious threat to vested interests, this has almost invariably represented their limit, especially when the interests of dominant groups have been identified --as has often, although not always, been the case-- with those of the main international actor in the Central American political arena in the terms referred to earlier. Thus, peaceful and orderly change or reform has been confined within very narrow limits in most of the countries in the region. In other words, economic progress has brought about major social changes, the ascent of many groups in the scale of income, and the formation of middle classes, but the maintenance of the historical pattern of development has meant that political institutions have made only slow and faltering progress.

This essential characteristic of "additive development" has often made it necessary for governments to seek substitutes for changes which perhaps ran the risk of exceeding those limits. For example, governments have resorted to external financing, in part, to defer or substitute for increases in the tax base; they have distributed State-owned land under so-called "colonization" programmes instead of restructuring land tenure systems; and they have turned to external savings as a substitute for (rather than as a complement to) the inadequate national mechanisms for attracting domestic savings.

Furthermore, tax pressure has come to be an interesting indicator of the limits faced in Central America by "additive development". Although substantial changes have occurred within all the countries' tax systems --as a reflection of the changes occurring in the structure of production-- it is interesting to note that fiscal revenue, as a percentage of the gross domestic product, has remained constant in some countries and increased only very slowly in others (see table 2). This tax coefficient is also seen to be extremely low in comparison with the coefficients of other countries of a similar economic and social structure. This should not be regarded as a mere coincidence: industry and trade associations in all the countries (albeit to varying degrees) have stubbornly

/Table 2

Table 2

CENTRAL AMERICA: TAXATION COEFFICIENT

	1955	1960	1965	1970	1975	1980	1981	1982	1983	1984 a/
Central America	9.5	9.3	9.4	9.7	11.3	11.4	10.9	9.2	11.5	12.7
Costa Rica	10.1	10.0	11.8	12.1	12.7	11.4	11.8	12.9	15.7	17.0
El Salvador	10.8	10.9	9.9	10.3	12.0	11.1	11.3	10.7	11.1	11.7
Guatemala	8.5	7.8	7.6	7.8	9.5	8.6	7.5	7.2	6.3	5.3
Honduras	7.3	10.1	9.7	11.2	12.1	14.0	13.2	12.8	12.0	13.8
Nicaragua	10.8	9.4	10.2	9.4	10.6	18.4	18.5	20.7	25.0	31.5

Source: ECLAC, on the basis of official data.
a/ Preliminary figures.

resisted tax increases, especially in respect of production and income. Financial constraints owing to the limited size of fiscal revenue have severely hampered the public sector's capacity to play a more active role in development, while the modest increases achieved in the coefficient of public spending (see table 3) have increasingly been financed through borrowing, especially from external sources.

The public sector's limited share in the gross domestic product, as measured by the central governments' intake of tax revenue and their expenditure, has also fitted in with the "laissez-faire" position of the dominant groups in Central American society. In the 1950s and 1960s, this sector gradually took over public services such as the generation and distribution of electricity, telephone communications, railway transport and port administration, while State activity was strengthened with the establishment of public development banks and bodies regulating the prices of basic goods. In all the countries, however, the public sector scrupulously avoided taking part in activities which were of interest to private enterprise. The main exception to this rule was perhaps the Costa Rican financial intermediation system.

/Table 3

Table 3

CENTRAL AMERICA: COEFFICIENT OF TOTAL CENTRAL GOVERNMENT SPENDING

	1955	1960	1965	1970	1975	1980	1981	1982	1983	1984[a/]
Central America	10.6	11.2	11.3	11.6	15.8	19.3	20.2	20.4	23.3	22.7
Costa Rica	11.2	13.3	13.8	13.7	17.9	20.0	16.9	16.8	21.9	21.8
El Salvador	10.9	12.2	10.9	10.3	13.4	17.2	19.8	20.5	28.0	22.1
Guatemala	9.5	9.3	10.6	9.9	12.5	15.2	16.9	14.4	12.1	11.2
Honduras	10.0	12.2	10.8	14.7	21.0	24.9	24.1	28.1	26.2	29.7
Nicaragua	12.4	11.1	11.2	11.8	19.4	29.5	32.4	37.4	56.4	55.1

Source: ECLAC, on the basis of official data.
a/ Preliminary figures.

Another example of the persistence of previous structures in the process of change described here is the limited forward or backward linkages of traditional agricultural export activities, inasmuch as the sectors depending on them have not tried to diversify in a systematic way by investing in more complex activities. The new agricultural export activities which have emerged (cotton, sugar and meat) have, in effect, merely repeated the pattern of traditional commodities, due to the fact that they have very few linkages with other production activities. Thus, traditional producers have diversified very little and the State has shared very little in the surplus generated by them. This, then, is how traditional economic and social structures have endured and how the changes so often referred to above have been superimposed on them without altering them in any essential way. In other words, changes have occurred within relatively narrow limits (although they may have varied somewhat from one country to another). Thus, despite the considerable expansion and change undergone by Central American economies and societies during the thirty years following the war, this change has proved to be insufficient, paradoxically enough, to meet the rising expectations of large segments of the population. Furthermore, the

/instinct for

instinct for self-preservation of vulnerable social systems has resulted in most of the countries in the continuation of existing economic patterns (which were able to take advantage of the international economic boom), sustained by political institutions of an exclusive nature, at least in terms of the distribution of power and of the benefits of economic development. Consequently, the social mobilization and gradual upward movement which went along with the postwar boom could not, in a comparable sense, make up for the backwardness of some political structures.

4. The exclusive nature of development

As a result of the foregoing, despite their economic dynamism the countries of the region were not able, during the thirty years following the war, to bring about a significant improvement in the distribution of income or to reduce the number of Central Americans living in a situation of extreme poverty. According to household surveys conducted in recent years, typically around 1980, the poorest 20% of the population received less than 4% of national income whereas, at the other extreme, the richest 20% of the population accounted for over 55%. There were substantial differences from one country to another, with the most untypical situation corresponding once again to Costa Rica (see table 4). In those countries where surveys were conducted at different times, available evidence --despite the use of methodologies which were not always comparable-- indicates that the gap between the groups at the two extremes of the scale widened, although the relative share of the intermediate strata may have tended to increase (see table 5). In Guatemala and Costa Rica, there was even a decrease in the real per capita income of the poorest 20% of the population. What is more, as discussed below, there is evidence that the distributive structure deteriorated even further between 1980 and 1984 as a result of rising unemployment and the fact that real wages lagged far behind inflation.

In terms of absolute figures, out of the total of over 20 million persons living in Central America in 1980, some 13.2 million (54%) suffered from poverty --in the sense that their income did not cover their basic needs-- and over 8.5 million (41%) did not even have sufficient income to cover the value of the minimum food basket regarded as necessary from a biological-nutritional standpoint (see table 6). The situation was much more serious in rural areas than in

/Table 4

Table 4

CENTRAL AMERICA: STRUCTURE OF INCOME DISTRIBUTION AND LEVELS OF PER CAPITA INCOME, BY COUNTRY, AROUND 1980

(1970 dollars)

Strata	Costa Rica		El Salvador		Guatemala		Honduras		Nicaragua	
	%	Average income	%	Average income	%	Average income	%	Average income	%	Average income
Poorest 20%	4.0	176.7	2.0	46.5	5.3	111.0	4.3	80.7	3.0	61.9
30% below the mean	17.0	500.8	10.0	155.1	14.5	202.7	12.7	140.0	13.0	178.2
30% above the mean	30.0	883.0	22.0	341.2	26.1	364.3	23.7	254.6	26.0	350.2
Richest 20%	49.0	1 165.2	66.0	1 535.5	54.1	1 133.6	59.3	796.3	58.0	1 199.8

Source: ECLAC, on the basis of official data supplied by the countries.

/Table 5

Table 5

CENTRAL AMERICA: FAMILY INCOME DISTRIBUTION TRENDS IN THE 1970s

(1970 dollars)

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

Source: ECLAC, on the basis of official data from the countries.
a/ Urban sector.

/Table 6

Table 6

CENTRAL AMERICA: ESTIMATES OF THE INCIDENCE OF POVERTY AROUND 1980

	Total			Costa Rica			El Salvador			Guatemala a/			Honduras b/			Nicaragua		
	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural
	Thousands of persons																	
Total	20 696	8 315	12 381	2 213	1 011	1 202	4 747	2 119	2 628	7 262	2 485	4 777	3 691	1 229	2 462	2 733	1 471	1 262
State of poverty	13 178	3 738	9 440	549	138	411	3 267	1 221	2 046	5 166	1 168	3 998	2 515	540	1 975	1 681	671	1 010
Extreme poverty	8 647	2 130	6 517	300	75	225	2 427	943	1 484	2 879	418	2 461	2 092	376	1 716	949	318	631
Basic needs not satisfied	4 531	1 608	2 923	249	63	185	840	278	562	2 287	750	1 537	423	164	259	732	353	379
Not poor	7 518	4 577	2 941	1 664	873	791	1 480	898	582	2 096	1 317	779	1 176	689	487	1 052	800	252
	Percentage distribution																	
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
State of poverty	63.7	45.0	76.2	24.8	13.6	34.2	68.1	57.6	76.4	71.1	47.0	83.7	68.2	43.9	80.2	61.5	45.6	80.0
Extreme poverty	41.8	25.6	52.6	13.6	7.4	18.7	50.6	44.5	55.4	39.6	18.8	51.5	56.7	30.6	69.7	34.7	21.6	50.0
Basic needs not satisfied	21.9	19.4	23.6	11.2	6.2	15.5	17.5	13.1	21.0	31.5	30.2	32.2	11.5	13.3	10.5	26.8	24.0	30.0
Not poor	36.3	55.0	23.8	75.2	86.4	65.8	31.9	42.4	23.6	28.9	53.0	16.3	31.8	56.1	19.8	38.5	51.4	20.0

Source: ECLAC, Proyecto de Necesidades Básicas en el Istmo Centromaericano, based on information from the countries and CELADE, Boletín Demográfico, vol. XIV, No. 28.

a/ The distribution of the urban and rural population corresponds to the figures given in the Household Income and Expenditure Survey, 1979-1980.

b/ The distribution of the urban and rural population corresponds to the figures given in the Household Income and Expenditure Survey, 1978-1979.

/urban ones,

urban ones, and there were major differences from one country to another (in Costa Rica, less than 25% of the population was living below the poverty line, whereas in Guatemala the figure was over 70%). Furthermore, although it is very probable that the percentage of Central Americans living under that line is smaller today than it was thirty years ago, it is nevertheless true that in absolute numbers, as a result of population growth, there are more "poor" --and more "non-poor" as well-- today than in the period immediately following the Second World War.

In summary, the development style which is characteristic of the region has had a concentrating effect or at any rate an exclusive effect in the sense that it has benefited different strata of the population in a clearly unequal way and has increased the degree of income concentration in some countries. In spite of the fact that there have been thirty years of rapid and sustained economic expansion, over half of all Central Americans --and three-quarters of those living in rural areas-- do not have a sufficient income to cover their essential needs for food, housing, clothing and basic services.

The exclusive pattern of development is not confined to the economic and social spheres. If one could speak of an essential characteristic of political interaction in most Central American countries, that characteristic would be the absence of broad popular participation, resulting in the virtual exclusion of the majority --especially peasants-- from political life. Neither the industrialization nor the urbanization which have occurred since the war have been able to modify to any substantial extent the still essentially agricultural nature of the societies. In rural areas, the majority of the people, with some exceptions, continue to be passive observers rather than organized actors in the political systems. This exclusive trait has also been a determining factor in the characteristics and scope of the various modernization projects undertaken in the region.

Thus, with some exceptions, their lack of real participation has meant that the emerging social classes have not been in a position to counterbalance the traditional power groups in the running of public affairs, and there has

/sometimes been

sometimes been an increase in the tensions caused by the contrast between rapid social development and the slow institutional development in the political arena. Put another way, the gap between the transformation and the strengthening of the political practices and institutions of a more complex society have contributed to the underlying situation of instability in Central America.

In summary, with the exception of Costa Rica, political interaction in Central America has generally been of an elitist nature and has not included the largest groups of the region's population in the project for the modernization of its societies. To do so would perhaps have involved eliminating, albeit gradually, the elements of authoritarianism mentioned above, and it would have called for the execution of long-postponed reforms to satisfy the aspirations of groups which have thus far been virtually excluded from the benefits of development.

II. RECENT EVENTS AND THE CURRENT ECONOMIC CRISIS

As already mentioned, Central America is passing through a critical situation of unprecedented proportions and seriousness. Economic activity has been declining, there are major imbalances with the exterior and in public-sector finances, levels of saving and investment have plummeted, and there is less and less manouvering room for attempting to eliminate these imbalances and to conduct economic policy.

In view of the high and rising levels of open unemployment and underemployment, it may be assumed that the long-standing inequalities of the Central American economies are tending to get worse. The lengthiness of the depression and the limited external borrowing capacity of some countries have made it necessary to undertake adjustment programmes --some of them within the framework of agreements with the International Monetary Fund-- which involve the adoption of unpopular economic policies.

The political upheaval which is being experienced by the region is closely related to the economic phenomena described above, and all this is perhaps leading up to a breakdown of "additive development" at a time when the characteristics of some alternative model of development are still not in sight. What is more, the gloomy economic outlook described above slows down and hinders attempts to bring about social change, yet the lack of such change could possibly jeopardize the political stability of a number of countries in the region.

The severity of the crisis has given rise to a climate of demoralization which no-one knows how to tackle or overcome. Uncertainty and even perplexity is caused by the realization that many problems go beyond the constituted governments' capacity for action and are beginning to erode the very foundations of the Central American integration process.

1. The break with historical trends

During the two-year period 1977-1978, the trends briefly described in the preceding chapter reached a turning point, at least in so far as sustained economic growth is concerned. Since that biennium, a progressive slowdown occurred which eventually resulted in negative rates in most of the countries in 1981 and 1983 and in all of them in 1982 (see figure 1 and table 1). The duration, intensity and special

/characteristics of

characteristics of this situation have no precedent in the postwar period. Suffice it to say that, after 30 years of steady increase in the per capita income of these five countries (with sporadic interruptions), there has been a widespread drop during the past five years. Although in 1984 a halt was put to the economic downturn of preceding years (except in Nicaragua), the picture is far from being that of a recovery, at least in most of the countries. Thus, the real per capita income recorded at the end of the past year in Costa Rica and Guatemala barely equalled its 1972 level; in Honduras, it stood at the 1970 level, and in El Salvador and Nicaragua the situation was even more dramatic, in that income was equivalent to the 1960 and 1965 levels, respectively. The widespread deterioration in the level of material well-being is not only reflected in the figures cited above, but is also shown by less tangible indicators such as the levels of social co-existence, personal security and quality of life of Central Americans.

The economic integration process, which had made it possible in previous periods to offset the recessionary fluctuations of the international economy, went to the other extreme and might now be said to be a factor which is exacerbating the crisis. The depth of this crisis, in combination with political circumstances and the lack of a strategy of regional scope, has caused the economic interdependence among the five countries to become a mechanism that now transmits recessionary economic forces.

The fact that this marked deterioration in economic trends has coincided with a period of growing political upheaval could be functionally associated with some of the characteristics of Central American society discussed earlier. One of the many manifestations of these phenomena led some groups to question the existing social order, resorting to violent challenges to the status quo in order to do so, and this in turn gave rise to violent responses which contributed to a rapid polarization of positions in certain countries, especially El Salvador and Nicaragua. There are multiple complex interrelationships which may reinforce one another among local political and economic factors, as well as the way in which both are intermingled with outside influences. These phenomena will be reviewed briefly below.

/2. The

2. The impact of exogenous phenomena

It is no accident that the economic crisis has affected all the countries, regardless of the extent of social peace or upheaval which existed in them, the economic policy objectives pursued, or the nature of relations between the public and private sectors. All of them have nevertheless been seriously affected by external factors. This was inevitable, in reality, because the common denominator influencing them all has been the deep international economic recession which, as already noted, has had a great impact on the overall performance of the Central American economies and even places a limit on their capacity for growth. Furthermore, the international recession has been compounded by the economic effects of the political crisis (the discouragement of private investment, flight of capital, difficulties in attracting external financing), and these two factors have combined and reinforced one another to such an extent that they have caused an economic breakdown which knows no precedent in Central America since the 1930s.

As far as the effects of the disorder reigning in the international economy are concerned, it may be recalled that the difficulties experienced by the industrialized countries in 1978-1979 (low growth rates, rapid inflation, declining savings, lags in the application of technological innovations) were compounded by another increase in hydrocarbon prices in 1979. Even greater importance may be attached to the attempts to change the economic policy in some industrialized countries which have stressed the fight against inflation (with some positive results), with the measures used to do this including restrictive monetary policies that have resulted in higher interest rates. These policies have tended to contribute to the slowdown of economic activity in the countries where they were applied, and have been partly responsible, in general, for the slower pace of the world economy, with the attendant repercussions on the levels of international trade. For the Central American countries, this situation has given rise to a decline in the demand for traditional export products. In view of the persistence of international inflation (although this has been dropping since 1982), this lowered demand causes a marked deterioration in the terms of trade. Furthermore, in the financial sphere the Central American countries have been adversely affected by the high interest rates on their large external debt and by recent difficulties in gaining access to fresh external financing.

/The figures

The figures given in table 7 and 8 speak for themselves. With the drop in the prices of virtually all the products which Central America exports and continuous upward pressure on the prices of the goods it imports --especially of hydrocarbons in 1979-1980--,5/ by the end of 1984 the region's terms of trade had deteriorated by nearly 50% since 1977, while the purchasing power of exports had fallen 30%. In general terms, the above means that if the 1977 purchasing power of exports had remained constant, the total value of exports in 1984 would have been 40% greater than it was, which would have added 2.0% to the gross domestic product in that year.

Between 1978 and 1983, the terms of trade for goods were negative in all the countries, while the very modest upturn seen in 1984 (3.8%) did next do nothing to reverse the plunge they had taken during the preceding six years. In addition, some countries' export volumes fell in absolute terms (including some export items, such as nickel in Guatemala, which ceased to be exported due to the lack of a market for them), increasing difficulties were encountered in incorporating new product lines into external sales as a result of market constraints and the protectionism of some industrialized countries, and there was a notable drop in the exports of some services such as tourism, not only due to the worldwide recession, but also due to some non-economic factors present in Central America.

On the other hand, despite the economic slowdown, the production of the Central American countries called for imports, especially in order to meet the demand created by the rise in public spending fostered by the governments in the early years of this recessionary cycle, partly to counteract the sluggishness of private investment. Consequently, the trade deficit of the five countries jumped from US$ 432 million in 1977 (equivalent to 2% of the GDP) to nearly US$ 1.6 billion in 1981 (8.7% of the GDP), subsequently levelling out at around US$ 1 billion annually between 1982 and 1984 (5.4% of the GDP in this last year, although there were major differences between one country and another) (see table 9). In addition, the debt service soared, not only because of growing indebtedness but also and especially (at least until mid-1984), because of skyrocketing interest rates. External factor payments rose, for example, from US$ 280 million in 1977 to US$ 980 million in 1984 for the region as a whole. This accounts for the fact that the deficit on current account climbed from US$ 573 million to over US$ 1.8 billion between the two years mentioned (3.8% and 9.3% of the GDP, respectively) (see table 10).

/Table 7

Table 7

CENTRAL AMERICA: MAIN FOREIGN TRADE INDICATORS

	1976	1977	1978	1979	1980	1981	1982	1983	1984a/
			Growth rates						
Exports of goods									
Value	29.7	35.3	-2.4	15.8	4.9	-10.3	-12.2	-1.0	5.2
Volume	5.1	-0.9	2.6	13.0	-6.4	-2.7	-8.3	0.8	-1.4
Unit value	23.4	36.5	-4.9	2.5	12.1	-7.8	-4.3	-0.9	6.7
Imports of goods									
Value	20.1	27.0	8.9	6.3	15.0	-2.7	-19.3	-0.9	9.0
Volume	22.0	20.5	-1.6	-5.5	-3.3	-7.1	-23.7	-1.8	6.0
Unit value	-1.6	5.4	10.7	12.5	18.9	4.7	5.8	0.9	2.8
Terms of trade (goods)	25.4	29.5	-14.1	-8.9	-5.7	-11.9	-9.5	-1.8	3.8
			Indexes						
Terms of trade	100.4	130.0	111.7	101.8	96.0	84.6	76.6	75.2	78.1
Purchasing power of exports of goods	140.0	179.7	158.4	163.0	143.8	123.2	102.2	100.3	102.6
Purchasing power of exports of goods and services	147.9	181.3	163.5	169.4	151.1	126.9	108.2	106.6	108.5

Source: ECLAC, on the basis of official data.

a/ Preliminary figures.

/Table 8

Table 8

CENTRAL AMERICA: TERMS OF TRADE (GOODS)

	Growth rates								
	1976	1977	1978	1979	1980	1981	1982	1983	1984 a/
Total	25.4	29.5	-14.1	-8.9	-5.7	-11.9	-9.5	-1.8	3.8
Costa Rica	19.7	30.6	-17.7	-1.6	-2.8	-14.8	-10.2	-4.5	-0.7
El Salvador	39.6	47.3	-26.2	-8.2	-15.4	-12.6	-0.8	-7.1	13.1
Guatemala	28.6	33.4	-5.1	-15.7	-2.7	-8.7	-13.0	-2.4	1.2
Honduras	8.2	15.4	-0.4	-9.1	-1.8	-13.0	-5.1	-1.0	1.1
Nicaragua	21.9	16.2	-13.8	-16.0	-3.4	-11.7	-10.4	-12.7	8.1

Source: ECLAC, on the basis of official data.

a/ Preliminary figures.

/Table 9

Table 9

CENTRAL AMERICA: BALANCE OF PAYMENTS TRADE DEFICIT, IN ABSOLUTE TERMS AND AS A PERCENTAGE OF THE GDP

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984[a/]
					Millions of dollars					
Total	570	427	432	887	653	1 323	1 572	906	898	1 044
Costa Rica	166	146	164	269	425	460	127	-73	16	73
El Salvador	79	12	-29	234	-2	51	237	218	151	207
Guatemala	77	227	99	354	320	228	570	323	141	151
Honduras	101	60	74	89	99	185	177	56	120	139
Nicaragua	147	-18	124	-59	-160	399	461	382	470	474
					As a percentage of the GDP					
Total	6.0	3.5	2.8	5.4	3.5	6.4	6.8	5.1	4.8	5.3
Costa Rica	8.7	6.1	5.3	7.6	10.5	10.1	4.8	3.0	0.5	2.1
El Salvador	4.4	0.5	1.0	7.6	0.1	1.5	7.3	6.9	4.6	6.1
Guatemala	2.4	5.2	1.8	5.8	4.6	2.9	7.2	4.3	1.8	1.9
Honduras	9.7	4.7	4.8	4.9	4.6	7.4	7.0	2.2	4.5	5.5
Nicaragua	9.5	1.0	5.5	2.9	7.7	17.1	18.2	18.7	23.0	20.0

Source: ECLAC, on the basis of official data.

Note: Minues sign indicates a surplus.

a/ Preliminary figures.

/Table 10

Table 10

CENTRAL AMERICA: BALANCE OF PAYMENTS CURRENT ACCOUNT DEFICIT, IN ABSOLUTE TERMS AND AS A PERCENTAGE OF THE GDP

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984[a/]
					Millions of dollars					
Total	700	455	573	1 088	880	1 690	2 152	1 715	1 608	1 806
Costa Rica	218	203	226	364	554	654	408	305	358	371
El Salvador	95	11	-21	249	24	117	271	271	239	276
Guatemala	65	79	37	271	180	178	567	376	224	314
Honduras	125	115	139	170	212	331	321	249	260	311
Nicaragua	197	47	192	34	90	407	585	514	527	517
					As a percentage of GDP					
Total	7.4	3.7	3.8	6.6	4.7	8.1	11.6	9.6	8.6	9.3
Costa Rica	11.4	8.4	7.4	10.3	13.7	14.3	15.6	12.6	11.9	10.9
El Salvador	5.3	0.5	0.7	8.1	0.7	3.4	8.1	8.6	7.3	8.1
Guatemala	2.1	1.8	0.7	4.5	2.6	2.3	7.2	5.0	2.9	4.0
Honduras	12.0	8.9	9.0	9.3	9.8	13.1	15.8	9.6	9.9	12.3
Nicaragua	12.7	2.5	8.6	1.7	4.3	17.4	27.1	25.1	25.8	21.8

Source: ECLAC, on the basis of official data.

Note: Minus sign indicates a surplus.

a/ Preliminary figures.

/During 1979-

During 1979-1980, Central America had ample access to both public and, especially, private international financing. External support for reconstruction programmes in Nicaragua were a major factor in this phenomenon, and these funds partly substituted for domestic saving, which tended to disappear rapidly as a result of public-sector deficits and the flight of private capital. In 1977 only 12.6% of total savings came from external sources; in contrast, this figure had grown to 38.8% in 1981 and remained above 35% in 1984 (see table 11). During the same period, the region's external public debt rose from US$ 2.4 billion to just under US$ 15 billion, thereby pointing up the limitations on a number of countries' capacity for additional borrowing.

This last fact, combined with the restrictions on the availability of new resources (the commercial banking system feels that the region is of high financial and political risk, while funds from most official sources have tended to diminish as a result of the austerity policies of the donor countries), created serious difficulties as from 1981 with respect to the mobilization of fresh external financing; thus, from 1982 onwards external savings, far from counteracting the drop in domestic savings, compounded that trend.

Most of the countries' balance-of-payments positions have shown increases in net capital inflows since 1981, especially in 1983 when they amounted to nearly US$ 2 billion. Roughly half of this revenue, however, does not represent injections of fresh foreign exchange, but is rather the result of the renegotiation of payments which have fallen due on the existing external debt, especially in Costa Rica and Nicaragua.6/

Those countries which have gained access to a larger amount of official financing, especially of a bilateral nature (Costa Rica, El Salvador and, to a lesser extent, Honduras) have had to accept increasingly stiff terms and conditions, mostly regarding their economic policy but also at times even including other aspects of national affairs. Along these lines, it should be noted that during 1984 the International Monetary Fund, which provides support for adjustment programmes in three countries, interrupted its disbursements in two of them (Guatemala and Honduras) because quantitative goals had not been met, while in the third (Costa Rica) a final agreement to renew the programme which had expired in December 1984 had still not been reached at the time of writing this report.

/Table 11

Table 11

CENTRAL AMERICA: INVESTMENT AND SAVINGS TRENDS

(Millions of US dollars at constant 1870 prices)

	1977		1978		1979		1980		1981		1982		1983		1984a/	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Central America																
Gross domestic product b/	10 091	100.0	10 519	100.0	10 535	100.0	10 624	100.0	10 492	100.0	10 040	100.0	10 015	100.0	10 170	100.0
Gross domestic investment	2 218	22.0	2 231	21.2	1 893	18.0	1 969	18.5	1 808	17.2	1 405	14.0	1 439	14.4	1 529	15.0
Domestic savings	1 939	19.2	1 719	16.3	1 548	14.7	1 409	13.3	1 106	10.5	871	8.7	949	9.5	993	9.7
External savings	279	2.8	512	4.9	345	3.3	560	5.2	702	6.7	534	5.3	490	4.9	538	5.3
Ratio: external savings/ total savings		12.6		22.9		18.2		28.4		38.8		38.0		34.1		35.1
Costa Rica																
Gross domestic product b/	1 975	100.0	2 099	100.0	2 202	100.0	2 220	100.0	2 170	100.0	2 012	100.0	2 059	100.0	2 159	100.0
Gross domestic investment	554	28.0	552	26.3	603	27.4	643	29.0	400	18.4	298	14.8	373	18.1	423	19.6
Domestic savings	443	22.4	399	16.0	386	17.5	421	19.0	270	12.4	204	10.1	266	12.9	315	14.5
External savings	111	5.6	153	7.3	217	9.9	222	10.0	130	6.0	94	4.7	107	5.2	108	5.0
Ratio: external savings/ total savings		20.0		27.7		36.0		34.5		32.5		31.5		28.7		25.5
El Salvador																
Gross domestic product b/	2 176	100.0	2 316	100.0	2 276	100.0	2 079	100.0	1 906	100.0	1 800	100.0	1 786	100.0	1 813	100.0
Gross domestic investment	531	24.4	547	23.6	422	18.5	287	12.8	276	14.5	234	13.0	240	13.4	257	14.2
Domestic savings	542	24.9	409	17.7	428	18.8	287	13.8	185	9.7	148	8.2	165	9.2	165	9.1
External savings	-11	-0.5	138	5.9	-6	-0.3	-	-	91	4.8	86	4.8	75	4.2	92	5.1
Ratio: external savings/ total savings		-2.1		25.2		-1.4		-		33.0		36.5		31.2		35.8

/Table 11 (conc.)

Table 11

	1977		1978		1979		1980		1981		1982		1983		1984a/	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Guatemala																
Gross domestic product b/	3 571	100.0	3 750	100.0	3 926	100.0	4 074	100.0	4 101	100.0	3 957	100.0	3 850	100.0	3 858	100.0
Gross domestic investment	611	17.1	675	18.0	585	14.9	499	12.2	575	14.0	465	11.8	384	10.0	386	10.0
Domestic savings	592	16.6	544	14.5	498	12.7	440	10.8	385	9.4	347	8.8	315	8.2	294	7.6
External savings	19	0.5	130	3.5	87	2.2	59	1.4	190	4.6	118	3.0	68	1.8	92	2.4
Ratio: external savings/ total savings		3.1		5.2		14.9		11.8		33.0		25.4		17.7		23.8
Honduras																
Gross domestic product b/	1 116	100.0	1 199	100.0	1 281	100.0	1 316	100.0	1 331	100.0	1 307	100.0	1 301	100.0	1 337	100.0
Gross domestic investment	203	18.2	323	26.9	342	26.7	383	29.1	315	23.7	208	15.9	224	17.2	261	19.5
Domestic savings	139	12.5	248	20.7	258	20.1	267	20.3	209	15.7	127	9.7	139	10.7	163	12.2
External savings	64	5.7	75	6.2	84	6.6	116	8.8	106	8.0	81	6.2	85	6.5	98	7.3
Ratio: external savings/ total savings		31.5		23.2		24.6		30.3		33.7		38.9		37.9		37.5
Nicaragua																
Gross domestic product b/	1 253	100.0	1 155	100.0	850	100.0	936	100.0	984	100.0	973	100.0	1 018	100.0	1 003	100.0
Gross domestic investment	319	25.5	135	11.7	-59	-6.9	157	16.8	242	24.6	200	20.5	218	21.4	202	20.1
Domestic savings	223	17.8	19	10.3	-22	-2.6	-6	-0.6	57	5.8	45	4.6	63	6.2	56	5.6
External savings	96	7.7	16	1.4	-37	-4.3	163	17.4	185	18.8	155	15.9	155	15.2	146	14.5
Ratio: external savings/ total savings		30.1		11.9		-62.7		103.8		76.4		77.5		71.1		72.3

Source: ECLAC, on the basis of official data.

a/ Preliminary figures.
b/ At market prices.

/Finally, another

Finally, another phenomenon of singular importance which was heightened during this period was the persistent and massive flight of capital from the entire region --albeit in some countries more than in others-- on account of both economic and especially non-economic factors. Very roughly, it is estimated that between 1979 and 1984 this flow came to about US$ 2 billion to US$ 2.5 billion for the five countries of the region.7/ This naturally aggravated each country's external situation and was a decisive influence in the plunge in economic activity. Paradoxically, the depletion of the countries' international monetary reserves at the outset of the recessionary period and their high level of external indebtedness were what made the above-mentioned capital outflows possible.

Furthermore, exogenous factors not only had an impact on economic performance: they also influenced political events. As will be discussed below, significant changes occurred in the region's political interaction in the late 1970s, especially in Nicaragua. Just as the long period of postwar economic expansion had reached a turning point, the social and political structures also were to undergo a major change. These factors gave rise to an alliance of many different groups which challenged the existing régime in Nicaragua. It was no coincidence, however, that the changes occurring in that country --like those which occurred in Guatemala, El Salvador and Honduras in the 1940s-- coincided with a United States foreign policy designed to support orderly change based on principles valued by that country. Thus it was that, during a brief interlude, the geopolitical limits referred to earlier were broadened and it became feasible to challenge the traditional model of development in one of these countries.

3. The challenge to the "additive development" model

The programme adopted by the Government of National Reconstruction of Nicaragua differs, in effect, from the well-known traditional guidelines. In another context, the events in El Salvador also depart from the "additive development" model in that they have given rise to changes which, in one way or another, alter pre-existing structures. It might even be said that, under the double onslaught of the economic crisis and the challenge to the status quo, pre-existing structures can hardly survive in some countries unless fundamental adjustments are made in them. This in no way prejudges the nature of the social organizations which might come to replace the preceding ones, nor their ideological affiliation; it only means that the postwar model that has prevailed for over 30 years may have run its course.

/Some of

Some of the economic phenomena which are the object and the subject of the crisis clearly illustrate the above. One such example might be the accumulation of capital. Investment has been declining markedly since 1978; this has been both a result and a cause of the slowdown in economic activity, the drop in domestic savings, the flight of capital and the reaction of the private sector to the political and social tensions troubling the region. Table 11 shows that domestic savings in the five countries fell from 19.2% of the gross domestic product to 9.7% between 1977 and 1984 --a serious situation for countries attempting to develop Private investment also suffered a particular reverse: it decreased in all the countries (the regional coefficient of private investment dropped from 13.4% in 1977 to less than 8% in 1984), while in those countries experiencing civil disturbances the coefficient of private capital formation has fallen by over 50% during the past seven years. The public sector made an effort to counteract this drop --thereby exacerbating another long-standing imbalance in the Central American economies: the deficit in the public finances-- but this was not enough: the total investment coefficient went down in all the countries and tended to create bottlenecks in those areas where public spending could not take the place of private investment.

The deliberate efforts made by governments to counteract the decline in economic activity at a time when there was a tendency for fiscal revenue to decrease caused the share of public spending in the regional GDP to rise from 17.7% in 1977 to 21.3% in 1981, although the taxation coefficient had dropped from 12.9% to 11.6% between those same years. The difference between the performance of expenditure and income caused the total deficit of the five governments to climb from 460 million Central American pesos in 1977 (3% of the GDP) to nearly 1.6 billion in 1984 (8.0% of the GDP) (see table 12). Since there was insufficient external financing to cover the deficit, domestic financing was used, but this expedient indirectly increased the balance-of-payments deficit (because of the imported component of the expenditure) and in some cases absorbed most of the expansion in domestic credit, thereby taking resources away from the countries' private sectors. Forces thus came into play which tended to disrupt or have already disrupted the traditional price and exchange-rate stability of the countries of the region: yet another manifestation of the gradual functional impoverishment of the pre-existing structures.

/Table 12

Table 12

CENTRAL AMERICA: CENTRAL GOVERNMENT DEFICITS

	1976	1977	1978	1979	1980	1981	1982	1983	1984 a/
	Millions of Central American pesos								
Total	579	459	789	910	1 470	1 609	1 462	1 709	1 571
Costa Rica	150	136	211	324	418	113	78	157	113
El Salvador	27	-60	52	36	198	232	249	313	244
Guatemala	225	98	138	254	446	674	459	301	316
Honduras	84	102	150	140	243	248	382	343	374
Nicaragua	93	183	238	156	165	242	294	595	524
	As a percentage of the GDP								
Total	4.7	3.0	4.8	4.9	7.1	8.7	8.2	9.1	8.0
Costa Rica	6.2	4.4	6.0	8.0	9.2	4.3	3.2	5.2	3.3
El Salvador	1.1	-2.1	1.7	1.0	5.7	7.1	7.9	9.6	7.2
Guatemala	5.2	1.8	2.3	3.7	5.7	8.5	6.0	3.9	4.2
Honduras	6.5	6.6	8.2	6.5	9.5	9.9	14.8	13.0	14.8
Nicaragua	5.0	8.2	11.7	7.5	7.1	11.2	14.4	29.1	22.1

Source: ECLAC, on the basis of official data.

Note: Minus sign indicates a surplus.

a/ Preliminary figures.

/4. The

4. The implications for intra-Central American co-operation

External sector constraints, reflected in the shortage of foreign exchange, have worsened to such an extent that since 1981 the countries registering deficits in intra-regional trade here even experienced difficulty in covering their balances due. At first, the central banks of the surplus countries extended bilateral lines of credit, and regional machinery was later established to deal with the same problem on a multilateral basis (the Central American Common Market Fund). When these sources were depleted,8/ however, and since sufficient assistance was not forthcoming from the international financial community, the lack of foreign exchange began to limit intra-Central American trade.

Some countries responded to the constraints affecting their external sectors by adopting exchange measures --parity variations, the use of multiple rates, or controls on the movement of foreign exchange-- which influenced the relative terms of trade at the inter-Central American level and, in some cases, restricted the volume of commercial transactions. As a result of these phenomena, intra-regional trade ceased to play its traditional role as a factor offsetting cyclical lows in extra-regional trade and became one more victim of the external-sector crisis. Thus, the value of such trade has steadily declined --from 1.13 billion Central American pesos in 1980 to 742 million in 1984-- while its relative share in the total exports of the five countries fell from 23.1% to 18.5% between those two years (see table 13).

One of the many repercussions of this situation on the productive apparatus was that the level of industrialization --which, as previously stated, had risen steadily between 1950 and 1978-- lost momentum and declined from 17.1% in 1978 to 16.2% in 1982 and to 16% in 1984. In other words, industry grew more rapidly than the economy as a whole during the boom period, but has proved to be less dynamic than the economy as a whole during the economic recession.

Another factor is that, although the Central American governments have historically managed to separate the sphere of economic co-operation from that of political relations and indeed continue to do so, the growing number of different ideologies now poses a latent risk that political differences may overflow into the sphere of economic co-operation just when intra-regional co-operation is most necessary in order to mitigate the effects produced by the external sector. Moreover, the danger that intra-regional conflicts might become internationalized could lead to a greater fragmentation of the Central American Isthmus, thereby repeating painful historical episodes of the past.

/Table 13

Table 13

CENTRAL AMERICA: VALUE OF INTRA-REGIONAL TRADE AND ITS SHARE IN TOTAL EXPORTS

	1977	1978	1979	1980	1981	1982	1983	1984[a/]
	Value of exports to the rest of Central America (millions of Central American pesos)							
Total	785 355	862 720	891 731	1 129 160	936 792	762 850	757 706	742 138
Costa Rica	173 802	178 679	175 354	270 328	238 023	164 592	187 089	175 459
El Salvador	211 653	233 569	266 601	295 796	206 484	174 229	168 101	176 515
Guatemala	222 465	254 971	299 602	403 728	355 501	320 067	308 155	289 851
Honduras	43 449	49 199	60 011	83 889	65 912	51 876	61 377	57 830
Nicaragua	133 986	146 302	90 163	75 419	70 872	52 086	32 984	42 983
	Ratio between the value of exports to the rest of Central America and the value of total exports (percentages)							
Total	19.0	21.4	19.1	23.1	21.3	19.8	19.8	18.5
Costa Rica	21.0	20.7	18.6	27.0	23.7	18.9	21.5	18.3
El Salvador	21.7	29.1	23.5	27.5	25.9	24.7	23.0	23.3
Guatemala	19.1	23.3	24.5	26.6	27.4	26.7	28.2	25.5
Honduras	8.2	7.9	7.9	9.9	8.4	7.7	8.8	7.5
Nicaragua	21.1	22.6	14.6	16.7	14.0	12.8	7.7	11.0

Source: SIECA.
a/ Preliminary figures.

III. SHORT-TERM PROSPECTS

Most of the Central American countries, as noted in the preceding chapter, have been registering negative growth rates and sharp imbalances in both the external sector and public finances for the past five or six years. Nearly all of them began adjustment programmes around 1981, once their international monetary reserves had been exhausted. The intensiveness of the policies and the ways in which they were applied varied a great deal from one country to another. As a general rule, however, imports dropped sharply (sometimes as a result of exchange rate adjustments, and other times simply as a reflection of quantitative restrictions and lowered demand), public spending was reduced, and restrictive credit policies and conservative wage policies were applied. In some cases, tax collection was also increased and the due dates for payments on the external debt were restructured. Even Nicaragua adopted a series of measures in 1984 --belatedly and without the support of the International Monetary Fund-- which point in the same direction.

Nonetheless, as already noted, in 1984 --two or more years after the adjustments were initiated-- the outlook continued to be unpromising. In four out of the five economies, the per capita gross domestic product showed a steady decline, and all of them, to differing extents, continued experiencing domestic and external financial imbalances (in two of the countries, the IMF even held up the disbursement of standby credits because the programmes that had been agreed upon were not fulfilled).

What are the prospects, then, at the beginning of 1985, that the economies of the region will successfully adjust to the changed circumstances at the international level and will be able to create a new basis upon which to reactivate production? Part of the material that could provide an answer to that question is explored in the following pages.

1. External and internal determinants

As 1985 began, the future of the Central American economies was full of uncertainty. The healthy recovery of the United States economy during the preceding two-year period had still not given an equally dynamic impetus to the other industrialized countries, and even less so to most of the developing

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nations and, especially, to the small agricultural-exporting economies such as those of Central America. Doubts were also still harboured as to whether or not that reactivation could be sustained.

The phenomena described above naturally had a powerful influence on the foreign trade performance and characteristics of the Central American countries. During 1983 and 1984, as mentioned in the preceding chapter, despite the recovery in the United States there was no significant improvement in the region's terms of trade. This is a departure from past experience, inasmuch as commodity prices have usually risen during the upswings of the cycles in the international economy.

These facts might be associated with the changes which the international economy is undergoing. New technologies --particularly the application of microelectronics and biogenetics, as well as the development of new materials (fibre optics and heat-resistant ceramics and plastics)-- are altering comparative advantages the world over as they change trade flows, and they are probably having an adverse effect on small agricultural exporting economies such as those of Central America. One example of this is the reversal of the redeployment of textiles industries from the developed countries to the Third World, which may be attributed to technological innovations that allow production processes to be automated. In addition to this phenomenon, there is the well-known income-inelasticity of demand in international markets for the commodities exported by Central America. Furthermore, as the United States dollar is the currency in which Central American commodity exports are quoted, the extent to which the dollar is overvalued in relation to other currencies only tends to aggravate this trend.

The uncertainty affecting the region's foreign trade is mirrored in the financial sphere. It would seem that, in the foreseeable future, balance-of-payments capital accounts in Central America will exhibit quite different characteristics from those they have had in past decades. First of all, it is unlikely that the levels of net external financing seen in the 1970s will again be mobilized. On the one hand, the private international banking system is extremely reluctant to commit fresh resources in a region where they anticipate

/a high

a high level of risk; on the other, the liabilities represented by the external debt service are so high that the possibility of the region becoming a net exporter of capital cannot be discounted.9/

Secondly, even if the countries of the region manage to obtain a greater flow of external public financing, these resources would probably be granted under stricter conditions, and this would affect both economic and non-economic policy. This involves a trade-off in relation to economic policy which is becoming much more clear-cut than in the past: the cost of formulating a reactivation policy without having access to sufficient external financing must be weighed against the possible costs --of another type, of course-- of obtaining such financing, but on terms which will mean maintaining or even increasing their economies' vulnerability.

Lastly, most of the countries are also faced with the equally unaccustomed problem of restructuring their external debt commitments. The terms on which this debt is to be serviced will be one of the factors that will determine the Central American economies' capacity to import --and to grow. Once again, this is an area in which it is difficult to made predictions.

In addition to the elements of uncertainty in the international economy, there is uncertainty about factors of domestic origin. Perhaps the most significant of these are the political and social conflicts taking place in the region. It would be utopian to consider reactivating the economies on the basis of a recovery in domestic savings and investment --which are in themselves insufficient-- so long as the prevailing climate of political instability is not resolved. This, in turn, would require changes in the patterns of political interaction in most of the Central American countries.

Thus, as long as ideological polarization which overflows into violence continues to exist and as long as the various segments of the population are not incorporated into political life and their level of participation is not improved, it is unlikely that it will be possible to restore the social harmony which, today more than ever, is a prerequisite for achieving goals related to material well-being. Otherwise, the flight of private capital and the erosion of existing capital holdings will persist, thereby jeopardizing the continuity of domestic mechanisms for generating savings and investment.

/Under these

Under these circumstances, it would also be unrealistic to look forward to a smooth and concerted process that would provide support for an economic reactivation policy. Indeed, the present mood of ideological and conceptual polarization, as well as the frequent resort to violence in some countries as a means of settling conflicts and the greater intensity of the struggle to gain a share in the decreasing benefits afforded by the economies, make it very difficult to achieve even a minimum of consensus with respect to any development project. Moreover, these tensions have caused a large amount of funds to be diverted towards defence and security spending at a time when the governments of the region should be allocating the greatest possible proportion of their scarce resources to the task of safeguarding the population's standard of living. In this respect, friction within and between the countries slows down the economic recovery and prevents an improvement in the climate of intra-regional co-operation.

In short, it is difficult to make predictions of the future course of the Central American economies. On the one hand, the depletion of their international monetary reserves, their external debt burden, the contraction in imports and the depressed levels of all the macroeconomic variables --consumption, savings, investment, employment-- have sharply reduced their freedom of action with respect to economic policy; on the other hand, the constraints --both external and regional-- on Central American development are subject to a constellation of factors which heighten the atmosphere of uncertainty existing in all the countries. The internal and external economic and non-economic circumstances which determined the course taken by the economies and societies of Central America during the thirty years following the end of the Second World War have thus changed. Different responses from those of the past will therefore be required if the region is to surmount the difficulties which now virtually cancel out any possibility of expanding and transforming the countries' economies.

2. The growing conceptual polarization

One of the many consequences of the international economic crisis is that it has overthrown the paradigms of the past. Thus, just as today the Keynesian theories which dominated public action in the industrialized countries for over thirty years

/are being

are being questioned, the methods used in the past to carry forward the development of the Third World economies are also being called into doubt. A major debate has arisen regarding the supposed decadence of the "discipline" of development.10/ Some maintain that developmentalist paradigms --including the idées forces repeatedly put forward by the ECLAC Secretariat-- have proved to be ineffective, and they therefore postulate various orthodox approaches, whether of the neo-classical or Marxist stamp.11/ In the case of Central America, this debate runs parallel to the ideological polarization already discussed in this document.

Furthermore, in a number of industrialized economies and especially in the United States of America, there has been what some see as a reaction to the excesses committed since the 1930s in relation to welfare policy, the expansion of public services, the increase in taxation and the growing regulation of various private activities.12/ The growing conservatism observed in the sphere of economic policy calls for a reduction in the role of the State (which, inter alia, would result in lower taxes and fewer public services); greater reliance on the market as the mechanism for allocating resources; the offer of incentives for savings and private investment; and the elimination or at least reduction of controls and regulations. In the civic and cultural sphere, an attempt is made to give policies legitimacy by appealing to traditional values.13/ Naturally, this set of ideas has found supporters and emulators in other areas of the globe, including of course the Central American countries.

These two phenomena --the overthrow of paradigms as a result of the economic crisis and a gradual evolution in the attitudes prevailing in some advanced societies with respect to social and economic organization-- lead to a clear conceptual polarization with respect to how the process of economic development is to be handled. This not only tends to create new divisions between the various social groups but has also caused some international financial agencies --multilateral as well as bilateral-- to take part in the debate, and in Central America these agencies have recently been spreading variations of the paradigm that is in vogue with respect to how to adjust and reactivate the economies.

/The combination

The combination of these phenomena has given rise to two opposing reactivation strategies. The first calls for the "opening up" of the Central American economies to trade and international financial flows and the adoption of a set of macroeconomic policies that give an export bias to the productive apparatus so that market forces will reorient it towards a dynamic position in the international economy in line with the region's comparative advantages. This "opening up" would be accompanied by incentives for private investment and sometimes a reduction in the role of the public sector, especially with a view to eliminating any obstruction of market signals. The advocates of this approach argue that a recovery of the industrialized economies would very rapidly spread to the Central American economies by way of the many channels that would thus be created.

The counterpoint to this is to be found among those who, having witnessed the magnitude of the adverse factors in the Central American external sector during recent years, believe that the region's economies should be more isolated from fluctuations in the international economy and that the State should play a greater role in order to counterbalance private enterprise and mitigate the regressive effects of the depression.

In short, old debates are taking place against the background of new circumstances, perhaps involving more extreme and doctrinaire approaches than before. All of this only serves to exacerbate the situation of uncertainty which has been mentioned so often here.

3. Alternative scenarios

Making predictions about the probable course of the Central American economies depends, at least in part, on the points of view of those undertaking such an exercise. According to some, the logical outcome of advocating that the market be allowed free play as a mechanism for allocating resources, of diminishing the guiding role of the State in its various manifestations, of encouraging private investment --both national and international-- and of eliminating all hindrances to such investment would be that the Central American countries would follow along in the wake of a newly-expanding international economy --primarily powered by the developed economies and particularly by the United States of America-- towards a new era of prosperity which, this time, would be

/based on

based on spearhead technologies and some tertiary activities. In other words, the same logic which would permit the economies of the centre to be reactivated would cause the dynamic effects of this reactivation to spread to the economies of the periphery by way of a new structure of comparative advantages on a worldwide scale.14/ It is, of course, admitted that there are obstacles which might mean that not all the countries could derive maximum advantage from such dynamic stimuli (e.g., some countries' high level of external indebtedness), but it is argued that these stumbling blocks can be lessened and overcome by timely negotiation and the application of "suitable" policies.

As an alternative scenario, one might accept the possibility that the recent expansion of the economies of the Organization for Economic Co-operation and Development (OECD) might not be sustained 15/ or, in any case, that its dynamic effects might not necessarily spread to the economies of the periphery. Moreover, as previously stated, at least in the case of Central America there are internal factors at work which seriously disturb the free operation of market mechanisms. Furthermore, the dynamic forces which had traditionally been associated with economic integration have gradually been waning over the past few years, due to the severity of the crisis. Given the uncertainty faced by the region, a realistic hypothesis might therefore be that the period needed for the Central American economies and societies to adjust to the new situation --externally, regionally and within each country-- might prove to be a relatively long one. Indeed, if the international economic crisis turned out to be merely a depressive cycle --albeit the most severe of the postwar period-- the positive effects of the reactivation, as we have already seen in Central America in 1984, would be very limited during the next two years, given the considerable external debt burden, the depletion of international monetary reserves and the serious imbalances which the recession has caused in these countries' production capacity and social structure.

Moreover, the need to undertake structural changes in order to adapt to a changing international economy will necessarily be a long process. The Central American countries have seen during recent years that the development of new export activities is not achieved instantly, simply by passing a law: it requires changes in the attitudes of businessmen and workers, long periods for tests and try-outs

/in some

in some cases, changes in production and marketing methods, and long lead times for new investments. Even if a strategy involving greater economic self-determination were to be chosen, a long period of time would still be needed. Dealing simultaneously with the whole series of problems faced by the region --carrying forward the painful but necessary task of adjustment, regaining acceptable levels of savings and investment, reactivating production and responding to even a small part of the long-delayed demands of the people-- only complicates the picture still further and confirms the fact that a relatively long time frame will be required for carrying out this task.

Given the magnitude of the problems involved, a realistic scenario would therefore be that the economies of the region will probably languish for quite a long time, with differences of degree and ups and downs from year to year, but always within an overall framework of quasi-stagnation. This does not mean that the countries are doomed to a permanent depression, but it will be essential to implement an active reactivation and development policy which will allow the Central American region to reorganize its considerable natural and human resources in order to lay the foundations for sustained development.

IV. BASES FOR A REACTIVATION AND DEVELOPMENT POLICY

It would be just as absurd to say that the crisis is a blind alley --there is always a "way out" in all human endeavours-- as to think that there are paradigmatic solutions or ready-made prescriptions for reactivating the Central American economies and putting them on the road towards general prosperity. Between the extremes of a permanent depression and a utopia, there is a range of intermediate situations which would make it possible to build, step by step, the bases for a development policy. Some of the critical areas for forming those bases are discussed in the following pages with a view to stimulating the debate as to how to respond to the multi-faceted and complex challenge faced by Central Americans.

To this end, consideration is given to the problem of choosing appropriate economic policy objectives in the light of the current economic situation; the resources which the region had at its command in order to achieve a sustained expansion of its economies are identified; the trade-offs, both explicit and implicit involved in economic policy and the requirements of a development style adapted to the new circumstances are explored; and, finally, the role which intra-regional co-operation can play in starting off a process of reactivation and development is defined. The interaction between the economic/social and political spheres is also briefly discussed, followed, in conclusion, by some observations about the role of the State. It should be stressed here that no detailed or global programme or plan is offered; only general guidelines for the more specific policies which each government would adopt as a function of its particular circumstances and objectives are presented.

1. The objectives of a reactivation and development policy

In the view of the Secretariat, one of the first topics which should be examined by the Central American governments is the set of objectives which reactivation and development policy should pursue. As is well known, the conventional objectives of development are to grow, to improve the distribution of income, to reduce the economies' external vulnerability, and to bring about changes in the social and political as well as the economic spheres. An attempt is thus made to achieve more pluralistic, participatory and democratic societies.

/It is

It is vital to assign some order of priority in the pursuit of these objectives, not only because there are obvious grounds for doubting the possibility of pursuing them all simultaneously --even during times of prosperity and all the more so during times of austerity-- but also because putting one of these objectives before the rest will determine the type of economic policy mix --or "menu"-- to be adopted. For example, if a given government chooses to give priority to the objective of equity, it might then decide to give preference to certain tools of economic policy (agrarian reform, more spending on social services, periodic wage adjustments) which, as a counterpart, might discourage private investment and militate against the objective of growth. In other words, notwithstanding the neoclassical conclusion that the objective of distribution is compatible with that of growth (by means of the proverbial "trickle down" effect of the benefits of such growth), the experience of Central America in the three decades of the postwar period -and, in general, that of Latin America as a whole-- suggests that there are major trade-offs between various development objectives. There is, in effect, little empirical evidence to support the idea that "all good things come together";16/ i.e., that it is possible to grow, improve the distribution of income, achieve greater autonomy and progress towards more democratic societies at one and the same time.17/

This does not mean, of course, that these oft-mentioned objectives are not laudable or worth pursuing. Nor is it true that one or more of them must necessarily be sought at the cost of the rest. What does appear to be necessary, however, is to clarify the relative importance of each one --and their reciprocal relationships-- in terms of the reactivation or development programme which the circumstances demand. Thus, in the present case of Central America, some governments might assign top priority to the objective of equity, even sacrificing growth-related goals; others might attempt to optimize growth, perhaps in order to regain some of the ground lost in recent years and to fulfill the imperative of creating jobs for a rapidly growing economically active population; and still others might lay the greatest stress on defending social coexistence and pluralistic, democratic institutions.

All of these are very worthy objectives. Nonetheless, a careful reading of the analysis presented in the first and especially the second chapters of this paper would suggest (at least as an issue for discussion in each country's

/governmental forums

governmental forums as well as in intergovernmental assemblies at the regional level) that, at the present juncture, what the Central American countries need most of all --both in the economic sphere and with respect to social organizations-- is to increase the very restricted freedom of action that they now have for formulating economic policy and forging a destiny of their own; i.e., in more parochial terms, what they need is to reduce their external vulnerability.18/

With respect to economic matters, the practical expression of pursuing this objective would, for example, involve attempting to attain relative self-sufficiency in food, while not neglecting efficiency; developing some of their own technologies for the Central American economies' most vital activities; diversifying and expanding exports; encouraging consumption patterns which are less dependent on the use of imported goods; adopting production patterns that are less capital- and energy-intensive; and making intensive use of manpower, which is the region's most abundant resource. These ideas are not necessarily novel ones, but the sense of urgency associated with them today is indeed new. With respect to non-economic matters, this objective would include the strengthening of the historical and cultural identity of Central Americans and consolidation of the concept of the nation-State.19/

These concepts should be carefully defined. Firstly, achieving autonomy or reducing external vulnerability should in no way be equated with autarky. The small size of the Central American economies, even when they are taken as a whole, and their natural leaning to export activities leave no room for doubt that economic performance will continue to be closely related to the performance of the external sector. This means, however, that attempts will have to be made to achieve a dynamic, diversified, selective and novel form of insertion in the international economy, not an indiscriminate "opening up" of the economy that, far from reducing vulnerability, would tend to increase it. In other words, it would be a question of diversifying and expanding the export sector so as to gain a measure of freedom of action with respect to the Central American countries' external relations, rather than producing even greater dependence on the vicissitudes of the international economy.

/Secondly, autonomy

Secondly, autonomy would not be sought at the cost of the other conventional development objectives; instead, the latter would be pursued through the central objective and mutual support between the former and the latter would be sought. If attempts are made to achieve growth, improve distribution and secure greater participation in society through the central objective of increasing the freedom of action which exists with respect to economic policy, then although not all of these might be optimized --as already noted, this would not be possible even in the best of cases-- neither would they be ignored. Thus, an effort to achieve relative self-sufficiency in food would not only help to lessen external vulnerability but would also contribute to growth and even to the objectives of redistribution, since food production is to a large extent in the hands of small and medium-scale farmers. Moreover, placing stress on the interdependence of the Central American economies would not only be a means of fulfilling the central objective which has been mentioned so many times; it might also appeal to cultural and historical values which would eventually aid in laying the foundation for more participatory and pluralistic societies.

Moreover, the objective of increasing freedom of action at the national level is functionally linked to the socio-political objectives of improving the distribution of income and progressing towards more pluralistic and participatory societies. Therefore, in view of the fact that the governments are not only prevented from using public spending as a means of persuading the agents of production, but are also confronted with increased social demands as a result of the overall loss of income, they should seek to achieve the consensus needed to increase economic autonomy through efforts to attain concerted approaches with various social groups and the incorporation of the latter into the decision-making process. Along the same lines, mechanisms will have to be established for sharing out more equitably both the burden represented by the economic recession and the benefits of reactivation. The possibility of using concertation as a line of action varies according to the political system, traditions and institutional structures of each country, but in all cases there is a real possibility that the central objective of broadening the limits of national autonomy and the subsidiary objectives of making progress with respect to social equity and concerted action and participation in the decision-making process will reinforce one another.

/As already

As already noted, heightening the sense of identity of Central America also has a social and cultural form of expression which would flow over into the economic and political spheres. It is therefore an attractive idea to consider a form of Central American development which would not be modelled in the image and likeness of an international pattern which is perhaps alien to the traditional values of the region (and its resource endowment), but would instead be based on its considerable historical and cultural heritage. This could have an impact on production and consumption patterns in that it would represent a more independent effort to propound development problems.

Finally, placing the achievement of autonomy above other objectives brings with it the additional advantage, in the case of Central America, of being a goal with which all the governments of the region, without exception, can easily identify. In view of the increasing heterogeneity of the approaches which are being formulated in Central America, on the one hand, and the patent need for at least a minimum of common objectives to serve as a basis for the formulation of joint activities within the framework of intra-regional co-operation, on the other hand, it is logical to give priority to pursuing the common --and ideologicall neutral-- purpose of extending the countries' freedom of action.

In short, this is an objective which is capable of rallying all the Central American governments around an "idée-force" which can serve as the axis for other subsidiary elements that are equally vital to the reactivation of their economies, such as economic growth, equity, and participation and democratization.

2. Characteristics of the structure of production which is sought

The first requirement of a reactivation and development policy is to define with some exactitude sectoral and subsectoral priorities. In this connection, the countries of the region might adopt a pragmatic approach that would consist of taking the maximum possible advantage of the opportunities that the international market continues to offer, while at the same time resolutely carrying forward efficient import substitution measures.

Central America has a resource base which can support its economic reactivatic and long-term development. Although the extent of such resources may have been exaggerated on occasion, it is certainly enough to meet the basic needs of the entire Central

entire Central American population and even to provide the majority with a reasonably decent standard of living. However, utilizing them fully would require large investments and an enormous effort of organization and mobilization.

Preparing human resources to adapt to changing circumstances in the international economy entails a major training effort at all levels. This would take in both formal and informal educational systems. In addition, there is no reason why Central America should have to resign itself to exporting five or six commodities: the resources at its command and its geographical location offer the possibility, despite the uncertain outlook of the international market, of expanding and diversifying its sales of a range of agricultural products (including fruit, vegetables, meat, fibres, marine products and plant-based chemical inputs, all of which would lend themselves to a greater degree of processing). The utilization of forest resources also has a high potential in some countries. In this connection the specialized development of the manufacturing sector in the northern European countries during this century could provide some valuable lessons, as could the advances made by some Asian economies in the export of labour-intensive manufactures.

These branches of activity would provide stimuli for future growth which could be classified into four main categories. Firstly, what the region already knows how to do must be consolidated: with respect to exports, the production of traditional crops should be strengthened; with respect to domestic consumption the same should be done with the output of staple foodstuffs. This would lead to increased productivity and efficiency, achieve a better agro-ecological balance among the various crops and areas of production and, in the case of some products, expand supply: all prerequisites for furthering national economic autonomy.

The region could hardly achieve sustained expansion on the basis of what used to be done in the past, however. As is well known, world demand places limits on traditional export products which stem from the characteristics of the market for most such goods (meat might be the exception), while on the supply side, the easily exploitable agricultural frontier has been on the verge of exhaustion since the late 1960s. This does not mean that a "ceiling" has been reached with respect to production levels of coffee, cotton, sugar cane and bananas, but it does mean that the extension of that frontier will involve increasing marginal costs in the future.

/Secondly, greater

Secondly, greater selective integration --involving the promotion of both forward and backward linkages-- of traditional products should be encouraged with a view to increasing Central America's share in the value added to them. Despite the protectionist measures which have begun to be used in the developed economies and which, for example, obstruct access to their markets for flat fabrics and ready-made clothing produced in Central America, there is room to move forward in the industrial processing of some commodities that are manufactured in the region with a reasonable amount of efficiency. Central American entrepreneurs will also have to take a more active part in the marketing of their products, even to the point of establishing companies in the developed countries whose markets they wish to penetrate. Throughout this entire sphere, there are opportunities for pooling private Central American capital with capital in the industrialized economies in an effort to expand markets and undertake more complex production processes.

Thirdly, there is a possibility of selectively promoting new export product lines, especially those which involve tapping the region's natural resources. Among the products which are suitable for such treatment and which would also lend themselves to integration with secondary activities are vegetables, citrus fruits, tropical fruits, hard fibres, pharmaceuticals, forestry and wood products and marine products, including shrimp. Some subcontracting activities could also create productive job opportunities as well as generating foreign exchange.

Fourthly, the possibilities of expanding and diversifying the manufacturing sector are far from having been exhausted. On the contrary, the abnormal functioning of the Central American Common Market during recent years has given rise to a backlog of projects which could be viable if there were a better climate for intra-regional co-operation and which could not only serve to meet regional market demand but also to export to other markets including, of course, the rest of the Latin American countries. It should be noted that Central America has already met with a certain amount of success in using integration as a platform for exporting manufactures outside the region.20/ In other words, reasonably efficient import substitution continues, as in the past, to be a means of providing more freedom of action with respect to economic policy and of diversifying and raising production.

Lastly, the region has the potential for increasing its tertiary activities, including transport, tourism and financial services. The latter could prove to be

/of special

of special importance if past savings and investment levels are regained, since this would call for more flexible and innovative means than currently exist for attracting funds.

To sum up, a first conclusion would be that the region has the necessary human and natural resource base for the sustained expansion of production. The main task would consist of creating the necessary institutions and organizational facilities for making use of this potential.

3. The requirements of a reactivation and development policy

Under the present circumstances of widespread uncertainty, sudden changes in the international economy and the heavy burden represented by the accumulated instances of delayed development described in the preceding chapter, there are a series of minimum requirements with respect to a reactivation and development policy which include pragmatism, selectivity, austerity, efficiency and the search for ways of meeting the minimum demands of major groups of the population.

a) Pragmatism

One of the main problems involved in formulating economic policy is the prevailing uncertainty, which to a large extent stems from factors beyond the control of the governments of the region. Reference has already been made to the queries which arise in relation to the future course of the international economy, the changes which the industrialized economies will have to confront or the results of the policies implemented in some of the main industrialized countries. It is not known what influence all these factors may have on the developing countries in general and on those of Central America in particular; nor is it known what the outcome of the severe political and social tensions in some countries of the region will be.

All this means that the Central American countries' economic policy must be designed and applied with flexibility and realism so that it can be adapted and adjusted to changing, unpredictable and basically unprecedented circumstances. The pragmatism thus called for would take various forms. Firstly, flexibility and effective responses would involve a certain break with the past because, traditionally, policy responses to fluctuations in the international economy have generally been passive or have lagged behind. Today, in view of the probability that what is occurring in the world economy is a structural change rather than a

/recessive cycle,

recessive cycle, it is necessary to create a capacity for response which would allow even slight opportunities to be taken advantage of and which would permit the limitations on the development of the Central American countries to be eased as much as possible; these aspects have particularly important implications in one of the areas which will be briefly discussed later on: the role of the State.

Secondly, despite the growing conceptual polarization surrounding the manner in which the resumption of economic development should be tackled, the pragmatic approach proposed would, by definition, be anti-doctrinaire. This is not the time to try out extreme economic doctrines, as the recent experience in Latin America has eloquently demonstrated. Instead, a break should be made with the stereotyped moulds of the past: there is no reason why governments wishing to give the State a guiding role should hold back from providing incentives and full support for private investment, nor should those which rely more on the market as the main resource allocation mechanism look askance at a more active State role. In other words, what is called for under the present circumstances is to seek a happy mean between the extreme approaches to economic policy (e.g., between strategies aimed at opening up the economy and inward-looking strategies; between distribution and growth; between public and private action; between the application of policies in the financial area and the real area of the economy), as well as an innovative mixture of such strategies. There is no reason, for example, why a government should not return inefficient public enterprises to private status while simultaneously raising the overall tax burden so that more resources can be obtained in order to provide the population with basic services, or why it should not implement an agrarian reform policy aimed at creating a larger number of small-scale agricultural entrepreneurs while at the same time encouraging saving and private investment by granting tax incentives.

Thirdly, economic policies should take into account the new situations created by the changing circumstances in the international economy. It must be realized that the days of fixed exchange rates and stable interest rates are over and have given way to schemes which are very different from those of the past; because of this, policies in Central America must be flexible and in keeping with the objectives sought.

/Fourthly, and

Fourthly, and precisely as a way of ensuring that the application of economic policy keeps in step with changing circumstances, the insistence on all-embracing approaches will have to be abandoned in favour of more pragmatic approaches of partial scope which are designed to resolve the most critical --but not all-- of the problems relating to reactivation and development. This does not mean that there can be no unifying guide for efforts to achieve the objectives mentioned above, but it does mean that greater reliance than in the past should be placed on a selective method of "trial and error" as a means of carrying forward the reactivation effort and adapting economic policy to the prevailing circumstances.

b) Selectivity

The application of an economic reactivation and development policy should not only be pragmatic, but also selective. This concept also has a number of different facets. For example, the disorder reigning in the international economy makes it just as risky to gear all economic policy to a strategy aimed at obtaining a dynamic position in world trade as it is to adopt one which would prevent the potential of such trade from being developed. Economic policy will have to be formulated with the necessary flexibility and selectivity so that it can be adapted to changing conditions in internal and domestic markets. Thus, contrary to what is usually maintained, the factor which jeopardizes the efficiency of Central American industry today is not so much an exaggerated form of protection based on tariffs as the existence of high levels of idle capacity resulting from the drop in total demand in each country and the obstacles to intra-regional trade.21/ Export promotion measures should therefore not be implemented at the cost of destroying what has been built up with such great effort during the last few decades, but should instead be applied selectively and gradually so that those goods which have the greatest potential access to international markets receive special incentives, while existing industry and some new activities can be developed with the aid of a reasonable amount of protection with a view to import substitution.

Along the same lines, the application of economic policy in general and that of public expenditure policy in particular should be much more selective than in the past in terms of the objectives which are chosen. It would be preferable, for example, to eliminate low-priority programmes fron national budgets entirely, rather than cutting all budget items by a fixed percentage. The same sort of selectivity is feasible in the application of credit, fiscal and tariff policies.

/Finally, in

Finally, in view of the widespread lack of confidence which exists among the main economic agents, it would seem unwise to leave reactivation programmes at the mercy of events in the international economy or to expose them exclusively to the interplay of market forces. For example, given the acute shortage of foreign exchange in all the economies of the region, it would not be advisable to rely solely on foreign exchange supply and demand for setting exchange parities if repressed needs and speculative pressure tended to place a higher value on "hard" currencies than what they are objectively worth. It would be equally rash to rely solely on administrative controls and on the overcentralization of economic policy implementation in dealing with external and internal imbalances.

c) Austerity

The widespread depression in Central America has given rise to constraints which have made it necessary to reduce imports and hence have lowered the levels of economic activity. However, the resulting austerity has by no means been felt equally by the various strata of the population. The shortage of foreign exchange and the need to increase the mobilization of domestic savings in response to the limitations of external financing while still satisfying the basic needs of the population make it necessary to use the resources generated by exports much more selectively and carefully and, in general, to keep the pattern of expenditure closely in line with priorities. Indeed, the new economic realities mean that expenditure and savings structures will also have to be adapted, and this will necessarily be reflected in austerity consumption patterns in both the private and public sectors.

Such austerity should have a two-fold purpose: to save foreign exchange by diminishing the consumption of non-essential goods and services which are either imported or which have a large import component, and to raise the savings coefficient With respect to the first of these aims, the countries of the region will need to use the foreign exchange they attain from exports carefully and with the strictest selectivity; this would, inter alia, presuppose realistic exchange rates. As regards consumption, the governments should discourage the consumption of non-essential goods and services of external origin and make the greatest possible use of the national and subregional potential for supplying demand. Stressing frugality and avoiding waste might result in different lifestyles from those of

/the past.

the past, especially for the middle- and high-income strata of Central American society. It would not, of course, be a question of further lowering the living standards of the majority, who are already living on the verge of poverty. On the contrary, as discussed below, the reactivation policy should also entail a redistributive effort which, inter alia, would provide greater support for the satisfaction of the population's basic needs.

With regard to investment, everything points to the need to review the possibility of resorting to more labour-intensive technologies, not only because of the imperative need to create jobs, but also because of the need to reduce the imported component of new fixed capital.

In order to improve the priority-based utilization of foreign exchange, the governments would have to rationalize public spending as much as possible and reorient it towards truly essential activities. This is of very special importance because the persistence of the international crisis, as well as other domestic factors, foreshadow increased social pressure on the governments; moreover, the marked openness of the Central American economies places strict limits on the deficit financing of public spending because of its effects on inflation and the balance of payments. In this respect, as already noted, it will be necessary to eliminate expenditure on luxury or non-essential items in so far as possible and to make progress towards political détente in the region so that some of the resources which are now devoted to military purposes can be used to further development instead.

Furthermore, public spending could help to moderate the external imbalance if, in selecting investments, priority is given to projects which call for a large proportion of national or regional inputs. In any event, the public sector will have to increase its revenue collection in line with the amount of expenditure in order to prevent its financial deficits from contributing to an increase in the demand for imported goods.

d) Efficiency

Another basic requisite of a reactivation policy is that it should favour growth on the basis of greater efficiency and productivity. In the present circumstances, there is an imperative need to raise efficiency, from both a macro- and microeconomic standpoint, in order to increase the multiplier effects

/of savings

of savings and investment and carry out import substitution on a reasonably competitive basis or maintain and increase exports to international markets. It is the duty of the State to increase the efficiency of the services which it provides, as well as to use fiscal and credit measures to encourage companies to increase their productivity.

Efficiency and employment can be significantly increased in the region, without resorting to the importation of capital goods, by fully utilizing the existing installed capacity. As is well known, there is a great deal of idle capacity, especially in nearly all branches of the manufacturing sector. There is also room for considerable improvement in the yield per unit of harvested area in the case of most of the region's agricultural products, including those in which the countries have already shown the greatest export capacity.

e) Reducing poverty

Since no significant progress was made in eradicating extreme poverty even during the 30 years of expansion in the Central American economies --although large segments of the population were indeed incorporated into modern economic life-- it is inevitable that the situation will deteriorate so long as the economic crisis continues, due to the interrelationship which exists between levels of employment and margination. Unemployment and underemployment have increased in recent years and, unless new ways are found to prevent it, this trend will become stronger in the future, given the high growth rates of the economically active population.

Unless the State takes steps to aid majority groups, the depressive effects of the crisis --and of the austerity policies which go along with it-- will tend to have a disproportionate impact on these groups, which are the least organized to defend themselves, and will thereby widen the gap between governments and those they govern, as well as having other consequences.

The spread of absolute poverty is unacceptable from any standpoint. It must be understood, however, that a policy aimed at meeting the basic needs of the majority is difficult enough to implement during periods of rapid economic expansion and still more difficult to apply in times of severe constraints, including those affecting public finances. Even so, reducing poverty is an essential part of the development approach which is needed. Without this, any effort to overcome the crisis would be meaningless, inasmuch as greater social discontent could make political tensions unmanageable and make it impossible to retain savings or to revive the investment and development process.

/Ways of

Ways of meeting the population's basic needs which involve a relatively moderate imported component must be found, so that foreign exchange limitations will not prove to be an obstacle. At all events, and quite apart from consideration of equity, the political crisis in many countries of Central America has reached a point where it is absolutely essential to restore at least a minimum of harmony among the population. Otherwise, social instability will inevitably lead to economic instability by paralysing, for example, the process of capital formation and bringing on a sort of State domination of spending which would be of little help in expanding production activities.

4. The role of intra-regional co-operation

Intra-regional co-operation is undoubtedly the best available means of loosening the constraints imposed by the external sector on the Central American economies and thus helping to lay the foundations for reactivation and development. Today, more than ever, it is necessary to press on with the programme which was begun in Central America nearly 30 years ago and which has resulted in valuable benefits and experience. This must be done not only in order to take advantage of the dynamism which can be expected from domestic (i.e., subregional) demand, but also in order to jointly address specific problems involved in the subregion's relations with the rest of the world. This aspect has been repeatedly discussed in ECLAC documents in the past, but it takes on renewed interest under the present circumstances.

The aim would be to employ intra-Central American co-operation to increase the limited freedom of action which each of the countries in the region has, in order to lessen the effects of the depression affecting the external sector. In the short run, the only effective way of increasing local demand seems to be linked to co-operation efforts at the regional level. There is nothing new about such a procedure, since as long ago as the 1950s it was successfully put into practice in order to overcome the same obstacle, i.e., the constraints on growth stemming from reliance on international demand. Now, however, it would be used in a different situation. If intra-regional trade could be increased as much as possible, it would effectively help to reactivate the economies by making full use of installed capacity, reducing the influence of adverse factors from abroad,

/increasing efficiency

increasing efficiency --both in import substitution and in improved competitiveness on international markets-- and even jointly taking advantage of the opportunities which the international market may continue to offer.

In recent years, all of this has been hindered by the barriers confronting intra-regional trade. It would be unrealistic to defend a system of unrestricted free trade which made no allowance for the great or lesser importance of the goods being traded, but it would nevertheless be desirable to keep restrictions to a minimum and even to adopt mechanisms for giving preference to reciprocal trade over similar trade flows with third countries. Only in this way could optimum use be made of the region's installed capacity while also, perhaps, even promoting some new activities based on regional demand. To this end, the countries would need to adopt effective procedures for financing intra-Central American trade debit balances, to do away with certain restrictions currently resulting from the exchange controls that are in force, and, in general, to grant essentially the same treatment to products originating from any Central American country as to those produced domestically. The region is not bereft of specific ideas for implementing such measures.

Furthermore, as has already been said, regional co-operation is the best way to take greater advantage of the opportunities offered by the international economy for increasing exports --e.g., on the basis of joint marketing systems-- as well as for obtaining additional external financing for projects and initiatives of common interest. The strengthening of the Central American Bank for Economic Integration and of the machinery made available by the Central American Monetary Council are examples of some measures which would give real force to this latter idea. It should be remembered that the lack of intra-regional co-ordination in so vital an area as external financing not only has an opportunity cost --if the opportunity is lost for the joint mobilization of a flow of resources which could not be obtained through individual negotiations-- but also jeopardizes the continuation of intra-Central American co-operation. A number of actors on the international scene have shown interest in co-operating with the Central American countries on a selective basis, which involves the exclusion of one or more countries from their programmes. Rather than uniting the Central American countries, however, this type of external co-operation would tend to separate them.

/Making intra-regional

Making intra-regional co-operation one of the pillars of reactivation and development would first require simply preserving the existing degree of economic interdependence, followed by joint efforts to rectify or relieve common problems. This would not be a question of instantly bringing about the integration of the region's economies, nor even of establishing co-operation in each and every national activity. Integration would instead be used as an important tool to help each country tackle the reactiviation process. Thus, for example, tariff policies --an area in which joint action has traditionally been taken-- could play a key role in taking a more selective and flexible approach which would allow installed industrial capacity to be protected while at the same time promoting exports. Although there would be no question of reaching regional agreements that might limit each country's ability to formulate its own exchange policy, the existence of the common market will obviously make it necessary to maintain at least a minimum basis of co-operation in this area which will facilitate the adoption of decisions in response to the requirements of reactivation.

Along these lines, subject-areas will have to be incorporated in the work schedule for integration during the next two years which, while preserving the level of economic interdependence among the countries of the region achieved in the past, will also facilitate the implementation of policies connected with the programme discussed here. These subject-areas include: first continuing and perhaps intensifying joint approaches to the international financial community to mobilize external financing for the purpose of providing the regional mechanisms which further the flow of intra-regional trade with foreign exchange liquidity; second, increasing the flow of external financing for industrial reactivation; third, making the common Central American tariff into a tool for reactivation and development policy by utilizing the opportunities presented by the recent signing of the Agreement on the Central American Customs and Tariff Régime;22/ fourth, promoting joint activities to give Central American products greater access to the markets of third countries; fifth, reaching partial-scope agreements along these lines on a co-ordinated basis with other countries of Latin America so as to reconcile the Central American integration commitments with the need to expand the geographic scope of such integration; sixth, dealing with the particular problems of countries which do not fully share in the potential benefits of intra-regional trade, by developing formulas to increase Nicaragua's exports to the rest of the

/region and

region and to establish a gradual and progressive system for incorporating Honduras into the multilateral integration agreements; seventh, undertaking joint projects of multinational interest, such as the interconnection of electricity systems and co-operation in the exploitation of marine resources; and lastly, strengthening Central American integration institutions so that they can help to carry out these activities.

5. The political expression of development and the role of the State

Although this document has focussed on the role played by economic policy --and, by inference, the role of economists-- in reactivation and development, the latter are obviously not the exclusive, nor even the main, preserve of economics. The changes which are inherent in any development process touch upon all spheres of national life --and all of the social science disciplines-- and it would be difficult indeed to formulate reactivation and development programmes without taking political and social considerations into account. Thus, there can be no question of reactivating these economies without overcoming the tensions which persist in some Central American countries. In other words, multidisciplinary approaches must be taken to development which incorporate into economics such areas as participation, political interaction, the role of the various economic agents and democratization.

This does not mean that a multidisciplinary approach need be taken in all activities related to development efforts. The formulation of economic policy proposals will continue to be primarily the work of economists, just as the study of political interaction will be that of political experts and research into social stratification will be that of sociologists. Nonetheless, there will be many points of contact and overlapping among the economic, political and social areas. A reactivation and development programme will therefore have to take into account at least some of the non-economic situations in the region, as has been pointed out throughout this paper.

This is not the proper place for a lengthy discussion of the subject. Some comments might be made about the role that could be played by the State, however, simply in order to illustrate the complex interrelationships which exist between economic and non-economic factors in the important tasks which the Central American

/governments and

governments and people have before them. Why single out the role of the State for special attention? Firstly, because this paper is basically aimed at the governments of the region and would therefore be incomplete if their role in reactivation and development were not considered. Secondly, this is a very controversial issue --sometimes involving highly ideological aspects-- which warrants ample debate and, later, investigation in greater depth. Lastly, regardless of the ideological and conceptual framework of this issue, each generic function of any State --preserving order, defending its sovereignty and contributing to the well-being of the population-- finds expression in the main concerns of this paper, such as overcoming the social and political tension in the region, mitigating the strong influence which external phenomena have on all aspects of national life, and reactivating these economies. In other words, this is a crucial subject.

The more specific manifestations of the State's role may however vary a great deal from one country to another or within the same country at different points in time, depending upon its institutional and political organization, its historical and cultural traditions, the results of political interaction itself, and a number of other circumstances. This question may even involve ethical and philosophical considerations (e.g., Is it accepted that the State should play a guiding role, and if so, should the State be able to use any means, including force, to influence events? What would be the limits on the procedures employed by the State for this purpose?, etc.). Given the wide range of situations existing in the region, all of these problems stand out very clearly in the Central America of today.

Thus, in some countries the power of the State is perceived as the result of ongoing tensions among various agents of society, with its limits stemming from the presence of other centres of power and the sovereignty of the law. In others, however, there is a tendency for the State to have a hegemonic (but not necessarily absolute) role, sometimes in representation of specific segments of society. It is therefore not possible to lay down a single formula applicable to each and every one of the countries as regards the precise part which the State should play in the reactivation and development process, i.e., as regards its generic function of watching over the population's well-being. Indeed, the same criteria that were mentioned previously as being applicable to a reactivation policy (pragmatism, selectivity, efficiency and austerity) are pertinent to the definition of this role,

/as well

as well as the State's relations with the other economic agents in the society. In addition to these criteria, the wide range of situations which exist and the ability to adapt the State's role to changing circumstances should also be considered.

Thirty years of experience in Central America suggests that there is no universal rule which would make it possible to define, ex ante, the degree of State intervention which is "desirable" for optimizing the population's well-being. It must be admitted that State action during this period has not always had a positive outcome, as the cases of many public enterprises or official institutions devoted to industrial promotion have shown. The fact that some of these companies have been victims of bureaucratization, of the practice of providing sinecures and even, on occasion, of corruption and inept management should not lead to the conclusion that they are therefore automatically ineffective. It does indicate, however, that the tendency which was in vogue during the thirty years of the post-war period of systematically increasing the scope and intensity of State action is not always an intrinsically desirable one and that, in general, State activities should be subject to the same requirements of efficiency, probity and flexibility as those carried out by other economic agents. On the other hand, it would be equally mistaken to come to the conclusion, on the basis of the above, that the State should renounce any important role in the development process and that the market should instead be relied upon as the only guide in this process.

An approach that would be more in keeping with the actual situation in Central America might consist of accepting the fact that the degree of State intervention in the economy or of the sway of market forces should depend on the circumstances prevailing in each country. Basically, apart from the family and the home, the two main organizing institutions of the world are, in effect, the market and the State.23/ For this reason, if we recognize the necessary presence of both these "organizing institutions" in any political system --even in socialist economies--, the greatest difference between one government and another lies in the degree to which the market takes the place of government or the government takes the place of the market.24/

/One way

One way of seeing the role of the State, then, would be to observe the tense and dynamic relationship which exists between the two "organizing institutions" described --the market and the State: "tense" because they continually confront one another, putting their respective limits to the test; "dynamic" because changing circumstances lead to changes in the relative importance of each, as well as to changes in the way they are interrelated. In times of intense change such as those now being experienced in Central America, it is therefore inevitable that the role of the State and of the market will undergo transformations. A creative tension surrounds the interaction of these two forces.

If we accept this view, it is obviously neither possible --nor necessary-- to proffer a universal rule concerning the role which the State should play in a region encompassing such diverse situations as those which exist in Central America. It would not be appropriate, on an abstract basis, to propose a hegemonic role for the State or to claim that the market has universal attributes. The relative impact of each on events will be determined by the dynamics of the development process itself and by the circumstances in each country.

An analysis of the present economic situation will bring out the fact that the public sector has a certain amount of manoeuvring room which should be utilized not only to mitigate the negative impact of the crisis, but also to orient its effects in a constructive manner. For example, the shortage of foreign exchange makes it necessary to establish an order of priority for the various importing sectors and to use the income from exports for essential imports. Present circumstances also demand that a resolute effort should be made to increase exports. It seems logical to assign these functions to the central banks and their foreign trade departments. At all events, the pressing need to rationalize the use of foreign exchange calls for more State intervention than would be necessary under normal conditions of external relations.

The shortage of foreign exchange also gives rise to conflicts of interest and, as a result, to pressure from the various import and export groups. The clashes which invariably occur in these situations can only be resolved by arbitration at a higher level. In this respect, regardless of the combination

/of exchange,

of exchange, credit or fiscal formulas used to deal with the crisis, the shortage of resources exacerbates the conflicts among interest groups and therefore --due to the fragmentation of demands-- provides more room which can be utilized by the public sector.

Another qualitative change in the role played by the public sector stems from its reduced dependence on international trade as a direct source of fiscal revenue. The decisive role traditionally played by export groups has caused the taxes levied on foreign trade to represent a considerable proportion of public sector revenues, but this situation will change as the external depression limits export and, as a counterpart, import opportunities. Consequently, financial problems will present themselves until such time as new domestic sources of taxation are found but, at the same time, the vulnerability of the State vis-à-vis certain pressure groups will be reduced.

All the foregoing only serves to illustrate how the present economic situation influences the role of the State, regardless of the conceptual or ideological framework of each society in Central America. The precise nature and scope of the State's responsibilities will vary from one country to another depending upon what the circumstances dictate in each country as the result of the interaction between the State and other economic agents. In this sense, the State's performance of its activities in the terms described above would be the logical counterpart of the pragmatic approach proposed in this document with respect to the execution of economic policy, according to which less emphasis would be placed on global, all-embracing frameworks and more on selective "trial and error" methods in the pursuit of specific development objectives.

/Notes

Notes

1/ These chapters are updated versions of parts of ECLAC, The crisis in Central America: Its origins, scope and consequences (E/CEPAL/G.1261), 2 September 1983.

2/ For the region as a whole, the main export product of each country in 1950 accounted for 70% of all foreign exchange earned from the export of goods. This ratio dropped by almost half (to 36.1%) in mid-1970 thanks to the diversification of the export sector, but it rose again to 45% in 1978 because of high coffee prices in that year, inasmuch as those prices have a large impact on the total value of exports. Furthermore, 80% of Central America's foreign trade in 1950 was with a single country (the United States), though this dropped to 35% in 1978.

3/ If countertrade is left out of these figures, the export coefficient for the region as a whole was as follows: 18.5% in 1950, 16.7% in 1960 and 23.5% in 1978; the coefficient for imports from outside the region during those same years was 16.2%, 19.8% and 27.3%, respectively.

4/ The swing between "realism" and "idealism" in United States foreign policy is admittedly an oversimplified description. Nonetheless, it is backed up by some in-depth analyses. See, for example, the description given by Dexter Perkins of cycles of "quietism" and "activism" in The American Approach to Foreign Policy, Cambridge, Mass., Harvard University Press, revised edition, 1962, Chapter VII, pp. 136-155. In other cases it is supported by what Stanley Hoffmann describes as the "dualism" of the United States style of foreign policy, one of whose manifestations is that of speaking two different languages, neither of them entirely convincing and both of them difficult to reconcile with each other, the first being the language of power and the second the language of community and harmony. As Hoffmann also says even more colourfully, only a symbolic eagle could easily hold both arrows and an olive branch at the same time (see Gulliver's Troubles or the Setting of American Foreign Policy, New York, McGraw-Hill Book Company, for the Council on Foreign Relations, 1968, pp. 177-178). Finally, the idea that foreign policy alternates between "realism" and "idealism" is also backed up by Samuel P. Huntington's recent description of the United States political system in which he says that one of its essential features is the gap between political ideals and political reality. Huntington admits that this gap exists in all societies, but asserts that the United States stands out by the way in which it approaches it, i.e., through four different responses which, however, all go to form part of a "cyclical pattern". Beginning with the "moralism" which tries to eliminate that gap, it then falls into "cynicism", which tolerates it; it then moves on to "complacency", which seeks to ignore that gap, and ends with "hypocrisy", which denies the very existence of such a gap, thus coming full circle to begin once again with "moralism". See American Politics: The Promise of Disharmony, Cambridge, Mass., The Belknap Press of Harvard University Press, 1981, pp. 3, 42, 64 and 68.

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5/ For the region as a whole, the relative share of total imports represented by petroleum rose from 4.4% in 1970 to 10.7% in 1976, to 18.7% in 1980 and to 21.6% in 1981, after which it dropped to 16.1% in 1984.

6/ See ECLAC, Centroamérica: El financiamiento externo en la evolución económica, 1950-1983 (LC/MEX/L.2), 4 March 1985.

7/ The identifiable deposits of Central American citizens in United States banks alone (excluding branches of these banks in the Bahamas, Panama and other "bank havens") increased by over US$ 1.4 billion between mid-1979 and 1984. The distribution by country was as follows:

CENTRAL AMERICA: DEPOSITS BY CENTRAL AMERICAN CITIZENS IN THE UNITED STATES INTERMEDIATION SYSTEM

(Millions of US dollars)

	Total	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
June 1979	1 104	318	265	147	171	203
June 1984	2 525	850	536	471	140	528
Variation	1 421	532	271	324	-31	325

Source: Federal Reserve Bulletins, Vol. 65, No. 12, table A60, and Vol. 70, No. 7, table A56 of December 1979 and July 1984, respectively, and Treasury Bulletins, published by the Department of the Treasury: October 1980, table CM-III-1, and fourth quarter of 1984, table CM-III-2.

The variation in the amount of these deposits is of course only a very rough indicator of the capital flight from these five countries. Part of the increase is accounted for by the reinvestment of the interest from these same deposits. Furthermore, these figures naturally do not include the investments made by Central Americans during the past five years in real estate and securities in the United States or any investments made in other countries receiving capital.

8/ By the end of December 1984, the bilateral debts contracted by the central banks in order to keep up trade in previous years came to over US$ 380 million; this level of indebtedness exhausted the financing capacity both of those countries with a trade surplus and of the multilateral mechanisms mentioned. See the periodic reports of the Central American Clearing House.

9/ This phenomenon is exacerbated by the fact that, due to the use of a range of mechanisms which vary from one country to another (stabilization bonds, guarantee funds, collateral guarantees), the public sector has virtually absorbed the risk represented by the private external debt, so that in one way or another the governments have assumed responsibility for the entire external debt service.

/10/ See

10/ See for example Albert O. Hirschman, "The Rise and Decline of Development Economics", Essays in Trespassing: Economics to Politics and Beyond, Cambridge University Press, 1981.

11/ Ibid., pp. 5-19.

12/ See for example George Gilder, Wealth and Poverty, New York, Simon and Schuster, 1981, and Charles Murray, Losing Ground, New York, Basic Books, 1984.

13/ See for example Irving Kristol, Two Cheers for Capitalism, New York, Basic Books, 1978, and Norman Podhoretz, The Present Danger, New York, Simon and Schuster, 1980.

14/ See for example Henry Nau, "Where Reaganomics Works", Foreign Policy, No. 57, Winter 1984-1985, pp. 14-37.

15/ The author of the article cited in the preceding footnote maintains that, if the United States fiscal deficit is not reduced, the economy of that country will shortly be faced with a new recessionary cycle caused by high interest rates and dwindling private investment.

16/ This phrase is used by Robert Packenham in Liberal America and the Third World, Princeton, Princeton University Press, 1973, p. 123. He attributes it to Samuel P. Huntington, Political Order in Changing Societies, New Haven, Yale University Press, 1968, pp. 5-7.

17/ For an interesting article on the difficulties of democratizing Latin America, see Marshall Wolfe, Towards Democratic Alternatives (E/CEPAL/R.351), April 1984.

18/ The ideas discussed in the following passage were strongly influenced by the posthumous work of Professor Dudley Seers, The Political Economy of Nationalism, Oxford, Oxford University Press, 1983. The term "manoeuvring room" is repeatedly used by the author almost as a synonym for achieving autonomy or reducing external vulnerability.

19/ To paraphrase the words of Professor Seers, this means the promotion of the supposed interests of a culturally coherent group which exhibits at least some degree of ethical and linguistic homogeneity and which usually lives in a political unit or nation-State (or sometimes a group of nation-States), ibid., p. 9.

20/ See ECLAC, Centroamérica: La exportación de productos industriales y las políticas de promoción en el contexto de la integración económica (E/CEPAL/MEX/1983/L.10), February 1983.

/21/ Recent

21/ Recent studies by the Inter-American Development Bank in relation to its industrial reactivation loan programme demonstrate that, in general, Central American industry is surprisingly efficient. See, for example, Centre for Latin American Development Studies (CLADES) of the University of Boston, Las ventajas comparativas de corto plazo en la producción manufacturera de Guatemala, Boston (mimeo), January 1984.

22/ This was signed in Guatemala by the Governments of Costa Rica and El Salvador on 14 December 1984 and by the Governments of Guatemala and Nicaragua on 27 December 1984.

23/ Charles Lindblom, Politics and Markets, New York, Basic Books, 1977, p. 11.

24/ Ibid., p. ix.