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The Central American Common Market

by Miguel S. Wionczek, Mexico City

Out of ten common markets, free trade zones and regional industrial cooperation schemes presently in existence in Latin America, Africa and Asia¹, the Central American Common Market (CACM), encompassing five small republics (Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica) is the most successful example of economic cooperation among a group of low-income countries. Assuming that from the view-point of the world economy as a whole, the acceleration of economic growth in some ninety independent underdeveloped states—most of which can hardly be considered separately as viable economic units—is of great importance, the first years of the CACM life contain many useful lessons both for the low-income and the high-income countries.

The Starting Point of the Scheme

After about a decade of preparatory work, undertaken largely under auspices of the UN Economic Commission for Latin America (ECLA), the scheme started with the entry into force of the Multilateral Treaty on Free Trade and Central American Integration (signed in Tegucigalpa, Honduras in 1958) and was subsequently expanded by the General Treaty of Central American Integration (Managua, Nicaragua, 1960) that committed the member countries to the establishment of a common market in the area within a six-year period.

During a short period, under the Tegucigalpa Treaty, Central America experimented with a system which had some characteristics of a common market and some of a free trade area. The 1958 treaty provided for the establishment of a common market among the signatory countries through the gradual addition to the free trade list of products submitted by the interested parties. But since at that time intra-regional trade in Central America was largely limited to a few agricultural products, the ECLA experts and the participating governments soon found out that the multilateral negotiation of lists of new products to enjoy free trade was a time-consuming, friction-creating and sterile exercise, given the magnitude of general ignorance about future mutual trade possibilities. In a sense, the extreme underdevelopment of the area and the small size of traditional trade flows

offered a stimulus for the rapid establishment of a simple common market mechanism in the area.

ECLA experts and Central American technicians intuitively have felt—and subsequent developments proved the correctness of this intuitive judgement—that it would be much easier to get from the interested governments a commitment to free all trade in principle and to look for products eligible for temporary restrictions than to follow the selective and gradual approach. Consequently, under the Managua Treaty of 1960 it was left to the actual producers in the area to prove that for the purpose of adjustment to regional free trade conditions they needed temporary protection against regional competition in addition to the protection vis-à-vis the rest of the world already available through national tariffs. This method automatically freed practically all trade in goods to be produced in the area after the entry of the Treaty into force and saved the Central American countries endless and bitter negotiations, which represent one of the stumbling blocks in the case of a free trade zone experiment, launched in 1960 by a group of South American countries and Mexico under the name of the Latin American Free Trade Association (LAFTA).

Politically Balanced Regional Development

By mid-1966, the Central American Common Market became a reality. Over 95 per cent of the tariff items, covering the same percentage of goods traded within the area, are included in the free trade category, and uniform tariffs against the rest of the world apply to close to 90 per cent of these items; external tariffs on others are to be equalised gradually over the next five years. Attempts are being made to make further cuts in the list of exceptions, which still contains a number of important commodities including such categories as transport equipment, electric appliances, crude and refined petroleum and some agricultural products. These goods account for about 20 per cent of Central American imports and are expected to be included in intra-regional free trade and to have uniform external tariffs by 1970. Also by that date, it is expected that the region will have a common customs administration.

Contrary to many other economic integration schemes involving underdeveloped countries, at no time did the builders of the CACM consider the freeing of intra-regional trade and the equalisation of external national tariffs as an end in itself. From the

¹ Latin American Free Trade Association (LAFTA), Central American Common Market (CACM), Caribbean Free Trade Area (CARIFTA), the Andean economic grouping, East African Economic Community, Central African Economic and Customs Union (UDEAC), West African Customs Union (UDEAO), Arab Common Market, Maghreb economic cooperation scheme and Regional Cooperation for Development among Pakistan, Irak and Turkey (RDC).

beginning their main concern was how to establish prerequisites—politically acceptable to all the participating countries—for accelerated diversification and industrialisation of the region's economy, or, in other words, how to guarantee a certain degree of politically balanced regional economic development.

The simple freeing of trade could not, it was suspected, among Latin American development economists, achieve that objective in view of the differences in development levels and the uneven distribution of industrial production facilities among the CACM members. Even under general conditions of underdevelopment of Central America, some countries (El Salvador and Guatemala) have potential advantages over others (Honduras and Nicaragua) with respect to possible economic gains from integration. Since a few minuscule development centres have already existed prior to the signature of the Managua Treaty, as a result of pre-integration growth within national boundaries, it was feared that they might attract the majority of new investment and increase intra-regional development disparities. Consequently, the key problem consisted of adding to the trade liberalisation programme various non-trade mechanisms which would neutralise the natural tendency to increase regional inequality under conditions of free movement of factors of production and in the absence of compensatory financial flows.

Since any attempt to establish a multilateral mechanism for compensating possible losses of government revenues from freeing trade was found premature and the question of a possible unfavourable impact of rapid trade liberalisation upon the existing productive facilities was provisionally taken care of by the exception lists, ECLA staff and governmental experts concentrated their efforts upon avoiding the undue degree of concentration of common market-induced activities in a few places.

Industrial Cooperation Instruments

Aware of political realities and the intangible political value attached by any developing country to industrialisation, the builders of the Central American integration scheme introduced at an early stage—concurrently with the Multilateral Treaty of 1958—a mechanism known as the Regime for Integration Industries. The purpose of that intra-regional industrial licensing system was to distribute—by inter-governmental agreements—new manufacturing activities that would require access to the markets of all member-countries of the CACM and to grant these activities special privileges and incentives under specifically stipulated conditions. The higher purpose of the system was to ensure for the participating countries a relatively equal share in the benefits of industrialisation. The Regime for Integration Industries was not able to work successfully, because, among others, of the US negative attitude which translated itself into the denial of external financial aid to industrial enterprises interested in special tariff pref-

erences and other incentives available under that Regime. But the industrialisation of the area received considerable help through other regional industrial cooperation instruments and agencies. Perhaps one of the most important is the Central American Integration Bank (CABEI), established in 1960 to provide financing for infrastructure projects and productive activities of regional interest. During the six years of its existence the CABEI loaned to the public and private sectors of the area close to \$ 100 million. Moreover, since the establishment of the CACM, the area received another \$ 200 million of private foreign investment largely because of the fusion of five minuscule national markets into one.

As a consequence of a number of important economic quid pro quo arrangements built into the integration mechanism, Central American economic cooperation has achieved considerable progress by 1967. Between 1961 and 1966 the value of intra-regional imports increased from \$ 37 million to \$ 176 million, and most probably it exceeded \$ 200 million in 1967. It represents presently over 20 per cent of the area's trade with the rest of the world, belying the early admonitions of sceptics who insisted that countries producing mainly bananas and coffee had nothing to trade among themselves. The composition of trade changed markedly: In 1966 over 65 per cent of intra-regional trade was composed of manufactures and semi-manufactures (including intermediate chemical products). While most of trade in manufacturing goods belongs still to the consumer goods category, the discovery of new markets for local industrial enterprises mobilised the support of Central American industrialists in favour of regional integration. The monetary and financial cooperation followed: over 80 per cent of all intra-regional transactions are carried out in domestic currencies through settlements in the regional clearing house, which has not only successfully survived situations in which some member-countries were forced to introduce currency restrictions for a limited period, but has proved that its existence permitted the unhindered flow of regional trade in spite of these temporary restrictions. In early 1968 the CACM member countries decided to establish a regional stabilisation fund with capital participation of their five central banks for the purpose of mutual aid in case of short-term balance-of-payments difficulties.

CACM at a Point of No Return

The non-trade mechanisms and institutions supporting the CACM have brought about considerable improvement in the region's physical infrastructure and quality of human resources. The impressive increase in the use of potentially available factors of production, in both the agricultural and industrial sectors, helped to mitigate somewhat the perennial problem of disguised unemployment in Central America. Furthermore, the effect of integration on the social structure of the area is also felt, although to a limited degree. For the first time in its history Central America today has a thin layer of entre-

preneurial talent in industry and services. Transport and telecommunications, and electric power facilities improved in the region more than in the previous quarter of a century; some measures of coordination were introduced in the field of taxation and budgetary policies and, finally, a climate has been established conducive to the first, although feeble, attempts at drawing up regional investment policies.

It must be remembered, however, that the first stage of the Central American integration programme took place under favourable internal and external conditions. At the beginning of the present decade practically all the countries possessed a high degree of unused and easily mobilised productive capacity, both in industry and agriculture. Its growing use under the conditions of free trade is largely responsible for the extremely rapid rate of expansion registered by intra-regional commercial transactions between 1960 and 1966. External conditions were extremely propitious, too. During the same period Central America's export trade to the rest of the world grew by the average of 15 per cent a year, because of the rapid mobilisation of available resources through export-oriented plantation agriculture in the area, where semi-feudal land tenure systems have not as yet been challenged seriously by the mass of the poor rural population. Thus, the balance-of-payments position of Central America, and of each CACM member country, with the rest of the world was until 1965 quite comfortable and permitted the area not to worry about intra-regional trade imbalances.

Although external conditions have deteriorated somewhat lately, there is a growing feeling in the area that the CACM has reached in some sense a point of no return. It is worth noting that in 1966 and the first half of 1967—in spite of restrictive monetary and import policies introduced by the majority of the CACM members—the intra-regional trade continued growing rapidly. Preliminary data suggest that in 1967 two thirds of the increase in imports came from the area itself. In spite of the obvious progress in commercial fields some fears are, however, expressed within the area that the CACM may not fulfil its main objectives—those of accelerating economic development and industrialisation of Central America—unless some clearcut decisions are arrived at within the reasonable future in the field of regional economic planning and investment policies. Moreover, the future of the CACM becomes more difficult to envisage because of possible socio-political complications.

Economic Policy Coordination

The whole integration progress has affected only slightly the existing productive and social structure of Central America. Industrialisation—the goal of integration—seems to be limited to the increased use of capacity in existing manufacturing enterprises and the appearance of numerous assembly industries, which put pressure on the region's import bill. Many Central American supporters of integration and out-

side observers suggest that the present situation calls for the elaboration of regional import-substitution policy, accompanied by economic policy harmonisation in the industrial and fiscal field. It is an encouraging sign that the problems of closer economic policy coordination started being discussed in 1967 at the highest economic policy level with the participation of ministers of economy, ministers of treasury and presidents of central banks of the five CACM member countries.

The difficulty of agreeing upon far-reaching adjustments of domestic policies to the needs of the region as a whole, involving regional planning and investment policies, close harmonisation of fiscal policies and measures tending to expand the regional market through income redistribution, should not be underestimated even in the area where considerable progress in the field of economic integration had already been achieved. The difficulties arise from the fact that in the next stage of regional integration in Central America the rules of the game applied by the builders of the CACM and responsible for the success of the first stage of integration (1961—1966) would have to be considerably changed. Obviously, the Central American integration experiment is facing a new stage, confirming what is well known from West European experiences: economic cooperation in one field within the framework of a common market creates inexorably need for cooperation in other fields.

Recourse to Socio-Political Adjustments

While the customs union, expected to come into force by the end of the decade, will provide for free movement of both goods and people, additional goals for the second stage of Central American integration include among others a unified fiscal policy and a regional industrial policy. The fulfilment of these goals will involve a gradual renunciation on the part of the member-countries of freedom of action in fields which are universally considered the legitimate domain of a sovereign state. But even supposing that mutually acceptable solutions can be found in respect of those economic policies, CACM can hardly forge ahead without recourse to broad socio-political adjustments which might upset the structure of political power in the area. It is difficult to believe that economic integration can proceed successfully in the longer run while only one-third of the population of Central America participates significantly in the market economy, the middle classes do not account for more than one-eighth of the population, and the degree of illiteracy varies from 20 per cent in Costa Rica to 70 per cent in Guatemala.

These data clearly show the limitation to the economic integration process arising under very slowly changing social conditions. On the other hand, assuming that accelerated economic growth within the framework of the CACM will stimulate social change, as many CACM supporters believe and hope for, such developments may offer one day a serious challenge

to the antiquated political structures prevailing in the majority of the Central American republics. Such prospects are not at present being discussed openly in the area, but small and expanding local intellectual groups—containing a surprising number of foreign-educated and nationalistically-oriented sons of the present politically backward elites—raise with growing frequency though not yet publicly, the following crucial question: Central American economic integration for whom? Put blandly, what is being questioned more and more is the socio-political variability

of an economic integration experiment which would bring benefits mostly to local and foreign business communities and their political backers.

In brief, the long-run success of the CACM will depend not only upon its effect on trade and industry creation in the area, but also upon the ability of the participating countries to absorb peacefully the unavoidable impact of economic change on the still largely backward structure of Central American societies.

East-West Trade

More Trade with the USSR

by I. Simonov, Moscow

The Soviet Union stands for as broad and wide trade relations as possible with all countries. The volume of Soviet foreign trade is mounting year by year, and Soviet trade relations with foreign countries are progressively being placed on a firmer basis.

It is the policy of the Soviet Union to foster matter-of-fact cooperation with countries having different socio-economic systems. The Soviet Union's guiding principles in this endeavour are equality, mutual advantages, and paying heed to the national interest of all trading partners.

Since the last war, the rate at which Soviet foreign trade has expanded, was greater than the growth of the Soviet Gross National Product. Annual GNP growth rates in the two decades between 1946 and 1966 were on average about 13 per cent in the Soviet Union.

Foreign economic relations have become an important factor for the Soviets, facilitating the successful fulfilment of plans designed to promote the economic development of the country, and increasing the national economy's efficiency.

Greatly Varied Forms of Cooperation

The Soviet economy's rapid growth and achievements in science and technology have laid the material foundations needed for expanding Soviet foreign trade.

During recent years, new forms of economic cooperation with Western countries have been born. Among them are mutual exchanges of goods based on long-term agreements, the buying and selling of production licences authorising the use of advanced technological methods and processes, the bartering of consumption goods, direct retail deliveries in frontier zones, construction of complete industrial plants with the aid of foreign specialists, the shipping trade between the ports of partner countries adjacent to the Soviet border

areas, commercial cooperation in the field of inland shipping, etc. In order to enliven economic and trade relations, we promote, on an exchange basis, the running of national and specialised industrial and commercial fairs and exhibitions staged in the USSR, and conversely, Soviet foreign trade organisations exhibit abroad at international fairs and big trade shows. Frequently, it is also the case that economic and/or scientific and technological missions and delegations visit each others' countries on the basis of exchanges between the Soviet Union and its foreign trading partners.

The combination of Soviet efforts to enlarge its economic and trade relationships with Western countries, and of businessmen of the West to intensify trade with the USSR in view of the mounting difficulties on the capitalist world market, has consistently pushed up the volume of goods exchanges. The following figures highlight the growth of trade between the USSR and developed capitalist countries (in Rouble million):

	1950	1955	1960	1966
Total volume of goods exchanged	440.2	904.3	1,917.3	3,181.4
Soviet exports	235.9	502.5	913.3	1,580.8
Soviet imports	204.3	401.8	1,004.0	1,600.6

It is shown in the above table that the volume of Soviet foreign trade has almost trebled. However, it must not be forgotten that in spite of the steep rise in the exchange of goods between the Soviet economy and the West, both its absolute volume and its share in total foreign trade turnovers of the Western countries are, in most cases, still relatively small.

Obstacles for Trade by the West

Actual possibilities which exist for economic cooperation are far from being fully exploited, because a number of Western countries have artificially placed