

CENTRAL AMERICA:
THE PRESENT PROCESS OF INTEGRATION
AS A FACTOR OF ECONOMIC GROWTH



RICARDO POMA

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You have done a comprehensive, masterful job. I can well imagine that many of your countrymen and their colleagues throughout Central America will be greatly interested in your thesis and the wealth of information which it contains. I feel that they would also be interested in and have respect for your own personal observations. Incidentally, I feel that you should have injected yourself into the thesis more fully by voicing your comments and criticisms at considerably greater length.

I have a few specific comments as follows:

On p. 29 you state that only 30% of the population were contributing to the gross regional product. What are the other 70% doing? I realize a great many of them are children.

You were too inclined to use the word "the" too often. I appreciate that this might happen to someone whose native language is Spanish. I noticed quite a few instances of excessive use between pp. 40 and 50 and in particular on p. 73. Along this line, the proper use of English prepositions should be watched.

Concerning footnote #10 on p. 66, I am surprised at the recent interpretation. Does this mean five plants manufacturing tires or another five manufacturing sheet glass? Why not interpret it that there shall be one integrated industry plant (each in a different industry) in each country before any given country can apply for a second plant.

On p. 67, (where I checked in the margin), I think you mean to use the word "implement" instead of "instrument." Also, that same sentence has some words missing.

I noticed that, beginning on p. 32 and continuing through most of the rest of your thesis, a

large proportion of your footnotes give credit to the Committee of Nine of the Alliance for Progress. Who are the Nine and what countries do they represent?

Referring to p. 86, where is INCAE located? In what city, in what country?

On p. 108 Young's book is listed as a reference but I do not see it in your bibliography.

After having read Chapter IV, I would be inclined possibly to add to the title of the Chapter the following words "and Some Observations on Same."

Despite these comments I do want to congratulate you on a very fine job.

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by

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Submitted to the Basic Engineering Program,
Princeton University,
In Partial Fulfillment of the Requirements for
the Degree of Bachelor of Science

A MIS PADRES

ACKNOWLEDGEMENTS

I would like to express my gratitude to Dean Howard Menand, Jr. for the interest that he has shown in this study, and for all his worthwhile suggestions. I am also indebted to my father for his constant encouragement and for his helpful criticism of the first draft.

TABLE OF CONTENTS

INTRODUCTION

CHAPTER I -- Historical Developments 1823-1950

CHAPTER II-- Economic Integration--Treaties and Agreements

CHAPTER III- Evaluation of the Central American Economy (1951-1965) and the National Plans of Development (1965-1969)

I. Trade and the Industrial Sector

II. Industrial Development

III. The Agricultural Sector

IV. Regional Consumption

V. Investment -- Private and Public

- (A) Economic Infrastructure
- (B) Social Infrastructure

CHAPTER IV-- The Effects of the Process of Economic Integration on the Central American Socio- Economic Structure

I. Industrial Development and the Integration Process

- (A) Duplicate Investments
- (B) The Integration Industries
- (C) Effects of the Common Market on the
Industrial Sector--Regional Objectives

II. The Reaction of Private Enterprise Towards the Common Market

- (A) Two Different Cases: Honduras and
El Salvador

III. Agriculture and Economic Integration

IV. Social and Economic Infrastructure in the Regional Context

V. "New Technology" in Economic Methods

- (A) The Central American Institute of Business Administration (INCAE)
- (B) Labor-Intensive versus Capital-Intensive Technology

VI. Financing Development

VII. Common Investments as a Method of Regionalization

- (A) The Multinational Firms
- (B) The Central American Stock Market

VIII. Balanced Growth Among Countries -- A Goal of Economic Integration

IX. The Process of Economic Integration -- In Whose Benefit?

- (A) The Industrialist
- (B) The Landowner
- (C) The Consumer
- (D) The Worker -- Urban and Rural

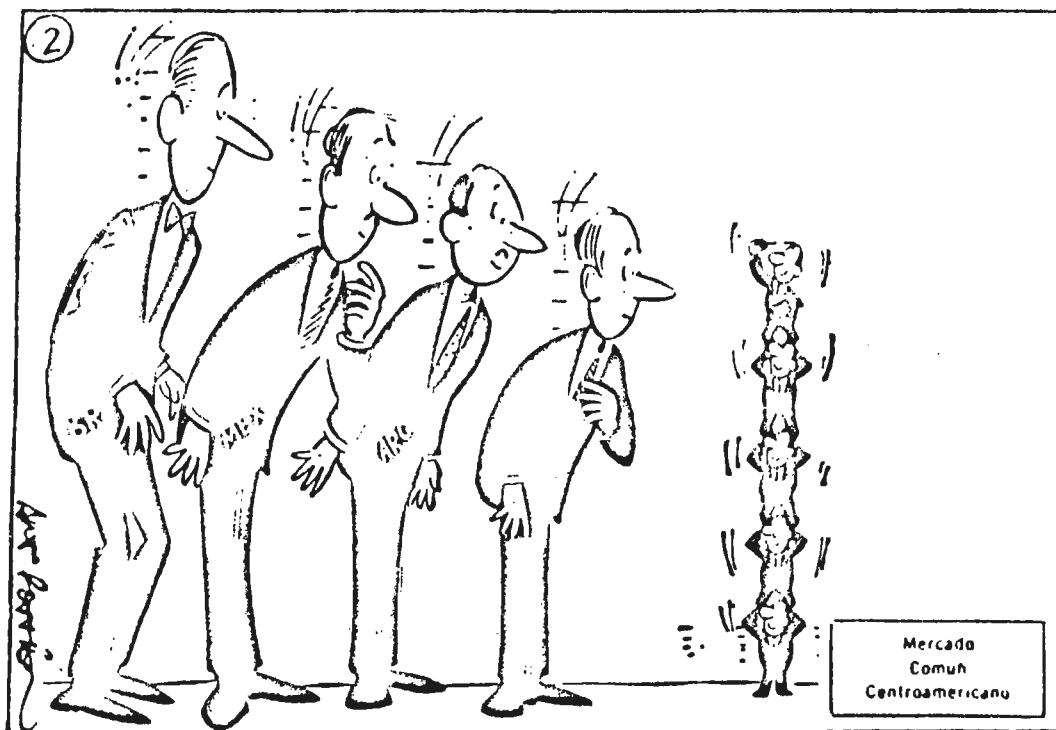
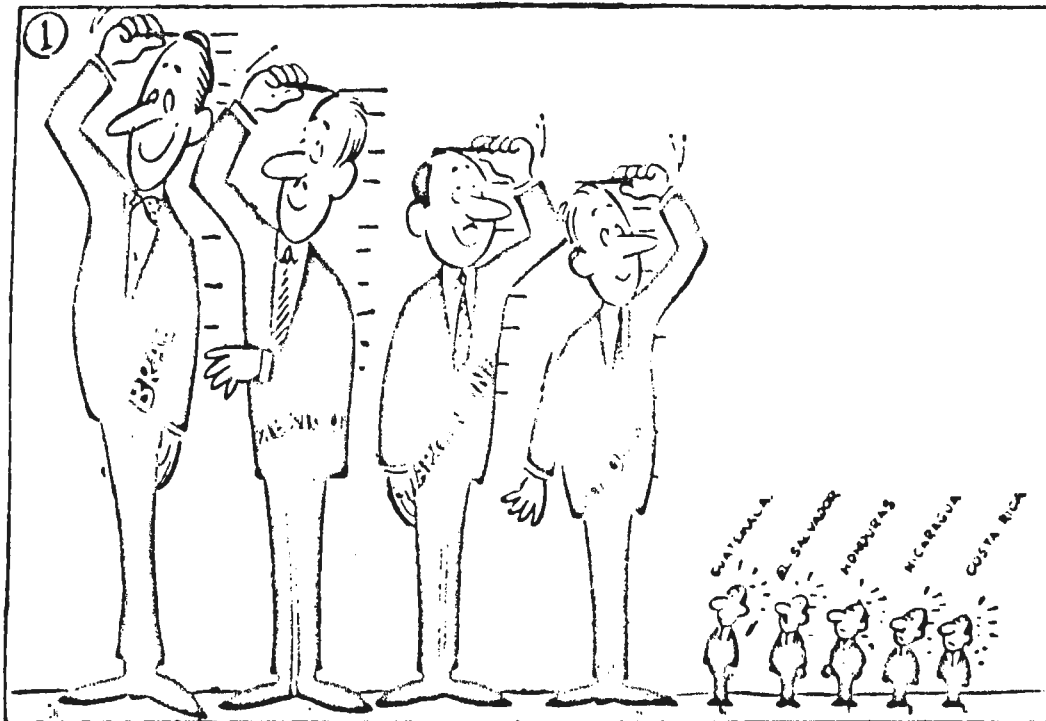
X. The Present Situation of the Institutional Framework of the Integration Process

- (A) The Mobility of Economic Factors
- (B) Monetary Union
- (C) A Jurisdictional Body for the Common Market
- (D) Other Problems
- (E) The Entrance of Panama into the Common Market

CHAPTER V -- Conclusions

APPENDIX A

APPENDIX B -- Interviews



INTRODUCTION

Since the end of World War II, several groups of the "less developed" countries in Africa, Asia, and Latin America have attempted international regional integration.¹ Regionalism, in the form of "economic" integration, has become the goal of many countries which are facing the problems caused by small markets and low per-capita incomes.

At the present time, there are only two or three examples of groups of sovereign nations that have achieved significant economic integration. Among the "developed" countries, the European Economic Community is one prominent example; among the "less developed" countries, the Central American Common Market has become the most prosperous.

International economic integration can be regarded as a process or a state of affairs; if viewed as a

¹"Integration is defined as the bringing together of parts into a whole. Economically this growth of interdependence can be measured in equalization of factor prices (internationally, the abolition of national discrimination between markets). Politically it can be judged by growth of a sense of community, either internal or across national boundaries." Joseph S. Nye, Jr., Central American Regional Integration (The Carnegie Endowment for International Peace, 1967) p.5.

process, "it encompasses measures designed to abolish discrimination between economic units belonging to different national states"; as a state of affairs, "it is represented by the absence of various forms of discrimination between national economies."² Several levels or degrees of economic integration are possible; these are usually ranked in increasing order of the interdependence they create. These levels are: a free-trade area, where tariffs among the participating countries are abolished; a customs union, where in addition to free-trade there is equalization of tariffs in trade with nonmember countries; a common market, where free movement of labor and capital is attained; an economic union, where fiscal and monetary policies are coordinated; and a complete economic integration where all economic policies are unified and supra-national bodies are created.

Through its integration treaties, Central America is, at present, in a state of transition between two levels: the free-trade area and the customs union. The region has not yet succeeded in establishing a common external tariff or in abolishing restrictions on factor

²Bela Balassa, The Theory of Economic Integration, (Illinois: Richard D. Irwin, Inc., 1961) p. 1.

³Ibid, p. 2.

movements. This degree of economic integration is incorrectly referred to as "the Common Market".⁴

Why are the Central American countries succeeding in integrating their economies when other groups of nations in similar circumstances are failing? One reason, given by Professor Joseph S. Nye in a recent article, is that "in Central America, at least among the nearly two-fifths of the population that is urban, nationalism, in the sense of a popularly felt right to exclude neighboring peoples from equal enjoyment of the resources of one's state, coexists with a considerable degree of economic integration."⁵ Another reason is based on the theory of "functionalism"; that is, these countries are succeeding in reordering their thinking along technical-functional lines. This has provided a minimal attack on state sovereignty.

These two reasons, however, only partially explain the relative success of the Central American countries in achieving some degree of economic integration. Given the problems encountered by many groups in other areas

⁴Note: in this study, "Central American Common Market, (CACM)" will appear from time to time in reference to the process of integration. It should be interpreted, in view of the theory discussed, as some level between a free-trade area and a customs union.

⁵Joseph S. Nye, Op. cit., p. 9.

of the world, it is difficult to explain this success in an area with high illiteracy rates, low per-capita incomes and alarming rates of population growth.

TABLE 1
CENTRAL AMERICA

Country	Area (Sq.Miles)	Popula- tion (Millions)	Popula- tion Density	% Literate ¹	% Urban	GNP Millions of \$CA	Per Cap. Income \$CA
Guatemala	42,000	4.3	97	39	34	1,220	284
El Salvador	8,200	2.8	332	51	39	768	272
Honduras	43,000	2.1	47	47	23	453	207
Nicaragua	57,000	1.6	27	27	41	458	290
Costa Rica	19,700	1.5	68	68	35	528	365

¹Ten years or older

Sources: SIECA, Centroamerica y Su Mercado Comun, Vol. 3 (1965); Cuarto Compendio Estadistico Centroamericano, Vol. II (1965).

Central America is a region of about 170,000 square miles with a population of approximately 13 million. It is divided into five small countries -- Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica. The average per capita income is approximately \$CA 300⁶ and the illiteracy rate is more than 50 per cent. It is estimated

⁶The symbol \$CA denotes "Central American pesos". These are equivalent in value to the United States dollar, but are only used for accounting purposes.

that the population will grow at an annual rate of 3.2 per cent in the period 1965-1974. This figure means that the population is likely to double in approximately twenty years.

The five nations and Panama form a geographic entity frequently referred to as the Central American Isthmus. (see Map 1) The flora and fauna in the region are extremely varied; the topography is, for the most part, mountainous and exotic. The Isthmus can be divided into four zones, each differing from the other by physical and climatic characteristics: 1) the Littoral Zone of the Atlantic, 2) the Zone of Sierras and High Plateaus, 3) the Zone of Sierras and Low Valleys, and 4) the Littoral Zone of the Pacific.

Historically, the five countries have had a common heritage. Colonized by the Spanish Empire, they achieved their independence in 1821. Since that time they have attempted many times to unite politically but with little success. The present process of integration, however, seems to be accomplishing what law and force together were unable to do in the 146 years since independence. The economic necessity of enlarging their mini-markets and the social need of meeting the demands of the people have "forced" the five countries to



MAP 1

cooperate in this form.

It is the purpose of this study to evaluate the process of economic integration in Central America and determine its effects on economic development. To this end, I have considered important to devote Chapter I to the historical background that led to the present process; Chapter II, to the description of all relevant treaties and agreements; and Chapter III, to a statistical evaluation of economic development in the periods 1950 to 1960, 1960 to 1965, and the future period 1965 to 1969, as seen in the national plans of development. These three chapters constitute an important source of "background" material that is essential to the understanding of Chapters IV and V. Chapter IV evaluates the process and discusses the effects of the Common Market on Central America's socio-economic structure, and Chapter V is devoted to conclusions.

CHAPTER I
HISTORICAL DEVELOPMENTS,
1823 to 1950

It is difficult to discuss economic integration without giving a brief historical sketch of the social, political, and economic background that has provided the stage for the present process of integration.

Three years after the proclamation of independence from Spain in 1821, the provinces of the now extinct Captaincy General of Guatemala-- El Salvador, Guatemala, Honduras, Nicaragua, and Costa Rica-- drafted a constitution that established the new government of the Federal Republic of Central America. This marked the beginning of a long series of futile attempts towards the desired goal of political union. "From the start, the Federation found itself in an atmosphere of marked divisionism between political parties who were fighting to obtain the power."¹

The Federal Republic of Central America lasted until 1838. The end of this new form of political union not only disrupted the political ties that had held

¹ Enrique Ortez h., La República Federal de Centro America, (San Salvador: Dirección General de Publicaciones del Ministerio de Educación, 1963) p. 99.

Central America as a nation, but also marked the beginning of petty and irreconcilable wars that were to divide the region in the next century.

The chaotic situation that prevailed after 1842, with the death of Francisco Morazan, President of the Federal Republic, made possible the invasion of Nicaragua by William Walker in 1855. Walker, whose ambition was to "conquer" the entire region, was stopped by the united Central American armies and this started what is known as the Great National War. It is significant to note that in times of stress, the unionist sentiment of the Central Americans prevailed. The united army, under the leadership of the governor of Costa Rica, Juan Rafael Mora, was able to expel Walker in 1856. Historically this war has been "the symbol of Central American fraternity that turns itself in defense of its liberty and independence."²

It would be beyond the scope of this work to discuss every one of the attempts towards the reconstruction of the Federal Republic. Suffice it to enumerate, with little elaboration, some of the political and juridical attempts that were added to the internecine

²Sieca, Centroamerica y su Mercado Comun, (Guatemala: Volume 3, 1965), p.7.

wars of the first years:

(1) The Chinandega Diet of 1842. This movement created the "Confederation of Central America" which was formed by El Salvador, Honduras, and Nicaragua. This confederation was the first attempt towards the restructuration of the Central American nation. It failed, however, because soon after, the states developed a fear of centralist government. "The trust among the confederated states' weakened to such an extent that a civil war broke between the states of El Salvador and Honduras on one side against Nicaragua."³ This ended the first attempt towards a confederation.

(2) The Pact of Union of 1895. This pact, signed again by the governments of El Salvador, Nicaragua and Honduras, was aimed to reconsider the federal system of government that had failed in 1839. It established what was known as the "Republica Mayor de Centro America." The new federal constitution that was drafted on August 27, 1898, marked, in the evolutionary process of Central American federalism, a major contribution to the field of

³Ortez h., Op. cit., p. 230.

political union; "it improved the Constitution of 1824, adopted the suggested reforms of 1835 and perfected, with the experience of the past, the federal system."⁴ The new republic, the United States of Central America, had a very short life and was dissolved by a military coup in El Salvador in November, 1898.

(3) The Pact of Washington of 1907. The failure of political union did not paralyze unionist propaganda. Civil wars and wars among the nations continued to plague the region in the first years of this century, and in 1907, Mexico and the United States interfered with the resulting Pact of Washington. This pact had three important consequences: (1) it incorporated a treaty of Peace and Friendship among the countries; (2) it established the Central American Court of Justice; and (3) it created a Central American International Office. The most significant legacy that this treaty has given the Central Americans was the establishment of the Central American Court, which was the first international body of its kind. Its importance is not so much that it was a "first"

⁴Ibid. p. 235.

but more in the context of the present-day process of economic integration. This will be discussed later in this work. The Court, however, failed in part, due to the Nicaraguan interest in the Bryan-Chamorro Treaty.⁵

(4) The Federal Union of 1921. On the centennial anniversary of the independence from Spain, the governments of Guatemala, El Salvador, Honduras, and Costa Rica signed another Pact of Union in which "considering a high patriotic duty to fulfill, in as much as possible, the reconstruction of the Federal Republic of Central America . . . we unite, in perpetual . . . union and will constitute from now on a sovereign and independent nation that will be denominated Federation of Central America."⁶ Nicaragua had not joined because the other states refused to recognize the validity of the Bryan-Chamorro Treaty. The final draft of the pact was

⁵The Bryan-Chamorro Treaty, ratified by the U. S. Senate in 1916, conceded rights to the United States over a future canal route in Nicaragua in return for \$3,000,000. This treaty created unexpected quarrels between Nicaragua, and Costa Rica and El Salvador. The Central American Court later rendered verdicts in favor of the last two countries.

⁶Ortez h., Op. cit., p. 236.

only approved by the national legislature of these countries. In January, 1922, however, after a coup in Guatemala, this new attempt was brought to an end; the federation was again dissolved.

(5) The Pact of Washington of 1923. The last attempt, juridical in nature, which I have considered important was the Pact of Washington of 1923. In 1922, aboard the United States ship, "Tacoma", the presidents of Honduras, Nicaragua and El Salvador agreed that they would consider valid the Treaty of Peace and Friendship, drafted in Washington in 1907. At the invitation of the United States, they also agreed to attend another conference in Washington, similar in nature to the one fifteen years earlier. As a result of this meeting, a pact was drafted in 1923, which revised and expanded the previous pact. However, from the Central American point of view the conference proved to be another failure. Alberto Herrarte in his book, La Unión de Centroamérica, says that "the camouflaged separatism made protests in favor of a long-term plan for union."⁷ It was to be a gradual union;

⁷ Alberto Herrarte, La Unión de Centroamérica, (Guatemala: Ministerio de Educación Pública, 1964), p. 196.

the date for this final goal was set as September 15, 1929. Under the pretext of unionism, however, the conference only helped to promote more separatism among the states.

The reader must not think that the attempts enumerated above were the only ones made towards political integration. In reality, more than twenty times did the nations try to unite unsuccessfully. Most of the attempts which have been left out for reasons of brevity were military, and many times bloody, efforts toward the goal of union.

It is difficult to determine the importance of the present-day process of economic integration on future political union. There exists, nevertheless, a definite relationship between economic and political integration. "Some theorists call the relationship a 'continuum' and they judge the likelihood of political union in areas undergoing economic integration according to a specific set of variables in three groups: background conditions, conditions at the time of economic union, and process conditions."⁸ These variables cannot

⁸Theory of Ernst Haas and Philippe Schmitter discussed in Francisco de Sola Jr. Social Structure and Integration in Central America - thesis presented to Harvard College (mimeographed) part I.

be evaluated equally as to their power in explaining the reasons for (or against) political union. One of them, the lack of elite complementarity, has been studied⁹ as one of the causative factors for the failure of union in the 146 years since Central American independence.

One cause for this failure, which antecedes the one mentioned above, lies in the structure, economic and political, left to us in 1821 after we became independent from Spain. The Spanish Crown had never attempted to unite, in any way, the provinces of the Captaincy. Consequently, the population centers of the provinces, which were later to become the capitals of the countries, grew separately. They developed, of necessity, their own infrastructure, their own bureaucracy, and became individual centers of growth. The fact that this separation created five development centers and that these have been key in the balanced growth of the five countries is something that can be stated in pro of separatism. Otherwise, the economy might have developed greatly in the federal district and very slowly in the outlying areas. This one consideration, however, does not override many of the advantages that could have resulted from political union -- the pooling of resources, human

⁹Ibid, part I.

and material, into one joint development program, with the resulting specialization that is so important for the optimum use of capital.

The economic history since 1823 can and should be studied country by country. However, the countries can be divided into two groups: (1) those that grew internally and (2) those that developed externally. In the first group can be placed El Salvador and, to a certain extent, Guatemala; these are the countries in which production of agricultural goods for export was in the hands of nationals with the resulting consequence that the profits normally stayed inside the country and were reinvested in new enterprises. This capital inflow made it possible to create a proper infrastructure that became essential to development. In the second group can be placed Honduras, Nicaragua, and Costa Rica. These were countries whose economies were heavily dependent on foreign companies who owned and exported their agricultural products. This resulted in an outflow of dividends and capital with consequences that hindered the natural development of their economies. In the case of Honduras, the northern Atlantic coast which cultivated bananas, was so geared to the outside that even today there does not exist a paved road uniting the north

coast with Tegucigalpa, the country's capital.¹⁰

These two types of economy had different effects on the basic social and economic structure of these countries. El Salvador and Guatemala, even though richer in absolute terms, developed a basically unbalanced social structure. The other countries, although still dependent to a great extent on the foreign companies, developed a more evenly distributed social structure that might prove helpful in the future.

Even though there have been definite differences in the economic development of the Central American countries and all their efforts towards political union have ended in failure, the new integration process has had substantial success in achieving the intended results. This new process, started in 1951, came about for two reasons: first, because of the economic necessity of expanding the markets and developing industry, and second, because the spirit of union still prevailed in the minds of most Central Americans.

¹⁰ At the present time, a highway is being built to connect San Pedro Sula in the north with Tegucigalpa. It is hoped that it will be finished in approximately three years.

CHAPTER II

ECONOMIC INTEGRATION - TREATIES AND AGREEMENTS

The social and economic needs in Central America were indeed the primary forces behind the efforts towards an economic integration. The more important factors that convinced the small nations that they should unite their resources and economic potential were the following:

(1) the need for a larger market in order to increase industrial production, (2) the necessity of organizing the regional exploitation of natural resources in order to become less dependent on the export of a few primary products, (3) the urgency of improving the standards of living and with it, the social structure of the region, and (4) the need of increasing the degree of specialization among the nations in order to attain, as far as possible, optimum capital utilization. Furthermore, economic integration would be a step in the right direction toward the long-sought ideal of political union.

Although there already existed in Central America bilateral treaties dating back to 1918, the origin of the present program of economic integration dates to the year 1951 when the Economic Commission for Latin America (ECLA), in its Fourth Period of Sessions, approved resolution 9 (IV). In this resolution, the governments of

Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica manifested their interest in

"developing industrial and agricultural production, and the transportation systems in their respective countries in a way that would promote the integration of their economies and the formation of larger markets through the free interchange of their products, the coordination of their development plans and the creation of projects in which all or some of the said countries would have interest."¹

Starting from this resolution, the governments of the five republics agreed to have a Meeting of Ministers of Economy. At this meeting, the Central American Committee for Economic Cooperation (CCE) was created and since then it has played a major role as one of the guiding forces behind the integration process. At the first reunion of the Committee in 1952 it was resolved to "start a program of gradual and progressive integration of the Central American economies, under the basis of cooperation and reciprocity among the governments."²

From this point the integration can be divided into three periods, each of which had particular significance:

¹Central American School of Public Administration (ESAPAC) Los Instrumentos del Mercado Común Centroamericano, (San José: 1965) p. 1.

²Permanent Secretariat of the General Treaty on Central American Integration (Sieca) Centroamérica y su Mercado Común, (Guatemala: 1965) Vol. 3, p. 19.

(1) The first period (1951-1958) involves the creation of bilateral treaties of free commerce between the countries in the area and the formation of the following regional bodies:

- a. Committee for Economic Cooperation (CCE)
- b. Organization of Central American States (ODECA)
- c. Central American Institute of Public Administration (ESAPAC)
- d. Superior Council of Central American Universities (CSUCA).

(2) The second period (1958-1960) marks the creation of two treaties:

- a. Multilateral Treaty of Free Trade and Economic Integration
- b. Agreement on the Regime for Central American Integration Industries

(3) The third and last period (1960-) involves the drafting of the two most relevant treaties with the resulting permanent juridical structure of integration at the multilateral level:

- a. Treaty of Economic Association
- b. General Treaty of Economic Integration

The first period is characterized by the development of bilateral treaties. The five governments, urged by economic necessity, tried to find markets in

which they could sell their products without restraints. In 1951, treaties were signed between El Salvador and Nicaragua, and between El Salvador and Guatemala; in 1953, between Costa Rica and El Salvador; in 1955, between Guatemala and Costa Rica; in 1956, between Guatemala and Honduras, and in 1957, between El Salvador and Honduras. It is significant to note that between these last two countries a treaty of free commerce had been previously signed in 1918. This treaty, however, was declared void by the new one.

During the period 1951-1958 the regional bodies that were enumerated before were formed and studies were carried out that were essential to the drafting of the first multilateral treaty. During the third meeting of the Committee for Economic Cooperation in 1956, that body resolved to promote the development of a zone of free trade in Central America and the drafting of a program of integrated industrial development that would induce the balanced growth of the five countries.

The second period (1958-1960) marks the beginning of the multilateral attempts at economic union. On June 10, 1958 the five governments subscribed to the Multilateral Treaty of Free Trade and Economic Integration. This treaty provided for the establishment of a zone of free commerce for products (natural or manufac-

tured) that were included in a special annex. To this effect, it was the purpose of the treaty to eliminate between the territories of the Central American countries the duties and obligations (such as import and export taxes) and all other charges caused by international trade for the products included in the given annex. The number of products was supposed to be enlarged and the zone of free commerce perfected in a period of ten years from the day the treaty went into effect. The treaty also included clauses relevant to international transit, transportation and communications, investments among the nationals of the signing countries, integrated industrialization and the establishment of a Central American commission for commerce.

Even though this treaty was the first attempt to create, at a multilateral level, what had been accomplished by the bilateral treaties, it did not attain the goal of achieving a zone of free commerce. More than this, due to the special annex, discriminatory practices developed which indeed retarded the process of integration. Business groups in some of the countries used their influence with the government in order that these would

treaty to reach a point of stagnation.

On the same date of the subscription of the multilateral agreement, the five governments signed the Agreement on the Regime for Central American Integration Industries. This treaty (actually called a "convenio") has as its objective the creation and development of industries that require free access to the entire Central American market in order to operate at economic and competitive conditions.

This "convenio" has not had the success that was expected and has been criticized strongly on the grounds that it creates industrial monopolies, which are incompatible with modern economic development. However, the failure of the treaty lies more in the fact that it has not achieved what it originally set out to do: that is, (1) accelerate the industrialization process and (2) accentuate the balanced development of the countries within the area. It is interesting to note that since the drafting of this "convenio" only three integration industries have been established. This problem will be discussed in more detail in Chapter IV.

These two treaties conclude what I have called the second phase of the evolutionary process of the Central American Common Market. By late 1959 and the

beginning of 1960, the structure of the integration process had reached an "impasse". The system of creating a positive list had proven to be a failure and there existed little enthusiasm for the "forced" industrialization provided by the treaty for Integration Industries. This setting provided the stage for the third period, which indeed has been the most successful.

By 1960, the need for a more solid structure for the process became apparent and on February 6, 1960 the Treaty of Economic Association was signed by the governments of Guatemala, El Salvador, and Honduras. This treaty made fundamental changes in the field of economic integration, guaranteeing not only the free movement of products and capital among the signing states but also the free transit of persons.³ This treaty also went a step further in achieving free commerce of natural and manufactured goods by annexing a negative list of products that would face restrictions; that is, all products that were not listed could have unhindered movement among the signing states. This list, would be reduced gradually to be finally eliminated in a period not exceeding five years. The important facets of this treaty were:

³SIECA, Convenios Centroamericanos de Integración Económica (Guatemala: 1963) p. 50.

(1) the establishment of a Common Market, (2) the creation of a Customs Union⁴, (3) the development of a Fund for Development and Economic Assistance, and (4) the formation of two new regional bodies -- the Executive Council and the Directing Committee.

The Fund for Development and Economic Assistance had the important role of accelerating the creation of a balanced infrastructure among the three states, and the financing and improvement of enterprises with the objective of attenuating the eventual maladjustments that could result from the creation of a Common Market.⁵

Even though the main purpose of this study is to evaluate and to give positive proof of the economic developments caused by the integration, it is significant to understand the above treaty since it has been the base for the more comprehensive General Treaty which established the juridical and operational base for the Common Market and the integration process.

The final step, therefore, was the drafting and signing of the General Treaty of Economic Integration on

⁴The signing states agreed to equalize the tariffs, in trade with non-member countries, during a period not exceeding five years.

⁵SIECA, Convenios . . ., Op. cit., p. 52.

December 13, 1960 by the governments of Guatemala, El Salvador, Honduras, and Nicaragua. Costa Rica joined the negotiations in 1962. It became effective in June 1961 for Guatemala, El Salvador and Nicaragua; in April, 1962 for Honduras and in September, 1963 for Costa Rica. The treaty developed and perfected the objectives of the Treaty of Economic Association and created new regional bodies of control that were to be the driving force of the integration process. Among these organisms were the Central American Economic Council, the Executive Council of the General Treaty, the Permanent Secretariat (SIECA), and the Central American Bank of Economic Integration, (CABEI).⁶

The treaty incorporated a new step towards the goal of free commerce by including in the annex all the products originating in the signing states with the exception of 20% of those listed in the NAUCA⁷; these few

⁶Other regional bodies have been created, but the study of these is beyond the scope of this work. There will probably be reference to some of them in later chapters, specifically, the Central American Institute of Business Administration (INCAE) and the Central American Monetary Council.

⁷The NAUCA list (Uniform Central American Customs Nomenclature), established in 1959, accounted for (a) the products on which uniform import tariffs would be placed immediately, and (b) those on which there would be gradual equalization. This list provides a positive step towards a customs union.

would be subject to transitory restrictions and would be liberalized automatically during a period not longer than five years.⁸

The General Treaty overrides by its nature all other treaties, except the parts of the earlier treaties which in no way contradict or create conflicting aims with the present one. The duration of the General Treaty is for twenty years, with the advantage that it can be renewed indefinitely.

It is left to Chapter IV and V to make conclusions and suggestions about the positive (or negative) elements that the General Treaty has incorporated in the Central American economy in the last five years. It can be said, however, that by 1960, Central America had achieved a solid, structural basis for its economic integration process.

⁸

SIECA, Centroamérica y su Mercado Común, p. 27.

CHAPTER III

EVALUATION OF THE CENTRAL AMERICAN ECONOMY (1951-1965) AND THE NATIONAL PLANS OF DEVELOPMENT (1965-1969)

No attempt has been made in this chapter to relate the statistical data and economic indices to the process of integration. This has been left to Chapter IV. If indirect correlation exists, the reason lies in the fact that one cannot divorce the economy from the process that was created to improve it.

The gross product of Central America, which increased by 4.5 per cent per annum in the period 1951 to 1960, showed a definite improvement in growth rate to 5.9 per cent for the period 1960 to 1964. In this last period, the gross regional product increased from \$CA 2.8 billion in 1960 to \$CA 3.5 billion in 1964. For the next period, 1964 to 1969, the national plans of development have programmed an increase in the annual rate to 6.6 per cent. By 1969, therefore, the total figure is expected to reach \$CA 4.8 billion, which will represent a per capita income of \$CA 335.3. Although the population is expected to grow very rapidly in this period, the plans hope to achieve a 3.4 per cent increase in per capita income for the next few years.

At the present time, less than half of the total

population is "economically active". In 1962, only 30 per cent of the population (3.5 million) were contributing to the gross regional product, 64 per cent of these were engaged in agriculture, 11 per cent in industry, 20 per cent in commerce, and 5 per cent in transportation and construction.

(I) Trade and the Industrial Sector

Since 1960, Central America has been in a period of rapid economic growth marked by an accelerated industrialization and by a growing awareness of the benefits derived from a larger market. One of the areas that has experienced a very rapid development has been intra-regional commerce. In the six years from 1960 to 1965, due mainly to the integration process but also to relative political stability and sound monetary policy, the commerce among the five countries increased from \$CA 32.7 million to \$CA 136.0 million. (See TABLE 2.) The share of intra-regional trade in total imports grew significantly in this six-year period from 6.4 per cent in 1960 to 15.6 per cent in 1965. According to the national plans of development this trend should continue, and by 1969, the commerce among the Central American nations should reach \$CA 220 million or 20 per cent of total imports (\$CA 1.071 million).

TABLE 2

CENTRAL AMERICA: IMPORTS - TOTAL AND REGIONAL (1960-1965)
(Millions of Central American Pesos)

	INTRA-CENTRAL AMERICAN IMPORTS (A)	Total IMPORTS (B)	A/B
1960	32.7	514.2	6.4
1961	36.8	495.9	7.4
1962	50.4	552.1	9.3
1963	66.2	651.6	10.2
1964	105.4	769.0	13.7
1965	136.0	867.8	15.6

Source: 1960-1963 SIECA Cuarto Compendio Estadístico
Centroamericano (Guatemala, 1965)
1964 SIECA Carta Información No. 44
1965 SIECA Carta Información No. 56

The development of industry has indeed caused a definite change in the composition of imports. More and more, consumer goods are being substituted by intermediate goods, fuels and capital goods. Since 1962, however, the production of some intermediate goods in the area has caused the decline of their share of total imports; this decline is being assimilated by the increase in the share of fuels and capital goods. (See Table 3.)

The emergence of transformation industries in the period 1960-1965 has accentuated the need for capital goods but at the same time, has solved to some extent the problem of importing large quantities of consumer goods that can be produced in the area. To what extent

TABLE 3
CENTRAL AMERICA: COMPOSITION OF IMPORTS

	(% of total)						
	1950	1955	1960	1961	1962	1963	1964
Consumer Goods	51.0	41.7	38.3	36.7	34.0	34.7	33.4
Intermediate Goods	21.4	25.8	29.3	32.2	31.4	30.3	28.4
Fuels	7.0	6.7	7.8	8.0	7.4	7.4	8.2
Capital Goods	20.6	26.8	24.6	23.1	27.2	27.6	30.0

Source: Committee of Nine, Alliance for Progress, Informe Sobre los Planes Nacionales de Desarrollo y el Proceso de Integración Económica de Centroamérica, (Washington, 1966).

this substitution has been beneficial to the region will be discussed in Chapter IV.

In the period since 1950, Central America has diversified considerably as far as the sources or countries from which it imports.. Although the value of imports from the United States has increased in absolute terms, its relative share in the total commerce has decreased from 70 per cent in 1950 to 45 per cent in 1964. This has been due mainly to the relative rise in the share of the regional commerce, and the commerce with Europe and Japan. (See Table I, Appendix A.)

In the context of regional trade, it is very interesting to note the composition of imports among the

Central American countries. The growth that can be seen in the commerce of foodstuffs, chemical products and manufactured goods confirm the influence of the Common Market.¹ (See Table II, Appendix A.) The growth of imports of manufactured products in the period 1955 to 1965 has indeed been surprising (from \$CA 1.2 million in 1955 to \$CA 37.1 million in 1965).

A serious problem that must be considered is that we are industrializing at a rate faster than the growth of the agricultural sector; since agriculture provides a very large percentage of the region's revenue, (see Table 4) this implies that soon we might run out of resources to finance the development of industry and the expenditures on infrastructure and public services which are essential to economic growth. Another problem is that we are industrializing for the national and regional markets; that is, only a very small percentage of the industrial output is exported to markets outside Central America. The need of developing new exports to the rest of the world is evident. The importance of the substitution of imports must not be underestimated, but by itself, cannot provide a solid basis for industrialization.

¹Committee of Nine, Alliance for Progress, Inferencia Sobre Los Planes Nacionales de Desarrollo y el Proceso de Integración Económica de Centroamérica, (Washington: 1966) p. 53.

TABLE 4
CENTRAL AMERICA: EXPORTS BY SECTORS

	1965		1969	
	Million \$	%	Million \$	%
<u>Agriculture</u>	519.1	68.5	623.3	60.6
Cotton	115.1	16.5	148.8	14.5
Coffee	264.3	34.9	289.9	28.3
Bananas	75.3	9.9	97.8	9.5
Others	54.4	7.2	86.8	8.5
Industrial	211.0	27.7	365.6	35.6
Others	27.2	3.8	36.5	3.6
TOTAL	757.3	100.0	1,025.4	100.0

Source: Joint Planning Mission for Central America
Resumen de los Planes Centroamericanos de
Desarrollo Económico y Social para el Período
1965-1969 (Guatemala: 1966).

The solution lies in attempting (a) to broaden the agricultural base and extend priorities to the development of food crops, (b) to carry out extensive research of the minerals and raw materials in the area, (c) to manufacture products for the world market, and (d) to encourage the development of tourism. This will give the region the needed foreign exchange and capital requirements to continue its economic growth.

II. Industrial Development

The industrial sector has, in the period 1955-1964 experienced a growth rate of 7.7 per cent per annum, increasing its participation on exports to the Central American area and to the rest of the world from 3.4 per cent in 1955 to 15 per cent in 1964.² (See Table 5). In Table 5, one can note that a large percentage of the industrial production is destined to the internal markets of the respective countries and to exports within the region. Only 7.8 per cent of the total production was exported outside the region in 1964; this is only expected to increase to 8.5 per cent by 1969.

In the period 1964 to 1969, the rate of growth of the industrial sector is expected to be about 12.6 per cent per annum; this growth will increase the participation of the manufacturing sector in total regional production from 14.9 per cent in 1964 to 19.6 per cent by 1969.³ According to the national plans, the country that will experience the highest annual rate of growth will be El Salvador at 14.4 per cent. The lowest rate will correspond to Costa Rica with 10.3 per cent.

²Ibid, p. 61

³Joint Planning Mission for Central America, Resumen de los Planes Centroamericanos de Desarrollo Económico y Social para el Período 1965-1969, (Guatemala: 1966) p. 16.

TABLE 5

CENTRAL AMERICA: DESTINATION OF INDUSTRIAL PRODUCTION
(In Millions of Central American Pesos of 1962)

	To Internal Market of the Producing Country	To the rest of the Central Amer. Region	To the rest of the world	To
1955	612.9	12.0 ¹	9.4	634.3
1960	790.2	32.5	30.9	853.6
1962	888.8	47.4	53.5	989.7
1964	1,050.6	88.6	96.7	1,235.9
1969*	1,656.3	290.8	181.4	2,128.5
		(in percentages)		
1955	96.6	1.9	1.5	100.0
1960	92.6	3.8	3.6	100.0
1962	89.8	4.8	5.4	100.0
1964	85.0	7.2	7.8	100.0
1969*	77.8	13.7	8.5	100.0
		(average growth rates per annum)		
1955-1964	6.2	25.0	30.0	7.0
1960-1964	7.4	29.0	30.0	9.0
1964-1969	9.5	27.0	13.4	11.0

¹Estimated

*Projections based on the national plans

Source: Committee of Nine, Alliance for Progress, Informe Sobre los Planes Nacionales de Desarrollo y el Proceso de Integración Económica de Centroamérica (Washington: 1966) p. 62.

(See Table IV, Appendix A) It seems, by looking at the rates of growth of the industrial sector, that the relatively less industrialized countries are those that will experience the smallest expansion in this sector. This is out of context with the objective of balanced growth among the countries, as set out by the General Treaty of Integration.

The five countries, however, are planning some

changes in the structure of the industrial base of products, by giving special attention to the development of the intermediate and the metallurgical industry. The traditional industry (mostly consumer goods) will diminish in its relative contribution to the total industrial production, reaching a figure of 74.9 per cent by 1969. The growth in

TABLE 6

CENTRAL AMERICA: STRUCTURE OF THE INDUSTRIAL PRODUCT
(1962, 1964, 1969)

Groups of Industries	Percentage Composition			Annual Rates of Growth	
	1962	1964	1969	1962-1964	1964-1969
Traditional	86.0	81.3	74.9	7.7	11.1
Intermediate	9.5	14.1	20.4	35.0	22.0
Metallurgy-Mechanic	4.5	4.6	4.7	11.9	13.5
TOTAL	100.0	100.0	100.0	10.9	12.9

Source: National Industrial Plans.

the manufacture of intermediate products is expected to come from the development of the chemical industry. In metallurgy, great advances are expected in the production of capital goods and durable consumer goods; the countries are also planning to develop the steel industry.

The realization of the program of development in the industrial sector, as appears in the national plans of the five countries will represent a net investment of

\$CA 599.8 million and employment for more than 178,000 in the period 1965-1969.⁴ The object is to optimize the present production facilities and create new projects. 30 per cent of the increase in the industrial product is expected to be achieved by operating existing plants at full capacity and by improving the methods of production.

The plans drafted by the five countries, however, show lack of regional coordination in this sector. Little has been done to avoid duplicate investments and to apply the principle of comparative advantage to the development programs. This will be discussed in greater detail in Chapter IV.

The plans also have modest goals with respect to exports of manufactured goods outside the region (See Table 5). "Self-sustaining progress can continue only if the increase in imports is matched by an increase in exports."⁵ The need for diversifying the export base is indeed great. More ambitious objectives should be set for exports of industrial goods outside Central America, especially from the traditional industries.

⁴Ibid.,p.18

⁵W. Arthur Lewis, Development Planning, (New York: Harper and Row, 1966) p.39.

III. The Agricultural Sector

The importance of the agricultural sector in the economic development of Central America must be constantly reaffirmed. It is indeed surprising to see how little of the entire instrumentation of the integration process deals with this sector. The process has given a much greater impetus to the industrial sector without noting that its development would tend to stagnate if it was not backed by the balanced growth of the agricultural sector.

The need for new agricultural techniques in the area is indeed great, especially when we realize that more than 60 per cent of the economically active population gains their subsistence from this sector.

TABLE 7

CENTRAL AMERICA: INDICES OF THE RELATIVE IMPORTANCE
OF THE AGRICULTURAL SECTOR, 1962

Participation of the Sector in:

	<u>Gross National Product</u>	<u>Economic Activity Population</u>
Guatemala	30%	67%
El Salvador	32	61
Honduras	46	71
Nicaragua	38	60
Costa Rica	32	52
Central America	34.2%	64.5%

Source: Committee of Nine, Alliance for Progress, Informe Sobre los Planes Nacionales de Desarrollo y el Proceso de Integración Económica de Centroamérica. (Washington, 1966) p. 118.

As can be seen in the table above, even though such a large percentage of the economically active population lives from the agricultural sector, it constitutes only 34.2 per cent of the gross regional product.

The productivity per man in this sector is, therefore, only about 28 per cent of that in the other productive sectors. Added to this, is the problem of the duality found inside the sector between (a) the highly exploited and technified subsector which exports most of its products outside of the region, and (b) the subsector which produces for the internal market. The productivity per man of this last subsector represents less than 20 per cent of that of the rest of the economy;⁶ in this subsector, a large fraction of the rural population is dedicated to the production of basic crops for the national markets.

In the last five years, agricultural production has been growing at about 5.2 per cent per annum; this growth, however, has been felt mainly in the subsector which exports outside the area. This has accentuated the duality problem, since the subsector which produces for the internal demand has not been able to show "significant advances on the road towards the structural transformation necessary to overcome its low productivity and

⁶Committee of Nine, Op. cit., p. 119.

social backwardness."⁷

Another problem that must be faced is the uneven distribution of land. This has determined, to some extent, the low standard of living of a large part of the rural population. The need for evolution in this area is essential. However, any reform geared to solve this problem should be compatible with the goal of optimum agricultural production; this cannot be attained unless the farms are large enough to afford modern methods of cultivation. Any agrarian reform should, therefore, be very carefully studied, and should not involve expropriation of land except in some cases of unused land, where adequate compensation must be afforded.

The development of industry demands the expansion of the regional market by way of increasing the per capita income in the rural zones. "The improvement of the agrarian situation and the structural transformation that is needed to accomplish it, are primarily the responsibility of each nation . . . but the situation stresses the need for a combined effort in the five countries, to coordinate the development of the agricultural sector with the regional objectives of industrialization, the growth of other productive activities, and the creation of an

⁷Ibid, p. 119.

adequate economic and social infrastructure."⁸

In the national plans of development (1965-1969) very little attention has been placed on a clearly defined program of development in the agricultural sector. Of special interest is the lack of coordination among the plans; almost no attempt has been made to achieve some degree of productive specialization which is already being demanded by the process of integration.

The sector is expected to grow at an annual rate of 5.4 per cent which is considerably higher than the 3.6 per cent annual growth registered in the period 1950-1962. However, due to the faster rate of growth of the gross regional product the participation of this sector is expected to decrease from 31.9 per cent in 1964 to 30.0 per cent in 1969.⁹

The composition of the total agricultural production is also expected to change in the period 1965-1969. The part of the sector that produces for outside markets will experience a relative decline in comparison to cattle raising, and forestry. The production of coffee, cotton, bananas, sugar and various other crops will grow at a rate of 7.1 per cent per annum compared to the 12.5 per cent growth rate in forestry and 8.4 per cent in cattle raising. (See table 8).

⁸Ibid, p. 121.

⁹Joint Planning Mission for Central Amer., Op.Cit., p.20.

TABLE 8

CENTRAL AMERICA: GROSS PRODUCT OF THE AGRICULTURAL SECTOR,
BY ACTIVITIES (MILLIONS OF 1962 CENTRAL AMERICAN PESOS)

	Growth Rate			Percentages	
	1965	1969	1965-1969	1965	1969
Export Crops and					
Basic Grains	947.	1,244.	7.1	74	72
Cattle Raising	261.	362	8.4	20	21
Forestry	62.	100.	12.5	5	6
Fishing	14.	18.	6.4	1	1
TOTAL	1,284.	1,724.	7.6	100.	100.

Source: Joint Planning Mission for Central America Resumen de los Planes Centroamericanos de Desarrollo Económico y Social para el Periodo 1965-1969. (Guatemala: 1965) p.24.

The development of these other activities will cause a certain shift in the destination of the agricultural product; that is, a larger share of the product of this sector will be destined for internal markets.

TABLE 9

CENTRAL AMERICA: DESTINATION OF THE AGRICULTURAL PRODUCT
(in Percentages)

Internal Market		External Market		Growth Rates 1965-1969		
1965	1969	1965	1969	Internal	External	Total
48	51	52	49	8.9	6.4	7.6

Source: Committee of Nine, Alliance for Progress, Informe Sobre los Planes Nacionales de Desarrollo y el Proceso de Integración Económica Centroamericana (Washington, 1966) p. 123.

Central America needs to develop even further the fishing industry and the production and exports of meat. This will undoubtedly help to solve the problem of structural inflation, set off by unbalanced growth; that is, it will help finance the growing industrialization and alleviate the problems in the balance of payments.

As was mentioned before, little has been done to coordinate the national plans of development with respect to the agricultural sectors; this coordination is necessary to achieve a greater degree of productive specialization and accelerate the formation of a true zone of free commerce for all agricultural products. The relationship between the process of economic integration and this sector will be analyzed in Chapter IV.

IV. Regional Consumption

In the period 1950 to 1964 mass consumption increased at a rate of 4.8 per cent per annum. The national plans expect that this figure will increase to 5.5 per cent during the period 1964-1969. The objectives of the plans of development with respect to this area are to "(a) liberate a larger quantity of resources for investment and (b) better the standard of living of the majority of the population."¹⁰ Total consumption can be divided into

¹⁰Ibid, p.30.

two categories: (1) private consumption, and (2) public consumption. The first of these will continue to represent 90 per cent of total consumer demand which amounted to \$CA 3.1 billion in 1964 and is programmed to increase to \$CA 4.1 billion by 1969.

In the next five years, however, the plans expect that the propensity to consume will start to decline in order to accelerate the capitalization process. No specific measures have been taken, however, to encourage this objective in a manner compatible with the intentions to increase the consumption level of the lower income groups.¹¹

V. Investment - Public and Private

Gross investment in the five countries increased at an annual rate of 8.1 per cent in the period 1960-1964 and is expected to increase by 11.2 per cent per annum for the five year period 1965-1969. The total figure for this last period is expected to be close to \$CA 3.6 billion, of which 64.8 per cent will represent private investment.

The plans expect that the share of public investment will grow from 27.7 per cent in 1964 to 37.5 per cent

¹¹Ibid, p. 32.

by 1969. The principal objective of this increase in public investment is to create, at a national level, an adequate social and economic infrastructure. In the last few years, however, attempts have been made to coordinate the public investment plans of the five nations in order to accelerate physical integration and create a regional socio-economic structure.

(A) Economic Infrastructure

Great progress has been achieved in the construction of roads and highways. Some of these projects have been joint ventures between two or more countries desirous to meet the demands created by the growing intra-Central American commerce. In the period from 1951 to 1962 the number of kilometers of roads of all types increased from 8,297 to 17,031 which represented a 6.8 per cent annual growth rate. It is expected that in the period 1965-1969, 8,502 kilometers of road will be built or improved. The construction of better roads and highways has broadened the base for the physical integration that was lacking.

Much less progress has been made in the regional coordination of investment plans for railroads and maritime transportation. In this area, a coordinated regional action is needed in order to avoid unnecessary duplication of investments and increase the efficiency of the existing

facilities. In the opinion of the ad-hoc Committee for the Alliance for Progress, there is great need of drafting a Central American Program of Transportation that will determine the regional priorities and systematize the channeling of public investment into the area.¹²

The plans estimate that in the period 1965-1969 \$CA 422 million will be invested in transportation. Of this amount about 78 per cent will be used for roads and highways and the rest is divided among maritime ports, airports, railroads and other forms of transportation.

TABLE 10

CENTRAL AMERICA: COMPOSITION OF PUBLIC INVESTMENT IN TRANSPORTATION 1965-1969

	<u>Amount</u> ¹	<u>Percentages</u>
Roads and Highways	330	78
Railroads	3	1
Ports	54	13
Airports	25	6
Others	<u>10</u>	<u>2</u>
TOTAL	422	100

¹in millions of Central American pesos.

Source: Joint Planning Mission for Central America, Resumen de los Programas Centroamericanos de Inversiones Publicas, (Guatemala: 1965) p. 119.

Regional planning will be essential in the future if optimum use of capital is to be achieved in this area.

¹²Committee of Nine, Op. cit., p. 20

In the field of development of electricity and hydroelectric resources the regional program has the following objectives: "(1) to take advantage of the opportunities afforded by the interconnection (of transmission lines) between countries . . . (2) to engage in common projects for the use of water sources, and the control and improvement of the navigable capacity of the waterways, and (3) to construct common hydroelectric plants."¹³

Up to now, most of the projects in the area have been carried out almost exclusively for national use. However, in the period 1959-1964 the installed capacity increased from 360.3 to 534.4 million watts or an equivalent 10.1 per cent increase annually.¹⁴ In the future, due to the demands on electricity placed by the process of industrialization, regional or multinational action will have to be taken. The installed capacity is planned to increase from the 543.4 million watts figure in 1964 to about 670 million watts by 1969.¹⁵ This will represent an investment of about \$CA 189 million which is 13.7 per cent of the total public investment figure for the period.

¹³Ibid, p. 144.

¹⁴Joint Planning Mission for Central America, Resumen de los Planes Centroamericanos de Inversiones Publicas, (Guatemala: 1965) p. 132.

¹⁵Ibid, p. 42.

Projects for the interconnection of their present hydroelectric resources are being carried out by Honduras and El Salvador (estimated net saving on investment: \$CA 30 million for the first seven years), Nicaragua and Costa Rica, and Costa Rica and Panama. A fourth project plans the inclusion of Guatemala's resources into the Honduras-El Salvador group in a three-way interconnection. Although the need for this type of joint effort is indeed great, many technical problems plague the projects. Difficulties have been encountered in ascertaining the technical and financial responsibilities that each country will have in the ventures.

The Central American systems of communications, especially the telephone system, was less than adequate before 1960. Since that time many projects have been undertaken, the most comprehensive of which was done by the French Mission. A treaty based on this project was drafted, but many problems arose in the technical aspects of the operation of the system. Recently, however, the governments seem to have come to some sort of an agreement. The plans of development have set as their objectives to: "(1) establish a system of automatic communication between the principal urban centers in the region, (2) modernize the present systems and extend the network to new urban centers, and (3) regionalize the present connections,

including Panama."¹⁶ The total investment in this area is planned to be around \$CA 58.5 million which represents 4.2 per cent of total public investment for the period 1965-1969.

(B) Social Infrastructure

The area of social development is one which will be positively favored by the progress achieved in the economic areas. The programs themselves state as one of their more important objectives the definite intention of raising the standards of living in the region. In the last six years, the high rate of growth of gross regional product has had positive effects in improving the economic well-being of a majority of the Central Americans; this can be measured by a definite rise in consumption which has been more evenly distributed among the various social levels. The social development of the region can be divided into three subsectors: education, health, and housing. The first of these, education, has been and still is deficient. The illiteracy rate is more than 50 per cent for a majority of the countries and there still is a definite shortage of teachers and a scarcity of physical facilities. This problem is more acute in the rural areas, where the number of schools is very small relative to the

¹⁶ Committee of Nine, Op. cit., p. 146.

population. The region, therefore, is in need of (a) enlarging the present facilities, and (b) achieving a better geographic distribution of the education centers. In 1964, only 58 per cent of the population in the age group between 7 and 12 were receiving primary education. The number of classrooms for this purpose was estimated at 35,257. The percentage figures for secondary education and university training are much smaller but the exact figures are not known.

The development plans of the five countries have put special emphasis on reducing the illiteracy rate and increasing the percentage of the population receiving a primary education. It is estimated that by 1969, 75 per cent of the population in the 7-12 age group will be able to receive such an education. The goal is to have all the eligible population receive primary training by 1980.

Less emphasis has been placed on secondary and superior education. Although 2,771 more classrooms will be built in the 1965-1969 period for the purpose of secondary schooling, only about 12 per cent of the eligible population will be receiving it in 1969.

To achieve the goals of the national plans \$Ca 79.0 million will be invested on education in the five year period 1965-1969. This represents only 5.7 per cent of total public investment. A large percentage of this

amount will be used in building new schools for primary education. (See Table V-Appendix A).

In the area of health, the indices show that there is great need for positive action. In 1964, there was an average of only 2.3 hospital beds per 1000 persons. The problem of extremely scarce facilities is further aggravated by an uneven geographic distribution of these facilities. Most of the hospitals are located in the urban areas, leaving many of the rural zones practically unattended.

The development plans have programmed a total investment of \$CA 193.9 in this area, for the period 1965-1969; this investment will be destined to the construction of hospitals and health centers, and the creation of systems for the distribution of drinkable water and better sewerage. By 1969, the number of hospital beds per 1000 people is expected to rise to 2.7; the plans estimate that, in the five year period, 34 hospitals and 305 health centers will be built.

Sixty per cent of the total investment in this area (\$CA 116.3) is expected to be financed by internal resources. The other 40 per cent will be financed through aid and loans from outside sources.

In the area of housing, Central America is also in need of definite improvement. It is estimated that

only one third of the total population live in houses that can be considered "adequate". In the last five years, however, many projects were undertaken which had positive effects in attenuating the problem. Nevertheless, as of 1964, the deficit in housing was calculated at 1.7 million houses or living units. Even though the national plans estimate that 125,249 houses or units will be built in the period 1965-1969, this will not even cover the housing deficit caused by the population growth. The problem, therefore, will tend to get worse. The investment in this area is planned to be \$CA 175.5 million, but this, it seems, will not be enough to counter the demographic "explosion".

The total public investment in the period 1965-1969 is expected to be \$CA 1,384.6 million. This will be divided in different proportions in the areas discussed before: economic infrastructure, social infrastructure, productive sectors and others. (See Table VI, Appendix A.) 52 per cent of the total public investment (\$CA 721.2 million) will be financed internally and the rest will come from external sources. These last sources are primarily international finance agencies. The Inter-American Bank of Development is considered the principal source of financing for housing and health; the International Bank of Reconstruction and Development will give vital backing to the development of highways, electric power supplies,

and communications. For the regional projects of infrastructure, the Central American Fund for Economic Integration will be the principal source of capital. The Agency for International Development has also planned to give financial help to projects involving health, education, and transportation.

The process of economic integration has indeed been of primary importance in the accelerated economic progress achieved in the last six years and has provided the momentum needed to set high objectives for the period 1965-1969.

The purpose of Chapter IV is to show the effects that this process has had on the Central American socioeconomic structure, and to discuss some of the problems that the process is encountering which are retarding the positive development of a more efficient (and more rewarding) integrated economy.

CHAPTER IV

THE EFFECTS OF THE PROCESS OF ECONOMIC INTEGRATION ON THE CENTRAL AMERICAN SOCIO-ECONOMIC STRUCTURE

The economic growth that Central America has experienced in the period 1960 to 1966 can be attributed, to a large extent, to the progress that has been achieved in integrating the economies of the five nations. Other factors, however, have contributed to this growth; the period has coincided with one of general political peace, of monetary stability, of relatively stable world markets for the region's agricultural exports, and of a new and positive attitude on the part of government and business leaders regarding the need for development. This last factor, to which I attribute great importance, has been a direct product of the general awareness that the social and economic problems must be solved. Most Central Americans are becoming conscious of the benefits derived from the new dynamic process of industrialization, which has been accelerated by the creation of the Common Market. This awareness is, in itself, one of the motors that has revolutionized the concept of economic development. Central Americans are getting more and more involved with the process and are starting to experience the dynamism of what Rostow has called the take-off. "The take-off" is the interval when the old blocks and resistances to steady growth are finally overcome. The forces making for

economic progress, which yielded limited bursts and enclaves of modern activity, expand and come to dominate the society. Growth becomes its normal condition."¹

It is difficult to measure exactly the effect that the process of economic integration has had on this growth. However, the creation of a free-trade area protected by tariffs against competition from outside the region has provided the base for a rapid industrialization and has been the principal factor behind the 315 per cent growth of intra-regional trade in the period from 1960 to 1965. More than this, the process of integration has created the institutional framework needed for "the transformation of a social and economic structure that had been, in the past, incapable of establishing a solid base for prolonged economic growth and for the bettering of the standards of living which are being demanded by a majority of the Central American population."²

This does not mean, however, that the institutional framework established in the General Treaty of Economic Integration is perfect. The base has been established;

¹W. W. Rostow, The Stages of Economic Growth, (Cambridge: Cambridge University Press, 1960), p. 7.

²Committee of Nine, Alliance for Progress, Informe Sobre los Planes Nacionales de Desarrollo y el Proceso de Integración Económica Centroamericana, (Washington:1966) p. 1

the process, nevertheless, is plagued with many technical problems, most of which, it is hoped, will be resolved with time. These problems will be discussed with more detail later in the chapter.

The rate of growth of Central America on the whole increased substantially since 1960, achieving a figure of 2.5 per cent per capita in the period 1960-1964, compared to 1.5 per cent for the 1950-1960 decade. It is interesting to note that the only country that experienced a reduction in the national product per capita for the period 1960-1964 was the last one to join the Common Market. This country, Costa Rica, has since experienced a sharp increase that can be attributed directly to its participation in the intra-Central American trade.

I. Industrial Development and the Integration Process

"Industrialization refers to the actual source of transition from the preceding agricultural or commercial society toward the industrial society."³ However, we must ask ourselves: What sort of industrialization is the most convenient for a developing region like Central America, given the limitations of human and capital resources? In the period 1950-1960, due mainly to the favorable

³Clark Kerr, John T. Dunlop, Frederick H. Harbison, and Charles A. Myers, Industrialism and Industrial Man, (New York: Oxford Univ. Press, 1964) p. 14.

conditions existing in the world markets for our traditional export products and to the bilateral treaties, Central America began to industrialize at a rate faster than the growth of the economy as a whole; the commerce of manufactured products became the most dynamic element in the intra-regional trade. This early industrialization, however, centered on the continuance of the traditional industries--foodstuffs, tobacco, liquor and soft drinks, textiles, wood articles, and furniture. The increase in the size of the markets provided by the bilateral treaties was not enough to start a more dynamic industrialization or to provide the basis for a transformation of the manufacturing sector. During this ten year period, the sector did not achieve a large degree of import substitution; the proportion of imported consumer goods also remained at the same level for the period, with a slight increase in durable consumer goods, intermediate goods, and capital goods.⁴

Since 1960 the creation of the Common Market has caused a definite structural transformation in the sector; it has provided the base for an accelerated process of import substitution, largely of durable and non-durable consumer goods. In the last six years, however, Central

⁴ SIECA and the Economic Commission for Latin America (CECLA) Los Problemas de la Politica Industrial Centroamericana (SIECA/CEC - III/Prov. 30, 1964) p. 6.

100

America has experienced a rapid growth in the production of intermediate goods such as fertilizers, insecticides, tires, metallic structures, and raw materials for the chemical industry.

If the production goals of the national plans of the five countries are met, it is estimated that import substitution will reach a figure of \$CA 375 million by 1969. In order to sustain this rapid growth rate, the region must encourage the development of industries that produce intermediate and capital goods. It must also recognize the necessity of achieving a greater degree of specialization in the production of consumer goods.

The Common Market is still too small for the creation of certain basic industries that demand a larger scale of production to operate economically. Taken as a whole, Central America represents a market comparable to a medium sized South American country such as Colombia or Peru. What is important, in the context of the 12-million market, is that it has created a new attitude among the Central American entrepreneurs focused on a regional concept of industrialization. This has permitted a better utilization of the present industrial capacity.

The fact that the businessmen are becoming aware of the opportunities afforded by the Common Market does not imply that the national mentality has disappeared and

been replaced by a regional outlook; the feeling of nationalism, aggravated by lack of communication among the business groups in the five countries, has caused duplicate or multiple investments in production areas where the combined capacity of the plants far exceed the regional demand. This naturally implies capital waste and the establishment of manufacturing plants that by themselves are too small to take advantage of the Common Market.

This all leads to one essential point which cannot be emphasized enough: the urgent need of establishing a regional policy of industrialization. The governments of the five countries should, at least, work towards a greater coordination of their national plans of development. This cannot be done without a systematic effort by the Central American entrepreneurs to attain greater specialization. "It would be important that . . . (the entrepreneurs) act jointly to consider the perspectives of industrial development and the different projects with regional outlook, coordinate these initiatives and establish agreements for common investments wherever possible."⁵

Some coordination of the national plans has been carried out by the Joint Planning Mission for Central

⁵Committee of Nine, Op. cit., p. 15.

America in its study Bases para un Programa Centroamericano de Desarrollo Industrial (March, 1965). This work is more a compilation of the data in the national plans than a study of regional industrial development. However, the work of the Joint Planning Mission must not be underestimated and may, in the future, prove very useful towards the coordination of development objectives.

(A) Duplicate Investments

The duplication of plants and projects in Central America has been a direct result of the profit opportunities provided by the Common Market. Lack of coordination, however, has caused excessive investment in the production of easily substituted consumer imports. Entrepreneurs in all five countries have provided capital for the manufacture of similar products in quantities that far exceed their demand. Although this can be considered a triumph for free enterprise, Central America is in definite need of a certain amount of economic planning in this area. The relatively scarce capital resources make it essential for the five countries to act jointly and establish priorities for investment in the industrial sector. There is no need, however, for direct government intervention; on the contrary, the "direction" should take the form of (a) effective use of the mechanisms for coordination that exist at a regional level, (b) tax exemptions, special

protective tariff systems and other encouragements for investments in areas such as the production of capital goods, (c) discouragements in areas facing much duplication by tighter credit facilities, higher taxes, and more restrictive policies. The capital waste and high degree of plant duplication is not only a problem of the present and the past. The national plans of development for the period 1965-1969 include projects for the manufacture of similar industrial goods, each of which require the entire, or a large part, of the Central American market. Some of the most notorious examples are the production of paper and pulp, fertilizers, iron and steel, and rayon.⁶ There exist eight projects for the development of the paper industry in Central America, two of which--in Guatemala and Honduras--are already in an advanced stage of preparation. The other six projects are still in the preliminary phase of study. Adding up the estimated capacity of all the projects, we arrive at a total production of 493,000 tons by 1969. If we compare this to the potential demand estimated by the Joint Planning Mission, we realize that the completion of these projects would mean a surplus of 353,000 tons for that year. In view of the scarcity of funds for other top priority areas, it does not seem logical to go ahead with these projects unless some of the

⁶These examples are taken from Ibid, p. 90-100, and from the national plans of development (1965-1969).

production is intended for exporting outside the region.

Another industry that is facing an overabundance of projects is the fertilizer industry. Due to its direct relationship to the agricultural sector, it is important to achieve some degree of regional programming for this industry in order to avoid price fluctuations that can have serious repercussions on the cost of the region's export commodities and basic grains. The national plans contemplate several projects for the development of solid fertilizers in the region; only in three of them--Guatemala, El Salvador, and Costa Rica--have the plans considered the production of ammonia and its derivatives. If the goal of the three projects for ammonia production are met, it is estimated that total capacity will be of the order of 281,000 tons. This figure would mean a surplus of approximately 170,000 tons in view of a total demand of only 110,000 tons. This excess capacity leads us to think about the obvious advantages and cost reductions that could be obtained if the three medium-sized projects were replaced by one common project for the entire region.

The examples of duplication mentioned above are only two of a wide gamut of areas where the national plans have showed definite lack of coordination. A more rewarding process of economic integration would certainly entail a growing specialization and close adherence to the principles of comparative advantage. How much of this regionaliza-

tion⁷ can be achieved without some degree of political integration is something that, I hope, will be resolved in the near future. For the present, we are faced with a certain game of national give-and-take, that must satisfy a number of political pressures, aggravated by an overpowering national mentality. It is essential, nevertheless, to create, through the process of "human" integration closer communication among the entrepreneurs of the five countries. This communication added to a combined effort of the coordinating regional bodies such as SIECA, ICAITI, the Joint Planning Mission, and the Central American Bank of Economic Integration, together with the National Planning Offices, can provide the base for the badly needed regional plan of industrialization.

The reader must not think that the process of integration has not had as one of its objectives the systematic development of the industrial sector. On the contrary, this has been one of its main preoccupations. To this end three important legal instruments were subscribed by the five governments: (1) Agreement on the Regime for Central American Integration Industries (1960), (2) the Special System for Promotion of Productive Activities (January, 1963), and (3) the Central American

⁷Throughout Chapter IV, "regionalization" is synonymous to "integration"; it is the process of making the region and its people "Central American".

Covenant of Fiscal Incentives for Industrial Development (July, 1962). The Special System establishes uniform protective tariffs for certain industrial activities only if the installed capacity of the Central American plants are capable of covering at least 50 per cent of the regional demand. The Covenant of Fiscal Incentives, although subscribed in 1962, has not yet become effective; it still lacks ratification by the government of Honduras. This "convenio" establishes "uniform incentives for industrial promotion . . . that grant first priority to industries producers of capital goods and raw materials, in relation to the amount of regional labor used and to the importance of the components of regional origin."⁸ The incentives extended to industry in Honduras and Nicaragua are for longer periods of time--an additional two years and one year, respectively--in the form of exemptions from income tax. This disparity in the periods of exemptions is in keeping with the goal of balanced economic development among the five countries. This will be discussed later in the chapter.

(B) The Integration Industries

We come now to an area that has created much controversy in the past four or five years. The Agreement

⁸ Committee of Nine, Op. cit., p. 10.

on the Regime for Integration Industries in Central America, subscribed in 1960, was designed to encourage the creation of basic industries that could only operate economically if guaranteed the entire or a large part of the Common Market. These industries would receive preferential treatment in the form of free commerce for their products within the region and encouragements in the form of exemptions from internal taxes and customs duties. Due to the "monopolistic" aspects of the given status, regional bodies would control prices, inventories, quality and distribution conditions in an effort to protect the consumer.

The Regime for Integration Industries was indeed the first multilateral instrument for industrial promotion. Apart from the development of needed basic industries, it has two other important objectives: (1) to encourage the balanced growth of the five countries by the strategic placement of these industries, and (2) to keep duplicate investments at a minimum in an effort to achieve greater specialization.

In the six years that this Regime has been in effect only three plants have received "integration industry" status. These are: a tire plant in Guatemala, a plant for the production of caustic soda and chlorinated insecticides in Nicaragua, and a plant that produces sheet

glass in Honduras. Guatemala has applied to obtain two more industries under the Regime: one to produce paper and pulp and the other to manufacture rayon. This seems to be in contradiction with the terms of the agreement which specifically states in its Transitory Clause that "in the hope of promoting an equitable distribution of the plants included as Central American industries of integration, the signing states will not assign a second plant to one country until each one of the five states has at least one . . ."⁹ This clause in itself defeats the purpose and operation of the entire Agreement; if one country decides not to have an integration industry, then the Regime becomes totally inoperative.¹⁰

Some lawyers and economists, especially in El Salvador and Guatemala, argue that the treaty was a "political conspiracy" against the more industrially advanced countries. They argue that the Regime was designed to tune down the initiative and drive of El Salvador and Guatemala in favor of a more dynamic industrialization in the other three countries. This said "conspiracy"

⁹ODECA, Boletin Informativo, (San Salvador:1961)p.32.

¹⁰Recently, however, the Central America Economic Council has interpreted this Transitory Clause to mean that a second plant within the same industry cannot be assigned to a given country until each one of the participating states has one plant of this same industry. This new interpretation has opened new perspectives to an agreement that would have otherwise faded away.

has actually little or no foundation; what is true is that the agreement has as one of its main objectives the promotion of the balanced growth of the five economies.

In the actual operation, the Agreement on the Regime for Integration Industries has had very little success as a mechanism to coordinate the industrial process in the region. Three reasons, among others, could explain this lack of success:

1. The operative system used to instrument the Regime has resulted unnecessarily complex.¹¹ Any industry desirous to come under the Regime has to obtain technical and economic approval of its project by the Executive Council of the General Treaty and then obtain formal authorization in the form of a Protocol that has to be signed by plenipotentiaries of the five countries. This entails several months of study and negotiations.
2. The preparation of industrial projects to be included in the Regime has been very slow.
3. The Regime has not had sufficient financial backing--notably little from sources that are themselves financed by the United States government agencies (such as the Central American Bank of Economic Integration). This has been due to the

¹¹Committee of Nine, Op. cit., p. 11.

widespread feeling in the United States that the integration industries are nothing more than disguised industrial monopolies.

Although the Regime on Integration Industries could constitute an important instrument to accelerate industrial growth in the region, it seems to me that it must be coordinated or fused into a more comprehensive program of incentives to the industrial sector. Under this system a set of priorities can be established depending on the amount of regional raw materials used, on the amount of local labor employed, on the importance of its production to the economic process (capital, intermediate or consumer goods), on whether the production is geared to exports outside the region and other considerations. This is simply an expanded Treaty of Fiscal Incentives to Industrial Development and would incorporate the plants that are now being treated as "integration industries." Five considerations are important for the correct functioning of this program: (1) a list of priorities must be established, consistent with the objectives of development in the sector, (2) a faster way must be found to study and approve the projects, (3) technical assistance must be supplied by regional bodies such as ICAITI, (4) the Central American Bank of Economic Integration should have a more active participation in the form of loans and

capital outlays, and (5) the Joint Planning Mission or other regional body should provide pertinent information to Central American entrepreneurs in order to avoid possible duplications.

(C) Effects of the Common Market on the Industrial Sector--Regional Objectives

Despite the problems encountered in coordinating the national policies of industrialization, the opportunities provided by the Common Market have had positive effects in the industrial development of Central America. The larger market has permitted the establishment of new firms at a regional level and the modernization and enlargement of firms that, at a national level, had been unable to use their installed capacity. The process of economic integration has also had another important consequence: it has contributed in the development of a more dynamic attitude in certain sectors of the entrepreneurial class and has fostered the concept of regionalism.

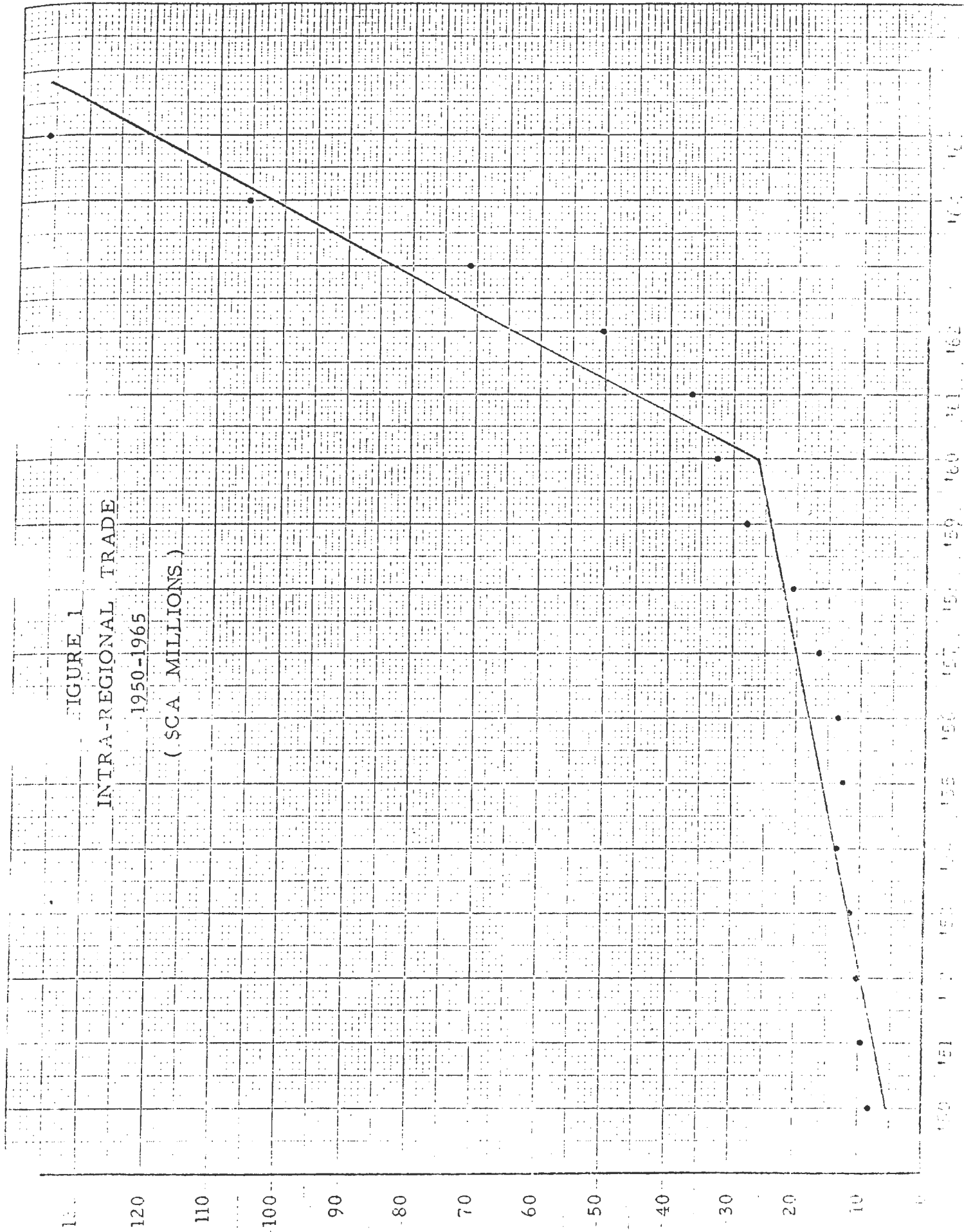
The rapid growth of intra-Central American commerce is probably the most significant variable that "shows" numerically the effects of the Common Market. In the period 1950 to 1960 the intra-regional trade grew from \$CA 8.3 million to \$CA 32.7 million. This growth can be attributed, in part, to a post-war economic boom and to the bilateral treaties signed among the countries. With

FIGURE 1

INTRA-REGIONAL TRADE

1950-1965

(\$CA MILLIONS)



the creation of the Common Market in 1960, the trade within the region received a definite boost that caused the commerce to increase from \$32.7 million in 1960 to \$136.0 million by 1965. (See Figure 1). In this five-year period the intra-regional trade grew at a much faster rate than it had ever before; by 1965, trade among the countries accounted for 15.6 per cent of total imports. More than 70 per cent of this commerce was composed of industrial products. This can be compared favorably with the year 1950, when the intra-regional trade accounted for only 2.5 per cent of total imports and this percentage was composed mainly of agricultural goods.

For the first nine months of 1966, trade among the countries has reached a figure of \$CA 113.7 million which indeed compares favorably to the \$CA 95.8 million figure for the first nine months of 1965. Presently 75 per cent of the trade is composed of industrial products. This figure, compared to the relatively low percentages for the years before 1960, shows the accelerated industrial development in the period 1960-1966. Although the industrial process is facing problems caused by the lack of a regional plan of development, the industrial growth has been a "success without proper direction". No promises were made in 1960, however, at the inception of the Treaty, that the process would be perfectly structured and programmed

from the beginning. If this had been the case, there would be no point in calling it a "process". After the first, relatively "easy" years, the industrial sector must now program its development and establish a list of priorities. At the Second Reunion of the Directors of Planning in August of 1965, a representative of ICAITI indicated the following criteria as needed to fulfill the objectives for a regional plan of industrial development:

1. Optimal localization of the basic industries from a technical and economic viewpoint and in keeping with the principle of balanced growth.
2. Maximum utilization of regional natural resources.
3. The improvement of industrial interrelationships, in order to achieve a greater specialization and industrial complementation.
4. The use of adequate technology; and
5. The maximum possible saving of foreign exchange and capital resources.

To these five criteria should be added (a) the need of promoting the creation of industries that will export outside the region, (b) the need of more solid financial backing to the industrial process, and (c) the need of the proper legal instrumentation in the form of a coordinated program of incentives such as was mentioned earlier in the chapter. The importance of achieving a

broader base of exports must be stressed; manufacturing for outside the region is one way which will help to solve some of the balance-of-payments problems that will be encountered in the future.

II. The Reaction of Private Enterprise Towards the Common Market.

"As a Central American, I say it's a dream. As a Honduran, it is bad; if I were a Salvadorean or Nicaraguan, I'd say great. It's working on paper, but it's not working here."¹²

As a general response to the Common Market, this comment by a prominent Honduran businessman is representative of the opinion received from members of Central America's private sector.

The attitudes of the members of the business communities differ considerably from country to country. The Guatemalans, Salvadoreans and Nicaraguans seem to favor economic integration; many Costa Ricans and Hondurans, on the other hand, are wary of the process. The reaction received from businessmen in the five countries also depends on how the Common Market has affected them personally. Those that have gained from the movement are, invariably, supporters of economic integration. Those

¹²Comment received by Meldon Levine, student of the Woodrow Wilson School of Public and International Affairs, from a prominent Honduran businessman during a summer of study in Central America.

that have been adversely affected are, for the most part, opposed to the movement. There are, however, strong exceptions to this generalization.¹³ In any case, it proves difficult to obtain objective responses from the members of the private sector.

The small number of businessmen that consider themselves "Central Americans" are very much in favor of the Common Market and consider economic integration of prime importance to the development of the area. This group, however, is very small; nationalism is still prevalent in the attitudes of a majority of the businessmen and this has had a disruptive influence in achieving better communications among the private sectors of the five countries.

(A) Two different cases: Honduras and El Salvador

The Honduran business community is that which most strongly opposes the process of economic integration. The one opposing argument frequently used is that the nations that are industrially more advanced are exploiting Honduras' less developed economic base. The Honduran businessman fears that with the Common Market the "industrial giants" of El Salvador and Guatemala are going to squeeze out the smaller industries. In recent years, however, a minority of industrialists in Honduras (the "new breed") are beginning to change their attitudes about

¹³ Meldon E. Levine, The Private Sector and the Common Market (Princeton: 1965), mimeographed, p. 1.

the CACM and are realizing the benefits derived from the larger market.

The reason for the generally widespread opposition to the Common Market lies, in part, in the political and economic evolution of the business community in Honduras. Until recently, much of the country's economy had been controlled by foreign interests.¹⁴ This had not permitted the healthy evolution of a dynamic national entrepreneurial class. "As the financial power shifted into the hands of the commercial class, the existing political relationships prohibited the ideas and attitudes of that new class from a proper exposure to those of the government. The government neither attempted to stimulate any positive changes in the private sector nor encouraged industrialization, and the commercial class was both unaware of industrial opportunities and wary of any substantial changes in this uncertain political atmosphere."¹⁵

This situation was aggravated by the fact that a great majority of the entrepreneurial class was of foreign descent.¹⁶ This made communications with the government

¹⁴ notably, the United Fruit Company.

¹⁵ Levine, Op. cit., p.4.

¹⁶ Mostly from the Middle East.

difficult. Due to lack of coordination between the government and the commercial class, the latter did not develop an industrial attitude until recently and did not pressure the government into the creation of a proper economic and social infrastructure.

A prominent Honduran economist¹⁷ has quantified the "effects" of the Common Market on the Honduran economy showing a loss of several million dollars of earnings. An explanation of this numerical method has been left out for reasons of brevity. However, by observing the attitudes of a majority of the members of the private sector, it seems that they have accepted this quantification as valid.

Whatever the reasons for Honduran opposition, sufficient concern about the problem of achieving balanced growth among the five nations has caused the governments of the five countries to consider granting special incentives and longer exemptions to the less developed countries in the region. More financial backing is also being considered, in order that countries like Honduras can improve their economic infrastructure.

The case of El Salvador is indeed the other extreme; the Salvadorean business community is the one which most

¹⁷Licenciado Praxides Martinez, Economic Advisor to the Congress.

strongly favors the Common Market and the process of economic integration. Compared to the other countries in the region, El Salvador has the most dynamic entrepreneurial class, and one which is firmly convinced that economic growth can only come from an integrated economy.

The development of the commercial and industrial class in El Salvador can also be traced to the country's economic and political evolution. The Salvadorean economy, in contrast to that of Honduras, developed from within. That is, the productive resources were in the hands of nationals who reinvested their profits in the country. This, plus a closer communication between the business community and the government, provided the base for the development of a suitable social and economic infrastructure.

The support of the CACM by the Salvadorean private sector can also be attributed to the fact that the business community is aware that, due to El Salvador's small size, it can benefit greatly from the use of the other country's raw materials and from the industrial opportunities provided by the larger market. In the actual operation, El Salvador has secured a large percentage of the intra-regional commerce. For the first nine months of 1966, it exported \$CA 36.4 million to the rest of the region compared to Honduras' \$CA 16.0 million. This

difference can be attributed to the fact that the industrial sector in El Salvador is much more developed than that in Honduras. These disparities have made the Hondurans feel that the more economically advanced countries are taking advantage of their economic situation. This, in part, has caused the opposition felt by the Honduran business group against the Common Market.

III. Agriculture and Economic Integration

The agricultural sector is of vital importance to the economic development of Central America and to the future success of the process of economic integration. This importance stems from two important reasons: (1) it is the traditional exporting sector and, as such, constitutes the principal source of foreign exchange in the region; and (2) it finances all other productive processes. It is indeed surprising, therefore, to see how little of the instrumentation of the process is devoted to the agricultural sector. Most of the legal instruments deal with the industrial sector; however, the industrialization would tend to stagnate if it was not accompanied by comparable growth in agriculture. The development of the agricultural sector is not only essential in providing many of the raw materials needed for the industrial process; it is vital in achieving an expansion of regional internal demand.

At the present time, Central America is in urgent need of diversifying its agricultural base for two important reasons: (1) it must attempt to rely less and less on the exports of a few agricultural commodities, (2) it must produce for the internal consumption of the region and make an effort to become as self-sufficient as possible. In recent years, the production of basic grains has grown at a faster rate than the increase in consumer demand. This has had positive effects in achieving regional self-sufficiency. This, however, has not solved "the food problem" which stems from the low caloric content of a large part of the traditional food grains.

The Committee of Nine for the Alliance for Progress, in its Informe Sobre los Planes Nacionales de Desarrollo y el Proceso de Integración Económica has enumerated a series of aspects that must be considered in programming the regional development of the agricultural sector:

- (1) There must be a detailed evaluation of the natural resources in the region.
- (2) Based on this evaluation, a zoning process must be carried out, that would specify the appropriate type of cultivation for each zone; this process would accelerate needed agricultural specialization.
- (3) Specific programs of development must be promoted in the region. For example, the favorable

conditions that exist in Nicaragua and Costa Rica for cattle-raising, indicate the advantages of fomenting a regional plan of meat production geared to markets outside the region. The fishing industry is another area that can be developed jointly and is of utmost importance in view of the low protein content of the diet of a majority of Central Americans.

- (4) The efforts in coordinating the agricultural programs, must not be limited to the purely economic aspects of the sector. The need for bettering the lot of the rural workers is indeed apparent. "The improvement of the buying power of the peasant sector and the dynamism of this sector, are an essential part of a process of integration that rests heavily on an internal market which is 65 per cent rural."¹⁸
- (5) The plans of development should contain policies destined to attenuate the differences of income caused by an uneven distribution of land ownership. This should be a gradual, evolutionary process.

In addition to the five points mentioned above,

¹⁸Committee of Nine, Op. cit., p. 18.

which are stressed by the ad-hoc Committee of Nine, it is important to increase the region's participation in the market for traditional products such as coffee and cotton. The combined effort of the five nations will improve their bargaining power vis-à-vis the other producers, and this might prove helpful in obtaining larger quotas for the export commodities.

The countries should also seek to exploit their agricultural comparative advantages and thus promote productive specialization. This process has to be incorporated to a comprehensive regional plan of economic development and must be tied together to specialization in the other productive sectors.

Although the national plans of development for the period 1965-1969 have projected a substantial increase in the rate of growth of the agricultural sector (5.4 per cent annually compared to only 3.6 per cent for the period 1950-1962), the programming in this area is less conclusive than that in the other sectors. The emphasis given to the industrialization of the region has, indeed, overshadowed the traditional sector. If Central America is to continue growing at the rate of the last five years, the development of agriculture must be considered as important as the growth of industry. The balanced growth of these two productive sectors is indeed vital to the process of economic integration, mainly because the well-being of one

depends heavily on the continued development of the other.

IV. Social and Economic Infrastructure in the Regional Context

The progress achieved by the integration process in the regional development of the social areas -- education, housing and health -- has not been as great as that achieved in developing the productive sectors. Since the very beginning, however, one of the most important objectives of the process has been to meet the demands of the Central Americans and improve their standards of living. Unfortunately, very little instrumentation has been specifically designed for the development of the social areas; the progress achieved in the last few years has been an indirect result of the economic growth in other areas and a consequence of the efforts of the governments to create better social conditions at a national level.

At a regional level, very little coordination of the plans of development has been accomplished. Although the figures (see Chapter III) show definite improvement in certain areas (such as the reduction of illiteracy and the construction of proper housing for the 1965-1969 period) the five countries have been acting independently in these matters. The need of joint action is indeed apparent, especially in obtaining the financing that is necessary for social development. A coordinated program

should include reforms in the educational systems; in the field of education at a secondary and university level, much can be done in achieving some degree of uniformity at higher standards and even some specialization among the five universities. A Center for Technical Studies should be considered in order to train the instructors needed to improve the quality of the labor force in the five countries.¹⁹

One important consideration must now be emphasized: Social demands must be met if Central America is to have continued economic growth and political stability. Central Americans are becoming more and more aware of the "things" that they are missing and are indeed demanding a better standard of living. This demand can only be satisfied by a coordinated action of the five countries; this action entails better communication and understanding between the respective governments and private sectors at a national and regional level.

Much more has been done in coordinating the development of a proper economic infrastructure. This is true, especially in the regional projects for the construction of roads and highways and the projects for the interconnection of the present hydroelectric systems. The national plans of development (1965-1969) have taken into

19 Ibid, p. 23.

account the regional needs in this area, and the joint action of the Planning Offices has proved very important in providing a proper physical integration in Central America that is of utmost importance to economic development.

A large part of the new roads and highways that have been built in the past few years are being used to meet the pressures placed on the old roads by the rapid growth of intra-regional commerce. Since 1960, the five governments have centered their attention on the construction of highways to connect the economic centers of the five countries. To this effect, the Central America Subcommittee for Transportation selected thirteen highways due to their regional importance and since 1960 began to prepare a plan of highway construction for the period 1965-1974.²⁰ The total investment in this plan is approximately \$CA 114 million; 32 per cent of this amount will be devoted to the development of a proper road system in Honduras. This is in keeping with the objective of balanced growth among the five countries as set forth in the General Treaty. It is interesting to note that 82 per cent of the total investment in the plan will come from external sources. External financing will be discussed later in this chapter.

²⁰Ibid, p. 133.

Some progress has been achieved in the coordination of the national programs of development in the field of electric power. Projects have been drawn for the interconnection of the electric sources of El Salvador and Honduras, and Costa Rica and Nicaragua.²¹ Although these projects are plagued with a variety of technical problems, the mere fact that interconnections of the present systems are being considered shows that the governments are thinking in regional terms. The progress achieved in increasing the electric capacity of the five countries has been considerable in the period 1960-1965. This, however, has been done at a national level. In the future, it will prove imperative to interconnect the present systems in order to make better utilization of the human and economic resources available. This can only be done if the present technical problems are solved as to the responsibilities of each country in the joint projects, and the technical and financial backing that each one must supply.

In the areas of railroad and maritime transportation, and communications, much less has been done in integrating the systems of the five countries. This will be essential to meet the future needs imposed by the increased trade among the countries. The development

²¹Two other projects have also been studied. (See Chapter III).

of suitable port facilities is also important to accommodate an industrialization process that, it is hoped, will produce for markets outside the region.

"What Central America must imagine . . . is no longer which projects must be coordinated in order to increase commerce and save costs, but what sort of infrastructure must be provided for an industrialized region, that possibly will have to export its goods to the rest of the world, and whose production will be geographically distributed in accordance with concepts of specialization. What has been done up to now is merely an attempt to furnish the region with a physical framework for the present needs of commerce and production. The integration process actually searches for a long-term transformation of the characteristics of development . . . " ²²

None of the plans actually foresee this future transformation. It is important, therefore, to understand the long-term changes in the methods of development in order to provide a suitable social and economic infrastructure for the future needs of Central America.

V. "New Technology" in Economic Methods

One of the problems that has retarded economic development in Central America has been the general lack of technology and modern economic methods. The region has industrialized without market studies, without proper training for its labor force, and without the proper feasibility studies considered necessary in more developed

²²Committee of Nine, Op. cit., p. 129.

areas. Nevertheless, the industrial growth has indeed been substantial; this has been due, in part, to the wide range of opportunities where good profits can be made even under inefficient conditions. In the future, as competition increases, new technology will be essential if a given industry is to survive. This technology must not come only in the form of more modern methods of production but also in the form of better trained managers and workers. "The new growth of industry and commerce has produced a shortage of managers which is perhaps the region's most significant bottleneck slowing economic development."²³

(A) The Central American Institute of Business Administration (INCAE)

INCAE was organized approximately four years ago by a group of Central American businessmen to attenuate the shortage of high-level administrators in the region. In its "Statement of Objectives" it was established that "it shall be the purpose of INCAE to become a permanent school of business administration, dedicated to teaching,

²³Survey Team of the Harvard Graduate School of Business Administration, Management Problems and Opportunities for Management Training in Central America, (Boston: 1963) p. 8.

research, and consultation . . ."²⁴ Up to now, the Institute has carried out four six-week training programs designed for managers at "decision-level"; these programs have been taught by professors of the Harvard Business School. In the future, INCAE will become a permanent post-graduate school as "it is its intention to recruit as speedily as possible an outstanding faculty of its own."²⁵

The importance of INCAE is that it is the first attempt to establish, at a regional level, a school designed for management training. This Institute is indeed a partial solution to the problems caused by the scarcity of entrepreneurial talent. INCAE has also had an indirect, but substantial effect in bettering the relationships among the entrepreneurs of the five countries. In this sense it has provided some of the "human" integration that is so important to achieve a closer regionalization. The mere fact that approximately 50 top managers have discussed administrative problems together at each course, has created a better understanding of their common problems.

²⁴J. Alexander Caldwell and Stephen B. Strauss, Private Sector Management Development in the Central American Isthmus, (Princeton: 1966), mimeographed, p. 21.

²⁵Ibid, p. 22.

In some cases the courses have even fostered the creation of common investments.

Generally, the reaction of the private sectors towards INCAE has been favorable. Some of the top managers in the region have already taken the course and others are very interested in participating in the future. INCAE is for the present an institute designed to improve the quality of the existing management in Central America. In the future its permanent graduate program will turn out some of the administrators that will be essential to the economic development of the region.

(B) Labor-Intensive Versus Capital-Intensive Technology

In the present process of industrialization, very little has been done in ascertaining the proper balance between labor-intensive and capital-intensive technology. In Central America, the tendency has been towards the former; this has been due in part to the general feeling that labor is "cheap" in the region. However, it is forgotten that this is true only if labor is at the same time efficient. The training of qualified workers is something that has been considered important for the region in the national plans. However, no balance has been made of the development of the industrial objectives in order to determine an equilibrium between capital and labor. The following considerations should be studied: (1) capital

imports demand payment in foreign exchange -- this deteriorates the balance-of-payments position; (2) increased employment improves the region's social situation; (3) now, what combination of capital and labor will produce a unit of output for lowest cost and at the same time reconcile with (1) and (2)? The answer to this last question is something that has not been studied by the national plans of development. A study of this sort would indeed be essential to ascertain the region's comparative advantages vis-à-vis the rest of the world. That is, if labor is actually as inexpensive as it is thought to be, then Central America could industrialize for the outside markets by manufacturing goods whose cost is largely labor.

New technological methods must be instituted in order to systematize economic development. No longer can the industrialization process be carried out "by feel". New machines, new methods of production, accounting, and marketing, and better trained personnel are needed in order that Central America may continue in its economic growth.

VI. Financing Development

The creation of the Central American Bank of Economic Integration in 1960 "to finance and promote integrated economic growth . . ." ²⁶ has been one of the most

²⁶ ESAPAC, Los Instrumentos del Mercado Común Centroamericano, (ESAPAC/EXT/018/3000/65), p. 25.

important steps of the process of economic integration. The Bank is financed largely by contributions of the governments of the five Central American countries and by U. S. Government agencies. According to recent reports, the Bank has granted a total of 149 loans for a total amount of \$CA 88.5 million. The distribution of these loans is in keeping with the objective to promote balanced development among the five countries. Honduras has received 34 loans for a total of \$CA 21 million; Nicaragua, 30 loans for a total of \$CA 23 million; and El Salvador, Guatemala, and Costa Rica loans amounting to \$CA 17, \$CA 14, and \$CA 13 million respectively.²⁷ These amounts, although substantial, are not enough to meet the needs of the region. In the future, the integration process will require an increase in the magnitude of technical and financial backing received from the Central American Bank; this backing, however, should not be a mere channeling of external resources but a coordinated effort to establish a program of regional financing. This program should consider the following: (1) projects of public investment (social and economic infrastructure), (2) financial backing for the national institutions of development, (3) specific industrial projects, for industries with regional import-

²⁷ SIECA, Carta Information, (Guatemala: March, 1967), No. 65, p. 16.

ance, (4) estimates of the financial needs of the five countries, based on their national plans of development with certain modifications, and (5) financial backing for areas which are not covered by the specific projects.²⁸

In the opinion of the ad-hoc Committee of Nine for the Alliance for Progress, "the international financial community can accomplish a contribution of great importance to the process of economic integration in Central America, by an adequate coordination of the external backing to regional development."²⁹ Although AID and other U. S. agencies have contributed to the development of a suitable social and economic infrastructure (housing, highways, port facilities, etc.) and have guaranteed new investments in commerce, industry and agriculture³⁰, these contributions should be assimilated into a program of external financing as was mentioned before.

In 1964, the Central American Bank of Economic Integration established the Fund for Integration; this

²⁸ Some of this is already being done by the Central American Bank.

²⁹ Committee of Nine, Op. cit., p. 30.

³⁰ In the five countries, AID had issued 99 separate guarantees to 29 firms totalling \$54.6 million at the end of March, 1965. Guarantees provide insurance against inconvertibility, expropriation, and war risk.

fund was designed to finance specific projects of regional interest. The Fund, which is administered by the Bank, actually has objectives similar to those of its "mother" institution.

The creation of the Common Market in 1960 and the favorable incentives given to industrial development also opened the doors to foreign investment. By 1963, U. S. private investment in Central America was \$375 million with a market value of over one billion dollars. Of this total, \$129 million or 34.4 per cent was in public services, \$102 million or 27.2 per cent was in agriculture, \$94 million or 25.1 per cent in petroleum exploration and the rest in industrial or commercial enterprises.³¹ Much of this foreign investment has been severely criticized. According to the ad-hoc Committee of Nine, "several companies from outside the area have entered a process of buying established enterprises that have been run for years by Central American entrepreneurs. The Committee considers that notwithstanding the importance of foreign investment, this acquisitive process has no important positive effects in the development of the region, and on the contrary, tends to detract from the Central American

³¹ Sheldon L. Schreiber, The United States Private Investor and the Central American Common Market (Princeton: 1965), mimeographed, p. 2.

business initiative."³²

The five countries must continue in their efforts to create uniform conditions for foreign investments. What these conditions must be, how much local participation must be supplied, and other technical considerations must be studied further by the Planning Offices of the countries. For the present, the incentives and exemptions given are attracting large amounts of capital from outside with relatively few restrictions. The opportunities available have made of Central America an "investor's paradise".

It is beyond the scope of this work to give a detailed description of the internal sources of financing within each of the five countries. Sufficient to say that the banks, private "financiers" and national development agencies³³ have played a significant role in financing economic growth at a national level.

VII. Common Investments as a Method of Regionalization

One of the objectives of the process of economic integration must be the gradual eradication of the national mentality in favor of a more comprehensive Central-Americanism. At the present time, only a very small percentage

³²Committee of Nine, Op. cit., p. 32.

³³Such as the Instituto Salvadoreño de Fomento Industrial (INSAFI) and the Instituto de Fomento Nacional (INFONAC)

of the Guatemalans, Salvadoreans, Hondurans, Nicaraguans and Costa Ricans think as Central Americans. This is especially true in the private sectors where competition and national pride have generally strengthened the nationalist sentiment. One method of achieving a higher degree of regionalism is to encourage common investments among members of the five countries. The joint ownership of a given company would indeed accentuate the need for closer relationships and better communication among the entrepreneurs in Central America.

(A) The Multinational Firms³⁴

Very little has been done to encourage joint ventures in the region. INCAE has had some indirect success in this area, but on a very small scale. Since the creation of the Common Market, however, many firms have extended their operations beyond their national borders. Although this has had a positive effect in creating a feeling of Central-Americanism, the fact that most of these firms are tightly controlled has caused some friction with the competing local firms. In some instances, the multinational companies have been considered as foreign as those from outside the region.

³⁴ "Multinational" in the context of this section means "among the nations of Central America."

In economic terms, the great importance of these regional companies is that they have been one of the vital elements in the rapid growth of intra-Central American commerce. This growth has been discussed earlier in the chapter.

(B) The Central American Stock Market

In order to accelerate the creation of common investments, the most important consideration is the possibility of forming a regional stock market. In my opinion, it will take several years before this can be accomplished. The stock markets that exist at a national level are virtually inoperative. This is due to two main reasons: (1) most of the large companies are "sociedad anonimas" which are, in their majority, tightly controlled by families or small groups of stockholders, and (2) the mentality that governs is that when a company is doing very well nobody sells, and when it is doing poorly, nobody buys. These two negative aspects must be significantly changed if there is to be a stock market in Central America. The strong economic ties that would result from such a venture, however, would prove helpful in changing the mentality of a majority of Central Americans.

VIII. Balanced Growth Among Countries -- A Goal of
Economic Integration

Many economists believe that an integration process can only be successful if carried out by countries that are similar in their degree of social and economic development. The great differences that exist in the South American countries, for example, have been a retarding force in the creation of a free-trade area. Difference in sizes, in economic resources, in social and monetary legislation have made the proper functioning of LAFTA a thing of the future. In Central America, however, this is not the case; the five countries have a common history, a common culture, a common language and religion, and basically similar degrees of social and economic development. Added to this is a certain geographical unity and an inherent Central-Americanism that has developed through the years. However, within these similarities there exist certain amount of differences -- differences in social conditions, in per capita income, in literacy rates -- very much the same as the differences that exist among the various states of larger nations. It is the expressed objective of the process of economic integration, to eliminate these differences as much as possible and to bring about balanced growth among the five countries. According to this objective, preferential treatment must

be given to those countries which are relatively less developed in order that they can "catch up" with those that are more advanced.

The principle of regional balanced development, as discussed here, must not be confused with the better known concept of "balanced growth" as developed by Ragnar Nurkse and Arthur Lewis. The latter deals with the balanced growth of the productive sectors.

In Central America, very little has been done to coordinate the development among the various sectors, particularly, between industry and agriculture. The great importance that has been given to the manufacturing sector has left the traditional sector in the background. Much more consideration has been given to the "desarrollo equilibrado" among the five countries. The relative position of Honduras has underlined the need to improve its social and economic infrastructure vis-à-vis the other countries. The per capita income of Honduras in 1964 was \$CA 210, or 25 per cent lower than the average in Central America. During this year its participation in gross regional product was only 13 per cent. In the social areas, especially in education and health, the relative position of Honduras is also unsatisfactory.

To overcome this situation and enable the less developed countries to attain a more suitable social and

economic base, the directing bodies of the integration process have thought it necessary to grant preferential treatment to these countries in a way that they might exploit more fully their comparative advantages. To fulfill this objective, the less developed countries have received more loans from the Central American Bank, have been looked upon favorably for the establishment of "integration industries", and are being given longer periods of exemptions from taxes and customs duties in order that they will accelerate their processes of industrialization. These preferential conditions are designed to create, in these countries, a suitable economic and social infrastructure in order that they "take fuller advantage of the opportunities for productive development that are compatible with a better use of the natural resources in the region."³⁵ The faster growth of the relatively less developed countries would also benefit the entire region insofar as it would help to broaden the base of the market.

The means by which the "desarrollo equilibrado" is being fostered does not seem to me compatible with the integration process. The fact that the preferential conditions involve longer periods of exemptions, and a

³⁵Committee of Nine, Op. cit., p. 39.

generally different treatment, breaks the uniformity which is so important for the successful operation of an integration process. The present trend should be towards uniformity -- common tariffs, similar tax laws, monetary union, etc. The differences created by the preferential treatment would only tend to retard the process. The arithmetic and equitative distribution of the industrial plants also seems illogical as a method of achieving balanced growth among the countries.³⁶ This does not mean, however, that the "help-thy-neighbor-to-develop" concept is not beneficial to the region. Nevertheless, it should be accomplished by properly developing the social and economic base needed for their respective productive processes. To do this, the regional financial institutions, such as the Central American Bank of Economic Integration, must channel its resources to first-priority projects such as the development of highways and roads, the construction of electric power sources, and the improvement of social conditions in countries that are relatively less developed. This improvement in their infrastructure would, by itself, accelerate the creation of industry and would place them in a better competitive position vis-a-vis the other more industrial countries.

³⁶ This has been done mainly for political reasons -- to satisfy the governments of the less developed countries in the region.

IX. The Process of Economic Integration -- In Whose Benefit

Unquestionably, the process of economic integration has had positive effects in the development of Central America. But the benefits derived, have not been divided equally among the economic "classes": the industrialist, the landowner, the consumer and the worker. Some have benefitted more than others, and some, it is argued, have been adversely affected.

(A) The Industrialist

The industrialists are probably the group which have benefitted most from the integration process. The process has transformed the five mini-markets that existed before into a regional market of sizable dimensions. The Common Market has provided the base for the creation of new industries at a regional level and for the efficient operation of some that had been un-economical at a national level. It has also increased competition inside the area; this has provided the incentive to produce more efficiently and to import needed technology.³⁷ The process has also imposed a uniform tariff barrier for products that are already being produced in Central America by plants that cover at least fifty per cent of the demand. This has

³⁷ Note: To some industrialists, competition might not be considered a benefit of the process.

protected the industrialists against competition coming from outside the area.

At a national level, but with regional outlook, the governments of the five countries have provided numerous incentives for industrial development. Exemptions from income and corporate taxes, and exemptions from customs duties for imports of capital goods, fuels, and raw materials are common in Central America. The Central American Covenant of Fiscal Incentives to Industrial Development has not yet gone into effect but is a regional plan of incentives that coordinates the legislation that exists at a national level.

We can conclude, therefore, that the process of economic integration has been responsible for a large part of the increase in total industrial production from \$CA 833.8 million in 1960 to \$CA 1,403.0 million in 1965.³⁸ This increase has indeed been beneficial to the industrial "class".

(B) The Landowner

Much less has the integration process done for the landowner. Surprisingly little of the instrumentation of the process has been designed for the agricultural

³⁸Source: Central American Bank of Economic Integration. Latest figures; not published.

sector. This is true, it is argued,³⁹ because it is difficult to integrate a sector which is largely geared to exports. At most, you can coordinate the quotas. However, very little has been done to work together on a regional plan for the entire sector, taking into account that part which stays in the region, and which is crucial in feeding the people.

The benefits of the process to the landowner come mainly in the form of increased bargaining power caused by the voice of Central America in international conventions. No longer do the five countries voice their opinions separately. This "union" has given the region a certain prestige which is helpful in obtaining larger quotas for its export commodities and better negotiations.

The small farmer, on the other hand, has received the benefits derived from a larger market for some of his basic grains; in the future he will probably gain from greater price stability for these crops. However, he has also been exposed to increasing competition from farmers in the other four countries who are now able to sell their goods in the national market.

Before concluding, it is interesting to note that

³⁹ Interview with Dr. Abelardo Torres, ex-Minister of Economy and President of the Central Bank of El Salvador.

13

some large landowners have diversified into industry. Although most of these usually hold minority interests in large industrial companies, they are also receiving, as industrialists, the benefits derived from the integration process.

(C) The Consumer

Every industrialization process entails, at the beginning, some sacrifice by the consumer. At first, the industries are inefficient and manufacture low quality products at relatively high prices. The creation of tariff barriers, close the doors to competition from imported products and this in turn hurts the consumer in the short run: high quality imported products are substituted in the region by lower quality goods that are sold at more or less the same prices.

This has been the case of Central America since the creation of the Common Market in 1960. The consumer has borne the price that must be paid for economic development. In the last two years, however, as competition has increased within given industries, these have been forced to modernize and produce more efficiently and this, in turn, has raised the quality of the products and lowered their cost.

In the long run, the process of economic integration will prove beneficial to the consumer also. The

trend is towards better quality at lower prices.

The Regime on Integration Industries is one instrument of the integration process which, on a small scale, has acted contrary to the interests of the consumer. Quality, prices, maximum profit, and volume are controlled by ICAITI in an effort to protect the consumer; however, due to the fact that supervision is difficult, the consumer is receiving an inferior product at a relatively high price. Unless the controlling regional bodies provide careful supervision or the "monopolies" are broken and competition is permitted, the consumer will continue to "suffer" from the integrated industries.

(D) The Worker -- Urban and Rural

The industrial development of Central America has indeed provided job opportunities for thousands of urban workers. The process of economic integration, therefore, through the accelerated industrialization that it has promoted, has had beneficial effects on the urban worker.

Much less can be said for the benefits provided for the rural worker -- the "campesino". The general lack of instrumentation designed for the agricultural sector has had the effect of "neglecting" the "campesino". The rural worker, therefore, has not been significantly affected by the integration process. This must indeed be changed; we must remember that Central America must meet the

growing demands of the worker if it is to continue developing economically. To do this, it is very important to raise the standards of living of the rural worker who represents a large percentage of the economically active population.

One benefit derived from the integration process, however, is that it has given the worker some degree of mobility. In theory, at least, the worker is now able to leave one country and go to another to find a better job or better working conditions. The free movement of persons in the area is more and more becoming a reality. This will help to optimize the productive process.

X. The Present Situation of the Institutional Framework of the Integration Process

In a recent study made by SIECA, the present stage of the process of economic integration is termed as "la crisis de la transición."⁴⁰ This transition is taking place because the process that has gathered so much momentum since 1960 is now demanding new mechanisms and new institutions that will integrate further the Central American economies. The need of coordinating monetary and fiscal policy, of attaining free movement of labor and capital, and of creating a jurisdictional body in the form of an "economic court" has now become apparent. In

⁴⁰ Quoted in Emilio Maza, La Corte de Justicia Centro-americana (San Salvador: ODECA, 1966) p. 7.

addition there is the preoccupation of the entrance of Panama into the Common Market and of coordinating the tax laws in the five countries. These will now be discussed in more detail.

(A) The Mobility of Economic Factors

The free movement of products, capital and labor in the Central American region is indeed one of the most important objectives of the integration process. At the present time, approximately 94 per cent of the categories of regional trade (95 per cent by value) have been freed. Much less has been achieved in the areas of labor and capital mobility. Visas are still needed to enter Guatemala and Costa Rica; this has not only discouraged the free movement of labor but has hindered tourism within the area. It is important, therefore, to eliminate the present restrictions in an effort to optimize the productive process and in order that more Central Americans -- especially those who think in national terms -- are able to visit and get to "know" the area in which they live. This will tend to attenuate nationalism and favor the development of a regional mentality.

The free movement of capital is still "a thing of the future". At the present time the lack of uniformity among the monetary policies in the five countries has

retarded this movement. Guatemala and El Salvador (and recently Costa Rica) have some sort of monetary exchange controls. The other two countries -- Honduras and Nicaragua -- have no controls whatsoever. This situation has not permitted capital mobility. In the future, the creation of a Central American Stock Market will indeed prove helpful in achieving this objective.

(B) Monetary Union

On February 23, 1964 the presidents of the Central Banks of Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica signed the "Acuerdo para el Establecimiento de la Unión Monetaria Centroamericana"⁴¹. The objective of this agreement is "to promote the coordination of monetary, exchange, and credit policies of the five Central American countries, and to create progressively the basis for the Central American Monetary Union."⁴² To this end, one of its most important goals is "to promote uniformity of the exchange systems in the countries as well as stability and convertibility of the currencies in the area."⁴³

⁴¹ "Agreement for the Establishment of Central American Monetary Union"

⁴² Consejo Monetario Centroamericano, Tres Años de Compensación Multilateral Centroamericana, (Tegucigalpa: 1966) p. 71.

⁴³ Ibid.

John Parke Young, in his book, Central American Monetary Union, has stated that "a single or common currency is necessary for a meaningful union". He believes that "by simplifying the making of payments, a single currency would encourage trade, investment and other transactions among the countries. It would facilitate the movement of goods, labor and investment capital." He also believes that it would have a psychological effect in achieving closer economic integration and would promote stability.

At the present time, payments among the countries are made through the Central American Clearing House which was created in July, 1961. The purpose of this institution is to "promote the use of Central American monetary units in the commercial and financial transactions among the countries in the Isthmus."⁴⁴ The Clearing House has been so effective that during 1966, 95 per cent of the total intra-regional trade (\$CA 153.2 million) was cleared in its offices.⁴⁵ This can be favorably compared to only \$CA 24.6 million (48.8 per cent) in 1962.

However, the Central American Clearing House is not a long-term substitute for the monetary union which

⁴⁴Ibid, p. 9.

⁴⁵SIECA, Carta Informativa, (Guatemala: April, 1967), No. 66, p. 19.

is being contemplated. John Parke Young, in his recent study, has outlined two approaches to monetary union and a common currency in Central America: "(1) the introduction of similar currency systems in each of the individual countries; or (2) the issuance of Central American pesos . . . on a gradually increasing scale against a central fund administered by a regional body."⁴⁶

The first approach involves the adoption of identical monetary units, that would continue to be national rather than regional, but would be of the same gold value and similar appearance. At first, these new units would circulate alongside the existing money, but gradually the latter would be replaced by the new monetary units.

The second approach considers the creation of a common currency, the Central American peso. The central banks of the five countries would establish a joint fund, to serve as backing for the new currency; the pesos would be issued to the banks according to their participation in the fund. The Central American pesos would circulate, at first, alongside the existing money, but would eventually replace the latter.

Any one of these two approaches would involve two things: (1) the coordination of monetary and fiscal

⁴⁶ John Parke Young, Central American Monetary Union, (Guatemala: AID, 1965) p. X.

policies, and (2) a partial pooling of reserves in a central fund. The fund must be used to stabilize exchange rates among the existing currencies and provide backing for the future money.

As a final stage, Professor Young's plan envisions the transformation of the fund, or Monetary Board, into a supranational central reserve bank, having the existing central banks as branches of the central institution.

None of all this can be accomplished, however, unless the central banks of the five countries come to an agreement as to their exchange controls and are able to coordinate their fiscal policies. This might very well take several years.

(C) A Jurisdictional Body for the Common Market

Jorge Sol, a prominent Salvadorean lawyer, has formulated a question which synthesizes the present stage of transition: "Can we continue growing with institutions and mechanisms of international character or must we adopt organs and systems of supranational strength, that is, of common government?"⁴⁷ This question poses another question:

⁴⁷Jorge Sol Castellanos "La Evolución Institucional del Mercado Común Centroamericano" in Curso de Derecho Comparado, (Tegucigalpa: 1965), p. 13.

How far can we continue in this process of economic integration without some political integration?

The creation of a supranational institution designed to guarantee to each Central American the rights that he has received from the process of integration seems very important at this stage. Emilio Maza, in La Corte de Justicia Centroamericana, quotes: "The possibility should be studied of establishing a special tribunal with jurisdiction limited to matters of economic integration, destined to settle the disputes of private parties . . ."⁴⁸ His project (made for ODECA) proposes the establishment of a judicial court to "offer a system of 'juridical security' to the signing states and to private interests."⁴⁹ A revised form of the Central American Court of Justice, however, is not the best solution to the present problem. The institution should be of the form of an "economic court"; that is, a supranational body where any person can settle disputes caused by disloyal practices in free trade or other economic matters that are included in the General Treaty. This "court" should operate so that decisions can be given as rapidly as possible, and in the general interest of the region. In the past, these decisions have been given by the Executive Council sometimes

⁴⁸ Maza, Op. Cit., p. 1.

⁴⁹ Ibid, p. 11.

with delays of several months and many times, too late to obtain positive results.

In the past year, disputes have caused Salvadorean eggs to rot at the Guatemalan border, and milk has been stopped from entering into El Salvador for political reasons. This, indeed, negates the advantages of free trade in the region. It would be the object of this "court" to settle these differences. The difficulty in creating such an institution, however, is that it involves giving up some of the national sovereignty of the five countries. This is the price that must be paid if further integration is desired.

(D) Other Problems

The creation of a Customs Union, the establishment of harmonized tax systems, and the coordination of legislation designed for attracting foreign investment are three areas where difficult problems are being encountered.

We have reached a point where customs offices between the borders of the Central American countries are incompatible with the concept of a common market. The General Treaty establishes as one of its objectives the creation of a Customs Union; this would mean having customs offices for commerce with the rest of the world, but none between the countries. This is tied together with the problem of a Monetary Union and the problem of creating

a common treasury for customs purposes.⁵⁰

Coordination of existing legislation as to foreign investment will be achieved once Honduras ratifies the Central American Covenant of Fiscal Incentives for Industrial Development. This, however, may take some time; Honduras fears that uniform conditions will channel investment into the other countries, and is, therefore, negotiating for preferential conditions.

Careful consideration is being given to harmonizing the tax systems in Central America. A very complete study has been done by a joint group from the Organization of American States and the Inter-American Development Bank. The project suggests (a) that the five countries agree to create uniform income tax systems, (b) that a new tax on sales be implemented, (c) that a system of accelerated depreciation replace the fiscal incentives as the only measure to stimulate new investments, (d) that taxes be imposed on rents obtained by local companies from operations outside their respective countries, and (e) that uniform taxes be imposed on real estate and automobiles.⁵¹ The project goes on to explain the administrative organization needed for the efficient operation of such a system.

⁵⁰ Sol Castellanos, loc. cit.

⁵¹ For more detailed information on this project, see Committee of Nine, Op. cit., p. 148-160.

Although it might take several years to implement this, or any other project on tax harmonization, it is encouraging to see that the problem is already being given thoughtful consideration.

(E) The Entrance of Panama into the Common Market

One of the areas that is carefully being studied at the present time is the possibility that Panama join the process of regional integration. In studying this possibility, three considerations must be kept in mind: first, the advantages of such a venture to the Central American countries; second, the advantages for Panama; and third, the technical problems involved.

The advantages to the existing Common Market countries are as follows: (1) more than two million people would be added to the present market; (2) if a Customs Union is achieved, all products entering the Panama Canal would have free movement inside the area; (3) if a new canal is built, it would entail the use of Central American capital, labor, and raw materials; and (4) a maritime tradition could possibly be created in the region.

The advantages for Panama are also considerable: (1) it would gain a market of 12 million people (but would also have to face the competition from countries with a more developed industrial base); (2) as an economic part

of a larger entity, it would achieve better bargaining power in international negotiations; (3) due to the Common Market, traffic in the canal would tend to increase and more tolls would be collected; and (4) Panama would gain from the productive specialization that the integration process hopes for in the future.

Many problems plague this project. Due to its canal, Panama has very different monetary and fiscal policies compared to the rest of Central America. Therefore, the difficulty of achieving uniform policies in this area is indeed great. If a new canal is constructed, another problem will inevitably arise: the need of ascertaining the contributions -- in the form of capital, labor, and raw materials -- of the other five countries.

Some of the "enlightened" businessmen in Central America feel that the entrance of Panama into the Common Market would indeed prove beneficial to the entire region. Some, however, feel that, due to the canal, and given favorable conditions in Panama for foreign investment, this country would industrialize very fast, creating great competition for the existing Central American firms. This, however, would disappear once the Isthmus achieves uniform fiscal incentives.

On the other side, some Panamanians feel that they are being "over-generous" in "sharing" their canal

with the other countries. This has no foundation, however, since the actual service charges and tolls collected would accrue only to the Canal Company which belongs to Panama and the United States.

Given the advantages mentioned before, it seems very likely that Panama might be the sixth country to join what is now the Central American Common Market.

CHAPTER V

CONCLUSIONS

Economic integration in Central America has not been just the result of the deliberations of a few technocrats "playing at integration". Directly or indirectly, it has been the product of a general "explosion of awareness"¹ which has radically changed the mentality of a majority of Central Americans. Not only have the masses become conscious of the things they lack, but the governments, and to some extent, the private sectors have also realized that the demands of the people must be met. We are now in a "decade of urgency"²; only by social improvement can the political atmosphere become calm, and this tranquility is indeed a prerequisite for continued economic development.

To think that the present process of integration is irreversible, is overly optimistic; the easiest phase is over. Now we must embark in a period that will probably challenge what has been accomplished already.

Intra-regional trade will grow at a slower rate; the possibilities of import substitution will become scarce; supranational bodies will have to be created, probably with some loss of national sovereignty; the governments of the five countries will have to cooperate further in

¹Conversation with Mr. Geo. Luce, Pres., Blue Bird Body Co.

²From the speech of Pres. Lyndon Johnson delivered at the Punta del Este Conference, April 1967.

order to draft a regional plan of development. Unpredictable internal or external factors might also appear such as the rise of nationalist sentiment in one country or deteriorating world markets for the region's commodities. Indeed, the costs of integration will be higher in the future.

Total collapse of what has been accomplished, on the other hand, is unlikely. The countries have become "dependent" on the advantages of the free-trade area. Regional integration has also had a definite psychological impact and has fostered a sense of Central-Americanism. "It can be argued that with the exception of perfecting the customs union and some minor projects, the Central American process will soon be in a state of equilibrium, with attitudes sufficient to support existing institutions . . ."³

Up to now, the process has indeed had positive effects. By itself, however, it is no panacea for the social and economic problems facing the region today. It must be reinforced by development at a national level. Indeed, regional integration will not be accomplished unless, at the same time, there is some national integration.

³Joseph S. Nye, Jr., Central American Regional Integration, (Carnegie Endowment for International Peace: 1967) p. 60

Whether this process will lead to political union is difficult to say. What can be concluded is that Central America is now closer to this ideal than ever before in its history as an independent area. As Professor Nye points out, this must not be the only standard of evaluation. "Many Central Americans will judge regional integration by whether it reinforces their security community, permits more efficient economic and industrial development, and facilitates democratic political changes."⁴ Others will judge it by whether it brings about the social transformation that is necessary for the well-being of the region. Whatever the point of view, the process has become the most dynamic element in brightening the future of Central America.

⁴Ibid, p. 66.

APPENDIX A

TABLE I
CENTRAL AMERICA: ORIGIN OF TOTAL IMPORTS
(% of Total)

	1950	1960	1961	1962	1963	1964
Latin America	9.0	10.8	11.6	13.2	16.2	20.1
Central America	3.1	6.4	7.5	8.7	10.3	13.7
Mexico	3.4	1.4	1.6	1.7	1.6	1.6
Others	2.5	3.0	2.5	2.8	4.3	4.8
North America	73.1	50.6	48.6	48.4	46.9	45.4
United States	70.4	48.5	46.5	46.0	44.7	43.5
Canada	2.7	2.1	2.1	2.4	2.2	1.9
Western Europe	12.0	27.5	27.6	26.9	26.1	24.2
European Common Market	6.1	19.8	19.8	19.3	18.3	17.0
Germany	2.6	10.3	9.7	9.3	9.0	9.0
Holland	0.7	3.5	4.0	3.9	3.5	2.9
Belgium-Luxembourg	1.2	2.8	2.9	2.6	2.5	2.5
Italy	1.0	1.6	1.7	2.0	1.8	1.4
France	0.6	1.6	1.5	1.5	1.5	1.2
United Kingdom	3.4	4.4	4.4	4.4	4.4	3.9
Japan	0.6	6.2	6.5	6.2	6.6	6.4
Others	5.2	4.9	5.7	5.3	4.2	3.9

Source: International Monetary Fund and Bank of Reconstruction and Development, Direction of Trade, 1960-1964.

TABLE II
CENTRAL AMERICA: RECIPROCAL IMPORTS 1955-1965
(Millions of Central American Pesos)

	1955	1960	1961	1962	1963	1964	1965
1. Foodstuffs	6.2	14.9	14.6	22.2	21.6	29.4	36.1
2. Drinks & Tobacco	0.8	1.1	0.9	1.0	1.1	1.4	1.9
3. Raw Materials	1.7	1.6	2.0	2.4	3.3	3.9	4.6
4. Fuels	0.3	0.1	0.2	0.1	3.8	5.0	3.5
5. Oils	0.5	1.6	1.7	1.8	1.6	1.6	2.5
6. Chemical Products	0.6	2.4	3.5	5.2	7.8	18.9	21.1
7. Manufactured Products	1.2	6.2	8.1	11.0	16.3	26.3	37.1
8. Machinery & Equipment	0.6	1.5	1.3	1.1	1.6	3.0	5.0
9. Other Manufactured Goods	0.8	3.0	4.4	5.3	8.9	15.4	23.9
TOTAL	12.7	32.7	36.8	50.4	66.2	105.4	136.0

Source: Committee of Nine, Alliance for Progress,
Informe Sobre los Planes Nacionales de Desarrollo
y el Proceso de Integración Económica de Centro-
américa, (Washington: 1966), p. 52.

TABLE III

CENTRAL AMERICA: PARTICIPATION OF EACH COUNTRY IN
TOTAL IMPORTS (1960-1965)

(Percentages)

Year	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
1960	23.2	41.2	16.3	8.5	10.8
1961	24.1	39.8	17.3	7.8	11.0
1962	22.3	43.7	17.7	9.4	6.9
1963	21.4	42.2	20.0	10.4	6.0
1964	25.0	37.2	17.1	12.6	8.1
1965	26.6	31.5	15.1	13.9	12.9

Source: 1960-1963 SIECA Cuarto Compendio Estadístico Centro-
americano, March, 1965.
1964 SIECA Carta Informativa, No. 44, Annex 39.
1965 SIECA Carta Informativa, No. 50, Annex 51.

TABLE IV

CENTRAL AMERICA: ORIGIN OF THE GROSS PRODUCTION
BY ECONOMIC SECTORS

(Millions of Central American Pesos of 1962)

	1964	1965	1969	Rate of Growth. 1964 - 1969
<hr/>				
Agricultural Product				
Guatemala	368.6	372.4	485.8	5.7
El Salvador	224.0	232.8	268.8	3.8
Honduras	209.4	221.4	262.9	4.6
Nicaragua ¹	171.7	175.5	235.2	6.4
Costa Rica ¹	146.9	151.9	199.6	6.3
Central America	1,120.6	1,154.0	1,452.3	5.4
Industrial Product				
Guatemala	162.2	181.0	295.4	12.8
El Salvador	133.9	150.8	262.2	14.4
Honduras	69.3	75.7	122.7	12.1
Nicaragua	70.4	81.9	123.6	11.9
Costa Rica	90.7	99.4	148.4	10.3
Central America	526.5	588.8	952.3	12.6
Mining Product				
Guatemala	1.9	1.8	2.3	3.4
El Salvador	7.8	8.9	12.0	9.0
Honduras	4.9	4.9	5.7	3.1
Nicaragua	8.9	9.0	9.9	2.1
Costa Rica	---	---	---	---
Central America	23.5	24.0	29.8	2.4
Construction ² Product				
Guatemala ²	24.0	26.8	35.1	7.9
El Salvador	16.1	18.8	25.5	9.6
Honduras	14.5	15.2	21.7	8.4
Nicaragua	16.9	17.5	25.7	8.7
Costa Rica	25.1	31.6	41.2	10.4
Central America	96.6	109.9	149.2	9.1
Central America: Total Production of Goods	1,767.2	1,876.9	2,583.7	7.9

TABLE IV (Continued)

	1964	1965	1969	Rate of Growth 1964-1969
<hr/>				
Activities Producing Services ³				
Guatemala	712.4	760.0	937.6	5.6
El Salvador	386.2	406.7	484.3	4.6
Honduras	165.2	174.8	223.6	6.2
Nicaragua	199.1	216.2	263.6	5.8
Costa Rica	283.9	290.9	351.3	4.3
Central America: Total Activities Producing Services	1,746.8	1,848.9	2,260.4	5.2
Central America: Gross National Product at Market Prices	3,514.0	3,725.8	4,844.1	6.6
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¹The year 1969 was estimated under the basis of projections of the period 1965-1969.

²Estimated as a per cent of GNP.

³Include: transportation, energy, government, commerce, banks, insurance, personal services, rent.

Source: Joint Planning Mission for Central America,
Resumen de los Planos Centroamericanos de Desarrollo
Económico y Social para el Periodo 1965-1969,
(Guatemala: 1966) p. 15-16.

TABLE V

CENTRAL AMERICA: COMPOSITION OF PUBLIC INVESTMENT
IN EDUCATION (1965-1969)

(Millions of Central American Pesos)

Countries	Primary	Secondary	University	Total
Guatemala	15.2	1.3	--	16.5
El Salvador	10.1	7.3	7.0	24.4
Honduras	8.8	1.8	--	10.6
Nicaragua	8.0	1.4	1.5	10.9
Costa Rica	11.5	4.1	1.0	16.0
Central America	53.6	15.9	9.5	79.0

Source: Joint Planning Mission for Central America,
Resumen de los Programas Centroamericanos de
Inversiones Publicas, (Guatemala: 1965) p. 185.

TABLE VI

CENTRAL AMERICA: COMPOSITION (BY SECTORS) OF THE
PUBLIC INVESTMENT (1965-1969)

(Millions of Central American Pesos and Percentages)

Economic Infrastructure	668.9
Per Cent	48.3
Social Infrastructure	448.4
Per Cent	32.4
Productive Sectors	197.0
Per Cent	14.2
Others	70.3
Per Cent	5.1
	<hr/>
TOTAL	1,384.6
	100.0

Source: Joint Planning Mission for Central America,
Resumen de los Programas Centroamericanos de
Inversiones Publicas, (Guatemala: 1965).

APPENDIX B
INTERVIEWS

APPENDIX B

GUATEMALA

Beck, Enrique	Director of the Regional Office of the Inter-American Bank of Development
Bolaños, Eduardo	Assistant to the Secretary General of SIECA
Noriega Morales, Manuel	Director of ICAITI
Sánchez Aguillón, Salvador	Director of the Joint Planning Mission

EL SALVADOR

Aquino, Francisco	President of the Central Bank
Borgatti, Joseph	Vice-President, First National City Bank
Borja Nathan, Guillermo	Head of the Planning Office
Cordero, Carlos	Ex-Economic Advisor to ODECA; General Manager of MONSANTO for Central America
de Sola, Francisco	First Director of H. de Sola e hijos; President of INCAE
Flores, Ulises	Well-known lawyer; involved in the integration process.
Galindo Pohl, Reinaldo	Official of ODECA
Huezo Hidalgo, Jaime	Under-Secretary of Economy
Lindo, Hugo	Official of ODECA
Martinez Moreno, Alfredo	Well-known lawyer; involved in the original negotiations of the integration process
Mayorga, Roman	Functionary of the Department of Economic Studies in the Central Bank

Moisés Beatriz, Alfonso	General Manager of the Salvadorean Association of Industrialists (ASI)
Ortiz, Roberto	General Manager of INSAFI
Palomo, Roberto	General Manager of ADOC, Shoe Manufacturer
Quezada, Jaime	Lawyer; also involved in the integration movement
Rochac, Alfonso	Ex-Minister of Economy; Economic Advisor to ODECA
Román y Vega, Albino	Secretary General of ODECA
Sol Castellanos, Jorge	Lawyer; author of many articles on economic integration
Torres, Abelardo	Minister of Economy

HONDURAS

Bueso, Guillermo	Director of Economic Studies for the Central Bank
Gomez, Salvador	Head of the Central American Clearing House
Matute, Carlos	High official of the Central American Bank. Ex-President of the Banco de Fomento and ex-Minister of Economy
Ramírez, Roberto	President of the Central Bank
Rivera, Roque	President of Rivera y Co; Important businessman

NICARAGUA

Armijo, Jorge	Under-Secretary of Economy
de Bayle, Enrique	Executive Director of INCAE

Gonzalez, Luis	Official of the Central Bank
Porta, Alvaro	Assistant to the General Manager of the Central Bank
Ramirez, Anibal	High official of INFONAC

COSTA RICA

Echeverria, Carlos Eduardo	Official of the Ministry of Industries
Gusmão, Osvaldo H.	Functionary of ESAPAC
Mora, Fernando	High official of the Planning Office
Navarro, Rigoberto	Head of the Department of Economic Studies for the Central Bank
Ruiz Avilés, Ernesto	General Manager and owner of Costa Rican Cocoa Products
Terán Valls, Francisco	Secretary of the Chamber of Industries

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