RESTRICTED

Report No. WH-170a

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

ECONOMIC DEVELOPMENT AND PROSPECTS OF CENTRAL AMERICA

(in eight volumes)

VOLUME IV

INDUSTRY

June 5, 1967

Western Hemisphere Department

EQUIVALENTS

Currencies	=	1 Central American peso (a unit of account)
)	=	1 Guatemalan quetzal
U.S. dollar 1)	=	2.5 Salvadorean colones
)	=	2.0 Honduran lempiras
	=	7.0 Nicaraguan cordobas
	=	6.62 Costa Rican colones

Weights and Measures

1 manzana	=	1.727 acres = 0.69 ha.
1 (60 kilo) coffee bag	=	132 pounds
16.6 coffee bags	=	1 metric ton
1 short ton	=	2000 pounds
1 quintal	=	approximately 101 pounds
Approximately 20 quintals	=	1 short ton (sugar)
1 banana box	=	42 pounds
1 banana stem	=	approximately 1.35 banana boxes
1 banana stem	=	approximately 57 pounds
1 (cotton) bale	=	480 lbs. net

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SUMMARY AND CONCLUSIONS

Overall Growth: Major Elements

1. The growth of industry in the region has averaged 11 percent per annum in the period since 1962, considerably in excess of the 6 percent rate achieved in the previous decade. As a result, the share of the manufacturing sector in gross domestic product which had risen from 11 percent in 1958 to 13.4 percent in 1962 increased further to 15.2 percent in 1965. The largest growth rate in manufacturing output in the recent period was recorded in Guatemala (14 percent) which previously had experienced little expansion in economic activity. Substantial increases in industrial production since 1962 were also recorded in El Salvador (12 percent) and Costa Rica (10 percent), although in the case of the latter the recent pace of growth represented a continuation of a trend which had begun earlier. For Honduras and Nicaragua, the recent rates of industrial expansion were moderate (7 and 9 percent respectively) but nevertheless representing some improvement over the previous periods.

2. The structure of manufacturing in the region exhibits the basic characteristics of less developed countries with the so-called "traditional" consumer goods industries--primarily food processing, beverages and tobacco, textiles, shoes and clothing--accounting for about 75 percent of output. With the sharp rise in disposable incomes after 1962, increased domestic demand led to a substantial expansion in output of these branches of industry, but slightly below that of the level of total manufacturing. New branches were established in the different countries during this period and were responsible for a slight change in the composition of output; these included petroleum refining in particular but also chemicals and metal products.

3. In the period prior to 1962, in addition to the steps taken to achieve economic integration, various policies were adopted and national development institutions were created with particular emphasis being given to accelerating industrial growth. In the absence of additional dynamic factors particularly on the external side, the main impetus in the past to economic growth, these measures had generally limited effects. In the early 1960's, external markets for agricultural products began to recover and increased local demand generated a rapid expansion of national industries aided by the measures previously taken. It is estimated that some three-quarters of the increment in manufacturing activity since 1962 was due to the increase in local or national consumption. Local production, particularly in the last two years, has received considerable stimulus from national development and financial institutions, both public and private, and the Central American Integration Bank. These in turn have received a substantial measure of assistance from the official external financial agencies.

4. In addition, there were the opportunities afforded through the creation of the Common Market. A comparison of the value of manufactured

product exports entering regional trade with the gross value of industrial production indicates that slightly over 20 percent of the increment to that output between 1962 and 1965 stems from the expansion of this trade (estimated at 75 million Central American pesos). Exports to world markets of manufactured products have been small in magnitude except in the case of processed foods, mainly sugar and meat. The expansion in trade of these items from 1962 to 1965 was probably less than 15 million Central American pesos (10 million for sugar and meat alone), less than 5 percent of the increase in gross value of manufacturing output.

5. The main characteristic of the Common Market has been the movement towards liberalization of intra-trade and the adoption of a common external tariff. For those products currently produced and traded within the region, the latter has represented generally a higher level than that prevailing under the national tariff systems which were in effect previously. This has stimulated the substitution of regional trade for imports from third areas for certain manufactures, both from the traditional and non-traditional industries. At the same time it has permitted an expansion of trade in other items largely from the traditional branches for which some local specialization had been developing under national tariff protection. In addition, local production and regional trade in a number of new product lines have been encouraged by national incentive laws in effect generally since the end of the 1950's. However, these were not too widely used until the increased liberalization widened the market.

6. Most of the trade has been in products which are generally not subject to economies of scale and whose production is relatively simple. Thus, at present economic integration, by creating a larger market, has encouraged a certain degree of competition and specialization and the higher protection associated with it has not led to generally higher prices for purchasers. While there continue to exist possibilities of import substitution, these will be found increasingly in products whose production is more complex, is subject to economies of scale and requires large capital inputs, limiting the possibilities of competition within the regional market which, with 12 million inhabitants, remains small. Hence the application of tariff policy and the granting of incentives to these industries will require that in the future the responsible integration agencies pay much greater attention to economic criteria than in the past.

Main Features of Intra-Trade

7. In 1958, intra-CACM trade represented some 4 percent of total imports of the member countries and rose rapidly to 9 percent of total by 1962 in absolute values from 20.5 million C.A. pesos to 50.4 million. The growth in commerce among the countries was largely due to exports of agricultural products (which accounted for about 45 percent of the intra-trade), and the beginning of an exchange of manufactured products among Guatemala, Honduras and El Salvador.

8. From 1962 to 1965, intra-trade continued to grow at a rapid pace, to 136 million pesos, its share rising to 15.3 percent of the total imports

of the region. The principal beneficiary of the increase in intra-regional imports was the industrial sector, with manufactured products accounting for some 85 percent of the increment in trade, rising from approximately 30 million to 105 million C.A. pesos, an increase of 75 million.

9. For Guatemala, Honduras and Nicaragua, some 15 percent of the increment to their industrial production in the 1962-65 period was accounted for by intra-regional trade. On the other hand, in El Salvador and Costa Rica the growth in regional exports of manufactured products made a considerable contribution to manufacturing output, 30 percent in the case of the former and 35 percent for the latter.

10. As regards the composition of intra-trade since 1962, less than half of the increase in exports of manufactured products has occurred among the traditional products (largely processed foods, textiles, shoes and clothing). This expansion represented in part an acceleration of a trend toward increasing trade in these items among the countries which had begun in preceding years under bilateral arrangements. These industries have been primarily dependent upon national markets and the recent increases in regional trade have represented only a small portion of the increment to production.

11. With respect to the growth in trade of non-traditional products, one-fifth of this increase was accounted for by fertilizers and petroleum products due to certain factors which may not be of a permanent nature. The remainder was made up principally of a variety of chemicals and metal products, which are also dependent to a great extent on imported raw materials. These are produced by industries which are essentially new to the region and intra-trade has represented an important share of the recent growth in their output.

12. Among the chemicals, particularly pharmaceuticals and cosmetics and related preparations, the growth in trade reflects intensive competition among brands which are made locally. These are, however, essentially mixing operations with low capital requirements as well as low value added. The existence of high tariffs on external imports as well as the excessively liberal industrial incentive laws under which these plants have been established, has played a major role in these trends.

13. In the cases of other chemicals, particularly insecticides and fungicides, while much the same conditions of production exist as for the above items, these are important agricultural inputs and local mixing plants have tended to try to meet the specific technical requirements of the area. Moreover, for the component compounds of some of these items, production in the region will soon be undertaken. A number of plastic products are in this same category.

14. Finally, the initiation of trade and production of some metal fabricated products, particularly those for construction, signifies the beginnings of a regional metal fabricating industry. In these cases, the

fabrication processes have high labor requirements tending to favor their production in these areas with relatively low wage rates. At the same time, transport costs for competitive products from other areas act as a natural protection for many of the locally produced items.

Tariff Policies - Their Characteristics and Impact

15. National attempts at formulating developmental tariff policies have been replaced at the regional level by a uniform external tariff and liberalization of intra-trade (or phased achievement of both) which now covers products accounting for more than 80 percent of total imports and about 95 percent of intra-trade.

16. Under both the previous national systems and the uniform tariff, the basic characteristics are the same, reflecting the similarity in productive structures of the countries covered. There is heavy protection for consumer goods and most of the inputs for these industries, with low rates on raw materials not found in the region and on capital goods. For some countries, the duties on certain of the inputs for consumer goods industries are now higher under the common tariff than under the previous national systems. This has led to some import substitution at the regional level, replacing imports from external sources with those from CACM member countries. For example, in the case of cotton textiles, which accounts for a substantial share of value in this category, expansion of the size of the market and growing demand has encouraged intensive competition among the national industries. Moderately sized but reasonably efficient producers have emerged in a number of countries, as indicated in the accelerated pace of modernization of the industry in recent years.

17. But the movement toward integration has also had an expansionist effect on trade. This can best be seen in the cases of consumer goods such as processed foods, clothing and shoes. High tariffs under national systems had tended to keep imports of these items to low levels. Various plants had been established in the different countries of the region to produce these items for local markets. With the advent of liberalization in intra-trade and access to larger markets, exports of these products within the region rose substantially. The products are generally produced by firms of relatively small or medium size, having low capital requirements, and as a consequence, there has tended to be, within the region itself, a fairly high degree of competition. The increased regional competition has helped to achieve relatively high levels of efficiency and low costs.

18. The development of the newer industries to serve the regional market will be increasingly found among those products in which economies of scale will limit the possibilities of competition within the area. In these circumstances the issue of how tariffs are to be used as a means to insure the establishment of economically sound enterprises will become more important.

19. In order to provide further stimulus to industrial growth a special system was adopted in 1963 which provides access to tariff increases by specific protocols for new industries if there exists capacity within the

region to produce at least 50 percent of regional demand. This has so far been applied to only three products (light bulbs, simple agricultural tools and glass bottles) but more applications are pending and even more can be expected. The need to develop and enforce economic criteria for the application of this special system is essential if excessive tariffs leading to a misallocation of resources and a distorted structure of production are to be avoided. This special system has, in effect, been designed to replace the regimen for integration industries which was formulated prior to the decision to move rapidly to complete freedom in intra-trade; once the countries moved toward this liberalization, the incentive features of the regimen were no longer effective.

Fiscal Incentives

20. Comprehensive laws to promote investment in industry were adopted in all five countries particularly at the end of the 1950's (Honduras and Nicaragua in 1958, Costa Rica and Guatemala in 1959, and El Salvador in 1952 but widened substantially in 1961). In most instances the broad sweep of the legislation represented a new approach by the governments to industrial promotion, establishing for the first time elaborate systems of incentives and the criteria for their application, which have a number of common characteristics among the countries.

21. Fiscal incentives in the form of exemption from income taxes and from tariffs on imported capital equipment and inputs are granted to individual enterprises in accordance with certain classifications which are established under specified criteria. In two countries, Guatemala and Costa Rica, the only criteria are whether the product to be produced is new or is already being produced in excess of a certain proportion of existing national demand. In addition to this distinction between new and established, economic characteristics of the product are considered in the three remaining countries (necessary or convenient industries in El Salvador; fundamental or basic, necessary and convenient in Nicaragua and Honduras). The criteria for classification in these cases are extremely vague or cover so many elements as to make them completely subject to administrative discretion in application.

22. There has been an increasing number of enterprises classified under these laws in all of the countries. In part, this is due to the fact that in four countries (i.e., excluding El Salvador) business income taxes are on the same basis as personal income taxes, with a progressive rate. Thus, there is in these cases a disincentive to the establishment of larger scale enterprises which has consequently encouraged wide use of the provisions of the incentive laws.

23. However, there is evidence that the number of such firms which are actually operating is considerably below those classified to receive benefits. Among the factors responsible for this situation is the apparent tendency in certain countries for project promoters to obtain classification before their proposals are fully advanced as a means of pre-empting the product field. In addition, for certain products for which plant location is not critical,

entrepreneurs have apparently applied for benefits in more than one country in order to determine which will grant the most favorable conditions.

24. The possibility of competition among the countries for industrial plants is, in fact, explicitly recognized in two of the national incentive laws (Guatemala and Honduras as recently revised). In both instances, national enterprises may receive benefits additional to those for which they qualify under the relevant legislation, if they can show that similar enterprises in other countries receive better treatment.

25. As a result of these situations, there has been a growth of small or medium size mixing or assembly plants producing mainly consumer goods based on tariff-free imports of the intermediate inputs with high tariff protection afforded to the final product. These include pharmaceuticals, cosmetics, toiletries and related preparations, as well as some simple metal fabricated products. These are among the new industries in the area for which intra-regional trade has represented a major share of the recent increase in output. For the first group of commodities, the competition which has developed particularly as regard foreign brands has apparently led to relatively favorable prices to consumers. But this has been at the expense of higher imports of inputs for items for which restraints on demand (high tariffs) had been imposed to curtail imports from abroad and/or at the expense of losses in government revenue.

26. On the other hand, the competition for plant location, with the resulting uncertainty as to the possibility that future competitors might obtain more favorable conditions in a different site, may have hindered investment in larger scale enterprises producing either intermediate or final goods in these branches (the chemical and metal fabricating industries). In spite of the fact that one of the main motivations for economic integration was to create larger markets and encourage the establishments of the larger enterprises, the period has seen only a few such plants coming into operation or even under construction and these have generally had direct links with buyers of the products to ensure disposition of output.

27. To reduce this competition, the five governments had negotiated in 1962 a common agreement on incentives which, lacking Honduran ratification, has not yet entered into force. The latter country has made its ratification dependent upon preferential treatment which has now been granted in a protocol approved in September 1966. Nevertheless, the protocol must be ratified by the other four countries before ratification by Honduras. In the meantime, the national legislations remain in force.

28. The Common Agreement will however not completely solve the problem of competition since its administration is left in national hands for seven years. Moreover, while somewhat more explicit than national legislation, a number of the criteria to be applied are vague. Thus it is essential that central administration be achieved as soon as possible and that more specific criteria be elaborated. Because of the narrow raw material base of the region, the newer industries producing for the regional market will become increasingly

dependent upon imports and the incentives should be reserved for those industries which will make the most effective contribution to the growth of the region.

29. More fundamental revisions should also be studied to improve the efficiency of these measures: the elimination of exemptions on income taxes, linked in four countries to the institution of proportional taxes on business income, and a shift to provisions for accelerated depreciation, and the establishment of tariff exemptions for products rather than to specific enterprises.

Investment Requirements and Source of Finance

30. Long-term capital requirements for the expansion in industry between 1962 and 1965 were moderate in relation to the growth in output. At the beginning of the period there existed considerable underutilized capacity, estimated at between one-third and one-fifth of installed plant. Increments in output were therefore possible with minimum levels of new investment but in 1964 and 1965 there was need to expand production facilities to meet the continued rising demand. Gross investment in manufacturing, estimated on the basis of imports of industrial equipment, rose from 65 to 75 million C.A. pesos in 1962 and 1963 to about 100 million pesos per annum in 1964 and 1965.

31. In the past, long-term capital for industry was obtained largely from the savings of existing enterprises or directly from the resources of the owners. While a number of local banking or financial institutions were relatively well developed, they concentrated in agriculture, exports and commercial activities such as the financing of imports. With the beginnings of modern industry in the region, there has emerged, as in other areas of the world, a trend toward the establishment of new forms of financial intermediaries as well as the use of newer types of business organization. In Guatemala and El Salvador, this development occurred somewhat earlier than in the other three countries. Thus for the latter (Costa Rica, Honduras and Nicaragua) the recent growth of specialized financial institutions in both the public and private sectors has played a particularly important role in the industrial expansion which has been experienced. The increased activity of these institutions has been made possible by assistance from the external lending agencies.

32. There has been a marked inflow of international public capital for industry in this period. Most of this finance has been channeled through national institutions both public and private, but there has also been some direct financing of enterprises; the major part of the indirect lending has been earmarked for small and medium sized industries, generally producing for local or regional markets. Beginning with an IBRD industrial equipment loan to the Central Bank of Costa Rica in 1956 (the first of four such loans), an increasing amount of funds has been channeled to this sector by the IBRD, and the IFC, the IDB and AID, annual disbursements from these agencies rising from 1.7 million C.A. pesos in 1962 to 9.2 million in 1965. It is expected that this will rise even further in the next three years. In addition, the Central American Bank for Economic Integration has also disbursed substantial

sums by direct lending to industry, its annual disbursements rising from 2.6 million pesos in 1962 to 5.2 million in 1965; about two-thirds of this has come from AID and IDB loans to the Bank.

33. In recent years among the most important channels for AID funds for investment in industry have been the private finance companies (financieras) established in four countries (i.e., excluding Guatemala), as a means of promoting the growth of national capital markets. These institutions, however, need to be oriented in the future to attract more local financial resources and to widen local participation.

34. The national public institutions to accelerate industrial growth include fomento corporations which can finance investment as well as undertake promotional activities, and specialized units either in ministries or other government departments restricted to the latter functions. In some instances, existing official banking institutions have established special financing facilities for industry. The degree of success achieved by these agencies in the countries of the region has varied, the nature of the public financing institutions, in particular, depending on the state of development of national financial systems. In general, there is need to separate the two functions of promotion and finance, at the least from the point of view of budgetary arrangements. The promotional activities (e.g. pre-feasibility and market studies) represent public expenditure which may prove to be indirect subsidies to new or expanding enterprises. On the other hand, lending institutions, providing a means for mobilizing domestic and external capital resources, must seek to obtain returns on their loans, although these need not be as high as current local market yields.

35. In connection with the growth of local capital markets, a number of proposals have been made for institutions or mechanisms to facilitate the establishment of a regional market. Given the differences among the countries, there is need for study of the precise contribution which a regional approach can make to the development of a financial structure aimed essentially at channeling additional resources to industry.

36. Foreign private capital inflows to manufacturing activities have also apparently increased rather sharply following the establishment of economic integration, attracted by the expanded market size permitting the larger-scale undertakings with which such enterprises are generally associated. Moreover, import substitution policies have encouraged local production of certain items formerly imported, and many of the foreign firms which supplied the latter have established plants - often in joint ventures with local capital in the region - to maintain their markets, a pattern which has been repeated in many areas of the world. In addition a number of existing local enterprises have been purchased by foreign firms as part of the investment diversification programs of the latter.

37. There is obviously great need for the participation of the foreign private sector in the development of the region, particularly with its know-how in the new industries for the domestic market. Nevertheless the experiences in other areas point up the necessity to consider the longer-term implications of this trend as regards the balance of payments, at the least to seek means to encourage the channeling of this expertise to the development of export-oriented industries which have not received sufficient

attention in the past. In this connection, a number of the various activities which are to be undertaken as part of the Mexican program of cooperation with the Common Market are directed at promoting exports and the progress achieved in these efforts should be carefully examined.

38. In contrast to the experience with long-term capital, the needs for short-term capital of industry have risen sharply in the period of growth. It is to be expected that with expansions in output and underutilized capacity, working capital requirements will rise as entrepreneurs seek funds for raw material purchases and labor needs. Moreover to the extent that there was an expansion in trade in manufactures among the countries, the increased time lag between shipment and receipt of payments as compared to similar time lags for sales to local enterprises created additional requirements in this respect. Credit largely of a short- or medium-term nature extended by the banking system to the industrial sector expanded considerably during the period in all countries, well in excess of the expansion in total credit. As a consequence its share in commercial credit rose rather sharply, although in Honduras and to some extent Guatemala, the sector's participation in the banking system's lending remains relatively low.

39. The concern over the shortage of this credit which was expressed throughout the visit of the mission to the region probably reflects certain subjective elements. There is considerable evidence that small and medium size enterprises, particularly the newer ones, underestimate working capital requirements; where capital is scarce there is a tendency to put whatever is available into machinery and equipment. Leaving aside these complaints of shortage arising essentially from the inexperience of the local private sector in modern industry, it is obvious that as the sector grows there will be increasing need for channeling this type of capital to it. Thus the monetary authorities must keep under review the requirements of industry and the ways and means these can be met.

Appraisals of Prospects in Industry

40. While the economic integration of the region has created a larger market, it is nevertheless true that this market remains relatively small. With its low per capita income, the possibilities of industrial growth on the basis of regional demand are limited. Thus industrialization is intimately linked, first, with general developmental policies aimed at raising incomes in all sectors and, second, with the development of export-oriented industries. The strategy is therefore two-pronged. On the one hand, there is the need to adopt measures to encourage the growth of industries serving the regional market--to meet growing consumption and a changing structure of demand within the context of an expanding regional economy. On the other is the need to promote the development of export-oriented industries, involving maximum elaboration of those natural resources which the region contains in some abundance combined with most efficient utilization of the available human resources. That these elements are not mutually exclusive is self-evident, that they are in reality complementary can be seen in the fact that future expansion of exports will require a healthy development of regional industries which can compete in world markets.

41. At the present, there appear to exist excellent opportunities for expanding exports to world market of processed foods and wood and products. With regard to the former, encompassing particularly meat and canned fruits and vegetables, export expansion will depend in the first instance on improvements in raw product supply which will require programs of official assistance. Expansion of production facilities has already occurred or is being planned in the case of meat but there will be need to expand processing plants for fruits and vegetables. Existing underutilized capacity for the latter can provide, however, the basis for initiating export programs with the pattern of future expansion to be determined on the basis of experience in the early stages. Particular emphasis will also have to be given to marketing aspects. Given inexperience in the region and the economies of scale in distribution, some form of a regional cooperative program should be undertaken in this field.

42. Wood products present a similar situation with current export of these items to other areas well below the region's capacity in view of its resources and world market conditions. Emphasis should be given in official programs of assistance, either technical or financial, to the creation of production facilities for such items as saw wood, veneer, plywood, and chip boards as well as to the establishment of marketing facilities. In this connection, the Honduran pulp and paper project will provide a substantial amount of saw wood for sale in world markets, particularly Europe.

43. The possibilities for exporting more elaborated products with higher labor use, such as cotton textiles and cloth, appear to be promising, as recent intra-regional competition has encouraged the establishment of modern, reasonably efficient plants in these branches. However, proposals to create export industries on the basis of imported raw materials or intermediate goods must take into account the external competition from areas such as the Far East where wages are considerably below those prevailing in Central America. In general, the region would in the immediate future have its best opportunities for developing exports in those products which are characterized by both high labor inputs (taking advantage of the prevailing reasonably low wage rates) and low raw material costs as a result of natural endowments.

44. With regard to industries for local and regional markets, there remain various possibilities for import substitution but these will be increasingly dependent upon imports of raw materials or intermediate products. Moreover, these industries will tend to require relatively large-scale output, limiting the possibilities of establishing a number of competitive plants in the region. Thus the proper application of tariff and incentive policies is essential to insure the establishment of efficient plants which will not distort the structure of industry and damage these sectors which are users of the products concerned. In the case of fertilizers, insecticides and fungicides, agricultural inputs which bulk large in imports of the region, the basic compounds are subject to very substantial economies of scale in production and under current demand conditions local plants would tend to be high cost producers. There remain, however, a number of possibilities for establishing local mixing plants and some simple transformation processes.

45. A similar situation prevails for plastics and synthetic fibres. The former have had growing use both for industrial and household uses, based on imports of intermediates such as powdered poly-vinyl-chloride, polyethylene and polysterene. Project proposals for establishing plants to produce the basic compounds for these items are now being prepared but pose the same scale problem as the other chemicals.

46. A number of project proposals have been prepared for the establishment of various assembly industries covering both consumer (e.g. passenger cars, radio and television sets) goods and some producers goods (e.g. trucks). A protocol is now under consideration which will specify the procedure and criteria to be used to permit the extension of the common tariff and free intra-trade to these products. In view of the experience in the region as well as in other areas, such plants should be carefully screened before incentives are granted to insure that the advantages to be obtained (in terms of employment, for example) exceed the possible losses in government revenues and drain on the balance of payments. Nevertheless, in view of the large labor requirements for these assembly operations, they are in general suitable to the area and, particularly the smaller and simpler products, can be produced in the region without excess granting of benefits, given the possibilities of producing economically an increasing proportion of the component parts.

I. REVIEW OF ECONOMIC AND RELATED CHARACTERISTICS AFFECTING GROWTH OF INDUSTRY IN CENTRAL AMERICA

1. Since 1962, industry in Central America has experienced one of the most, if not the most important periods of sustained growth in its short history. This expansion is associated with two major economic and political events. First is the recovery of the basic product exports of these countries after a relatively long period of stagnation; these exports have traditionally been the dynamic element in the Central American economies determining the paths of personal income and consumption as well as investment. In the second place, the basic agreements underlying the establishment of the Central American Common Markets have come into force in this period, and, in particular in the most recent years, there has been a substantial degree of liberalization of intra-trade combined with the establishment of a common external tariff on a large number of products. The principal objectives of this section of the report of the mission is to analyze the prospects for continued growth of industry in the region, the requirements for maintaining this dynamism and the appropriateness of existing policies in this respect. The relative roles of domestic expansion and increase in intra-trade in the recent period of industrialization are examined with a view to identifying critical areas for future policy decisions.

2. While there has been considerable growth in past years, the share of industry in gross domestic product in the five Central American countries remains at relatively low levels--only slightly more than 15 percent. This ratio is associated with the low level of per capita income as well as the small size of each of the countries--or the region as a unit. The creation of the Common Market in fact derives one of its principal motives from the desire to expand the possibilities for industry by providing a larger market. Nevertheless even the larger unit represents with some 12 million inhabitants a relatively small population size. Before analyzing the industrial sector itself, it is considered useful to review various economic, geographic and demographic characteristics of the countries of the region which play a role in shaping economic development in general. Many of these aspects are dealt with in depth in other sections of the report of the mission; it is intended to summarize very briefly at this point a number of strategic elements in the unique configuration of resources, geography and population which is found in Central America.

3. One of the principal characteristics of the region is the high degree of dispersion of the population. In comparison with many of the Latin American countries, Central American countries have a relatively high density of population averaging about 29 inhabitants per square kilometer, varying from the extremes of the highly populated El Salvador to the case of Nicaragua. Some two-thirds of this population, however, lives in rural areas, and is dependent primarily on subsistence agriculture, thus lying on the periphery of the money economy.

	Population density, 1965 (per square km)	Urban population[a/] as percent of total, 1965
Guatemala	41	34
El Salvador	131	39
Honduras	20	23
Nicaragua	12	42
Costa Rica	29	35
Total	29	35
Chile	12	60
Colombia	16	53
Mexico	21	55
Peru	9	47

Sources: UN Statistical Yearbook 1965; IDB Social Progress Trust Fund, Fifth Annual Report 1965.

a/ Data on urban-rural distributions in Latin America vary from country to country, but the definitions used for Central America tend to overstate the degree of urbanization in comparison with other countries. Thus the situation indicated in the table is in reality more unfavorable for Central America.

It is this dispersion which contributes to much of the degree of industrial underdevelopment which these countries have demonstrated. By making more difficult and expensive the marketing and distribution processes, this characteristic has severely curtailed the real size of the market and thus has acted as a strong disincentive to the growth of industry.

4. The diffusion of the market can perhaps be better illustrated by noting the relatively small size of the major urban centers as well as the limited number of those with populations in excess of 100,000. Guatemala City with a population of approximately 570,000 is the largest urban center followed by the capital cities of the other countries--San Jose (Costa Rica) 324,000; Managua (Nicaragua) 275,000; San Salvador (El Salvador) 250,000; Tegucigalpa (Honduras) 170,000. Other than these capitals the next largest cities are under 100,000 with San Pedro Sula (Honduras) approximately 85,000 and Santa Ana (El Salvador) 75,000.

5. There are considerable variations in these demographic characteristics among the subregions of the individual countries in the area. The greatest degree of dispersion, the combination of the low level of urbanization with low population density, is found in Honduras. While the population density is lowest in Nicaragua, nevertheless this population is concentrated in the area along the Pacific Coast and the country

has the highest degree of urbanization in the region; the bulk of the land mass extending to the Atlantic Coast is sparsely populated. A similar situation is found in Costa Rica with a high degree of concentration of population in the central valley area. While the capital city of Guatemala is the largest in the region, most of the inhabitants of the rest of the country are found among the central highlands but with few large secondary urban agglomerations. Finally the heavy population density in El Salvador represents one of the major socio-economic problems of the region.

6. Given this dispersion it is no surprise that, in spite of recent developments, particularly the Pan American Highway and the Pacific coast highways of Guatemala and El Salvador, the transport system for Central America continues to reflect a foreign trade orientation with most of the main arteries of traffic tunnelling toward the ports. This commerce has been until relatively recently the only type which has had sufficient value and volume to justify investments in this field. Recent expansions of road systems, in particular the intra-regional ones have served to link the different urban centers both within the individual countries and the region. Nevertheless the construction of such links between the main cities remains to be obtained in the case of Honduras while in the cases of Nicaragua and Costa Rica considerable importance is being attached to the growth of transport networks with the relatively unexplored areas of the Atlantic coast. Even with the improvements achieved, however, it has been reported that road transport costs remain relatively high and a major factor in determining the location of any industry which is to be based on the regional market. In locating industries to serve the regional markets, the population dispersion when linked to the pecularity of the geography--the long, relatively narrow isthmus--becomes an even greater consideration. The bulk of the regional market as measured by population is to be found in the area covered by Guatemala, El Salvador, and the western portion of Honduras; the urban centers of Costa Rica lie more than 1,000 kilometers by road from the edge of this triangle, while those of Nicaragua are almost 500 kilometers from it.

7. Other elements of infrastructure also reflect the factors tending to inhibit industrial growth. Electric power availability and per capita consumption of all forms of energy are in Central America among the lowest in the hemisphere, considerably below countries with similar total population and/or per capita incomes. As indicated in the section of the report dealing with energy, there has been a considerable expansion in these facilities in recent years which has coincided with the period of growth and has no doubt contributed to it.

	Population 1965 (in millions)	Installed electric capacity, 1965 (thousand KW)	Per capita consumption of energy (kgs. of coal equivalents)
Central America	12.6	487	191
Chile	8.7	1,490	1,078
Colombia	18.1	1,478 a/	494
Peru	11.3	1,123	602

a/ 1963.

Source: UN Statistical Yearbook, 1965.

8. In regard to natural resources, much of present industry is based on inputs from agriculture, including forest products. The latter resource has only recently been exploited to any degree, but this is still not at a level which either natural or comparative advantage would indicate.

9. In the case of mineral resources, present indications are that the region is lacking in major metalliferous ore deposits but new and more intensive geological surveys are now underway. Much of the isthmus is covered by substantial volcanic residues--particularly the Pacific Coast area--and metallic deposits have not been found in these locations. There is the possibility that such deposits exist well below the volcanic residue and at extreme depths below the earth's surface but whether these would be economically exploitable under current economic conditions is a major question. On the Atlantic Coast side, some ores have been found and are currently being mined. Small amounts of gold, lead and zinc ores are exported from Honduras and some copper from Nicaragua. A fairly large bauxite deposit is now being explored in Costa Rica. In Guatemala a major ferro-nickel project is being studied, but for various reasons the project is apparently still far from being implemented. In practically all of the above cases it should be noted that the size of the deposits has so far justified only the simplest of processes in the region and the ores are exported in beneficiated states for refining abroad; the major exception would be the Guatemala case. A relatively rich deposit of iron ore in Honduras was discovered a number of years ago but its size is apparently small. With present world market conditions for iron ore, exploitation for export as ore does not appear economic. The public authorities of Honduras are studying the possibilities of establishing a relatively small iron and steel industry based on this deposit, but numerous economic as well as technical problems need to be solved before this can be undertaken. In the same connection, the availability of hematitic sands with relatively high iron content along the Pacific Coast of Costa Rica has led to preliminary investigations as

regards the feasibility of locating a steel plant in this area. However technical problems connected with the utilization of such lands appear to be rather serious at this point and further work as regards technology is required before any action can be considered.

10. A number of non-metallic mineral resources appear to be available in sufficient quality and quantities in relation to current or foreseeable demand for major industrial uses. Existing cement plants have programmed large expansions in capacity utilizing local supplies of sand and limestone. Raw materials for ceramic manufactures have been found in many locations and new and relatively large ceramic plants are under construction or in the planning stage which will be primarily based upon local supplies; however, some special clays may have to be imported. A newly discovered sulfurous deposit in Costa Rica is also being surveyed at this time. Sands for glass manufacture are known to exist, but are not currently exploited. A major glass bottle factory which has just begun operations in Guatemala is based in its initial stages on imported raw materials, but expects to be able to shift soon to local supplies to the extent of 80 percent of its mineral inputs. The projected sheet glass plant in Honduras is expected to follow the same pattern. A caustic soda plant under construction in Nicaragua also will import in its early phases industrial salt rock but expects to be able to rely on a local solar salt project which is now under study. The growth of these industries, their size and potential impact on the balance of payments suggest the need for governments to adopt policies to insure that local supplies are in fact utilized as soon as possible. As in the case with most of Latin America, no deposits of phosphate or potash, which are essential for fertilizer production, are known at this time in the Central American region.

11. Finally, as regards the human resources of the region, the population of the region is characterized by a high degree of illiteracy with the major exception of Costa Rica (see section on education) but current efforts at increasing educational facilities have improved the situation. Recent experience with the establishment of new industries puts emphasis on the capacity of the younger age group (from 16 to 20), to learn factory skills and relatively few difficulties have been encountered by these newer plants in training nearby personnel from this group to undertake machine tasks and other related factory work. It would appear that the main bottleneck in this regard lies with the availability of supervisory and foremen personnel. While higher technical and engineering skills may be, and in fact, are, "imported",1/ it is extremely difficult, due to the nature of the responsibilities

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1/ From the longer-term point of view, it is of course necessary to insure an adequate supply of local personnel at these higher levels. See also the section of the report dealing with education.

of this particular type of personnel, to employ foreigners as foremen. The relatively new stage of industrialization which these countries have now entered has encountered numerous problems arising from this shortage. Many of the newer plants have indicated an inability to function with more than one shift due to the difficulties in obtaining the required supervisory staff.

12. The availability of managerial skills is even more difficult to evaluate. Given the infancy of the industrialization of the region most of the owners of the newer industrial enterprises are from commercial or agricultural backgrounds. The transition from commerce to industry is not an easy one and experience varies not only from country to country but from province to province within the same national boundaries. In some instances, one of the indirect impacts of the establishment of the Common Market has been to widen the view of the new industrialists as a response both to the challenge of potential competition and to the opportunities for larger markets. In many instances within the region the impetus for developing new industries or expanding old ones comes from small groups of individuals. But this may be as much a reflection of the limited numbers with managerial or entrepreneurial talents, as of any tendency for a concentration of economic power. One of the most popular means of attempting to overcome this shortage is through the establishment of public development institutions; some of the factors which have contributed to the mixed degrees of success experienced by these agencies in the Central American region are discussed below.

II - BRIEF SUMMARY OF CHANGES IN INDUSTRIAL PRODUCTION AND ROLE OF INTRA-TRADE

A. Overall rate of growth

13. The growth of industry in the region has averaged 12 percent in the period since 1963, a rate of growth considerably in excess of that achieved in previous years:1/

Period	Average annual rate of growth of manufacturing sector
1955-1958	5.8
1959-1962	6.2
1963-1965	12.2

As a result, the share of the manufacturing sector in gross domestic product which had risen from 11.0 percent in 1958 to 13.4 percent in 1962 increased further to 15.2 percent in 1965.

1/ Estimate for 1963-65 by Mission staff; for previous periods, Joint Planning Mission.

14. In the decade prior to 1962, in addition to the steps taken to achieve economic integration, various policies were adopted and national development institutions were created with particular emphasis being given to accelerating industrial growth. In the absence of additional dynamic factors particularly on the external side, the main impetus in the past to economic growth, these measures had generally limited effects. In the early 1960's, external markets began to recover and a rapid expansion of national industries was generated which was assisted by the opportunities afforded through the creation of the Common Market. The increase in national demand after the period of stagnation is estimated to have accounted for some three-quarters of the increment in manufacturing activity in recent years.

15. The structure of manufacturing in the region exhibits the basic characteristics of less developed countries with the so-called "traditional" consumer goods industries--primarily food processing, beverages and tobacco, textiles, shoes and clothing--accounting for the bulk of output. These items are primarily based on local raw materials and even in those cases (such as shoes) where imports of inputs may be required, local value added is relatively high. With the sharp rise in disposable incomes after 1962, increased domestic demand led to a substantial expansion in output of these branches of industry, but slightly below that of the level of total manufacturing. New branches were established in the different countries during this period and were responsible for a slight change in the composition of output; these included petroleum refining in particular but also chemicals and metal products, based in large measure on imported inputs.

SHARE OF MAJOR TRADITIONAL INDUSTRIES IN MANUFACTURING OUTPUT IN SELECTED COUNTRIES
(As a percent of total industrial product)

	Guatemala		El Salvador		Nicaragua	
	1962	1965	1962	1965	1962	1964
Food, beverages and tobacco	51.2	42.8	56.8	49.3	57.7	53.7
Textiles	10.4	17.3	8.6	8.8	6.8	6.3
Clothing and shoes	15.9	17.8	13.8	13.8	18.9	15.7
Total above	77.5	77.9	79.2	71.9	83.4	75.7

16. The growth of intra-trade, in particular its share in total imports of the region, has its origins in the partial measures which were taken at the end of the 1950's to promote the economic integration of the region. In 1958, intra-CACM trade represented some 4 percent of total imports of the member countries and rose rapidly to 9 percent of total by 1962, in absolute values from 20.5 million C.A. pesos to 50.4 million. This was however a period of almost static imports reflecting

the general economic stagnation which the countries were experiencing at the time. The growth in commerce among the countries was largely due to exports of agricultural products (which accounted for about 45 percent of the intra-trade), particularly from Honduras to El Salvador, and the beginning of an exchange of manufactured products among Guatemala, Honduras and El Salvador. The latter was facilitated by bilateral accords entered into between the countries as well as the Multilateral Treaty of 1958 which entered into force among them in 1960. From 1962 to 1965, intra-trade continued to grow at a rapid pace, to 136 million pesos, its share rising to 15.3 percent of the total imports of the region but this time during a period of rapid expansion in the latter. The principal beneficiary of the increase in intra-regional imports was the industrial sector, with manufactured products accounting for some 85 percent of the increment in trade, rising from approximately 30 million to 105 million C.A. pesos.

17. A comparison of the value of manufactured product exports 1/ entering regional trade with the gross value of industrial production indicates that a little over 20 percent of the increment to that output between 1962 and 1965 (estimated at 360 million Central American pesos) stems from the expansion of this trade (estimated at 75 million C.A. pesos). Exports to world markets of manufactured products have been small in magnitude except in the case of processed foods, mainly sugar and meat; other items include simply elaborated wood products and essential oils. The expansion in trade of these items from 1962 to 1965 was probably less than 15 million C.A. pesos (10 million for sugar and meat alone), less than 5 percent of the increase in gross value of manufacturing output.

18. With regard to the composition of intra-trade in manufactured products, the traditional consumer goods described earlier which make up three-fourths of total industrial output, plus other traditional items (e.g. furniture), accounted for no more than half of the increment in exports from 1962 to 1965, but this increased intra-trade represented only a small portion of the rise in output. The other half of the trade expansion occurred among non-traditional products which are produced by the branches of industry newly established in the region. These exports however represented between 30 and 40 percent of the increase in gross output of the items concerned.

1/ Manufactured exports include sections 3 through 8 of the Central American Tariff Nomenclature plus selected manufactured foodstuffs (included in section 0).

	Absolute value of increase in intra-trade 1962-1965 (million C.A. pesos)	Share of total increase in intra-trade (percentages)
Manufactured foods a/	8.8	11.6
Textiles	11.4	15.1
Clothing and shoes	10.8	14.3
Wood products and furniture	4.3	5.6
Fertilizers	4.0	5.3
Toiletries, cosmetics and related products	5.5	7.3
Other chemicals	6.4	8.5
Petroleum products	3.2	4.2
Basic metals and fabricated products	4.3	5.6
Machinery and transport equipment	3.9	5.2

a/ Including inedible fats and oils.

19. Among the textiles, largest growth was experienced in cotton products, both yarns and cloth. This reflected a trend which had begun earlier, most of the trade concentrated between Guatemala and El Salvador. The expansion in exports of clothing and shoes, on the other hand, was more widely spread among the countries of the region covering many individual products; this trade also had its origins in the pre-Common Market period. Other manufactured items, also largely based on local raw materials, which experienced growth in trade include cereal preparations, candies and gum, simply elaborated wood products and furniture.

20. As regards the growth in regional trade in non-traditional products between 1962 and 1965, the expansions recorded by petroleum and fertilizers are due to special circumstances and may not be a lasting feature in the new developing pattern of trade. Exports of petroleum products from El Salvador to Guatemala had actually begun in 1964. The refinery at Acajutla, having come on stream in 1963, was able to export to the latter country. With the completion of the two refineries in Guatemala, this trade has fallen off, the level in 1965 being almost 2 million C.A. pesos below that of the previous year.

21. In the case of fertilizers, practically all of the exports which began in 1964 are from Costa Rica, originating in a plant which produces various types of these products, from imported ammonia, phosphate rock and other elements. The plant has experienced difficulties in sales to the region and the 1965 level of intra-trade also was some 2 million pesos below that of 1964.1/ Among the chemicals, particularly

1/. The fertilizer problem is discussed in more detail in Chapter IV dealing with the impact of tariff policies.

pharmaceuticals and cosmetics and related preparations, the growth in trade reflects intensive competition among brands which are made locally. These are, however, essentially mixing operations based on imports of intermediate products; they have both low capital requirements and low value added. The existence of high tariff on external imports, linked to excessively liberal industrial incentive laws under which these plants have received exemption from the tariffs on imported inputs, contributed very substantially in the increase in output and intra-trade. In the cases of other chemicals, particularly insecticides and fungicides, while much the same conditions of production exist as for the above items, these are important agricultural inputs. Local mixing plants have tended to try to meet the specific technical requirements of the area and their establishment was not generally dependent upon tariff protection which, in any case, is moderate. Moreover, for the component compounds of some of these items, production in the region will soon be undertaken. A number of plastic products are in this same category.

22. Finally, trade in metal fabricated products has covered a wide variety of items, from consumer goods, such as hardware, to producer goods such as construction materials. There has also been some export of simple machinery, tanks and tools. In these cases, the fabricating processes have high labor requirements tending to favor their production owing to the relatively low wage rates prevailing in the area. At the same time, transport costs for competitive products from other areas act as a natural protection for many of the locally produced items.

B. Review of trends by country

23. The largest increase in output since 1963 was recorded in Guatemala (14 percent), followed by El Salvador (12 percent), Costa Rica (10 percent), Nicaragua (9 percent) and Honduras (7 percent). For Guatemala, Nicaragua and Honduras, the growth in intra-trade played a minor role in the expansion in industrial activity (of the order of 15 percent); in the case of the latter two countries, however, the higher growth rate experienced in the last four years as compared to previous decade would not have been possible without the rise in regional trade. For El Salvador and Costa Rica, the increase in exports of manufactured products within the Common Market has played a major role in the recent period of accelerated industrialization, accounting for 30 percent in the former case and 35 percent in the latter of the respective increments to the sector's output.

Guatemala

24. The largest expansion in output since 1963 has been recorded by Guatemala, an increase of approximately 50 percent over this period. This has followed periods of relatively slow growth in industrial output, due in part to political difficulties as well as the stagnation of basic product exports.

Period	Average annual rate of growth in manufacturing
1955-58	5.7
1959-62	4.5
1963-65	14.3

As a consequence the share of industry in gross domestic product, which had only risen from 11.8 percent in 1955 to 13.1 in 1962, rose sharply to 15.2 percent in 1965. An estimate of the increase in exports of manufactures (25 million C.A. pesos) to the rest of the Common Market in relation to the increment in gross value of output between 1962 and 1965 indicates that no more than 15 percent of the production increase (165 million C.A. pesos) was due to the growth in this trade.

25. The major product categories for which a rise in output was recorded were the traditional ones of textiles, clothing, and foods. Thus the sharp increases in consumption following upon the recovery of basic exports have been the major factors determining industrial growth in this country. The expansion in output was made possible by reducing the high level of under-utilized capacity which existed at the beginning of the 1960's. A survey of enterprises in 1962 indicated that plant utilization was, on the average, 25 percent below capacity, with some branches recording as low as 50 percent, particularly among textiles and clothing.

26. It is important to note that for certain specific items, exports to the Common Market have represented a significant proportion of output. These include candies and gums among the processed foods, industrial textiles, including packaging materials, cement, batteries, cosmetics and related preparations, and auto and truck tires. Among exports outside the region, meat and sugar, primarily destined for the United States, have risen sharply since 1960-61 accounting for a considerable part of the expansion in output for these particular items. Sugar shipments declined in 1965, however, in response to adjustments to the new U.S. quota arrangements, while meat exports declined as attempts were made to increase supplies available for domestic consumption. In addition, Guatemala has exported to other areas practically all of its production of essential oils from seeds and plants which are used largely in the production of perfumes, paints and drugs.

27. The structure of production has changed very little during this period.1/ The relative shares of the traditional industries--food, textiles and clothing, which are primarily based upon local raw materials--

1/ The present production account does not include the new petroleum refineries. However, the low level of production in these establishments through 1964 would not change this conclusion to any degree. In 1965, production was somewhat larger and would require some modification. For 1966 and future years, it is necessary to ensure inclusion of this product in the accounts.

have remained about the same in spite of the appearance of new plants for cement and tires. The relative importance of other intermediate goods industries declined as a result of the starting up of the newer industries.

El Salvador

28. Manufacturing in El Salvador has represented a larger proportion of gross domestic product than in the other Central American countries. From 13.5 percent in 1958, its share has risen to 14.7 percent in 1962 and 16.7 percent in 1965, the larger increase in the latter period reflecting the acceleration in rate of growth in the sector.

Period	Average annual rate of growth of manufacturing
1955-1958	4.5
1959-1962	6.5
1963-1965	12.1

It would appear that the opening of the Common Market and the consequent movement toward trade liberalization has made a substantial contribution to the growth in output in this country. From 1962 to 1964, the increase in the value of manufactured goods exported to the other Central American countries (17 million C.A. pesos) amounted to over 25 percent of the growth in gross industrial output (65 million C.A. pesos); from 1964 to 1965 gross output rose some 20 million C.A. pesos while intra-regional exports rose 10 million. Of particular importance were the sales of textiles (both yarns and cloth), clothing and shoes, but it is significant that trade expanded in a wide variety of items. This includes processed foods (such as margarine), paper bags and cardboard boxes, cosmetics and similar preparations, paints, insecticides and fungicides, construction materials (such as asbestos-cement and copper wire and cables), and simple metal products (such as housewares, hardware and furniture). There was also a considerable export in 1964 of refined petroleum products from the new refinery at Acajutla, mainly to Guatemala. This trade, however, fell off in 1965 as the new refinery in Escuintla (Guatemala) came on stream.

29. Exports of manufactured products by El Salvador to non-Central American Common Market areas have changed very little during this period and generally remain at low levels. The main exception is sugar which, since 1960-61 has been of some importance as a result of the sugar quota granted to this country in the United States market; in recent years the level of this trade has remained practically constant.

30. The major change in the composition of output has been the emergence of petroleum refining as an important branch in the industrial sector. The relative share of the food processing industries declined in spite of the establishment of a major flour mill while there were small changes among the other groups.

Costa Rica

31. The rate of growth of Costa Rican industry since 1962 has, in contrast with the previous two countries, been no greater than the growth in the immediate preceding years. The manufacturing sector in Costa Rica was particularly small, accounting for 11.9 percent of gross domestic product in 1950 and 11.4 percent in 1956. Numerous steps were taken by the government in the second half of the decade of the 1950's, including a revision in tariff policies and the negotiation of industrial equipment loans with the IBRD. By 1962, industry's share in gross domestic product had risen to 13.9 percent. The recent increases have raised that share to 14.8 percent by the end of 1965.

Period	Annual Average Rate of Growth of Manufacturing Sector
1955-1958	6.6
1959-1962	9.6
1963-1965	9.9

32. The maintenance of the rate of growth in industry since 1962 would not have been possible without the growth in exports of manufactured products to the Central American Common Market. From 1962 to 1965, the gross value of industrial output is estimated to have risen by 42 million CA pesos while manufactured goods exports rose some 15 million. Among the commodities which bulk large in this trade are processed foods (cereal preparations and sugar products), clothing, furniture, cosmetics, toiletries and related preparations, fertilizers 1/ and metal fabricated products for construction. Costa Rica has also expanded its exports of manufactures to third areas. In addition to sugar, among the processed foods there has been some increase in exports of meat and frozen shrimp. Some expansion in exports of wood products was also recorded particularly to the United States as well as to the neighboring Caribbean countries, apparently accounting for a major part of the output of the commodities involved. Trade with Panama has also expanded, to some extent in many of the same items which figure heavily in Common Market trade, aided to a great extent by a bilateral agreement between Costa Rica and Panama in which reciprocal trade preferences are extended. This trade is, however, still at very low levels, 1 million CA pesos in 1965.

1/ Fertilizer exports in 1965 amounted to some 3 million CA pesos, a sharp decline from the 5 million recorded in 1964. The fertilizer plant at Puntarenas has experienced recent difficulties and it is reported that it will adjust its product lines with possible consequent changes in the trade pattern. Nevertheless even if this is excluded from the production and trade calculation, manufactured exports to the Central American Common Market still account for 30 percent of the output increase.

Honduras

33. Honduran industry has been expanding slowly from very low levels since the mid-1950's but its expansion has exceeded by a substantial margin the slow rate of growth of the total economy. Thus, the sector accounted for 10.9 percent of gross domestic product in 1953, rising to 13.0 percent in 1962 and to 14.2 percent in 1965. In spite of the fact that Honduran manufacturing has grown at this slower pace, the increase in its contribution to domestic product has been relatively larger than the increase in the contribution of the sector to total output in the other CACM countries.

Period	Average Annual Rate of Growth in Manufacturing Sector
1955-1958	4.3
1959-1962	6.5
1963-1965	7.1

Among the factors which have helped to determine this pace of industrialization are dispersion of population, the overall low level of per capita income, deficiencies in infraestructure. In the period 1962 to 1965, the increase in exports to CACM countries of manufactured products (of the order of 4 million CA pesos) accounted for no more than 15 percent of the increase in the gross value of manufacturing output (estimated at 25 million CA pesos), but contributing in great part to the higher rate of growth as compared to previous periods. This trade has been important in determining the recent sharp rate of growth of the existing clothing industries and for certain types of shoes, as well as for some new products - detergents and soaps and cement. 1/ Exports to third areas of simple wood products have also accounted for a substantial share of output of these commodities. One of the most significant developments, however, has been the growth of the banana box industry - fabricating banana cartons from imported liner and cardboard and other material inputs for the present, but establishing a proven demand for major new local supplying industries in the future. Other new industries established during this period and producing primarily for the local market include a flour mill, powdered milk plant and plastic products fabrication.

Nicaragua

34. As in the case of Honduras, the contribution of industry to gross domestic product in Nicaragua was relatively low during the 1950's, rising from 10.2 percent in 1950 to 10.9 percent in 1956. During the second half of the decade, various measures were taken by the government to acce-

1/ The exports of cement were mainly to El Salvador where exhaustion of raw material supplies at the site had caused the existing plant to close down and seek a new location. When this country begins to produce cement once more, intra-trade in this product may decline.

lerate the pace of industrialization and by 1962, the sector's share in total product had risen to 12.7 percent. In 1965, the share was 13.0 percent. 1/

Period	Annual Average rate of growth of manufacturing activity
1955-1958	6.5
1959-1962	6.1
1963-1965	9.3

35. In the 1962-65 period, the increase in exports of manufactured products to the CACM (6 million CA pesos) accounts for some 15 percent of the estimated increase in the gross value of industrial product (40 million CA pesos). This trade has consisted largely of cosmetics and related preparations, fabricated steel products for construction, insecticides and certain types of shoes and has represented a major share of the production of these items. Among processed foods, there have been increases in exports of soluble coffee and meat to third areas which have accounted for a substantial portion of the increased output in these categories; this trade fell off somewhat in 1965, partly in response to supply difficulties in the case of meat and demand in the case of coffee. There has also been a moderately growing export to other areas of shrimp and of wood products.

1/ In 1964, the share was 13.8 percent. For 1965, the preliminary estimates of the national accounts indicate a rise of 9.7 percent in total product but only 2.9 percent in manufacturing activity. The latter figure is believed to be underestimated.

III. TARIFF POLICY AND RELATED INSTRUMENTS

36. The commitment to the establishment of a common external tariff and freedom of intra-trade was first made in the Multilateral Treaty on Free Trade and Central American Economic Integration signed in 1958; ratified by three members, this pact became the basis for the more sweeping General Treaty signed at the end of 1960--ratified by Guatemala, El Salvador, Honduras and Nicaragua in the course of 1961 and entering into force among these countries in June of the year and ratified by Costa Rica in 1962 subject to a special protocol.

37. The Central American Agreement on Equalization of Import Tariff was negotiated in 1959 following upon the Multilateral Treaty. The essential characteristic of this pact was to provide a list of products for which a common tariff would be immediately applicable and to provide a separate list of products for which a progressive movement toward equalization was to be achieved. Liberalization of intra-trade was provided as soon as the common tariffs came into effect. Ratified by three countries (Guatemala, El Salvador and Nicaragua), its provisions went into effect for this intra-trade in late 1960; Honduras ratified in 1962 and Costa Rica in 1963.

38. The process of tariff equalization and intra-trade liberalization has been almost completed through the adoption of five Protocols to date (Managua, December 1960; San Jose, July 1962; San Salvador, January 1963; Guatemala, August 1964; San Salvador, November 1965). In late 1966, there remained pending only 32 tariff sub-items, mainly: wheat and wheat flour; crude oil and oil products; radio and television sets; passenger cars; refrigerators; and accessories and parts thereof; and special transactions, such as gold, coins, returned articles and bank notes. (See Table 36 in Volume II.) Imports of these goods in 1964 represented 17.7 percent of the region's total imports and 6.5 percent of intra-regional imports. Wheat and wheat flour and oil products accounted for approximately one-half of the total still pending agreement and assembly goods for the other half. Discussions have been in progress on trade liberalization for these items.

39. In relation to the expectations which existed during the period of intensive negotiations on the various instruments of the Common Market (the late 1950's), the pace of achievement has been rather remarkable. This can be seen most clearly if one considers the limited use which has been made of the Agreement on the Regime for Central American Integration Industries which, when negotiated in June 1958, was considered one of the principal policy instruments for the promotion of both the Common Market and the industrial growth of the region. The Agreement has as its purpose the promotion of those industries denominated "integration industries,"

which would require access to the Central American market in order to operate in reasonably economic and competitive conditions since the production of the items is subject to economies of scale. Application to specific plants is achieved through the adoption of individual protocols which determine location, their initial capacity and the conditions under which additional plants in the same industry may be admitted. The protocols also set quality standards, rules relative to the participation of Central American capital, maximum prices, and the level of the common external tariff.

40. The incentives offered to the qualifying plants are the granting of free trade for their output in the region and the external tariff protection, as well as any additional benefits available in the relevant national incentive legislations. It is guaranteed that the uniform tariff on imports of the same or similar products shall not be subject to waivers or reductions, nor imports to preferential exchange rates, except in cases of emergency. But similar products produced by plants not covered by the regime (if they existed) would be eligible for a ten percent annual tariff reduction within the region, ensuring complete liberalization in ten years. Thus, the incentive for the specified plant was in essence free (and favored) access to the Common Market for a stipulated period of time. When in December 1960, the General Treaty was negotiated, there was a sharp change in the conditions. The establishment of complete free trade within the area and a uniform external tariff was a firm commitment which was vigorously implemented in the treaty and subsequent protocols now embracing, as noted earlier, practically all commodities entering trade. Only a few products[1/] are excluded from free trade within the area, in the expectation that these will eventually be subject to an integration industry protocol. Moreover, the San Salvador protocol to the Regime adopted in 1963 made it clear that the granting of integration industry status could not limit or restrict trade taking place under the General Treaty. Thus the number of industries to which integration status could be applied is clearly limited to those currently excluded from the common tariff.

41. Thus far integration industry status has been granted to a tire factory now in operation in Guatemala, a caustic soda-chlorine complex under construction in Nicaragua and a toxaphene (insecticide) plant also under construction in the same country, relying on the chlorine. Both plants are expected to be in operation in 1967. A protocol extending this status to a sheet glass factory in Honduras has been negotiated but has not yet been ratified by all countries. Finally, a draft protocol for a second tire factory in Costa Rica has been prepared but has not yet been acted upon by the Executive Council, although the factory is already under construction.

1/ Other than the petroleum and assembly industries noted earlier.

42. In an effort to formulate a new instrument within the framework of the General Treaty, the San Salvador Protocol to the Integration Industry Regime (1963) also contained a chapter providing a new special system. New industries of particular interest for the region's economic development may be stimulated through a special system for the promotion of productive activities. Tariff increases may be granted through the adoption of new protocols at the request of interested countries if it has been determined that plants existing in the region have a capacity to produce at least 50 percent of the regional demand. Under the provisions of this arrangement, tariff increases have relatively recently gone into effect for electric light bulbs, glass bottles and certain simple agricultural hand tools.

Characteristics of the common tariff

43. While there have been many changes among individual items as a result of the harmonization of national tariffs, the basic structures of the latter continue to be reflected in the common system--high protective rates for consumer goods and their components, generally low rates for raw materials not found in the region and for capital goods. There existed few differences in the structure of output among the countries in the pre-integration period, and consequently only a few differences in the national treatment of certain specific items. Thus the establishment of a regional protective tariff in the latter cases has induced a certain shift from extra-regional sources but it appears that the increases in prices which occurred have been only moderate. For example, in the case of manufactured products of cotton which is one of the major industrial branches in the region, there have been substantial increases in output and demand. For cotton yarns, tariffs were moderate under the national systems and remain so under the common system.

Estimated ad valorem equivalents based on 1964 import unit values

Item	Previous National Tariffs					Common tariff
	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica	
Unbleached cotton yarn	22	16	20	25	20	23
Bleached cotton yarn	20	11	11	24	11	16

Source: Table 6.

Trade liberalization encouraged the shift to regional sources but the total increase in demand was in excess of the region's capacity even though this also rose and imports from third areas expanded:

(in million C.A. pesos)

	1962		1965	
	CACM	Other	CACM	Other
Total imports, cotton yarn	0.9	2.4	2.6	4.4

Source: SIECA Trade Statistics.

44. For cotton cloth, the establishment of a common tariff represented a substantial increase in most of the national tariffs which had prevailed previously; the following table provides a comparison for three major commodities in this group.

Estimated ad valorem equivalents based on 1964 import unit values

Item	Previous National Tariffs					Common tariff
	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica	
652-02-03 Bleached cotton textiles under 80 grams	59	27	28	39	33	63
652-02-04 Bleached cotton textiles over 80 under 150 grams	33	28	28	40	47	64
652-02-05 Bleached cotton textiles over 150 grams	76	34	28	45	60	116

Source: Table 6

In this case, the expansion in local demand could be met largely by increasing local production and under the protection of the common tariff imports from outside the area were reduced while intra-trade expanded considerably.

Importing Countries	(in million C.A. pesos) 1962		1965	
	CACM	Other	CACM	Other
Total	1.1	19.5	5.8	18.6
Guatemala	0.7	3.7	1.9	4.0
El Salvador	0.3	4.0	1.2	3.3
Honduras	0.0	3.8	1.9	2.6
Nicaragua	0.1	4.1	0.5	4.6
Costa Rica	0.0	3.9	0.3	4.1

Source: SIECA Trade Statistics.

But the general competitive situation which has developed in this industry as existing plants throughout the region seek to take advantage of the larger market resulting from integration as well as to expand output to meet the increasing local demand has apparently resulted in limited price increases, if at all. The bulk of trade in cotton products takes place between El Salvador and Guatemala, a trend which had begun during the 1950's. This apparently reflects increasing specialization among the two countries within this commodity category.

45. The benefits from the widening of the market (the trade expansion effect) are most clearly seen in the development of specialization which has occurred among shoes, clothing and processed foods. Production of different items was scattered throughout the region but was limited by the smallness of the national markets. The establishment in individual countries of efficient plants for these products often reflected the unique location of entrepreneurial skills, based at times on factors which are exogenous from the economic point of view: for example, a men's shoe factory in El Salvador, a biscuit bakery in Costa Rica, men's clothing and plastic shoe plants in Honduras, a ladies' shoe factory in Nicaragua and a candy factory in Guatemala.

	Previous National Tariffs 1/					
	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica	Common tariff 1/
053-04-02 Fruit juice	136	33	141	96	201	136
062-01-02 Candy	97	48	74	86	161	125
841-01-02 Stockings, synthetic fibers excluding rayon	134	40	56	55	89	35
841-02-02 Knit underwear, of synthetics	95	18	56	70	63	60
841-02-03 Knit underwear pure or mixed rayon	129	22	56	79	77	74
841-02-05 Knit underwear clothing, pure or mixed cotton	87	29	56	81	64	87
841-03-05 Outer clothing cotton, knit	84	33	56	87	62	143
851-02-02 Shoes, leather	150	74	56	59	78	68
851-03-01 Sport shoes, cloth	133	52	56	122	234	147
851-04-00 Shoes, rubber	400	120	56	73	79	404

1/ Estimated ad valorem equivalents based on 1964 import unit values.

Source: Table 6.

Where there was no production of specific products in one country, the items had to be imported. With high tariffs under the national systems, the relatively high cost of such goods kept imports, as well as consumption, at low levels. The liberalization of intra-trade, moreover, coming at a time of rising personal incomes, permitted access to a wider range of consumption goods and intra-trade in these products rose very sharply (proportionately greater than production or consumption) accounting for practically all of the increase in total imports of the items consumed, in

some cases accompanied by a decline in the region's imports from external sources. All of the examples cited in the previous paragraph had initiated exports to their neighbors in the period prior to integration; once the market opened, they were in excellent positions to expand.

46. A similar situation is found in the cases of wood products (mainly simply elaborated wood for construction) and furniture. These industries, based mainly on local raw materials and high local value added, even in those cases where imports of inputs are important, are not subject to any great extent to economies of scale in production. Possibilities of competition within the region remain and act to promote efficiency.

	Percent increase in value of total imports 1962 to 1965	Share of increase in intra-trade in total increase
Clothing	74.7	95.2
Shoes	234.3	106.6
Processed fruits and vegetables	117.4	67.4
Candy and sugar preparations	125.4	112.0
Wood products	183.5	110.7
Furniture and accessories	126.5	95.9

Source: See Table 5.

Thus, as the region moves to a new stage of industrialization where the new industries are to depend more and more upon imported inputs, because of the narrow raw material base, and will be subject to economies of scale, the role that the existing tariffs will play in ensuring the growth of economic industries and in preventing a misallocation of scarce resources is a critical one. For in these cases the number of plants which the market can support will be small; in many cases only one could produce the entire regional supply and competition within the area to ensure efficiency will not be possible.

47. The present level of tariffs represents the fruit of a rather long, and complicated set of negotiations. Nevertheless, economic conditions change and one can expect growing pressures for various adjustments, as permitted in the various treaties and protocols establishing the Common Market. The SIECA has in fact already received a number of such requests and the Executive Council is to act on these at its forthcoming sessions. While there may be resistance to reopen negotiations so laboriously completed, it is inevitable that this will be done and moreover it is desirable if the region is to continue to grow. The concern over renegotiation can be seen in the recommendations which were made by the Ministers when they met as the Economic Cooperation Committee in Guatemala in January 1966. These called for the establishment of procedures for reviewing petitions for tariff adjustments, including arrangements for holding hearings on these matters. In setting up the ground rules it is vital that agreement be reached on

economic criteria for these adjustments. Where upward revisions are sought, the granting of such requests must be based on the expectation of achieving a cost of production reasonably competitive with world prices within a reasonable time period. Moreover, it is important that explicit recognition be given to the possibility of receiving requests for downward tariff adjustments from other productive sectors which require for their operation access to low cost industrial inputs.

48. At present, changes in tariffs which might provide excessive protection for products produced by one regional plant appear to be limited by the fact that few single plant industries actually exist in the region and the countries individually have been reluctant to permit increases in duties on items in which they have strong interests as consumers. The present controversy over fertilizer production in Costa Rica apparently is an example of this situation. A plant to produce nitric phosphate fertilizers began operating in that country in 1964, based on imported ammonia and phosphate rock and local production of nitric acid. The mission is not in a position to evaluate either the reasons why this plant may operate with high costs of production, or the suitability of the product mix to the needs of the region. But the fact is that its prices have been above those of exporters in other areas. With the common external tariff at only 5 percent, importers in the other four countries have purchased the bulk of their supplies from abroad. Most of the imports are also of a different type than produced at this plant. Thus, the enterprise has been operating well below its capacity[1/] and there are reports that it has applied for an increase in fertilizer tariffs. Opposition to any increase has been expressed in the other countries, since fertilizers represent an important input for commercial agriculture, particularly export crops such as cotton which are experiencing difficulties in world markets. It is therefore essential that in dealing with these types of regional plants, the proposals must be carefully screened in advance to ensure their meeting economic criteria. There is however the possibility that, over time, as the number of products so produced increases, there may be a temptation to engage in log-rolling among the countries for tariff adjustments to protect uneconomic plants.

49. One approach to achieve the objectives indicated would be to entrust all decisions on tariff matters to a technical regional body with the purpose of ensuring that technical and regional interests, rather than national and political, be the dominant criteria. Such an Industrial and Tariff Commission would have authority delegated by the Governments to effect upward and downward tariff adjustments within specified limits and also to decide on the granting of fiscal incentives, at least as they concern tariffs. It is possible, however, that there may be objections at the national level to the delegation of this responsibility to regional officials. In that case it is likely that the body that will be entrusted

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1/ It has been reported that the plant has recently been temporarily closed

with the management of tariff adjustments will be formed by representatives of the five countries. In this connection the Economic Cooperation Committee in January 1966 recommended the creation of a "permanent technical group" made up of the alternate representatives of the Executive Council which would be put in charge of the study and negotiations of matters relating to tariff policy. The recommendations of this group would be given to the Council for necessary action. In such a situation, in order to ensure that technical and economic aspects of tariff matters be given appropriate examination prior to the formulation of recommendations, the staffs of SIECA and ICAITI[1/] should be strengthened to enable them to perform their advisory role properly.

50. It seems likely that in the immediate future the major efforts at revisions in the tariff will be sought through recourse to the Special Regime or Etereo. As described earlier, the criteria for applications for upward tariff revisions under this protocol are that the industry be "new" and "of particular interest" and that installed capacity be enough to satisfy at least 50 percent of the regional demand. The first two expressions are somewhat loose while the capacity requirement has little economic content. It is stipulated that the Executive Council shall maintain vigilance to avoid prices for these products excessively higher than those prevailing in world markets. But there is no mechanism specified to ensure systematic determination or prices and costs. Moreover, there is no mention of time limits on the tariff revisions approved. Thus the need to subject the applications under this protocol to the economic tests (and administrative procedures) suggested in connection with possible renegotiation of the common tariff is even greater. There is a real danger that the Special Regime, by providing the appearance of technical criteria and regional considerations, may become an instrument for the trading of reciprocal concessions among the five countries in the name of regional industrial development without due regard to costs and efficiency considerations.

51. An indication of the trend toward increased tariff protection can be seen in the recent requests which have been received by the Executive Council, seeking direct renegotiation of duties or special protection under "Etereo."[2/] The relative as well as absolute increases in proposed tariff levels are generally substantial. In contrast, the particular common tariff

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1/ The principal organs of the Common Market are described in the main body of the report. ICAITI is a specialized institution which was created in 1955 largely with the support of the United Nations Special Fund. It has in the past tended to concentrate in its work technological aspects but has recently shifted towards consideration of problems of industries economics, i.e., micro-economics. For the functions which are described above, it would be necessary to strengthen further its activities in this latter area.

2/ See documents, SIECA/CE-XXII/D.T.2-A and 2-B, dated June 1966.

increases specified under the original special paragraph of the San Salvador protocol in 1963 were much more moderate, estimated for machetes from 10 to 20 percent ad valorem and for glass bottles from 20 to 40 percent.

Item	Estimated ad valorem equivalents 1/	
	Existing common tariff	Proposed revision
	(in percentages)	
Bicycles and parts	25	80
Paint brushes	18	51
Plastic sheets and shapes	44	99
Fluorescent tubes 2/	38	164
Hydrometers	17	165

1/ Based on import unit values for 1963 or 1964.
2/ Refers to request by El Salvador, for a specific size of tubes.

Source: See statistical appendix, Table 8.

But it should be pointed out that the evaluation of the economic justification for each proposal is complex. No judgments can be made without more careful analysis. Nevertheless, it is important to note this development since cost data and elements for judgment are not always provided in the requests. Thus, the need for specifying economic criteria and for establishing a procedure which will permit these and technical considerations to have a major role in political decisions is of paramount importance at this stage of development of the Common Market.

IV. FISCAL INCENTIVES

Characteristics of the national legislations

52. Each of the five participating governments has in recent years enacted extensive laws for the promotion of industrial development. In Nicaragua and Honduras, the legislation was approved in 1958, in the former case modifying and expanding certain decrees promulgated in 1955 which provided limited incentives for industry. Costa Rica and Guatemala passed these statutes in 1959 while in El Salvador a reform of an industrial incentive law dating from 1952 was approved in 1961. In most instances the broad sweep of the legislation represented a new approach by governments to industrial promotion, establishing for the first time a comprehensive system of incentives and the criteria for their application.

53. While there are a number of significant differences in their content, nevertheless the basic provisions are very similar. This fact and the timing, coming in a period when rapid progress was being achieved in framing the basic instruments of economic integration, suggest that each country viewed the establishment of the Common Market as a unique opportunity to re-orient industrial growth and believed that it was possible to capitalize on the new situation by providing incentives which would affect the relative profitability of industry and so attract resources to it. The stated objectives of the national laws are rather diverse but essentially are aimed at increasing the pace of industrial growth which is considered necessary for the raising of national incomes. In a similar vein industrialization is viewed as the main solution to the problems of both unemployment and underemployment which characterize the region.

54. There are basically three types of incentives which are granted to the qualifying enterprises for specified periods under these laws--exemption from income and other taxes, exemptions from tariffs on imported raw materials and capital equipment, and access to tariff protection for the finished product. Since the latter is now subject to a regional agreement, differences in national treatment in this regard have been reduced to a small number of items. The extent of the exonerations on tariffs and taxes, as well as the time period for which they are granted, are fixed in accordance with certain categories of industries which are established under each of the national laws. In all countries industries qualify for benefits dependent upon whether the industry is new (beginning) or existing; in addition economic characteristics are considered in establishing the categories in three of the countries. For illustrative purposes, a summary has been prepared indicating the incentives which are granted to enterprises qualifying for maximum benefits under individual national laws. These

generally include complete or almost complete exoneration from customs duties on imports of capital equipment and raw material needs for up to 10 years plus total exemption from income taxes for five years with partial exemption for an additional five (See Table 11.)

55. With regard to the benefits, the national legislations generally grant almost complete exonerations from duties on imported raw materials and capital equipment for a period of 5 or 10 years, depending upon the particular categories. Less sweeping exonerations are granted for income and related taxes, generally not exceeding five years; for the lower priority enterprises these exemptions are granted for as little as two or three years and may also be limited to 50 percent of the applicable tax rate.

CLASSIFICATION OF INDUSTRIAL ENTERPRISES UNDER INVESTMENT INCENTIVE LAWS

Costa Rica	Guatemala	El Salvador	Nicaragua	Honduras
New	New	Beginning	New	New
		necessary convenient	fundamental necessary convenient	basic necessary convenient
Established	Existing	Expanding	Former	Established
		necessary convenient	fundamental necessary convenient	basic necessary convenient

Source: Texts of national laws or decrees.

56. Maximum benefits under their respective laws are granted in Guatemela and Costa Rica to "new" industries. These are defined in the case of Guatemala as "those devoted to the manufacture of goods not currently produced in the country as long as they are not simple variants or mere substitutions for goods already been produced...;" "those whose purpose is the manufacture of goods which are being produced in the country by inefficient methods and in quantities which are insufficient to satisfy domestic consumption requirements, provided that the deficit is considerable and does not arise from transitory causes ...;" "those devoted to the provision of non-existing or neglected services which provide a net benefit to the domestic economy or to the population."1/ In Costa Rica, new

1/ See Article 5, Industrial Development Law, published by the Centro de Desarrollo y Productividad Industrial, Guatemala City (no date).

industries are simply defined as those which will manufacture products not produced in the country or, if produced, account for less than 10 percent of national consumption. Less liberal benefits are provided in both countries to industries classified as existing or established.

57. Maximum benefits in El Salvador are granted to those industries which are both "beginning" and "necessary," the latter term defined as "those concerned with the production of goods designed to satisfy the basic needs of the population such as food, health, shelter and the like." Slightly modified and less liberal exemptions are granted to convenient industries, "those concerned with the production of goods which although not designed to satisfy essential needs are useful and of economic importance to the country." The classification of "beginning" industry may also be granted in this country to "existing industries which may change their structure by the introduction of modern machinery, equipment process and production techniques and procedures, so that their fundamental character is changed."1/

58. With regard to economic characteristics, the laws of Honduras and Nicaragua differentiate as between "fundamental (basic)," "necessary" and "convenient." In the case of Nicaragua, the determination of the specific economic category is to be made in accordance with "their importance to the national economy" taking into account certain factors. Among these are included:

1. contribution to national income and distribution among various factors of production;
2. advantages to consumers;
3. quality and amount of labor needed;
4. capacity and efficiency of equipment and amount of investment;
5. value and quantity of domestic raw materials consumed;
6. need and use for the product;
7. income or saving of foreign currency.2/

In Honduras, the law lists fourteen criteria (including most of those cited above) which are to be considered in granting status to the applying enterprise.

59. This review, by nature partial, nevertheless points up the vagueness of the criteria which are being used and the fact that the specific advantages to be granted to any enterprise is largely dependent upon the

1/ All quotes taken from the pamphlet issued by INSAFI, Information for Industrialists and Investors (San Salvador, no date) pp. 23-25.

2/ See Nicaragua Laws on Foreign Investment and for the Protection and Promotion of Industrial Development, Nicaragua Industrial Promotion Office (New York, no date).

discretion of the body responsible for administration of the laws. Not only is it possible for similar manufacturing activities to receive different treatment within a single country, but there may be differences in the benefits which individual countries grant to a particular enterprise. The possibility that competition for plants may arise within the Common Market area is, moreover, explicitly recognized in certain of the national legislation. Guatemala, for example, provides that import duties as well as other provisions of the law may be revised at the request of any industry whose competitive position is adversely affected either as a result of higher import duties or because of less liberal provisions as regards tax and tariff exonerations than those in existence in another Central American country. A recent revision of the Honduran regulations also specifies that a local enterprise can receive additional benefits if it can show that a similar enterprise in another Central American country is receiving larger exemptions.

Factors affecting growth in use of incentives

60. It would appear that there has been considerable recourse to the benefits of the law by individual enterprises in most of the countries. For example, in Costa Rica the following data indicate the numbers of enterprises which received classification and corresponding benefits in the years since the inception of the law:

1960	1961	1962	1963	1964	1965	Total
8	33	47	76	108	97	369

Moreover, in the period January through May 1966, there were 90 enterprises which received benefits, although some of these may have represented modification of existing agreements.1/ In Honduras, in the period from December 1959 when the law came into effect until May 1966, 158 enterprises had been granted classification. In the calendar year 1965 alone, 45 were granted while from January 1, 1966 to May 17, 1966, 28 industries received classification for benefits.

61. However, it is not known how many of these particular enterprises are actually producing. In the case of Guatemala, of over 700 enterprises classified for benefits as of the beginning of 1966, only 350 were in operation at that time. In Nicaragua, 512 enterprises were registered under the incentive law as of July 1965; the great majority of these are registered in Managua. However, according to a special tabulation of the Planning Office only 209 classified plants were actually operating in that city on

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1/ Major revisions have recently been proposed for the Costa Rican law with a view to tightening its provisions. The recent upsurge of applications may therefore reflect a rush to take advantage of the present situation.

the indicated date. In part, the excess of applicants over actual producing enterprises is explained by the tendency for entrepreneurs to seek classification in various countries, so as to identify the Government granting most benefits in those instances where location is not a major problem. In other cases, status as a classified enterprise may be sought before a project is fully developed in order to preempt the product.

62. While the above rate of growth of industries receiving benefits of the laws may not have risen as much as the data would suggest, there is still a substantial number of new firms which each year actually utilize the benefits. In the first place, there appears to have been a general improvement in purely administrative procedures associated with the processing of the necessary applications. Secondly, in a number of instances in certain countries, the recent steps at equalization of import duties had significantly changed tariff levels as regards imports of important inputs from outside the area so that enterprises sought classification to avoid the new tariffs on these inputs. One of the most important elements, however, is apparently the prevailing pattern of business or corporate taxation. Four countries (Costa Rica, Guatemala, Honduras and Nicaragua) have a system of taxation on "juridical persons" similar to that on individuals, involving a progressive schedule of rates. Under this situation large enterprises which by their size may be expected to earn relatively large gross profits before taxes are subject to high marginal rates. With the growth of modern industry there has been a tendency to establish larger-size firms. Since the current tax system in these countries is a dis-incentive to the creation of such enterprises, these firms have obviously taken advantage of the possibility to obtain exoneration under the investment law.

STRUCTURE OF INCOME TAXES

	Costa Rica	Guatemala	Honduras	Nicaragua
Minimum rate (in percent)	1.0	5.0	3.0	4.0
on taxable income under (in C.A. pesos)	450	1,000	2,500	5,700 (approx.)
number of intermediate rates	28	65	7	22
Maximum marginal rate (in percent)	30.0	48.0	40.0	30.0
on taxable income in excess of (in C.A. pesos)	75,000	500,000	500,000	285,000 (approx.)

63. In the case of El Salvador, business income is subject to a proportionate tax, with four tranches, as follows:

	Taxable income (C.A. pesos)	Marginal rate (percent)
up to:	4,000	2.5
	4,000 to 10,000	5.0
	10,000 to 40,000	10.0
	40,000 and above	15.0

Nevertheless, even in this country, as indicated earlier, the number of enterprises which have applied for benefits under the existing laws is rather large. For El Salvador, the data are as follows:

Old legislation	Current legislation 1/				
1959-61	1962	1963	1964	1965	Total
250	98	107	187	88	471

1/ It is not clear from the information available if the acceleration in classifications granted in 1964 reflects attempts by enterprises classified under the previous law to obtain the new and wider benefits provided by the current legislation.

The rates of taxation suggest, however, that the income tax exemption could have been a major factor influencing investment decisions in few cases. With one exception, none of the countries have recorded the value of the exemptions from the income and related taxes which are granted through this law. For Costa Rica, estimates for 1965 indicate that these have amounted to 25 million colones, or 23 percent of total direct revenues, increasing from some 18 million or 17 percent in 1964.

64. The importance of exonerations from import duties on imported inputs and capital goods, depends upon the existing level of tariffs. In general, import duties on machinery and equipment have been low both under previous national regimes and the current common tariff. This is to be expected since the region does not produce these items. With regard to imported inputs, raw materials not found in the region are also generally subject to low or zero tariffs. For finished consumer goods, both the final product and the intermediate inputs used in their production are subject to relatively high tariffs. In this situation, exoneration from tariffs on the intermediate product can be an important element in decisions to invest in plants producing these types of commodities.

65. A numerical example, based on an actual situation observed in the region, may serve to illustrate the point. A certain product may be imported in finished form at $120 per unit. The intermediate products used for this commodity can be imported for $100. The simple transformation process necessary to produce the final item will involve local expenditure on energy, other inputs, and wages and salaries amounting to less than $30. The final product is subject to a tariff of 25 percent while the inputs, before exoneration, were also subject to 25 percent. Under these conditions the local product costing $155 is unable to compete with imports selling at $150. With exemption from duty on imported inputs, however, the processor could easily compete and could sell his product at $130 (not much above the import price less tariff) with a reasonable level of profit. Generally, however, the producer will price his item to meet existing competition. If imports are his only competition, since the import price plus tariff is $150, the locally "produced" item may be priced close to that figure, yielding a considerable additional profit.

66. This type of situation has been found to exist among the cosmetics, toiletries and related preparations, paints and other chemical mixtures and simple products from plastic extrusion, as well as among certain simple metal products. These items were cited earlier as among the group for which the growth in intra-trade has represented a major share of output. Generally speaking, plants producing these products from imported intermediate goods have low capital requirements, are not subject to substantial economies of scale, are simple both to design and to operate and the manufacturing facilities can be constructed and put in operation quickly. Thus, given variations and vagueness among the countries in the criteria for the extension of benefits under incentive legislation and given the common external tariff with free access to the entire regional market, prospective investors will seek to locate where the maximum benefits, primarily associated with exoneration from import duties, will be granted.

67. There are, however, certain economic implications which need to be evaluated in considering the future usefulness of this type of incentive policy. If entry is as relatively easy as indicated, then competition will emerge over time and will tend to reduce prices. This competition could be either local or located in another CACM country. In fact, in a number of Central American countries the prices of the toiletries appear to be not out of line with prices for similar brands in the United States. There is some presumption therefore that in the case of these products there has been, as one result of incentive competition, an intensive brand competition among brand names associated with foreign enterprises. On the other hand, luxury items which have been subject to high tariffs in order to ease their impact on the balance of payments or to yield fiscal revenues are now available for consumption at prices to the final consumer below that which prevailed in the past. Price and brand competition in effect may have led to both a substantial increase in imports of the necessary intermediate goods and a loss in government revenue. While trade data for these items indicated a reduction in imports from outside the area, the total import was probably

larger since many component elements or compounds and packaging materials were imported, the values being recorded among other categories of imports and not separately identifiable. Nevertheless, the fact is that, given the narrow raw material base, the establishment of new industries in the region will depend to an increasing extent on imports of intermediate goods. 1/ If incentives are to be used, then clearly they should be granted with a fuller recognition of the balance of payments and other implications than has been the case up to now.

68. As regards the impact of the tariff exonerations on government revenue, the issue is somewhat more complex. There is, first of all, the presumption that, without the import duty exemption, some of the products would not have been imported. Moreover, this legislation is only one of the many policy measures the Central American governments have taken to provide such exemptions, not the least important of which is the establishment of a common market itself. Thus, while tariff policy is increasingly being formulated for developmental purposes rather than for revenue, it has become even more important to guard against unnecessarily giving up those portions which can yield revenue. At present, the tariff exemptions represent a significant percentage of actual total tariff revenue in Costa Rica and El Salvador and to a lesser extent in Nicaragua:

	In million CA pesos		
	(1) Actual tariff receipts, 1965	(2) Tariff exonerations under industrial incentive laws, 1965	(2) as a percent of (1)
Guatemala	30.9	5.7	18
El Salvador	25.1	8.0	32
Honduras	20.6	2.5	12
Nicaragua	24.2	7.1	29
Costa Rica	31.9	9.9	31

It is therefore significant that Costa Rica in mid-1964 began to impose sales taxes on many of the final products the production of which had been encouraged by the incentive laws. These items include automobiles (imposed in June 1964) 2/, television sets (July 1964), radios (May 1965)

1/ As the market grows for many of these inputs, local production from imported raw materials will be increasingly possible in the longer run.

2/ There are four automobile assembly installations in Costa Rica, with a total capacity to assemble 25 cars per day on the basis of completely imported parts.

detergents (May 1965) and cosmetics (December 1964). For the other countries sales taxes are not possible since exonerations from these levies are included in their incentive laws.[1] The total yield from these taxes in 1965 was 18 million colones (or 2.7 million C.A. pesos). Originally imposed to offset the loss of tariff revenues, these taxes are to be continued and may be extended to other products as a means of reducing imports which have risen sharply in recent years.

Problem of duplication of investment: impact of national competition

69. Another harmful effect of the current competition among the countries for industries which has been cited on numerous occasions is the apparent tendency to encourage duplication of investment for the production of various commodities. The problem of duplication--or more precisely speaking in these circumstances, the establishment of excess capacity for producing any product as a result of investment in two or more competing plants in two or more of the Central American countries--is a difficult one to deal with in free enterprise economies. This prospect is after all one of the essential elements of the competitive system whose advantages are expected to outweigh the disadvantages. Underdeveloped countries which are characterized by a shortage of capital resources must be particularly careful to avoid policies which would encourage capital waste. In smaller countries or regions such as Central America the limited markets for many commodities, particularly in the category of the intermediate goods, and the constraints imposed by the current state of technology for these products would tend to restrict the number of plants which one would expect for the items concerned.

70. It is therefore necessary to adopt a purely pragmatic approach and to determine if there exists any evidence that there has actually taken place over-investment among the Central American countries in specific products which is attributable to this competition in granting incentives. One of the main policy instruments designed to avoid investment duplication is the integration industry regime described earlier. A number of intermediate goods industries have benefited in one way or another from this treaty and its protocols and their location has been subject to regional decisions. If the region were to be considered as one political unit, it could be expected that normal market forces would operate such that, as demand for various products particularly the intermediate, increased, potential investors would select these items for production and would locate their plants and select their size in accordance with general economic criteria. The fact that there exists five political units with uncertainty as to the granting of incentives suggests that investors will be reluctant to operate in this "normal" fashion. While the usual economic criteria would tend to narrow the choice of location, potential investors in any one enterprise must be wary of special incentives which could be granted to competitors to locate their installations in another country and this has undoubtedly caused some hesitation over investment decisions.

1/ See Table 9.

71. At the present time it appears possible to single out only the case of petroleum refineries as an example of an industrial branch whose structure has been severely affected under existing national competition. Small refineries have been established and are operating in three of the countries (two in Guatemala, one each in El Salvador and Nicaragua); another small installation has been constructed in Costa Rica but is not yet operating (as of the visit of the mission in June 1966), while the preliminary work for a small project in Honduras is now being undertaken. These plants are essentially designed to satisfy local demand, although some intra-regional trade has taken place as a result of special situations at various points of time. It is significant to note in this context that refined petroleum products are among the few items for which no agreement has yet been reached on liberalization of intra-trade. The mission is not able to appraise the exact economic situation of each of these facilities. Nevertheless in terms of the general experience with large-scale, low-cost refineries in other areas of the world, these must be considered as high-cost producers, even if special design features have been incorporated to lower to some extent unit costs. In terms of total demand of the region, one large-scale refinery might be adequate but transport costs for the products--even from a reasonably central location--to the main consuming areas would possibly justify the establishment of two smaller installations (still considerably larger than any of the present ones) which would be located somewhere near the northern and southern population centers. Moreover the existing small plants make more difficult the possibilities of establishing viable petro-chemical complexes based on by-products since these facilities do not produce sufficient quantities. There are proposals for linking the establishment of petro-chemical industries to existing refineries but the raw material requirements will have to be met through high-cost imports to supplement the limited supplies which are available but which are now being wasted.

72. While the desire of each of the five governments to have a refinery located within its boundaries has played a fundamental role in this development, it must be recognized that the different foreign oil companies undertook the investment involved with a view to insure their continuing presence and operations in the area. There is a presumption that the burden of the direct loss which has resulted from the existence of high-cost production has been borne by government revenues, since there is no evidence of any increased cost of these products to consumers. The matter is difficult to identify, however, since the revenues before the installation of the refineries were based on tariffs on imported refined products but are based now on sales taxes of such items.

73. The fears of excessive investment in production facilities were largely derived from the preparations which were undertaken by each government beginning in 1962 of national economic development plans, in particular those sections dealing with industry, and the discussions surrounding their implementation. These documents represent, however, a compromise of

economic and political considerations while the project inventories which are the main elements in the industrial plans generally failed to take into account the very different stages of development or possibilities of the projects concerned. Many proved to be dependent upon further technical, economic and financial analysis. Moreover, there have been a number of rather important changes in general economic conditions since the major portion of the work on the plans were completed, particularly the growth in export incomes.

74. The industrial branches in which the national investment programs indicated the greatest possibilities as regards over-expansion are textiles, chemicals and pulp and paper products. As regards textiles, it was noted earlier that with the recent growth in incomes, demand has risen sharply, production of cotton textiles in particular has grown rapidly and continued prospects exist for growth. One of the major fears as regards duplication arose from the existence of project proposals which had been prepared for artificial fibers and fabrics. As of the time of the visit to the region of the Bank mission, these projects were still in the discussion stages with many details left to be worked out. Financing remained one of the major areas of uncertainty since the sizes of these proposals were relatively large and external financing or credit from the Central American Bank was essential for eventual implementation.1/ In the case of chemicals as noted earlier, two projects (caustic soda-chlorine and toxaphene) have been granted integration industry status and are under construction while various small plastic plants have been established primarily based on imported materials. A number of proposals for producing the latter items as well as for producing poly-vinyl-chlorides are in the same stage as the artificial fiber projects mentioned above. Finally the pulp and paper situation has undergone a radical change in the past few years as a result of the expansion of banana exports and their transport in cardboard boxes with the consequent growth of demand for liner and corrugated medium. The implications of this development, in particular the possibility that more than one large plant in this area will be required in the next five to ten years, is discussed in more detail in the special appendix to the report of the mission dealing with forest products. Thus at this stage of the development of integration some four years after the establishment of the Common Market, one is led to the conclusion that uncertainty resulting from the existence of national competition in the granting of incentives has tended more to hinder new investment than to encourage duplication. Once this uncertainty is removed, it can be expected that investment will flow more freely to the industries requiring larger-scale operations. For these particular products, as noted earlier, regional demand will be met to an increasing extent by one plant, or possibly two.

1/ One must also note that there is still no final agreement on tariff equalization for many of the textiles with artificial fiber content.

The major issue therefore is the adoption of policies which would provide the necessary elements of control over the monopolistic situation which results from the establishment of but one plant as well as any oligopolistic tendencies where two or three plants may act jointly to reduce competition. It is hardly necessary, nor would it be particularly useful to review in this report, the theoretical, economic or legal issues which exist relating to control of industrial competition and pricing. If only because of the administrative burden, direct control over prices or profits of such industries would not be desirable.[1/] To introduce the degree of competition which is desired to insure that price policies of the firms are in agreement with general economic criteria, the main instrument which could be used would be tariff policy as discussed earlier.

Common Agreement on Fiscal Incentives: main characteristics and appraisal

75. In an effort to reduce the competition which has arisen from the differences in the content and administration of national incentive legislation, a treaty to establish a common agreement was signed in 1963. It has been ratified by all countries except Honduras and as a consequence is not in force. At the Economic Committee meeting in Guatemala in January 1966, the Honduran government announced that its ratification would be dependent upon the adoption of changes which would provide it with preferential treatment. A protocol providing greater benefits for Honduras was adopted at the Ministers' meeting in Managua in September 1966. Once this protocol has been ratified by the other four member governments, it is expected that the Honduran government will deposit its ratification to both the original agreement and the revision. However, in view of the fact that two of the countries are to hold presidential elections in early 1967, it is not likely that the agreement will be in force until late in that year.

76. The agreement authorizes specific percentages of exonerations for specified time periods for: a) customs duties on imports of machinery and equipment, raw materials, semi-processed products, containers and fuel for industry (excluding gasoline); b) income and profit taxes; and c) taxes on assets and property. Maximum benefits are provided to those industries that produce industrial raw materials or capital goods, or produce consumer goods, containers or semi-manufactures containing at least 50 percent of materials of Central American origin (Group A). These benefits include 80 percent exoneration of duties on imported raw materials (100 percent for Honduras) for five years and 100 percent exoneration of income taxes for six years (8 years for Honduras). A second group of enterprises which receives somewhat reduced benefits is composed of those producing consumer goods, containers or semi-manufactures which make a significant net contribution to the balance of payments and have a high value added

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1/ Although under the integration regime maximum prices and other conditions of production are established for the products of integration plants, the procedure involved in defining these elements and in preparing the necessary legal protocol has tended to be an elaborate and overly time-consuming one.

even if they use a high proportion, in value terms, of raw materials, containers or semi-manufactures produced outside the region (Group B). Among the benefits granted are 80 percent exemption from customs duties on imported raw materials for three years (100 percent for Honduras) and 100 percent exemption from income taxes for four years (six years for Honduras). A third group (Group C) is made up of all industries other than those qualifying under Groups A and B, and which solely assemble, wrap, cut or dissolve products or are among those specifically identified in an annex to the agreement (non-alcoholic drinks, wines, manufactured tobacco and toiletries). The benefits granted to these industries involve only an exemption on duties on capital equipment imports, five years for Honduras and three years for the other countries. The distinction between new and established industries which characterized the national legislation is retained but the only difference in benefits is to make the time periods for the exonerations somewhat shorter for existing industries classified under the first two groups. The preferences provided to Honduras consist of a longer period for the exonerations on import duties for machinery and equipment, on income and property taxes and taxes on property for industries classified as either "new" or "existing" under Group A and B, and "new" under Group C. Moreover, a higher rate of exemption from customs duties on imported raw materials, semi-manufactures or containers is authorized for "new" industries under both Groups A and B. These preferences are to expire 10 years after entry into force of the protocol.

77. There is some reduction in the extent of the exonerations granted under the common agreement as compared to those prevailing under national legislation. The major improvement, however, is in making more specific the criteria for granting maximum benefits; in other words many industries qualifying for most favorable treatment under national systems could only qualify for Group B under the regional accord. The agreement thus represents an attempt to make more specific the criteria and to make them rest on economic characteristics. There is, nevertheless, the problem of quantifying the criteria for industries in Group B--those which "make a significant net contribution to the balance of payments." The real problem, however, is not so much the criteria as the way in which these are to be administered, just as the difficulties over the national laws lie in great part in their administration. The administration of the agreement is to be a national responsibility during the first seven years following its entering into force. Thus, the essential question of classification is left to the individual countries for this period. Only on representation from countries can the regional organization make decisions on classification. Under these circumstances a solution to the basic problem of competition is largely postponed. In the absence of more fundamental changes in the agreement, a minimum requirement to achieve a rational solution for the region (and to avoid the problem of uncertainty stressed earlier)is the shortening of the period of transition to obtain as soon as possible the administration of the incentives by a strong central body.

Moreover, there is a need to define more specifically the criteria relating to industries under Group B.

78. The difficulties which have been experienced under the national laws, as regards impact on balance of payments and loss of fiscal revenues, are not likely to be avoided under the Common Agreement. At the September 1966 meeting of ministers, concern was expressed on these problems and SIECA was requested to study the entire matter of policies on fiscal incentives which might involve the preparation of a new draft agreement as well as mechanisms in this field. The analysis should identify in more detail the precise nature of the incentives which are actually offered to enterprises. On the basis of the limited study which the mission was able to undertake, the present progressive tax rate structure in four countries is an obvious dis-incentive to modern industry. An OAS/BID tax mission has recommended that this be replaced by a proportional tax system linked to a system of accelerated depreciation allowances. Another reform in incentive legislation which has been proposed after analysis of the effectiveness of these measures in various parts of the world is to eliminate tariff exemptions for specific enterprises and to replace them with a general tariff policy on products based on developmental needs. The general approach to such a policy has already been presented in the previous section which dealt with tariffs. One of the arguments which has been presented in support of this approach is that it would eliminate those instances of abuse of the law in which classified enterprises have imported, under their benefits, both equipment and intermediate goods which were sold at substantial profit to other users. Given the problem of adequate administration of the existing legislation in Central America, concern has been expressed that such abuses are current in the region.

V. INVESTMENT REQUIREMENTS AND SOURCES OF FINANCE

A. Investment Trends

79. Long-term capital requirements for the expansion in industrial output between 1962 and 1965 were relatively moderate in relation to the growth in production. At the beginning of the period, there was considerable underutilized capacity reflecting the general relatively low level of economic activity. A survey conducted by the Joint Planning Mission in the course of 1962 indicates the following rates of utilization of capacity as estimated by individual enterprises:

	(Percentages)
Guatemala	74
El Salvador	73
Honduras	63
Nicaragua	82
Costa Rica	72

80. In the absence of official data, estimates of gross fixed capital formation in the manufacturing sector of the region have been made by the Mission on the basis of imports of industrial equipment. The trade classification used in the region permits the identification of certain equipment which is special purpose, i.e. designed for use in specific industries.1/ In addition, however, industries use multi-purpose equipment such as conveyer belts, electric controls and pumps; since this equipment is used in construction and for services it is not possible to identify that share of imports which is used for manufacturing only. Special purpose equipment has been found to account generally for some 80 percent of industrial equipment needs while machinery in general accounts for some 50 percent of total fixed investment in manufacturing.2/ On this basis, it may be estimated that gross fixed capital formation in the sector in the region amounted to some 65 million C.A. pesos in 1962, 70 million in 1963, 95 million in 1964 and 100 million in 1965.

1/ The table excludes equipment for petroleum refining.

2/ These ratios obviously vary from branch to branch. For a detailed description of the basis for these calculations, see United Nations, Bulletin on Industrialization and Productivity, No. 7 (1964), "Projection of Demand for Industrial Equipment".

CENTRAL AMERICA: IMPORTS OF INDUSTRIAL EQUIPMENT BY MAJOR BRANCHES
(In millions of C.A. pesos)

	1962	1963	1964	1965
Total	24.5	28.4	38.0	39.6
Textile industry	4.4	5.8	8.3	9.8
Food processing	5.9	6.2	10.1	7.0
Printing industry	1.3	2.0	2.6	2.7
Sewing machines 1/	3.8	1.9	2.3	3.6
Leather and shoes	0.5	0.6	0.9	1.0
Machinery for metal working	1.5	2.7	2.8	5.1
Others	7.1	9.2	11.0	10.4

1/ Including those for household use.

81. The rise in investment after 1963 indicates the need to add at a more rapid rate to productive facilities as demand continued to expand. The non-traditional industries (that is, other than food, textiles, clothing and shoes) which have accounted for no more than 25 percent of output have a larger share in gross investment particularly in most recent years, reflecting the construction of a number of new plants in these branches, most of which were not yet operating in 1965 or were just beginning operations. There were indications in some instances that at the time of the visit of the mission to the region (April-June 1966) the rate of utilization of available capacity was still below the level which individual enterprises considered as reasonably full. The difficulties in raising output were principally connected with production and organization, rather than with any deficiency in demand. In particular, some enterprises were having difficulties in obtaining adequate supplies (particularly those of local origin) of raw materials of appropriate quality while others were experiencing shortages in supervisory personnel preventing full use of three or even two shifts.

IMPORTS OF INDUSTRIAL EQUIPMENT BY COUNTRIES
(Millions of C.A. pesos)

	1962	1963	1964	1965
Guatemala	8.3	7.9	10.1	9.9
El Salvador	4.9	4.8	11.4	11.3
Honduras	2.9	3.8	5.1	4.4
Nicaragua	3.2	6.0	5.2	6.2
Costa Rica	5.2	5.8	5.1	7.4

The rate of investment has expanded most in El Salvador embracing a number of the newer industries such as metalworking and chemical industries, as well as textiles. Guatemala has also experienced a substantial rise in similar industries.

B. The Changing Pattern of Industrial Finance

82. In the past, long-term capital for industry was obtained largely from savings of existing enterprises themselves or directly from the resources of the owners. During periods of good export earnings, some of the profits from the agricultural sector found their way into industry either through personal lending in which the security of the individual borrower was essentially pledged rather than that of the enterprise or through an occasional direct participation by landholding interests in industrial ventures. Since many industries were originated by commercial interest, profits from this sector also provided some of the original stimulus to growth of manufacturing. The activities of financial intermediaries in the field of industry were of limited importance. Commercial banks, generally restricting their lending to a maximum of three years and usually less, basically supplied working capital for manufacturing enterprises. While a number of local banking institutions were well developed, they concentrated in agriculture, exports and commercial activities, such as the financing of imports. The few long-term lending institutions which existed in some countries (e.g. Guatemala and El Salvador) concentrated on mortgages for real estate.

83. Modern industry is characterized by generally larger size establishments as well as complexity in management and operation. Thus, it requires the establishment of a more diversified pattern in the origin of its financial resources as well as in its financial structure. While the pace of change has varied from country to country in recent years, there has been a considerable adaptation in the region with a growth in the number of financial intermediaries and of modern forms of business organization to meet the new and increasing financial needs. In part, this has stemmed from an historical development as local entrepreneurs strained to meet the financing needs for expansion or for establishment of the new larger enterprises. An additional element of flexible financing has been the growth of the joint venture in which local and foreign interests share in various proportions the equity as well as other investment. Finally, the increased activity in the industrial sphere of the official regional and the external financial agencies (beginning with the first IBRD loan for industrial equipment to the Central Bank of Costa Rica in 1956) has encouraged either directly or indirectly the utilization of the newer types of corporate organization, in some instances promoting directly the establishment of financial intermediaries previously lacking in the region. However, the creation of true national capital markets is still far from achievement. While there is evidence of some capital flows among the countries, a regional capital market is also far from being established.

The Growth and Diversification of Local Financing Institutions

84. While commercial banks have doubled and tripled their lending to industry since 1961, the character of this activity has changed little. The banks continue to limit their loans generally to a maximum of three years, but most bankers interviewed by the mission indicated that the overwhelming majority of loans are for less than 18 months. While there

doubtless are many cases in which the loans are "rolled over" by agreement so as to provide long-term financing, the major portion of commercial banking operations are clearly designed to meet working capital needs. In some instances this has freed other financial resources available to individual enterprises for use for longer-term investment. In general, however, there has been a very rapid increase in working capital requirements, and this indirect financing of long-term capital needs does not appear to have been an important source of funds in recent years.

85. The commercial banks are reluctant--even where permitted by law--to commit their own capital resources, much less their deposits, to longer-term and consequently more risky financial operations[1/] in comparison to short-term ones. Thus, with the rapid growth of economic activity in recent years accompanied by a substantial increase in the demand for funds, there have been no shortages in opportunities to lend at short term. In practically all the countries there exist ceilings on the rate of interest which banks may charge (of the order of 9 percent) and in the absence of differential rates they choose the safest forms of lending. The lack of facilities for rediscounting or generally marketing longer-term paper has also restrained their willingness to accept such paper. Numerous structural differences exist among the national banking systems in respect to these various factors, affecting the long-term credit market but it is beyond the scope of the present report to deal in detail with these aspects.

86. Of particular importance is the development of national specialized financial institutions both public and private which has characterized this period. To a considerable extent, external assistance either from international financial agencies or bilateral aid programs has been the principal factor in bringing this about. While there has been some direct financing of industrial enterprises, these external funds are increasingly being channelled to manufacturing through the national institutions.

87. Loans from the IBRD to the Banco Central de Costa Rica for relending through the commercial banks began in 1956. The Inter-American Development Bank (IDB) has made loans to two autonomous development institutions in El Salvador (Instituto Salvadoreno de Fomento Industrial or INSAFI) and in Nicaragua (Instituto de Fomento Nacional or INFONAC) as well as to publicly owned banking institutions in Honduras (Banco Nacional de Fomento) and in Costa Rica (Banco de Costa Rica). These funds are loaned directly to enterprises by the institutions involved.

88. Loans from the Agency for International Development (AID) have also been made to INSAFI and INFONAC. In addition, the AID undertook in late 1963 a program to assist in the creation of private investment

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1/ Data available in the case of Guatemala, for example, indicate some increase in longer-term lending to industry, but these are generally mortgages against real estate and buildings.

companies (financieras) in the different countries of the region. These institutions can provide both longer-term credit and equity capital to the private sector, particularly in the productive areas.

89. Financieras have been established in all countries but Guatemala and discussions are continuing as regards the possibility of creating a comparable institution in that country. External assistance from AID has taken the same form for these existing institutions and with similar terms except in the case of Nicaragua. A first loan was made a low interest rates (generally 2 percent) with the provision that local equity capital would have to be raised equivalent to 20 percent of the loan. Negotiations are now underway or have been completed for second loans to some of the financieras at a somewhat higher rate of interest, but requiring that the new loans be matched with local equity equivalent to one-third. The institutions so aided are as follows: Financiera Hondurena; Corporacion Nicaraguense de Inversiones (CNI), Corporacion Costarricense de Financiamiento Industrial (COFISA); and Financiera de Desarrollo e Inversion (El Salvador, FISA).

90. The rate of disbursements of these external loans rose considerably in 1965 and is expected to remain at high levels under existing commitments.

DISBURSEMENTS BY EXTERNAL FINANCIAL AGENCIES OF LOANS TO INDUSTRY CHANNELLED THROUGH NATIONAL INSTITUTIONS
(Millions of C.A. pesos or U.S. dollars)

Agency	1962	1963	1964	1965
Total	1.3	2.3	2.7	8.4
IBRD	0.9	1.4	0.6	0.8
IDB	0.4	0.9	1.0	2.6
AID - public	-	-	0.3	1.1
private	-	-	0.8	3.9

Source: Table 13.

Most of the financial assistance is earmarked for small and medium size enterprise. In addition, the loans usually cover both industry and agriculture; the data presented in this section refer only to credit to the industrial sector.

CABEI

91. Industrial lending to the private sector[1/] from the Central American Bank for Economic Integration amounted, as of mid-1966, to 32 million C.A. pesos, of which approximately 20 million pesos had been

1/ Loans to the public sector, for industry, approximately $1 million, have been primarily for the purpose of pre-investment studies and have been financed through and AID grant for this purpose.

disbursed. The main sources of these funds have been AID and BID, but in addition, CABEI received a loan from the Bank of Mexico at the end of 1965. The balance of its loan commitments to industry (10 million C.A. pesos) was financed from its own sources. The AID loan not yet fully committed carries the provision that it must be spent on goods of U.S. origin.

(As of May 31, 1966)

	Amount of Loan	Committed to Industry	Date of Loan
	(In million CA Pesos)		
AID	10.0	2.2	1964
	5.0	5.0	1962
IDB	5.7	5.7	1963
	8.1	8.1	1964
Sub-Total	28.8	21.0	
Bank of Mexico	5.0	0.7	1965
Total	29.3	21.7	

92. The lending authority of CABEI as regards industry has been interpreted rather broadly since its establishment in 1961; credits have been given to hotels in two of the capital cities as well as to major industrial projects such as the cement plants in Honduras and El Salvador and textile plants in most of the countries. The terms of its loans are relatively liberal; up to mid-1966 long-term credit to industry was available at 7 percent, but after that the rate was increased to 9 percent. While the Bank is permitted by its charter to take equity participation, it has not yet undertaken such investments. The pace of the development of the various national institutions has varied from country to country reflecting differences in economic conditions as well as in political factors. A brief summary for each country follows.

El Salvador

93. The Instituto Salvadoreno de Fomento Industrial (INSAFI) was established at the end of 1961, to replace the Instituto Salvadoreno de Fomento de Producion which had been created in 1956. Since 1962, its lending, primarily to small and medium-sized industries, has grown rather sharply; primarily dependent in the past on government contributions, it has recently received loans from AID and IDB. It has also obtained medium-term loans from private banks in the United States.

(In million C.A. pesos)

	Loan commitments	Loan disbursements
1962	1.5	1.0
1963	3.3	1.6
1964	4.5	3.6
1965	5.8	4.0

This country has long had a relatively advanced banking system with a growth of specialization among the existing financial institutions. INSAFI, in an effort to promote accelerated industrial investment, has attempted to use its funds as a catalytic agent working very closely with private sector groups, including foreign interests. In recent years, with official external assistance, it has increased its longer and medium-term lending; the portfolio contains a number of equity holdings, but most of this form of investment is accounted for by its interest in one copper products company, a joint venture with U.S. capital. The developmental orientation is reflected in the change in the nature of the purposes for which credit has been given:

	(In million C.A. pesos)		Distribution in percent	
	1962	1965	1962	1965
Construction	0.31	1.11	21	19
Refinancing	0.33	0.29	22	5
Machinery and equipment	0.40	3.16	27	54
Working capital	0.44	1.28	30	22
Others	-	0.01	-	-
Total	1.48	5.84	100	100

FISA, Financiera de Desarrollo e Inversion, was organized in 1964 with the assistance of AID as part of the latter's program to promote throughout the region the creation of financial institutions in the private sector. In 1965 it received a loan of $5 million for 20 years (with 5 years grace), at an interest rate of 2 percent, with the condition that local capital amounting to the equivalent of $1 million would be raised. In its initial phases of operations, this institution has had a slow pace of lending, with most of its funds directed toward commercial operations. In large part, this has been due to an inability to define the specific areas of its activity given the already existing financial institutions in the Salvadorean economy.

Nicaragua

94. In Nicaragua, a very rapid development of a diversified financial institutional structure has played a major role in the recent economic growth of the country. The Instituto Nacional de Fomento (INFONAC) which was established in 1953, has been the focal point of much of this activity, particularly in the field of industry which accounts for about two-thirds of its present portfolio (approximately 5.9 million C.A. pesos). Most of this (4.4 million) is made up of long-term credit and equity investment. The institute is heavily involved in the ownership of two integration industries now under construction, as well as in the agricultural development schemes which have priority in the plans for future economic growth. INFONAC has received long-term loans from IDB (1961) and from the AID (1964) as well as short and medium-term credit from external sources such as the United States private banks. Data on the loans and investment in industry are as follows:

	(Thousand CA pesos)
1954-1959 (annual average)	921
1960	2,015
1961	2,821
1962	1,722
1963	1,968
1964	2,836
1965	
1966 (first 4 months only)	2,710

While INFONAC has specialized in assistance for new industries, the Banco Nacional de Nicaragua (a state-owned commercial bank), has concentrated in the industrial field in providing funds to existing firms for their modernization and expansion; such loans have generally been of medium-term but the Banco has also provided short-term credit for working capital. Its principal area of activity has, however, been agriculture with manufacturing accounting for less than one-fourth of the credit extended. At the end of 1964 a private financial company, Corporación Nicaraguence de Inversiones (CNI), was organized with a low-cost, (2.5 percent) long-term loan of 20 years from AID, amounting to $3 million, local capital was to be raised equivalent to $1 million. While essentially designed to provide equity development capital, in its initial phase of its operation a large portion of its portfolio was made up of short-term loans to industrial and other borrowers. In part, this is explained by the obvious desire to place available funds as soon as possible in order to earn income and the normal gestation period which is needed to develop projects requiring either or both long-term loans and equity capital. Considerable attention has been given to the problem of improving its portfolio and the corporation is currently involved in developing a number of major projects in the industrial field. At the end of 1965 and in the first months of 1966, long-term loans, as well as direct investments, were made. While these commitments did not exhaust the available funds, additional resources were sought in order to insure an adequate supply in the future. A second loan from AID has been negotiated, for $5 million with a 5 1/2 percent rate of interest for 20 years and the requirement that local equity be raised by an amount equivalent to $1 million. Moreover, both short and medium-term loans have been negotiated with foreign banks and with the ADELA investing company. Finally, a small specialized institution for small industries has recently been created, INFISA, with the assistance of INFONAC, and CNI. The maximum credit it can extend for any single operation is approximately $14,000. It uses the technical services of both CNI and INFONAC in its operations.

Costa Rica

95. The structure of financial institutions in Costa Rica is somewhat unique with the banking system owned by the government. External assistance for the development of a longer-term lending program through the existing

commercial banks had its origins in a $3 million loan for agricultural and industrial equipment which was given by the IBRD in 1956 and which was channeled through the Central Bank. Three additional loans were made in 1959 ($3.5 million), 1960 ($2.0 million) and 1961 ($3.0 million). The second loan also covered both agricultural and industrial equipment but the third and fourth loans were only for industrial use. In 1963 the IDB granted credit for small and medium-size industries of $3.2 million which was given directly to the Banco de Costa Rica (one of the commercial banks). With technical assistance from the IDB, the Banco de Costa Rica has established an industrial credit division to monitor and disburse the loan, as well as to undertake certain promotional activities in the field of industry. A further IDB credit of $4.2 million was negotiated in June 1966 to permit expansion of present activity. The private financiera, Corporacion Costarricense de Financiamiento Industrial (COFISA), was established in 1964, receiving an AID loan for 20 years at 2 percent for $5 million, with local capital equivalent to $1 million. As of the end of 1965, the Corporation had committed about half of the proceeds of the AID loan and disbursed almost all of this amount. It has also been receiving short and medium term credits from foreign banks.

Honduras

95. In many respects, financing of industry in Honduras is the least advanced in the region. For example, the share of industries in the total loans of the commercial banks has exceeded 10 percent only in the last two years. In 1964 the IDB granted a loan of $8.5 million for medium and small sized enterprises in agriculture and industry which was channelled through the Banco Nacional de Fomento. This institution had been established by the Honduran government in the 1940's to provide longer-term credit to the productive sectors of the economy. The Bank, however, has tended to concentrate its activity in the agricultural sector and loans to industry from the IDB credit have been rather small, amounting to only some $770 thousand in 1965. An additional credit is now being negotiated with an increased sum being set aside for industry. Steps are expected to be taken to strengthen the administrative capacity of the Bank as regards its operations in the industrial field. The lack of an adequate institutional structure for long-term industrial finance has been of concern to the Honduran authorities in recent years and various proposals have been studied in an attempt to remedy the situation. Active consideration has been given to the establishment of a Corporacion de Fomento; functions of this autonomous agency would include providing long-term finance, including in particular equity capital, for high priority industrial projects. However, for a number of reasons, including in particular the problem of the shortage of qualified technical and administrative personnel, this proposal has been temporarily shelved in favor of the strengthening of the Banco Nacional. Consideration is being given to the creation of an investment fund, presumably to be administered by the National Bank, which would have the power to make equity investments. The Financiera Hondurena, with an AID loan of $5 million (20 years at 2 percent) and local capital of $1 million, was established in mid-1964 in San Pedro Sula, reflecting the geographic concentration of industry in the country. Its pace of lending has been rapid, disbursing almost half of the AID funds by the end of 1965. It was the first financiera to request a second loan which has been negotiated; $3 million is being made available for 20

years at 4 percent, matched by local capital of $1 million. Lines of credit also were established with foreign banks, while negotiations for loans and joint financial operations are underway with the ADELA investing company. In connection with the latter point, the financiera has undertaken a number of measures in the financial field, including the underwriting of a large sugar mill and the purchase of a mortgage bank, with a view to stimulating the development of a capital market in the country.

Guatemala

97. Guatemala has a long established domestic banking system but most of these institutions have specialized in the agricultural and commercial sectors. A public credit institution, Instituto Nacional de Fomento de Produccion (INFOP), has existed since the 1940's but the majority of its operations have also been in agriculture. The IDB granted a credit for agriculture and industry in 1962, through the Central Bank of Guatemala but industrial operations under this loan have been rather small. It should be noted that an Industrial Bank was created by the government at the beginning of 1966, its subscriptions equivalent to a specified percentage of the exonerations received by industries under the incentive laws. The Bank which will be privately run has yet to be organized although funds in its name have accrued to an amount in excess of $1 million as of the end of February, 1966. A private financiera, with AID assistance, has also been under consideration but no decision has yet been made in this case. The new government in Guatemala inaugurated in mid-1966, has indicated its intention to establish a specialized public institution for the financing of industrial development. Consideration is now being given to the formulation of its specific functions as well as to the administrative location of such an entity - within the existing or modified framework of INFOP, or in a separate agency.

Factors Affecting Future Growth of Local and Regional Capital Markets

98. In the immediate future there is need for additional steps to strengthen and develop the local capital markets and financial intermediaries. In El Salvador in particular and to a lesser extent in Guatemala, the private sector is relatively advanced in its experience with the workings of modern financial mechanisms and instruments and moreover has shown a willingness to change its operations in accordance with new needs. Corporate forms of ownership and organization are increasingly used and there is a growing share-owning community, although still very narrow by external standards. In Costa Rica, Honduras and Nicaragua, this experience is of more recent origin. In these cases, the newly organized private financieras can play and have played a major role in developing capital markets. In the early stages of their operations, these institutions tended to have a very high ratio of working capital or commercial loans in their portfolios with very small amounts in equity and long-term investments. This tendency was to some extent to be expected since there has been great demand for short-term funds in the region while the development and processing of long loans or equity investments requires more time. It was obviously important to accumulate earning assets as quickly as possible to meet

expenses and to give shareholders quick return. 1/ Nevertheless if these institutions are to serve their objectives which have qualified them for foreign public assistance, longer term assets of a developmental type must become a more important element in their portfolios, in particular equity investments in industry. At the same time, as local sources of finance for the companies themselves are being tapped for additional funds to match the external loans, it will be important to widen the base of stock-ownership. Clearly these companies cannot continue to rely on external credit as their main source of finance. Only if this base is continually widened can they hope in the future to attract the local interest which will be required both for expansion as well as to replace the foreign loans when repayments begin. 2/ At the regional level, a number of proposals are being discussed to create institutions to promote a regional capital market. These include a joint investment company sponsored by the four private financieras (plus a Panamanian company) with additional participation of external sources such as ADELA. But the details of these enterprises and how they would provide a means of mobilizing local capital on a broader scale, given the variation in national experiences, are yet to be worked out.

Public Assistance to Industry

99. The role of public sector institutions to accelerate industrial growth is somewhat more complex, involving the provision not only of financial assistance but also of technical and similar assistance not provided by any other agency or institution. Mention was made earlier of IMSAFI and INFONAC which have made significant contributions to expansion in their respective countries in the recent periods. With regard to finance, these bodies have channelled external credit to small and in particular medium size industries; that this type of enterprise may require special attention derives from the fact that private financial institutions find it difficult to loan to them or must charge high interest rates due to the overhead involved in processing and administering loan applications. Their participation in new larger scale enterprises either through equity or long-term investments, permits financing of the pilot riskier undertakings which in their initial phases may not attract the amount of capital required.

1/ One of the obstacles to the growth of equity financing in industry in underdeveloped countries is that considerable time elapses before the manufacturing facility comes into operation and begins to be profitable; consequently shareholders will not receive dividends during this period. Since alternative uses of potential shareholders' capital are plentiful, less risky and can yield quicker returns, it is often difficult to attract these funds to this type of finance. A number of foreign companies with interest in joint ventures in the region have had considerable difficulty in finding matching local capital equity.

2/ Moreover broader participation is essential to avoid possible criticisms that the financieras may become instruments to effect centralized control over economic activities.

Consideration is being given in both Honduras and Guatemala to the creation of similar bodies or to reorganize existing agencies which have related functions to take on these wider responsibilities. In Costa Rica, while there have been discussions in the past concerning the need to create such a body, the present government has indicated that it believes it may not be necessary at this time to take such a step in view of the existing institutional arrangements both for the channelling of finance to industry and for direct promotional activities. 1/ Such considerations should obviously determine the nature and functions of whatever agencies are to be established in the two countries mentioned earlier.

100. Some of the difficulties in operating successful fomento institutions which have been experienced, not only within the region but in other areas as well, relate to the linking of promotion activities to financing. Promotional operations are essentially designed to identify promising and priority ventures for potential investors. Such activities are essentially public subsidies to reduce pre-investment costs for entrepreneurs so as to make investments more attractive. If this public policy is accepted, it consequently should be financed from government revenues. Public financial assistance, however, is designed to help fill certain gaps; channelling either public or external funds to individual enterprises, these must nevertheless earn a return although the average need not be as high as the current market yields. Thus to an increasing extent, there is a tendency to separate promotion and finance, if not in different institutions then in budgetary provisions and accounting.

101. In this connection, consideration is now being given to the establishment of a regional promotion body affiliated with CABEI. While the promotional activities of the Bank have been limited in the past, a broad program covering external trade and tourism as well as industrial investment is being discussed. For the reasons above, it appears desirable that eventually this work should be organized outside the Bank, although the new group should continue to count on contributions from it to help finance these activities. Moreover, activities in the agricultural sector should also be undertaken. The regional program must have the direct support of the national institutions to which it should be linked both formally and at the working level. One of the principal concerns should be the problem of balanced growth of the region paying special attention to studying the needs of those areas whose growth has not been adequate in relation to potential, given available human and natural resources.

1/ Within the Costa Rican Ministry of Industry, there is a special group with AID technical assistance for industrial promotion.

C. Private Direct Foreign Capital Inflows

102. Discussions with both the public and private sector officials indicate that private foreign capital inflows are having an important impact on industrial growth, particularly on the installation of new industries but also on expansion and modernization of existing traditional lines. In a number of instances, purchases by foreign corporations of existing operating plants were also noted, as part of the investment diversification programs of the former. Available data from the Central American countries are unfortunately rather limited as regards capital flows. Balance of payments data generally indicate gross inflows but there are no breakdowns as to the sectors in which the investments are taking place. Most of the inflows appear to be from the United States but it also appears that direct investments are originating from Japan and Western Europe.[1/] Balance of payments data on capital flows from the United States do not show separately the five Central American republics or the region itself, but a total covering Central America, Haiti and the Dominican Republic is given. It is believed that flows to the latter two countries have been very small during recent years; in the discussion which follows they are ignored. U.S. direct investment in manufacturing (excluding petroleum refining) in these countries has risen sharply since 1962, both new capital and reinvested earnings, as follows:

	(in millions U.S. dollars)			
	1962	1963	1964	1965
Manufacturing - new	1	5	5	11
reinvested earnings	-	-	4	4
Total	1	5	9	15

Investment in the petroleum industry has been considerably greater, reflecting the participation of U.S. petroleum companies in the establishment of refining capacity, as well as of the distribution systems:

	(in millions U.S. dollars)			
	1962	1963	1964	1965
Petroleum - new	6	18	20	11
reinvested earnings	1	-	-	2
Total	7	18	20	13

1/ A number of entrepreneurs stated that there is also considerable suppliers' credit to private activities available from these areas, to finance the purchase of capital equipment.

It is believed that these data understate to some extent the flow of capital from the United States since wholly or partially owned subsidiaries of U.S. corporations domiciled in Panama have also made investments in the region.

103. The importance of private foreign capital in the growth of industry in the region has been rather substantial and it is not likely to decline in the future. This inflow is required not only because of the financial resources it brings but also because of the transfer of technology and specialized knowledge of marketing and markets which accompanies it. As the industries of the region become more complex and begin to look to foreign markets, the latter factors will become of greater significance. The experience which other countries or regions have had in recent years in achieving this new stage indicates certain precautions which must be thoroughly understood by all concerned if economic and political crises are to be avoided in the future. The need for know-how in connection with the establishment of new industries which are domestic-market oriented often means that such enterprises cannot be created without a foreign partner. But since these products are to be sold essentially in local or regional markets, they will not earn the foreign exchange which is needed to service the external support. While there may be some exchange savings through local production, the accelerated process of development will be increasing import needs. In fact the new industries will tend to have high import content themselves and as consumption rises, inputs for these industries may rise in absolute terms, even if not in relative terms.

104. Thus to fill out its role in this development process, foreign capital should increase its participation in the establishment of manufacturing activities for export to the rest of the world. In the past, a considerable part of the inflow has been essentially to protect a market which a firm has already established; consumption of a given item was based on imports from foreign firms and the creation of tariffs as well as the political pressures brought to bear to establish local production facilities meant that if the firm did not establish such a plant in the area, it would lose the market to someone who would set up the necessary plant. This situation is hardly new and is characteristic of development in other countries and regions in the recent past. In this connection, the intention of the Mexican Government in its plan of assistance to the region, to create joint ventures, part of the output of which would be exported to Mexico, represents one approach to the solution of this problem. The precise measures and the results achieved should be studied with great care. In addition, some of the existing plants which have been purchased by foreign firms produce the traditional consumer goods having relatively high labor components and local raw material inputs for which the region is at present a potential exporter. Rapid expansion of production for sales abroad from these and locally-owned plants would make an immediate contribution to easing the balance of payments pressures. Public action to promote exports will need to be linked to the efforts of private enterprise, in effect in programs of joint action.

D. Working Capital Needs

105. Throughout the visit of the mission to the region, both public and private sector officials emphasized the need for expanding the supply of working capital for industry. Recognizing that there are numerous subjective aspects to this problem, it may be useful to attempt to appraise certain elements, particularly those on the side of supply, which are subject to measurement. Credits granted by the commercial banking system to industry in the region, representing essentially working capital, have expanded at a substantial pace in recent years. From 1961 to 1965 banking system credit to industry in Nicaragua almost tripled; in El Salvador and Honduras, it more than doubled; while in Guatemala and Costa Rica it almost doubled. These increases were considerably more than the expansion in total credit and there was therefore a sharp rise in industry's share in the portfolio of the commercial banks. However, in the case of Honduras, and to some extent in Guatemala, despite the rapid expansion of this credit in recent years the share of industry in bank loans is still below that prevailing in other countries.

Commercial Bank Credit to Industry

Share of industry in total bank credit

	1961	1965
Guatemala	11.9	15.9
El Salvador	14.2	23.3
Honduras	7.5	12.5
Nicaragua	16.7	26.1
Costa Rica	13.8	19.1

106. An appraisal of the demand for this type of credit is much more difficult. In periods of expansion when there is underutilized capacity, working capital needs will generally expand at rapid rates. Moreover, to the extent that an important share of the increased production during the 1962-1965 period was destined for exports within the Common Market, there was a consequent lengthening in the lag between shipments and receipt of payments, since these exports generally require more time than domestic deliveries.[1] There is a strong tendency for new entrepreneurs to underestimate their working capital needs, often in the mistaken impression that such capital is not productive.[2] Since capital

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1/ Thus one of the proposals now being discussed among the private banks in the region is the establishment of facilities for discounting paper arising from intra-trade.

2/ This is often found among small and medium-size enterprises in developed countries as well.

in general is in short supply in the region, an attempt is made by the entrepreneur to channel as much as possible of these funds to the purchase of fixed assets. The mission visited a number of new enterprises which had made little or no provision in their financial structures for working capital requirements and as a consequence were having difficulties either in beginning operations or in maintaining the current working level. In addition, in mid-1966 balance of payments difficulties had resulted in efforts to restrain credit expansion in some of the countries. To a considerable extent the burden was being borne by the industrial enterprises which represented new accounts for the commercial banks.

107. Leaving aside complaints of shortage arising essentially from the inexperience of the local private sector in modern industry, it is obvious that as the sector grows there will be increasing need for channelling working capital to it. Thus the monetary authorities must keep under review the requirements of industry and the ways and means these can be met.

E. Future supply of long-term capital

107b. As has been indicated in the previous parts of this chapter, the future growth of industry will require increasing amounts of long-term capital. To appraise the prospects for the supply of this finance, it is useful to review the estimates presented relating to different aspects of sources for 1965:

	In million CA pesos	
Total estimated gross investment	100	
Estimated foreign exchange component		50
Disbursement by official external agencies		14
U.S. direct private investment in manufacturing: new capital		11

The data suggest a substantial portion of the foreign exchange component has been met in the past by external sources and it is likely that this will continue. As regards the international financial agencies, present indications are that, with the increase in new commitments, particularly as regards IDB and the second loan of AID to the financieras, this support will increase. 1/ Moreover, CABEI has recently negotiated a loan of $11 million with Spain, a substantial portion of which will be for industrial lending; this is in addition to the 1965 loan from Mexico mentioned earlier. As regards private foreign investment, there are indications of additional interest on the part of U.S. investors as well as those in other advanced

1/ See Table 13, containing a list of loans by official external agencies.

countries for which data are not available. The mission was told by a number of industrialists that a number of offers of suppliers' credit had been made by the latter countries, in some instances linked with equity or other direct participation.

108. The prospects therefore are for supply of long-term credit generally adequate to meet the overall needs of the region. There may however be specific problems in relation to finance to which the authorities may have to address themselves. As noted earlier, much of the external lending to developmental institutions has been for small and medium sized industry. The enterprises which require larger amounts of capital (that is, relative to normal enterprise needs), for example, the refineries, have relied in great part on external private sources. It is likely that, as in the case of the proposal for the Honduran pulp and paper, these types of projects may require additional external public support. Closely linked to this aspect is the need for further stimulation of the use of equity investments. It is important to recall that while CABEI has been permitted by its charter to undertake this form of financial participation, it has as yet not ventured into this area. External agencies can assist in promoting greater use of equity financing, which remains relatively new in the region.

VI. APPRAISAL OF PROSPECTS FOR INDUSTRY

A. General Considerations

109. Prospects for industry in the region depend, more than is the case for other areas, on the general economic growth of the member countries. The small size of the manufacturing sector in the area at present is essentially due to the smallness of the market in terms of the size of population as well as the limited purchasing power reflected in the low level of per capita income and its generally unequal distribution. While there is some further room for import substitution, these possibilities pose some difficulties. Among the principal objectives in the economic integration of the five countries is the enlargement of the potential market but with a population of some 12 million, the region remains nevertheless relatively small. As a consequence, there is not sufficient demand at present for many of the intermediate and finished products which currently bulk large in imports to justify regional production.

110. As regards the possibility of raising per capita income (and the potential demand for manufactures) by accelerating the pace of industrial growth itself, this can also be seen to have very definite limits. In 1962 employment in industrial establishments (i.e. excluding artisan and handicrafts) amounted to no more than 150 thousand persons, or about 5 percent of the economically active population. While this employment has increased somewhat in recent years, it apparently has not kept pace with the growth in the labor force, even in this period of rather favorable progress, and its share in the latter has fallen. Thus, at this stage of development, income generated in this sector cannot be expected to absorb a substantial part of its own output; the bulk of the latter will have to be sold to other sectors, either domestic or regional, or outside the area. While some of the higher income from industry will increase demand for the products and services of other sectors, and consequently their incomes, its overall impact cannot be very large because of the small magnitude involved. Due to relatively higher income elasticities for manufactured goods, particularly in this range of income levels, the rate of growth of industry is usually found to be higher than the rate of growth of the economy as a whole. While cause and effect are interrelated to some extent, the main thrust for growth must still come from those sectors of the economy with greater importance. Thus industrial growth is intimately connected with the movement of per capita income in all sectors and appropriate economic development policies in general, in particular agriculture which is the dominant sector as regards both income and employment in the region.

111. Another element for expansion, as noted, is the creation of industries oriented toward exporting outside the region and the adoption of relevant policies in this regard, Moreover, given the general benefits from specialization and participation in international trade, the smaller the population size the larger will be the share of exports of goods and services in total domestic product. While increasing attention is being

given in each of the countries to this aspect, little concrete action has so far been undertaken. The urgency surrounding the stimulation of such industries is even greater in view of the prospective balance of payments constraints facing the region.

112. Obviously the level of industry in any specific country is also closely related to its natural resource endowment and its human resources. In particular, the resource base will determine the pattern of industries both for domestic and export markets, the latter in accordance with both absolute and comparative advantage. Specific elements are examined in more detail in the consideration which is given to individual industries in the next section.

112. These general observations on the level of industry and its determinants have received some corroboration in recent statistical analyses particularly one undertaken by the United Nations drawing upon an earlier study of Prof. Hollis Chennery. Based on regression analysis of data for a broad sample of countries, the value of manufacturing output has been found to be a function of per capita income and population. In an appendix to this section of the report, the possible implications for Central America of these findings are discussed in more detail.

113. In summary, the strategy for industrial development is essentially two-pronged. On the one hand, there is the need to adopt measures to encourage the growth of industries serving the regional market - to meet growing consumption and a changing structure of demand within the context of an expanding regional economy. On the other is the need to promote the development of export-oriented industries, involving maximum elaboration of those natural resources which the region contains in some abundance, combined with most efficient utilization of the available human resources. That these elements are not mutually exclusive is self-evident, that they are in reality complementary can be seen in the fact that future expansion of exports will require a healthy development of regional industries which can compete in world markets. Some of the specific aspects entering into this strategy and an attempt to identify products in the various categories are dealt with in the following pages.

B. Export-oriented industries

114. In the immediate future, there is little doubt that there exist important opportunities for expanding exports to major world markets of processed foods (particularly meat and canned foods) and wood and wood products. The problems of adequate production of the raw material inputs for these items are dealt with in the sections of the mission's report dealing with agriculture and forestry products. In this section, main concern lies with the factors affecting investment in facilities for elaboration of the commodities involved.

115. Longer-term opportunities for products with a greater degree of elaboration are more difficult to identify. Nevertheless, the recent structural changes in the textile and clothing industries have put many of these enterprises in very strong competitive positions and some trade

opportunities can be expected, particularly in neighboring countries of the Caribbean area, as well as in important consuming areas outside the region. Prospects for exports to world markets of these manufactured products must be viewed in the context of a dynamic, expanding world economy where comparative advantage is constantly changing and where the developed countries adopt policies to permit such changes. As painful as these adjustments may be, experience has clearly indicated the net advantages in the restructuring over time of national production. The areas such as western Europe which have limited supplies of natural resources which Central America can provide, as well as high labor-cost areas such as the United States have experienced great prosperity as a consequence of a rational development of their production and trade; they must insure that the logical next steps in the evolution of world economy are achieved. In raising this very complex political and economic issue at this juncture, recognition is given to the justifiable concern of the developing countries that the measures which they take in the future to expand their economies through export-oriented activities are not negated by excessively nationalistic policies in the principal world markets. It is assumed in the discussion which follows that the future restructuring of world trade shall proceed on the basis of economic rationality.

Meat Products

116. The development of this branch as an industry for exports abroad has been rather remarkable, from less than one million dollars in 1957 to over $25 million in 1964 and 1965 (3 percent of total exports). The major element in the sales to the United States, accounting for most of this increase, has been the demand from industrial and institutional users, 1/ which has been growing very sharply in recent years as a result of changes in consumption patterns. However, for a number of reasons the region has not been in a position up to this time to take full advantage of the booming market in western Europe for these products, although there have been some exports to Italy. Continued high levels of world demand for meat products depend upon maintaining increases in incomes in the developed regions. Under the prevailing market conditions, most of the Central American countries have important investments planned in slaughter houses and related facilities. Since output in the immediate future is limited by the ability of producers to increase and improve animal supply, exports may be restricted in order to maintain or increase domestic consumption. Public programs for assistance to livestock development are therefore essential for longer-term growth.

Sugar

117. In the case of sugar, the principal element determining exports is the United States market. This demand is expected to change very little during this period in view of the legislative arrangements for the quota system which have been adopted. However, rapid growth in domestic consumption provides considerable scope for expansion in production.

1/ Those who reprocess the chilled beef for sale in other forms (frozen specialties) or as other products (hamburgers and "hot dogs") used particularly by mass feeding institutions.

Processed fruits and vegetables

118. As regards other processed foodstuffs, it appears likely that numerous possibilities exist for expanding exports. Based on the experience with meat, these should be found among products which are consumed at high levels of income and which are used for further processing. The successful development of an export industry for these items, of which processed fruits and vegetables is a likely category, will be dependent in the first stages upon the introduction of some improvements in raw product cultivation. A program of official assistance in this area may be required as in the case of livestock. Exports could be based on better utilization of existing plants which, while small, are currently operating at well below capacity, processing almost exclusively for local or regional household use. In some areas where changes in cultivation have occurred and these new products are being farmed, it will be necessary to construct processing plants. Particular emphasis will have to be put on marketing aspects. Given the characteristics of the market for these commodities in the United States and other developed high-income countries, consideration should be given to the establishment of some types of cooperative marketing facilities, involving a number of producers in one or more countries. In the early stage of penetration of U.S. market, attention should be given to the institutional and industrial consumers. As these prospects are developed, expansion of plants and establishment of new processing facilities may be required.

Wood products

119. While there has been some growth in recent years in exports of forest products, the level of activity nevertheless remains well below what one would expect in view of the present availability of natural resources and world market conditions. In all the countries with the exception of El Salvador, present resources appear to be generally excellent although certain management problems exist. 1/ The major new project proposal (considerably larger, moreover, than any now in operation) for liner board and corrugated medium production in Honduras is basically oriented towards meeting the region's requirements for the manufacture of banana boxes which have been growing at a spectacular rate. While important quantities of sawnwood will also be produced for export to European markets, this will account for a somewhat smaller portion of the value of total output when the project is in full operation and by itself would not justify the infrastructure investment required. There are however, a number of forest products (for example, veneer, plywood, and pressed woods) for which capital requirements (either direct or infrastructure) are not as large but nevertheless the recent expansions in output have not been up to expectations. 2/ While there exist numerous feasibility and pre-feasibility studies relating

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1/ See the special appendix on forest products.

2/ See appendix, op. cit.

to these items, few new projects have actually been implemented. Although the necessary direct capital for producing these items is considerably lower than in the Honduran project, in the context of the characteristics of the region it is still relatively large. There remains a lack of experience in the proper promotion of such projects, in spite of the recent growth of larger-scale enterprises, particularly in the local financial institutions.

120. Related to this problem is the inexperience in the procedures for marketing abroad. Traditionally the export of basic products has been in the hands of importers or their agents and the producers in the Central American countries tended to concern themselves only with production and delivery to the ports. For manufactured products, marketing problems are much more complex although for intermediate goods such as wood products they are less difficult than for finished consumer or producer goods. Thus, as in the case of processed foods, given the overhead costs of adequate marketing programs, there is need for establishing marketing mechanisms on a joint basis which could involve a number of producers in one country, or in some instances, on a regional basis. Moreover the national and regional development institutions should explore more systematically in their feasibility studies the specific marketing aspects for the commodities concerned.

121. In addition to export industries based on the further elaboration of natural resources of the region, in the longer run there should be possibilities of establishing export-oriented industries requiring large labor inputs since labor is relatively abundant in the region and wages are relatively low. Among the most important branches in which such possibilities may exist in the future are the cotton textile and clothing industries. As already noted the region is approaching self-sufficiency in these products and for a number of them, local production is becoming increasingly competitive, both as regards price and quality, with items produced in the industrialized countries. In the opinion of one technical assistance expert, such exports will be possible in a few years.

122. A number of proposals have been made to promote the establishment of export industries based on the elaboration or transformation of imported raw materials or intermediate goods. Labor intensive industries of this type could provide considerable local employment and, even though dependent upon imported inputs, could make a net contribution to the balance of payments. These proposals stem from a consideration of the experience of such areas as Japan and, more recently, Formosa and Hong Kong. The viability of the projects will therefore depend upon relative competitiveness of labor in Central America as compared to the other areas. In the latter, wage costs for products such as toys and electronics are low as a result of combining low wages with high skills and productivity. For example, representatives of U.S. firms importing the items mentioned have indicated that wage rates in Hong Kong and Formosa are as low as 11 U.S. cents per hour. A recent U.N. report has estimated average wage rates for industrial workers (presumably semi-skilled) in Central America as follows (excluding social charges which may add as much as 10 percent):

	In CA pesos per hour
Nicaragua	0.166
El Salvador	0.192
Guatemala	0.237
Honduras	0.250
Costa Rica	0.250

Source: ECLA, Industrial Productivity, Labor Costs, and Costs of Production in the Central American Isthmus, (UN document E/CN:2/CCE/335, Rev. 1, 14 April 1966).

While no comparisons can be made of productivity differences in the absence of specific studies, the wage rate data for Central America do indicate some difficulties in competing with the Far East in these particular industries. Nevertheless, the rates are rather low in relation to more advanced areas. Thus, where such low wage rates can be combined with low raw material costs as a result of natural endowments, the region would, in the immediate future, have its best opportunities for developing exports to the larger world markets.

C. Industries for Local and Regional Markets

123. There remain possibilities for both regional and national import substitution within varying limits in the immediate future. In spite of recent changes, the general structure of imports from outside the area remains heavily concentrated in finished manufactures; possibilities for the production of different items will grow as demand will rise. Nevertheless, because of the limited raw material base, the new industries will require imports of raw materials or intermediates. Recent shifts in the composition of imports from third areas will illustrate the nature of probable trends.

	Percentage share of group in imports from third areas	
	1962	1965
Crude materials	2.3	4.4
Crude foodstuffs	2.8	4.2
Manufactured foodstuffs	6.2	3.7
Semi-manufactures for consumption	4.2	3.3
Semi-manufactures for production	10.4	13.0
Finished consumer goods	30.5	27.6
Finished producer goods	43.5	43.8
Total	100.0	100.0

124. The growth in the shares of crude materials (primarily of crude petroleum) and crude foodstuffs (largely wheat) reflect the increase in the region's refining and flour milling capacity; the concurrent declines in imports of flour and refined petroleum account for a good part of the relative reduction in imports of manufactured foods and finished consumer goods. As regards the latter group, increased production within the region of other consumer items (e.g. toiletries) also contributed to the decline. The increase in intermediate goods imports required for the production of such products as fertilizers has led to a rise in the importance of the group containing semi-manufactures for producers goods.

Traditional industries

125. With rising levels of income and consequently demand, further possibilities for import substitution among the consumer goods will emerge. Among these will continue to be textiles which has accounted for substantial changes in external and regional trade, as well as in output. The region's production is dominated by cotton textiles, based on locally produced fibers. Self-sufficiency is rapidly being achieved among the cruder and heavier fabrics with imports of lighter and finer types from other areas rising. Increased production of the latter within the Common Market can be expected. Under the existing common tariff, high protection to local output is provided for these items; local production of some of the fine types may not be economic in view of the small market and some consideration should be given to a reduction in duties for these items. Imports of cotton yarn have risen in spite of the expansion in productive capacity and in this case there also is room for further growth in output. For this product, a moderate level of tariff protection (around 20 percent) prevails but the salutary growth in output and efficiency already achieved indicates that self-sufficiency can be attained with competitive costs in relation to external prices. Perhaps the most important group of textile products for which future production possibilities exist is the synthetic fibers and fabrics. The recent rapid expansion in consumption of synthetics, including mixtures with cotton, appears to be in excess of earlier expectations. Thus, moderately sized new plants appear to be distinct possibilities for the near future; such expansion might include a plant for nylon yarns. This will moreover have an important impact on the growth of a regional chemical industry. However, in the case of these products, current tariff levels are relatively high, over 100 percent in some cases. The main factor which might provide pressure to achieve efficiency in production will be the competition from the relatively cheap cotton textiles available in the area.

126. Production possibilities for a number of products not currently imported or traded in small quantities may also be expected to emerge as a result of income growth as well as expanding public investment programs. The latter will require substantial increases in output of construction materials, which because of the low value in relation to volume rarely enter international trade, transport costs acting as a natural protection for local production. Among the products are cement, concrete blocks, pipes, and related materials as well as ceramics (bricks and tiles). In this connection, there appears to exist wide scope for low-cost housing based on properly treated wood products, offering excellent opportunities for the further development of wood industries in the region.

127. Demand for manufactured foodstuffs, which is highly income elastic in the income ranges of the region particularly of the population in urban centers, can also provide the basis for expansion of this industrial branch. Among these are the canned fruits and vegetables for which export prospects, as noted above, appear particularly bright. Others include dairy and meat products, as well as many food specialties.

Non-traditional products

128. As stressed on a number of occasions, the growth of the newer industries will be dependent upon imports of raw materials or intermediate goods as a result of the limited raw material base. Thus, tariff and incentive policies must be used carefully to encourage those branches which will provide maximum benefits to the area in terms of their contributions to the balance of payments and to increasing employment.

129. Within the area, considerable attention is being given to the petrochemical industries. As already noted, the prevalence of small national petroleum refineries has made it uneconomic to utilize many by-products of refining, limiting the possibilities of establishing a number of important industries. In addition the present market for such items as the polyvinyl-chlorides, polyethylenes and polysterenes are too small to warrant local production. Consumption of the first item however has risen rapidly and could reach by the early 1970's a level adequate for an economic size plant if local petroleum by-products were available. Given costs of transportation and economies of bulk handling, if the plant is to rely on imported materials it will have to be considerably larger. At present, tariffs on these intermediates are relatively low, for some items under 10 percent. Should the establishment of a regional plant to produce these elements be based on a request for an upward tariff adjustment, it is essential that full account be taken of the impact of the higher prices for these products on industrial branches which use these as inputs. Among the chemicals, there is also growing demand for such important agricultural inputs as fertilizers and insecticides and fungicides. Imports of these items from outside the region have risen sharply, as follows:

	(In million CA pesos)	
	1962	1965
Fertilizers	13.6	33.7
Insecticides and fungicides	19.3	23.8

Production facilities now existing and operating in the region are essentially mixing plants based on imports of essential components with some simple chemical processes undertaken locally, e. g. production of sulfuric acid in El Salvador and using this to treat imported phosphate rock to produce superphosphates. A plant to produce toxaphene, an insecticide using chlorine, is under construction in Nicaragua, linked to the caustic-soda-chlorine plant also under construction there. This product is, however, only one of the

insecticides and fungicides now used in the region and possibilities may exist for the production of additional items. Tariffs on fertilizers are low, reflecting the interest of the region as a consumer dependent upon agriculture 1/ to obtain the cheapest possible inputs for the sector. Similarly the new toxaphene plant will be given, under integration status, only moderate levels of protection (17 percent).

130. As regards engineering industries, a major controversy has developed over the establishment within the region of assembly plants for durable consumer goods. A common tariff has not yet been agreed upon for such items as household refrigerators, radios,television sets and passenger cars. These are to be subject to a special protocol in which a procedure is to be established, specifying economic criteria under which plants assembling these items are to be included in the common external tariff, subject to free intra-trade. Some governments have granted benefits under national legislation to plants producing these items, based almost completely on imported parts. It was noted earlier that the Costa Rican government has imposed sales taxes on certain products in this category which are being assembled locally under the existing incentive law and which have been responsible for both higher imports and reduced government revenue. Other governments have not extended the benefits of their incentives to such plants, believing that these made at best a limited contribution to economic growth, at worst contributing to balance of payments rigidities and losses in fiscal revenues. For the simpler and small products (e.g. radios and household appliances) local assembly with an increasing proportion of regionally produced parts may be possible and can provide some employment opportunities and gradually increasing import savings. However in the case of the larger items, particularly passenger cars, the experience already obtained in the region as well as in other areas points towards more cautious consideration of proposals for establishing plants of this type. With the demand limitations existing now and in the immediate future in Central America, few components for these items could be economically produced in the region.

131. Finally, metal fabrication industries, embracing a wide range of goods from hardware to construction materials, have already been started within the region. Because of the labor-intensity of the fabrication, this production is suited to the region and should be encouraged. In general, the common tariff represents an increase over the average of the national tariffs which existed previously. But most of these items are also not subject to great economies of scale and there has been competition within the region to promote efficiency and low prices. Demand is likely to increase for a wide variety of these products, particularly those associated with construction (e.g. cement-reinforcing bars, simple structures) as well as consumer products (e.g. household utensils) and producers goods (e.g. simple hand tools). Proposals for plants producing these items are among those now being prepared or studied by various national development agencies.

1/ The special problem of a fertilizer plant producing ammonia products was discussed earlier.

132. In connection with the development of a basic metals industry to meet the needs of the region in this area, consideration is currently being given to the installation of a steel plant in Honduras with an annual output of 100,000 tons. The plant would use ore from a deposit which has been found in the area of Agalteca. This deposit is apparently of relatively rich iron content (60 percent), but is of small size, estimated at 6.8 million tons of ore. There are a number of problems which still must be studied. The first is to reassess and prove the sufficiency of the ore reserve in relation to the estimate of the economic life span of a steel plant. In addition, it is necessary to resolve the problem of the reductant material which is expected to be charcoal. The use of this fuel for a plant of 100,000 tons appears to be beyond the current supply possibilities for the eucalyptus wood which would be the fuel source. In this connection studies are being undertaken of the possibility of supplementing the charcoal with oil injection, a technological process which has still to be worked out. In any case, the final decision surrounding the possible establishment of this plant must be carefully taken in the light of the effects which it would have on the future structure of industry in the region. If the cost conditions are such that the plant can only be established with a high protective tariff, the resulting high price of steel, a basic input in many of the new industries now under construction, would seriously affect the economic viability of the latter industries imposing a burden on them and hindering their future development.

133. While emphasis has been placed on limitations which exist for the expansion of industry, many possibilities for growth exist. These limitations imply essentially the need to adopt a certain discipline not only in the private sector but in the policies of the public sector as well in encouraging growth. It is also necessary to stress the essential fact that future development is dependent upon the leadership of the region itself. While foreign external assistance may be called upon to fill various gaps, financial and/or technical, the capacity of the countries, both in the public and private sectors, to make proper decisions in this and other fields must determine the path of growth.

APPENDIX

THE LEVEL OF INDUSTRY IN CENTRAL AMERICA - SOME THEORETICAL CONSIDERATIONS

1. In considering the prospects for industry it is necessary to examine the problem of the overall level of this sector in the economy - what has been and will be its particular role in the growth of the Central American region? For purposes of establishing some benchmarks in defining that role, it is of some interest to refer to recent econometric studies of the determinants of the level of industry. An analysis has been prepared by the United Nations, drawing upon earlier work by Professor Hollis Chenery, utilizing basic data for a wide sample of countries, over 80 in total. The results show that the share of industry in gross domestic product is a function of population and per capita income. 1/ These two variables, the product of which would be total income, represent essentially measures of the size of the market and its "depth", within the range of incomes being considered for the less developed countries, industrial products generally have a larger income elasticity than other goods so that per capita income is a major determinant of demand for them.

2. The limitations on applying the results of this study to individual countries are many, but nevertheless, one can get useful insights into the performance of and prospects for industry in the Central American countries if one calculates for the region the relationship based on these statistical results. The degree to which the actual size of industry differs from the theoretical level must be explained in terms of various additional elements. Obviously, for a fuller appreciation of the problems affecting the growth of industry in any one country or in the region, the economic, political, geographical, geologic and demographic characteristics must be evaluated.

3. Fully aware of the cautions to be exercised, it is proposed to examine industry in the region with these theoretical benchmarks (see Table 17). In the first place, one may note that the nature of the statistical relationship is such that the expected role of industry for the region as a unit is greater than that obtained by adding up the results calculated for the five countries on an individual basis. 2/ This is of course the logic behind the establishment of the Common Market - a larger market permits greater growth of industry since one of the characteristics of this sector is economy of scale in production with the consequent advantages deriving from specialization.

4. In 1962, only one country had achieved a level of output in manufacturing more or less consistent with the observed characteristics for the large sample. The case of El Salvador represents no major surprise since

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1/ See United Nations, A Study of Industrial Growth (1963).

2/ A measure of the "integration effect" would be the expected output for the region as a unit divided by the sum of the expected industrial output of each of the five countries.

the limited agricultural base of this country with its great population density has provided for many years a great pressure to industrialize. Three countries had achieved levels of output somewhat below the expected values - Costa Rica, Honduras and Nicaragua. That actual industrial production in the latter two is not too far from the expected level is a bit surprising, but it reflects the fact that given the low per capita incomes and small size, there is little scope for industry based only on the domestic market. Finally, the relatively low level of achievement of industry for Guatemala emphasizes the fact that given its size there is still considerable scope for output of manufactured goods.

5. From 1962 to 1965, the expansion which occurred in the individual countries in the industrial sector has been in the direction of increasing the importance of industry, a result also to be anticipated from the nature of the observed relationships. Only in the case of Nicaragua did this expansion fail to reach the level which one would expect, as reflected in the reduction in the relative degree of industrialization in 1965 in comparison with 1962. Output in El Salvador has slightly surpassed its expected volume, reflecting the appropriateness in broad terms of the efforts which are being made to accelerate industrialization in view of this particular circumstance. In Honduras, industrial product has almost reached the theoretical level, once again emphasizing the limits of its domestic market. In the case of Guatemala, the rapid growth in manufacturing activity can be seen as part of the process of achieving a "normal" balance among the productive sectors: its relative level of industrialization, however, continues to be the lowest in the region.

6. It is not proposed to deal at length at this stage with the general strategy of economic development since this is discussed in the main body of the report. Nevertheless the approach which has been taken to industrialization in this part - intimately integrated with development in general - requires that some consideration be given to this aspect. The discussion has indicated that under the conditions now prevailing in the region it is possible to conceive of an "industrial gap" - that while the creation of the Common Market has provided the basis for an expansion of some one-third in the level of industrial output, this could contribute to roughly no more than a 10 percent increase in total product, 1/ all other elements remaining constant. This of course is a rather static and over-simplified approach but the calculation emphasizes the need to understand both the limits and the possibilities of the industrial sector as the "engine of development" if the region is considered in isolation. If other productive sectors have limits to the possibilities for expansion, limits determined by both internal demand and the conditions of world markets for their products, and if local demand limits the scope for further expansion of industry, it is necessary to explore the possibilities for expansion of the industrial sector through increasing the exports of manufactured goods.

1/ Other Commodity producing sectors (mainly agriculture) are two to three times larger than manufacturing; this estimate assumes that service sectors are affected in the same proportion.

STATISTICAL APPENDIX

Table 1: CENTRAL AMERICA: SELECTED INDICATORS OF INDUSTRIAL PRODUCTION, 1959-1965

	1959	1960	1961	1962	1963	1964	1965
Flour ('000 metric tons) 1/	42.3	55.4	62.3	64.6	74.2	118.9	129.1
Beer (million liters)	59.7	57.5	56.1	57.7	62.0	68.0	72.6
Cigarettes (million packs)	274.0	290.8	277.5	303.3	319.4	331.4	345.9
Cement ('000 metric tons)	291.5	324.3	339.0	340.2	438.1	525.1	678.5
Fertilizer ('000 metric tons) 2/	-	-	-	-	-	119.4	187.7
Sugar ('000 short tons)	251.0	272.5	318.3	379.9	416.2	449.4	499.5
							Prelim.
Value added in manufacturing	327.5	349.0	376.9	406.5	456.5	522.6	573.2
Percent of GDP	11.4	12.9	13.4	13.4	14.0	14.8	15.2
Percent increase over preceeding year		6.6	8.0	7.9	12.3	14.5	9.7

1/ Data not available for Nicaragua. Costa Rica has no flour mill to date.
2/ Output of the FERTICA plants in Costa Rica and El Salvador. Other plants are simple mixers.

Source: Following country tables.

Table 2a: GUATEMALA: INDICATORS OF INDUSTRIAL PRODUCTION 1957-1965

	1957	1958	1959	1960	1961	1962	1963	1964	1965
Flour (thousand metric tons)	27.5	32.1	37.0	48.8	52.5	52.6	59.1	67.1	68.7
Beer (million liters)	15.5	18.7	20.2	16.6	16.1	15.4	17.9	20.3	21.9
Cigarettes (million packs)	85.4	86.2	87.6	94.5	92.7	95.6	99.0	104.8	115.1
Cement ('000 metric tons) 1/	129	174	163	167	182	171	224	265	330
Sugar ('000 short tons)	66.0	69.5	68.5	80.7	91.5	120.7	142.8	145.5	137.4
Production Indices (1946=100)									
Non-durable goods:	149	161	173	174	184	186	210	248	236
Food	163	159	179	172	198	185	213	193	204
Beverages	137	139	141	138	136	131	136	135	141
Tobacco	151	152	155	167	164	168	176	185	203
Chemicals	200	239	321	383	423	467	664	673	611
Textiles	99	115	102	108	124	131	152	155	182
Clothing	144	226	219	215	191	168	183	228	280
Electric Power	262	302	385	374	427	484	553	616	736
Durable goods	218	256	242	221	237	208	252	485	530
Lumber	157	144	140	106	115	84	84	128	136
Non-metallic minerals	285	380	355	348	372	345	437	522	666
GDP: Value added in manufacturing (million CA pesos in 1958 prices)	116.8	123.0	126.9	132.4	139.2	151.6	172.2	198.5	218.7

1/ Staff estimate based on constant price data for value of production, assuming a price of $1.00 per 42.5 kg. bag.

Source: Direccion General de Estadistica, and Bank of Guatemala.

TABLE 2b: EL SALVADOR: INDICATORS OF INDUSTRIAL PRODUCTION 1959-65

	Unit (millions)	1959	1960	1961	1962	1963	1964	1965
Wheat flour	Kg.	-	-	-	-	-	33.5	37.7
Beer	Liters	13.2	14.8	14.0	14.4	14.5	12.8	13.3
Cigarettes	Packs	39.0	43.2	47.2	50.5	53.8	57.3	58.4
Cloth	Yards	17.0	24.2	30.2	34.7	39.5	43.0	40.8
Soap	Lbs.	17.8	19.6	23.3	27.1	29.5	34.3	29.7
Shoes	Pairs	0.41	0.51	0.64	0.79	0.82	1.08	1.44
Paint	Gallons	-	-	0.23	0.31	0.42	0.52	0.54
Insecticides	Liters	-	-	0.47	0.44	1.98	5.79	9.50
Cement	Quintals	1.81	1.88	1.62	1.41	1.69	1.96	1.78
Fertilizers	Kg.	-	-	-	-	-	41.4	85.7
Industrial Production Index (1961=100)		n.a.	n.a.	100.0	108.3	123.2	142.6	153.3
Gross value of manufacturing output (million colones)		159.1	177.4	189.4	205.2	233.5	270.3	291.1
Percent increase		50.0	11.5	6.7	8.3	13.9	15.7	7.7
Value added in manufacturing (million colones)		74.2	82.7	89.3	96.5	107.0	122.4	136.1
Percent increase		-1.7	11.5	8.0	8.0	10.9	14.3	11.2

Source: Direccion General de Estadistica y Censos, Anuario Estadistico; Central Bank; Cemento de El Salvador, S.A.

Table 2c: HONDURAS: INDICATORS OF INDUSTRIAL PRODUCTION, 1955-65

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
Flour ('000 metric tons)	6.2	5.2	5.3	5.4	5.3	6.6	9.8	12.0	15.1	18.3	22.7
Beer (million liters) 1/	12.6	15.5	17.1	15.4	14.3	13.4	13.4	14.4	14.4	16.8	17.8
Cigarettes (million packs)	42.0	48.9	46.4	47.7	52.0	53.2	53.4	56.2	60.2	59.8	57.2
Cement ('000 quintals)	-	-	-	-	2,449	866	980	1,308	1,415	1,663	1,985
Sugar ('000 quintals)	181	243	262	276	311	406	494	468	575	601	653
GDP: value added in manufacturing (million CA pesos, current prices)	26.0	34.5	35.5	36.5	40.5	42.0	47.5	49.5	52.0	61.0	67.5
Percent (%) of GDP	9.1										14.3

1/ One liter=2.933 12-oz. beer bottles.

Source: Central Bank.

Table 2d: NICARAGUA: INDICATORS OF INDUSTRIAL PRODUCTION, 1955-65

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
Beer (million liters)	4.3	4.7	4.0	4.7	4.2	4.1	4.2	5.7	7.6	9.7	11.2
Cigarettes (million packs)	38.9	39.5	38.4	38.9	39.5	41.0	40.5	41.3	44.5	46.7	50.4
Cloth (million yards)	7.2	5.5	6.3	7.2	10.0	10.3	9.3	9.3	12.2	12.4	13.0
Soap (million lbs.)	9.8	9.5	8.6	9.6	9.6	9.5	11.4	14.8	15.3	15.3	13.7
Vegetable oils ('000 quintals)	64	77	87	158	148	153	121	131	192	150	206
Cement ('000 quintals)	635	922	949	880	777	658	860	1,012	1,613	1,316	1,410
Sugar ('000 quintals)	713	875	1,182	1,401	1,322	1,375	1,735	1,896	1,800	2,200	2,300
GDP: value added in manufacturing (million CA pesos, 1958 prices)	34.3	35.0	38.9	42.0	42.0	43.3	46.4	52.9	60.0	67.0	68.9
Percent (%) of GDP		10.9									13.0

Source: Direccion General de Estadistica y Censos; Banco Central.

Table 2e: COSTA RICA: INDICATORS OF INDUSTRIAL PRODUCTION, 1958-65

	1958	1959	1960	1961	1962	1963	1964	1965
Beer (million liters) 1/	7.2	7.8	8.6	8.37	7.8	7.6	8.4	8.4
Cigarettes (million packs)	n.a.	55.9	58.9	60.7	59.7	61.9	62.8	64.8
Cotton cloth (metric tons)	600	610	645	697	825	928	1,180	1,360
Shoes, factory-made ('000 pairs)	n.a.	84	128	241	248	233	273	347
Paint ('000 gallons) 2/	n.a.	156	185	204	265	321	366	472
Cement ('000 metric tons)	-	-	-	-	-	-	36	114
Fertilizer ('000 metric tons)	-	-	-	-	-	-	78	102
Automobiles assembled units	-	-	-	-	-	-	337	1,291
Sugar ('000 quintals)	888	1,010	1,047	1,391	1,433	1,820	1,907	2,041
GDP: value added in manufacturing (million CA pesos, current prices)	42.2	43.9	48.2	53.1	60.8	65.2	73.5	80.3
Indices (1955=100)								
Energy consumed by industry	134	151	174	203	251	335	430	498
Employment in manufacturing	106	111	118	130	146	154	182	195
Salaries paid in manufacturing	114	121	138	158	175	193	243	281

1/ 3.199 11oz. bottles per liter.
2/ Ammonium nitrate and multiple fertilizers: excludes fertilizers merely mixed domestically.

Source: Central Bank. No published data on industrial output exist in Costa Rica: the industrial economics section of the Central Bank carried out a special survey to obtain these data for the mission.

Table 3a: GUATEMALA: VALUE ADDED IN MANUFACTURING BY MAJOR INDUSTRIAL BRANCHES, 1950, 1955, 1960-65

	(in million CA pesos at 1958 prices)								(as percent of total)			
	1950	1955	1960	1961	1962	1963	1964	1965	1950	1955	1960	1965
Food processing	26.2	29.5	39.9	41.0	43.8	48.2	51.7	53.5	30.3	29.9	30.1	24.5
Beverages	19.1	19.7	24.6	23.8	22.5	23.8	24.9	26.3	22.1	20.0	18.6	12.0
Tobacco	9.4	9.6	11.2	11.1	11.4	11.9	12.5	13.7	10.8	9.7	8.5	6.3
Textiles	4.7	6.4	10.4	11.9	15.7	21.0	30.8	37.9	5.5	6.5	8.0	17.3
Clothing and Footwear	11.1	13.2	18.9	20.2	24.1	29.0	34.5	38.9	12.8	13.4	14.3	17.8
Wood and Cork manufacturers	2.0	2.5	2.5	3.0	3.2	3.2	3.8	3.8	2.3	2.5	1.9	1.7
Furniture and fixtures	3.6	4.1	4.8	4.9	5.1	5.2	5.4	5.6	4.1	4.2	3.6	2.6
Paper and pager goods	-	0.1	0.6	1.1	1.4	1.7	1.9	2.6	-	0.1	0.4	1.2
Printing and allied industries	1.2	1.7	2.4	2.4	2.6	2.7	2.9	3.4	1.3	1.7	1.8	1.5
Leather and leather products	1.4	1.4	1.6	1.6	1.6	1.7	1.6	1.6	1.6	1.4	1.2	0.8
Rubber products	0.1	0.2	1.1	1.3	1.5	1.8	2.0	2.1	0.2	0.2	0.8	1.0
Chemicals and products	2.7	2.9	4.6	5.1	5.8	6.0	6.4	6.6	3.1	2.9	3.5	3.0
Non-metallic minerals	3.8	4.8	5.3	6.4	6.2	7.1	9.3	10.1	4.4	4.9	4.0	4.6
Metal products	0.4	0.9	1.5	1.9	2.6	3.8	4.8	5.4	0.5	0.9	1.1	2.5
Machinery, excluding electrical	0.1	0.1	0.2	0.3	0.4	0.6	0.8	0.9	0.1	0.1	0.2	0.4
Electrical machinery	0.1	0.2	0.3	0.3	0.5	0.7	0.8	0.9	0.1	0.2	0.2	0.4
Transportation equipment	0.6	1.0	1.6	1.7	1.8	1.9	2.2	2.5	0.7	1.0	1.2	1.1
Miscellaneous	0.1	0.2	0.8	1.1	1.4	1.8	2.3	2.9	0.1	0.2	0.6	1.3
Total	86.6	98.5	132.4	139.2	151.6	172.2	198.5	218.7	100.0	100.0	100.0	100.0

Source: Central Bank of Guatemala.

Table 3b: EL SALVADOR: VALUE ADDED IN MANUFACTURING BY MAJOR INDUSTRIAL BRANCHES, 1958, 1960, 1962-65

	(in million CA pesos, current prices) 1/						(as percent of total)			
	1958	1960	1962	1963	1964	1965	1958	1960	1962	1965
Food processing	29.7	32.7	37.1	36.7	39.0	44.6	39.4	39.5	38.4	32.8
Beverages	11.4	11.6	12.1	13.0	14.1	15.8	15.1	14.0	12.6	11.6
Tobacco	4.4	4.8	5.6	5.8	6.3	6.7	5.8	5.8	5.8	4.9
Textiles	4.0	5.8	8.3	9.8	11.6	12.0	5.3	7.0	8.6	8.8
Clothing and shoes	12.4	11.7	13.3	15.2	18.1	18.8	16.4	14.1	13.8	13.8
Furniture	0.6	0.9	1.1	2.0	2.2	2.1	0.8	1.1	1.1	1.5
Wood and wood products	0.6	0.5	0.6	0.6	0.6	0.6	0.8	0.6	0.6	0.4
Paper and cardboard	0.2	0.2	0.7	1.4	1.8	1.5	0.3	0.2	0.7	1.1
Printing	1.4	1.6	1.9	1.9	2.5	2.6	1.9	1.9	2.0	1.9
Leather and leather products	0.9	1.0	1.0	1.0	1.0	1.0	1.2	1.2	1.0	0.7
Rubber products	0.3	0.5	0.9	1.0	1.1	1.2	0.4	0.6	0.9	0.9
Chemicals	2.0	2.5	4.3	4.8	6.1	6.0	2.6	3.0	4.5	4.4
Petroleum products	-	-	-	2.7	4.6	6.3	-	-	-	4.6
Basic metals	0.1	0.2	0.2	0.2	0.2	0.4	0.1	0.2	0.2	0.3
Metal products	0.6	0.8	1.2	1.4	1.5	1.7	0.8	1.0	1.2	1.2
Machinery (excluding electric)	0.2	0.5	0.5	0.7	0.9	1.0	0.3	0.6	0.5	0.7
Electric equipment and appliances	0.4	0.4	0.5	0.6	0.6	1.4	0.5	0.5	0.5	1.0
Transport equipment	2.2	1.8	2.1	2.2	2.4	2.8	2.9	2.2	2.2	2.1
Miscellaneous	4.2	5.2	5.0	6.4	7.9	9.6	5.6	6.3	5.2	7.1
Total	75.5	82.7	96.6	107.1	122.4	136.1	100.0	100.0	100.0	100.0

1/ Preliminary

Source: Central Bank of El Salvador (subject to revision).

Table 3c: NICARAGUA: VALUE ADDED IN MANUFACTURING BY MAJOR INDUSTRIAL BRANCHES, 1958, 1960-1964

	(in million CA pesos at 1958 prices)						(as percent of total)			
	1958	1960	1961	1962	1963	1964	1958	1960	1962	1964
Food processing	14.5	14.7	17.7	20.5	21.4	23.7	34.5	33.9	38.8	35.2
Beverages	5.2	4.8	5.1	6.0	6.9	8.0	12.3	11.2	11.3	11.9
Tobacco	3.8	3.9	3.9	4.0	4.4	4.4	9.0	9.1	7.6	6.6
Textiles	2.0	2.6	2.5	3.6	3.9	4.3	4.8	6.0	6.8	6.3
Clothing and footwear	8.9	9.9	9.1	10.0	10.2	10.6	21.2	22.9	18.9	15.7
Wood and products	2.2	1.9	2.0	2.0	1.7	1.8	5.3	4.3	3.8	2.7
Furnitures and fixtures	0.2	0.3	0.4	0.4	0.5	0.6	0.4	0.7	0.8	0.9
Paper and products	-	-	-	-	0.1	0.1	-	-	-	0.2
Printing and allied industries	0.6	0.5	0.6	0.5	0.5	0.4	1.4	1.3	0.9	0.6
Leather and products	0.8	0.9	0.9	0.9	1.0	1.0	1.8	2.0	1.8	1.5
Rubber products	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.4
Chemical and products	1.5	1.5	1.6	1.8	2.3	2.6	3.5	3.5	3.5	3.9
Petroleum	-	-	-	-	2.4	3.8	-	-	-	5.6
Non-metallic chemicals	1.7	1.4	1.6	1.8	2.3	2.8	4.1	3.2	3.5	4.1
Basic metals	-	-	-	-	-	-	-	-	-	-
Metal products	0.1	0.2	0.3	0.4	1.3	2.1	0.3	0.6	0.7	3.1
Machinery, excluding electric	-	-	-	-	0.1	0.1	0.1	0.1	0.1	0.1
Electric machinery	0.1	0.1	0.2	0.1	0.1	0.1	0.3	0.3	0.2	0.2
Transport	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.2
Miscellaneous	0.2	0.2	0.2	0.4	0.5	0.6	0.4	0.4	0.6	0.9
Total	42.0	43.3	46.4	52.9	59.9	67.5	100.0	100.0	100.0	100.0

Source: Central Bank of Nicaragua.

Table 4: CENTRAL AMERICA: VALUE OF INTRA-TRADE BY MAJOR CATEGORIES OF MANUFACTURED PRODUCTS, 1962 AND 1965
(in million CA pesos)

	1962	1965
Manufactured foods	4.6	11.7
Petroleum products	-	3.2
Fats and oils	1.8	2.5
Chemical products	5.2	21.1
Manufactured products classified by materials	11.0	37.1
Machinery and transport equipment	1.1	5.0
Miscellaneous Manufactures	5.4	23.9
Total	29.1	104.5

Source: SIECA Trade Statistics

Table 5: CHANGES IN TOTAL IMPORTS AND INTRA-REGIONAL TRADE BY SELECTED MAJOR INDUSTRIAL PRODUCTS, FROM 1962 TO 1965

A. TRADITIONAL PRODUCTS
(values in million CA pesos)

	1962			1965			Increase from 1962 to 1965		
		of which			of which				Increased imports from CACM as percent of increases in total imports
	Total imports	From CACM 1/	From other areas	Total imports	From CACM	From other areas	Total imports	Imports from CACM	
Textiles	50.3	4.1	46.2	78.0	15.4	62.6	27.7	11.4	41
Yarns	8.9	0.9	8.0	19.1	3.0	16.1	10.1	2.1	21
Cotton years	3.3	0.9	2.4	7.0	2.6	4.4	3.7	1.7	46
Others	5.6	-	5.6	12.0	0.4	11.6	6.4	0.4	6
Cotton cloth	20.6	1.2	19.4	24.4	5.7	18.7	3.7	4.6	124
Textile specialties	5.9	1.3	4.6	6.4	3.1	3.3	0.5	1.8	360
Others	14.9	0.7	14.2	28.2	3.6	24.6	13.4	2.9	22
Clothing	9.2	2.2	7.0	16.0	8.8	7.2	6.8	6.5	96
Shoes	1.7	1.1	0.6	5.8	5.4	0.4	4.1	4.3	105
Manufactured foods	11.9	4.6	7.3	19.1	11.7	7.3	7.2	7.1	99
Cereal preparations	3.8	0.2	3.6	5.7	2.4	3.3	2.0	2.2	110
Processed fruits and vegetables	2.0	0.6	1.4	4.4	2.3	1.1	2.4	1.6	67
Candy and preparation	1.4	1.0	0.4	3.2	3.0	0.2	1.8	2.0	111
Sugar	1.2	0.7	0.5	1.6	0.8	0.8	0.4	0.2	50
Other	3.4	2.1	1.3	4.1	3.2	0.9	0.6	1.2	200
Wood products	0.6	0.4	0.2	1.6	1.5	0.1	1.0	1.1	110
Furniture	1.9	0.4	1.5	4.4	2.8	1.6	2.5	2.4	96
Leather and products	3.9	0.7	3.2	3.6	1.1	2.5	-0.4	0.4	-
Construction materials	3.7	1.4	2.3	4.8	2.9	1.9	1.2	1.5	125
Sub-total	83.2	14.9	68.3	133.3	49.6	83.7	50.1	34.7	69

Table 5: CHANGES IN TOTAL IMPORTS AND INTRA-REGIONAL TRADE BY SELECTED MAJOR INDUSTRIAL PRODUCTS, FROM 1962 TO 1965

B. NON-TRADITIONAL PRODUCTS
(values in million CA pesos)

	1962			1965			Increase from 1962 to 1965		
		of which			of which				
	Total imports	From CACM 1/	From other areas	Total imports	From CACM	From other areas	Total imports	Imports from CACM	Increased imports from CACM as percent of increases in total imports
Fertilizers	13.6	-	13.6	33.7	4.0	29.7	20.1	4.0	20
Petroleum products	37.0	-	37.0	28.1	3.2	24.9	-8.9	3.2	-
Cosmetics, toiletries and similar preparations	7.1	2.1	5.0	10.0	7.6	2.4	2.9	5.5	190
Pharmaceuticals	43.2	0.1	43.1	49.3	3.4	45.9	6.1	3.3	54
Miscellaneous chemicals	27.8	0.6	27.2	40.3	4.1	36.2	12.6	3.5	28
Insecticides and fungicides	19.3	0.2	19.1	23.8	3.1	20.7	4.5	2.9	64
Plastic materials	5.3	0.3	5.0	10.3	0.8	9.5	5.0	0.5	10
Others	3.2	0.1	3.1	6.1	0.2	5.9	3.0	0.1	3
Paints and Preparation	3.5	0.8	2.7	5.3	1.8	3.5	1.8	1.0	56
Basic materials and products	26.0	0.2	25.8	44.4	2.2	42.2	18.4	2.0	11
Miscellaneous metal Fabricated products	24.9	0.9	24.0	36.2	2.8	33.4	11.3	2.0	18
Paper and paper goods	10.0	1.1	8.9	13.8	6.1	7.7	3.9	5.0	128
Rubber products	8.4	0.6	7.8	10.2	1.9	8.3	1.8	1.3	72
Sub-total	201.5	6.4	195.1	271.3	37.1	234.2	70.0	30.8	44

1/ Central American Common Market

Source: SIECA Trade Statistics.

Table 6: CENTRAL AMERICA: MEASURES OF SPECIALIZATION INTRA-TRADE AMONG MAJOR INDUSTRIAL GROUPS

Code	Item Description	Volume of 1965 Intra-Trade (Thousands CA Pesos)	Percent of Imports Accounted for by major supplying country or countries
841-01-02-01	Ladies Stockings, synthetic fiber	599.5	64.4 - Guatemala 34.4 - Costa Rica
841-01-05	Stockings, cotton	188.9	77.5 - El Salvador
841-03-02	Clothing (orlon), knit of synthetic fiber	604.7	70.3 - Guatemala
841-04-02	Underclothing and pajamas (excluding knit) of synthetic fiber	393.1	45.2 - Costa Rica 30.4 - Honduras
841-11-01	Hats (excluding felt or asbestos) for men and children	354.8	81.8 - El Salvador
841-19-06	Ladies brassieres, corsets and similar articles	513.8	43.1 - El Salvador 35.5 - Costa Rica
851-02-02	Sport shoes, leather	2,302.3	59.3 - El Salvador
851-03-02-01	Espadrilles	749.7	42.7 - Guatemala 39.6 - Nicaragua
851-09-01	Shoes of plastic materials (excluding house slippers)	1,166.2	45.0 - Nicaragua 25.6 - El Salvador
062-01-01	Chiclets and gums	1,655.3	95.7 - Guatemala
073-01-03	Chocolates and preparation	266.7	72.2 - Costa Rica
048-01-02	Toasted wheats, oatmeal and related preparations (including breakfast foods)	949.7	91.1 - Nicaragua
048-04-02	Biscuits	1,022.1	65.1 - Costa Rica

Source: SIECA, Foreign Trade Statistics, 1965

TABLE 7

CENTRAL AMERICA: COMPARISON OF PREVIOUS NATIONAL TARIFFS AND THE COMMON TARIFF FOR SELECTED TARIFF SUB-ITEMS, AT 1964 UNIT IMPORT VALUES

		1964			Total Advalorem						2/ Average of		
		Value of imports from outside region (CA$)	Volume (Gross kgs.)	Unit Value (CA$)	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica	Common Tariff	Tariffs	Decreases	Increases
Manufactured Foodstuffs													
053-04-02	Fruit Juice	39,386	99,223	0.397	136	33	141	96	201	136	121		15
061-02-00	Refined sugar	21,836	52,419	0.417	46	68	25	44	63	46	49	3	
062-01-01	Chiclets and chewing gum	118,055	90,907	1.299	87	41	65	78	143	87	83		4
062-01-02	Candy	133,316	116,413	1.145	97	48	74	86	161	125	92		33
Chemical Products													
[illegible]-03-01	Paints, prepared	880,171	1,551,519	0.567	28	14	49	98	36	50	45		5
[illegible]-01-02	Lotions	273,345	88,569	3.086	69	34	56	69	130	105	72		33
[illegible]-01-03	Cosmetics	340,144	62,862	5.411	48	26	56	75	78	77	57		20
[illegible]-01-05-01	Tints, Pomades and other hair preparations	297,555	172,190	1.728	64	32	56	61	84	137	59		78
[illegible]-01-06	Toothpaste	58,347	27,784	2.100	22	19	11	17	25	32	19		13
[illegible]-01-07	Shaving creams and other similar products	110,115	55,445	1.986	96	30	56	17	114	126	63		63
[illegible]-02-01	Bath soaps	213,294	196,106	1.088	84	32	28	39	58	75	48		27
[illegible]-02-03-01-02	Washing and cleaning, non-abrasive	697,448	1,354,267	0.515	68	18	28	49	72	29	47	18	
[illegible]-01-00	Nitrogen fertilizers	8,245,925	156,223,652	0.050	1	2	Free	10	10	5	5		
[illegible]-09-00	Other manufactured, including mixed	6,804,970	77,236,569	0.088	1	1	Free	10	10	5	4		1
[illegible]-01-01-01-	Cellophane paper	1,210,876	1,065,504	1.136	28	10	25	10	22	20	19		1
[illegible]-01-03	Plastic cloth, except synthetic	1,244,172	1,281,636	0.971	20	19	144	41	58	72	56		16
[illegible]-01-04	Other plastic material, Non-manufactured	5,220,948	10,214,779	0.511	Free	5	66	20	106	25	39	14	
[illegible]-02-00	Insecticides and fungicides	27,171,920	40,633,088	0.669	Free	6	9	10	8	17	7		10
Manufactured Products Classified by Materials													
611-01-02	Tanned Hides	1,845,571	570,792	3.233	41	16	10	16	31	27	23		4
629-01-02	Tires	7,944,565	5,270,603	1.507	Free	11	6	17	18	126	10		116
631-02-00	Low-grade Lumber	37,215	86,561	0.430	55	31	0.07 1/	33	27	55	29		26
642-01-02	Cardboard Boxes	2,807,647	10,691,667	0.263	58	10	43	124	120	72	71		1
651-03-00	Cotton Yarn, Unbleached	1,415,673	1,035,035	1.366	22	16	20	25	20	23	21		2
651-04-00	Cotton Yarn, Bleached	2,713,133	885,064	3.065	20	11	11	24	11	16	15		1
652-02-03	Bleached Cotton Textiles Under 80 Grams	1,066,319	378,461	2.818	59	27	28	39	33	63	37		26
652-02-04	Bleached Cotton Textiles Over 80 Under 150gr.	12,133,352	4,354,043	2.787	33	28	28	40	47	64	35		29
652-02-05	Bleached Cotton Textiles Over 150 Grams	5,415,728	2,529,085	2.141	76	34	28	45	60	116	49		67
653-05-02	Rayon Textiles	4,960,580	2,589,319	1.916	323	61	28	204	240	140	171	31	
656-03-05	Blankets, Cotton	618,497	512,731	1.206	242	43	28	93	112	163	104		59
656-04-03	Towels	161,958	60,689	2.669	132	36	28	44	50	66	58		8
661-02-00	Cement	1,733,905	84,210,024	0.021	58	16	106	48	52	58	56		2
681-03-00	Structural Steel and Bars	7,106,019	58,404,238	0.122	5	11	22	18	20	10	15	5	
681-13-00	Iron and Steel Pipe	4,551,894	17,239,734	0.264	6	12	21	23	283	23	69	46	
684-02-02	Aluminum Rods and Wire	[illegible],851	364,990	1.194	5	9	15	12	19	32	12		20
699-01-04	Finished Structural Steel Pieces	[illegible],495	2,069,947	0.407	25	21	13	12	21	54	18		36
699-02-01	Windows, Etc.	[illegible],690	152,467	1.880	34	14	21	25	27	41	24		17
699-07-01	Iron and Steel Matls., Screws, Washers	2,[illegible],558	4,740,621	0.492	16	21	Free	Free	24	36	12		24
699-12-01	Steel Agricultural Hand Tools	1,[illegible],633	1,738,378	1.085	5	21	Free	10	10	20	9		11
699-14-01	Aluminum Kitchenware	[illegible],194	129,111	2.449	22	21	46	22	20	39	26		13
699-21-06	Other Thin Metal Containers	[illegible],305	1,203,647	0.785	45	13	7	23	33	29	24		5
699-29-06	Metallic Bottle Caps	1,[illegible],555	1,020,895	1.000	10	12	11	11	22	30	13		17
732-01-02	Passenger Cars	15,[illegible],373	10,334,846	1.533	55	26	15	26	91	3/	52		
732-03-02	Trucks	20,[illegible],862	16,503,665	1.223	10	18	Free	10	56	15	19	4	
821-01-02	Wood furniture, upholstered	[illegible],553	33,559	2.460	67	18	56	53	75	67	54		13
821-01-03	Other wood furniture	[illegible],282	90,982	1.531	59	24	56	47	102	89	58		31
821-02-03	Metal furniture	[illegible],375	425,064	1.335	77	26	56		112	85	54		31
841-01-02	Stockings, of synthetic fibers except rayon	[illegible],869	63,025	10.089	134	40	56	55	89	35	75	40	
841-02-02	Knit under and sleep wear, synthetics(excl.rayon)	[illegible],452	29,104	19.944	95	18	56	70	63	60	60	-	
841-02-03	Knit under or sleep clothing, pure or mixed rayon	[illegible],875	3,031	13.816	129	22	56	79	77	74	73		1
841-02-05	Knit under or sleep wear, pure or mixed cotton	[illegible],878	17,187	7.789	87	29	56	81	64	87	63		24
841-03-02	Outer clothing, of syn. fibers (exclud. knit)	[illegible],483	16,409	14.290	125	22	56	78	84	90	73		17
841-03-04	Clothing of wool knit (outer)	[illegible],531	35,284	17.842	76	21	56	67	55	55	55		0
841-03-05	Clothing of cotton knit (outer)	[illegible],401	19,702	8.141	84	33	56	87	62	143	64		79
841-04-05	Underwear of cotton, excluding knit	[illegible],519	13,266	7.728	88	27	106	82	90	108	79		29
841-05-06	Clothing, of cotton, pure or mixed (outer)	1,[illegible],702	254,553	4.084	387	67	56	15	161	216	157		59
841-11-01	Hats, except felt	[illegible],179	4,388	7.789	74	31	56	59	65	64	57		7
841-19-01	Belts, all types	[illegible],562	30,320	5.060	119	34	56	61	62	110	66		44
841-19-06	Corsets, Brassieres, and similar articles	1,[illegible],345	114,134	10.333	87	25	56	42	44	137	51		86
851-02-02	Shoes, leather	[illegible],440	34,498	5.143	150	74	56	59	78	68	83	15	
851-03-01	Sport shoes, cloth	[illegible],130	59,450	1.180	133	52	56	122	234	147	119		28
851-04-00	Rubber shoes	41,211	32,359	1.270	400	120	56	73	79	404	146		258
899-07-01	Kitchen and chinaware, of plastic material	189,163	81,649	2.317	53	20	60	85	50	75	54		21
899-07-03	Ash trays, soap boxes, household gadgets and adornments	82,887	33,219	2.495	50	20	56	80	126	120	66		54
899-11-01	Bags, bottles and other containers, plastic	577,035	245,676	2.349	21	11	48	23	25	31	26		5
899-11-03	Nets, furniture fixtures, plastic	825,611	526,822	1.567	10	14	18	116	42	10	41	31	
	TOTAL	160,420,180	530,422,118										

1/ Hondura's specific duty on ply-wood, expressed in Lempiras per cubic meter was converted to kilograms using an average conversion rate of 18.18 kilograms per cubic foot.

2/ Agreed Common Tariff rates have been included, although in some cases they are still under the transition periods established in the Second Protocol of San Salvador and the Guatemala Protocol.

3/ Pending agreement.

Sources: Tariff legislation: Guatemala, Decree No. 1269 of January 14, 1955; El Salvador, Decree No. 2781 of January 23, 1959 and Decree No. 2867 of July 8, 1959; Honduras, Law-Decree No. 80 of May 2, 1955 and Decree No. 3 of March 5, 1958; Nicaragua, Decree No. 128 of July 1, 1955; Costa Rica, Law No. 1738 of March 31, 1954 and subsequent modifications. For Trade Data, SIECA Foreign Trade Yearbook, 1964; Costa Rica's exchange rate used CA $1.00=CR ₡5.67 in effect in 1954.

Table 8: CENTRAL AMERICA: COMPARISON OF PRESENT COMMON TARIFFS WITH PROPOSED REVISIONS UNDER RECENT REQUESTS

	Current Common Tariff 1/ Equivalent ad valorem	Proposed new tariff equivalent ad valorem
A. Requests for tariff renegotiations		
Bicycles and parts	25	80
Paint brushes	18	51
Ladies clothing - undergarments		
Knit		
Silk, pure or mixed	113	163
Synthetics, pure or mixed	66	120
Rayon, pure or mixed	111	195
Other than knit		
Silk, pure or mixed	98	196
Synthetics, pure or mixed	78	139
Rayon, pure or mixed	138	240
Plastic sheets and shapes	44	99
Water proofed canvas	24	106
Manufactures of water proofed canvas		
Truck coverings	22	179
Others	41	125
Pipes and accessories, iron and steel	22	39
Kitchen utensils, of iron and steel, not elsewhere specified	39	92
B. Requests under Special System for Promotion of Productive Activities 2/		
Fluorescent tubes (request for El Salvador)	38	164
Fluorescent tubes (Costa Rica)	38	194
Hydrometers	17	165
Parts for umbrellas	32	85

1/ Based on unit values for periods 1962 through 1964; refers to common tariff although at present certain of the products are subject to equalization process.

2/ In addition, a request has been received for revisions of tariffs among certain chemical products, requiring the establishment of new tariff items so that it is not possible to make comparisons similar to those shown in the table. The proposed tariffs are generally of the order of 100 percent.

Source: SIECA, documents CE-XXII/D.T.2-A and 2-B; estimates of Mission Staff.

Table 9: CENTRAL AMERICA: SUMMARY OF EXEMPTIONS GRANTED TO FUNDAMENTAL OR BASIC NEW INDUSTRIES BY CURRENT NATIONAL LEGISLATION 1/

Type of Exemption	Guatemala		El Salvador		Honduras		Nicaragua		Costa Rica	
	Amount %	Period (years)	Amount %	Period (years)	Amount %	Period (years)	Amount %	Period (years)	Amount %	Period (years)
Custom duties on:										
Machinery and equipment	100	10	100	10	100	10	100	10	99	10
Construction material	100	10	100	10	100	10	100	10	99	10
Raw material	100	10	100	10	100	10	100	10	99	10
Fuel, oil and lubricants	100	10	-	-	100	10	100	10	99	10
Sales and excise taxes:										
Initial period	100	5	100	5	100	5	100	5	-	-
Subsequent period	50	5	50	5	-	-	-	-	-	-
Income tax:										
Initial period	100	5	100	5	100	5	100	5	100	5
Subsequent period	50	5	50	5	75	5	50	5	50	5
Tax on capital:										
Initial period	100	5	100	5	100	5	100	5	100	5
Subsequent period	50	5	50	5	-	-	-	-	50	5

1/ Includes classification designation as follows: Guatemala, "New Industry;" El Salvador, "Beginning and Necessary Industry;" Honduras, "Basic New Industry;" Nicaragua, "Fundamental New Industry;" Costa Rica, "New Industry."

Source: National legislation of the several countries.

Table 10: CENTRAL AMERICA: COMPARISONS OF INDUSTRIAL TARIFF EXEMPTIONS WITH TOTAL ASSESSED TARIFFS
(million CA pesos)

	1962	1963	1964	1965
Guatemala				
Tariffs collected 1/	26.5	25.4	27.3	30.9
Tariffs exempted	2.8	5.1	6.1	5.7
Total assessed	29.3	30.5	33.4	36.6
Percentage exempted to total	9.6	16.7	18.3	15.6
El Salvador				
Tariffs collected	24.0	24.1	25.6	25.1
Tariffs exempted	2.6	3.6	6.5	8.0
Total assessed	26.6	27.7	32.1	33.1
Percentage exempted to total	9.8	13.0	20.2	24.1
Honduras				
Tariffs collected	17.4	17.9	17.8	20.1
Tariffs exempted	0.3	1.2	2.0	2.5
Total assessed	17.7	19.1	19.8	22.6
Percentage exempted to total	1.7	6.3	10.1	11.1
Nicaragua				
Tariffs collected	21.8	23.1	21.9	24.2
Tariffs exempted	4.0	3.4	4.9	7.1
Total assessed	25.8	26.5	26.8	31.3
Percentage exempted to total	15.5	12.8	18.3	22.7
Costa Rica				
Tariffs collected	29.0	31.1	29.7	31.9
Tariffs exempted	1.4	2.1	5.6	9.9
Total assessed	30.4	33.2	35.3	41.8
Percentage exempted to total	4.6	6.3	15.9	23.7

1/ Except for 1965 refers to fiscal year ending.

Source: Official figures.

Table 11: CENTRAL AMERICA: SUMMARY OF PRINCIPAL EXEMPTIONS IN CENTRAL AMERICAN AGREEMENT ON FISCAL INCENTIVES, 1966 [1] FOR NEW INDUSTRIES

Category and Description of Enterprise	Exemption of Custom Duties and Related Charges on Imports: Of Machinery and Equipment	Of Raw Materials, Semi-processed Products and Containers	Of Fuel for Industrial use, except Gasoline	Exemption on Income Tax and Profit Tax	Exemption on Taxes on Assets and Properties
Group A Those producing raw materials or capital goods, or those that produce consumption goods, containers or semi-manufactures containing at least 50 percent materials of Central American origin.	100 percent for 10 years for Honduras; but 8 years for other countries.	100 percent for 5 years for Honduras, but 80 percent for other countries. 60 percent for additional 3 years, and 40 percent for additional 2 years.	100 percent for 5 years.	100 percent for 8 years for Honduras, but 6 years for other countries.	100 percent for 10 years for Honduras, but 8 years for other countries.
Group B Those that produce consumption goods, semi-manufactures or containers, provided they make significant net contribution to the balance of payments, have a large value added even if they have a a high proportion, in value terms, of raw materials, semi-manufactures or containers produced outside the region.	100 percent for 8 years for Honduras, but 6 years for other countries.	100 percent for 3 years for Honduras, but 80 percent for other countries. 50 percent for additional 2 years.	100 percent for 3 years; 50 percent for additional 2 years.	100 percent for 6 years for Honduras, but 4 years for other countries.	100 percent for 6 years for Honduras, but 4 years for other countries.
Group C Those not meeting conditions under Group A and B; or that only assemble, wrap, cut or dissolve products; or those listed in Annex I of the Agreement, namely: non-alcoholic drinks, wines, manufactured tobacco and toiletries.	100 percent for 5 years for Honduras, but 3 years for other countries				

1/ Terms set forth in Central American Agreement on Fiscal Incentives, 1962, as modified by protocol approved by Central American Economic Council, September 1966.

Table 12: IMPORTS OF INDUSTRIAL EQUIPMENT BY MAJOR BRANCHES, BY COUNTRY 1962-1965
(in million CA pesos)

Category and Country	1962	1963	1964	1965
Textile industry	4.4	5.8	8.3	9.8
Guatemala	1.8	2.5	2.6	3.0
El Salvador	1.5	1.5	2.8	4.5
Honduras	0.2	0.1	1.4	0.6
Nicaragua	0.4	0.9	0.3	0.6
Costa Rica	0.6	0.8	1.1	1.1
Food processing	5.9	6.2	10.1	7.0
Guatemala	1.9	2.0	2.4	1.4
El Salvador	1.5	0.7	4.0	1.6
Honduras	0.9	1.0	1.3	1.2
Nicaragua	0.7	1.2	1.1	1.5
Costa Rica	0.9	1.2	1.3	1.2
Printing industry	1.3	2.0	2.6	2.7
Guatemala	0.5	0.7	0.6	0.7
El Salvador	0.2	0.4	0.9	0.6
Honduras	0.2	0.1	0.3	0.4
Nicaragua	0.2	0.3	0.5	0.5
Costa Rica	0.3	0.4	0.4	0.6
Sewing Machines	3.8	1.9	2.3	3.6
Guatemala	1.3	0.4	0.6	1.0
El Salvador	0.6	0.5	0.5	0.7
Honduras	0.5	0.3	0.3	0.6
Nicaragua	0.5	0.4	0.5	0.6
Costa Rica	0.9	0.3	0.5	0.7
Leather and shoes	0.5	0.6	0.9	1.0
Guatemala	0.2	0.1	0.2	0.3
El Salvador	0.1	0.2	0.2	0.2
Honduras	-	0.1	0.2	0.2
Nicaragua	0.1	0.1	0.2	0.1
Costa Rica	0.1	0.1	0.1	0.2
Machinery and Metal Working	1.5	2.7	2.8	5.1
Guatemala	0.5	0.4	0.6	1.0
El Salvador	0.2	0.6	1.0	1.9
Honduras	0.1	0.1	0.1	0.2
Nicaragua	0.2	1.2	0.4	1.0
Costa Rica	0.5	0.4	0.6	1.0

Table 12: IMPORTS OF INDUSTRIAL EQUIPMENT BY MAJOR BRANCHES, BY COUNTRY 1962-1965
(in million CA pesos)

Category and Country	1962	1963	1964	1965
Others	7.1	9.2	11.0	10.4
Guatemala	2.1	1.8	3.1	2.7
El Salvador	0.8	0.9	2.1	1.8
Honduras	1.2	2.1	1.5	1.3
Nicaragua	1.1	1.9	2.2	1.9
Costa Rica	1.9	2.6	2.1	2.7
Total	24.5	28.4	38.0	39.6
Guatemala	8.3	7.9	10.1	10.1
El Salvador	4.9	4.8	11.5	11.3
Honduras	2.9	3.8	5.1	4.5
Nicaragua	3.2	6.0	5.2	6.2
Costa Rica	5.2	5.8	6.1	7.5

Source: SIECA Trade Statistics.

Table 13: DISBURSEMENT OF OFFICIAL EXTERNAL FINANCIAL AGENCIES FOR INDUSTRIAL PURPOSES, 1962-1965
(millions of CA pesos)

Country, external agency, and recipient	1962	1963	1964	1965
Guatemala 1/				
CABEI, direct loans	0.3	2.4	1.8	0.3
El Salvador	-	0.3	2.6	4.5
IDB, loan to Central Bank 2/	0.0	0.3	0.3	0.5
AID, loans to INSAFI	-	-	0.3	0.8
IDB, loan to INSAFI	-	-	-	4/
AID, loan to FISA 1/	-	-	-	0.5
CABEI, direct loans	-	-	2.0	2.7
Honduras	0.3	1.5	2.5	3.4
IDB loan to National Development Bank	-	-	-	0.8
AID loan to Financiera Hondurena 3/	-	-	0.6	1.5
CABEI, direct loans	0.3	1.5	1.7	1.1
IFC, direct financing	-	-	0.2	0.2
IDB - direct	-	-	-	-
Nicaragua	0.4	1.1	0.9	1.9
IDB, loan to INFONAC	0.4	0.6	0.4	0.7
AID, loan to INFONAC	-	-	-	0.3
AID, loan to CNI 3/	-	-	-	4/
CABEI, direct loans	-	0.5	0.5	0.9
Costa Rica	1.3	3.6	2.7	5.4
IBRD, Loan to Central Bank	0.9	1.4	0.6	0.8
IDB, loan to Bank of Costa Rica	-	0.3	0.6	1.1
AID, loan to COFISA 3/	-	-	0.2	1.9
IDB - direct	0.2	1.6	0.6	0.4
CABEI, direct loans	-	0.2	0.7	1.0
IFC, direct financing	0.2	0.1	-	0.2
Total	2.3	8.9	10.5	15.5
of which:				
- indirect financing	1.3	2.6	3.0	8.9
- direct financing	1.0	6.3	7.5	6.6
CABEI	0.6	4.6	6.7	5.8
Others	0.4	1.7	0.8	0.8

1/ A small portion of $11 million of IDB loans to Banco de Guatemala, was disbursed for industry.
2/ Estimated.
3/ Private investment company (financiera).
4/ No disbursements recorded from loan commitments.

Source: Central Banks and external financial agencies.

Table 14: CREDIT GRANTED TO INDUSTRY BY FINANCIAL SYSTEMS AND BY COMMERCIAL BANKING SYSTEMS, BY COUNTRY, 1961-1965
(in million CA Pesos, balances at end of year)

	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
	Financial Systems 1/				
1961	12.8	14.1	2.7	11.5	14.6
1962	12.8	15.3	3.6	16.3	17.3
1963	16.4	19.0	4.7	19.2	19.6
1964	22.7	24.8	6.9	28.3	24.7
1965	24.3	40.1	11.1	37.1	31.2
	Commercial Banks				
1961	12.1	10.1	2.6	9.0	14.6
1962	10.8	9.9	2.8	13.5	17.3
1963	13.0	13.2	3.8	14.2	19.6
1964	19.9	15.8	5.5	19.8	24.3
1965	22.6	25.3	6.4	26.6	28.9

1/ Includes commercial banks, other banks (e.g. savings), investment companies and public credit institutions.

Source: Central Banks and reports of financial institutions.

Table 15: CENTRAL AMERICA: CREDIT TO INDUSTRY AS PERCENTAGE OF CREDITS TO PRIVATE SECTOR, 1961-1965

	Guatemala	El Salvador	Honduras	Nicaragua 1/	Costa Rica
	Financial System				
1961	11.6	10.0	7.9	19.1	13.8
1962	11.6	12.0	9.5	24.5	15.4
1963	12.9	13.5	11.3	25.7	17.0
1964	15.8	15.0	13.8	27.9	18.6
1965	15.4	22.3	17.1	29.0	20.8
	Commercial Banks				
1961	11.9	14.2	7.5	16.7	13.8
1962	10.8	13.5	7.4	22.9	15.4
1963	11.6	15.2	9.1	22.0	17.0
1964	15.4	15.0	10.9	24.7	18.3
1965	15.9	23.3	12.5	26.1	19.1

1/ Includes commercial banks, other banks (e.g. savings), investment companies and public credit institutions.

Source: Central Banks and financial institutions.

Table 16: STRUCTURE OF EXTRA-REGIONAL IMPORTS, 1962-1965
(values in million C.A. pesos as percentage of total)

	Guatemala				El Salvador				Honduras				Nicaragua				Costa Rica			
	Value		Percent of total		Value		Percent of total		Value		Percent of total		Value		Percent of total		Value		Percent of total	
	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965
Crude Materials	6.0	11.7	4.5	6.0	2.1	10.9	2.0	6.9	1.5	1.7	2.2	1.8	1.5	6.4	1.6	4.6	1.0	2.0	0.9	1.2
Crude foodstuff	6.9	7.6	5.1	3.9	3.3	8.0	3.2	5.1	1.7	3.8	2.4	4.0	1.7	10.3	1.9	7.5	1.1	2.1	1.0	1.3
Manufactured foodstuff	6.7	7.4	5.0	3.7	7.5	4.0	7.3	2.6	4.3	3.6	6.0	3.8	6.0	3.5	6.4	2.6	7.8	9.2	7.0	5.6
Semi-manufacture for consumer goods	7.5	9.6	5.6	4.9	3.8	3.9	3.7	2.5	2.1	2.4	2.9	2.5	3.4	3.4	3.6	2.5	5.2	5.3	4.7	3.3
Semi-manufacture for producer goods	14.6	26.5	10.9	13.5	9.2	20.0	9.0	12.7	6.4	9.1	9.2	9.5	10.9	19.2	11.5	13.9	12.7	23.5	11.5	14.5
Finished consumer goods	37.8	44.4	28.3	25.2	35.5	40.5	34.6	25.8	23.9	33.4	33.7	34.9	28.5	36.9	30.3	26.8	32.3	46.0	28.8	28.3
Finished producer goods	54.1	77.1	40.5	42.8	41.1	69.8	40.1	44.4	30.8	41.7	43.5	43.5	42.1	58.0	44.7	42.1	51.8	74.5	46.2	45.8
TOTAL	133.6	178.4	100.0	100.0	102.5	157.1	100.0	100.0	70.7	95.7	100.0	100.0	94.1	137.7	100.0	100.0	111.9	162.7	100.0	100.0

Source: Based on SIECA Trade Statistics.

Table 17: NICARAGUA: STRUCTURE OF THE GROSS VALUE OF PRODUCTION IN SELECTED PRODUCT LINES, 1965
(As a percent of total value)

	Raw Materials		Other 1/	Value Added	
	National	Imported	Inputs	Total	% which Wages and Salaries
Food products	54.4	6.7	5.9	33.0	12.6
Textiles	15.8	20.4	14.9	48.9	23.8
Shoes	26.4	13.6	0.6	59.4	23.5
Clothing	26.6	30.0	5.1	38.3	19.9
Wood and Cork	35.5	9.5	5.7	49.5	23.6
Furniture	24.6	16.2	7.9	51.1	5.5
Paper and Products	0.2	61.6	8.7	29.4	14.4
Leather Products	44.3	10.5	2.8	42.4	18.9
Rubber and Products	-	39.2	7.0	53.8	15.4
Chemicals	8.6	51.8	4.0	35.9	9.0
Petroleum Products	-	73.1	10.1	16.8	3.8
Non-metallic chemicals	18.0	3.9	20.8	57.3	17.3
Metal Products	0.2	54.0	7.5	38.3	16.4

1/ Including electricity, fuels and lubricants.

Source: Annual Report of the Central Bank of Nicaragua, 1965, page 124.

Table 18: THE LEVEL OF INDUSTRY IN CENTRAL AMERICA - ACTUAL AND THEORETICAL

	Value added in Manufacturing (in million CA pesos)				Percentage Share of Manufacturing in Gross Domestic Product				Relative Level of Industrailization	
	1962	1965	1962	1965	1962	1965	1962	1965	1962	1965
	Actual		Theorectical 1/		Actual		Theoretical 2/			
					(A)	(B)	(C)	(D)	(A÷B)	(B÷D)
Costa Rica	60.8	80.7	71.4	92.2	13.9	14.7	16.3	16.8	0.85	0.87
El Salvador	96.6	136.1	101.8	120.4	14.9	17.4	15.7	16.0	0.95	1.13
Guatemala	146.7	218.7	208.9	285.1	13.1	15.2	18.7	19.4	0.70	0.78
Honduras	49.5	67.5	56.9	70.9	12.6	14.3	14.4	15.0	0.87	0.95
Nicaragua	52.9	68.9	60.9	85.5	12.7	13.0	14.6	16.1	0.87	0.80
Total of above	406.5	566.4	499.9	649.0	13.5	15.1	16.6	17.3	0.81	0.87
Central America 3/	406.5	566.4	591.8	777.6	13.5	15.1	19.7	20.8	0.69	0.73

1/ Based on the equation: $\log V = 1.637 + 1.369 \log y \div \log 1.124 \log P$, where y = per capita national income and P = population. Taken from United Nations, A Study of Industrial Growth: to be precise all data should be deflated to 1953 prices.
2/ Using actual data on gross domestic product.
3/ Computed as a regional unit.

Note: National income data for 1965 are based on extrapolating 1962 data prepared by Joint Planning Mission which relate national income to gross domestic product.

Sources: Mission calculations based on Data of Joint Planning Mission and national statistical services.