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Trade Liberalization and Economic Integration in Central America

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ABBREVIATIONS

| | |
|---------------|---|
| CABEI | Central American Bank for Economic Integration |
| CACM | Central American Common Market |
| CAT | Certificado de Abono Tributario |
| CBI | U.S. Caribbean Basin Initiative |
| CCC | Camara de Compensacion Centroamericana |
| CDT | Certificado de Descuento Tributario |
| CEFEX | Certificado de Fomento a las Exportaciones |
| CET | Common External Tariff of the CACM |
| CETRA | Certificado Transferible de Opcion a Divisas por Exportacion |
| CIEX | Certificado de Incremento de Exportacion |
| CMCA | Consejo Monetario Centroamericano |
| DICA | Derecho de Importacion Centroamericano |
| ECLAC | U.N. Economic Commission for Latin America and the Caribbean |
| FCMC | Fondo Centroamericano del Mercado Comun |
| FOCEM | Fondo Centroamericano de Estabilizacion Monetaria |
| FOPEX | Fondo para el Financiamiento de las Exportaciones |
| FTZ | Free Trade Zone |
| ICAITI | Instituto Centroamericano de Investigacion y Tecnologia Industrial |
| ICAP | Instituto Centroamericano de Administracion Publica |
| ISI | Import Substitution Industrialization |
| NAUCA | Nomenclatura Arancelaria Uniforme Centroamericana |
| NVA | National Value Added |
| SIECA | Secretaria Permanente del Tratado General de Integracion Economica Centroamericana |

PREFACE

This report is based on the findings of a mission that visited Central America from June 2 to June 24, 1988. The mission comprised Messrs. Ulrich Lächler (IENIN, mission chief and principal author of the report), Hans O. Moritz (LA2TF), Ivan Rivera (LATTF), Enrique Mendez (LATTF) and Irwin Baskind (Consultant). Valuable research assistance was provided by Messrs. Nicholas W. Kirk (IENIN), Jose Campa (Summer Intern) and Alvaro Benitez (Consultant), and editorial assistance by Ms. Stephanie Gerardi.

The Green Cover draft of the report was distributed to the member Governments and regional institutions of the Central American Common Market at the end of March 1989. It was discussed at the technical level in July 1989 with staff members of the CACM Secretariat, and subsequently with officials of several CACM member Governments. The Governments of Costa Rica, El Salvador and Nicaragua have formally cleared the report, while the Governments of Guatemala and Honduras have not expressed any objections to its publication. It is important to note that in the case of El Salvador the discussion in the report mainly refers to the economic situation existing prior to the election of the new Government, which took office in June 1989 and has since then embarked on a process of gradual trade liberalization. The World Bank accepts sole responsibility for the contents of the report.

TRADE LIBERALIZATION AND ECONOMIC INTEGRATION IN CENTRAL AMERICA

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EXECUTIVE SUMMARY AND RECOMMENDATIONS

The Economic Crisis of the 1980s

i. Beginning in the late 1970s, Central America experienced a series of internal and external shocks that led to a deep economic crisis from which the region has yet to recover. Between 1980 and 1985, all countries exhibited negative growth rates; by 1987, real incomes per capita were at levels attained in the early 1970s or before. At the same time, the region has been afflicted by serious political and social tensions, including armed conflicts in El Salvador, Guatemala and Nicaragua that continue to extract a heavy toll in lost human and physical resources.

ii. One consequence of the regional economic crisis has been the progressive disintegration of the Central American Common Market (CACM). Comprising Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, the CACM was officially created in 1960, with policies based on an import substitution industrialization (ISI) strategy to accelerate growth and promote the diversification of production and exports. During the first two decades of the CACM's existence, the region's economies grew at a rapid pace, supported by an overall expansion of trade and industrialization. Intra-regional trade, which accounted for only about 7.5% of total exports by CACM members in 1960, reached 25% in 1970 and remained at that level until 1980. By this criterion, the CACM was the most advanced of all integration efforts among developing countries. The rapid expansion of intra-regional trade, however, was largely due to trade diversion, rather than trade creation.

iii. Between 1980 and 1983, total exports from the region suffered a massive drop of 23%, with intra-regional trade contracting by 33%. Since 1983, total exports have stopped falling, but intra-regional trade has continued to decline, and currently accounts for only about 12% of all exports. This decline had a particularly strong negative impact on the industrial sectors in the CACM countries, which depended heavily on the regional market. Between 1980 and 1985, total regional manufacturing activity, valued in current dollars, contracted by approximately 10%.

Main Causes of the Crisis and the Decline of the CACM

iv. The economic crisis and the decline of CACM trade were mutually reinforcing. Both were precipitated by: (i) a protracted decline in commodity prices that caused a steep fall in the value of the region's principal agricultural exports; (ii) the oil price hike in 1979; (iii) the unprecedented increase in international interest rates, accompanied by decreased external borrowing opportunities; and (iv) the onset of armed conflict and political disturbances in the region. This last factor, in particular, has created a climate of instability and uncertainty that strongly contributed to the decline in gross domestic investment in all CACM countries, except Costa Rica, and represents a major obstacle to the region's economic revival.

v. An equally important factor contributing to the economic crisis was the high vulnerability of the CACM economies to these disturbances. Macroeconomic policy decisions taken before and during the time of the shocks contributed to this vulnerability. In the mid-1970s, several of the Central American countries began to experience increasing difficulties in balancing their fiscal and trade accounts. These imbalances were initially absorbed by an accommodating external environment, where countries in deficit could borrow abroad on easy terms instead of adjusting. The external environment became far less accommodating after 1979, forcing countries with deficits to take abrupt measures with contractionary effects on their economies, which in turn were transmitted to those CACM partners that had maintained greater policy discipline. Difficulties were compounded in some countries by inappropriate exchange rate and macroeconomic policies, which led to an increased reliance on foreign exchange controls. An exceptionally high dependence on external trade taxes, accounting for over 25% of central government revenues in most CACM countries, and volatile commodity prices made fiscal control hard to maintain.

vi. Another major element contributing to the region's economic vulnerability is the structure of trade that developed under the ISI strategy. The Central American economies remained fairly open despite the adoption of this strategy, but the pattern of trade was severely distorted: intra-regional trade mostly consisted of manufactured products, with a high concentration in final consumer goods. Extra-regional trade mainly consisted of a limited set of agricultural commodities, dominated by coffee, on the export side, and of intermediate and capital goods on the import side. The composition of extra-regional trade remained very similar for all CACM countries, with the consequence that adverse changes in the terms of trade had recessionary effects on all countries simultaneously, so that none could provide a stabilizing influence on regional demand.

vii. The contraction of aggregate demand resulting from the shocks in the late 1970s affected imports from within as well as outside the region. Intra-regional imports declined even more than extra-regional ones, however, and continued to fall after 1983, when trade with third countries stabilized. This further decline was largely due to the introduction of exchange controls, which applied to intra-regional as much as to extra-regional trade. These controls proved especially restrictive to intra-regional imports, because priority in the allocation of foreign exchange is generally given to essential imports (foods, medicines) and to intermediate and capital good imports needed to sustain domestic production. Less priority was given to manufactured consumer goods, the main items traded within the region. Furthermore, the demand for these goods is generally more elastic than that for intermediates and basic foods and, thus, is likely to have fallen off more rapidly in the course of recession. The collapse of the regional payments clearing house (Camara de Compensacion Centroamericana, CCC) following an unsustainable accumulation of unsettled intra-regional debts, made foreign exchange controls even more restrictive for intra-CACM trade.

viii. The decline of intra-regional trade while extra-regional trade remained constant meant that the individual economies became increasingly closed to trade: in 1975-1980, total exports accounted for 27% of the region's

GDP, and only 22% in 1985. This inward orientation was particularly pronounced in the manufacturing sector. Whereas intra-regional manufactured imports accounted for 10% of total regional consumption of manufactured goods in 1980, this share declined to 6% in 1985. The share of extra-regional imports over the same period remained the same. Part of the manufacturing production capacity initially installed as a result of the CACM protection barriers represented an inefficient allocation of resources. Once installed, however, the closure of the regional market implied a further efficiency loss, since it prevented the capture even of the limited economies of scale previously available in a more open regional market.

Two Primary Issues

ix. The continuing economic recession and advanced state of common market disintegration raise two basic issues: the first is how to reactivate and sustain growth in the region. The second is whether it would be in the best interests of the individual countries to revive the CACM as part of that growth strategy.

x. With regard to the first issue, it is important to recognize that the pursuit of an ISI strategy, either in a regional or national context, no longer offers a promising basis for achieving sustained growth in the region: The opportunities for rapid growth in the 1960s, which were provided during the first easy stages of import substitution, are largely exhausted. Also, the external economic environment has changed and is now less accommodating toward an ISI approach. Contrary to its declared objective, the past ISI strategy did not reduce the region's dependence on primary agricultural exports. Manufactured exports increased, but mainly in the context of intra-regional trade. Since these industries developed behind high protective barriers, they did not become competitive in third country markets. This was not a problem as long as commodity prices had been improving: agricultural export earnings stimulated growth and provided enough foreign exchange liquidity to facilitate the expansion of intra-regional trade. Intra-regional trade deficits, if not balanced through extra-regional export earnings, could be financed through easily obtainable external credit. Over most of the 1980s, however, the relevant agricultural commodity prices remained depressed and the prospects of improvement are not encouraging. New external credit also has become much more difficult to come by, particularly now that the region is laboring under a significantly heavier debt burden than in earlier periods.

xi. Recommendation. The primary motor for growth in the past was the expansion of trade, and this remains the most promising vehicle for overcoming the present crisis, especially in view of the small economic size of the CACM. To generate an expansion of trade, however, it is necessary to reduce the anti-export bias created by the past ISI policies, which relied on high external tariff barriers and distortionary fiscal incentives. Instead, trade liberalization is required to provide a better incentive framework, more conducive to both efficient import substitution and efficient export growth. In view of the limited prospects for improved traditional commodity export prices, the expansion of non-traditional exports toward third country markets is especially important, both to reactivate domestic production and to relieve the foreign exchange shortage that currently represents an important

constraint to intra-regional trade. Such an expansion is also needed to achieve a more diversified export base, given the need of reducing the region's vulnerability to commodity price fluctuations.

xii. The second issue is whether there would be any point in seeking to revive the common market, if the Central American countries were prepared to embark on a course of comprehensive trade liberalization. The purpose of trade liberalization is to achieve greater integration into the world economy, enabling the countries in the region to maximize the gains from trade and specialization. In a fully integrated world economy, there would be little reason to address the issue of regional integration, since this would already be an implicit byproduct of international integration. But the benefits of greater regional economic integration could be significant during the transition toward greater integration into the world economy.

xiii. The cornerstone of the CACM is the customs union, involving a common external tariff toward third countries and liberalized trade among the members. A central objective in seeking to revive the CACM would be the removal of intra-regional trade barriers, which had risen significantly in the course of the economic crisis beginning in the early 1980s. In the past, the liberalization of intra-regional trade was accompanied by an increase of external tariff barriers. That was the main policy element of the regional ISI strategy. For reasons discussed in para. x and in view of recent reform initiatives, discussed below, the reintegration of the CACM along the same policy lines would not offer a viable basis for sustained growth. Rather, the issue is whether the region would benefit if, along with reductions in the external trade barriers, intra-regional trade barriers were completely eliminated.

xiv. Recommendation. In the trade liberalization programs recently proposed in Central America, trade barriers are to be reduced in a gradual manner. Furthermore, even after all reforms have been carried out, some external tariff barriers will still remain, partly to generate government revenues. Domestic industries would, therefore, still be receiving a certain amount of protection against outside competition, both during the transition, while external trade barriers are being lowered, and afterwards. The removal of intra-regional trade barriers in this context would enable efficiency gains through greater economies of scale. Even though the regional market is small by world standards, it is several times larger than each national market and thus offers some potential for a more efficient division of labor. In general, however, it is unclear whether the trade creation gains from liberalizing trade within a region would outweigh the efficiency losses of trade diversion. In the case of the CACM, trade diversion significantly exceeded trade creation during the rapid intra-regional trade expansion of the 1960s. The reduction of intra-regional trade during the 1980s, however, was not accompanied by an increase or re-diversion of trade toward third countries. Since the level of integration achieved in the past was far advanced, much of the infrastructural and capital investments in activities oriented toward the regional market have already been made. A renewed expansion of trade within the region, therefore, could create gains without requiring an additional major diversion of resources away from other trade oriented activities. Although the original decision to make these investments in many cases may

have represented a resource misallocation, intra-regional trade liberalization would enable a better utilization of the now existing capital and thus reduce the efficiency losses. Moreover, the reduction in intra-regional trade barriers, as recommended here, would be accompanied by lower extra-regional trade barriers. This would also reduce the danger of inefficient trade diversion, which is inversely related to the level of extra-regional trade barriers.

xv. Several additional factors argue in favor of reestablishing the CACM as an effectively functioning common market: (i) given the geographical proximity of the national markets, the elimination of intra-regional trade barriers would lead to greater gains from the regional exchange of goods and services that would be considered "non-tradeable" from an extra-regional perspective. (ii) Infant exporters could benefit from the learning experience of selling in a regional market before they can hope to succeed in more distant and less familiar markets. Greater regional integration would expand the opportunities for obtaining that experience. (iii) Finally, effective economic integration could improve the basis for political cooperation and help defuse current tensions in the region. These arguments present a case in favor of achieving regional reintegration in the context of an overall free trade environment, but not as an alternative to external trade liberalization since Central America, even if fully integrated, would still be better off by liberalizing trade with the rest of the world.

xvi. The ideal situation from an efficiency standpoint would be for the Central American countries to be economically integrated with low trade barriers toward third countries. That would enable the countries to capture the benefits of integration while reaping the gains from increased trade with the rest of the world. The main problem to be solved, however, is how to approach that ideal situation from the current starting position. Two features of the current CACM prevent an easy solution: (i) some countries are far better prepared than others to initiate the reduction of external trade barriers, and (ii) the effective elimination of intra-regional trade barriers may be contingent on the adherence to a common external tariff. This has the consequence that measures to achieve greater external trade liberalization may conflict during the initial stages of policy reform with measures needed to promote greater regional integration.

xvii. The main purpose of this report is to suggest a regionally coordinated policy strategy, taking into account current reform initiatives, that would reduce the potential conflict between liberalizing external trade and reintegrating the CACM. An initial step toward defining such a strategy, taken in Chapters II and III, is to review the current economic situation in Central America, identify the main barriers to extra-regional and intra-regional trade and point out needed reforms to reduce distortions in resource allocation. Chapter IV discusses several key elements of the current Central American policy reforms initiated at the national levels, and proposes a way to coordinate these and further policies at the regional level. Chapter V examines the currently malfunctioning regional payments system, which constitutes one of chief obstacles to the expansion of intra-regional trade, and suggests means of improvement. Chapter VI examines the national incentive systems to promote non-traditional exports to third countries, which represent

an important part of the strategy to expand trade and diversify exports. It recommends various reforms to increase the effectiveness of these incentives and identifies some areas where greater regional cooperation could improve the exporting effort.

Extra-Regional Trade Barriers

xviii. Nominal Legal Tariff Structure. A central policy element of the CACM has been the adherence to a common external tariff (CET) schedule, which applies to over 90% of all import tariff positions. The key feature of the current CET is not that the average level of tariffs is exceptionally high by international standards, but that tariff levels are highly dispersed. That creates a problem of relative price distortions that leads to intra-sectoral resource misallocations, rather than one of overall trade suppression. The unweighted average legal tariff in the CACM countries is about 21%, with small variations across countries due to different rates on items not covered by the CET; legal tariffs range from 1% to 15%. When tariff surcharges are also included, the nominal average tariff rises to 26% in Costa Rica and 25% in Guatemala. (In Honduras, the other country to rely on tariff surcharges, a more complex system has evolved that leaves the average rate indeterminate.) At a more disaggregated level, manufactured consumption goods receive an average tariff of over 30%, while capital and intermediate goods receive average tariffs of between 10% and 20%. This disparity in tariff rates is even more pronounced when production weighted averages are used and when tariff exemptions are taken into account.

xix. The cascading pattern of nominal tariff protection, with the highest rates on manufactured consumer goods and the lowest rates on intermediate inputs, fosters the expansion of inefficient consumer goods industries, producing for the regional market but unable to compete in world markets, and discourages intermediate and capital goods industries, thereby imparting an anti-export bias to the manufacturing sector. It also tends to induce a high dependence on imported intermediates and to encourage excessive capital intensity, which does not correspond to regional factor endowments. These observations are partly reflected in the skewed composition of intra-regional and extra-regional trade, discussed earlier in para vi. They also receive some empirical support from various statistical regression results.

xx. Actual Tariff Structure. Another critical problem in most Central American countries is the erosion of fiscal revenues from tariffs. While the unweighted average legal tariff (including surcharges) is around 23%, the actual import duty revenue collected currently amounts to about 10% of the value of extra-regional imports (except in Honduras, which collects about 20% mainly on account of tariff surcharges). This difference between the unweighted average legal and actual rate is due to (i) the high disparity of legal tariff rates, (ii) arbitrary tariff exemptions granted to certain imports originating outside the CACM, and (iii) the existence of non-tariff barriers and quantitative restrictions. The dispersion of tariffs, noted earlier, reduces potential fiscal revenues by influencing import patterns: even fewer items with high tariffs are imported from third countries and capital and intermediate goods, with low tariffs, are imported more. This reduces the import-weighted average tariff rate. The main source of tariff

exemptions in the past was the regional fiscal incentives agreement to promote industry. This agreement was abolished during the 1986 CACM trade reform, but other exemptions are still granted at the national levels, especially for public sector imports. Non-tariff restrictions also reduce tariff collections by distorting import patterns: generally, items subject to the most restrictive non-tariff barriers simultaneously are subject to the highest tariffs, so that the presence of QRs results in fewer higher tariff items imported. Though not captured by these figures, smuggling activity motivated by profit opportunities arising from high tariffs appears to be significant and, thus, may also constitute an important source of foregone duty revenues. In Honduras, the erosion of fiscal revenues from the basic legal tariff has been particularly severe, so that the Government has had to rely increasingly on tariff surcharges, which currently account for almost 75% of total import duties collected. The result has been to create a highly opaque trade policy environment.

xxi. Non-Tariff Import Restrictions. Until 1989, foreign exchange restrictions were the single most important non-tariff barrier in El Salvador, Honduras and Nicaragua. In July 1989, El Salvador introduced a floating parallel exchange market for most trade transactions, thus largely eliminating the need for controls. Honduras and Nicaragua, still depend heavily on exchange controls, but have also introduced a limited system of multiple exchange rates to relieve pressures on official foreign exchange reserves. Under these systems, some items can only be imported at higher exchange rates than others, which is equivalent to imposing another set of tariff surcharges. Costa Rica and Guatemala, which have adopted more flexible exchange rate management and improved macroeconomic control, rely less on exchange controls; while exchange licenses are still required for all importers, they are generally granted within five to ten working days. Other quantitative import restrictions are also applied in all CACM countries, even though their legal status within the CACM Agreements is unclear. These QRs, however, are much less comprehensive than exchange controls. Most licensing requirements and import prohibitions currently imposed involve health, sanitary and security reasons. In Guatemala, for example, import prohibitions not related to health or security apply to 44 items and import licenses are needed for another 35 items (out of a total of 1885 tariff positions); in manufacturing, the value of domestic production covered by these QRs is less than 6%.

xxii. Export Restrictions. Export taxes are imposed primarily as a means of generating revenues, and mainly apply to traditional agricultural exports, particularly coffee. Non-traditional exports are generally subject to a low tax or are entirely exempt. Most countries also impose quantitative export restrictions on certain basic foods, that are also subject to price controls, and on a limited set of industrial inputs. As in the case of import licenses, the list of products subject to export restrictions for reasons other than health supervision is quite short; in Guatemala, for example, they comprise 61 tariff positions and roughly cover about 6% of domestic manufacturing production. Since the range of products exported from the region is also limited, however, the economic significance of these restrictions is difficult to estimate.

xxiii. Effective Protection. It is generally acknowledged that the 1986 CACM tariff reform reduced the average level of nominal tariffs and dispersion, but it also appears that these measures largely eliminated the "water" in the tariff without substantially altering effective protection rates. Several recent studies have estimated effective tariff protection rates for manufacturing in Central America to average around 70% - 80%, with considerable dispersion across industries. In one study on Costa Rica, effective rates ranged from 0 to over 200%. For Honduras, effective protection rates were also calculated on the basis of domestic and international price comparisons (instead of using relative nominal tariff rates), which yielded a considerably higher average rate of 178% for manufacturing activities. The lack of adequate data, however, makes an accurate calculation of effective protection difficult, so that these estimates can only serve as a rough approximation.

Intra-Regional Trade Barriers

xxiv. Under the CACM agreement, intra-union trade of regionally produced goods is to be exempt from all import duties and quantitative restrictions, with the exception of certain basic foods. Since the early 1980s, barriers to intra-regional trade have increased significantly, thus reducing the free trade character of the CACM. The main obstacle restricting imports is provided by foreign exchange controls. These controls initially emerged as a byproduct of balance of payments disequilibria and a reluctance in some countries to adopt more flexible exchange rates; and not as measures specifically intended to restrict CACM trade, since they apply to extra-regional as well as to intra-regional imports (see para. xxi). The collapse of the regional payments clearing house made the shortage of convertible currency even more problematic for intra-regional trade.

xxv. The inability of some CACM countries to settle their intra-regional debts has caused others to impose discriminatory foreign exchange and export restrictions in some instances. Most affected in this respect are Nicaragua, which owes more than US\$ 500 million in arrears to its regional partners, and Honduras. Tariff restrictions play a minor role in intra-regional trade. Import tariffs were imposed briefly when a trade conflict erupted among the CACM members during the early 1980s, but they were soon rolled back. Honduras continues to impose modest duties (of around 10%) as stipulated in the bilateral trade agreements and Nicaragua has imposed a similar levy on traders operating along the frontiers. Selective consumption taxes, which differ from country to country, represent another potential barrier to intra-CACM imports.

Recommendations

xxvi. Major trade policy reforms are needed in Central America to reduce relative price distortions leading to inefficient resource allocation, and make the trade environment more transparent, with the objective of providing a more solid basis for trade expansion and sustained growth. To maximize the benefits from trade liberalization, both extra-regional and intra-regional trade barriers should be reduced. With respect to extra-regional trade barriers the main reforms needed are: the reduction in levels and, particularly, in the dispersion of external tariff rates, the elimination of tariff

surcharges and exemptions for non-CACM imports, and the removal of quantitative restrictions and foreign exchange controls, accompanied by improved macroeconomic management. With respect to intra-CACM trade, the main obstacle that needs to be removed is foreign exchange restrictions.

xxvii. In implementing a trade liberalization, the maintenance of macroeconomic control and the appropriate sequencing of reforms are essential. These requirements impose a constraint on the speed at which reforms can be introduced and, thus, impinge on the issue of inter-country coordination of reforms. A change in tariff rates designed to adjust relative prices and induce structural adjustments will lose much of its effectiveness in the presence of widespread quantitative restrictions. For the tariff reform to have its desired effect, it is necessary to first remove foreign exchange controls, enabling the market mechanism to generate the appropriate price signals. The permanent removal of foreign exchange controls, in turn, is contingent on sufficiently flexible exchange rate management, coupled with enough fiscal control. Moreover, the reduction in trade barriers will attract more imports and, in the context of external tariff reductions, will also reduce fiscal revenues, which makes the task of preventing macroeconomic disequilibria even more critical.

Current Trade Reform Initiatives

xxviii. The depth and persistence of the current crisis prompted the region's policymakers to reevaluate further their past ISI strategy. Various reforms of the common market agreement, including a revised CET with reduced rates, the elimination of specific tariffs and the cancellation of the regional system of fiscal incentives to industry, had already been adopted in January 1985. Currently, all CACM governments are signalling a greater commitment toward more outward-oriented trade policies by seeking to join GATT, and some CACM countries have initiated additional reforms at the national levels: Costa Rica began a broad-based structural adjustment program in 1985, and is now implementing the second phase of reforms, involving substantial reductions in external tariff protection. Guatemala introduced a stabilization program in 1986, with considerable success, and is preparing to initiate trade reforms similar to the Costa Rican ones. While the other CACM members have also made some advances in policy reform, Costa Rica and Guatemala have progressed furthest in designing and implementing concrete trade liberalizing measures. An important feature in both economies is that they have implemented the most flexible exchange rate management and rely least on foreign exchange controls.

xxix. External Tariff Targets. The tariff reforms initiated in Costa Rica and planned in Guatemala involve phased reductions in the external tariff ceiling (including tariff surcharges). In 1987, this ceiling was over 200% in Costa Rica and 150% in Guatemala. In both cases, a tariff ceiling of 40% is the medium term (3-year) target to be reached in six half-yearly adjustments, while the tariff floor is to remain at 5%. In Costa Rica, there are two basic exceptions to this rule: for textiles, garments and shoes, the tariff ceiling reduction is to be spread out over 5 years, and certain "essential" imports (medicines, basic foods) may receive a tariff below 5%. Another element in the Costa Rican reform, is that some tariffs within the 5% to 40% tariff range

have also been lowered. This could conceivably weaken the adjustment effort, since lower tariffs on imported inputs raise the effective protection granted to final products. Nevertheless, the Costa Rican tariff reform targets yield a considerable reduction in the average nominal tariff rate, from 26.4% to 16.4%; more important, tariff dispersion is reduced, from a standard deviation of 21.4% to 13.1%. According to Government calculations, this reform reduces the average effective tariff protection rate from 72% to 60%, and dispersion from 50% to 25%. In Guatemala, the reduction of the tariff ceiling to 40%, leaving lower tariffs unchanged, reduces the average nominal tariff rate from 25% to 21% and the dispersion from 22% to 14%.

xxx. Macroeconomic Implications. The tariff reductions are likely to cause macroeconomic disequilibria by attracting more imports and reducing government tariff revenues, unless they are accompanied by appropriate fiscal and exchange rate responses. A series of simulations, based on a partial equilibrium trade model (SINTIA-T), were carried out with 1986 import data for Costa Rica and 1987 data for Guatemala, to estimate the impact of the tariff changes. Assuming certain "standard" demand elasticities, the results for Costa Rica suggest that the tariff reduction would cause yearly imports to increase by 10% in real terms after all tariff changes have taken place. This import surge would be prevented by a real devaluation of approximately 8%. Total tariff revenues in domestic currency, however, fall by around 40% according to these calculations, requiring significant fiscal adjustments to prevent a rising deficit. The simulation analysis for Guatemala, which takes tariff exemptions into account and only considers a tariff ceiling reduction to 40%, suggests that the required exchange rate adjustment would be considerably smaller (2%) and the simulated revenue decline to be only 8%. These simulation results overestimate the revenue loss, however, by not taking into account several factors: the real devaluation that accompanies the tariff reform would raise the domestic currency value of export tax revenues. Furthermore, the ultimate objective of the tariff reform is to induce an expansion of trade. The expansion of exports and imports would generate an increase in trade tax revenues from both sources.

Recommendations

xxxii. While the tariff ceiling reduction to 40% represents an unquestionable improvement in reducing economic distortions, effective protection rates would still remain significant, particularly for manufactured final goods. Further tariff reductions after the current reforms have been completed are, therefore, critically important from an efficiency standpoint. Such tariff reductions, however, would initially cause further declines in government revenues, thus tending to destabilize the fiscal budget. This decline could be avoided by raising the tariff floor, which yields the added benefit of reducing the dispersion in effective protection rates. Further simulation results suggest that a tariff floor increase to 10% would enable a reduction of the tariff ceiling to 20% in Guatemala without the need for major exchange rate and fiscal adjustments. According to the simulations for Costa Rica, a mere increase of the tariff floor to 10% would allow the Government to recover almost 60% of the revenue loss arising from the initial tariff reform.

xxxii. A unified tariff rate of between 10% and 20% would generate enough tariff revenues to maintain the fiscal accounts balanced at current levels. This represents the optimal long term policy, since it eliminates all distortions due to tariff dispersion. In addition to tariff unification, the optimal policy strategy also requires the gradual reduction of the currently high fiscal dependence on trade tax revenues, to be replaced by other less trade-inhibiting taxes.

Toward a Regional Trade Liberalization Strategy

xxxiii. The current trade reforms in Central America were initiated at the national levels and primarily focus on the removal of external trade barriers. Moreover, the proposed tariff reductions in Costa Rica and Guatemala violated, until recently (para. xliii) the precept of a common external tariff schedule, which has been one of the central policy elements of the customs union. While most policymakers in the region agree on the need to adopt more outward oriented policies, there is no consensus as to the speed and extent of reforms to be taken. This lack of policy coordination and uniformity has raised concern that the new reforms could lead to a further disintegration of the CACM.

xxxiv. As argued earlier (para. xvi), an effectively integrated common market with a liberalized trade policy toward third countries offers the best prospects for achieving sustained growth in the region. In view of current economic circumstances, however, the reforms needed to achieve trade liberalization and the principle of adhering to a common policy strategy are likely to conflict in the short run: continued adherence to a common external tariff schedule would mean that either Costa Rica and Guatemala postpone their tariff adjustments until the other CACM members are prepared to embark on a trade liberalization or, alternatively, that the other CACM members push ahead and introduce similar adjustment programs, regardless of their particular macroeconomic circumstances. Both alternatives would be counterproductive: Nicaragua, for example, already has severe difficulties in maintaining macroeconomic control and is experiencing political turmoil, which limits the scope for trade liberalizing reforms. In this case, a reduction in tariffs before greater macroeconomic control is achieved would likely lead to further destabilization and the eventual abandonment of reform efforts. If conversely, Costa Rica and Guatemala, were to hold off on their adjustment efforts, the opportunity costs would be considerable. At the present low levels of intra-regional trade activity, the gains from liberalizing external trade are bound to outweigh the potential losses from reduced intra-CACM trade. Moreover, any delays in introducing structural reforms increases the chances that new external developments could again destabilize their economies and lead to further postponing of reforms.

Recommendations

xxxv. In view of the current economic disparities in the region, a united approach to trade liberalization is impractical and difficult to achieve in the short run. Instead, the recommended approach is for each country to initiate its trade reform program at a separate speed best suited to its individual economic circumstances, with a joint commitment to converge

at common policy targets within a predetermined time horizon. This approach involves the suspension of the common external tariff schedule during the initial stages of reform, to give policymakers in the different countries greater flexibility in implementing policy reforms. The main idea behind this strategy is to first establish a well-functioning free trade area, as a stronger basis for eventually reestablishing a viable customs union. Inter-country coordination may be required in some areas, however, to succeed in attaining both trade liberalization and economic reintegration.

xxxvi. Coordination of External Tariff Reform. The proposed regional reform strategy requires a temporary suspension of the CET. That raises the question of when external tariffs should be harmonized again and at what level. The 5% floor - 40% ceiling adopted as tariff range targets in the Costa Rican and proposed Guatemalan reform programs represent a reasonable medium term target for all the CACM countries. But beyond the medium term, further adjustments toward a 10% - 20% tariff range and, then, toward a single uniform tariff within that range are recommended on economic efficiency grounds discussed earlier. The adoption of a common external tariff schedule at some point during these separate adjustment phases would enable further tariff reforms to be taken in unison. Such a step would facilitate intra-regional trade relations, but could also slow down progress in liberalizing external trade. The Costa Rican and proposed Guatemalan medium term tariff reforms are scheduled to be fully completed by mid-1992. Unless the other countries initiate similar reform programs soon they will not likely meet this deadline. By that time, however, the more rapidly reforming countries may be ready to initiate further tariff reforms, especially after the initial measures begin to yield their expected benefits. It is important then that the momentum toward economic liberalization be maintained, and not be held back by commitments to wait until the other partners have caught up with their adjustments.

xxxvii. It would, therefore, be impractical to negotiate a common tariff schedule within the 5% - 40% range, that would soon be superseded by further reforms. Instead, it would be preferable for the regional negotiations to focus on the adoption of a common tariff schedule further ahead in time and within a narrower target range, say 10% - 20%, that is closer to the optimal end-target tariff. This would set a common goal consistent with the liberalization objective and provide more time and flexibility for individual countries to adjust. At the same time, such a common market agreement should only be binding with regard to the tariff range limits and relative levels of tariff rates within those limits, thus permitting countries that are in a favorable position to unify tariffs further to proceed.

xxxviii. Intra-Regional Trade Liberalization. The temporary suspension of the CET under the proposed strategy should not impede progress in removing existing intra-regional trade barriers. Foreign exchange controls constitute the main restriction to intra-regional trade, and their removal primarily requires the elimination of severe macroeconomic imbalances in several of the CACM countries and the realignment of exchange rates. These measures are needed in any event, independent of common market considerations. Improved macroeconomic control is also a prerequisite for solving the problem of

outstanding intra-regional debts, which provides an additional encumbrance for regional payments transactions; see Chapter V.

xxxix. The success of the proposed joint trade liberalization strategy involving the temporary creation of a free trade area presupposes that all the CACM countries are committed to a strategy of overall trade liberalization. Some countries may be reluctant to embark on such a reform course, however. That reopens the fundamental question of whether the other countries would be better off liberalizing unilaterally or remaining within a more protected common market. Given the small size of the CACM, the potential economic benefits of liberalization toward the rest of the world are far greater than those that could be expected from a reintegrated CACM, even in the event that all intra-regional trade barriers were eliminated. Other considerations also play a role in decisions to liberalize, however, and certain countries may not be prepared to proceed. In that case, it would be best for all countries concerned to consider a looser regional arrangement, such as the bilateral trade ties that currently exist between Honduras and Panama, on one side, and the other CACM countries, that allow for preferential tariffs to be imposed on partner country imports. The imposition of tariffs on intra-regional trade would still constitute a major improvement over the current situation, which is dominated by intransparent non-tariff restrictions. Furthermore, such an arrangement should not impede needed progress in areas other than tariff policy; e.g., the harmonization of customs procedures and transport legislation, and cooperation in the upkeep of regional infrastructure, which are equally important in creating a freer regional trade environment and advancing the objectives of regional integration.

xl. Coordination of Tax Reform. The CACM countries are overly reliant on trade taxes. Also, the tariff reductions envisaged in the medium term reform programs will likely lead to significant reductions in government revenues (para xxx). To avoid macroeconomic disequilibria, governments will need to seek alternative revenue sources. Increased taxes on income and on consumption expenditures generally represent the best options. Such taxes can lead to resource allocation problems within a customs union, however, if they are applied selectively by product or industry. To avoid these problems, some harmonization of tax policies may need to take place: either each country applies a uniform tax (which may differ across countries) on all products, or all countries apply the same tax (which may differ across products). Just as certain import categories are currently excluded from the CET, however, it is also possible to exempt certain products from a regional tax harmonization agreement without causing appreciable distortions in the customs union.

xli. Intra-regional Compensation. The costs and benefits of a customs union are generally not equally distributed among its members. Under an ISI strategy, the less industrialized partner countries are likely to end up paying a disproportionate share of the costs of protection; Honduras' partial separation from the CACM in 1971 was partly prompted by the perception that its burden was excessive. To assure that it would be in each country's interest to further participate in the CACM, it may be necessary to create a transfer mechanism by which the net beneficiaries of the customs union compensate the relatively disadvantaged members. In the past, no explicit provision was made for compensation payments within the CACM. Instead, the

problem was handled through the lending policies of the regional development bank, CABEI, as part of its mandate to promote regionally balanced development. This compensation system has two basic drawbacks: first, as a development institution held accountable by its creditors, CABEI needs to focus on economically viable projects, especially in view of its current financial difficulties, and the simultaneous pursuit of compensation objectives will dilute this effort. Secondly, this compensation system does not solve the problem that the countries receiving the greatest benefits from protection do not share equally in the costs.

xlii. A central principle in designing a proper compensation mechanism is that the total regional costs of protection be shared in direct proportion to the benefits received. Aside from the equity aspect involved, this is important from the viewpoint of providing proper incentives: by establishing a direct link between costs and benefits, all countries are made aware of the costs of the commonly granted protection, and thus will have a greater incentive to limit protection barriers, in conformance with the trade liberalization effort. Establishing a compensation mechanism may be a cumbersome process, however, and in view of the currently reduced levels of trade in the region, it does not rank among the most pressing problems to be solved at this time. Furthermore, with progress made in the reduction of external tariff reductions, the total costs of protection requiring potential compensation are reduced.

xliii. Recent Actions Taken at the Regional Level. On November 17, 1988, the Ministers of Economy of the Central American countries, in an official resolution of the CACM Tariff Council, decided that: (i) work be initiated to revise the common external tariff; and (ii) individual countries be permitted to adjust external tariffs as part of their structural adjustment programs, until a new CET has been agreed upon. On December 13, 1989, the Ministers of Economy and Central Bank Presidents of the CACM agreed to prepare a program to progressively eliminate existing restrictions on intra-regional trade. These decisions clearly reflect an acceptance of the need for both intra- and extra-regional trade liberalization and represent important initial steps toward implementing a regional strategy that would conform with the earlier recommendations.

Reforming the Regional Payments System

xliv. The regional payments clearing house (CCC) was one of the most effective institutions of the CACM. In the late 1970s, 100% of all intra-regional exports were cleared through the CCC. This mechanism enabled CACM member countries to hold fewer liquid foreign exchange reserves for trade intermediation, led to net savings in transactions costs arising from payments made through third country banks, and served as an automatic vehicle for extending short term credit between central banks, which greatly facilitated intra-regional transactions. After the early 1980s, the volume of transactions made through the CCC steadily decreased until the system ceased to operate by 1987. Several bilateral payments agreements have been negotiated in the meantime, but these arrangements are poor substitutes for a smoothly functioning clearing house.

xliv. The most visible cause of collapse of the CCC is the unprecedented accumulation of unpaid balances by countries with intra-regional trade deficits. From a broader perspective, the regional payments crisis represents one aspect of the overall balance of payments and external debt crisis that has afflicted the region since the early 1980s. Although most CACM members have succeeded in rescheduling their extra-regional debts, thus enabling extra-regional trade transactions to proceed smoothly, no similar solution has been found for intra-regional debts. This situation constitutes one of the main impediments to the expansion of intra-CACM trade.

xlvi. Various proposals have been advanced and partly implemented to solve the regional payments crisis and revive intra-regional trade, including: (i) rescheduling of outstanding intra-regional debts with external assistance, (ii) introduction of negotiable import right certificates (DICAs), and (iii) establishment of freely functioning regional currency markets. These proposals have correctly focused on reestablishing a well functioning payments system as a crucial step in facilitating the expansion of trade. Even after debts have been rescheduled, however, a well functioning payments system can only persist if a realignment of exchange rates takes place in the region, together with the implementation of appropriate macroeconomic policies, which are needed to prevent balance of payments disequilibria, the need for foreign exchange controls and a recurrence of debt problems. In this respect, several proposals have narrowly emphasized only the realignment of exchange currencies within the region and the promotion of balanced regional trade; i.e., the equal expansion of intra-regional exports and imports for each CACM country so as to avoid the accumulation of debts. Such intra-regionally balanced trade is bound to be inefficient. But most importantly, it is highly unlikely that the foreign exchange markets can be segmented in a manner that would allow a realignment within the CACM without also realigning the regional exchange rates vis-a-vis third currencies. The preferable approach is to strive for a comprehensive realignment of exchange rates to generate an overall sustainable trade balance, including intra- and extra-regional trade partners.

xlvii. Recommendations. If the CACM member countries are prepared to implement a more flexible exchange rate management, a revised multilateral clearing house system represents the best solution to the current payments difficulties. This solution requires: (i) that some means of settling outstanding intra-regional debts be found; and (ii) that any refinancing arrangement be made conditional on various up-front macroeconomic policy adjustments. The creation of the new clearing house can take place gradually; initially including only the regional net creditors, and then successively incorporating additional member countries as soon as the requisite policy adjustments have been implemented.

xlviii. Several operating characteristics of the former clearing house mechanism will also have to be revised: first, the former rules required the joint adoption of a fixed exchange rate policy with occasional adjustments. This rule would have to be waived, at least over the medium run, since a sufficiently flexible exchange rate policy stance will likely be needed to complement the prospective external tariff reductions. Secondly, it is necessary to establish clear procedures in the event that some members encounter renewed debt repayment difficulties. Thirdly, any financing of

unsettled debts must occur on the basis of policy conditionality, applied early and before disequilibria become too large, with the possibility of enforcing a temporary suspension from participating in the clearing house when countries do not comply. The procedures established under the former clearing house mechanism lacked clarity and frequently were determined by political considerations. To avoid this problem, it is necessary to set up a sufficiently independent decision making body with the technical capabilities to identify required policy adjustments and monitor their implementation. In this regard, limited participation by external donors in the decisionmaking committee would guarantee greater independence from regional political influences. During 1989, the CACM countries reached an agreement with the European Commission to establish a Central American Payments System in the first half of 1990 with European Community support. The features of that system are not yet clear and should be reviewed with the preceding considerations in mind once it has been implemented.

The Promotion of Non-Traditional Exports to Third Countries

xlix. A fundamental objective in creating the CACM was to achieve the diversification of exports with the aim of reducing the region's vulnerability to commodity price shocks. Despite the failure of the ISI strategy in achieving this objective, it remains an important concern for the region and, since the mid-1980s, has led to an intensification of efforts to promote non-traditional exports outside the CACM. Legislation was introduced in all countries to establish new incentive mechanisms or to streamline and broaden existing incentive systems. Currently, all CACM members also are seeking or have obtained provisional access to GATT (Nicaragua being one of the original charter members).

xlx. The Main Export Incentives comprise (i) tax credit certificates granted in proportion to the value of exports (in Costa Rica, El Salvador and Honduras), (ii) income and sales tax exemptions to exporters, (iii) duty exemption through temporary admissions systems, (iv) free trade zone status (except in Nicaragua), (v) access to special foreign exchange funds for export financing (in Costa Rica, Nicaragua, and planned in Guatemala), and (vi) foreign currency retention schemes (in Honduras and Nicaragua).

1. The Effectiveness of Export Incentives. The total value of benefits currently granted to non-traditional exporters is significant in most CACM countries, and is also perceived as important by exporters, as reflected in survey polls. Nevertheless, these incentives do not fully compensate for the anti-export bias generated by the current external tariff structure. For the CACM as a whole, non-traditional exports to third countries have expanded since the promotion efforts intensified, but still not enough to make up for the decline in exports within the CACM. This pattern applies for each country taken individually, except Costa Rica: in 1987, the total value of non-traditional exports from Costa Rica (including to the CACM) exceeded its previous peak (in 1980) for the first time. Furthermore, the Ministry of Exports estimates that in 1988 non-traditional exports could even exceed the value of traditional exports. Part of this success may be explained by the fact that export promotion efforts began earlier and were more vigorously implemented in Costa Rica than in other CACM countries. Also, Costa Rica has

been the politically most stable country in the region, therefore more attractive to new export oriented domestic and foreign investments, and the most aggressive in its flexible exchange rate management. Costa Rica's successful performance provides a useful example to other countries with similar resource endowments in showing that greater orientation toward third country markets can lead to significant export growth and diversification.

Recommendations

li. Export incentives represent an important policy instrument needed to reduce the strong anti-export bias created by tariff and non-tariff import barriers in Central America. Furthermore, since the region's apparent comparative advantage lies in the production of coffee, bananas and a few other basic agricultural commodities, a comprehensive trade liberalization by itself may not generate a sufficient expansion of non-traditional exports in the short run. Export incentives for non-traditional exports would then still be needed, at least temporarily, to satisfy the region's objective of reducing the vulnerability to international commodity price movements. What a trade liberalization would achieve is to reduce the costs involved in promoting export diversification. While the current incentives granted on average do not compensate for the anti-export bias generated by other trade policies, further incentives in the form of higher subsidies are not recommended. They would put additional burden on the fiscal budget (especially by raising administrative costs) and may provoke foreign retaliation in the form of countervailing duties, as happened with cement and cut flower exports from Costa Rica. Furthermore, in attempting to correct existing distortions in the trade regime, many export incentives introduce other distortions into the economy. The more efficient strategy would be to reduce the levels of tariff and non-tariff protection that cause an anti-export bias, instead of attempting to fully compensate for that bias through alternative means.

lii. Streamlining Export Incentives. To reduce distortions from the export incentives themselves, effective incentive rates granted to different producers must be uniform. In Costa Rica, for example, the method of granting tax-credit certificates (CATs) gives the greatest incentive to eligible export activities with the lowest national value-added content, thereby encouraging export industries that are relatively dependent on imported inputs. To eliminate this bias, the incentives should be granted in proportion to value-added measured as the difference between export receipts and imported input costs. Other areas in need of reform in particular instances are: (i) the simplification of eligibility criteria; (ii) the reduction in time horizons over which previously negotiated export benefits are granted; (iii) the assurance that all potential direct and indirect exporters have equal access to incentives; and (iv) the reduction of incentives for other activities not related to exporting. Finally, there is an issue of achieving compatibility with the rules of GATT, to avoid foreign trade policy retaliation. Countervailing duties can create serious harm in the context of infant exporters. It would be prudent, therefore, to reduce reliance on fiscal subsidies as much as possible, and replace these with other instruments less likely to provoke countervailing actions abroad.

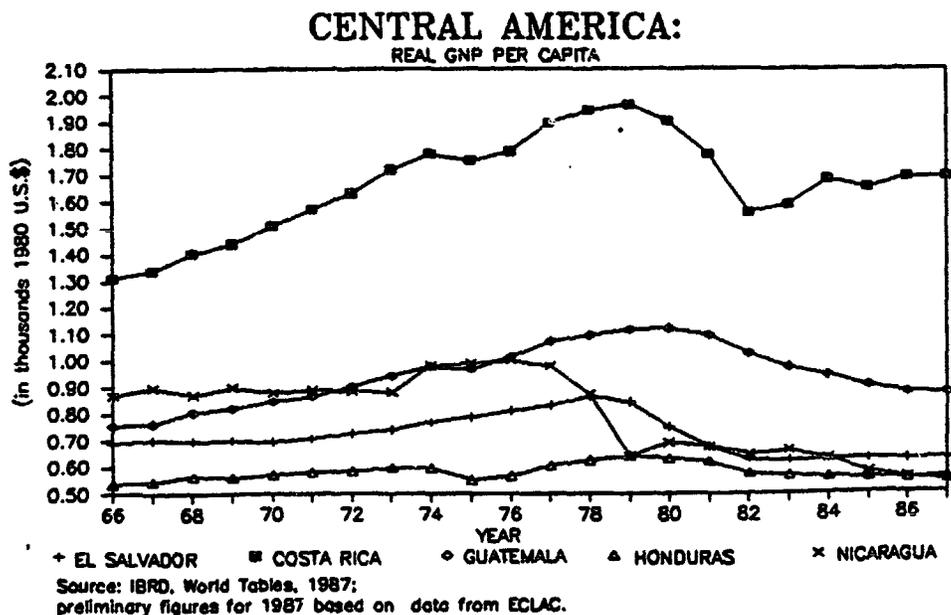
CHAPTER I

INTRODUCTION

1.01 Central America experienced a series of internal and external shocks beginning in the late 1970s that has left the region's economies in disarray. These shocks included a steep decline in the international prices of Central America's major export commodities, a rise in the price of oil and an external credit squeeze brought on by the international debt crisis. Internally, a widening of macroeconomic imbalances since the mid-1970s and a distorted trade structure fostered by past trade policies rendered the Central American economies highly vulnerable to those shocks and inhibited their ability to adjust. Meanwhile, the region has been afflicted by increased political and social tensions since 1978, including armed conflicts in El Salvador, Guatemala, and Nicaragua, that continue to extract a heavy toll in lost human and physical resources.

1.02 These developments culminated in a deep economic crisis, involving a fall in most social and economic indicators, from which the region has yet to recover. The profound magnitude of this crisis is illustrated in Figure 1: in 1987, real per capita income in Costa Rica and Guatemala barely reached the levels achieved in 1973, while in Honduras it had receded to a level achieved in 1970. Even more dramatic declines occurred in El Salvador and Nicaragua, where real incomes were set back by more than two decades.

Figure 1



1.03 An important consequence of the regional economic crisis has been the progressive disintegration of the Central American Common Market (CACM). The CACM was created in 1960, with a customs union as its focal point. During the first two decades of the CACM's existence, the region's economies grew at a fast pace, supported by rapidly expanding trade and industrialization. Intra-regional trade, which represented about 7.5% of total exports from the CACM members in 1960, reached 25% in 1970 and remained near that level until 1980. By this criterion, the CACM was the most advanced of all integration efforts among developing countries (see Annex Table C.10). Since 1980, however, intra-regional trade declined steeply and currently accounts for only about 12% of total regional exports.

1.04 The depth and persistence of the economic crisis has forced Central America's policymakers to reevaluate their past economic policies, which were based on an import substitution industrialization (ISI) strategy. This has led to several economic reform measures at both the regional and national levels. Different economic and political circumstances, however, have enabled some countries to advance further than others in introducing policy reforms. Costa Rica has initiated and Guatemala is planning a comprehensive trade liberalization program, but in some CACM countries progress in trade reform has been slower. This policy disparity has strained economic relations within the region and has raised concerns over the possible further disintegration of the CACM. Many policymakers in the region consider the common market, despite its shortcomings, to have been a positive force in promoting regional development. Moreover, as with most regional integration efforts, the CACM was motivated as much by political reasons as by economic ones. In view of the region's current political problems, some policymakers fear that a further severance of regional economic ties could have a destabilizing impact and might undermine ongoing peace efforts.

1.05 Two basic questions facing the Central American countries are (i) how to reactivate and sustain growth and (ii) whether it would be in their best economic interests to revive the CACM as part of that growth strategy. This report argues that the ISI strategy pursued through the CACM in the past is no longer viable as a basis for achieving sustained growth. Instead, comprehensive trade liberalizing policy reforms are needed to encourage structural readjustments that would enable the region's economies to perform more successfully in the current international economic environment. A reintegrated regional market could play a positive role in this strategy, especially during the transition toward an overall liberalized trade policy environment.

1.06 The ideal objective would be for the Central American countries to be economically reintegrated with low trade barriers toward the rest of the world. The disparity in economic circumstances currently affecting the separate CACM countries, however, has created a potential conflict between achieving overall trade liberalization and regional economic reintegration. That is, some countries are better prepared to initiate trade liberalizing reforms, while economic reintegration may hinge on the adherence to common trade policies. The main purpose of this report is to suggest a regionally coordinated policy strategy, taking into account current reform initiatives,

that could reduce this conflict and promote progress toward achieving sustained economic growth in the region.1/

1.07 The report is organized as follows: Chapter II reviews the recent economic developments, with primary attention devoted to the region's trade and industrial performance, and discusses the need for structural reforms. Chapter III analyzes the trade policy environment, identifying the main barriers to intra- and extra-regional trade and assessing their economic consequences. Chapter IV analyzes key elements of the recent trade reforms initiated at the national levels and proposes a strategy to coordinate and implement these and further needed reforms at the regional level. Chapter V examines the currently malfunctioning regional payments system and the measures needed for reestablishing a viable payments system to facilitate the expansion of intra-regional trade. Chapter VI, examines the policy incentives to promote non-traditional exports to third-countries and recommends various reforms to improve their effectiveness in generating efficient export expansion and diversification.

1/ Earlier Bank studies on Central America (Economic Development and Prospects of Central America, Report No. WH 170a, dated June 5, 1967; Report of the Industrial Finance Mission to Central America: The Common Market and Its Future, No. PI 7a, dated May 2, 1972; and Central America: Special Report on the Common Market, No. 2325b-CA, dated September 29, 1980) were completed before the current economic crisis and, thus, do not adequately address many of the issues now confronting the region.

CHAPTER II

ECONOMIC STRUCTURE AND PERFORMANCE OF CENTRAL AMERICA

2.01 With historical roots dating from the beginning of the 19th century, the movement toward Central American integration intensified during the 1950s. Efforts were made to harmonize tariffs and investment incentive legislation, and major expansions of regional infrastructure (particularly roads) took place. In December 1960, the General Agreement on Central American Economic Integration was signed, marking the official beginning of the Central American Common Market (CACM), which comprises Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.^{2/} The central element of the CACM was a customs union, designed on the basis of an import substitution industrialization (ISI) strategy.^{3/} The main objectives in choosing this strategy were to accelerate growth and reduce the region's traditional dependence on primary agricultural export commodities.

A. Overall Trade and Growth Performance

2.02 During the 1960s, the Central American economies grew rapidly, comparable to the experience of other developing countries over that period (Table 2.1). The region's total real GDP expanded at an annual rate of almost 6%, with individual rates ranging from 5% for Honduras and 6.5% for Nicaragua. Real GDP growth was reduced during the 1970s (in parallel with the world economy), but still remained high; averaging 5.4% per annum. The region's positive growth performance over this period was supported by a steady expansion of exports and imports (Figure 2). Except for a temporary deterioration in 1974-75, coinciding with the first oil price hike, the terms of trade developed favorably for the region. Agricultural exports, in particular, were strongly stimulated by increasing international commodity prices.

^{2/} Honduras partially withdrew from the CACM customs union in January 1971, after a border conflict with El Salvador and disputes over the sharing of protection costs. Honduras subsequently established preferential trade ties with the other CACM members on a bilateral basis, and continued to participate in the other CACM institutions. Similar preferential trade arrangements also exist between the CACM and Panama. Throughout the report, however, Honduras is included as part of the CACM, but not Panama.

^{3/} The CACM also encompassed various other regional arrangements and institutions, including a permanent secretariat (SIECA), to oversee and coordinate the integration effort, a regional development bank (CABEI), a regional payments clearing house (CCC), a balance of payments stabilization fund (FOCEM) administered by a regional monetary council (CMCA) and agreements on fiscal incentives to industry.

Table 2.1
CENTRAL AMERICA: REAL GDP GROWTH RATES
(average annual growth rates of GDP at constant prices)

| | Costa Rica | El Salvador | Guatemala | Honduras | Nicaragua |
|--------------------|----------------------|-------------|--|----------|-------------------|
| 1950-1960 | 6.4 | 4.8 | 3.7 | 2.8 | 5.4 |
| 1960-1970 | 5.9 | 5.5 | 5.2 | 5.0 | 6.5 |
| 1970-1979 | 6.3 | 4.6 | 5.8 | 4.8 | 0.8 ^{a/} |
| 1980-1987 | 1.3 | -1.9 | 0.1 | 1.9 | 1.6 |
| 1985 | 1.0 | 2.0 | -0.6 | 3.2 | -4.1 |
| 1986 | 4.6 | 0.6 | 0.2 | 2.7 | -0.6 |
| 1987 ^{b/} | 3.0 | 2.6 | 2.5 | 4.2 | 1.7 |
| | Developing Countries | | Latin America & Caribbean (oil importers) | | |
| 1965-1973 | 6.6 | | 7.1 | | |
| 1973-1980 | 5.4 | | 5.4 | | |
| 1980-1987 | 3.6 | | 1.8 | | |

^{a/} In 1979, Nicaragua experienced a -24.5% decline in GDP. Excluding that year, its average growth rate over the 1970s would have been 3.9%.

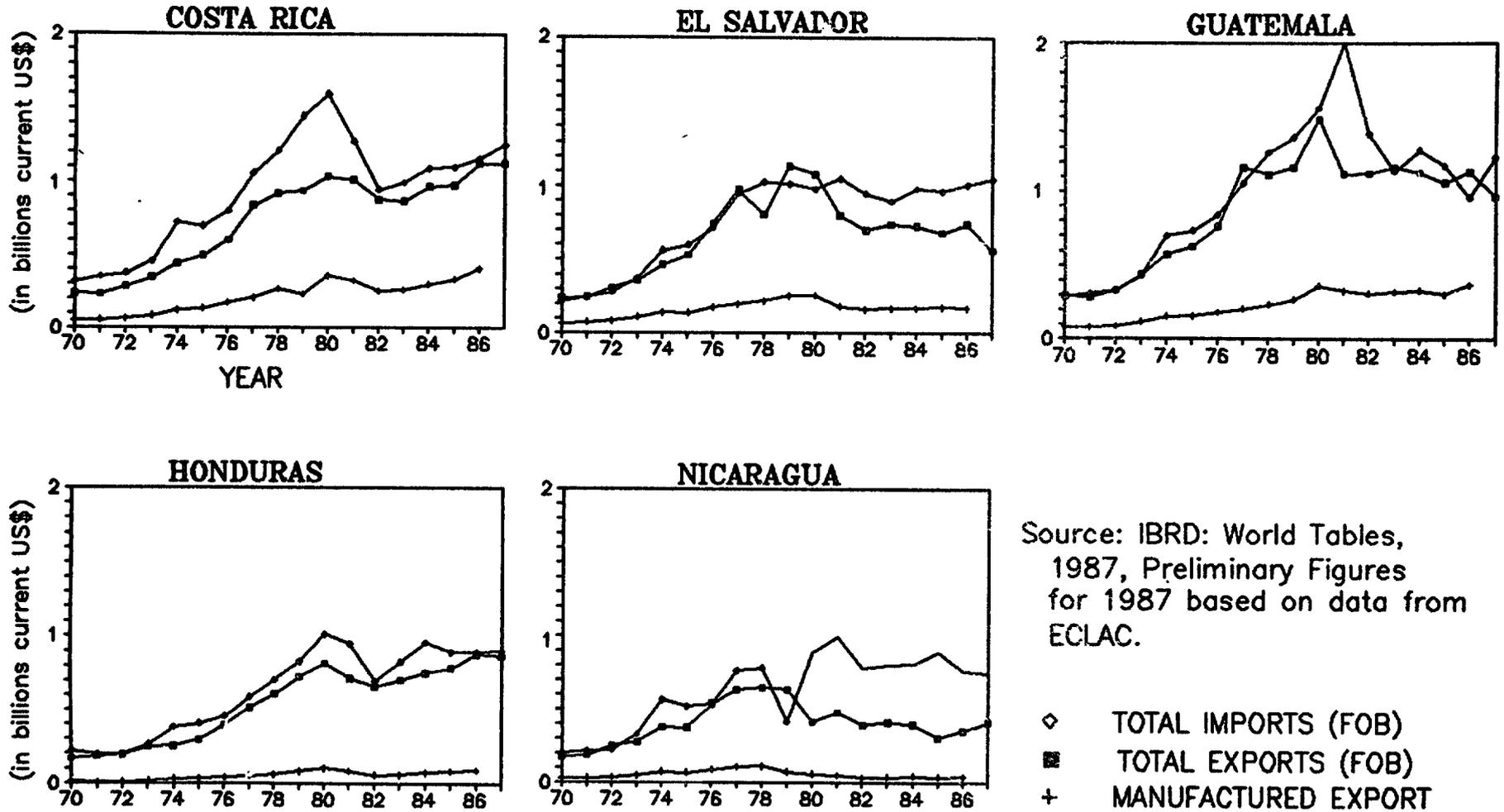
^{b/} Preliminary figures

Source: ECLAC; IBRD, World Development Report, 1986, 1987.

2.03 In the early 1980s, the favorable developments of the preceding two decades reversed: total exports of the region suffered a massive decline of 23% between 1980 and 1983, while imports declined by 16%. Annual real GDP growth rates fell dramatically for the entire region, attaining negative figures in every country. The worst decline was experienced by Nicaragua, where the economic crisis began in 1978, followed by El Salvador, which had five successive years of negative growth beginning in 1979, and Guatemala; in all three countries internal political conflicts played a significant role in disrupting their economies. Since 1985 there have been a few signs of recovery, but growth rates remain small by earlier standards and generally lie below population growth. Total trade flows have also remained stagnant in dollar terms, except in Costa Rica, which has achieved a slow but continued expansion of exports and imports.

Figure 2

TRADE PERFORMANCE CENTRAL AMERICA



Source: IBRD: World Tables,
1987, Preliminary Figures
for 1987 based on data from
ECLAC.

B. The Significance of Intra-Regional Trade

2.04 Intra-regional trade also contributed significantly to the overall expansion of exports and imports during the 1960s and 1970s. Encouraged under the protective umbrella of the newly created common market, intra-CACM exports grew faster than extra-regional exports during the 1960s (but starting from a much lower base), and then expanded at the same rate as extra-regional exports during the 1970s. As a result, the share of intra-CACM exports to total exports, which only amounted to 7%-8% in 1960, more than tripled to 25% by 1968-70, and remained at that level until 1980 (Table 2.2). El Salvador and Guatemala accounted for the highest share of intra-regional exports during this period, in absolute value and in proportion to their total exports. For Honduras, exports to the other CACM countries declined in significance during the early seventies, after its partial withdrawal from the CACM in 1971, but then increased again to reach 10% of total exports by 1980.

Table 2.2
CENTRAL AMERICA: THE VALUE OF INTRA-REGIONAL TRADE

| Value of Exports to CACM | (in millions US\$) | | | | | |
|-----------------------------|--------------------|--------------|---------------|--------------|--------------|--------------|
| | 1960 | 1968 | 1980 | 1983 | 1986 | 1987 a/ |
| Costa Rica | 1.9 | 37.7 | 270.3 | 187.1 | 100.5 | 104.7 |
| El Salvador | 12.7 | 84.9 | 295.8 | 168.1 | 86.7 | 117.2 |
| Guatemala | 7.3 | 77.5 | 403.7 | 308.2 | 192.0 | 230.6 |
| Honduras | 7.4 | 31.3 | 83.9 | 61.4 | 18.8 | 25.0 |
| Nicaragua | 3.4 | 26.9 | 75.4 | 33.0 | 15.2 | 14.4 |
| Total CACM | 32.7 | 258.3 | 1129.2 | 757.7 | 413.3 | 491.9 |
| ----- | | | | | | |
| CACM Exports/Total Exports | 1968 | 1980 | 1983 | 1986 | 1987 a/ | |
| Costa Rica | 2.1 | 21.3 | 27.0 | 22.7 | 9.3 | 7.7 |
| El Salvador | 10.9 | 40.3 | 41.1 | 35.2 | 12.1 | 19.4 |
| Guatemala | 5.5 | 31.2 | 27.4 | 27.6 | 17.7 | 21.8 |
| Honduras | 10.9 | 17.3 | 10.3 | 9.3 | 2.6 | 2.9 |
| Nicaragua | 4.5 | 15.2 | 17.3 | 7.8 | 6.6 | 7.5 |
| Total CACM | 6.8 | 23.5 | 25.4 | 21.6 | 10.4 | 11.9 |

a/ Preliminary.

Source: See Annex Tables C.14 and C.15.

2.05 The fall in exports taking place in the early 1980s was particularly pronounced in the case of intra-regional exports. Between 1980 and 1983, extra-regional exports from the CACM countries declined by 17%, primarily due to a fall in commodity prices rather than volume decline, but intra-regional exports contracted by 33%. After 1983, extra-regional exports slowly recovered. Intra-regional trade, however, continued to fall significantly, from US\$ 758 million to US\$ 413 million in 1986. These export patterns are reflected in the share of intra-CACM exports to total exports, which declined by a modest amount between 1980 and 1983 (from 25.4% to 21.6%), but then suffered a large drop after 1983, declining to 10% in 1986.

2.06 In 1987, intra-CACM trade expanded again, but still only amounted to less than half the dollar value achieved in 1980. Intra-regional trade remains significant for El Salvador and Guatemala, accounting for roughly 20% of their total exports, but has become a progressively smaller proportion of exports in Costa Rican and Nicaragua (with shares of 8%), and is negligible in Honduras (with a share of less than 3%).

2.07 The progressive disintegration of the CACM had the effect of reducing the overall openness to trade of the Central American economies.^{4/} In 1980, total exports to GDP for all the countries in the region averaged almost 27%, with Guatemala recording the smallest share (22%) and Honduras the largest (38%). By 1986, the average share declined to 22%. (By comparison, this share averaged 25% for middle income economies worldwide in 1984-85.) Considering the CACM as one unit, the share of extra-regional exports to the region's GDP was about 20% in 1980 and fell to 19% in 1986.

Table 2.3
CENTRAL AMERICA: TOTAL EXPORTS AS A SHARE OF GDP
(percentages based on current prices)

| | 1968 | 1975 | 1980 | 1983 | 1985 | 1986 |
|-------------|------|------|------|------|------|------|
| Costa Rica | 28.2 | 30.4 | 24.8 | 36.0 | 32.0 | 32.6 |
| El Salvador | 25.5 | 33.1 | 34.1 | 23.6 | 23.7 | 24.9 |
| Guatemala | 16.7 | 21.4 | 22.0 | 12.9 | 17.8 | 15.7 |
| Honduras | 29.9 | 30.7 | 37.8 | 27.1 | 27.3 | 28.1 |
| Nicaragua | 26.5 | 28.2 | 22.7 | 18.9 | 12.6 | 8.5 |
| Total CACM | 23.7 | 27.3 | 26.6 | 20.8 | 22.4 | 21.7 |

Source: See Annex Table C.11.

^{4/} The economic disintegration of the CACM was also accompanied by a steady reduction in the operating scope of CACM institutions: CABEI and FOCEM still operate, but their lending activities have contracted sharply (although in 1987/88 CABEI's lending volume increased), and the regional payments clearing house (CCC) currently accounts for a negligible fraction of trading activities; see Chapter V.

C. The Pattern of Industrialization

2.08 In the early 1960s, the CACM countries exhibited a lower degree of industrialization than other developing countries at a comparable stage of development. The industrial sector in 1965 accounted for about 18% of GDP in Guatemala and 24% in Nicaragua, with the other countries ranging in between. In contrast, the weighted average for all middle income countries, and the subset of lower middle income countries (according to the IBRD, World Development Report classification), was 30% and 24%, respectively. Two factors account for these relative differences: in comparison to many other developing countries, mining activity has always been small in the Central American countries, and conversely, traditional agricultural export commodities accounted for an inordinately large share of economic activity.

2.09 The promotion of industrialization was a primary objective behind the creation of the CACM. The manufacturing sector in each country consequently benefitted most from the creation of an expanded market and increased protection during the first two decades of the CACM.^{5/6/} By the same token, the manufacturing sector became highly dependent on the regional market. Between 1970 and 1980, total manufacturing exports increased from US\$ 234 million to US\$ 1.2 billion. More than half of this increase is accounted for by intra-regional trade. In 1980, the share of intra-regional manufactured exports to total production was 14%, while the share of extra-regional manufactured exports was 9%.^{7/} When processed foods are excluded from the

-
- ^{5/} The recorded shares of manufacturing in GDP (as well as the intra-CACM trade shares in Table 2.2) overstate the true shares by an undetermined amount and, thus, must be approached with caution. This bias arises because the manufacturing sector receives the highest protection within the customs union, so that the intra-regional prices of manufactured goods are likely to be considerably higher than the international prices. In Nicaragua, price controls may also be distorting the figures; Nicaragua's GDP share of manufacturing (almost 26%) appears exceedingly high, and the share of services (44%, see Annex Table C.9) is extremely low compared to shares in other CACM members.
- ^{6/} For the CACM as a whole, the manufacturing sector is dominated by agro-based industries: in 1984, processed foods accounted for roughly 40% of total manufacturing output, and beverages and tobacco represented another 10%. Chemical industries (including petrol derivatives) represent the next largest subsector, with 17% of manufacturing output, followed by textiles, garments and shoes, with 10%.
- ^{7/} Trade with Panama is included in these figures, which may bias the calculations for the CACM. The share of trade with Panama to total exports and imports by CACM countries is only about 2%, but exports to Panama account for about 25% of all manufactured goods exported to third countries. The United States and Puerto Rico, account for 29% of manufactured exports to third countries, other Caribbean countries for 19%, Europe for 8%, South America for 8%, and Belize for 6% (based on

calculation, the dependence of manufacturing on intra-regional trade is even higher: almost 19% of manufacturing production was exported within the regional market and less than 4% was exported elsewhere. While the manufacturing sector depended highly on the regional market as a source of demand, it also became dependent on extra-regional imports as a source of inputs: the import component of manufactured goods traded within the CACM is estimated to average between 50% and 60%.

Table 2.4
RATIO OF MANUFACTURING OUTPUT TO GROSS DOMESTIC PRODUCT

| | 1960 | 1970 | 1975 | 1980 | 1985 |
|------------------------|-------------|-------------|-------------|-------------|-------------|
| <u>Central America</u> | <u>12.1</u> | <u>16.4</u> | <u>17.0</u> | <u>17.7</u> | <u>17.5</u> |
| Costa Rica | 11.1 | 15.5 | 17.9 | 18.6 | 18.8 |
| El Salvador | 13.8 | 15.2 | 15.4 | 15.0 | 14.6 |
| Guatemala | 11.7 | 16.7 | 16.1 | 17.6 | 16.8 |
| Honduras | 11.4 | 12.7 | 14.7 | 14.0 | 14.3 |
| Nicaragua | 12.6 | 20.9 | 21.7 | 25.6 | 25.9 |

Source: Willmore, L. "Export Promotion and Import Substitution in Central America's Manufacturing Sector (CEPAL/Mexico, 22.6.88, mimeo) based on data from: Statistical Yearbook for Latin America 1979, and Statistical Yearbook for Latin America and the Caribbean 1987.

2.10 The decline in intra-regional trade after 1980 had a severe impact on the manufacturing sectors in the CACM; from 1980 to 1985, manufacturing output in the Central American countries declined by 5% to 10% in real terms. At the same time, the manufacturing sectors of the separate CACM countries became increasingly inward oriented; the share of intra-regional exports to production fell from 14% to 9%, and the share of intra-regional imports to domestic consumption fell from 10% to 6% (Table 2.5). The share of extra-regional manufactured imports to domestic consumption, meanwhile, remained virtually unchanged (around 35%). In other words, a larger share of domestic consumption of manufactures in each of the CACM countries is now being satisfied by national production rather than by imports.

figures from ICAITI).

Table 2.5
CENTRAL AMERICA g/
TRADE INTENSITY OF MANUFACTURING SECTOR
(percentages)

| | <u>Intra-CACM Exports</u> Production | | | <u>Extra-CACM Exports</u> Production | | | <u>Intra-CACM Imports</u> Consumption | | | <u>Extra-CACM Imports</u> Consumption | | |
|--|---|------|------|---|------|------|--|------|------|--|------|------|
| | 1970 | 1980 | 1985 | 1970 | 1980 | 1985 | 1970 | 1980 | 1985 | 1970 | 1980 | 1985 |
| Costa Rica | 11.9 | 12.8 | 7.6 | 7.3 | 8.3 | 8.3 | 9.5 | 7.7 | 3.6 | 34.6 | 35.2 | 30.2 |
| El Salvador | 17.8 | 12.0 | 6.9 | 4.7 | 5.3 | 6.8 | 11.5 | 15.5 | 11.4 | 27.5 | 23.6 | 28.2 |
| Guatemala | 22.7 | 25.1 | 20.0 | 8.0 | 9.7 | 8.8 | 10.7 | 6.0 | 5.5 | 36.2 | 46.6 | 42.8 |
| Honduras | 6.6 | 6.3 | 2.6 | 15.2 | 14.9 | 12.0 | 13.6 | 5.9 | 5.7 | 37.3 | 40.4 | 34.0 |
| Nicaragua | 11.8 | 5.8 | 1.4 | 13.1 | 7.8 | 3.1 | 11.0 | 16.5 | 3.7 | 28.0 | 21.8 | 39.2 |
| Total CACM Manufacturing | 16.0 | 14.3 | 9.0 | 9.1 | 9.0 | 8.0 | 11.5 | 10.3 | 6.4 | 32.8 | 34.6 | 34.4 |
| Total Excluding Processed Food | 21.7 | 18.7 | 12.0 | 3.2 | 3.5 | 4.7 | 12.7 | 11.4 | 7.3 | 41.1 | 41.3 | 42.1 |

g/ Intra-regional trade includes trade with Panama.

Source: ECLAC estimates based on official statistics; see Annex Table C.16.

2.11 Much of the manufacturing production capacity initially installed to serve the regional market was stimulated by the protection granted through the customs union and, thus, inefficient at world market prices. Once that capital was installed, however, the progressive closure of the regional market, reflected in the decline of intra-regional trade, resulted in a further efficiency loss, since it prevented the capture even of the limited economies of scale previously available in the more open regional market. Moreover, the closure of the regional market was not accompanied by an opening up toward extra-regional markets. Instead, the ISI strategy originally designed to be applied at the regional level, in effect, was increasingly applied at the national levels.

D. Main Causes of the Crisis and the Economic Decline of the CACM

2.12 The economic crisis in the early 1980s and the decline of the CACM were mutually reinforcing. Both were precipitated by: (i) a protracted decline in commodity prices that caused a steep fall in the value of the region's principal agricultural exports; (ii) the oil price hike beginning in 1979; (iii) the unprecedented increase in international interest rates, accompanied by decreased external borrowing opportunities; and (iv) the onset of armed conflict and political disturbances in the region.

2.13 An equally important factor responsible for the severity of the crisis was the high vulnerability of the CACM economies to these economic shocks. One element that contributed to the region's economic vulnerability was the structure of trade that developed under the ISI strategy adopted by the CACM. Another major element was the fragile macroeconomic situation in several CACM countries when the economic shocks appeared. The continuing

macroeconomic instability in several economies and the inability to achieve needed structural adjustments, moreover, are largely responsible for the persistence of the crisis, long after the external shocks had taken place.

The Structure of Trade

2.14 Export Structure. During the 1950s, coffee and bananas accounted for over two-thirds of all exports from the region. Efforts were made to develop other agricultural export crops (mainly beef, cotton and sugar), but by the 1960s, these efforts were redirected toward diversification through industrialization, with the adoption of the regional ISI strategy. Although progress was achieved in diversifying the export base, coffee and bananas still predominate, as seen in Table 2.6, and about 60% of the region's total export revenues is accounted for by seven commodities. This dependence on a few export commodities is even more pronounced in the individual countries: over 60% of export revenues are accounted for by coffee alone in El Salvador, coffee and bananas in Honduras, coffee and cotton in Nicaragua, and coffee, bananas and beef in Costa Rica. The share of manufactured exports to total exports from the CACM countries is between 20% and 25%.

Table 2.6

CENTRAL AMERICA: PRINCIPAL EXPORTS AS SHARE OF TOTAL MERCHANDISE EXPORTS (1985-1987 period average in %)

| | Coffee | Bananas | Beef | Cotton | Sugar | Wood | Seafood ^d |
|-------------|--------|---------|------|--------|-------|------|----------------------|
| Costa Rica | 34.3 | 20.3 | 5.6 | .. | 2.2 | .. | .. |
| El Salvador | 66.4 | .. | .. | 1.8 | 3.0 | .. | 2.4 |
| Guatemala | 42.5 | 7.1 | .. | 3.8 | 5.0 | .. | .. |
| Honduras | 28.1 | 33.6 | 2.3 | .. | 2.1 | 4.0 | 5.8 |
| Nicaragua | 43.8 | 5.7 | 3.8 | 21.9 | 4.6 | .. | 4.4 |
| Total CACM | 41.4 | 15.1 | 2.5 | 3.1 | 3.2 | 0.9 | 2.3 |

Source: ECLAC and SIECA, Series Seleccionadas de Centroamerica, 1987.

2.15 The traditional agricultural exports almost all go to markets outside the CACM and represent the dominant source of hard-currency foreign exchange earnings in the region. Intra-CACM exports, in contrast, consist mostly of manufactured products, particularly final consumer goods. For 1976 it was estimated that manufactured products accounted for 83% of Honduran exports to the other CACM countries, and for El Salvador this share was as high as 97%. Currently, manufactured goods account for 90% to 95% of total intra-regional exports, but only constitute around 15% of all extra-regional exports. In the 1970s, over 80% of the extra-regionally exported manufactures were processed foods. This share declined to about 66% in 1985. Manufactured exports other than processed foods, however, still only account for around 5% of CACM exports outside the region. Within the region, processed foods play a relatively minor role in trade; less than 20%.

2.16 Import Structure. The broad composition of imports is fairly similar across all the Central American countries (Annex Table C.13). Intermediate goods and raw materials average 57% of all imports, while consumer goods and capital goods account for the remainder in approximately even proportions. During the initial stages of industrialization, the first industries to develop are typically those producing final consumer goods (e.g., processed foods and assembly operations), and requiring relatively low levels of capital intensity and technological sophistication. This pattern of development was further encouraged by the structure of protection granted through the customs union, which is biased in favor of consumer goods and discriminates against intermediate and capital goods (see chapter III). As a result, the structure of imports is such that intermediates and capital goods primarily originate in third countries, while consumer goods imports are largely supplied by the CACM partners.

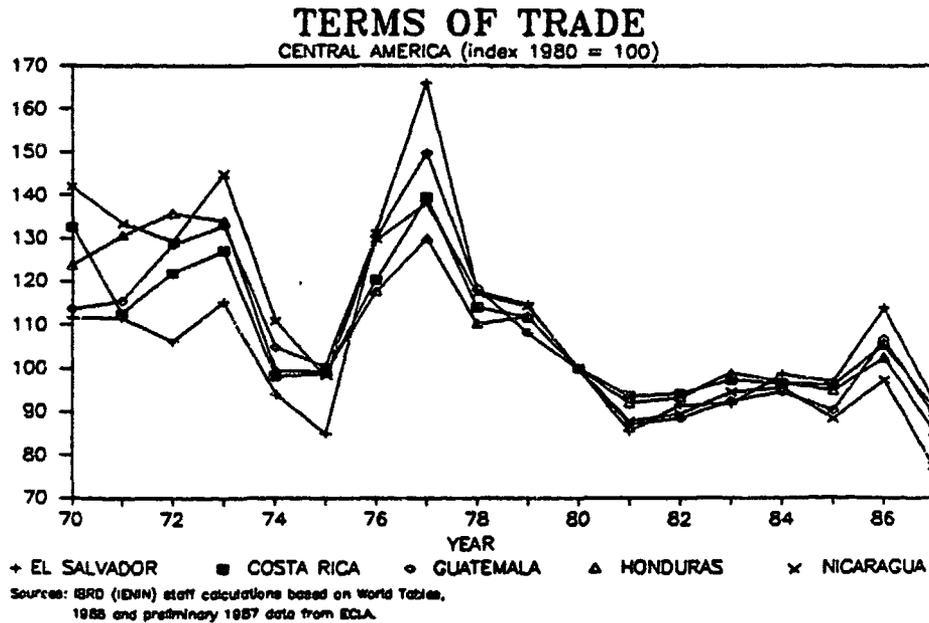
2.17 Terms of Trade. The high export concentration in relatively few agricultural commodities has rendered the CACM countries extremely vulnerable to commodity price changes, which are reflected in the fluctuations of the terms of trade. Since all the countries exhibit a similar structure of exports and imports, these fluctuations are highly synchronized, as shown in Figure 3. Despite a brief decline in 1974-75, the terms of trade had been favorable over most of the 1970s, peaking in 1977. In contrast, the terms of trade remained depressed during the 1980s, except for a temporary improvement of coffee prices in 1986.

2.18 Summary. Although the diversification of exports was a primary motivation behind the creation of the CACM, it only succeeded in this respect on a regional scale. Extra-regional exports remained heavily concentrated in a few primary agricultural products, intra-regional trade consisted almost exclusively of manufactured goods, with an emphasis on final consumer goods, and extra-regional imports were heavily biased toward intermediate and capital goods. That is, the CACM countries continued to rely almost exclusively on traditional exports to obtain the necessary hard-currency inflows to pay for extra-regional imports. These imports were critically needed, in turn, to sustain the highly import-intensive regional manufacturing production and intra-regional trade. Moreover, a consequence of the structural similarity in trade patterns among the CACM countries is that adverse terms of trade changes have a recessionary impact on all countries at once, so that no country can rely on its partners to provide a stabilizing influence on demand for its products.

2.19 The decline of commodity prices is largely responsible for the fall in the value of extra-regional exports between 1980 and 1983. This led to balance of payments difficulties in the region that resulted in a contraction of aggregate demand. Intra-regional trade was particularly susceptible to disruptions in this context, given that manufactured consumer goods tend to have higher price and income elasticities of demand than production inputs or essential foods. Consequently, a decline in aggregate demand would have a stronger negative impact on regional trade, which was concentrated in final manufactures, than on extra-regional imports (see para 2.15). Furthermore, since intra-regionally traded manufactures were highly dependent on extra-

regionally imported inputs, the overall compression of imports is also likely to have created some production bottlenecks on the supply side.

Figure 3



2.20 After 1981, the terms of trade for the CACM countries stabilized, but the level of intra-regional trade continued to decline. The most important cause for the further decline of intra-CACM trade is the progressive macroeconomic destabilization and increasing disparity of macroeconomic policies which occurred after the late 1970s. The countries in the region responded to the ensuing balance of payments difficulties by resorting to exchange controls rather than adopting greater flexibility in exchange rates and allowing relative prices to play an allocative role. These controls applied to intra-regional as much as to extra-regional transactions, but were particularly damaging to intra-regional trade: when exchange controls are applied, imports of an essential nature (basic foods, medicines) typically tend to be given priority in the allocation of import permits, followed by intermediate goods and capital goods needed to sustain domestic production. Final manufactured consumer goods, which dominate intra-regional trade, are lowest on the priority list and, thus, are effectively discriminated against (see Table 3.8).

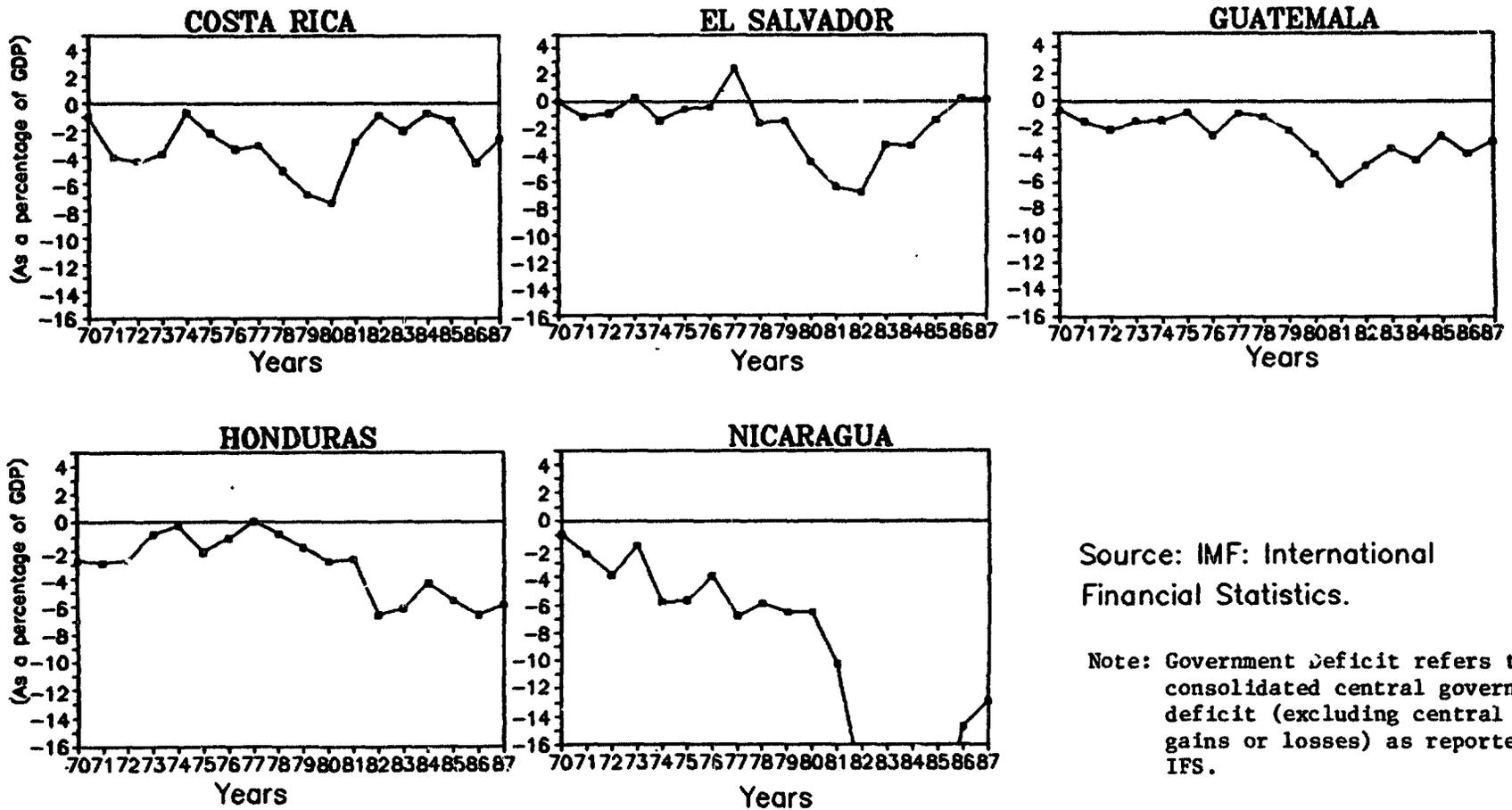
E. Macroeconomic Policy and Performance

Fiscal Policy

2.21 The fiscal situation, measured by central government deficits, began to deteriorate since the early 1970s in the region as a whole, though it occurred earlier and more pronounced in some countries (Figure 4). In

Figure 4

GOVERNMENT DEFICIT (-) OR SURPLUS CENTRAL AMERICA



Source: IMF: International
Financial Statistics.

Note: Government Deficit refers to
consolidated central government
deficit (excluding central bank
gains or losses) as reported in
IFS.

Nicaragua, the deterioration of the fiscal accounts has been almost uninterrupted since 1970. In Costa Rica, which had also been experiencing persistent fiscal difficulties, deficits increased steadily after 1974. In El Salvador, Guatemala and Honduras, on the other hand, the deterioration of the fiscal deficit did not set in until 1978-79; coinciding with the drastic decline in the terms of trade. By the early 1980s, all countries exhibited central government deficits on the order of 6%-7% of GDP, and were forced to take contractionary measures, which had a negative impact on trade and domestic growth. Since then, Costa Rica, El Salvador and Guatemala were able to achieve significant deficit reductions, but in Honduras and Nicaragua the fiscal situation continued to deteriorate. (In El Salvador, especially, significant foreign grants facilitated fiscal deficit reductions after 1982.)

2.22 An important source of fiscal instability in the region is the inordinately high dependence on trade taxes (Table 2.7). Except in Nicaragua, taxes on international trade flows accounted for over 25% of total current government revenues in 1986-87, with Honduras showing the highest ratio (averaging 35%). These ratios are comparable to those in low-income economies (exhibiting an average ratio of 29% in 1985), which have the least developed taxation structures. The average ratio for lower-middle-income economies, which includes the CACM countries, was below 15% in 1985, and is less in higher income economies. (Nicaragua represents a special case because much of its external trade currently takes place through public trading companies, and increasingly in the form of barter, with trade taxes often not explicitly recorded.) The dependence on external trade taxes has made fiscal management inherently difficult in Central America, and highly susceptible to destabilization through volatile commodity prices.

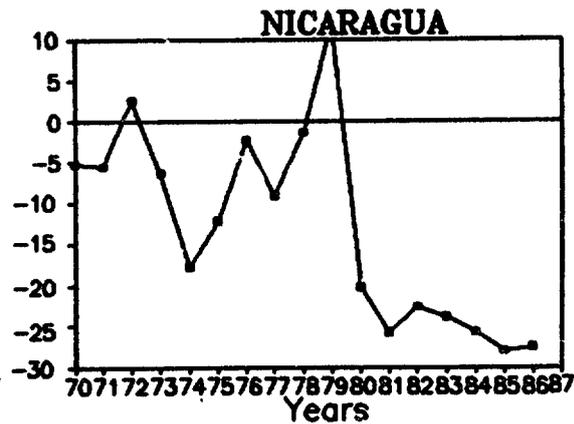
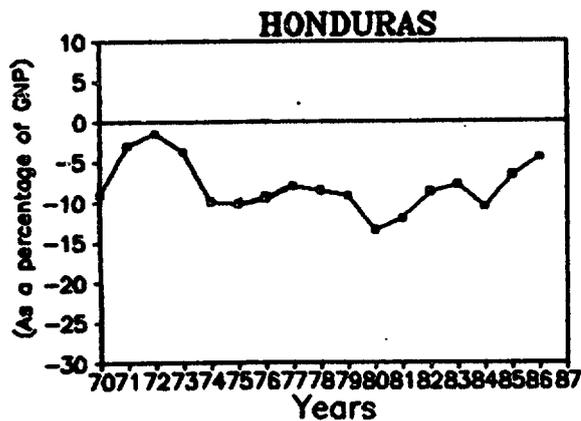
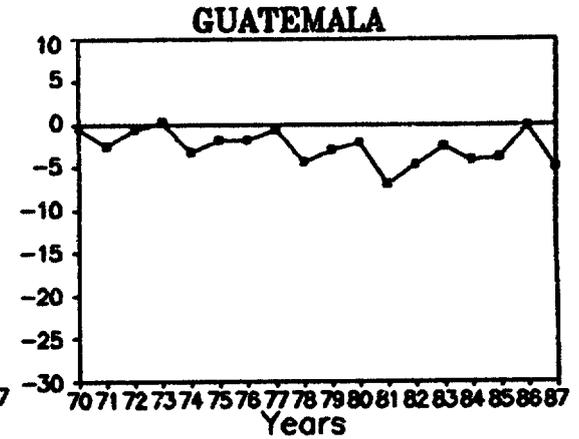
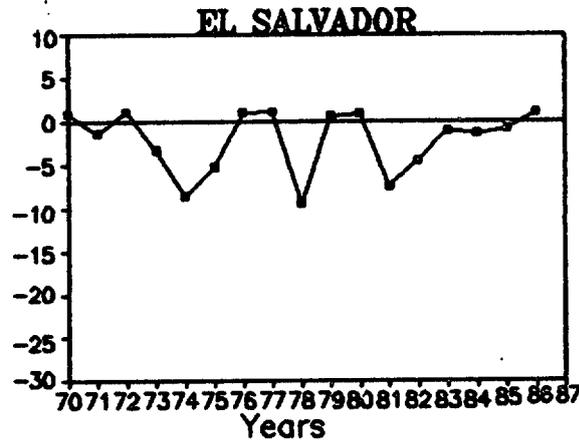
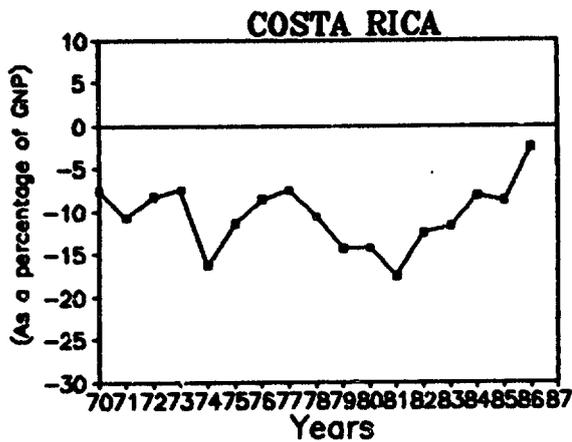
Table 2.7: CENTRAL AMERICA: EXPORT AND IMPORT DUTY REVENUES AS A SHARE OF TOTAL CURRENT CENTRAL GOVERNMENT REVENUES (percentages)

| | Costa Rica | El Salvador | Guatemala | Honduras | Nicaragua |
|------|------------|-------------|-----------|----------|-----------|
| 1978 | 27.1 | 39.1 | 40.1 | 43.2 | 16.4 |
| 1979 | 29.3 | 47.0 | 36.1 | 40.7 | 12.7 |
| 1980 | 26.3 | 36.1 | 34.8 | 36.7 | 14.2 |
| 1981 | 37.4 | 29.1 | 23.0 | 42.1 | 11.8 |
| 1982 | 38.6 | 25.1 | 17.2 | 35.1 | 10.0 |
| 1983 | 30.2 | 22.7 | 14.3 | 35.7 | 7.3 |
| 1984 | 30.9 | 23.6 | 16.2 | 35.4 | 7.0 |
| 1985 | 33.6 | 27.9 | 10.2 | 38.4 | 7.8 |
| 1986 | 33.3 | 40.5 | 24.8 | 35.1 | 8.0 |
| 1987 | 30.1 | 25.4 | 25.8 | 34.2 | 5.5 |

Source: SIECA, Series Seleccionadas de Centroamerica, June 1987, and ECLAC.

Figure 5

CURRENT ACCOUNT DEFICIT (-) OR SURPLUS CENTRAL AMERICA



Source: IBRD: World Tables, 1987; preliminary figures for 1987 based on data from ECLAC.

Note: Current Account Deficit includes net current transfers but not official capital grants.

Balance of Payments

2.23 Figure 5 illustrates the behavior of the current account in the balance of payments of the five CACM economies. Some of the year to year fluctuations are due to changes in the terms of trade, but the substantial differences from country to country are mainly due to disparities in fiscal behavior, in exchange rate management, in the availability of external grants and in the willingness or ability to borrow abroad. Costa Rica, which began the 1970s with the largest fiscal deficits, also exhibited the highest current account deficits. Similarly, Nicaragua's high current account deficits (except in 1979) are clearly linked to the continuing fiscal imbalances. El Salvador and Guatemala on average have exhibited the smallest current account deficits.

2.24 All CACM countries experienced balance of payments difficulties in the late 1970s, as exports declined, oil import prices increased and external credit became increasingly scarce. Problems were compounded by capital flight, which became significant in El Salvador and Nicaragua, beginning in 1978. (The total capital flight for all five countries has been estimated at around US\$ 2.0-2.5 billion over 1979-84, representing about 20% to 25% of the net increase in their combined external debt over that period.) Since the early 1980s, current account deficits gradually decreased in all countries, except in Nicaragua, which went heavily into arrears vis-a-vis its creditors, including its CACM partners. Increases in foreign grants and migrants' remittances played a significant role in reducing the current account deficit in El Salvador after 1982. Net foreign transfers also became important in Honduras, after 1984, and in Guatemala, after 1986.

External Debt

2.25 The differences in the current account behavior among the CACM countries are reflected in the external debt indicators, shown in Table 2.8. Costa Rica, Honduras and Nicaragua, which on average experienced the largest current account deficits in the 1970s, emerged with the highest debt burdens in the 1980s. The ratios of total external debt to both GDP and total exports for these three countries are significantly higher than the average ratios for all developing countries, and also in comparison to the more highly indebted Latin American and Caribbean nations as a whole. El Salvador and Guatemala, in contrast, have relied less heavily on external borrowing and, consequently, their debt burdens have remained relatively low, even by international standards.

2.26 During the early 1980s, intra-regional debts also accumulated rapidly, reaching over US\$400 million by 1984. Nicaragua, and to a lesser extent Honduras, relied heavily on credit from the other CACM members, extended primarily through the regional payments clearing house (see Chapter V). By 1982 loans from third-country sources had become increasingly scarce and international interest rates had increased sharply, so the regional creditors themselves experienced debt servicing difficulties and had to contract intra-regional credits. That forced regional debtors into arrears and eventually led to the collapse of the regional clearing house, which further hampered intra-regional trade.

Table 2.8
CENTRAL AMERICA: EXTERNAL DEBT INDICATORS
 (percentages)

| | 1970 | 1975 | 1980 | 1983 | 1985 | 1986 | 1987 |
|--------------------------------|-------|-------|-------|-------|--------|--------|-------|
| <hr/> | | | | | | | |
| Total External Debt/GNP | | | | | | | |
| Costa Rica | 44.1 | 54.2 | 59.5 | 148.0 | 121.8 | 110.1 | 115.7 |
| El Salvador | 13.9 | 27.9 | 25.9 | 46.6 | 46.5 | 44.8 | 38.1 |
| Guatemala | 15.1 | 13.0 | 14.9 | 20.2 | 27.4 | 39.3 | 41.1 |
| Honduras | 26.1 | 49.4 | 61.7 | 74.4 | 83.1 | 83.6 | 86.9 |
| Nicaragua | 41.8 | 59.0 | 106.2 | 177.4 | 217.9 | 250.9 | 246.4 |
| <hr/> | | | | | | | |
| Memo: | | | | | | | |
| Developing Countries | .. | .. | 27.8 | 39.6 | 45.6 | 48.3 | 49.7 |
| Latin America & Caribbean | .. | .. | 35.3 | 59.6 | 61.2 | 61.8 | 60.1 |
| <hr/> | | | | | | | |
| External Debt/Exports | | | | | | | |
| Costa Rica | 154.9 | 173.1 | 224.5 | 355.1 | 344.4 | 314.5 | 314.5 |
| El Salvador | 55.5 | 84.6 | 71.1 | 167.2 | 162.7 | 164.2 | 189.8 |
| Guatemala | 80.4 | 59.4 | 63.6 | 149.5 | 216.1 | 229.4 | 241.0 |
| Honduras | 93.1 | 145.7 | 152.5 | 261.6 | 293.5 | 290.1 | 332.4 |
| Nicaragua | 147.3 | 199.0 | 422.3 | 875.4 | 1603.5 | 2087.0 | - |
| <hr/> | | | | | | | |
| Memo: | | | | | | | |
| Developing Countries | .. | .. | 122.4 | 176.2 | 198.2 | 222.7 | 212.1 |
| Latin America & Caribbean | .. | .. | 189.3 | 303.2 | 308.9 | 369.0 | 359.5 |

Source: Figures for 1980-87 are from IBRD, World Debt Tables, 1988-89; Pre-1980 data is from R. Caballeros, "External Debt in Central America", CEPAL Review No. 32 (Aug. 1987).

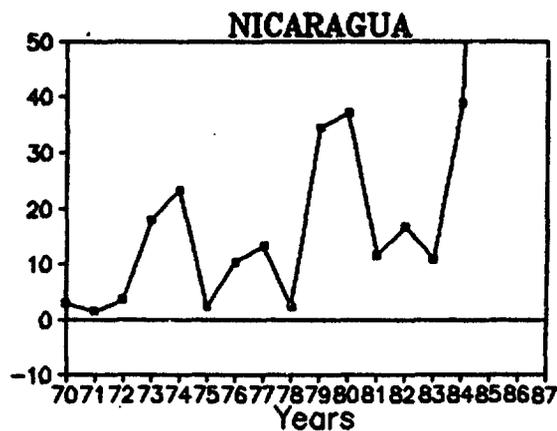
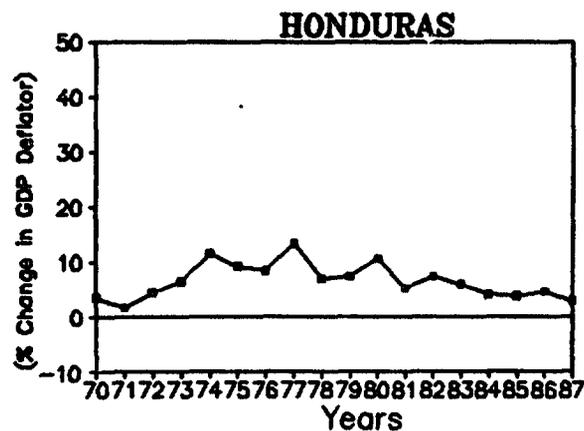
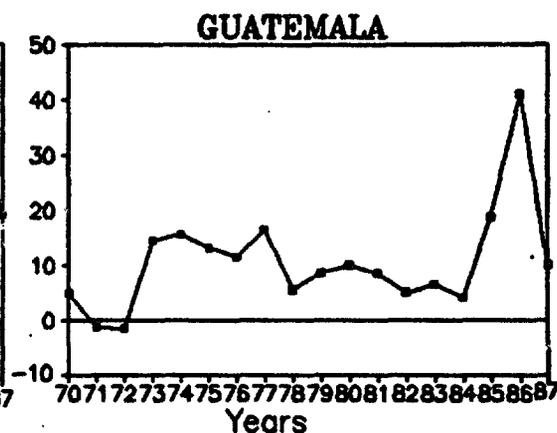
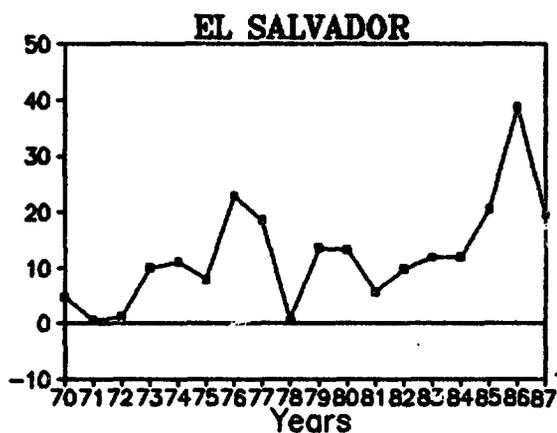
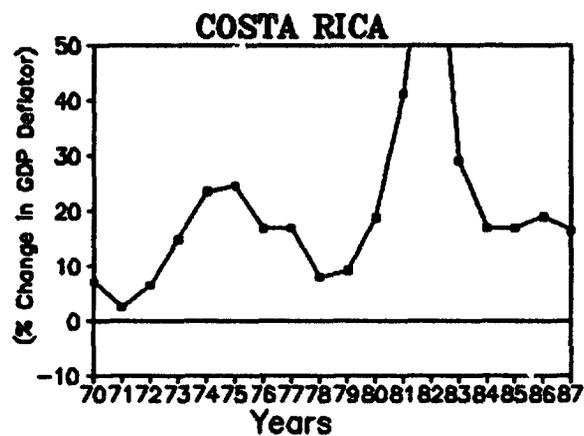
Inflation

2.27 During the 1970s, all countries in the region displayed a roughly similar pattern in the rates of inflation (Figure 6), with average annual GDP Deflator growth rates ranging from 7.1% in Honduras to 10.4% in Costa Rica. This uniform behavior was possible, despite the disparities in the fiscal and current accounts, because of the joint adherence to fixed exchange rate policies (see below), which was sustained, in turn, by the availability of international reserves and foreign lending. As a result, countries with high deficits could avoid taking recourse to inflationary domestic finance, while domestic excess demands were satisfied by imports.

2.28 By 1980, however, foreign commercial credit became scarcer for the more highly indebted countries and fiscal deficits increasingly had to be financed internally. It became more difficult to maintain the fixed exchange rate policies pursued in the past and some countries had to devalue. This boosted inflation, especially in Costa Rica and Nicaragua. Nicaragua introduced price controls to suppress inflation in 1981-84, but these eventually became ineffective as inflationary pressures remained high. El Salvador and Guatemala were able to maintain relatively low inflation rates throughout the early 1980s, having depended less on external credit, but both eventually needed to devalue their currencies, causing a temporary surge of inflation in 1985-86. Honduras has had the longest record of low inflation.

Figure 6

ANNUAL INFLATION CENTRAL AMERICA



Source: IBRD; World Tables,
1987.

Exchange Rate Policy

2.29 Until 1980, each CACM country adhered to a fixed exchange rate policy, pegging its currency to the U.S dollar. This policy uniformly played an important role in facilitating the expansion of intra-regional trade and in the general coordination of common market activities. This fixed exchange rate policy was accompanied by conservative monetary policies that kept inflation rates aligned from country to country. Moreover, the similar composition of exports and imports, and relatively uniform inflation rates, meant that the terms of trade facing each country moved in unison, so that real exchange rates also remained fairly stable relative to each other.

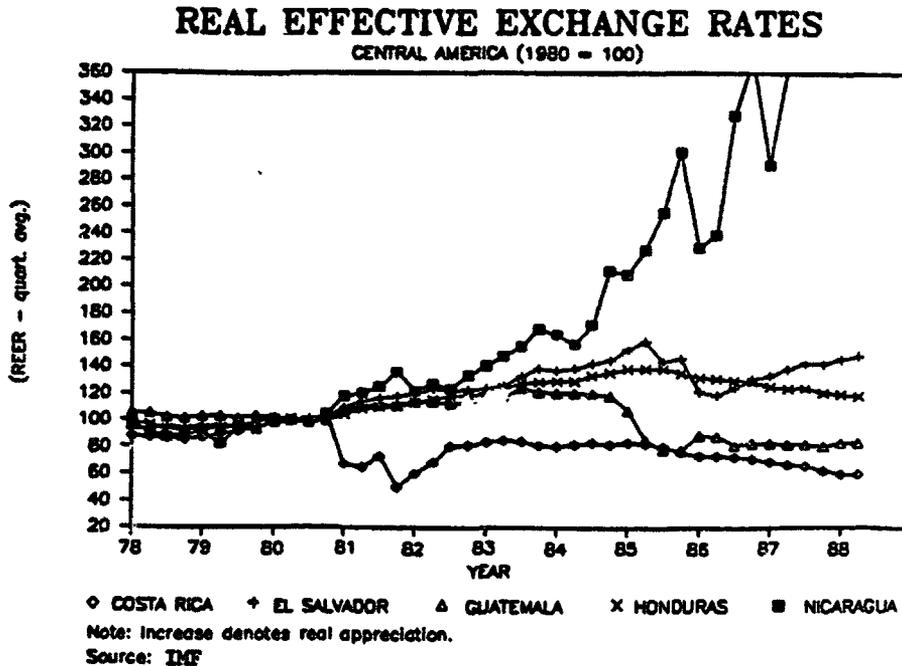
2.30 By the late 1970s, the macroeconomic disequilibria that had developed in several countries were aggravated by external economic shocks and made fixed exchange rates unsustainable. Large premia developed in the black exchange markets and a process of successive devaluations began, initially with the adoption of multiple exchange rates, followed by a devaluation of the official rate and, finally, an attempt to unify rates. These adjustments were not regionally coordinated; Costa Rica first adopted multiple rates in late 1980, while Guatemala did not adopt a multiple rate system until late 1984.

2.31 Costa Rica currently maintains a unified exchange rate and follows a policy of frequent mini-devaluations, responding to differences in domestic and international inflation rates and to foreign exchange reserve movements. El Salvador devalued and unified its exchange rates at five Colones/US\$ in early 1986, and maintained a fixed exchange rate policy until June 1989. Since then, a two-tier system was introduced: an official market where the exchange rate remains fixed at 5 Colones/US\$ and a banking market with a freely flexible exchange rate that was progressively expanded and now covers most trade transactions. Guatemala progressively unified its exchange rates since 1986. A single exchange rate was introduced in June 1988 and managed on a fixed basis with periodic adjustments until early November 1989, when it was allowed to float. Honduras still maintains the official rate pegged at two Lempiras/US\$, but an officially sanctioned parallel market (CETRA/autofinanciamiento) has been expanded to include an increasing share of trade transactions. Nicaragua continues to operate a multiple exchange rate system with periodic maxi-devaluations.

2.32 The disparity in exchange rate management is illustrated by the pattern of real effective exchange rate movements in Figure 7. Following a period of uniform movements from 1978 to 1980, the real exchange rate paths increasingly flared apart, with Costa Rica at one extreme following a strategy of gradual real devaluation, and Nicaragua at the other extreme allowing its exchange rate to become massively overvalued. Since 1984, Guatemala's real exchange rate management has been moving in the direction of Costa Rica's flexible management. In contrast, El Salvador's real exchange rate continued to appreciate after 1986.^{8/}

^{8/} The relative patterns of real exchange rates are partly reflected in the premia quoted in the parallel markets for these currencies. Since 1987, the black market premium remained near 5%-6% in Costa Rica, and the free

Figure 7



2.33 The continuing disparity in real exchange rates since 1980 represents a major obstacle to the normalization of trade within the CACM. Costa Rica and Guatemala, which have adopted more flexible exchange rate management, have reduced their reliance of exchange controls to maintain balance of payments equilibrium. But El Salvador, Honduras and, particularly, Nicaragua, all having relatively appreciated real exchange rates, continued to depend of exchange controls up through 1988, which hampered the expansion of intra-regional as well as extra-regional trade.

(banking) rate premium over the regulated rate was around 8% in Guatemala until June 1988, when all rates were unified and set at the banking rate level. In El Salvador, the premium was around 5% in 1987, rising to 10% in mid-1988. Despite inflation rates above international rates, the premium has remained stable on El Salvador on account of large inflows of foreign grants and migrants' remittances. In Honduras the premium was around 15% in 1987, rising to 90% in November 1988, and then declining to 40% in December. The greatest difference existed in Nicaragua, where in January 1988, the black market premium over the official rate (then used for a significant number of transactions) was several thousand percent, and the premium over the legal parallel rate was over 100%. Since then, the official and legal parallel rates have been drastically devalued several times, but domestic inflation continues to be high, so that current real exchange rate levels are difficult to ascertain.

Aggregate Savings and Investment

2.34 Another major obstacle to the region's economic revival is the steep decline of aggregate investment in most countries. Aggregate investment as a proportion of GDP remains high in Costa Rica, exceeding 23%, despite the economic and political turmoil in the region during the 1980s (Table 2.9). This provides a stark contrast to the other Central American countries. In El Salvador, Guatemala and Honduras, gross domestic investment rates declined significantly from the rates achieved in the late 1970s, which in some cases, however, had been exceptionally high. Nicaragua surprisingly exhibits a relatively high investment ratio, mostly due, however, to foreign savings in the forms of accumulating arrears (instead of new net inflows) together with the sharp decline of real GDP. The decline in investment rates is only partly due to the reduction in foreign savings rates; El Salvador and Guatemala, for example, depended little on foreign borrowing during the 1970s. Rather, the most important cause is the drastic decline in gross domestic savings. In Costa Rica, by comparison, domestic savings increased after 1980, to compensate for the decline in foreign savings. This contrasting savings performance largely accounts for Costa Rica's relative success in recovering from the economic crisis.

Table 2.9
CENTRAL AMERICA: GROSS DOMESTIC SAVINGS (GDS) AND
GROSS DOMESTIC INVESTMENT (GDI)
(As percentages of GDP)

| | Costa Rica | | El Salvador | | Guatemala | | Honduras | | Nicaragua | |
|------|------------|------|-------------|------|-----------|------|----------|------|-----------|------|
| | GDI | GDS | GDI | GDS | GDI | GDS | GDI | GDS | GDI | GDS |
| 1970 | 20.6 | 13.8 | 12.9 | 13.2 | 12.8 | 13.6 | 20.9 | 14.7 | 18.6 | 16.2 |
| 1975 | 21.7 | 13.2 | 22.1 | 17.0 | 16.1 | 14.3 | 17.9 | 8.9 | 21.4 | 12.5 |
| 1980 | 26.6 | 16.2 | 13.3 | 14.2 | 15.9 | 13.1 | 26.0 | 18.5 | 15.4 | -2.7 |
| 1981 | 29.0 | 24.1 | 14.2 | 8.1 | 17.0 | 10.5 | 20.6 | 13.9 | 23.6 | 3.3 |
| 1982 | 24.7 | 27.6 | 13.2 | 8.2 | 14.1 | 10.2 | 14.4 | 11.5 | 18.8 | 3.7 |
| 1983 | 24.2 | 23.4 | 13.3 | 8.5 | 11.1 | 9.5 | 15.8 | 12.0 | 22.5 | 5.1 |
| 1984 | 24.1 | 23.3 | 14.0 | 7.1 | 11.4 | 9.4 | 19.9 | 14.5 | 21.3 | 3.7 |
| 1985 | 23.3 | 21.8 | 12.8 | 5.9 | 11.5 | 9.1 | 17.3 | 13.0 | 18.8 | -2.1 |
| 1986 | 23.1 | 24.4 | 13.3 | 7.0 | .. | .. | 14.0 | .. | .. | .. |
| 1987 | 23.4 | .. | 12.9 | .. | .. | .. | 13.8 | .. | .. | .. |

Source: IBRD, World Tables, 1987; Figures for 1987 are based on data from ECLAC

2.35 The climate of instability and uncertainty created by the social and political disturbances in the region played an important role in the decline of domestic savings rates. It has also discouraged foreign direct investments. As shown in Table 2.10, FDI inflows represented a significant source of foreign capital during the early 1970s, particularly in Costa Rica and Guatemala, where they rivaled long term loans in importance. Since 1980, total FDI inflows to the region have declined in absolute value and in proportion to foreign debt creating inflows.

Table 2.10
FOREIGN DIRECT INVESTMENT INFLOWS TO CENTRAL AMERICA

| | FDI p.a. (U.S.\$ millions) | | | FDI/Long-Term Capital Inflows (%) | | |
|-------------|----------------------------|---------|---------|-----------------------------------|---------|---------|
| | 1970-74 | 1975-80 | 1981-86 | 1970-74 | 1975-80 | 1981-86 |
| Costa Rica | 31.6 | 54.8 | 54.5 | 38.7 | 17.7 | 15.4 |
| El Salvador | 8.7 | 10.7 | 7.7 | 13.6 | 9.5 | 5.3 |
| Guatemala | 31.2 | 90.9 | 69.2 | 69.1 | 46.6 | 28.3 |
| Honduras | 4.8 | 11.4 | 18.2 | 12.4 | 6.8 | 9.5 |
| Nicaragua | 13.1 | 7.3 | - | 15.1 | 6.4 | - |

Source: IBRD, World Tables, 1987.

Summary

2.36 The plunge in agricultural commodity prices, rising energy prices and international interest rates, and increased social and political disturbances in the late 1970s led to a drastic deterioration of the fiscal and balance of payments accounts in the Central American economies. Paralleling the experience of many other Latin American countries during that period, the CACM countries initially responded by borrowing more abroad, thus postponing necessary domestic expenditure and price adjustments. This strategy was unsustainable, and once external commercial borrowing opportunities dried up in the early 1980s, the CACM countries were confronted by a severe foreign exchange shortage. That led to a severe compression of imports and a sharp decline in economic activity in all countries, which strongly contributed to the increasing economic disintegration of the CACM. The macroeconomic policies adopted in Central America during the 1980s were highly disparate; some countries introduced greater exchange rate flexibility (Costa Rica and, later, Guatemala) and were able to exercise greater fiscal discipline (though many became critically dependent on external official grants). Nicaragua became increasingly destabilized, which severely hampered trade relations with intra- and extra-regional trading partners. A common feature in all countries was the introduction of exchange restrictions to maintain balance of payments control. As explained earlier (para. 2.20), exchange controls had a particularly contractionary impact on intra-regional trade, due to the system of priorities used in rationing foreign exchange and the distorted composition of trade. Furthermore, the reliance on foreign exchange restrictions and other import barriers inhibited the expansion of exports to third countries and, thus, perpetuated the foreign exchange scarcity that led to the shrinkage of intra-regional trade.

F. Main Issues and Recommendations

2.37 The continuing economic recession in Central America and advanced state of disintegration of the common market raise two basic issues: the

first is how to reactivate and sustain economic growth in the region. The second is whether it would be in the best interests of the individual countries to revive the CACM as part of that sustainable growth strategy.

Need for a New Development Strategy

2.38 Several countries in the region are afflicted by armed conflicts and maintain unsustainable macroeconomic policies. Unless these conflicts cease and greater macroeconomic control is obtained, sustained growth will be extremely difficult to achieve. Even in the absence of those problems, however, fundamental structural changes are needed in the CACM countries to create a better basis for reviving growth. A disturbing development in this regard is the increased inward orientation of the CACM economies in the mid-1980s, which has prevented them from taking full advantage of potential benefits from international trade and specialization.

2.39 In this context, it is important to recognize that the pursuit of an ISI strategy, either in a regional or national context, no longer offers a promising basis for achieving sustained growth in the region. The opportunities for rapid growth, which were provided during the first easy stages of import substitution in the 1960s, are largely exhausted. Already prior to the onset of the economic crisis, the growth of intra-regional exports, which exceeded extra-regional export growth during the 1960s, had slowed down by the early 1970s to the same pace as extra-regional export growth (para 2.04). The further pursuit of ISI under these circumstances would involve considerable inefficiencies and losses in productivity.

2.40 Furthermore, the external economic environment has changed significantly since the late 1970s, and is now less accommodating toward an ISI approach. Contrary to its objectives, the past ISI strategy did not succeed in significantly reducing the region's dependence on primary agricultural exports, and likely has increased the dependence on imported inputs from third countries. Manufactured exports increased, but mainly in the context of intra-regional trade, since the anti-export bias generated by the ISI strategy prevented these from becoming competitive in third country markets. During the 1960s and 1970s, this strategy was viable because of favorable international commodity prices and easily obtainable external credit, which enabled deficit countries to finance current account imbalances without needing to compress imports, either from other CACM partners or third countries. The external environment became less favorable in this respect during the 1980s and the prospects of significant future improvements are not encouraging: the projected international prices for the major commodities exported from Central America (shown in Table 2.11) all remain below the real levels achieved in 1980. New external credits also have become much more difficult to come by, especially now that the region is laboring under a significantly heavier debt burden than in earlier periods. Nor is it clear that further indebtedness, even when possible, would be to the region's best advantage.

Table 2.11
COMMODITY PRICE TRENDS AND PROJECTIONS, 1980-2000
 (constant 1985 dollars)

| | Actual | | | Projections | | | | |
|-------------------|--------|------|------|-------------|------|------|------|------|
| | 1980 | 1986 | 1987 | 1988 | 1989 | 1990 | 1995 | 2000 |
| Bananas (US\$/MT) | 363 | 323 | 290 | 303 | 281 | 280 | 310 | 290 |
| Beef (USc./kg.) | 265 | 177 | 184 | 177 | 172 | 167 | 189 | 200 |
| Coffee (USc./kg.) | 330 | 363 | 193 | 213 | 211 | 211 | 204 | 205 |
| Cotton (USc./kg.) | 196 | 89 | 127 | 99 | 99 | 111 | 123 | 116 |
| Sugar (USc./MT) | 606 | 113 | 115 | 240 | 268 | 300 | 224 | 254 |

Note: Constant dollar projections are deflated by the IBRD's Manufacturing Unit Value Index (1985 = 100).

Source: IBRD, International Commodity Markets Division, Oct. 17, 1988.

2.41 Recommendation. The primary motor for growth in the past was the expansion of trade, and this remains the most promising vehicle for overcoming the present crisis. To achieve a trade expansion in the most efficient manner, the CACM countries need to embark on a strategy of overall trade liberalization, involving the reduction of barriers to both extra-regional and intra-regional trade. (A detailed analysis of these barriers is provided in chapter III.) The objective of this trade liberalization is to create a less distorted trade policy environment, which is more conducive to efficient export growth and efficient import substitution than that created by the past ISI strategy. In view of the limited prospects for improved traditional agricultural commodity prices, the expansion of non-traditional exports toward third country markets is especially important. This is needed to (i) stimulate domestic economic activity, (ii) relieve the foreign exchange constraints that currently hamper intra-regional trade, and (iii) bring about a more diversified export base, thereby reducing the region's traditional vulnerability to commodity price fluctuations.

Benefits of Economic Reintegration

2.42 If the Central American countries were prepared to embark on a new policy strategy of comprehensive trade liberalization, is there any point in seeking to revive the common market? The purpose of a comprehensive trade liberalization is to achieve greater integration into the world economy. In a fully integrated world economy, there would be little reason to address separately the issue of regional economic integration, since this would already arise as a byproduct of world economic integration. Where benefits from greater regional integration may emerge, however, is during the transition toward greater integration into the world economy.

2.43 The cornerstone of the CACM is the customs union, which in principle involves a common external tariff toward third countries and liberalized trade among the members. In recent years, however, barriers to

trade between the CACM members have increased significantly with the result that the share of intra-regional trade to total trade has declined almost to the levels that existed before the creation of the CACM. The removal of these barriers, therefore, would be a crucial step needed to achieve greater regional integration. When the CACM was first created on the basis of an ISI strategy, the removal of intra-regional trade barriers was accompanied by an increase in external tariff barriers. For reasons discussed in the preceding paragraphs, economic reintegration along these lines would not constitute a promising strategy for generating sustained growth in the region. In view of recent reform initiatives within the region, discussed in chapter IV, the reintegration under such a strategy is also not a likely prospect. Rather, the issue now is whether the region would benefit if, along with the reduction in external trade barriers, intra-regional trade barriers were eliminated completely.

2.44 In the trade liberalization programs currently being considered in Central America, trade barriers are to be reduced in a gradual manner. Furthermore, even after all reforms have been carried out, external tariff barriers generally remain positive, partly to generate government revenues. Domestic industries, therefore, would still be receiving a certain amount of protection against outside competition, both during the transition, while external barriers are being lowered, and afterwards. The complete elimination of intra-regional trade barriers in this context would, give preferential treatment to intra-regional trade relative to extra-regional trade. The argument in favor of such a step is that it would encourage more trade and yield potential efficiency gains through greater economies of scale. Even though the regional market is small compared to the rest of the world, it is several times larger than each national market and, thus, offers an opportunity for a more efficient division of labor.

2.45 In general, it is unclear whether the trade creation gains from a customs union outweigh the losses from trade diversion.^{9/} In the case of the CACM, however, the level of integration achieved in the past was already far advanced so that much of the infrastructural and capital investments in activities oriented toward the regional market have already been made. An expansion of trade within the region could, therefore, create gains without a major diversion of resources away from other activities. Although the original decision to make these investments in many cases may have been unwise on grounds of inefficiency and, thus, represented a misallocation of resources, intra-regional trade liberalization would enable a better utilization of the already invested capital, thereby reducing the efficiency loss.

^{9/} William R. Cline and Enrique Delgado, eds. Economic Integration in Central America (Washington, D.C.: Brookings/STECA, 1978) provides an exhaustive discussion of the past costs and benefits of integration to the CACM countries. The authors conclude that trade diversion significantly exceeded trade creation over the period 1958 to 1972, but that this net loss was outweighed by other static and dynamic net gains. See also, IBRD Report No. 2325b-CA (Sept. 1980), Annex II, for a summary of these results.

2.46 For the CACM members combined, the decline of intra-regional trade in manufactures as a share of regional production and consumption that took place after 1980 was accompanied by a slight reduction in extra-regional trade (Table 2.5). The same pattern was also observed in most countries individually, with the partial exception of El Salvador and Nicaragua. That is, the decline in intra-regional trade had little effect on extra-regional trade in manufactures, but rather, the individual economies became more closed. By reversing this process, a revival of intra-regional trade could lead to a significant trade creation without diversion of trade away from third countries. Furthermore, the danger of inefficient trade diversion, which is inversely related to the height of extra-regional trade barriers, would be reduced to the extent that the decline in intra-regional trade barriers is accompanied by lowered extra-regional barriers.

2.47 Several additional factors argue in favor of reestablishing the CACM as an effectively functioning common market: (i) given the geographical proximity of the national markets, the elimination of intra-regional trade barriers would lead to gains from the regional exchange of goods and services that would be considered "non-tradeable" from an extra-regional perspective. This argument recognizes that the distinction between "tradeable" and "non-tradeable" is largely an issue of transportation costs rather than an intrinsic feature of the goods themselves. (ii) Infant exporters often require the learning experience of selling in a regional market before they can hope to succeed in more distant and less familiar markets. Greater regional integration would expand the opportunities for obtaining that experience. (iii) Finally, effective economic integration could improve the basis for political cooperation and help defuse current tensions in the region.

2.48 Recommendation. The preceding arguments present a case in favor of achieving greater regional integration in the context of an overall free trade environment; not as an alternative to external trade liberalization. I.e., Central America, even if fully integrated, would still be better off by liberalizing trade with the rest of the world. The ideal state from an efficiency standpoint would be for the Central American countries to be economically integrated with low and uniform trade barriers toward third countries.

2.49 The main problem to be solved is how to approach this ideal state from the current starting point. Two considerations concerning the current state of the CACM economies prevent an easy solution: (i) some countries are better prepared to initiate the reduction in external trade barriers, and (ii) the effective elimination of intra-regional trade barriers may be contingent on the adherence to a common external trade policy. Consequently, the measures needed to achieve external trade liberalization could conflict during the initial stages of policy reform with the process of liberalizing intra-regional trade. The purpose of the next two chapters is to identify the main barriers to intra- and extra-regional trade, and then to define a coordinated policy strategy, based on current reform initiatives in the region, that would reduce the potential conflict between liberalizing external trade and reintegrating the CACM.

CHAPTER III

TRADE POLICY IN CENTRAL AMERICA

3.01 The most important instruments used to pursue the ISI strategy in the CACM were tariffs and fiscal incentives. Under the customs union, a common external tariff schedule (CET) applied to imports from third countries, while regionally produced items were to be exempt from tariff and non-tariff policy barriers. Most product categories were included in this arrangement, but some important ones were not: basic agricultural products were always excluded from the provision to liberalize intra-regional trade and certain other products (mainly petrofuels, automobiles and distilled spirits) were subject to different external tariffs in the separate countries. Fiscal incentives comprised a variety of subsidies and tax exemptions to promote industry, but most important in this respect were duty exemptions for imported inputs and capital goods.

A. The Legal External Tariff Structure

Background

3.02 The tariff rates in the initial CET schedule tended to be near the upper range of the rates prevailing in the individual countries prior to integration. The tariff schedule also included specific rates as well as ad-valorem rates. Over time the levels of protection generated by specific tariff rates were eroded by inflation. Tariff revenue erosion and balance of payments difficulties led the CACM policymakers to introduce a 30% tariff surcharge (applied to the basic external tariff in a multiplicative manner) under the San Jose Protocol in 1969. Table 3.1 shows the average ad-valorem-equivalent nominal tariff levels over all tariff positions, inclusive of surcharges, prevailing in 1972.

Table 3.1
CENTRAL AMERICA: AD-VALOREM-EQUIVALENT EXTERNAL TARIFF RATES IN 1972

| | Unweighted Mean | Trade-Weighted Mean |
|-------------|-----------------|---------------------|
| Costa Rica | 51.5% | 36.6% |
| El Salvador | 47.6% | 25.4% |
| Guatemala | 50.1% | 26.6% |
| Honduras | 41.2% | 26.2% |
| Nicaragua | 54.4% | 35.8% |

Source: IBRD Report No. 2325b-CA, based on data from SIECA.

3.03 On January 1, 1986, the CACM introduced a trade policy reform that contained the following major elements:

- (i) the common external tariff schedule was revised and included only ad-valorem rates, eliminating all specific tariffs;
- (ii) the system of tariff classification was modernized on the basis of the Brussels tariff nomenclature;
- (iii) the Central American Agreement on Fiscal Incentives, in effect since 1969, was terminated (see para. 3.16); and
- (iv) the 30% import surcharges of the San Jose Protocol were eliminated, and the combined average ad-valorem tariff level was reduced.

3.04 In designing the new tariff schedule, a distinction was made between competing imports, i.e., goods that were also produced in the region, and non-competing imports.^{10/} As a general guideline, among non-competing imports, (a) essential consumer goods would receive a tariff rate between 0 and 5%; (b) non-essential consumer goods would receive rates of around 10% or more in certain instances; and (c) capital goods, intermediates and raw materials would receive about 10%. Among competing imports, (a) raw materials, intermediate and capital goods would receive rates of 10%, 20% and 30%, depending on the degree of processing and domestic input content; and (b) final consumer goods would receive rates between 35% and 90%, with the understanding that most rates would be below 60%. These guidelines had a clear protectionist intent, favoring domestically produced consumer goods in the final stages of processing. The target range of effective protection rates aimed for with the new CET was between 50% and 150%.

^{10/} When the new tariff schedule was adopted there remained some disagreements among policymakers as to the level of rates to be applied on several items. Consequently, the tariff positions were divided into three parts: Part I includes all tariff positions on which a regional consensus was established, and comprises about 90% of all tariff positions. Part II, comprising about 5% of all tariff positions, contains the items on which a regional agreement could not be reached. It involves goods produced in the region, including textiles, clothing, shoes and paper products, which are generally highly protected. Part III comprises the remaining 5% of all tariff positions, and primarily involves petroleum, automobiles and some alcoholic beverages, where it was agreed that each country may set and alter rates independently.

Current Tariff Structure

3.05 Table 3.2 describes the nominal legal tariff schedules for Central America in 1987. The average rates represent a considerable reduction compared to the legal rates prevailing before the reform. The dispersion of tariff rates also declined, especially due to the reduction of some inordinately high rates arising from specific rates. In Costa Rica, for example, several rates exceeded 1,000 percent prior to the reform. Currently, the maximum legal rate is 100%, but when tariff surcharges are taken into account, the maximum combined rate rises to 253% (applied to automobiles). Among the other countries, the post-reform maximum tariffs are 154% in Guatemala, 130% in El Salvador (except for spirits and liquors, receiving up to 290%), and 100% in Nicaragua. Honduras introduced its new tariff schedule in December 1987. It has maximum nominal tariffs of 90%, though here also the ceiling is substantially raised by the application of tariff surcharges (para. 3.13).

3.06 The manufacturing sector receives the highest nominal tariff protection under the new legal tariff regime. Agriculture follows close behind, reflecting a strategy of self-sufficiency in basic foods that has been followed in the region since the 1960s. Within the manufacturing sector, the tariff structures exhibit the cascading pattern associated with a protectionist industrialization strategy, with the highest rates placed on final consumer goods, followed by capital goods, and with the lowest rates on intermediate goods and raw materials.

3.07 The production-weighted average tariffs are considerably higher than the unweighted figures, as expected in view of the protective purpose of the CET. In Costa Rica, the production-weighted average tariff for manufacturing is about 33% (compared to an unweighted figure of 27%); in Guatemala the weighted average is 32% (compared to 26%); and in Honduras, the weighted average is 29% (compared to 20%). For Costa Rica, a listing was obtained that distinguishes between imports considered to be competing with regional production and non-competing. As indicated in Table 3.3, the difference between the average legal tariff on competing final goods and on non-competing intermediates and capital goods is extremely high, and considerably more pronounced than suggested in Table 3.2, even though the overall average rate is the same.

Table 3.2

CENTRAL AMERICA: The Structure of Legal Customs Tariffs, 1987

| | <u>Costa Rica</u> | | Mean | <u>El Salvador</u> | | <u>Guatemala</u> | | <u>Honduras</u> | | <u>Nicaragua</u> | |
|----------------------------------|-------------------------------|-----------|------------------------|--------------------|-----------|------------------|-----------|-----------------|-----------|------------------|-----------|
| | Mean | Std. Dev. | | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. |
| | (Including import surcharges) | | (Excluding surcharges) | | | | | | | | |
| Whole Economy | 26.4 | 21.4 | 21.1 | 23.0 | 25.5 | 25.2 | 21.7 | 19.6 | 18.9 | 21.3 | 20.9 |
| Agriculture | 23.3 | 17.8 | 18.3 | 19.0 | 18.8 | 21.3 | 18.6 | 18.1 | 17.8 | 19.1 | 18.7 |
| Mining | 11.6 | 3.5 | 6.7 | 7.2 | 4.2 | 10.9 | 4.6 | 8.3 | 7.7 | 7.2 | 4.3 |
| Manufacturing | 26.9 | 21.7 | 21.6 | 23.5 | 26.0 | 25.7 | 22.0 | 19.9 | 19.0 | 21.7 | 21.1 |
| Consumer Goods | 36.4 | 24.6 | 32.1 | 35.8 | 32.7 | 36.2 | 25.2 | 30.4 | 21.1 | 32.6 | 24.3 |
| Intermediate Goods | 19.1 | 15.2 | 14.2 | 14.6 | 14.1 | 17.6 | 13.9 | 12.5 | 13.6 | 13.7 | 13.4 |
| Capital Goods | 22.8 | 18.6 | 13.5 | 16.5 | 17.5 | 19.4 | 18.5 | 12.3 | 10.9 | 15.5 | 16.9 |
| Manufacturing Sectors | | | | | | | | | | | |
| 31 Food, Beverages, Tobacco | 36.0 | 21.3 | 32.2 | 37.3 | 41.5 | 37.7 | 26.6 | 30.6 | 19.2 | 33.3 | 23.2 |
| 32 Textiles & Leather | 38.3 | 22.5 | 34.9 | 43.3 | 31.4 | 36.3 | 27.6 | 33.8 | 25.7 | 35.9 | 27.6 |
| 33 Wood, Cork & Products | 40.2 | 22.5 | 36.9 | 38.7 | 22.1 | 42.7 | 22.1 | 35.8 | 17.0 | 38.7 | 22.1 |
| 34 Paper & Printing | 28.0 | 21.0 | 23.5 | 25.2 | 21.6 | 29.0 | 21.7 | 19.2 | 18.1 | 20.6 | 20.4 |
| 35 Chemical, Petro. & Coal Prod. | 18.3 | 15.1 | 13.9 | 14.5 | 15.9 | 17.5 | 15.9 | 11.3 | 15.5 | 14.1 | 15.4 |
| 36 Nonmetallic Minerals | 29.8 | 23.7 | 22.7 | 24.6 | 20.0 | 29.1 | 20.2 | 22.5 | 17.4 | 24.6 | 20.0 |
| 37 Basic Metal Indus. | 14.3 | 8.1 | 9.7 | 10.1 | 9.1 | 13.9 | 9.3 | 11.5 | 10.9 | 9.9 | 9.0 |
| 38 Metal Products, Machinery | 25.9 | 23.7 | 17.8 | 19.6 | 19.9 | 22.1 | 18.2 | 16.4 | 13.0 | 19.0 | 18.4 |
| 39 Other Manufacturing | 30.3 | 19.9 | 26.4 | 28.7 | 21.8 | 32.8 | 20.6 | 25.8 | 16.6 | 26.3 | 20.3 |

Notes: Figures for Guatemala include the 4% tariff increases of September 1987. Unless otherwise noted, all figures exclude tariff surcharges.

Source: Ministerio de Economía y Comercio (Costa Rica); Secretaría de Hacienda y Crédito Público (Honduras); Arancel de Importación, 1988; Arancel Centroamericano de Importación, Julio 1986 (El Salvador, Guatemala, Nicaragua).

Table 3.3
COSTA RICA: AVERAGE NOMINAL TARIFF RATES, 1987

| | Unweighted Mean | Standard Deviation |
|---------------------------------|-----------------|--------------------|
| Raw Materials and Intermediates | | |
| Competing | 30.7 | 17.4 |
| Non-Competing | 10.3 | 5.5 |
| Capital Goods | | |
| Competing | 34.7 | 20.7 |
| Non-Competing | 17.1 | 4.8 |
| Final Goods | | |
| Competing | 50.0 | 17.5 |
| Non-Competing- essential | 9.7 | 7.5 |
| - non-essential | 56.3 | 35.6 |
| All Goods | 26.4 | 21.4 |

Source: IBRD estimates based on data from Ministry of Economy in Costa Rica.

The Impact of the Tariff Structure

3.08 In comparison to other developing countries, the average nominal tariff rates prevailing in Central America do not appear particularly high (see Annex Table C.18).^{11/} Moreover, in looking at the overall frequency distribution of tariffs (Annex Table C.19), close to one-half of all tariff positions have rates below 10%. A more significant problem is the high dispersion of tariffs. While a high average tariff level suppresses trade, thus closing off the economy, a high dispersion of tariffs distorts relative prices and leads to resource misallocations across industries without necessarily reducing the overall level of trade. As observed in Chapter II, the Central American economies are fairly open in terms of overall trade flows, but the pattern of trade is highly skewed, with extra-regional exports mainly accounted for by relatively few traditional commodities, and third-country imports heavily biased toward intermediate goods and capital. As shown in Table 3.4, the share of intermediate goods in total manufactured imports is uniformly higher in the Central American countries than in all other country groupings, including the large Latin American economies which had also adopted an ISI strategy on the same principles as the CACM.

^{11/} CACM tariff rates are considerably higher, however, than those prevailing in the major industrialized countries: prior to the Tokyo Round of GATT negotiations (1974-79), unweighted average tariffs in the EEC, U.S. and Japan ranged from 7% to 10%, and by 1980, the unweighted average tariffs fell to 5%-6% while the import-weighted average tariff was 6.5% (see IBRD World Development 1987, Chapter 8).

Table 3.4
CENTRAL AMERICA: PERCENTAGE SHARE OF INTERMEDIATE
MANUFACTURED IMPORTS IN TOTAL MANUFACTURED IMPORTS

| | 1972-74 | 1979-81 | | 1972-74 | 1979-81 |
|-------------|---------|---------|--------------------------|---------|---------|
| Costa Rica | 42.6 | 39.5 | 44 Developing countries | 36.9 | 32.9 |
| El Salvador | 47.7 | 45.2 | Low Income | 36.2 | 32.2 |
| Guatemala | 45.3 | 35.0 | Middle Income | 38.1 | 34.6 |
| Honduras | 41.5 | 36.3 | High Income | 36.0 | 31.4 |
| Nicaragua | 42.0 | 41.1 | 6 Largest Latin American | | |
| CACM avg. | 43.8 | 37.8 | Economies | 38.8 | 32.4 |

Source: UNIDO, Handbook of Industrial Statistics, 1984.

3.09 The cascading pattern of the tariff structure tends to distort import patterns and also to generate a bias against exports toward third countries. To estimate the significance of these effects in Central America, legal tariff rates were regressed against the share of extra-regional imports to total consumption in 18 industry categories (see Annex Table C.16) for Costa Rica, Guatemala and Honduras. In each case, the two variables were negatively correlated with highly statistically significant correlation coefficients.^{12/}

B. Actual External Tariff

3.10 To reduce the dispersion of tariffs, Costa Rica introduced a series of surcharges during the first stage of its structural adjustment program in 1985. The aim was to raise the low tariffs on imported capital and intermediate goods so as to reduce the overall dispersion of tariff rates. Comparing the average tariffs on consumer, intermediate and capital goods, with and without surcharges, on Table 3.2, the range of average rates has narrowed as a result of the surcharges, but only to a marginal extent.

3.11 Honduras has also introduced a series of tariff surcharges since the early 1980s, but for a different reason; to prevent the erosion of tariff

^{12/} The legal tariff structure was also regressed against the shares of extra-regional exports to total production in the manufacturing sectors in order to test the influence of the anti-export bias. The correlation coefficients were not significant, however, and had varying signs. The lack of a significant negative relation between tariff levels and export orientation may be partly due to the granting of export incentives (see Chapter VI), which are meant to correct the anti-export bias of the tariff structure.

revenues. In 1972, the revenues collected from the basic tariff code in Honduras amounted to 13% of the CIF value of imports. This share declined to 7% in 1980, and by 1985 had fallen to 4.5%. This decline was partly due to the inflation-generated reduction in the ad-valorem equivalent rates of specific duties, prevailing before 1987. The most important cause, however, was the granting of tariff exemptions.^{13/} The Honduran Finance Ministry calculates that of the total value of merchandise imports in 1985, close to half entered under some form of tariff exemption. In response to the erosion of tariff revenues, there evolved an increasingly complex system of tariff surcharges devised to reverse this income loss.^{14/} By 1985, the basic tariff only accounted for 26.5% of all revenues collected from imports, with the other 73.5% accruing from tariff surcharges. By means of these surcharges enough revenues are generated so that the actual import duty rate is approximately equal to the unweighted average legal tariff. But this has rendered the trade policy environment highly opaque.

3.12 In countries where tariff surcharges were not applied to the same extent as in Honduras, tariff revenues eroded considerably during the early 1980s; seen by comparing the rates of actual import duties collected in Table 3.5 with the unweighted average legal tariff rates in Table 3.2. While the average legal rates are in the order of 20-26%, the actual rates are generally less than 10%, except in the Honduran case. In Costa Rica, El Salvador and Guatemala, the actual average tariff rate declined after 1978, partly reflecting the impact of inflation on specific-tariff revenues. By 1984-85, actual tariffs rose again, as each country became more aware of the need to shore up government finances.

^{13/} The fiscal incentive regime accounted for 36.5% of total exemptions granted in 1985 and duty-exemption for public sector imports for 25%.

^{14/} The surcharges currently applied are: (a) a 12% surcharge plus 8% consular fees on all imports; (b) a 6% duty (Vigilancia) applied on the value of exonerated import duties that would otherwise have been collected, together with a similarly applied 10% surcharge, with rates destined to the national development finance corporation (CONADI); (c) a 5% rate on raw materials and intermediate imports and a 10% surcharge applicable to all other imports (Decreto No. 54); (d) a 20% surcharge applied only to imports that are not eligible for exonerations (Decreto No. 59); and (e) a 5% surcharge on all private sector imports except medicines (Decreto No. 85-84).

Table 3.5
CENTRAL AMERICA: ACTUAL IMPORT AND EXPORT DUTIES COLLECTED
AS A FRACTION OF EXTRA-CACM TRADE
(in %)

| | Costa Rica | | El Salvador | | Guatemala | | Honduras | | Nicaragua | |
|------|------------|------|-------------|------|-----------|------|----------|-----|-----------|---|
| | M | X | M | X | M | X | M | X | M | X |
| 1978 | 8.7 | 7.8 | 8.6 | 18.3 | 10.1 | 18.9 | 11.3 | 8.3 | 9.7 | 0 |
| 1979 | 8.4 | 7.7 | 10.2 | 18.8 | 9.7 | 13.7 | 10.6 | 8.0 | 8.8 | 0 |
| 1980 | 8.1 | 9.0 | 6.6 | 17.5 | 8.3 | 13.5 | 8.8 | 8.5 | 11.9 | 0 |
| 1981 | 4.6 | 11.8 | 5.1 | 20.3 | 7.7 | 7.6 | 12.7 | 7.9 | 9.4 | 0 |
| 1982 | 3.5 | 14.3 | 5.5 | 19.8 | 7.1 | 6.0 | 14.8 | 7.5 | 11.6 | 0 |
| 1983 | 5.2 | 15.6 | 5.7 | 15.7 | 7.9 | 5.0 | 15.2 | 6.2 | 11.2 | 0 |
| 1984 | 10.5 | 8.9 | 6.8 | 18.2 | 7.7 | 3.4 | 16.8 | 6.2 | 14.4 | 0 |
| 1985 | 11.6 | 7.4 | 8.9 | 23.0 | 2.9 | 0.4 | 18.7 | 6.0 | 9.4 | 0 |
| 1986 | 10.9 | - | - | - | 9.7 | - | 18.3 | 6.0 | - | - |
| 1987 | - | - | - | - | 9.8 | - | 20.6 | 5.6 | - | - |

Notes: M refers to total import duty collected (from customs tariffs, tariff surcharges and other duties) divided by total FOB merchandise imports originating outside the CACM. X refers to total export duty revenues collected, divided by total FOB merchandise exports destined outside the CACM. Entries denoted by (-) indicate that data are unavailable.

Source: SIECA, Series Estadísticas Seleccionadas de Centroamérica, June 1987, ECLAC and separate Ministries of Economy.

3.13 The actual average tariff rate is considerably lower than the unweighted average legal tariff for two basic reasons: the skewed structure of imports and the granting of exemptions. Both are analyzed in detail for Guatemala, where sufficiently disaggregated import and tariff data are available. Table 3.6 shows that about 20% of all Guatemalan imports in 1987 were exempt from duty payment. Since imports originating from other CACM partners accounted for 8% to 10% of total import value and were generally duty-exempt, this means that between 11% and 13% of all extra-regional imports were duty-exempt in 1987.

3.14 Table 3.6 also shows that the weighted-average import tariff, using non-exempt imports as weights (column II), is less than half the weighted average using only duty-exempt imports (column III). Similarly, Table 3.7 shows that over 72% of all non-exempt imports are subject to tariffs of less than 10%, but only 36% of all duty-exempt imports fall into these tariff categories. Alternatively, the share of non-exempt imports paying duties over 40% is only 9%, while almost 30% of all duty-exempt imports belong in this range. These differences are partly explained by the fact that almost

half of the duty-exempt imports represent imports from other CACM partners, and this trade is highly biased toward manufactured final products that receive the highest external tariffs. Another straightforward explanation for this difference involves importers' responses to prices: since tariffs raise prices, importers that pay the tariff will tend to switch toward domestic substitutes or foreign substitutes with lower tariffs, while for duty-exempt importers the tariff level has no relevance and so there is no incentive to switch to lower priced substitutes.

Table 3.6
GUATEMALA: THE ACTUAL TARIFF STRUCTURE, END-1987
(percentages)

| Sector | I Unweighted Mean | II Weighted Mean using Non-Exempt Imports | III Weighted Mean using Duty-Exempt Imports |
|----------------|-------------------------|--|--|
| Whole Economy | 21.3 | 12.0 | 29.5 |
| Agriculture | 16.2 | 6.5 | 22.2 |
| Mining | 6.0 | 7.8 | 6.1 |
| Manufacturing | 21.9 | 12.2 | 29.7 |
| Consumer goods | 33.8 | 22.2 | 41.9 |
| Intermediates | 13.5 | 7.6 | 24.9 |
| Capital goods | 12.5 | 6.9 | 13.9 |

Memo Items:

| | | |
|---|---|-------------------------|
| (a) Total 1987 Imports (CIF) | = | 3,453 million Quetzales |
| (b) Total Duty-Exempt Imports | = | 696 million Quetzales |
| (c) (b)/(a) | = | 20.2% |
| (d) Total Adjusted 1987 Import Tariff Revenue | = | 331 million Quetzales |
| (e) Value of Exempted Import Duties | = | 205 million Quetzales |
| (f) (e)/(d + e) | = | 38.2% |

Note: Actual tariff rates are calculated for every tariff position as total tariff revenues collected, divided by total non-exempt imports (CIF). The necessary data for calculating these rates was only available on an annual basis. Therefore, the actual tariff rates obtained for the entire year in 1987 represent a hybrid combination of the tariffs prevailing before the September 1987 increases (Decreto No. 63-87) and those applied toward end-1987. The actual rates in this table are estimates of the rates applied during the last quarter of 1987, and reflect an adjustment factor, derived by comparing overall actual rates for 1986 and those calculated for the entire year of 1987.

Source: Banco de Guatemala; IBRD Staff calculations using SINTIA-T.

Table 3.7
GUATEMALA: THE FREQUENCY DISTRIBUTION OF ACTUAL TARIFFS, 1987

| <u>Tariff Range (%)</u> | <u>Percent of Tariff Positions within Range</u> |
|-------------------------|---|
| 0 - 10 | 51.1 |
| 10.1 - 20 | 6.6 |
| 20.1 - 30 | 9.9 |
| 30.1 - 40 | 11.1 |
| 40.1 - 50 | 6.7 |
| 50.1 - 60 | 6.1 |
| > 60 | <u>8.6</u> |
| | 100.0 |

| <u>Tariff Range (%)</u> | <u>Share of Non-Exempt Imports within Tariff Range (%)</u> | <u>Share of Duty-Exempt Imports within Range (%)</u> |
|-------------------------|--|--|
| 0 - 10 | 72.3 | 36.0 |
| 10.1 - 40 | 18.4 | 35.0 |
| > 40 | <u>9.3</u> | <u>29.0</u> |
| | 100.0 | 100.0 |

| | | |
|--|-----------------|---------------|
| CIF Value of 1987 Imports (in Quetzales) | 2,757.1 million | 696.1 million |
|--|-----------------|---------------|

Source: Banco de Guatemala; IBRD Staff calculations using SINTIA-T.

3.15 A further reason for the erosion of tariff revenues is the presence of non-tariff import restrictions. As a rule, imports which are subject to the most restrictive quantitative barriers, also on average are subject to the highest tariffs. Consequently, high-tariff items are less likely to be represented in the total import bundle than low-tariff items, which brings down the import-weighted average tariff rates. (The Honduran foreign exchange licensing system described in Table 3.8 provides supporting evidence in this regard).

Fiscal Incentives

3.16 A large source of duty exemptions in the past was the regional Agreement on Fiscal Incentives for Industrial Investment, implemented in 1969.

Prior to this agreement, each Central American country had its own fiscal incentive programs to stimulate industrialization, in addition to the stimulus already provided by the protective tariff structure. The regional agreement aimed to harmonize national incentive systems and limit their scope to prevent excessive subsidization by the CACM countries in competing with each other to attract new industries. In addition to fiscal cost considerations, policy-makers also recognized that the granting of fiscal incentives in a non-uniform manner would render the CET irrelevant. The incentive system introduced fixed time limits over which exemptions were to be granted to beneficiary enterprises. This would allow governments to support infant industries, but would discourage subsidization of unviable industries over an indefinite period. In practice, these time limits were extended continually through revisions of the original agreement.

3.17 The incentive scheme undermined fiscal control in the region. In El Salvador, for example, the total value of duty exonerations granted under the fiscal incentive scheme during the fiscal year 1985/86 amounted to 206 million Colones, which exceeded the total import duty revenues collected over that period (estimated at 189 million Colones). Moreover, the size of this lost income represented about 10% of total government tax revenues. In Honduras, fiscal revenues lost through tariff exemptions under this scheme amounted to almost 40 million Lempiras in 1985 (although much of this was recouped through tariff surcharges), compared to 80 million Lempiras of total duty revenues from imports.

3.18 The trade policy reform of 1986 eliminated fiscal incentives granted under the regional agreement. Each country, however, continues to maintain some national incentive programs, involving tariff exemptions, and public sector imports also continue to be exempt from duties. Both still represent a significant amount of foregone government revenues, as shown earlier for the case of Guatemala (para. 3.13).

Export Taxes

3.19 All Central American countries, except Nicaragua, impose substantial taxes on their traditional export commodities, particularly coffee, in lieu of income taxes. In most cases, however, nontraditional exports are exempt from duties or subject to a minor charge only.^{15/} El Salvador exhibits the highest dependence on export taxes, virtually all of which is accounted for by duties on coffee. Its total revenues collected from exports have been on average twice as high as import duty revenues over the last three years. In Guatemala, export duties were significant during the late 1970s but have

^{15/} In Honduras, for example, all exports are subject to a 1% tariff, with the following exceptions: silver and gold products pay a 5% tariff, and the non-precious metals, steel/copper/lead/zinc, which account for about 3 percent of total merchandise exports, pay a 4% tariff. Bananas and coffee are subject to special systems of export levels, involving specific rates and a progressive tax schedule whereby rates increase once international commodity prices exceed certain levels.

become increasingly smaller over time.^{16/} A similar but less pronounced decline in the significance of export taxes can also be observed in Honduras, while Costa Rica has maintained approximately the same rates as prevailed at the beginning of the decade. Nicaragua represents a special case in this regard, not comparable to the other CACM members, because most exports are channeled through public sector trading agencies, or carried out on a barter basis, with export taxes not levied explicitly.

Effective Rates of Protection

3.20 The 1986 regional tariff reform brought about a substantial reduction in the average level of nominal tariffs and in their dispersion, but it appears that these measures largely eliminated the "water" in the tariffs without substantially changing the protective nature of the system. One published study on Costa Rica ^{17/} examines 17 four-digit manufacturing industries, and finds that the 1986 reforms have only had a marginal effect in terms of reducing effective tariff protection. As a result of the tariff reform, the average protection for the 17 industries declined from 121% in 1985 to 112% in 1986. Another study,^{18/} based on a sample of over 200 Costa Rican firms and using international price comparisons rather than legal tariff levels arrives at a considerably higher estimate of the average level of effective protection granted to the manufacturing sector in 1986. In 1987, the Ministry of Economy and Commerce in Costa Rica estimated the unweighted average level of effective tariff protection over all four-digit manufacturing industries to be around 72%, with a standard deviation of 50%. Effective rates ranged from less than 0 to over 200%. In a study by SIECA,^{19/} production and trade-weighted average effective protection rates are estimated for

^{16/} Export taxes were significantly raised in mid-1986, however, with a 40% to 80% marginal tax on traditional exports, and a 4% tax on all non-traditional exports. These tax increases were introduced as a temporary measure to raise fiscal revenues and are scheduled to be slowly phased out.

^{17/} Ricardo Monge Gonzalez, La Reforma Arancelaria; San Jose, 1987.

^{18/} Ricardo Monge Gonzalez and Jorge Corrales Quesada, Politicas de Proteccion e Incentivos a la Manufactura, Agroindustria y Algunos Sectores Agricolas en Costa Rica. San Jose, Costa Rica, 1988. This study estimates that the average nominal protection rate granted to manufactured final products through tariff and nontariff barriers is 46% and that granted to inputs is 9%, yielding an average effective protection rate of 288%. This EPR estimate seems rather high as an average for the whole manufacturing sector, and implies that the average value-added rate in Costa Rican manufacturing (at international prices) is only about 13.5%.

^{19/} Reported in Willmore, L. "Export Promotion and Import Substitution in Central America's Manufacturing Sector." CEPAL/Mexico. 22/6/88, mimeo.

the manufacturing sectors in each CACM country in 1986, yielding rates between 70% and 80%.

3.21 In a series of studies commissioned by the Honduran Ministry of Finance,^{20/} the average level of effective protection granted prior to the Honduran tariff reform in 1987 is estimated to be 83% for all final manufactured products, while the post-reform average is estimated to have remained around 80%. These calculations are based on the legal tariff, various surcharges, and exonerations, but do not take into account the effect of non-tariff protection. In another study in this series, effective protection is calculated for a sample of 42 firms in 32 industries on the basis of domestic and international price comparisons. Here, the average effective protection rate is found to be 178%, as compared to 90% when using legal tariff rates applicable to those industries. This difference is likely due to the presence of non-tariff barriers, which are discussed in Section C.

3.22 In view of the data difficulties that hamper the computation of effective protection rates (mainly the lack of input-output data and of domestic-international price comparisons), accurate calculations of effective protection are difficult to make. The existing studies, therefore, can only serve as a rough approximation. Nevertheless, they all suggest that the effective protection rates granted to regional manufacturers remain high on average (well above 50%), and are highly disperse.

C. Non-Tariff Trade Restrictions

3.23 Foreign exchange restrictions currently constitute the single most important non-tariff barrier to imports in Central America. In all countries, importers must obtain licenses to ensure that they will be able to purchase foreign exchange at one of the official rates from the Central Bank, before placing an import order. Strict exchange controls were introduced in response to the balance of payments crises in the early 1980s, as an alternative to currency devaluation and to prevent capital flight. Exports also were monitored by way of licenses to assure the delivery of foreign exchange inflows to the Central Bank.

3.24 The restrictiveness of foreign exchange license requirements varies by country, depending upon the degree of currency overvaluation and the availability of reserves at the Central Bank. When the exchange rate is not allowed to equilibrate demands and supplies, a system of priorities has to be devised according to which foreign exchange is rationed. Honduras provides a characteristic example: the process of obtaining foreign exchange involves two steps. First, the importer needs to obtain an import authorization before placing orders; and once the shipments arrive, another license is required, authorizing the transfer of foreign exchange to the importer's commercial bank account. Each license can take between 30 and 120 days, depending on the

^{20/} Berlinski, J. "Honduras, Estructura de Proteccion de la Industria Manufacturera," July 1986, mimeo; and "Honduras, La Proteccion Implicita en Actividades de la Industria Manufacturera," May 1987, mimeo.

priority assigned to the imported items. All imports are divided into five categories: 1 (essential goods), 2 (fuels), 3 (raw materials and intermediates), 4 (capital goods) and 5 (non-essential and luxury consumer goods). Goods in category 5 are further subdivided into three classes (A, B, and C), in declining order of priority. Items included in category 5C are prohibited from obtaining official foreign exchange, yet they can be imported, together with all other permissible goods, with foreign exchange obtained in the parallel market. Moreover, imports purchased through the parallel market still require a license, but this is issued automatically within 5 working days and does not require a further transfer authorization. As noted in Table 3.8, the items that are lowest in the order of priority also in general are subject to the highest average tariff rate. In other words, although exchange controls were not primarily introduced as a vehicle for protection, they in effect strengthen the structure of protection generated by the tariff system, as discussed in para. 3.15.

Table 3.8
HONDURAS: THE IMPORT LICENSE REGIME, 1988

| | Foreign Exchange Licensing Category | | | | | | |
|-------------------------|-------------------------------------|-------|---------------|---------|----------------|----|-----|
| | essential | fuels | intermediates | capital | other consumer | | |
| | 1 | 2 | 3 | 4 | 5A | 5B | 5C |
| No. of Tariff Positions | 478 | 20 | 530 | 190 | 150 | 18 | 328 |
| Tariff Structure | (percentages) | | | | | | |
| Maximum Tariff | 80 | 30 | 80 | 60 | 90 | 80 | 90 |
| Unweighted Mean | 11 | 5 | 17 | 11 | 31 | 34 | 36 |
| Standard Deviation | 14 | 6 | 16 | 10 | 22 | 20 | 19 |

Source: Secretaria de Hacienda y Credito Publico, Arancel de Importacion, 1988; Banco Central de Honduras. IBRD staff calculations using SINTIA-T.

3.25 In 1987, about one-third of all merchandise imports in Honduras were purchased through the parallel market. By virtue of this mechanism, it is possible to make a rough calculation of the restrictiveness of the licensing requirement as a trade barrier: the official exchange rate is 2 Lempiras/-US\$ while the rates quoted on the parallel market (December 1988) hovered around 2.8 lempiras/US\$. The trade-weighted average exchange rate therefore is 2.27 lempiras/US\$, so that the premium on the parallel market is 23%. This means that the maximum ad-valorem equivalent rate of nominal protection provided by the licensing system is 23%. Coupled with the legal tariff system, however, the restrictiveness of the foreign licensing system is even greater, since both rates apply in a multiplicative, rather than additive,

fashion. That is, an imported item subject to a legal tariff rate of 30% and not eligible to receive foreign exchange at the official rate, in effect pays a combined duty of 60% = $(1 + 23\%)(1 + 30\%)$.

3.26 El Salvador and Nicaragua granted foreign exchange licenses in a similar manner as Honduras, also with a system of priorities, except for the absence of a freely functioning officially sanctioned parallel exchange market. In El Salvador, the legal parallel market was eliminated after the exchange unification reform in 1986, but has been legalized again since July 1989, with a market-determined flexible parallel rate. In Nicaragua, there is currently a multiple exchange rate system in effect, but all rates are set by the government. In Costa Rica and Guatemala, foreign exchange licenses are also required but are far less restrictive than in the other three countries. According to reports by importers, foreign exchange licenses are granted within 5 working days in Guatemala, and within 10 working days in Costa Rica. The relative rapidity with which licenses are granted is related to the greater flexibility of official exchange rate management observed in these two countries; partly reflected in their relatively lower real exchange rates (see Figure 7).^{21/}

3.27 Other quantitative restrictions are also applied in each of the Central American countries, but these have a less comprehensive product coverage than the foreign exchange licensing requirement and mainly affect the agricultural sector. In Guatemala, for example, import prohibitions applied for other than health and security reasons affect 44 tariff positions, and import licenses affect another 35 tariff positions (out of a total 1885 tariff positions); according to the usual calculation methods, the value of manufacturing production covered by these QRs on imports is about 6% (see Annex B). Similar export QRs apply to 61 tariff positions and also cover roughly 6% of Guatemalan manufacturing production. (As shown in Annex B, however, QRs are potentially more restrictive than these calculations indicate.) Many agricultural imports and some chemicals require licenses from the Ministries of Agriculture and Health. In such instances, it is difficult to distinguish to what extent such licenses are used to assure adequate health and sanitary standards or to protect domestic producers. In the case of basic grains, imports and exports are generally channelled through government marketing board, with the two-fold objective of assuring adequate domestic supplies to consumers (at low prices) and protecting domestic farmers. (The result has been that the marketing boards usually operate at a loss.)

^{21/} Costa Rica also requires prior deposits at the Central Bank, when importers place a foreign exchange request. The amount of domestic currency deposits required for this purpose has varied, and has been used as an instrument of monetary management to control the degree of domestic liquidity. Although this system constitutes a trade barrier, imposing an additional cost in terms of foregone interest, the barrier is small as long as the license processing period remains short.

D. Intra-Regional Trade Barriers

3.28 A central principle of the CACM is the elimination of trade barriers among its members. From the beginning, this principle did not apply to certain products, primarily agricultural goods. With the advent of the economic crisis in the 1980s, however, intra-regional trade barriers increased significantly, thus reducing the free trade character of the CACM. The main barrier to trade is provided by foreign exchange controls, which emerged in response to balance of payments disequilibria, and not as independent measures specifically directed at CACM partner imports. Although exchange licensing requirements apply equally to extra- and intra-regional imports, they tend to be especially restrictive for intra-regional imports because of the system of priorities in allocating foreign exchange, which discriminates in favor of essential foods and intermediate inputs and against final consumer goods. The collapse of the regional payments clearing house (CCC) made the shortage of foreign exchange even more problematic for intra-regional trade. The inability of some CACM countries to settle their intra-regional debts (which largely caused the collapse of the CCC) also prompted the other partner countries to impose more discriminatory foreign exchange and export restrictions in some instances. Most affected in this respect are Nicaragua, which owes more than US\$ 500 million in arrears to its regional partners, and Honduras.

3.29 Tariff restrictions play a minor role in intra-regional trade. Import tariffs were imposed briefly when a trade conflict erupted among the CACM members in late 1981, but they were rolled back by early 1983. Honduras continues to impose modest duties (of around 10%) as stipulated in bilateral trade agreements and Nicaragua has imposed a similar levy on traders operating along its frontiers. The external tariff structure combined with generally insignificant intra-regional tariffs, therefore, still discriminates in favor of intra-regional trade. In contrast to earlier years, however, the tariff structure has largely lost its effectiveness in promoting regional trade due to the advent of non-tariff restrictions.

3.30 The prevalence of non-tariff restrictions makes it difficult to estimate the height of intra-regional trade barriers. W.R. Cline ^{22/} estimated that between 1978 and 1983, the level of trade barriers in Central America increased by the equivalent of a 16% tariff on intra-regional trade and 22% on extra-regional trade. That estimate, however, was roughly based on the observation that over this period the proportion of intra-regional imports to total imports remained approximately the same for the region as a whole. Since 1984, however, that proportion has declined significantly (see Table 2.2), suggesting that intraregional trade barriers have risen considerably more in relation to external trade barriers than was initially estimated by Cline.

^{22/} In "The Role of Economic Integration in Central American Development" prepared for the International Symposium on Central America in Cartagena, Colombia; Nov 1984.

3.31 A source of complaints among the regional trading partners is the recent introduction of selective consumption taxes in some countries, to raise fiscal revenues. Although these taxes do not discriminate by country of origin, it sometimes turns out that the consumption good in question is not produced domestically but is produced by a CACM partner. Moreover, to facilitate tax collections, the consumption tax is often applied by the customs authorities at the port of entry, giving the appearance of an import duty.

3.32 Another source of discord in regional trade relations is the problem that some final goods may enter below the legal tariff barriers in one country, be subjected to marginal treatment and then reexported duty-free to a partner country, thereby subverting the purpose of the external tariff. Since many of the manufactured products traded within the region have a high content of inputs from third countries (see para. 2.10) agreement on a minimum national value-added criterion and on the procedures to verify compliance is necessary. 'Rules of origin' designed to meet this problem already exist in the CACM, specifying a 35% minimum national value-added to qualify as a regional product. Progress was made also in verifying compliance with this rule, but some exporters still complain that the criteria used in different countries are not uniform and inhibit intra-regional exports. Monitoring rules of origin is made particularly difficult by smuggling activity, which appears to be high according to informal reports.

3.33 Finally, there is some concern over the deterioration of transport infrastructure, as governments are being forced to cut back their expenditures to cope with budgetary deficits. The efforts devoted to the development of transport links before the formal establishment of the CACM are generally recognized to have had high payoffs in terms of encouraging and accommodating the subsequent expansion of intra-regional trade. While the present low level of trade does not place a major burden on the existing infrastructure, the resumption of previous trade volumes could lead to bottlenecks if normal road maintenance and improvements are not undertaken.

E. Summary and Concluding Remarks

3.34 In Chapter II, it was shown how the distorted trade pattern that evolved in Central America rendered the CACM economies extremely vulnerable to changes in the external economic environment. This chapter argued that the trade policies adopted in the CACM strongly contributed to the development of that trade pattern and continue to distort incentives despite the regional trade reforms in 1986. Especially important in this respect have been the external tariff schedule and the system of exemptions, which grant high protection to final manufactured goods within the region and promote excessive dependence on intermediate and capital good imports from third countries. Since the industries encouraged in this manner largely remained uncompetitive in third countries, the region's dependence on traditional agricultural exports as the dominant source of hard currencies became even stronger. In the 1980s, the biasing of incentives due to the tariff system was aggravated by the introduction of non-tariff trade restrictions, which also discriminated against final manufactured imports and in favor of intermediates and capital inputs. The only difference is that the non-tariff restrictions affected both

extra- and intra-regional imports, with the result that the same protectionist policies initially applied at the regional level have been applied increasingly at the even smaller national market levels.

3.35 With the advent of foreign exchange controls, the customs union has lost much of its force as an integration instrument; as reflected in the drastic decline of intra-regional trade. The integrative influence of a customs union rests on two elements: intra-regional trade liberalization and a common external tariff schedule. A free trade area, which only comprises the element of intra-regional trade liberalization, also exerts an integrative influence, though more weakly than a customs union. In contrast, the adherence to a common external tariff without the element of intra-regional trade liberalization, which largely characterizes the current CACM, has little economic justification. Intra-regional trade liberalization, therefore, is a necessary step if any significant economic benefits are to accrue from the CACM.

3.36 Most critical, however, is the need to liberalize extra-regional trade. Major trade policy reforms are required in Central America to reduce the distortions that have led to inefficient resource allocation and to make the overall trade environment more transparent. This would encourage the expansion of trade with third countries and relieve the foreign exchange shortage in the region, creating a more solid basis for sustained growth. The main reforms needed in this regard are the reduction in levels and, particularly, in the dispersion of external tariffs, the elimination of intransparent tariff surcharges and exemptions, and the adoption of appropriate exchange rate and macroeconomic policies to remove the reliance on foreign exchange controls. Since exchange controls are the main barrier to intra-regional trade, their removal would also encourage an expansion of such trade.

3.37 In implementing a trade liberalization program, the maintenance of macroeconomic control and the appropriate sequencing of reforms are essential. A change in tariff rates designed to adjust relative prices and induce structural adjustments in the economy will lose much of its effectiveness in the presence of widespread quantitative restrictions. Also, the relative price signals resulting from a tariff reform would remain obscured by the continued application of tariff surcharges and exemptions. Both would have to be removed for the tariff reform to have its desired effects. The permanent removal of exchange controls, in turn, is contingent on sufficiently flexible exchange rate management, coupled with enough fiscal and monetary control. Moreover, a reduction in tariffs will attract more imports and likely reduce fiscal revenues in the short run, which makes the task of preventing macroeconomic disequilibria even more critical. Achieving sufficient macroeconomic control may take time and, thus, imposes a constraint on the speed with which a comprehensive trade liberalizing program can be launched. In view of the current disparity of individual macroeconomic circumstances among the Central American countries, this constraint becomes important in designing a regional trade liberalization program, as discussed next.

CHAPTER IV

TRADE LIBERALIZATION AND ECONOMIC REINTEGRATION

A. Current Trade Reform Initiatives

4.01 The initial responses to the economic crisis in Central America centered on the reestablishment of macroeconomic equilibrium, i.e., reducing the balance of payments and fiscal deficits, and controlling inflation. Despite some countries' relative progress in halting their economic decline, there is still no sustained recovery. Output growth remains fragile, extra-regional exports are sluggish, and intra-regional trade stagnates. This situation has prompted policymakers to reconsider their former development strategy focused on regional import-substituting industrialization. They have increasingly recognized that to overcome the present economic crisis a more efficient allocation of domestic resources and the expansion of external trade are essential, which requires fundamental structural adjustments, beyond macroeconomic stabilization. One indication of increased outward orientation is that all CACM countries (except Nicaragua which is already a GATT member) have begun negotiations to obtain provisional access to GATT; see Chapter VI. The reactivation of growth will also depend on the cessation of armed conflicts in the region. Policymakers have realized, however, that these conflicts cannot serve as an excuse to postpone needed economic adjustments.

Costa Rica

4.02 Costa Rica initiated a structural adjustment program in 1985. The first phase of that program emphasized macroeconomic stabilization and included trade measures taken in connection with the regional trade reform of January 1986. Also, some progress was made in the promotion of non-traditional exports. The Government now is introducing the second phase of its structural adjustment program, which involves the following: (i) further trade policy reform, (ii) additional reductions in the overall public sector deficit, (iii) efficiency-improving revisions of the public investment program, (iv) financial sector reforms, and (v) better pricing, marketing and subsidy policies in agriculture. A central element of the Costa Rican program is the trade liberalizing policy reform. It consists of (i) external tariff adjustments (particularly, tariff ceiling reductions), coupled with a flexible exchange rate management, (ii) streamlining the export incentives, and (iii) expansion of free trade zones and transport links. The objective of this reform is to reduce the anti-export bias of the economy, to make the domestic trade environment more competitive, to create greater clarity in the trade policy environment, and to remove other obstacles to export growth.

Guatemala

4.03 The Guatemalan Government implemented various stabilization measures in 1986-88, resulting in a considerable reduction in inflation and improved fiscal and balance of payments accounts. Some improvements also have been made recently in export promotion, with the creation of a one-stop window ("ventanilla unica") to expedite export-related paperwork and the gradual

unification and realignment of exchange rates. Having achieved considerable progress in macroeconomic stabilization, the Guatemalan policymakers recognize the need to consolidate these gains by promoting structural changes in the external sector. The Government is currently considering further trade reforms, similar to those initiated in Costa Rica with respect to the external sector, including a gradual tariff ceiling reduction coupled with accommodative exchange rate devaluations and tax reform as the principal components.

Honduras

4.04 In contrast to Costa Rica and Guatemala, the primary focus of Honduras' policymakers is still on short-term stabilization issues. Despite some outward signs of macroeconomic stability (the inflation rate remained below 3% in 1987), money supply growth has been extremely high, and the fiscal balance remains in disequilibrium. These developments are inconsistent with the Government's objective of maintaining the official exchange rate fixed and are likely to have seriously disruptive consequences unless corrective actions are taken quickly. In 1987, some improvements in tax collection, including import tariffs, were made, and the parallel exchange rate market was given a substantially wider operating scope in mid-1988, though policymakers are unwilling to contemplate an outright devaluation. Measures so far mainly serve the stabilization objective but do not resolve the structural problems faced by the economy.

4.05 The Honduran authorities now are preparing a three-year economic plan involving further stabilization measures to be followed by a medium-term structural adjustment program. Although the Government has not announced specific targets, it has agreed tentatively to prepare a trade reform program in 1989. In this context, the Government first is considering the elimination of various tariff surcharges and exemptions, thereby putting more emphasis on the basic tariff schedule. Some deliberations on possible tariff reductions to reduce the protection granted to the manufacturing sector have also taken place, but no specific proposals have been advanced.

El Salvador

4.06 Despite ongoing political turmoil, El Salvador has made progress in reducing imbalances in the basic macroeconomic accounts since the early 1980s, and in 1987 reversed the process of rising inflation. The success in stabilization remains fragile, however; the slowdown of inflation was achieved largely by fixing the exchange rate, which since 1986 has been continuously appreciating in real terms; the reduction in the current account deficit was made possible by large increases in foreign net transfers (remittances and official grants) rather than by adjusting merchandise trade, and finally, the fiscal deficit was narrowed primarily by reducing government expenditures rather than raising revenues. A problem in this last regard is that defense expenditures account for at least 20% of the central government budget and are likely to remain unpredictable. Also, El Salvador's current reconstruction needs are so great that they cannot be met with such low non-defense government expenditure levels. In view of the fragility of the macroeconomic situation, Salvadoran policymakers have been understandably cautious in the area of trade reform. In 1987, some reforms streamlined the export incentive regime,

with the aim of expanding non-traditional exports. In mid-1989, a new Government took office and initiated a comprehensive adjustment program, including tax reforms, tariff reduction and unification, and a more flexible exchange rate management, designed to place the economy on an outward-oriented growth path.

Nicaragua

4.07 The Nicaraguan economy confronts the most serious problems in terms of macroeconomic instability and structural distortions. Inflation rates have risen to hyperinflationary dimensions, fiscal and balance of payments accounts are highly disequilibrated, the exchange rate has been allowed to become vastly overvalued, and defense expenditures eat up between 40% and 50% of the government budget. Under these circumstances, economic activity can be sustained only through direct controls, leaving little room for the pricing mechanism, or through black markets. Since early 1988, the Government has taken valiant measures to reduce some of the most extreme sources of distortions, including a drastic devaluation of exchange rates, with the intention of adopting a crawling peg; strong reductions in the rate of monetary expansion; the elimination of price controls; the reduction of subsidies, particularly through interest rates, which are to be indexed to inflation to yield positive real rates; and significant cuts in government expenditures. Nicaragua also participated in the regional trade reform of January 1986 and continues to be involved in CACM economic policy discussions, which have recently addressed the possibility of further trade reforms. These steps give rise to some optimism, both in terms of reducing economic distortions and in making Nicaragua's economic policies more compatible with those of the other countries in the region.

B. Key Elements of the Trade Liberalization Initiatives

4.08 This section analyzes two key elements of the trade liberalization programs initiated in Central America: (i) the revision of external tariff levels, and (ii) the macroeconomic implications of the tariff reforms, with a focus on the trade and fiscal accounts.

Tariff Reform Targets

4.09 The tariff reforms initiated in Costa Rica and planned in Guatemala involve phased reductions in the external tariff ceiling (including any tariff surcharges). In 1987, this ceiling was over 200% in Costa Rica and 150% in Guatemala. In both cases, a tariff ceiling of 40% was chosen as the medium term (3-year) target to be reached in six half-yearly adjustments. The tariff floor is to remain at 5%. In Costa Rica there are two exceptions to this rule: for textiles, garments and shoes, the tariff ceiling reductions are to be spread out over five years instead of three, although the same 40% end-target will apply, and certain "essential" imports (medicines, basic foods) may be subject to tariffs below 5%.

4.10 The objective of the tariff ceiling reductions is to reduce the levels and dispersion of effective protection rates in the economy. Lack of data, however, makes an accurate calculation of these rates difficult, so that

the reforms have focused on nominal rates. The reduction in tariff ceilings while leaving the tariff floor unchanged, however, should reduce the average level and dispersion of effective protection because of the following well known propositions: (i) the lower is the average level of nominal tariffs, the lower is the average level of effective tariff protection, and similarly (ii) the smaller is the dispersion of nominal rates, the smaller is the dispersion in effective rates.

4.11 A general feature of the proposed tariff reforms is that the tariff changes are to be introduced in a gradual manner to avoid unnecessary disruptions and to allow the adjustment costs to be spread out over a longer period. When adjusting tariffs in a gradual manner, it is important that the level and dispersion of effective protection rates be reduced at each step, in order to give consistent signals to producers over time. The basic options for achieving this objective are: (i) the concertina method, whereby the highest nominal tariff is reduced first to the level of the next highest, and then both are reduced simultaneously toward the third highest, and so on; and (ii) the proportional method, whereby all nominal tariffs are reduced simultaneously by the same proportion relative to the end-target rates.

4.12 The tariff reforms in Costa Rica and Guatemala are essentially based on the concertina method of adjustment. In Costa Rica, the method is not applied uniformly, however, since some tariffs currently within the 5% - 40% end-target range are also being lowered, particularly tariffs on intermediates and capital goods. This step could conceivably weaken the adjustment effort, since lower tariffs on imported inputs raise the effective protection granted to final products. Nevertheless, the Costa Rican tariff reform targets yield a considerable reduction in the unweighted average nominal rate, from 26.4% to 16.4%, and most importantly, a reduction in nominal tariff dispersion, from a standard deviation of 21.4% to 13.1%. According to rough Government calculations, this reform reduces the average effective tariff protection rate in manufacturing from 72% to 60% and the dispersion from 50% to 25%. For Guatemala, the reduction of the tariff ceiling to 40%, leaving lower tariffs unchanged, would reduce the average nominal tariff rate from 25% to 21% and the dispersion from 22% to 14%.

Macroeconomic Implications

4.13 The success of a trade liberalization program depends critically on the government's ability to maintain a stable macroeconomic environment. Trade liberalization is less likely to succeed in a destabilized environment for the following reasons: first, trade reforms work by permanently altering relative prices, thereby changing the economic incentive structure. In a destabilized environment, relative price signals are likely to be swamped by high and variable inflation rates occasioned by macroeconomic disequilibria and will, thus, not be perceived clearly. Second, with unstable macroeconomic conditions the chances of policy reversals are increased, so that agents are bound to be less responsive to relative price signals even when these are perceived. That prolongs the structural adjustment process and increases adjustment costs.

4.14 A reduction in trade barriers is likely to bring about macro-economic disequilibria that need to be countered by appropriate policy responses. In particular, the decrease in the external tariff ceiling will attract more imports and, unless import demand elasticities are extraordinarily high, also will cause a reduction in tariff revenues, resulting in a deterioration of both the balance of payments current account and the fiscal account. To offset such a deterioration, the government must be prepared to manage the real exchange rate and fiscal policy in a flexible manner and in coordination with the trade policy reforms. In this respect, Costa Rica and Guatemala have made considerable progress in closing their fiscal deficit gaps in recent years, and their Governments have expressed a commitment as part of their reform programs to continue their flexible management of exchange rates.

4.15 The impact of the tariff changes on import demand and fiscal revenues has been simulated for Costa Rica and Guatemala, using the SINTIA-T ^{23/} partial equilibrium model. In the Costa Rican example, the simulations are based on the legal tariff structure and on 1986 import data; the Guatemalan example is based on the actual tariff structure and on 1987 import data. (The full set of simulation results is presented and discussed in Annex A). The results for Costa Rica suggest that the tariff reductions contained in the reform program would cause yearly imports to be about 10% higher in real terms after all medium term tariff targets have been reached. This import surge could be prevented by a real devaluation of approximately 8%. Total tariff revenues in domestic currency (Colones), however, fall by around 40% according to these calculations, requiring significant fiscal adjustments to prevent a rising deficit. In Guatemala's example, the impact of the tariff ceiling reduction to 40% turns out less severe. The simulations suggest that only a 2% real devaluation is needed to prevent a deterioration of the current account, while tariff revenues would decline by only 8%.^{24/}

4.16 The significant decline in tariff revenues resulting in the Costa Rican simulations has to be adjusted by several considerations not accounted for in the model. First, the Costa Rica simulations are based on legal tariffs and, therefore, do not accurately account for duty exemptions. As indicated by Guatemalan data (chapter III, Tables 3.5, 3.6), high tariff items represent a considerably greater proportion of duty-exempt imports than of duty-paying imports. Therefore, the tariff ceiling reduction simulations based on legal tariffs overstate the decline in tariff revenues (by about

^{23/} SINTIA-T denotes the software for Industrial, Trade and Incentives Analysis developed by the IBRD.

^{24/} The main causes for the large discrepancy in the simulated revenue impact for Costa Rica and Guatemala are: (a) the average legal tariff is initially higher in Costa Rica than in Guatemala, so that the tariff ceiling decline causes a greater revenue decline in Costa Rica; (b) the Guatemalan simulation is based on a tariff ceiling reduction to 40% while in the Costa Rican program other tariffs currently below 40% are also reduced; as reflected in the observation (Table 4.1) that the average tariff falls to 16.4% at the end of the reform program in Costa Rica, but only to 21% in Guatemala.

10%). Second, any devaluation that accompanies the tariff reform will raise the domestic currency value of export tariff revenues. Third, the simulations ignore the possibility of endogenously stimulated export growth (that being one of the objectives of the tariff reform), which would also increase trade tax revenues. On the other hand, a devaluation will raise the value of public sector expenditures, to the extent that these are made on imported items, which increases the fiscal deficit.

4.17 Another major concern is the impact of the tariff reform and macropolicy accommodation on inflation. When the exchange rate is devalued just enough to compensate for reductions in tariff protection, the direct inflationary impact of the devaluation would be offset by the deflationary impact of the tariff reduction. I.e., the tariff reform, coupled with a sufficient devaluation to keep the trade account balanced, would lead to relative price changes, but would leave unchanged the average price level. A potential problem of inflation does arise, however, if the tariff reform leads to increased fiscal deficits that are then financed through money creation. This danger underlines the need to maintain close fiscal control throughout the reform process.

Recommendations

4.18 The tariff ceiling reduction to 40% represents an unquestionable improvement in reducing the economic distortions arising from the current tariff structure. Effective protection rates would still remain significant, however, particularly for manufactured final goods. As shown in Table 4.1, the nominal protection afforded to final consumer goods, after the 40% tariff ceiling has been implemented, is almost double the nominal protection to intermediate manufacturing inputs. Further tariff reductions and unification after the current tariff reforms have been completed are, therefore, critically important from an efficiency standpoint and to reduce the considerable anti-export bias still remaining in the economy.

4.19 A further tariff reduction, however, would cause further declines in government revenues, thus potentially destabilizing the fiscal budget. This decline could be avoided by raising the tariff floor, which yields the added benefit of reducing the dispersion in effective protection rates. Additional simulation results presented in Annex A suggest that a tariff floor increase to 10% would enable a reduction of the tariff ceiling to 20% in Guatemala without the need for major exchange rate and fiscal adjustments. According to the simulations for Costa Rica, an increase of the tariff floor to 10% would allow the Government to recover almost 60% of the earlier estimated revenue loss arising from the initial medium term tariff reform. Moreover, as indicated in Table 4.1, the dispersion of nominal tariffs within the manufacturing sector would be almost eliminated. Finally, a unified tariff rate between 10% and 20% represents the optimal policy, since it eliminates all distortions due to tariff dispersion and still would generate enough tariff revenues to keep the fiscal accounts balanced at current levels. In view of the currently high fiscal reliance on tariff revenues, however, the unified tariff also should be progressively reduced and replaced by other less trade inhibiting taxes (see para. 4.30).

Table 4.1

CENTRAL AMERICA: IMPACT ON LEGAL TARIFF STRUCTURES OF
ALTERNATIVE TARIFF UNIFICATION TARGETS

(unweighted means and standard deviations; in %)

| New Tariff Range Ceiling Floor | Economic Sector | Costa Rica | | El Salvador | | Guatemala | | Honduras | | Nicaragua | |
|-----------------------------------|--------------------|------------|------|-------------|------|-----------|------|----------|------|-----------|------|
| | | Mean | S.D. | Mean | S.D. | Mean | S.D. | Mean | S.D. | Mean | S.D. |
| 40% 5% | Whole Economy | 16.4 | 13.1 | 18.7 | 14.8 | 21.0 | 13.8 | 17.2 | 14.1 | 18.2 | 14.6 |
| | Agriculture | 14.7 | | 16.5 | | 18.3 | | 16.3 | | 16.7 | |
| | Mining | 6.7 | | 7.2 | | 10.9 | | 8.3 | | 7.2 | |
| | Manufacturing | 16.7 | | 19.0 | | 21.3 | | 17.5 | | 18.5 | |
| | Consumer goods | 23.6 | | 25.9 | | 27.4 | | 25.4 | | 25.7 | |
| | Intermediates | 11.8 | | 14.0 | | 16.9 | | 11.8 | | 13.3 | |
| | Capital goods | 11.5 | | 15.0 | | 17.1 | | 12.1 | | 14.2 | |
| 40% 10% | Whole Economy | 18.8 | 10.9 | 21.0 | 12.7 | 21.8 | 13.0 | 19.4 | 12.2 | 20.6 | 12.5 |
| | Agriculture | 17.3 | | 19.0 | | 19.5 | | 18.9 | | 19.1 | |
| | Mining | 10.8 | | 10.7 | | 11.9 | | 12.2 | | 10.8 | |
| | Manufacturing | 19.1 | | 21.3 | | 22.2 | | 19.6 | | 20.9 | |
| | Consumer goods | 25.0 | | 27.3 | | 28.0 | | 26.2 | | 27.1 | |
| | Intermediates | 14.8 | | 17.0 | | 17.9 | | 15.0 | | 16.3 | |
| | Capital goods | 14.8 | | 17.8 | | 17.8 | | 14.7 | | 17.2 | |
| 30% 10% | Whole Economy | 17.4 | 8.5 | 18.5 | 9.3 | 18.9 | 9.3 | 17.3 | 9.0 | 18.3 | 9.2 |
| | Agriculture | 16.2 | | 16.7 | | 17.1 | | 16.9 | | 16.9 | |
| | Mining | 10.8 | | 10.7 | | 11.9 | | 12.2 | | 10.8 | |
| | Manufacturing | 17.7 | | 18.8 | | 19.2 | | 17.5 | | 18.5 | |
| | Consumer goods | 21.9 | | 22.6 | | 22.9 | | 22.2 | | 22.6 | |
| | Intermediates | 14.7 | | 16.1 | | 16.5 | | 14.1 | | 15.6 | |
| | Capital goods | 14.5 | | 16.2 | | 16.2 | | 14.0 | | 15.9 | |
| 20% 10% | Whole Economy | 14.7 | 4.9 | 14.8 | 4.9 | 14.9 | 4.8 | 14.2 | 4.8 | 14.7 | 4.9 |
| | Agriculture | 13.5 | | 13.7 | | 14.1 | | 13.8 | | 13.8 | |
| | Mining | 10.8 | | 10.7 | | 11.7 | | 11.3 | | 10.8 | |
| | Manufacturing | 14.8 | | 14.9 | | 15.8 | | 14.3 | | 14.8 | |
| | Consumer goods | 16.7 | | 16.7 | | 16.8 | | 16.8 | | 16.7 | |
| | Intermediates | 13.5 | | 13.7 | | 13.7 | | 12.5 | | 13.4 | |
| | Capital goods | 13.2 | | 14.0 | | 13.7 | | 12.5 | | 13.9 | |

Notes: For Costa Rica, the 40% ceiling - 5% floor tariff structure reflects the tariff rates to be in place in 1990. For all other countries, this tariff reform is simulated by reducing all tariffs that were above 40% in 1987 to a rate of 40%, while leaving the tariff floor unchanged. The other tariff structures are uniformly simulated for all countries by reducing all rates above the ceiling rate toward the new ceiling, and similarly, by raising all rates below the floor rate to the new floor (in accordance with the "concertina" method).

Source: IBRD Staff calculations using SINTIA-T

C. Toward a Regional Trade Liberalization Strategy

4.20 The current trade reforms in Central America are being initiated at the national levels and primarily focus on the removal of external trade barriers. Moreover, the proposed tariff reductions in Costa Rica and Guatemala violate the precept of a common external tariff schedule, which has been one of the central policy elements of the customs union. Most policy-makers in the region recognize the need to adopt a more outward-oriented development strategy to bring about fundamental structural adjustments in their economies. Yet there is little consensus on the speed and extent of reforms to be taken, due in part to the current disparity in economic circumstances from country to country. This lack of policy coordination and uniformity has raised widespread concern that the new reforms will lead to a further disintegration of the CACM.

4.21 An effectively integrated common market with a liberalized trade policy toward third countries offers the best prospects for achieving sustained growth in the region. In view of the current economic circumstances, however, the reforms needed to achieve trade liberalization and the principle of adhering to a common policy strategy are likely to conflict in the short run. Among the CACM members, Costa Rica and Guatemala have made the most progress in realigning real exchange rates and reducing their dependence on foreign exchange controls. This places them in a relatively favorable position to initiate trade reforms, including needed reductions in external tariffs. Continued adherence to a common external tariff schedule would mean that either Costa Rica and Guatemala postpone their tariff adjustments until the other CACM members are also prepared to embark on a trade liberalization or, alternatively, the other CACM members push ahead and introduce similar adjustment programs, regardless of their particular macroeconomic circumstances. Both alternatives would be counterproductive: Nicaragua, for example, already has severe difficulties in maintaining macroeconomic control and is affected by political conflicts, which limit the scope for trade liberalizing reforms. In this case, a reduction in tariffs before greater macroeconomic control is achieved would likely lead to further destabilization and the eventual abandonment of reform efforts. If conversely, Costa Rica and Guatemala were to hold off on their adjustment efforts, the opportunity costs would be considerable. At the present low levels of intra-regional trade activity, the economic gains from liberalizing external trade are bound to outweigh any potential losses from reduced intra-CACM trade that could result from the decision to depart from the common external tariff schedule. Moreover, it remains uncertain how long it will be until the other CACM partners are prepared to initiate trade liberalization. Indefinite delays in promoting needed structural adjustments increases the risk that the reform efforts run out of steam and that new external developments could destabilize economic activity again, leading to further postponing of reforms.

Recommendations

4.22 A united approach to trade liberalization is impractical and difficult to achieve in the short run, given the current disparities in the economic circumstances confronting the different countries in the region. Instead, the recommended approach is for each country to initiate its trade

reform program at a speed best suited to its economic circumstances and reform capabilities, with a joint commitment to converge at common policy targets within a predetermined time horizon. This approach calls for a suspension of the common external tariff schedule during the initial stages of reform to give policymakers in the separate countries greater flexibility in implementing the reforms. The main idea behind this strategy is to first establish a well-functioning free trade area to create a stronger basis for reestablishing a reformed customs union.

4.23 For the proposed strategy to succeed in attaining both objectives, trade liberalization and economic reintegration, inter-country cooperation is needed in setting common policy targets, particularly in the areas of extra-regional and intra-regional trade liberalization and tax reform. The implementation of appropriate macroeconomic policies during the course of the trade reform is essential, but it is not an area where explicit coordination among the CACM members is necessary or possible at this time. What is important is that each country design its macropolicies consistently with the trade measures taken and with sufficient flexibility to respond to unforeseen external developments.

4.24 Coordination of External Tariff Reform. The proposed regional reform strategy requires a temporary suspension of the CET. That raises the question of when external tariffs should be harmonized again and at what level. The 5% floor - 40% ceiling adopted as tariff range targets in the Costa Rican and proposed Guatemalan reform programs represent a reasonable medium term target for all the CACM countries. But beyond the medium term, further adjustments toward a 10% - 20% tariff range and, then, toward a single uniform tariff within that range are recommended on economic efficiency grounds discussed earlier. The adoption of a common external tariff schedule at some point during these separate adjustment phases would enable further tariff reforms to be taken in unison. Such a step would facilitate intra-regional trade relations, but could also slow down progress in liberalizing external trade. The Costa Rican and proposed Guatemalan medium term tariff reforms are scheduled to be fully completed by mid-1992. Unless the other countries initiate similar reform programs soon they will not likely meet this deadline. By that time, however, the more rapidly reforming countries may be ready to initiate further tariff reforms, especially after the initial measures begin to yield their expected benefits. It is important then that the momentum toward economic liberalization be maintained, and not be held back by commitments to wait until the other partners have caught up with their adjustments.

4.25 It would, therefore, be impractical to negotiate a common tariff schedule within the 5% - 40% range, as this could soon be superseded by further reforms. Instead, it would be preferable for the regional negotiations to focus on the adoption of a common tariff schedule further ahead in time and within a narrower target range, say 10% - 20%. This would set a common goal consistent with the liberalization objective and provide more time and flexibility for individual countries to adjust. At the same time, such a common market agreement should only be binding with regard to the tariff range limits and relative levels of tariff rates within those limits, thus permitting countries that are in a favorable position to unify tariffs further to

proceed. To avoid arbitrary changes in the tariff rates within the negotiated range, however, the process of tariff unification should obey either the proportional or concertina method of adjustment (see para. 4.11).

4.26 The implementation of a longer term CET may not be easy since the adjustment horizon of the reforms would exceed the terms of office of the current policymakers. In this regard, the CACM permanent secretariat (SIECA) could play a coordinating role in designing the new tariff targets, within the ranges prescribed by the regional governments, and provide continuity between successive administrations. One benefit of choosing a narrow tariff range in this context is that it limits the options for granting differentiated protection levels to different sectors and, thus, simplifies the negotiations.

4.27 Liberalization of Intra-Regional Trade. The temporary suspension of the CET under the proposed strategy should not impede progress in removing existing intra-regional trade barriers. As discussed in Chapter III, foreign exchange controls constitute the main restriction to intra-regional trade, and their removal primarily requires the elimination of severe macroeconomic imbalances in several of the CACM countries and the realignment of exchange rates. These measures are needed in any event, independent of common market considerations. Improved macroeconomic control is also a prerequisite for solving the problem of outstanding intra-regional debts, which provides an additional encumbrance for regional payments transactions; see Chapter V.

4.28 Some policymakers have voiced concern that a temporary suspension of the CET would give producers in the countries with lower external tariffs access to the more protected market in the partner country without a reciprocal advantage being granted to the partner country's producers. That is, the high-tariff country would bear the full costs of protection but only capture part of the benefits. The potential costs giving rise to such concerns are of minor importance in the case of the CACM: first, existing intra-regional trade barriers are high, so that the unequal advantages would only become relevant after significant reductions in these barriers have taken place. Second, the medium term tariff reforms contemplated by the more rapidly reforming countries in the region mainly focus on reductions in the tariff ceiling rather than lowering rates near the tariff floor, which mainly apply to imported intermediates and capital inputs. Consequently, the tariff adjustments would not give producers in the country with lowered tariffs an immediate cost advantage to penetrate the high-tariff partner country. The main result would be that industries in the high-tariff country would face more competition from third country imports in the low-tariff country and a possible loss of market share. However, these shares have become quite small in recent years, so that the additional loss would be relatively minor. Third, the main payoff expected from the elimination of intra-regional trade barriers arises from increased commerce in goods from existing regional industries whose exports have contracted during the economic crisis, and from goods and services that are largely non-tradeable from an extra-regional perspective (see paras. 2.44-2.46). The expansion of trade in these goods would be largely independent of extra-regional tariff levels. Moreover, if new industries did expand primarily because they were granted reciprocal protection in partner countries, it would represent a resource misallocation, especially since that protection would only be granted temporarily.

4.29 The success of the regional trade liberalization strategy involving the temporary creation of a free trade area presupposes that all the CACM countries are committed to a strategy of overall trade liberalization. Some countries may be reluctant to embark on such a reform course, however. That raises the fundamental question of whether the other countries would be better off liberalizing unilaterally or remaining within a more protected common market. Given the small size of the CACM, the potential economic benefits of liberalization toward the rest of the world are far greater than those that could be expected from a reintegrated CACM, even in the event that all intra-regional trade barriers were eliminated. Other considerations also play a role in decisions to liberalize, however, and certain countries may not be prepared to proceed. In that case, it would be best for all countries concerned to consider a looser regional arrangement, such as the bilateral trade ties that currently exist between Honduras and Panama, on one side, and the other CACM countries, which allows for preferential tariffs to be imposed on partner country imports. The imposition of tariffs on intra-regional trade would still constitute a major improvement over the current situation, which is dominated by intransparent non-tariff restrictions. Furthermore, such an arrangement should not impede progress in areas other than tariff policy; e.g., the harmonization of customs procedures and transport legislation, and cooperation in the upkeep of regional infrastructure, which are at least as important in creating a freer regional trade environment and advancing the objectives of regional integration.

4.30 Coordination of Tax Reform. The CACM countries are overly dependent on trade taxes. Moreover, the tariff reductions envisaged in the medium term reform programs will likely lead to significant reductions in government revenues (see simulations in section B). To avoid macroeconomic disequilibria and create a more stable fiscal basis, governments will need to seek alternative revenue sources. In this respect, taxes on income and on consumption expenditures are generally considered the most efficient options.

4.31 Consumption and production taxes can lead to resource allocation problems and regional discord (para. 3.37) when applied selectively by product or industry. These problems could be avoided if a uniform consumption tax is applied on all products, though the level of the tax need not be the same for each country. A uniform tax is not always feasible, however, and may conflict with other development or social objectives--arguably milk and alcoholic beverages should not receive equal tax treatment. In such cases, applying selective taxes is preferable, but that may require regional coordination. A possible strategy is to reach an agreement whereby all product categories are separated into two parts, such that a regionally uniform consumption tax is applied on all part I items, while each country remains free to apply individual taxes on items in part II. (A similar strategy was used in negotiating the 1986 CACM trade reform; see para. 3.04)

4.32 The application of unequal personal income and corporate taxes in different countries could also present a problem for regional integration. While consumption taxes influence product flows, income taxes influence factor and investment flows, which may be less responsive in the short run but will have a resource allocation impact in the longer run. With capital mobility,

industries would have an incentive to relocate from the areas with high taxes to areas with lower taxes. Moreover, capital mobility would be enhanced by the increased product mobility encouraged by a well functioning customs union since firms could continue to supply the home market from another CACM base. Similarly, direct foreign investment also would be attracted, other factors being equal, to the country with the lowest taxes. The problems presented here are the same as were addressed earlier in the CACM's attempt to harmonize fiscal incentive legislation. In the current economic situation, harmonizing tax legislation is not among the most pressing issues, but may become important if intra-regional economic activity significantly revives.

D. Further Issues in Regional Policy Coordination

Intra-regional Compensation

4.33 The costs and benefits of a customs union are generally not equally distributed among its members. Under an ISI strategy, the less industrialized partner countries are likely to end up paying a disproportionate share of the costs of protection; Honduras' partial withdrawal from the CACM in 1971 was largely motivated by the perception that its burden was excessive. To assure that it would be in each country's interest to further participate in the CACM, it may be necessary to consider a transfer mechanism by which the net beneficiaries of the customs union compensate the relatively disadvantaged members.

4.34 In the past, no explicit provision existed for making compensation payments in the CACM. The problem was handled instead through the lending policies of the regional development bank, CABEI, as part of its mandate to promote balanced regional development: the two least developed countries in the region, Honduras and Nicaragua, accounting for less than 25% of the region's total GDP, received over 40% of the loans approved by CABEI. The idea was that in channeling a higher proportion of development projects to the less industrialized countries in the region, not only would this constitute a form of compensation, but at the same time the process of industrialization would be accelerated in those countries, enabling them to compete more effectively within the region.

4.35 This compensation scheme has several basic problems associated with it: first, as a development finance institution held accountable by its creditors, CABEI's efforts have to focus on the promotion of viable projects in the region, particularly in view of current financial difficulties. The simultaneous pursuit of compensation objectives dilutes this effort and may lead to the financing of less economic projects, thus impairing the financial soundness of the institution. Second, even if CABEI were to be given a separate fund to be disbursed purely in accordance with compensatory objectives, this would not represent an adequate solution to the compensation problem. In this case, there would still remain the problem that the countries receiving the highest benefits from the protection granted through external tariff barriers do not share equally in the costs associated with that protection.

4.36 Recommendation. A central principle in designing a proper compensation mechanism is that the total regional costs of protection be shared in direct proportion to the benefits received. Aside from the equity aspect involved, this is important from the viewpoint of providing proper incentives: when payments to compensate for the costs of protection are made out of some common pool, there is no direct link between the costs and benefits of protection, and so the beneficiary members have no incentive to limit or reduce the amount of protection granted through the customs union. By establishing a direct link, these members would have an incentive to limit protection barriers, in conformance with the current trade liberalization efforts. Establishing a proper compensation mechanism may be a cumbersome process, however, and in view of the currently reduced levels of trade in the region, it does not rank among the major problems to be solved at this time. Moreover, with progress made in the reduction of external tariffs, the total costs of protection requiring potential compensation are reduced.

Legal Issues

4.37 Under the pre-1986 CACM legal arrangements, any change in the external tariff structure required the unanimous consent of all the countries involved. This system has been made more flexible under the 1986 regional trade reform agreement. There are now two legal routes by which the external tariff can be modified: (i) through a majority vote in the CACM Tariff Council, which is required to implement permanent external tariff changes; and (ii) through a safeguard clause, by which a country may temporarily change tariffs unilaterally on short notice, primarily in response to severe balance of payments difficulties.

4.38 Neither legal channel is quite adequate for introducing a regional tariff reform program as recommended in the preceding section; i.e., involving agreement on final tariff targets, but where each country retains the flexibility to approach that target at different speeds. The CACM Vice-Ministers of Economy have explicitly recognized this problem and in a joint resolution of June 1988 recommended that (i) a tariff reform proposal be prepared and submitted for regional negotiation within one year, and (ii) that until the new tariff agreement has been made, adherence to the current CET is to be waived so that individual member countries have the flexibility to proceed with the implementation of already initiated policy reforms. The recommendations made in the Vice-Ministers' resolution were officially adopted by the Ministers of Economy on November 17, 1988, through a resolution of the CACM Tariff Council. Also, on December 13, 1989, the Ministers of Economy and Central Bank Presidents of the CACM member countries agreed to prepare a program for progressively eliminating existing restrictions on intra-regional trade. These actions clearly reflect a positive acceptance of the need for trade liberalization and represent an important step toward providing the necessary legal flexibility for implementing a regional strategy as suggested above.

CHAPTER V

THE REGIONAL PAYMENTS SYSTEM

A. Evolution of the Regional Payments System

5.01 Intra-regional trade was fairly insignificant and irregular before the creation of the CACM in 1960, and the existence of five different national currencies did not constitute a trade-limiting factor, as payments were made through third-country dollar accounts. Nevertheless, the central banks of the region foresaw the benefits of a mechanism that would facilitate payments for an increasing volume of regional trade with a minimum amount of extra-regional currency intermediation. This led to the creation of the Central American Clearing House (Camara de Compensacion Centroamericana--CCC) in 1961, as a multilateral payments clearing system, with a number of special features. Regional transactions were cleared in five different currencies, each expressed in Central American pesos, a fictitious currency pegged with one-to-one parity to the US dollar. The clearing mechanism functioned in conjunction with a US\$12 million line of credit, opened by and in each country for its four CACM partners to cover the balances accumulating over a six-month clearance interval. Only the net balances that remained after clearance every six months (or earlier if the credit line was exhausted) had to be cancelled in US dollars or other convertible currency. The clearing system was later bolstered by a monetary agreement that stipulated an "exchange guarantee", whereby the regional currencies were to remain pegged to the US dollar with unrestricted convertibility.^{25/}

5.02 The clearing house was one of the most effectively functioning institutions of the CACM. The total cumulative volume of payments channeled through the CCC until end-1987 amounted to US\$11.5 billion, compared to a total intra-regional trade volume of US\$12.5 billion (Table 5.1). The share of regional transactions registered with the CCC increased from 48% of total CACM exports in 1962 to 116% during 1976-1980, indicating that other current and capital transactions in addition to trade were recorded through the CCC. Meanwhile, the share of intra-regional payments cleared through the CCC increased from 60% of CACM exports in the early 1960s to 100% in the late 1970s.

^{25/} The Central American Monetary Agreement was signed by the five regional central banks in 1974, with the objective of gradually creating a monetary union that would encompass the harmonization of monetary, exchange rate and credit policies. This agreement unified into one document three earlier agreements, which had respectively led to the creation of the clearing house in 1961, the Central American Monetary Council in 1964, and the Fund for Monetary Stabilization in 1969.

Table 3.1
CENTRAL AMERICA
CAMARA DE COMPENSACION CENTROAMERICANA
(million US\$)

| Period | Intra Regional Trade \$ | Transactions | | | | | | a/ |
|-------------|-------------------------------|---------------------|------------|------------------|------------|------------------------|------------|----|
| | | Registered with CCC | | Cleared with CCC | | Bilateral Arrangements | | |
| | | \$ | % of Trade | \$ | % of Trade | \$ | % of Trade | |
| [1962 only] | 50.8 | 24.6 | 48 | .A. | .A. | .A. | | |
| 1962-1965 | 364.6 | 265.1 | 73 | 219.3 | 60 | 45.8 | 13 | |
| 1966-1970 | 1,188.8 | 1,063.2 | 89 | 906.6 | 76 | 158.6 | 13 | |
| 1971-1975 | 2,016.5 | 1,997.6 | 99 | 1,792.6 | 89 | 205.0 | 10 | |
| 1976-1980 | 4,196.3 | 4,868.5 | 116 | 4,188.7 | 100 | 679.8 | | |
| [1980 only] | 1,100.0 | 1,256.0 | 114 | 920.0 | 84 | 336.6 | 30 | |
| 1981-1985 | 3,854.0 | 3,102.0 | 80 | 2,252.0 | 58 | 850.0 | 22 | |
| 1986 | 421.0 | 189.3 | 45 | 126.0 | 30 | 63.0 | 15 | |
| 1987 | 507.0 | 253 | 5.7 | 7.0 | 1.4 | 22.0 | 4.3 | |
| | 12,548.2 | 11,514.4 | 92 | 9,492.2 | 76 | 2,022.2 | 16 | |

a/ Partly paid in cash, partly pending for payment at the end of the year.

Source: Consejo Monetario Centroamericano.

Table 3.2
CENTRAL AMERICA
CAMARA DE COMPENSACION CENTROAMERICANA
UNCLEARED DEBT BALANCES AS OF DECEMBER 31, 1987 a/
(thousand US\$)

| Debtor Country | Creditor Country | | | | | TOTAL |
|---------------------------|------------------|-------------|-----------|----------|-----------|---------|
| | Costa Rica | El Salvador | Guatemala | Honduras | Nicaragua | |
| El Salvador | 14,485 | --- | 20,099 | 1,327 | 25 | 35,936 |
| 1. Documented Debt | 14,485 | --- | 20,099 | --- | --- | 34,584 |
| 2. Not Documented Debt b/ | --- | --- | --- | 1,327 | 25 | 1,352 |
| Guatemala | 31,482 | 2 | --- | 1,129 | --- | 32,613 |
| 1. Documented Debt | 31,482 | --- | --- | --- | --- | 31,482 |
| 2. Not Documented Debt | --- | 2 | --- | 1,129 | --- | 1,131 |
| Honduras | 66,085 | 3,421 | 14,603 | --- | 55 | 84,164 |
| 1. Documented Debt | 49,233 | --- | 14,603 | --- | --- | 63,836 |
| 2. Not Documented Debt | 16,852 | 3,421 | --- | --- | 55 | 20,328 |
| Nicaragua | 249,729 | 17,238 | 196,318 | 58,636 | --- | 521,921 |
| 1. Documented Debt | 249,729 | 4,398 | 189,297 | 58,500 | --- | 501,924 |
| 2. Not Documented Debt | --- | 12,840 | 7,021 | 136 | --- | 19,997 |
| TOTAL | 361,781 | 20,661 | 231,020 | 61,092 | 80 | 674,634 |
| Documented Debt | 344,929 | 4,398 | 223,999 | 58,500 | --- | 631,826 |
| Not Documented Debt | 16,852 | 16,263 | 7,021 | 2,592 | 80 | 42,808 |

a/ Excludes US\$32.6 millions owed by Nicaragua to the Fondo Centroamericano del Mercado Común (FCMC).

b/ 'Not Documented Debt' refers to debts which have not been fully documented through contracts or other arrangements.

Source: Central American Central Banks and Camara de Compensacion Centroamericana.

5.03 Increased reliance on the multilateral clearing house provided the following advantages to the CACM: (i) each country required fewer liquid foreign exchange reserves for trade intermediation purposes, and (ii) the transaction costs arising from payments made through third country banks, where the reserves were held, were correspondingly reduced. Both resulted in net savings for the region. Furthermore, since outstanding balances were cleared only every six months (or once they exceeded a certain sum), the CCC served as an automatic vehicle for extending short-term credit between central banks, which greatly facilitated intra-regional transactions.

5.04 After 1980, the volume of transactions made through the CCC decreased with total intra-regional trade. By 1986 the proportion of trade cleared through the CCC amounted to only 30% of intra-regional exports. Although intra-regional trade increased again in 1987 (by almost 20% in dollar terms), the role of the CCC continued to decline. In that year, only US\$ 29 million, or 5.7% of intra-CACM trade, was registered with the CCC, of which 1.4% was cleared while the other 4.2% had to be paid in convertible currencies or remained pending. Guatemala suspended its operations with the CCC in 1986, followed by Costa Rica in 1987.

Causes and Consequences of the Regional Payments Crisis

5.05 The most visible cause of the collapse of the CCC is the unprecedented accumulation of unpaid balances on the part of countries with deficitary intra-regional trade balances. From insignificant levels before 1980, total intra-regional debt increased to US\$422 million in 1983 and to an unmanageable level of US\$675 million in 1987. As shown in Table 5.2, the main debtor countries are Nicaragua (accounting for 77% of total outstanding debt) and Honduras (13%), and the main creditors are Costa Rica (54%) and Guatemala (34%). El Salvador's debt and credit positions remained small (less than 5%) and almost balanced. Initially, the regional payments crisis was treated as a temporary phenomenon, and the countries with surpluses were prepared to finance the deficit countries by rolling over their intra-regional debts. In this way, the multilateral clearing system was transformed into a permanent credit granting mechanism. When the creditor countries themselves experienced external debt problems, they were no longer able to extend credit and had to withdraw from the CCC.

5.06 Another reason for the withdrawal of the creditor countries was that the CCC was beginning to subvert monetary stability: since the credits extended represented assets that had been converted into local currencies (as a counterpart of exporters' claims registered with the CCC), further credit extension automatically led to domestic monetary expansion without foreign exchange backing.

5.07 From a broader perspective, the regional payments crisis is merely one aspect of the overall balance of payments and external debt crisis that has affected the region since the late 1970s. Although the CCC was designed to circumvent the need for hard-currency intermediation in the conduct of intra-regional trade, it nevertheless depended on foreign reserves, since these were ultimately required to settle net trade balances. The lack of foreign exchange reserves, coupled with the unwillingness of deficitary

countries to adjust exchange rates, therefore constitute the more fundamental cause for the collapse of the CCC.

5.08 In response to the foreign exchange shortage, the CACM countries introduced foreign exchange licenses instead of enabling the market mechanism to work through more flexible exchange rate management. In this context, an important consequence of the collapse of the CCC is that foreign exchange licenses became necessary for intra-regional transactions as much as for extra-regional ones. Another consequence is the suspension of the automatic credit facility that had functioned in combination with the clearing house mechanism. Both developments created trade barriers, which had an especially damaging impact on intra-regional trade.

The Role of FOCEM

5.09 Established in 1969, the Central American Fund for Monetary Stabilization (FOCEM) was created specifically to assist member countries in response to either temporary or persistent balance of payments disequilibria. Similar to the IMF, its purpose is to provide stabilization credits (with maturities of up to eight years) to facilitate macroeconomic adjustments. Its medium-term lending operations are conditional on the presentation and adoption of a stabilization program involving monetary, fiscal, and exchange rate measures. Because the fundamental causes of the payments crisis are macroeconomic, FOCEM represents the appropriate regional institution to address those problems. Inadequate lending practices and the profound magnitude of the economic crisis (which exceeded FOCEM's financial capabilities), prevented a more effective impact in this regard.

5.10 FOCEM is managed by the Central American Monetary Council (CMCA) and administered by the Central Bank of Guatemala. Its total resources in December 1987 amounted to US\$225 million, of which 56% is accounted for by CACM member contributions and accumulated profits, while the remaining portion is made up of external credits obtained from USAID and various Latin American banks, partly on concessionary terms. During the early 1980s, FOCEM played a significant role in providing adjustment lending, almost matching (90%) the total volume of IMF credit granted to the region. In terms of financing the region's current account deficits, however, its importance has progressively declined: in 1978, FOCEM's lending operations amounted to 22.8% of the combined regional deficit, falling to 11% in 1985.

5.11 A critical feature of CMCA's credit policies has been the absence of sufficiently strict criteria of conditionality for balance of payments support. The increasing economic difficulties of the region have led CMCA to disburse credits without realistic programs to correct the underlying disequilibria. As a result, the member countries have failed to adjust sufficiently and are unable to pay back their credits from FOCEM, which are now rolled over on a regular basis (forcing FOCEM's external creditors to do the same).

Further Developments

5.12 With the breakdown of the regional clearing house, payments transactions among the CACM members have increasingly taken place through bilateral payment agreements and barter agreements. In 1984, the principle of multilateral payments clearing was suspended in the CCC, and all payments were liquidated on a bilateral country-by-country basis. Subsequent bilateral agreements have allowed for payments transactions to be made with a variety of instruments, including US dollars, national currencies, countertrade arrangements and Derechos de Importacion Centroamericanos (discussed below).

5.13 Since 1982, barter arrangements have gained increased importance in regional trade, particularly for Nicaragua, which transacts most of its trade in this manner. Such provisional arrangements represent poor substitutes for a smoothly functioning CCC and have not succeeded in eliminating the main obstacles that hamper intra-CACM trade. Barter arrangements are inefficient compared to monetary intermediation and are unlikely to lead to the levels of trade formerly supported through the CCC.

5.14 The bilateral payment agreements preserves the clearing house character of the CCC, but the lines of credit made available through these arrangements are too limited (US\$1 million) and the clearance interval too short (two weeks); for practical purposes, trade has to be carried out on a cash basis. Finally, neither barter nor bilateral payments are operable without extensive licensing requirements, the same as with trade conducted via US dollar intermediation. This is especially true for barter transactions, which are only allowed for certain products and for which licenses are needed to monitor the relative prices at which goods are exchanged (given the absence of realistic exchange rates).

B. Recent Proposals for Solving the Regional Payments Crisis

5.15 Various proposals to solve the regional crisis have focused on the possibility of reestablishing the CCC or of devising alternative mechanisms that could yield the same benefits as were provided by the CCC.

Rescheduling Arrears with the CCC

5.16 A series of proposals have been advanced to reschedule the large volume of unsettled intra-regional debts, to clear the way for reactivating the operation of the CCC. The "Special Plan of Economic Cooperation for Central America," presented to the UN General Assembly in April 1988, calls for US\$350 million to be channeled through the Central American Fund of the Common Market (FCMC) for the purpose of rescheduling the existing debts. Earlier debt reschedulings were mainly concerned with debts to parties outside the region and failed to correct the problem of debts within the region. The Special Plan proposes to correct this omission and thereby facilitate the expansion of intraregional trade.

5.17 One problem with this proposal is that the solution has been tried before but did not succeed. The FCMC, created in 1981, was to finance uncleared balances at the CCC in convertible foreign currencies. The

countries that borrowed from the FCMC went into arrears, and the rescheduling facility ceased operations when its funds were exhausted in 1983. The total funds originally available to the FCMC were fairly limited in relation to the overall outstanding debts, in contrast to the currently proposed amount, which would cover almost half of the outstanding intra-regional debt. Even this greater infusion of funds would not achieve lasting success, however, unless the underlying macroeconomic difficulties that led to the debt problem are also corrected.

Strengthening FOCEM's Role

5.18 The Special Plan also calls for a US\$250 million inflow of fresh funds to FOCEM in order to strengthen its financial position and enable it to play a more effective role in promoting needed macroeconomic adjustments. Increasing FOCEM's financial resources represents no more than a short term palliative unless FOCEM itself is restructured into a more effectively operating institution with its members prepared to follow its advice on policy adjustments. Several reforms are required: FOCEM needs to be reconstituted as an autonomous legal entity, independent of the central banks and adequately protected against a freezing of its funds in the central bank accounts. The credits granted for stabilization have to be based on strict policy conditionality using economic criteria rather than political considerations. FOCEM needs sufficient technical expertise to perform the macroeconomic analyses in order to formulate realistic policy conditions.

Introducing the DICA

5.19 The Derecho de Importacion Centroamericano (DICA) represents a new instrument for settling intra-regional transactions and was introduced in November 1986 on the recommendation of the Central American Monetary Council. This instrument represents a claim on exports of the issuing country and has the following principal features: it is denominated in US dollars and issued in the name of an exporter by the Central Bank of the importer against a deposit in national currency equivalent to the face value at the current exchange rate. It is redeemable in the national currency of the issuing Central Bank after 18 months, with no interest, and calculated at the exchange rate used by the Central Bank for trade transactions at the time of redemption. The face value of the DICA is based on the CIF cost of the original import. The DICA can be used directly by the foreign exporter to pay for imports from any of the other CACM countries participating in this arrangement, sold to any other regional importers, or held until redemption.

5.20 DICA was to serve as a multilateral payment instrument without requiring hard-currency intermediation. By denominating the DICA in US dollars, its holder would be protected against official exchange rate devaluations by the issuing country, thereby making this instrument more attractive than payment in national currency. By making the DICA freely negotiable, its price would respond to demand and supplies, and therefore could partially substitute for greater exchange rate flexibility, narrowing the difference in the real exchange rates in the region. That is, the supply of DICAs (reflecting the demand for imports in the issuing country) and the demand for DICAs (reflecting the demand for exports from the issuing country) would together

determine the price of DICAs, such that the surplus countries within the region would see their DICAs sold at a premium, and those of deficit countries would be sold at a discount. This would stimulate demand for exports from the deficit countries and reduce demand for imports from surplus countries, thereby fostering a more balanced intra-regional trade.

5.21 The DICA has been unsuccessful so far. Costa Rica is unable to participate in the DICA scheme because of domestic legal constraints. The remaining members of the CACM have sanctioned the use of DICAs, but so far only a negligible amount of about US\$2 million has been issued (by the Central Bank of El Salvador), and these have not been used beyond the initial transaction.

5.22 Various factors are responsible for the DICA's lack of success:

- (i) Honduras and Nicaragua which have either highly deficitary trade balances or overvalued currencies, likely would face acceptance problems for their DICAs. Their DICAs would be valued on the market at a discount from the beginning, and unless the central banks of these countries were willing to issue DICAs at an exchange rate that reflects that discount, the exporter who accepts them would incur an immediate capital loss. It is unlikely that the central banks would be willing to sell DICAs at a discount while they remain reluctant to devalue in the first place.
- (ii) The protection against capital losses afforded to the holder by denominating the DICA in US dollars is quite limited. Since the exchange rate at which the DICA is ultimately converted into national currencies is determined by the issuing central bank, there is no guarantee that its value will reflect market forces. The central bank could keep its currency overvalued or may have adopted a multiple exchange rate system. Moreover, in the absence of an active capital market to exchange DICAs before redemption, their transactions costs are likely to be high and their value may be subject to significant variations.
- (iii) DICAs have to be registered with the central banks at each step and do not free the user from the same export and import licensing requirements applicable to other more conventional and familiar forms of payment.

5.23 Finally, there are two fundamental design aspects of the DICA that limit its effectiveness as an instrument for reactivating intra-regional trade. First, the DICA was conceived on the principle of a dichotomized foreign exchange market. It was hoped that the free exchange of DICAs within the CACM could bring about a realignment of exchange rates within the region, independent of exchange rates vis-a-vis outside currencies. This would, however, give rise to considerable arbitrage opportunities that would eventually force policymakers to realign their external exchange rates as well. Unless the policymakers are prepared to introduce such flexibility, they are likely to resort to controls limiting the use of DICAs. That would defeat

DICA's original purpose to reduce the payments restrictions that impede intra-CACM trade.

5.24 Second, the DICA was designed to encourage a balanced expansion of regional trade--each country's trade account with the other CACM partners combined would be more or less balanced. The achievement of balanced intra-regional trade is not an adequate policy objective, however, and would most likely involve an inefficient pattern of resource allocation. More important is the achievement of a sufficiently balanced overall trade pattern, including both intra- and extra-regional partners. The fact that a CACM member records trade deficits vis-a-vis its partners is irrelevant as long as that country has an offsetting surplus vis-a-vis the rest of the world. Moreover, by inducing that country to balance its trade with the regional partners, an unnecessary constraint on trade is imposed that has the effect of limiting overall trading opportunities rather than expanding them.

Modifying the Payments Clearing Mechanism

5.25 An inter-institutional working group comprising SIECA, CMCA, CABEI and ECLAC proposed a modified payments clearing system in 1986 and recommended the establishment of a clearing mechanism similar to the CCC in most respects, but with two additional features: (i) The debts remaining at the end of the clearing period are to be cancelled in US dollars only in proportion equivalent to the direct import content of goods traded within the region (where import content refers to inputs originating outside the region); (ii) the remaining proportion is to be paid to CABEI to cancel outstanding obligations of the debtor country or into a special CABEI fund to finance projects in the debtor country.

5.26 Although such a mechanism would reduce intra-CACM trade's dependence on US dollar intermediation, it does not deal with the more fundamental causes that have led to the regional payments crisis, particularly the misalignment of real exchange rates. Also, there is the problem that the creditor countries would not be repaid adequately for the domestic component (which may contain an indirect third-country import component) of their net trade surpluses vis-a-vis the regional deficitary countries. Further deficiencies of this proposal are (i) the operational complexity of the mechanism, since it requires the estimation of direct import contents, and (ii) the role of CABEI. A large part of CABEI's resources are already frozen in the accounts of the five central banks because of existing foreign exchange transfer problems.^{26/} The pattern of CABEI lending to its five members, as a result, is largely determined by its past portfolio; repayments in inconvertible currencies are merely rolled over. The proposed clearing mechanism would increase this element of inflexibility by automatically forcing additional loans to the deficit countries.

^{26/} IBRD Report of a Reconnaissance Mission to the Central American Bank for Economic Integration, 10/31/88.

Establishing Regional Currency Markets

5.27 Policy discussions in Central America are increasingly focusing on the creation of a market for the regional currencies, which would be less complex to operate than the DICA system. The beginnings of a regional currency market already exist on an informal (and sometimes illegal) basis in several of the Central American countries. One example is the system of CETRAS and auto financiamiento in Honduras, which in effect involves the exchange of lempiras for US dollars and other currencies through the commercial banks. In Guatemala, the exchange of regional currencies and US dollars has become increasingly tolerated with the declining restrictiveness of exchange controls. These markets could be expanded and legalized, which would allow them to function more efficiently, and at the same time enable a closer monitoring by the central banks.

5.28 The major advantages of a freely functioning regional currency market are that it would bring about a needed realignment of exchange rates, both within the region and with respect to third currencies, and render exchange rates more responsive to market forces. This is especially important for the main deficitary countries, Nicaragua and Honduras, but also for El Salvador, whose real exchange rate has continued to appreciate since early 1986. The potential disadvantage is that exchange rates would be more susceptible to speculative fluctuations brought on by incipient capital movements. It was this concern that prompted the regional central banks to discard the prospect of a currency market in 1986 and to opt for the DICA scheme. The region's policymakers were willing to contemplate a system with limited currency convertibility within the region, but they were not prepared for a system that would also lead to a free float with respect to third currencies.

5.29 The establishment of a free regional currency market would clearly conflict with the maintenance of foreign exchange controls in the separate CACM countries. This may be one of the best arguments in favor of creating such a market; it would accelerate the dismantling of exchange controls, which represent the main barrier to intra-CACM trade expansion. It is difficult, if not impossible, however, to create an isolated market for regional currencies, which does not involve third currencies, and which is restricted to current account transactions. To enforce those limitations, the market would have to be highly regulated, as in the DICA scheme, which would impair its ability to function. If the market is to function effectively, it would have to encompass open trading of third currencies and include capital account transactions.

C. Recommendation: Trade Liberalization and Payments System Reform

5.30 The fundamental problem to be addressed in any solution to the payments crisis is how to bring about a realignment of exchange rates, coupled with appropriate macroeconomic policies, in order to reduce current account imbalances without recourse to foreign exchange controls. Some of the proposals (e.g., the DICA scheme) have taken too narrow a perspective by emphasizing only the realignment of currencies within the region and in attempting to promote balanced trade within the region. Such a solution would

eliminate the persistent accumulation of intra-regional debts. The drawbacks are that a pattern of balanced intra-CACM trade is unlikely to be efficient and involves a constraint that would limit the potential expansion of intra-regional trade flows. Most importantly, it is highly unlikely that the foreign exchange market can be segmented in such a manner that intra-regional exchange rates are realigned without also realigning exchange rates vis-a-vis third currencies. The preferable objective is an overall equilibration of trade balances, including intra- and extra-regional trade partners, which would render the issue of intra-CACM trade deficits irrelevant, as these would be paid for by offsetting surpluses elsewhere.

5.31 In realigning exchange rates to promote an overall balanced current account, there are two basic options: one is to adopt more flexible exchange rate management, as currently implemented in Costa Rica and Guatemala, and the other is to allow open trading in a legalized free currency market. The latter option amounts to a free float, and takes the question of finding the appropriate exchange rate out of government hands. Both options are essentially equivalent from a static perspective, in that the same exchange rate has to equilibrate demands and supplies. Also, if the central banks desire to smooth out fluctuations in the exchange rate, they can do so by intervening in the foreign currency market as well as by managing the exchange rate directly. The only difference is that under the managed exchange rate option, the central banks may be better able to discriminate between participants in the market.

5.32 In view of the current economic and political instabilities in the region, central banks may want to reserve access to the official exchange rate market for exporters and importers (i.e., current account transactions), and limit the participation of agents using the market for capital flight purposes. That is, they may want to weaken the link between capital and current account transactions. The best solution, of course, would be to correct the underlying problems that motivate capital flight in the first place. But this may take time, so that intervention may be required during the interim period to avoid economic disruptions.

5.33 Under the managed exchange rate option, the return to a revised multilateral clearing house system arguably represents the best course toward improving the regional payments situation. This solution requires that some means to settle the outstanding intra-regional debts be found. A refinancing of the outstanding debt, in turn, has to be made conditional on various up-front macroeconomic adjustments (especially exchange rate realignments) on the part of the main debtor countries. This may take longer to implement in some countries than in others. Meanwhile, the net creditor countries (Costa Rica and Guatemala) could proceed to develop a revised multilateral clearing house among themselves (including the provision of adequate credit lines and the extension of the clearance period, beyond the terms allowed under the current bilateral arrangements, para. 5.12). The remaining CACM members could be admitted progressively to this arrangement, once the necessary macroeconomic adjustments have taken place and their debts have been rescheduled. Nicaragua poses a major problem in reaching an intra-CACM debt settlement, since it has large debts to all CACM partners and also the most destabilized economy. El Salvador and Honduras have a modest net debtor position within

the CACM (Table 5.2). On a bilateral basis, however, both countries have a substantial debtor position vis-a-vis Costa Rica and Guatemala, and a substantial creditor position vis-a-vis Nicaragua, which may render a process of bilateral debt settlements difficult.

5.34 In reestablishing a multilateral clearing house, several basic reforms are necessary in the rules of operation to prevent the recurrence of events that caused the earlier CCC to fail. The "exchange guarantee" included in the original CCC agreement, which called for a pegged relationship between regional currencies and the US dollar, has to be temporarily eliminated. Intra-regional trade flows should still be recorded, and net imbalances settled, in terms of a hard-currency, but this should not inhibit individual countries from adjusting their exchange rates as needed in response to particular circumstances. Furthermore, with the introduction of trade liberalizing measures, it is essential that a sufficiently flexible exchange rate policy be maintained. It is also necessary to establish clear procedures when members encounter debt repayment difficulties: any financing of unsettled balances must occur on the basis of policy conditionality, applied before disequilibria become too large. Countries that fail to meet the agreed policy conditions would have to be suspended temporarily from the clearing house. This is necessary to encourage compliance with the adjustment conditions and to prevent an excessive accumulation of debt that would eventually cause the entire system to collapse. Finally, it would be necessary to set up a sufficiently independent decision making body (such as a reconstituted FOCEM) with the requisite technical capabilities to identify policy adjustments and monitor their implementation. Limited participation by external donors in the decision making committee would help promote greater independence from regional political influences.

CHAPTER VI

THE PROMOTION OF NON-TRADITIONAL EXPORTS
TO THIRD COUNTRY MARKETS

6.01 The inward-oriented ISI strategy of the past has left the CACM economies with a considerable anti-export bias, which impedes export growth and distorts domestic resource allocation. The trade liberalizing reforms recently initiated in several of the Central American economies, including more flexible exchange rate management, will have the effect of reducing that bias. Until that bias is eliminated, however, special incentives are needed to support the export expansion process. Even in the absence of tariff distortions, potential exporters in Central America may still require temporary incentives to overcome such obstacles as imperfect credit markets, externalities associated with infant industries and lack of adequate marketing channels.

6.02 If the expansion of exports and the generation of foreign exchange were the only objectives motivating export promotion efforts, there would be no reason to discriminate between traditional and non-traditional export products. From an efficiency standpoint, all should be eligible for the same incentives. However, the diversification of exports to reduce the region's vulnerability to commodity price fluctuations also remains a major policy objective in Central America. The creation of a less distorted trade environment by itself is not likely to satisfy this objective in the short run. A natural tendency under a liberalized economic environment would be to concentrate resources in products where Central America's comparative advantage has already been tested, particularly the traditional agricultural commodities. In spite of currently stagnant commodity prices, this may still constitute the most efficient allocation of resources in terms of maximizing expected long term growth, but it may not take into account all the economic costs in terms of risk. In the absence of fully developed forward markets that would enable an efficient diversification of risk, incentives that discriminate in favor of non-traditional products then would be necessary to satisfy the diversification objective.

A. Recent Policy Developments and Initiatives

6.03 Efforts to promote non-traditional exports outside the CACM intensified during the mid-1980s, motivated by the continuing depression of international commodity prices and stagnating demand for Central America's principal export crops, on the one hand, and the persistent decline in CACM

trade, on the other.^{27/} In Costa Rica, a special facility for export finance (FOPEX) was established in mid-1983, followed by the implementation of an export contract scheme in mid-1985. In El Salvador, a new law consolidating and strengthening existing export incentives (Ley de Fomento de Exportaciones) was passed in early 1985. In Guatemala a similar export incentives law was adopted in 1984. Honduras adopted several laws that streamline the Customs Office (Nov. 1987), strengthen the temporary admissions scheme (Oct. 1986), expand the scope of export processing zones (April 1987) and establish fiscal subsidies for non-traditional exports (April 1987). In Nicaragua, a foreign exchange fund for non-traditional export activities began operations in 1988, and (as in Honduras) a partial foreign currency retention scheme is to be introduced. Finally, to streamline the procedures involved in export activities and to reduce bureaucratic impediments, Costa Rica, Guatemala and Honduras have recently introduced "one-stop windows" for processing the documents needed by exporters. At the regional level, SIECA and CABEI have begun to focus on means to coordinate national export expansion efforts, with the objective of strengthening the CACM as a "regional platform for production of exports to third-country markets", but no concrete measures have been taken.

6.04 All CACM members are currently in the process of obtaining or have obtained provisional access to the GATT, while Nicaragua already has full access as one of the original charter members. A hoped-for benefit of GATT membership is that the CACM could better challenge countervailing actions in trade disputes with other countries that could arise (and did in the case of Costa Rica) ^{28/} in response to the export promotion measures recently introduced. (This benefit remains uncertain, however, as discussed below.) More generally, GATT is being used by the region's policymakers to signal to their constituencies and their trading partners the commitment to a more outward-oriented development strategy. One aspect of the GATT negotiations involves the agreement to "bind" tariff ceilings, which provides a particularly useful opportunity to strengthen that signal.

^{27/} Many of the current export promotion programs in Central America date back prior to the 1980s: a regional export promotion program (PROMECA) was established within SIECA in the mid-1960s, with support from USAID through CABEI. Nationally, efforts to promote non-traditional exports were initiated later: in Costa Rica, the creation of the Center for Export Promotion (GENPRO) in 1968 and the Export Promotion Law of December 1972 (whereby tax credit certificates, CATs, were first introduced); in El Salvador and Nicaragua, export development laws and special credit facilities for non-traditional exporters in 1976. The creation of free trade zones in Guatemala, El Salvador and Honduras date back to the latter half of the 1970s (in Costa Rica these were first established in 1981), along with the establishment of duty-drawback systems.

^{28/} In 1986, the U.S. initiated countervailing actions against cut flowers and cement exports because of fiscal subsidies. The trade dispute was ultimately settled in favor of Costa Rica, but not without discouragement to exporters in the region.

6.05 Costa Rica is also planning to reform its export incentive regime. One reform proposal being considered by the Government gradually would eliminate most of the fiscal subsidies currently granted to exporters, particularly the tax-credit certificates (CATs), and replace them by "compensatory payments meant to reimburse exporters for certain quantifiable expenses directly incurred in the process of export production. Such a reform has four motivations: first, with the reduction in levels and dispersion of tariffs under the new trade reform, the anti-export bias of the economy declines, and there would be a lesser need for subsidies among exporters. Second, these subsidies have become an increasing burden on the public purse. Third, it is felt that the promotion of efficient import substitution is as important as efficient export activities, so that less emphasis should be placed on destination in granting subsidies, particularly as the trade liberalization program proceeds. Finally, there is an increasing awareness that fiscal subsidies could trigger countervailing actions abroad. This reform is still under review by the Ministry of Exports but has met with heavy opposition from exporter associations, who favor the existing system.

B. Main Export Incentives

Fiscal Subsidies

6.06 Costa Rica, El Salvador and Honduras grant direct fiscal subsidies to eligible non-traditional exporters in tax-free negotiable certificates that can be used by the exporters to pay taxes. The face value of these certificates is determined as a percentage of the total FOB value of exports destined to third-country markets. These percentages vary, as described in Table 6.1.

6.07 In Honduras, an explicit attempt has been made to introduce uniformity in the effective incentive rate granted to exporters by applying a progressively higher nominal CEFEX rate as the national value-added content of the exported product increases. The average effective incentive rate (calculated in relation to national value added, NVA) granted under the current nominal rate structure is about 20%, and ranges from 15% for products with 100% NVA to 26% for products with 30% NVA. The Salvadoran system also has a provision (though less explicit) to vary the nominal incentive rate according to the value-added content, but it includes other criteria. The Costa Rican system, in contrast, grants the same nominal incentive rate for all NVA levels provided they exceed 35%. This system simplifies the incentive processing procedures but makes the effective incentive rate highly variable: e.g., exports to the U.S. with 35% NVA receive an effective incentive rate of 42.7% on the value-added, while those with 100% NVA receive only 15%. That is, the effective subsidy granted to low value-added activities is systematically greater than that granted to high value-added activities. In all cases, only direct exporters are eligible to receive the tax-credit certificates and the certificates are not granted for exports to CACM partner countries.

Table 6.1
CENTRAL AMERICA: BASIC CHARACTERISTICS OF THE TAX-CREDIT
CERTIFICATES FOR NON-TRADITIONAL EXPORTERS, 1988

| | Percentage rate Applied to FOB Export Value | Basic Eligibility Conditions |
|--|---|--|
| Costa Rica (Certificado de Abono Tributario, CAT) | 15% for exports to U.S. 20% for exports to other non-CACM countries | National value-added must be > 35% |
| El Salvador (Certificado de Descuento Tributario, CDT) | Rate negotiable, with a maximum of 30%, based on | Value of CDT cannot exceed total tax liability |
| | 1) national value added 2) labor input share 3) impact on export diversification 4) generation of foreign exchange | |
| Honduras (Certificado de Fomento a las Exportaciones, CEFEX) | 5% 8% 10% 14% 15% | National Value-Added 20% - 29.9% 30% - 49.9% 50% - 59.9% 60% - 89.9% 90% - 100% |
| Guatemala: | Despite legal provisions permitting tax credit certificates, the system was suspended in 1986, and the respective law is to be abolished. | |
| Nicaragua: | Currently there are no legal provisions to grant tax credit certificates. | |

6.08 To become eligible for the tax-credit certificates, exporters enter into an export contract with the relevant government agency. Under these contracts, which generally expire after about 10 years, the exporter is also eligible to receive other tax exemptions. In Costa Rica and Honduras, for example, producers enjoy exemptions, in proportion to the value of exports, from income taxes and sales taxes on domestic purchases, as well as accelerated depreciation allowances. Moreover, in Costa Rica indirect exporters (i.e., domestic suppliers of inputs to the exporting firm) have recently been eligible to receive tax exemptions but not the CAT. Similar exemptions are granted to exporters in Guatemala, except for the tax-credit certificate. In El Salvador, exporters are eligible for tax exemptions, but these are subtracted from the value of tax-credit certificates granted, so

that the overall nominal fiscal incentive rate does not exceed 30% of the FOB export value.^{29/}

Temporary Admissions

6.09 All CACM countries have implemented incentive mechanisms that provide for the suspension of import tariffs on raw materials, intermediates, and capital goods used in the production of non-traditional exports, either as part of the export contract or under separate maquila (drawback) schemes. Whereas the tax-credit certificates and income tax exemptions are granted on an ex post basis (after the products have been exported), import tariff exemptions are generally granted on an ex ante basis. This requires the existence of monitoring mechanisms to screen out other imports not used for the production of non-traditional exports.

6.10 The temporary admissions schemes have not played a major role in most CACM countries as vehicles for promoting non-traditional exports. In 1986 in Guatemala, 80 firms accounting for only US\$ 30 million in exports were registered under the temporary admissions scheme, while the total value of non-traditional exports to third countries amounted to US\$ 126 million. In 1985 in Honduras, 60 firms reportedly operated under a temporary admissions or duty-drawback system, but these accounted for a negligible fraction (less than 1%) of all duty-free imports. A likely cause for the scheme's unpopularity was that duty exceptions could be obtained for numerous other activities, thus removing the incentive to apply for temporary admission since it is limited to exporting. For example, the industrial incentives regime in Honduras, which placed no restrictions on the destination of outputs, accounted for over 70% of all duty-exempted imports in 1985. The temporary admissions scheme could regain its attraction when some of the other incentives, especially the industrial fiscal incentive agreements are phased out.

6.11 In Costa Rica, a temporary admissions mechanism is operated in conjunction with the export contract. This system has been popular largely because exporters are eligible simultaneously to receive tax credit certificates. The maquila regime also has become popular in recent years for assembly firms that do not meet the minimum NVA requirement to qualify for the tax certificates. It is estimated that maquila exports increased from US\$10 million in 1984 to US\$ 40 million in 1987, amounting to over 10% of non-traditional exports to third countries in 1987. Moreover, in the case of maquila exports, only the value-added (estimated on average to be 25%) is recorded as an export of services, which therefore underestimates the total value of these exports.

^{29/} In the mid-1980s, Costa Rica and Honduras had also provided tax-credit certificates based on incremental export growth (denoted Certificados de Incremento de Exportaciones, CIEX), but these have been discontinued.

Free Trade Zones

6.12 Each CACM member, except Nicaragua, currently operates one or more free trade zones (FTZs). Except for the tax-credit certificates, FTZ status generally confers the same benefits granted under the other export incentive systems, plus foreign currency retention, speedier on-site customs procedures, and greater facility in repatriating profits. So far, the success of FTZs in Central America has been limited. The San Bartolo FTZ in El Salvador has difficulties in attracting investors because of guerrilla disruptions. The Puerto Cortes FTZ in Honduras and the Santo Tomas de Castilla FTZ in Guatemala have not grown significantly in recent years and account for a negligible portion of both countries' non-traditional exports. Inadequate management, high overhead costs and difficulties with labor unions have been cited as major problems hampering their operations. In Costa Rica, two FTZs were established in 1981 under public management in Funtarenas and in Moin, but these had little success, mainly due to lack of infrastructure and poor location. An FTZ facility was established under private management in Cartago (near San Jose) in 1985, however, with good results: 17 firms had initiated operations by mid-1987, providing direct employment for almost 2,000 people, and further growth is expected.

Export Finance

6.13 Specialized institutions for export financing do not exist yet in most CACM countries. In 1983 Costa Rica created an Export Financing Fund (FOPEX) as a second-tier facility at the Central Bank. It discounts pre-export and short-term working capital loans extended by commercial banks. FOPEX functions as a revolving foreign exchange fund, which also encompasses indirect exporters. It included a window for automatic access to foreign exchange for exporters. This window ceased operations in 1985 when access to foreign exchange from the Central Bank became easier as the government adopted a more flexible exchange rate policy. The total financial resources of FOPEX now amount to about US\$ 68 million. Annual disbursements of the fund reached US\$ 62 million in 1987, in 890 operations involving 173 exporting firms. Loans are made at competitive international rates and are repayable in hard currency. The Costa Rican Government is now planning to expand FOPEX financial resources and also introduce an Export Guarantee and Insurance Scheme, a facility so far not available in any of the CACM countries. Guatemala is also preparing to introduce a similar export financing fund and insurance scheme.

Foreign Currency Retention

6.14 In Honduras, a partial retention scheme (autofinanciamiento) was introduced in 1985 for certain exporters. This scheme was expanded in 1988 with the creation of transferable foreign currency certificates (CETRAs), which allow automatic purchases of foreign exchange at the official exchange rate. Eligible non-traditional exporters receive CETRAs for the equivalent of 30% of the value of exports. The foreign exchange certificate is transferable once, within 30 days of the date of issue, and has to be used for import purposes within seven months. This last restriction was introduced to prevent the hoarding of CETRAs. Since the parallel market exchange rate exhibited a premium about 40% over the official exchange rate during end-1988, the partial

retention system provides a nominal subsidy rate of 12% on the total value of exports, provided the exporter is able to purchase all his imported inputs at the official exchange rate. Originally, the scope of the CETRA system remained limited, covering only about 18 product categories. In Mid-1988, however, the Government approved the extension of CETRA coverage to all products except bananas and minerals, which are subject to separate retention schemes.

6.15 Nicaragua also is considering the introduction of a partial currency retention scheme for non-traditional exporters. According to official press reports, industrial exports are to be eligible for 25% foreign currency retention of total export value under this scheme, while non-traditional agricultural exports will retain 50% of the foreign exchange generated. In exceptional cases, involving products never before exported from Nicaragua, full currency retention is contemplated. The remaining CACM countries are not planning to adopt foreign currency retention schemes, except to the extent that intra-regional trade is allowed to be carried out in national currencies. Moreover, in Costa Rica and Guatemala, such schemes now would not constitute a major incentive since the parallel market exchange rates do not exhibit a significant premium.

C. The Effectiveness of Export Incentives

Effectiveness in Reducing the Anti-Export Bias

6.16 In discussing the anti-export bias of an economy arising from policy induced distortions of relative prices and incentives, it is useful to distinguish between a direct bias and a total bias. Direct bias refers to the higher costs to domestic producers of imported inputs because of tariff and non-tariff barriers, which places them at a competitive disadvantage vis-a-vis producers abroad. In this regard, an adequately functioning temporary admissions system, unhampered by quantitative and foreign exchange restrictions, would enable domestic producers to obtain imported inputs on the same terms as foreign competitors. Such a system would not eliminate total bias, however, which refers to the relative incentive to produce for the domestic market, as indicated by the level of effective protection, versus the incentive to export. This takes into account that (a) an industry may be able to compete abroad but finds it more profitable to produce for the more highly protected domestic market; (b) to the extent that import substitution is favored by protection, import substituting industries are competing with exporters for domestic inputs, which raises their prices and reduces the exporters' ability to compete abroad; and (c) import restrictions that raise effective protection rates tend to drive up a country's real exchange rate, thereby also making exports less attractive. A criterion for judging the effectiveness of export promotion programs is to calculate whether the effective incentives granted for exports exceed or fall below the disincentives created by other trade policy instruments.

6.17 Several indicative studies on effective protection levels (Chapter III) have estimated that the average effective protection granted to manufacturing activities through the legal tariff system lies in the range of 70% to 80%. Including non-tariff barriers, the effective protection rates are much

higher. In contrast, some rough calculations suggest that the quantifiable incentives currently granted through the export promotion programs are smaller and thus do not eliminate the total bias of the trade policy system against export activities, though they may be sufficient to overcome the direct bias. In Costa Rica, for example, a CAT subsidy of 20% on export value combined with the duty-free admission of imported inputs would yield a maximum effective incentive of 57% for a firm generating a 35% value added (the smallest permissible level for CAT eligibility). In Honduras, the maximum incentive would be 27% for a firm with 30% value-added. In addition, if this firm has access to preferential exchange rates under the CETRA scheme, the maximum total effective incentive rate would increase to 67%; well below the average effective protection rate granted for import substitution activities.^{30/}

6.18 A further incentive in the preceding examples is the exemption from taxes on profits. The maximum marginal income tax in the CACM countries lies between 30% and 40%, and the exemption from this tax potentially could raise the total effective incentive rates above 100%. Income tax collection in Central America is weak, however, so that few firms pay such high rates. Furthermore, to the extent that such exemptions also are granted to import substituting activities, the total bias against export activities would not change.

Perceived Effectiveness of Incentives

6.19 According to most opinion polls among international investors, tax incentives are not among the major deciding factors in entrepreneurial planning, though they may be important at the margin when choosing between competing countries as a location for direct investment. Economic and political stability, availability of skilled labor, infrastructure, proximity to markets, and access to raw materials are usually listed as more important.

6.20 To investigate what are perceived to be the main problems confronting industrial exporters and the effectiveness of promotion instruments in Costa Rica, an opinion poll in 1985 sampled 220 firms of which about half were involved in export activities either to the CACM or to third countries. Table 6.2 shows that 50% of all firms cited a lack of competitiveness as a constraining factor in exporting toward third country markets; each of four other factors was cited by about 25% of the firms: inadequate marketing channels, inadequate credit, uncertainty about foreign markets, and low profitability of exports. Finally, inadequate infrastructure and inability to supply in sufficient volume were cited by less than 15% as a major constraining factor.

6.21 To assess the effectiveness of government measures in promoting exports, the sample was limited to exporting firms and each was asked to

^{30/} In their detailed study on effective protection in Costa Rica, Monge Gonzales and Corrales Quesada (Políticas de Protección e Incentivos..., ibid; Footnote 18) also conclude that on average the export incentives do not compensate for the anti-export bias generated by import restrictions in 1986.

evaluate the importance of various incentives on a scale of 0 to 10. The highest score (Table 6.2) was given to facilitation or reduction of bureaucratic impediments in importing and exporting procedures. The next most important instrument is the tax-credit certificates, primarily the CAT. Tax and tariff exemptions, which are the main elements of the export contract (aside from the CAT), ranked near the middle. The most surprising result is that exchange rate devaluations, though considered to have a marginally positive impact in stimulating exports, ranked lowest in effectiveness among all policy instruments.

Table 6.2
**OPINION SURVEY OF COSTA RICAN ENTREPRENEURS REGARDING
 THE PROBLEMS AND EFFECTIVENESS OF EXPORT PROMOTION EFFORTS**

| Principal Restrictions Affecting Ability to Export to Third Countries | | Importance of Measure in Stimulating Exports | |
|---|---|--|------------|
| Factor | Share of Respondents Citing Factor as Restrictive (%) | Measure | Mean Score |
| Non-competitive prices | 50.0 | Facilitation of import & export procedures | 8.48 |
| Inadequate marketing channels | 26.7 | CAT, CIEX | 7.72 |
| Inadequate credit | 25.6 | Preferential rates for inputs of services | 7.62 |
| Uncertainty | 23.3 | Access to foreign exchange | 7.48 |
| Unprofitability | 22.2 | Export contract | 7.41 |
| Inadequate infrastructure | 14.4 | Preferential interest rates | 7.14 |
| Inadequate Sales Volume | 12.2 | Labor cost reductions | 6.64 |
| | | Technological support | 6.42 |
| | | Devaluation | 5.83 |
| | | Minidevaluations | 5.50 |

Note: The opinion poll was taken in the first half of 1985, with a total sample of 220 firms. The sample was limited to 110 exporting firms in the inquiries on the importance of policy measures--the scores on the right are based on a scale of 0 to 10, with 10 denoting a highly positive impact and 0 a highly negative impact in stimulating exports.

Source: Morales, Pedro A. "Esfuerzos y Problemas del Sector Industrial Tradicional para Exportar: Un Analisis con Base de Encuestas de Opinion a los Industriales." Instituto de Investigaciones en Ciencias Economicas; Working Paper No. 106, University of Costa Rica, June 1987.

6.22 Because lack of competitiveness was cited most frequently as limiting export growth, real devaluations would be expected to be considered important in improving export competitiveness by (a) reducing the relative price of domestic exports vis-a-vis foreign goods, and by (b) raising the

domestic price of tradeable goods vis-a-vis nontradeables. These effects are negated, however, if the government does not take compensatory macroeconomic actions when implementing a nominal devaluation and allows domestic prices to rise rapidly, as had happened in Costa Rica in the past and which may have influenced the responses to the poll. Another reason why fiscal incentives are perceived as relatively more important than exchange rate adjustments is that the former generate an immediate cash income, especially in the case of CATs, whereas a real devaluation will also impinge on import prices and could, thus, reduce the overall profitability of firms that also produce partly for the domestic market. Finally, the CAT yields the highest effective benefit to firms that have a high import content (i.e., low national value added), which are also those firms that would benefit least from devaluation.

Apparent Effectiveness as Reflected in Non-Traditional Export Growth

6.23 Since 1984-85, when export promotion efforts intensified, non-traditional exports to third country markets have increased for most CACM countries. It is difficult to judge the extent to which particular export incentives were responsible for this expansion because other measures were introduced simultaneously. As shown in Table 6.3, by far the most successful exporter of non-traditional products to third countries is Costa Rica, where export values have almost doubled since 1985, even though it started with the highest base value among CACM members. Part of this success may be explained by export promotion efforts having begun earlier there than in the other countries. But other factors also played a major role, in particular, Costa Rica has been politically the most stable country and, thus, relatively more attractive to both domestic and foreign investors aiming to export. Costa Rica has also been the most aggressive in its flexible real-exchange rate management (see Figure 7).

6.24 El Salvador, Guatemala and Honduras also have increased their non-traditional exports over the last few years. (The figures in Table 6.3 understate this growth because of the manner in which maquila exports are recorded; as discussed in para 6.10.) The least successful in this regard has been Nicaragua, largely due to internal disruptions from the war and to the U.S.'s suspension of trade. For the other countries, a further stimulus was provided by the U.S. Caribbean Basin Initiative (CBI), launched in 1984, which allows certain products from eligible countries to be imported to the U.S. at preferential tariff rates. As seen in Table 6.4, non-traditional imports by the U.S. from the combined CACM countries have accelerated since 1983.

6.25 For the CACM as a whole, the expansion of non-traditional exports to third countries still does not compensate for the decline in non-traditional exports to the CACM. The same also applies to each country separately, except Costa Rica: in 1987, the total value of Costa Rican non-traditional exports exceeded its previous peak (in 1980) for the first time. The Costa Rican Ministry of Exports estimates that in 1988, nontraditional exports could exceed even the value of traditional exports. This successful performance provides good ground for optimism to other countries with similar resource endowments by showing that third-country markets are indeed penetrable, enabling significant gains in export growth and diversification.

Table 6.3
CENTRAL AMERICA: TRADITIONAL AND NON-TRADITIONAL
EXPORT PERFORMANCE
(in US\$ millions)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|----------------------|------|------|------|------|------|------|------|------|
| Costa Rica | | | | | | | | |
| Traditional | 567 | 582 | 535 | 526 | 597 | 591 | 690 | 642 |
| Non-Traditional-CACM | 270 | 238 | 167 | 198 | 193 | 143 | 99 | 98 |
| -Other | 164 | 189 | 167 | 128 | 207 | 205 | 297 | 374 |
| El Salvador | | | | | | | | |
| Traditional | 725 | 537 | 482 | 550 | 499 | 520 | 586 | 382 |
| Non-Traditional-CACM | 296 | 207 | 174 | 165 | 157 | 96 | 91 | 120 |
| -Other | 54 | 54 | 44 | 43 | 70 | 79 | 78 | 89 |
| Guatemala | | | | | | | | |
| Traditional | 851 | 726 | 698 | 660 | 706 | 725 | 731 | 576 |
| Non-Traditional-CACM | 441 | 379 | 344 | 321 | 291 | 208 | 185 | 230 |
| -Other | 228 | 186 | 128 | 111 | 135 | 127 | 128 | 175 |
| Honduras | | | | | | | | |
| Traditional | 635 | 585 | 536 | 534 | 595 | 632 | 737 | 694 |
| Non-Traditional-CACM | 84 | 66 | 52 | 61 | 48 | 20 | 19 | 25 |
| -Other | 131 | 133 | 88 | 104 | 110 | 138 | 135 | 144 |
| Nicaragua | | | | | | | | |
| Traditional | 310 | 347 | 313 | 352 | 319 | 261 | 193 | 200 |
| Non-Traditional-CACM | 75 | 71 | 52 | 34 | 37 | 24 | 15 | 14 |
| -Other | 65 | 82 | 41 | 37 | 30 | 16 | 35 | 37 |

Note: Traditional exports comprise: (i) coffee, bananas, beef and sugar for Costa Rica; (ii) coffee, cotton, sugar and shrimp for El Salvador; (iii) coffee, cotton, bananas, sugar, beef, petroleum and cardamom for Guatemala; (iv) coffee, bananas, wood, beef, lead, zinc, silver, seafood, sugar and tobacco for Honduras; and (v) cotton, coffee, sugar, beef, seafood and bananas for Nicaragua.

Source: USAID, and Clarence Zuvekas, Jr., "Central America's Foreign Trade and Balance of Payments: The Outlook for 1988-2000." Presented at Symposium on the Future of the Central American Economies, Univ. of Texas (Austin), April 1988.

Table 6.4:
U.S. IMPORTS OF MANUFACTURED AND HORTICULTURAL PRODUCTS
FROM CENTRAL AMERICA
 (in US\$ millions)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|--|------------|------------|------------|------------|------------|------------|------------|-----------------|
| U.S. Imports of Manufactures <u>a/</u> (SITC categories 5-8) from: | | | | | | | | |
| Costa Rica | 58 | 66 | 73 | 102 | 134 | 167 | 219 | 271 |
| El Salvador | 107 | 85 | 89 | 95 | 122 | 91 | 57 | 77 |
| Guatemala | 14 | 12 | 16 | 15 | 28 | 28 | 39 | 67 |
| Honduras | 31 | 37 | 39 | 37 | 39 | 46 | 56 | 70 |
| Nicaragua | 18 | 11 | 2 | - | - | - | - | - ^{c/} |
| Total CACM | 227 | 211 | 219 | 249 | 323 | 333 | 370 | 486 |
| U.S. Imports of Horticultural <u>b/</u> Products from: | | | | | | | | |
| Costa Rica | 13 | 12 | 13 | 15 | 22 | 24 | 34 | 42 |
| El Salvador | 3 | 2 | 3 | 2 | 3 | 4 | 5 | 7 |
| Guatemala | 12 | 15 | 18 | 16 | 21 | 23 | 27 | 37 |
| Honduras | 13 | 13 | 13 | 12 | 16 | 18 | 18 | 29 |
| Total | 41 | 42 | 46 | 46 | 62 | 69 | 83 | 115 |

- a/ Includes full value of assembled goods entering under maquila (drawback).
b/ Includes fruits & vegetables (except bananas) and plants, flowers, etc.
c/ (-) = less than US\$1 million.

Source: Zuvekas, C. op. cit., based on figures from the U.S. Department of Commerce.

D. Recommendations: Reforming the Export Incentive Systems

6.26 Export incentives represent an important instrument for expanding trade in the presence of import restrictions. Although the incentive benefits currently granted to non-traditional exporters are significant, these do not suffice on average to compensate fully for the anti-export bias generated through the tariff structure. Further benefit increases, however, would entail increasing administrative costs and could provoke countervailing trade policies abroad. This limits the effectiveness of fiscal subsidies in promoting new investments in export activities. Furthermore, while export incentive schemes correct certain existing distortions, they often introduce additional distortions into the economy. A more efficient strategy would be to reduce the levels of tariff and non-tariff protection that give rise to an anti-export bias before attempting to compensate fully for that bias through alternative means.

Reducing the Disparity in Effective Incentive Rates

6.27 Both the tax-credit certificates and the profit tax exemptions are issued generally in proportion to the value of exports. When this proportion is fixed, as with CATs in Costa Rica, the consequence is that economic activities with low value-added receive a greater effective incentive than activities with high value-added. This has the distorting effect of encouraging activities that are relatively dependent on imports.

6.28 This distortion can be eliminated by expressing the incentive rate as a fixed percentage of value-added generated in the export activity. The Honduran system of tax-credit certificates significantly reduce but does not eliminate the disparity of effective incentives by applying a progressively higher incentive rate to export values with rising value-added content. The most efficient approach is to express incentives as a fixed share of the national value-added contained in the exported output. In this context, it is important to evaluate national value-added at international prices. That is, the fiscal subsidy would be applied to the value of exports minus the value of imports. It should not be applied, however, to value-added as calculated by domestic factor cost, as this could have the unwanted consequence of generating higher subsidies to the relatively less efficient producers.

Simplifying Eligibility Criteria

6.29 Although there are many objectives underlying export promotion efforts (e.g., expanding employment opportunities, generating foreign exchange, production diversification), there is a danger of diluting the incentive to export if the value of the incentive is contingent on too many criteria. For example, with the Salvadoran tax incentive certificates, a prospective exporter is not given a clear basis on which to calculate his profit margins because the value of incentives hinges on several criteria and may vary depending on negotiations with the relevant government agencies.

Reducing the Time Horizon of Export Contracts

6.30 Export contracts, giving eligible exporters the right to receive fiscal incentives, generally expire after a period of 10 years, which may be too long in view of current trade liberalization initiatives. As the trade liberalizing measures reduce the anti-export bias, the need for compensatory subsidies declines. When contracts remain fixed over ten years, the government may be oversubsidizing certain exporters, which represents a waste of public resources. A short timeframe, alternatively, may not give new exporters sufficient incentive to invest in new export capacity. Shorter contracts, but with automatic renewability on terms that are contingent on progress made in trade policy liberalization, would be a solution.

Ensuring Access to Incentives

6.31 It is important that access to export incentives is for all potential applicants, not just a prerogative of established producers. Greater emphasis on developing an ex post draw-back system may be useful by

helping potential exporters to recover some import costs once they decide to export. Under the ex ante-based temporary admissions system, such flexibility is not possible. Moreover, the ex ante system requires extensive monitoring capabilities to ensure that exporting actually takes place, which would not be necessary under a draw-back system.

Removing Other Exemptions

6.32 Generally, it is impossible to promote all activities at once. Therefore, to the extent that tax or tariff exemptions are granted for import substituting as well as for export activities, the effective incentive to exporters is reduced. The greatest exemptions in the past were through the industrial fiscal incentives regime, which is being phased out as part of the CACM trade reforms of 1986. This is an important step in streamlining the trade regime and should enhance the importance of the temporary admissions system.

6.33 In this context, there is an additional benefit of raising the tariff floor as part of future tariff reforms. In an extreme case, if imported capital and imported inputs were subject to a zero tariff, the rationale for a temporary admissions scheme would be lost. Now the tariff rates on these imports are very low compared to final products (as discussed in Chapter III), with the effect that tariff exemptions constitute a weak export promoting instrument. Raising those tariffs, complemented by the appropriate exchange rate management, would strengthen the exemptions' impact on export promotion.

Achieving Compatibility with GATT Rules

6.34 Strictly speaking, the letter of the GATT prohibits all direct subsidies that discriminate by destination of product. In the interpretation of these rules, however, some types of subsidies have aroused less opposition than others. The tax-credit certificates have received the greatest attention, being the primary cause for countervailing actions initiated by the U.S. against Costa Rica. The ability to request an "injury test" would provide an important safeguard against such actions. Because of the relatively small size of the CACM economies, they are unlikely to become a major supplier in any particular export market (barring coffee and bananas) and thus not capable of causing injury. To be eligible for the injury test, a country would have to be a signatory to the GATT and its Subsidies Code, though even that does not guarantee the test application in all cases (cf. Richard H. Snape, "Export Promoting Subsidies" PPR Working Paper Nr. 97, IBRD, Sept. 1988).

6.35 Although foreign opposition to direct export subsidies, as distinct from other government intervention impinging on exports, may rest on dubious economic foundations, the fact remains that countervailing actions can create serious harm. Consequently, it would be prudent to reduce reliance on fiscal subsidies and use instruments considered less abrasive by the major external trading partners. Eventually, the best course of action would be to phase out such instruments altogether by eliminating the underlying distortions that motivate their adoption.

E. Potential Areas for Regional Cooperation in Export Promotion

Facilitating Regional Transportation

6.36 A well functioning regional transportation system is as important to commerce with third countries as it is to intra-CACM trade. Central America's major trading partner, the United States, is accessible by land so that a road transport system unhampered by intra-CACM border impediments could aid exports greatly. Greater accessibility to partner-country port facilities by CACM exporters would also reduce export costs. A recent report on the regional transportation system ^{31/} points out several areas where cooperative effort could prove useful: the regional standardization of trucking regulations; common representation at regional shipping conferences to negotiate transport tariffs and schedules; regional harmonization of contract laws pertaining to transport services; and removal of institutional bottlenecks.

Establishing Common Marketing Arrangements

6.37 The lack of adequate marketing channels has been cited frequently as an important obstacle to non-traditional export growth. Permanent representatives in the major trade centers, e.g., Miami and Rotterdam, could prove useful in this respect by investigating potential markets as well as overseeing regional shipments, to inspect for quality control and prevent fraud. Many small exporters would be unable individually to support permanent representatives abroad, but a cooperative effort would enable the sharing of overhead costs. Various proposals to create a regional marketing agency have been advanced in the past (particularly by SIECA and CABEI), but these have not met with much enthusiasm among the partner countries.

Facilitating Structural Adjustment

6.38 Structural adjustment of the CACM economies will require adequate financing to hold down transitional costs during trade reform. The region's development bank, CABEI, could make a potentially valuable contribution through a broader lending strategy, beyond a focus on integration and toward projects that would facilitate the restructuring of industries in the CACM countries. Besides providing direct finance, CABEI could become a regional source of expertise in designing such projects.

6.39 CABEI first would have to overcome its present financial difficulties and implement certain internal reforms. Between 1978 and 1982, loans approved annually by CABEI were around US\$ 150 million. Between 1983 and 1986 annual lending dropped to an average of J\$ 25 million, involving only about 6 projects. Loans increased again in 1987/88, but CABEI's financial position remains weak: as of June 1987, 25% of CABEI's loans (or US\$ 202 million) were in arrears, while another US\$ 132 million of funds due were frozen in central bank accounts for lack of foreign exchange. (Nicaragua accounts for about 60%

^{31/} Central America: Regional Transportation Study, June 1987, commissioned by USAID and prepared by Parsons Brinckerhoff International, Inc.

of all arrears.) Recently, there has been increased interest by external donors and agencies in providing financial support to CABEI. A lasting solution also will require various internal reforms, both organizational and operational, which are outlined in the IBRD Reconnaissance Mission Report (08/31/88).

Harmonizing Export Incentives

6.40 Because the CACM export promotion programs apply only to exports destined to third-country markets, not to CACM partners, there is no immediate need to harmonize those incentives. Moreover, to the extent that the speed of trade liberalization varies from country to country, the need to compensate for anti-export biases will differ as well, so that a uniform level of incentives across countries would mean oversubsidization in some and insufficient compensation in others. Some harmonization may be considered later if the CACM countries compete with each other for direct foreign investment, which may be attracted by export subsidies. But this is not an area of high priority, since international investors generally regard the benefit of tax incentives as a secondary factor in deciding on location.

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ANNEX A

TARIFF REFORM IMPACT SIMULATIONS FOR COSTA RICA AND GUATEMALA

1. This annex presents several simulation results derived from a SINTIA-T partial equilibrium model to calculate the impact of tariff changes on import demand and tariff revenues, as discussed in Chapter IV.

The Costa Rican Case

2. Table A.1 describes the effect of replacing the current legal nominal tariff structure in Costa Rica with the 1990 target structure, using the 1986 structure of imports as a basis for the simulation. Calculations are made under three import-demand-elasticity assumptions and alternative-real-exchange-rate-devaluation responses. The tariff structure encompasses the legal external tariff plus any surcharges but does not explicitly consider exemptions, which, it is assumed, are uniformly granted in proportion to the hypothetical import duty that would be collected through the legal tariff structure. Finally, it is assumed that there are no exogenous import changes, other than those caused by tariff modifications or exchange rate devaluations.

3. The percentage figures in the table indicate the changes in the corresponding variables over the course of a year, occasioned by a policy reform relative to a base case where no policy changes occur. For example, the first simulation on Table A.1 states that if the current tariff structure were to be replaced immediately by the 1990 target tariff structure, if no devaluation occurs and if import demand elasticities are 0, then the annual import tariff revenue collected by the government would be 48.9% less than what would have been collected had the current tariff structure been maintained. It is necessary to keep in mind that tariff reform is to be phased in over three years, so that the simulation overstates the impact for the first two years.

4. Table A.1 shows that in the absence of a real devaluation, the new tariff structure causes imports to increase, thereby worsening the current account, and causes a significant reduction in import tariff revenues, thereby raising the fiscal deficit. The higher the import-demand price elasticities, the greater the import response, but conversely, the smaller the impact on tariff revenues: the decline in revenues due to lower tariffs is partly offset by the increase in the duty-eligible import base as importers respond to lower tariffs. Assuming that aggregate demand is held constant, the figures in Table A.1 suggest that a real devaluation of about 8%, phased in simultaneously with the tariff reform, would be enough to prevent an import surge, thereby maintaining trade balance equilibrium.

5. An 8% real devaluation would not, however, equilibrate the fiscal account. Further real devaluations would raise the domestic currency (colon) value of tariff revenues only in the event that overall import demand is inelastic (less than 1). Even in such a case, the necessary devaluation may be extremely high, creating disruptions elsewhere in the economy. For

example, when import elasticity is -.5, the real devaluation to keep tariff revenues unchanged would be substantially in excess of 50%.

Table A.1

COSTA RICA: THE ESTIMATED IMPACT ON IMPORTS AND TARIFF REVENUES OF REPLACING THE 1987 TARIFF STRUCTURE WITH THE 1990 TARGET TARIFF STRUCTURE

| Import Price Tariff Elasticity Assumptions | (percentage changes) | | |
|--|----------------------|----------------------------------|---|
| | Real Devaluation | Total Value of Imports (in US\$) | Total Value of Revenues (in CR colones) |
| All elasticities - 0 | 0 | 0 | -48.9 |
| ----- | | | |
| "Standard" elasticities <u>a/</u> | 0 | 9.9 | -39.9 |
| | 8 | - 1.1 | -40.8 |
| | 10 | - 1.3 | -41.2 |
| | 20 | -14.7 | -43.9 |
| ----- | | | |
| All elasticities - -2.0 | 0 | 15.3 | -38.3 |
| | 10 | - 3.6 | -42.1 |
| | 20 | -13.9 | -47.9 |
| ----- | | | |
| All elasticities - -0.5 | 0 | 3.8 | -46.3 |
| | 10 | - 0.9 | -43.4 |
| | 20 | - 6.5 | -41.0 |
| | 50 | -28.2 | -36.5 |

a/ The "standard" elasticity assumptions are: agricultural, mining and intermediate goods have an elasticity of -1.0; the elasticity for consumer goods is -2.0, and for capital goods -0.5.

Explanatory Notes:

These simulations are based on the 1986 structure of Costa Rican imports, whose value amounted to US\$ 1,130 million. With no exemptions, these imports would have yielded a hypothetical annual tariff revenue of US\$ 283 million, under the legal tariff structure in 1987. The simulations are made with a partial equilibrium model by substituting the 1987 tariff rates with the tariff rates programmed to be in place in 1990, assuming there is no exogenous import growth. All changes in imports in this model result from the changes in tariffs and devaluations. Since there is no information on the structure of duty-exempt imports, the model assumes that the total value of exempted duties is distributed in proportion to the hypothetical tariff revenue over all tariff positions.

Source: IBRD : aff calculations using SINTIA-T based on figures from the Ministry of Economy.

6. To assess the impact of tariff reform on the government budget additional consideration are involved. On the positive side, a real devaluation that accompanies tariff reform also will raise the dollar value of export tax revenues. In 1986, these accounted for about 45% of total revenues from trade, while import tariffs accounted for 55%. Assuming that the dollar value of exports remains unchanged and using "standard" elasticities (defined in Table A.1), the real devaluation needed to keep trade revenues constant would be about 50%, which would mean a significant decline in dollar import value that would have an adverse impact on domestic production. Another consideration is that the simulations ignore the possibility of endogenously stimulated export growth, this being one of the main objectives of trade reform. To the extent that exports grow as a result of the reduced anti-export bias, the devaluation needed to reduce the current account gap is lowered. On the negative side, a devaluation will raise government expenditures in Colones to the extent that these are made on imported items, and thus worsens the fiscal deficit.

7. In general, a devaluation by itself will not be sufficient both to balance the current account and maintain fiscal equilibrium. Unless the government is willing to reduce expenditures, it is necessary to raise other taxes or eliminate existing tariff exemptions. One option is to raise the tariff floor when tariff ceilings are reduced, which would simultaneously reduce the dispersion in tariff rates. Table A.2 describes the simulated impact of potential tariff reforms to reduce further the average level and dispersion of protection rates.

8. The first observation from Table A.2 is that an increase in the tariff floor to 10%, while maintaining all other tariffs above 10% at their 1990 values, would raise import tariff revenues by 23.2% and cause a small decline (-3.3%) in import volume. (Further simulations not shown here also suggest that a 2% real exchange rate appreciation would be enough to compensate for the import decline, leaving the current account unchanged, while marginally raising tariff revenues by another percentage point.) This increase in revenues would allow the government to recover almost 60% of the decline in tariff revenues occasioned by the initial trade reform. Assuming that the government has found alternative tax sources to compensate for the roughly 40% simulated decline in import revenues in 1990, the table also reveals that an increase of the tariff floor to 10% would enable a progressive reduction in the tariff ceiling to 20% without further worsening the fiscal account and without requiring significant compensatory exchange rate adjustments.

Table A.2
COSTA RICA: IMPACT SIMULATIONS OF FURTHER TARIFF RANGE REDUCTIONS

| New Tariff | | Real Devaluation | (Percentage changes) | |
|------------|-------|------------------|---------------------------|-----------------------------------|
| | | | Import Value (in US\$) | Tariff Revenue (in CR colones) |
| Ceiling | Floor | | | |
| 40% | 5% | 0 | -0.6 | 4.0 |
| 40% | 10% | 0 | -3.3 | 23.2 |
| 30% | 10 | 0 | -1.7 | 17.9 |
| 20 | 10 | 0 | 1.3 | 4.2 |

Notes:

These simulations are based on the "standard" elasticity assumption, and all use the 3rd simulation in table A.1 as the starting base. That is, the 1990 tariff structure is assumed to have replaced the 1987 tariffs, and an 8% real devaluation has taken place, both of which have influenced the structure of imports. The value of imports and tariffs revenues serve as the initial levels to which the percentage changes shown in the current simulations refer. For the simulation, all tariffs initially outside of the new tariff range are set to the nearest endpoint (corresponding to the "concertina" method), e.g., in the first simulation, all tariffs below 5% under the 1990 tariff structure are raised to a rate of 5%.

Source: IBRD Staff calculations using SINTIA-T using data from Min. of Economy.

The Guatemalan Case

9. Two sets of simulation experiments are provided for Guatemala, using the 1987 import structure. In both cases, tariff ceilings are progressively reduced and tariff ceilings raised, according to the concertina method. Table A.3 is based on the 1987 legal tariff structure and assumes that exemptions are granted uniformly. This corresponds to the assumptions made in Tables A.1 and A.2 and enables a comparison with the Costa Rican simulations. Table A.4, however, is based on actual tariff rates paid by non-exempt importers. (These data were available for Guatemala but not for Costa Rica.) Here it is assumed that the tariff changes apply only to imports that are subject to duties, while the others continue to be exempted.

10. For Table A.3, the initial impact of a tariff ceiling reduction to 40%, leaving lesser tariffs unchanged, has a fairly modest impact under the standard elasticity assumptions: in the absence of a compensating devaluation, imports would rise by 2.4% and tariff revenues would decline by

less than 8%. This is considerably smaller than the impact simulated for Costa Rica, for several reasons: in the Guatemalan example, only tariffs above 40% are reduced to 40%, while others remain unchanged. The 1990 target rates for Costa Rica, however, include a reduction of the ceiling to 40% plus additional tariff reductions below the 40% ceiling. If the same simulation performed in Table A.3 had been done for Costa Rica, i.e., reducing all rates above 40% in the current (1987) tariff structure to 40%, the impact under standard elasticities would be to raise imports by almost 3% and reduce tariff revenues by 17%. Another reason for the discrepancy in both results is that the initial (1987) Costa Rican average external tariff, including surcharges, is somewhat higher than the Guatemalan average.

11. Table A.3 also describes the impact of alternative tariff ceiling and floor adjustments, showing that a ceiling reduction to 40% coupled with a raised tariff floor of 10% would leave imports virtually unchanged and slightly raise government revenue. Further reductions in tariff ceilings, however, would cause a progressive deterioration in tariff revenues.

12. Table A.4 (based on actual tariffs), on the other hand, suggests that a tariff floor increase to 10% would enable a tariff ceiling reduction to 20% without major compensatory exchange rate actions and alternative government income. That is, the revenue increase from the raised tariff floor more than compensates for the revenue decline due to the lowered tariff ceiling. This result in contrast to Table A.3 arises because exemptions are not granted in strict proportion to the level of legal tariffs across import categories as assumed in the simulations. As was shown in Table 3.7, 72% of all imports that are not exempted pay duties of less than or equal to 10%, but only 36% of exempt imports involve items with (unpaid) duties in this range. Conversely, only 9% of non-exempt imports pay duties in excess of 40%, but almost 30% of exempt imports fall in this range. Since proportionately more high-tariff items are included among the duty-exempt imports than among duty-paying imports, the simulations performed initially on the basis of legal tariffs overstate the revenue impact of lowered tariff ceilings and understate the revenue impact of a raised tariff floor.

Table A.3
GUATEMALA: HYPOTHETICAL TARIFF REFORM IMPACT SIMULATIONS
BASED ON THE LEGAL (END-1987) TARIFF STRUCTURE

(percentage changes)

| New Tariff Ceiling | New Tariff Floor | Elasticity Assumption | Real Devaluation (Quetzal/US) | Import Value (in US \$) | Tariff Revenue (in Quetzales) |
|-----------------------|---------------------|----------------------------|----------------------------------|----------------------------|----------------------------------|
| 40% | 0 | e = 0 | 0 | 0 | -13.8 |
| | | e = standard ^{a/} | 0 | 2.4 | -7.9 |
| | | | 2 | 0.1 | -8.3 |
| ----- | | | | | |
| 40% | 5% | e = 0 | 0 | 0 | -9.5 |
| | | e = standard | 0 | 1.7 | -3.8 |
| | | | 2 | -0.7 | -4.3 |
| ----- | | | | | |
| 40% | 10% | e = 0 | 0 | 0 | 0 |
| | | e = standard | 0 | 0.1 | 4.5 |
| ----- | | | | | |
| 30% | 10% | e = 0 | 0 | 0 | -9.6 |
| | | e = standard | 0 | 1.7 | -3.6 |
| | | | 2 | -0.6 | -3.9 |
| ----- | | | | | |
| 20% | 10% | e = 0 | 0 | 0 | -26.7 |
| | | e = standard | 0 | 4.6 | -20.8 |
| | | | 5 | -1.1 | -21.4 |

^{a/} For a definition of "standard" elasticities see Table A.1.

Notes: All simulations use the 1987 import structure and the hypothetical revenue collected in the absence of exemptions as the base for calculating tariff reform impact. Tariff changes takes place according to the "concertina" method.

Source: IBRD Staff calculations using SINTIA-T using figures from Banco de Guatemala.

Table A.4
**GUATEMALA: TARIFF REFORM IMPACT SIMULATIONS BASED ON ACTUAL
 1987 TARIFF STRUCTURE**

| (Percentage changes) | | | | | |
|----------------------|------------------|------------------------|------------------|------------------------|-------------------------------|
| New Tariff Ceiling | Elasticity Floor | Elasticity Assumption | Real Devaluation | Import Value (in US\$) | Tariff Revenue (in Quetzales) |
| 40% | 0 | e = 0 | 0 | 0 | -12.6 |
| | | e = standard <u>a/</u> | 0 | 1.7 | -7.1 |
| | | | 2 | -0.1 | -7.7 |
| ----- | | | | | |
| 40% | 5% | e = 0 | 0 | 0 | -9.1 |
| | | e = standard | 0 | 1.2 | -3.8 |
| | | | 2 | -1.5 | -4.4 |
| ----- | | | | | |
| 40% | 10% | e = 0 | 0 | 0 | 19.5 |
| | | e = standard | 0 | -2.0 | 21.9 |
| ----- | | | | | |
| 30% | 10% | e = 0 | 0 | 0 | 10.6 |
| | | e = standard | 0 | -0.8 | 14.7 |
| ----- | | | | | |
| 20% | 10% | e = 0 | 0 | 0 | -0.9 |
| | | e = standard | 0 | 0.7 | 3.4 |

a/ For a definition of "standard" elasticities, see Table A.1.

Notes: The 1987 import structure and the actual structure of tariff revenues collected on non-exempt imports in 1987 (described in Table 3.6) are used as the base for these simulations. As in Table A.3, tariff changes are implemented by way of the "concertina" method. Unlike preceding simulations, it is assumed that imports exempted from duty in 1987 continue to be entirely duty-free. This means that the tariff changes will only affect demand for those imports that are subject to duties (79.8% of total imports). In contrast, real devaluations have an effect on both duty-exempt and non-exempt imports.

Source: IBRD Staff Calculations using SINTIA-T based on figures from Banco de Guatemala.

ANNEX B

THE QR COVERAGE OF MANUFACTURING PRODUCTION IN GUATEMALA

1. The import and export licensing requirements and prohibitions (other than foreign exchange restrictions) that applied in Guatemala as of September 1986, can be classified into four broad categories:

- (i) License category S refers to licenses that must be obtained from the Ministry of Health or other government institution to assure that health, sanitary and safety standards are maintained.
- (ii) Category Q refers to import or export prohibitions applied for similar health and safety reasons as pertain to category S. A characteristic example is the prohibition to import Bees originating from countries infested by the African Bee and the diseases Varriosis and Acariosis.
- (iii) Category E refers to import or export licenses from the Ministry of Economy or other ministries, sometimes accompanied by declarations from domestic producer associations, for reasons other than health or security.
- (iv) Category P refers to import and export prohibitions, also for reasons unrelated to health and security.

2. In the main text, only categories E and P are considered quantitative restrictions applied for economic reasons; meaning, either to subsidize domestic consumers or to protect domestic producers from foreign competition. While the other categories, Q and S, may conceivably be misused for protectionist purposes, there is no evidence that this has been the case in Guatemala.

3. One way to assess the importance of QRs in protecting domestic industries is to calculate their production coverage. This is defined as the value of domestically produced items that would require licenses or are prohibited if they were imported (or exported). Unfortunately, information concerning the import and export items subject to QRs is published at the 8 or 10 digit NAUCA tariff position (Nomenclatura Arancelaria Uniforme Centroamericana), whereas domestic manufacturing production data are only available at a more aggregated level; four digit ISIC. Consequently, each ISIC category (of which there are 75 in Guatemala) comprises several NAUCA positions (totalling 1885).

4. A standard (or "neutral") procedure for estimating the production coverage of QRs is as follows: for each set of NAUCA positions contained in every ISIC category, a percentage is calculated as the number of NAUCA positions subject to QRs divided by the total number of NAUCA positions in the set. That percentage is multiplied times the value of production in the corresponding ISIC category. The resulting value, summed up over all ISIC categories, is then divided by the total value of manufacturing production,

yielding the estimated fraction of total manufacturing activity covered by QRs.

5. Table B.1 provides the estimated shares of Guatemalan manufacturing output in 1985 covered by the different licensing requirements and prohibitions, according to the standard calculation procedure. Import QRs, encompassing categories E and P, only cover 5.7% of total manufacturing output and export QRs cover 6.1%. By this criterion, QRs are not very significant in Guatemala, except for a small set of items. Licensing requirements and prohibitions applied for health and sanitary reasons mainly apply to processed foods.

6. The standard method of calculating QR coverage has considerable "holes" and may underestimate the true coverage: as a hypothetical example, consider an ISIC category comprising, say, 10 NAUCA positions. Further, suppose that domestic production in that ISIC category is entirely concentrated in one of the 10 NAUCA positions, which also happens to be subject to a QR while the remaining 9 positions are assumed free from QRs. The standard method of calculating QR coverage would yield a production coverage of only 10% for that ISIC category, while in fact 100% is being covered.

7. A similar hypothetical example could be constructed that would result in an overestimate of QR coverage when using the standard calculation method. (For instance, assume all output to be concentrated in a subset of NAUCA positions not subject to QRs, while the remaining NAUCA positions involve QRs.) However, to the extent that QRs are applied to protect domestic production, the standard method will most likely underestimate rather than overestimate the true QR coverage.

8. To account for the possibility of underestimating QR coverage, it is useful to calculate also the Maximum Potential QR coverage. That is, if at least one of the NAUCA positions included in a particular ISIC category is subject to QRs, it is assumed that all production corresponding to that category is concentrated in that NAUCA position with QRs. The calculated Maximum Potential QR coverage is provided in Table B.2, which shows that at most 29.5% of domestic manufacturing production is covered by import licenses or prohibitions unrelated to health and security, and at most 20% is covered by similar export restrictions.

Table B. 1

GUATEMALA: ESTIMATED PRODUCTION COVERAGE OF QRS, SEPT. 1986

| MANUFACTURING SECTOR | PROD. VALUE (1000 Quetzales) | PRODUCTION VALUE COVERED BY: 1/ | | | | | | | | | |
|-------------------------------------|---------------------------------|---------------------------------|---------|---------|----------|----------|-------------------------------|----------|--------|--------|----------|
| | | -----IMPORT RESTRICTIONS----- | | | | | -----EXPORT RESTRICTIONS----- | | | | |
| | | FREE | E | P | Q | S | FREE | E | P | Q | S |
| 31 FOOD, BEVERAGES & TOBACCO (%) | 945263.0 | 346457.6 | 38627.5 | 25358.8 | 417545.8 | 117005.3 | 58387.4 | 115454.6 | 0.0 | 1188.6 | 770062.1 |
| | | 36.7 | 4.1 | 2.7 | 44.2 | 12.4 | 6.2 | 12.2 | 0.0 | 0.1 | 81.5 |
| 32 TEXTILES & LEATHER (%) | 294849.0 | 282922.9 | 11926.1 | 0.0 | 0.0 | 0.0 | 288355.1 | 4859.1 | 1623.5 | 0.0 | 0.0 |
| | | 96.0 | 4.0 | 0.0 | 0.0 | 0.0 | 97.8 | 1.6 | 0.6 | 0.0 | 0.0 |
| 33 WOOD, CORK & PRODUCTS (%) | 24471.0 | 24471.0 | 0.0 | 0.0 | 0.0 | 0.0 | 13454.5 | 11016.5 | 0.0 | 0.0 | 0.0 |
| | | 100.0 | 0.0 | 0.0 | 0.0 | 0.0 | 55.0 | 45.0 | 0.0 | 0.0 | 0.0 |
| 34 PAPER & PRINTING (%) | 115584.0 | 109238.8 | 0.0 | 3767.4 | 2624.7 | 0.0 | 114441.3 | 1142.7 | 0.0 | 0.0 | 0.0 |
| | | 94.5 | 0.0 | 3.3 | 2.3 | 0.0 | 99.0 | 1.0 | 0.0 | 0.0 | 0.0 |
| 35 CHEMICALS, PETR, COAL (%) | 547966.0 | 431876.3 | 2853.5 | 37258.7 | 5886.5 | 69948.7 | 543736.4 | 122.5 | 1064.6 | 0.0 | 3030.7 |
| | | 78.8 | 0.5 | 6.8 | 1.1 | 12.8 | 99.2 | 0.0 | 0.2 | 0.0 | 0.6 |
| 36 NONMETALLIC MINERALS (%) | 146483.0 | 146483.0 | 0.0 | 0.0 | 0.0 | 0.0 | 146483.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | | 100.0 | 0.0 | 0.0 | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 37 BASIC METAL INDUSTRIES (%) | 62985.0 | 62985.0 | 0.0 | 0.0 | 0.0 | 0.0 | 42717.3 | 20204.7 | 0.0 | 0.0 | 0.0 |
| | | 100.0 | 0.0 | 0.0 | 0.0 | 0.0 | 67.8 | 32.1 | 0.0 | 0.0 | 0.0 |
| 38 METAL PRODS, MACHINERY (%) | 135893.0 | 129275.5 | 5662.1 | 566.3 | 0.0 | 335.3 | 134761.5 | 450.8 | 0.0 | 0.0 | 680.7 |
| | | 95.1 | 4.2 | 0.4 | 0.0 | 0.2 | 99.2 | 0.3 | 0.0 | 0.0 | 0.5 |
| 39 OTHER MANUFACTURING (%) | 6811.0 | 6398.0 | 0.0 | 99.9 | 308.7 | 0.0 | 6272.1 | 225.7 | 0.0 | 0.0 | 308.7 |
| | | 93.9 | 0.0 | 1.5 | 4.5 | 0.0 | 92.1 | 3.3 | 0.0 | 0.0 | 4.5 |
| Total Manufacturing... (%) | 2217402.0 | 1477205.0 | 59151.2 | 67133.1 | 426447.6 | 187371.3 | 1305973.2 | 133353.8 | 2770.1 | 1270.6 | 774164.2 |
| | | 66.6 | 2.7 | 3.0 | 19.2 | 8.5 | 58.9 | 6.0 | 0.1 | 0.1 | 34.9 |

- 1/ E = Trade transaction requires license from Ministry of Economy or producers association;
P = Import (or export) prohibition;
Q = Imports (or exports) are partly prohibited for health or security reasons;
S = Import (or export) requires health certificate or license from Ministry of Health.

Source: Ministerio de Economía, Guía Legal sobre las Regulaciones a las Importaciones y Exportaciones, Guatemala, 1987.
IBRD Staff calculations using SINTIA-T.

Table B. 2

GUATEMALA: MAXIMUM POTENTIAL PRODUCTION COVERAGE OF QRS, SEPT. 1986

| MANUFACTURING SECTOR (%) | PROD. VALUE (1000 Quetzales) | PRODUCTION VALUE COVERED BY: 1/ | |
|-------------------------------------|---------------------------------|---------------------------------|------------------------|
| | | IMPORT RESTRICTIONS | EXPORT RESTRICTIONS |
| 31 FOOD, BEVERAGES & TOBACCO (%) | 945263.0 | 258745.0 27.4 | 269431.0 28.5 |
| 32 TEXTILES & LEATHER (%) | 294849.0 | 179885.0 61.0 | 11353.0 3.9 |
| 33 WOOD, CORK & PRODUCTS (%) | 24471.0 | 0.0 0.0 | 14160.0 57.9 |
| 34 PAPER & PRINTING (%) | 115584.0 | 77754.0 67.3 | 30885.0 26.7 |
| 35 CHEMICALS, PETR, COAL (%) | 547966.0 | 93872.0 17.1 | 32131.0 5.9 |
| 36 NONMETALIC MINERALS (%) | 146483.0 | 0.0 0.0 | 0.0 0.0 |
| 37 BASIC METAL INDUSTRIES (%) | 62985.0 | 0.0 0.0 | 62985.0 100.0 |
| 38 METAL PRODS, MACHINERY (%) | 135893.0 | 39913.0 29.4 | 30050.0 22.1 |
| 39 OTHER MANUFACTURING (%) | 6811.0 | 4539.0 66.6 | 2257.0 33.1 |
| Total Manufacturing... (%) | 2217402.0 | 654790.0 29.5 | 453252.0 20.4 |

1/ Import and export restrictions refer to prohibitions or licencing requirements for reasons other than Health and National Security.

Source: Ministerio de Economía, Guía Legal sobre las Regulaciones a las Importaciones y Exportaciones, Guatemala, 1987.
IBRD Staff calculations using SIITIA-T.

ANNEX C

STATISTICAL TABLES

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Table C.1

COSTA RICA: MACROECONOMIC ACCOUNTS

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987a/ |
|--------------------------------------|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| CURRENT GNP PER CAPITA (US\$) | 560.00 | 610.00 | 660.00 | 750.00 | 860.00 | 950.00 | 1060.00 | 1300.00 | 1530.00 | 1750.00 | 1900.00 | 1480.00 | 1100.00 | 1020.00 | 1190.00 | 1310.00 | 1420.00 | .. |
| POPULATION (THOUSANDS) | 1732.00 | 1774.00 | 1822.00 | 1868.00 | 1916.00 | 1965.00 | 2024.00 | 2085.00 | 2148.00 | 2212.00 | 2279.00 | 2343.00 | 2406.00 | 2470.00 | 2534.00 | 2600.00 | 2663.00 | .. |
| ORIGIN AND USE OF RESOURCES | | | | | | | | | | | | | | | | | | |
| | (Billions of current Costa Rican Colones) | | | | | | | | | | | | | | | | | |
| Gross National Product (GNP) | 6.43 | 7.04 | 7.96 | 9.88 | 12.89 | 16.28 | 20.08 | 25.70 | 29.31 | 33.31 | 39.42 | 50.67 | 81.42 | 115.64 | 144.45 | 175.92 | 222.59 | .. |
| Gross Domestic Product (GDP) | 6.62 | 7.14 | 8.22 | 10.16 | 13.22 | 16.80 | 20.68 | 26.33 | 30.19 | 34.58 | 41.41 | 57.10 | 97.51 | 129.31 | 163.01 | 192.42 | 233.47 | 281.82 |
| Indirect Taxes Net | 0.73 | 0.77 | 0.74 | 1.00 | 1.45 | 2.12 | 2.57 | 3.41 | 4.00 | 4.22 | 4.86 | 6.78 | 11.31 | 18.62 | 23.91 | 28.69 | 33.25 | .. |
| GDP at factor cost b/ | 5.80 | 6.37 | 7.47 | 9.17 | 11.77 | 14.69 | 18.11 | 22.92 | 26.19 | 30.37 | 36.54 | 50.74 | 86.19 | 110.69 | 139.10 | 165.73 | 205.22 | .. |
| Agriculture | 1.47 | 1.44 | 1.60 | 1.96 | 2.62 | 3.42 | 4.21 | 5.78 | 6.16 | 6.40 | 7.37 | 13.4 | 23.68 | 28.45 | 34.57 | 38.43 | 49.45 | .. |
| Industry | 1.66 | 1.80 | 2.08 | 2.57 | 3.58 | 4.60 | 5.68 | 6.89 | 7.87 | 9.15 | 11.17 | 13.90 | 25.10 | 37.00 | 47.69 | 55.65 | 68.75 | .. |
| Manufacturing | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Services, etc. | 3.48 | 3.90 | 4.54 | 5.63 | 7.12 | 8.79 | 10.79 | 13.68 | 16.16 | 19.04 | 22.87 | 28.76 | 48.52 | 63.67 | 80.55 | 98.05 | 120.27 | .. |
| Resource Balance | -0.44 | -0.74 | -0.53 | -0.62 | -1.96 | -1.48 | -1.24 | -1.44 | -2.37 | -3.55 | -4.28 | -7.80 | 2.85 | -0.96 | -1.34 | -2.93 | 2.92 | .. |
| Domestic Absorption | 6.97 | 7.68 | 8.74 | 10.78 | 15.17 | 18.23 | 21.92 | 27.77 | 32.56 | 38.14 | 45.69 | 59.71 | 94.66 | 130.28 | 164.35 | 195.36 | 235.54 | 282.54 |
| Consumption | 5.63 | 6.14 | 6.93 | 8.34 | 11.64 | 14.59 | 17.03 | 21.38 | 25.48 | 29.39 | 34.69 | 43.33 | 70.59 | 99.01 | 125.05 | 150.52 | 180.35 | 219.81 |
| Gross Domestic Investment | 1.34 | 1.74 | 1.81 | 2.44 | 3.53 | 3.64 | 4.89 | 6.39 | 7.08 | 8.75 | 11.00 | 16.58 | 24.07 | 31.27 | 39.80 | 44.84 | 55.19 | 66.81 |
| Fixed Investment | 1.27 | 1.68 | 1.80 | 2.25 | 3.17 | 3.69 | 4.85 | 6.09 | 6.95 | 8.05 | 9.99 | 13.74 | 19.81 | 23.27 | 33.60 | 37.31 | 45.52 | 59.71 |
| Memo Items | | | | | | | | | | | | | | | | | | |
| Gross Domestic Saving | 0.90 | 1.00 | 1.28 | 1.62 | 1.68 | 2.21 | 3.65 | 4.95 | 4.71 | 5.20 | 6.72 | 13.77 | 26.92 | 30.31 | 37.96 | 41.91 | 58.11 | .. |
| Gross National Saving | 0.85 | 0.95 | 1.07 | 1.55 | 1.32 | 1.77 | 3.17 | 4.46 | 3.98 | 4.03 | 4.90 | 7.93 | 11.94 | 17.58 | 20.82 | 27.60 | 49.32 | .. |
| | (Billions of 1980 Costa Rican Colones) | | | | | | | | | | | | | | | | | |
| Gross National Product | 23.76 | 25.37 | 27.04 | 29.26 | 30.98 | 31.33 | 32.92 | 35.95 | 37.97 | 39.54 | 39.42 | 37.84 | 34.06 | 35.64 | 38.79 | 39.13 | 41.01 | .. |
| DOMESTIC GDP DEFLATOR | 27.10 | 27.80 | 29.60 | 34.00 | 42.00 | 52.30 | 61.10 | 71.40 | 77.10 | 84.20 | 100.00 | 141.10 | 259.00 | 334.20 | 390.70 | 458.80 | 543.50 | 632.63 |
| MONETARY HOLDINGS | | | | | | | | | | | | | | | | | | |
| | (Billions of current Costa Rican Colones) | | | | | | | | | | | | | | | | | |
| Money Supply, Broadly defined | 1.28 | 1.81 | 2.17 | 2.64 | 3.45 | 4.90 | 6.59 | 8.66 | 11.07 | 14.87 | 17.24 | 23.27 | 40.99 | 56.14 | 65.76 | 76.00 | 92.16 | 136.13 |
| Money as Means of Payment | 1.01 | 1.32 | 1.50 | 1.87 | 2.15 | 2.77 | 3.41 | 4.50 | 5.62 | 6.23 | 7.27 | 10.83 | 18.45 | 25.62 | 30.13 | 32.44 | 42.49 | 52.23 |
| BALANCE OF PAYMENTS | | | | | | | | | | | | | | | | | | |
| | (Millions of current US dollars) | | | | | | | | | | | | | | | | | |
| Exports of Goods & Services | 277.90 | 281.40 | 344.20 | 418.80 | 539.60 | 600.50 | 710.60 | 969.10 | 1025.00 | 1111.30 | 1218.60 | 1199.30 | 1143.40 | 1172.60 | 1313.70 | 1270.20 | 1435.50 | 1527.37 |
| Exports of goods & MF Services | 278.90 | 280.70 | 342.90 | 416.20 | 535.40 | 598.30 | 704.90 | 958.70 | 1007.70 | 1098.20 | 1197.80 | 1175.50 | 1116.70 | 1132.70 | 1276.00 | 1220.40 | 1388.50 | .. |
| Factor Services | 1.00 | 0.70 | 1.30 | 2.60 | 4.20 | 4.20 | 5.70 | 10.40 | 17.30 | 13.10 | 20.80 | 23.80 | 26.70 | 39.90 | 37.70 | 49.80 | 47.00 | .. |
| Imports of Goods & Services | 357.90 | 403.30 | 450.80 | 537.90 | 815.40 | 827.80 | 925.20 | 1210.50 | 1404.80 | 1681.70 | 1897.00 | 1639.10 | 1451.00 | 1527.60 | 1609.50 | 1618.70 | 1681.50 | 1850.91 |
| Imports of Goods & MF Services | 341.10 | 385.50 | 411.90 | 494.60 | 769.50 | 757.60 | 843.90 | 1120.40 | 1274.20 | 1518.90 | 1657.70 | 1304.00 | 1042.40 | 1147.70 | 1251.70 | 1278.80 | 1337.30 | .. |
| Factor Services | 16.80 | 17.80 | 38.90 | 43.40 | 45.90 | 70.20 | 81.30 | 90.10 | 130.60 | 162.80 | 239.30 | 335.10 | 408.60 | 379.90 | 357.80 | 339.90 | 324.20 | .. |
| Long-Term Interest | 14.20 | 15.30 | 17.70 | 23.70 | 31.10 | 36.80 | 40.90 | 51.40 | 84.60 | 116.00 | 170.50 | 135.10 | 109.00 | 528.90 | 243.30 | 341.80 | 217.10 | .. |
| Current Transfers, net | 5.90 | 7.40 | 6.60 | 6.90 | 9.60 | 9.60 | 13.20 | 15.80 | 16.60 | 12.20 | 19.70 | 27.20 | 29.60 | 23.00 | 31.90 | 43.40 | 128.50 | .. |
| Current Account Balance | -74.10 | -114.50 | -100.00 | -112.20 | -266.20 | -217.70 | -201.40 | -225.60 | -363.20 | -558.20 | -658.70 | -412.60 | -278.00 | -332.00 | -263.90 | -305.10 | -99.50 | .. |
| Long-Term Capital, net | 43.80 | 57.10 | 80.10 | 92.40 | 135.90 | 238.00 | 217.40 | 298.80 | 352.70 | 354.70 | 397.00 | 217.50 | 28.40 | 1221.30 | 176.40 | 519.00 | -34.50 | .. |
| Direct Investment | 26.40 | 22.10 | 25.80 | 37.70 | 46.30 | 69.00 | 60.70 | 82.50 | 47.00 | 42.40 | 48.10 | 66.20 | 26.50 | 65.30 | 52.00 | 65.20 | 62.00 | .. |
| Official Capital Grants | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | -5.20 | -0.10 | 6.30 | 46.00 | 109.00 | 175.60 | .. | |
| Long Term Loans | 18.90 | 35.20 | 53.20 | 61.20 | 83.40 | 157.60 | 156.20 | 247.50 | 211.80 | 198.60 | 369.40 | 187.90 | 122.70 | 292.60 | 99.80 | 168.90 | -8.10 | .. |
| Disbursements | 59.90 | 78.20 | 103.40 | 118.10 | 157.60 | 280.00 | 275.90 | 399.00 | 515.20 | 484.80 | 532.50 | 366.00 | 243.50 | 429.70 | 238.40 | 310.80 | 169.40 | .. |
| Repayments | 41.00 | 43.00 | 50.20 | 56.90 | 74.20 | 102.20 | 119.70 | 151.50 | 303.90 | 266.20 | 163.10 | 178.10 | 120.80 | 137.10 | 138.60 | 141.90 | 197.50 | .. |
| Other Long-Term Capital | -1.50 | -0.20 | 1.10 | -6.50 | 6.20 | 11.20 | 0.50 | -11.20 | 94.40 | 113.70 | -15.30 | -36.60 | -127.10 | 827.40 | -84.40 | 109.30 | -88.40 | .. |
| Other Capital, net | 15.00 | 63.50 | 23.60 | 46.10 | 79.50 | -18.20 | 35.80 | 35.10 | -13.30 | 120.70 | 222.10 | 120.50 | 354.20 | -823.20 | 79.50 | -79.50 | 219.50 | .. |
| Change in Reserves | 15.30 | -6.10 | -3.70 | -26.30 | 50.80 | -2.10 | -51.80 | -108.30 | 23.80 | 82.80 | 39.60 | 71.60 | -109.60 | -68.70 | 6.00 | -134.40 | -85.50 | .. |
| Memo Items: | | | | | | | | | | | | | | | | | | |
| Int'l Reserves Excluding Gold | 14.20 | 27.20 | 40.60 | 48.50 | 42.10 | 48.80 | 95.40 | 100.50 | 193.90 | 118.60 | 145.60 | 131.40 | 226.10 | 311.30 | 405.00 | 506.40 | 523.40 | .. |
| Conversion Factor (Annual Avg) | 6.63 | 6.63 | 6.64 | 6.65 | 7.93 | 8.57 | 8.57 | 8.57 | 8.57 | 8.57 | 8.57 | 21.76 | 37.41 | 41.09 | 44.53 | 50.45 | 55.99 | .. |
| | (Millions of US dollars, outstanding at end of year) | | | | | | | | | | | | | | | | | |
| EXTERNAL DEBT | 246.10 | 282.50 | 339.30 | 401.30 | 508.50 | 684.40 | 842.70 | 1317.20 | 1679.00 | 2109.70 | 2735.50 | 3220.50 | 3449.30 | 4246.30 | 4030.90 | 4433.60 | 4452.90 | .. |
| Public/Publicly Guar. Long-Term | 134.20 | 168.90 | 207.30 | 248.80 | 303.20 | 421.00 | 541.90 | 732.60 | 946.80 | 1300.60 | 1691.70 | 2210.40 | 2428.20 | 3226.20 | 3289.50 | 3579.50 | 3582.10 | .. |
| SOCIAL INDICATORS | | | | | | | | | | | | | | | | | | |
| Infant Mortality Rate | 61.50 | 56.50 | 54.40 | 44.80 | 37.50 | 37.80 | 33.10 | 27.90 | 23.80 | 23.30 | 20.10 | 17.90 | 19.30 | 19.20 | 19.10 | 19.00 | .. | .. |
| Life Expectancy at Birth | 66.90 | 67.40 | 67.90 | 68.40 | 69.10 | 69.80 | 70.40 | 71.10 | 71.60 | 71.90 | 72.20 | 72.60 | 73.00 | 73.20 | 73.30 | 73.50 | .. | .. |
| Food Production, p.c. ('79-81=100) | 96.70 | 100.90 | 102.50 | 103.80 | 98.20 | 107.10 | 107.50 | 106.40 | 104.60 | 105.10 | 98.60 | 76.40 | 89.00 | 89.20 | 91.20 | 91.70 | 92.40 | .. |
| Labor Force, Agriculture (%) | 42.60 | 41.40 | 40.20 | 39.00 | 37.80 | 36.60 | 35.40 | 34.30 | 33.10 | 32.00 | 30.80 | .. | .. | .. | .. | .. | .. | .. |
| School Enroll. Ratio, primary | 110.00 | .. | .. | .. | .. | .. | 107.00 | 108.00 | 109.00 | 107.00 | 107.00 | 106.00 | 106.00 | 103.00 | 102.00 | 101.00 | 101.00 | .. |

Source: The World Bank: World Tables, 1987 Washington, 1988.

a/ Estimates from ECLAC/CEPAL data.

b/ GDP by industrial origin data for at least some years are in purchaser values and not at factor cost.

Table C.2

EL SALVADOR: MACROECONOMIC ACCOUNTS

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987a/ |
|---|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|----------|----------|----------|----------|----------|
| CURRENT GNP PER CAPITA (US\$) b/ | 298.00 | 300.00 | 310.00 | 340.00 | 380.00 | 440.00 | 500.00 | 590.00 | 700.00 | 780.00 | 750.00 | 750.00 | 740.00 | 750.00 | 800.00 | 820.00 | 820.00 | .. |
| POPULATION (THOUSANDS) | 3568.00 | 3682.00 | 3779.00 | 3878.00 | 3980.00 | 4085.00 | 4189.00 | 4256.00 | 4344.00 | 4433.00 | 4525.00 | 4573.00 | 4621.00 | 4669.00 | 4718 | 4768 | 4863 | .. |
| ORIGIN AND USE OF RESOURCES | (Millions of current Salvadoran Colones) | | | | | | | | | | | | | | | | | |
| Gross National Product (GNP) | 2549.00 | 2679.00 | 2855.00 | 3294.00 | 3891.00 | 4412.00 | 5689.00 | 7095.00 | 7522.00 | 8547.00 | 8789.00 | 8427.00 | 8660.00 | 9735.00 | 11068.00 | 13519.00 | 19220.00 | .. |
| Gross Domestic Product (GDP) | 2571.00 | 2704.00 | 2882.00 | 3332.00 | 3944.00 | 4478.00 | 5706.00 | 7167.00 | 7692.00 | 8607.00 | 8917.00 | 8647.00 | 8966.00 | 10092.00 | 11474.00 | 14018.00 | 19895.00 | 24413.07 |
| Indirect Taxes Net | 198.00 | 199.00 | 223.00 | 268.00 | 329.00 | 353.00 | 582.00 | 948.00 | 645.00 | 855.00 | 842.00 | 661.00 | .. | .. | .. | .. | .. | .. |
| GDP at factor cost c/ | 2375.00 | 2505.00 | 2659.00 | 3064.00 | 3615.00 | 4125.00 | 5144.00 | 6319.00 | 7047.00 | 7752.00 | 8275.00 | 7986.00 | .. | .. | .. | .. | .. | .. |
| Agriculture | 781.00 | 729.00 | 728.00 | 922.00 | 999.00 | 1028.00 | 1614.00 | 2374.00 | 2049.00 | 2508.00 | 2480.00 | 2106.00 | 2075.00 | 2160.00 | 2355.00 | 2814.00 | 4037.00 | .. |
| Industry | 600.00 | 644.00 | 712.00 | 769.00 | 915.00 | 1115.00 | 1246.00 | 1486.00 | 1664.00 | 1851.00 | 1846.00 | 1847.00 | 1896.00 | 2175.00 | 2455.00 | 3032.00 | 4115.00 | .. |
| Manufacturing | 485.00 | 519.00 | 563.00 | 611.00 | 707.00 | 831.00 | 983.00 | 1047.00 | 1205.00 | 1338.00 | 1339.00 | 1359.00 | 1382.00 | 1572.00 | 1791.00 | 2196.00 | 3080.00 | .. |
| Services, etc. | 1240.00 | 1381.00 | 1442.00 | 1640.00 | 2030.00 | 2335.00 | 2845.00 | 3304.00 | 3979.00 | 4248.00 | 4591.00 | 4693.00 | 4995.00 | 5757.00 | 6664.00 | 8370.00 | 11742.00 | .. |
| Resource Balance | 8.00 | -80.00 | 32.00 | -94.00 | -332.00 | -228.00 | 21.00 | 82.00 | -713.00 | -15.00 | 82.00 | -527.00 | -454.00 | -485.00 | -789.00 | -659.00 | -1240.00 | .. |
| Domestic Absorption | 2563.00 | 2754.00 | 2850.00 | 3425.00 | 4275.00 | 4706.00 | 5885.00 | 7105.00 | 8405.00 | 8622.00 | 8835.00 | 9173.00 | 9420.00 | 10577.00 | 12263.00 | 14978.00 | 21185.00 | 25055.00 |
| Consumption | 2232.00 | 2332.00 | 2442.00 | 2916.00 | 3363.00 | 3715.00 | 4585.00 | 5426.00 | 6571.00 | 7066.00 | 7552.00 | 7942.00 | 8235.00 | 9235.00 | 10657.00 | 13188.00 | 18498.00 | 21898.78 |
| Gross Domestic Investment | 331.00 | 421.00 | 408.00 | 609.00 | 892.00 | 991.00 | 1120.00 | 1679.00 | 1834.00 | 1566.00 | 1183.00 | 1231.00 | 1185.00 | 1342.00 | 1698.00 | 1787.00 | 2899.00 | 3158.24 |
| Fixed Investment | 298.00 | 381.00 | 474.00 | 621.00 | 719.00 | 1031.00 | 1148.00 | 1520.00 | 1852.00 | 1512.00 | 1210.00 | 1173.00 | 1131.00 | 1275.00 | 1533.00 | 1950.00 | 2580.00 | .. |
| Netto Items | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Gross Domestic Saving | 339.00 | 372.00 | 440.00 | 515.00 | 561.00 | 762.00 | 1140.00 | 1740.00 | 1122.00 | 1541.00 | 1265.00 | 704.00 | 731.00 | 857.00 | 817.00 | 827.00 | 1399.00 | .. |
| Gross National Saving | 353.00 | 390.00 | 443.00 | 512.00 | 564.00 | 765.00 | 1196.00 | 1757.00 | 1120.00 | 1609.00 | 1260.00 | 636.00 | 652.00 | 1179.00 | 1180.00 | 1189.00 | 2878.00 | .. |
| Gross National Product | (Millions of 1980 Salvadoran Colones) | | | | | | | | | | | | | | | | | |
| | 6454.00 | 6752.00 | 7109.00 | 7452.00 | 7925.00 | 8340.00 | 8743.00 | 9174.00 | 9731.00 | 9674.00 | 8789.00 | 7992.00 | 7487.00 | 7531.00 | 7645.00 | 7750.00 | 7922.00 | .. |
| DOMESTIC GDP DEFLATOR | 39.50 | 39.70 | 40.20 | 44.20 | 49.10 | 53.00 | 55.10 | 77.20 | 77.70 | 88.30 | 100.00 | 105.60 | 115.90 | 129.60 | 145.10 | 174.90 | 242.80 | 347.31 |
| MONEY HOLDINGS | (Millions of current Salvadoran Colones) | | | | | | | | | | | | | | | | | |
| Money Supply, Broadly defined | 598.00 | 658.00 | 807.00 | 958.00 | 1116.00 | 1353.00 | 1770.00 | 2004.00 | 2241.00 | 2478.00 | 2583.00 | 2834.00 | 3316.00 | 3637.00 | 4366.00 | 5558.00 | 7194.00 | 9223.52 |
| Money as Means of Payment | 295.00 | 315.00 | 390.00 | 466.00 | 567.00 | 648.00 | 917.00 | 988.00 | 1087.00 | 1321.00 | 1429.00 | 1437.00 | 1717.00 | 1657.00 | 1961.00 | 2488.00 | 3047.00 | 3804.24 |
| BALANCE OF PAYMENTS | (Millions of current US dollars) | | | | | | | | | | | | | | | | | |
| Exports of Goods & Services | 260.50 | 271.40 | 339.30 | 402.30 | 518.70 | 600.00 | 899.70 | 1128.30 | 959.70 | 1355.70 | 1270.80 | 970.30 | 672.40 | 908.40 | 954.20 | 951.50 | 1009.10 | 898.84 |
| Exports of goods & MF Services | 255.90 | 267.60 | 335.80 | 397.90 | 513.60 | 593.30 | 862.10 | 1088.50 | 923.10 | 1265.60 | 1215.40 | 924.40 | 622.60 | 873.30 | 893.50 | 905.80 | 990.10 | .. |
| Factor Services | 4.60 | 3.80 | 3.50 | 4.40 | 5.10 | 6.70 | 37.60 | 37.80 | 36.60 | 89.00 | 55.40 | 45.90 | 40.80 | 35.10 | 60.70 | 45.70 | 19.00 | .. |
| Imports of Goods & Services | 268.10 | 302.90 | 339.00 | 459.80 | 671.20 | 720.40 | 905.10 | 1135.10 | 1298.70 | 1385.70 | 1289.00 | 1281.00 | 1195.40 | 1216.90 | 1315.50 | 1328.80 | 1401.30 | 1451.27 |
| Imports of Goods & MF Services | 251.90 | 288.50 | 322.80 | 439.30 | 631.40 | 673.40 | 832.30 | 1069.60 | 1207.90 | 1255.30 | 1170.30 | 1161.00 | 1040.40 | 1060.70 | 1153.50 | 1184.50 | 1247.30 | .. |
| Factor Services | 14.20 | 14.40 | 16.20 | 20.50 | 39.80 | 47.00 | 52.80 | 65.50 | 89.60 | 130.40 | 118.70 | 120.00 | 155.00 | 158.20 | 182.00 | 139.30 | 154.00 | .. |
| Long-Term Interest | 9.30 | 9.70 | 11.00 | 14.60 | 18.80 | 18.80 | 26.30 | 31.20 | 37.10 | 41.20 | 35.50 | 39.10 | 44.00 | 67.40 | 74.00 | 75.50 | 74.80 | .. |
| Current Transfers, net | 14.90 | 17.30 | 12.10 | 13.60 | 18.30 | 27.40 | 29.20 | 39.50 | 51.30 | 51.50 | 48.90 | 60.40 | 170.80 | 271.50 | 307.50 | 343.60 | 430.80 | .. |
| Current Account Balance | 8.70 | -1.20 | 12.40 | -43.90 | -134.20 | -93.00 | 23.80 | 30.70 | -285.70 | 21.30 | 30.70 | -250.30 | -182.20 | -37.00 | -53.80 | -28.70 | 88.80 | -23.84 |
| Long-Term Capital, net | 6.00 | 21.10 | 62.20 | 37.00 | 193.10 | 128.70 | 72.70 | 88.40 | 175.90 | 78.30 | 174.30 | 165.60 | 169.30 | 316.70 | 63.90 | 99.40 | 78.40 | .. |
| Direct Investment | 3.70 | 7.00 | 6.60 | 6.00 | 20.10 | 13.10 | 12.90 | 18.70 | 23.40 | -9.90 | 5.90 | -5.80 | -1.00 | 28.10 | 12.40 | 12.40 | .. | .. |
| Official Capital Grants | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Long Term Loans | 9.00 | 18.60 | 46.70 | 3.40 | 94.10 | 52.60 | 73.60 | 41.90 | 77.60 | 27.10 | 99.00 | 198.50 | 230.90 | 322.30 | 61.40 | 44.80 | 9.10 | .. |
| Disbursements | 31.20 | 48.30 | 73.80 | 46.50 | 140.40 | 132.30 | 134.80 | 136.50 | 136.20 | 90.00 | 125.00 | 238.20 | 285.40 | 429.00 | 211.00 | 182.70 | 144.40 | .. |
| Repayments | 22.20 | 29.70 | 27.10 | 43.20 | 46.30 | 79.70 | 61.20 | 94.60 | 80.00 | 62.90 | 35.10 | 37.70 | 54.50 | 107.60 | 129.60 | 138.40 | 125.30 | .. |
| Other Long-Term Capital | -6.70 | -4.50 | 8.90 | 27.70 | 78.90 | 73.00 | -13.60 | -22.20 | 74.90 | 61.10 | 68.60 | -7.10 | -40.60 | -33.70 | -9.90 | 42.70 | 69.30 | .. |
| Other Capital, net | -12.50 | -13.60 | -59.50 | -3.50 | -44.20 | -16.10 | -12.10 | -26.30 | 165.30 | -233.50 | -285.90 | -19.30 | -29.50 | -250.50 | -37.30 | -49.80 | -73.50 | .. |
| Change in Reserves | -2.20 | 6.90 | -15.10 | 10.40 | -14.70 | -29.60 | -84.40 | -40.80 | -55.50 | 133.90 | 80.90 | 84.00 | -7.60 | -29.20 | 7.20 | -20.90 | -43.50 | .. |
| Netto Items | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Int'l Reserves Excluding Gold | 45.40 | 46.20 | 63.00 | 41.30 | 77.00 | 107.00 | 185.40 | 211.20 | 268.10 | 142.60 | 77.70 | 71.90 | 108.50 | 160.20 | 165.80 | 179.80 | 169.70 | .. |
| Conversion Factor (Annual Avg) | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.57 | 2.73 | 2.82 | 3.67 | 5.00 | .. |
| EXTERNAL DEBT | (Millions of US dollars, outstanding at end of year) | | | | | | | | | | | | | | | | | |
| Public/Publicly Quar. Long-Term | 182.50 | 208.20 | 252.00 | 244.40 | 360.40 | 412.30 | 480.40 | 723.30 | 913.30 | 899.90 | 914.80 | 983.10 | 1289.10 | 1691.90 | 1710.50 | 1740.10 | 1679.50 | .. |
| | 87.70 | 92.70 | 109.10 | 108.80 | 178.80 | 198.90 | 282.60 | 266.00 | 333.70 | 411.30 | 527.40 | 727.30 | 975.70 | 1348.10 | 1388.90 | 1465.00 | 1463.20 | .. |
| SOCIAL INDICATORS | .. | | | | | | | | | | | | | | | | | |
| Infant Mortality Rate | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | 70.00 | 68.30 | .. | .. | .. |
| Life Expectancy at Birth | 57.50 | 58.10 | 58.80 | 59.30 | 59.70 | 60.20 | 60.60 | 61.00 | 61.60 | 62.30 | 63.00 | 63.70 | 64.80 | 64.90 | 65.40 | 63.60 | .. | .. |
| Food Production, p.c. ('79-81=100) | 95.60 | 97.40 | 87.20 | 99.70 | 98.70 | 105.60 | 102.10 | 100.50 | 110.50 | 109.40 | 99.90 | 90.70 | 82.00 | 83.90 | 91.70 | 88.60 | 88.70 | .. |
| Labor Force, Agriculture (M) | 58.00 | 54.70 | 55.40 | 52.00 | 50.70 | 49.40 | 48.20 | 46.90 | 45.70 | 44.40 | 43.20 | .. | .. | .. | .. | .. | .. | .. |
| School Enroll. Ratio, primary | 65.00 | .. | .. | .. | .. | 75.00 | .. | 76.00 | 78.00 | 79.00 | 74.00 | 61.00 | 68.00 | 68.00 | 69.00 | 70.00 | .. | .. |

Source: The World Bank: "World Tables, 1987", Washington, 1988.

a/ Estimates from ECLAC/CEPAL data.

b/ GNP per capita in US\$ is calculated using an alternative conversion factor.

c/ GDP by industrial origin data for at least some years are in purchaser values and not factor costs.

Table C.3

QUATZMALA: MACROECONOMIC ACCOUNTS

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987a/ |
|---|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|----------|----------|----------|----------|
| CURRENT GNP PER CAPITA (US\$) b/ | 260.00 | 280.00 | 300.00 | 430.00 | 500.00 | 570.00 | 680.00 | 790.00 | 910.00 | 1030.00 | 1120.00 | 1200.00 | 1190.00 | 1170.00 | 1180.00 | 1020.00 | 930.00 | 925.00 |
| POPULATION (THOUSANDS) | 5246.00 | 5393.00 | 5544.00 | 5699.00 | 5859.00 | 6022.00 | 6192.00 | 6366.00 | 6544.00 | 6728.00 | 6917.00 | 7113.00 | 7315.00 | 7524.00 | 7740.00 | 7963.00 | 8187.00 | .. |
| ORIGIN AND USE OF RESOURCES | (Millions of current Guatemalan Quetzales) | | | | | | | | | | | | | | | | | |
| Gross National Product (GNP) | 1662.00 | 1941.00 | 2054.00 | 2321.00 | 3112.00 | 3577.00 | 4302.00 | 5445.00 | 6044.00 | 6990.00 | 7808.00 | 8505.00 | 8708.00 | 9263.00 | 10834.00 | 15283.00 | 17241.18 | .. |
| Gross Domestic Product (GDP) | 1904.00 | 1965.00 | 2101.00 | 2599.00 | 3161.00 | 3645.00 | 4365.00 | 5401.00 | 6071.00 | 6903.00 | 7879.00 | 8607.00 | 8717.00 | 9050.00 | 9470.00 | 11129.00 | 15694.00 | 17947.79 |
| Indirect Taxes Net | 132.00 | 139.00 | 144.00 | 170.00 | 227.00 | 252.00 | 316.00 | 492.00 | 536.00 | 545.00 | 597.00 | 581.00 | 539.00 | 481.00 | 437.00 | 588.00 | .. | .. |
| GDP at factor cost c/ | 1772.00 | 1847.00 | 1956.00 | 2399.00 | 2935.00 | 3394.00 | 4049.00 | 4908.00 | 5535.00 | 6360.00 | 7282.00 | 8047.00 | 8178.00 | 8569.00 | 9033.00 | 10542.00 | .. | .. |
| Agriculture | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Industry | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Manufacturing | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Services, etc. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Resource Balance | 15.00 | -29.00 | 8.00 | 17.00 | -103.00 | -65.00 | -282.00 | -99.00 | -351.00 | -311.00 | -215.00 | -560.00 | -340.00 | -141.00 | -104.00 | -284.00 | .. | .. |
| Domestic Absorption | 989.00 | 2013.00 | 2093.00 | 2582.00 | 3264.00 | 3712.00 | 4626.00 | 5579.00 | 6422.00 | 7214.00 | 8094.00 | 8707.00 | 9067.00 | 9191.00 | 9664.00 | 11392.00 | .. | .. |
| Consumption | 115.00 | 1728.00 | 1838.00 | 2200.00 | 2876.00 | 3125.00 | 3994.00 | 4481.00 | 5110.00 | 5920.00 | 6844.00 | 7168.00 | 7824.00 | 8189.00 | 8585.00 | 10118.00 | .. | .. |
| Gross Domestic Investment | 144.00 | 285.00 | 255.00 | 382.00 | 588.00 | 587.00 | 634.00 | 1098.00 | 1312.00 | 1294.00 | 1250.00 | 1466.00 | 1233.00 | 1002.00 | 1079.00 | 1276.00 | .. | .. |
| Fixed Investment | 239.00 | 284.00 | 272.00 | 357.00 | 468.00 | 571.00 | 900.00 | 1039.00 | 1218.00 | 1288.00 | 1294.00 | 1443.00 | 1309.00 | 950.00 | 892.00 | 1237.00 | .. | .. |
| Memo Items | | | | | | | | | | | | | | | | | | |
| Gross Domestic Saving | 259.00 | 258.00 | 283.00 | 389.00 | 485.00 | 521.00 | 672.00 | 1000.00 | 961.00 | 983.00 | 1035.00 | 905.00 | 893.00 | 861.00 | 885.00 | 1012.00 | .. | .. |
| Gross National Saving | 235.00 | 239.00 | 245.00 | 363.00 | 490.00 | 530.00 | 797.00 | 1063.00 | 1050.00 | 1098.00 | 1074.00 | 894.00 | 838.00 | 776.00 | 707.00 | 738.00 | .. | .. |
| Gross National Product | 4468.00 | 4712.00 | 5057.00 | 5422.00 | 5780.00 | 5870.00 | 6322.00 | 6877.00 | 7220.00 | 7562.00 | 7808.00 | 7840.00 | 7551.00 | 7362.00 | 7347.00 | 7273.00 | 7279.00 | .. |
| (Millions of 1980 Guatemalan Quetzales) | | | | | | | | | | | | | | | | | | |
| DOMESTIC GDP DEFLATOR | 41.00 | 41.40 | 40.80 | 45.70 | 54.00 | 61.10 | 68.10 | 79.30 | 83.70 | 90.90 | 100.00 | 108.50 | 114.00 | 121.40 | 128.40 | 150.00 | 211.40 | 332.75 |
| MONETARY HOLDINGS | (Millions of current Guatemalan Quetzales) | | | | | | | | | | | | | | | | | |
| Money Supply, Broadly defined | 344.00 | 383.00 | 477.00 | 590.00 | 688.00 | 808.00 | 1052.00 | 1249.00 | 1434.00 | 1537.00 | 1692.00 | 1907.00 | 2191.00 | 2155.00 | 2399.00 | 3193.00 | 3875.00 | 4019.14 |
| Money as Means of Payment | 173.00 | 179.00 | 214.00 | 284.00 | 305.00 | 354.00 | 494.00 | 594.00 | 664.00 | 735.00 | 753.00 | 778.00 | 787.00 | 834.00 | 869.00 | 1347.00 | 1808.00 | 1979.31 |
| BALANCE OF PAYMENTS | (Millions of current US dollars) | | | | | | | | | | | | | | | | | |
| Exports of Goods & Services | 353.70 | 342.20 | 397.70 | 541.70 | 720.10 | 797.50 | 1007.70 | 1371.60 | 1354.00 | 1552.50 | 1632.90 | 1516.60 | 1310.20 | 1203.80 | 1261.10 | 1195.40 | 1202.30 | 1121.00 |
| Exports of goods & NFServices | 349.50 | 338.60 | 394.00 | 531.90 | 701.90 | 779.30 | 993.10 | 1332.60 | 1305.70 | 1479.70 | 1730.20 | 1413.30 | 1230.60 | 1169.70 | 1228.20 | 1162.30 | 1172.30 | .. |
| Factor Services | 4.20 | 5.60 | 3.70 | 9.80 | 18.20 | 14.60 | 39.00 | 48.30 | 73.20 | 102.70 | 106.30 | 79.60 | 34.10 | 32.90 | 33.10 | 30.00 | 25.60 | .. |
| Imports of Goods & Services | 370.10 | 416.70 | 439.20 | 576.40 | 878.60 | 941.00 | 1284.20 | 1499.10 | 1733.80 | 1884.10 | 2106.50 | 2195.80 | 1778.50 | 1480.70 | 1671.50 | 1455.60 | 1288.20 | 1490.00 |
| Imports of goods & NFServices | 336.70 | 371.20 | 389.90 | 520.70 | 812.50 | 860.40 | 1201.20 | 1423.70 | 1643.20 | 1794.00 | 1956.00 | 2029.30 | 1627.90 | 1314.40 | 1429.10 | 1257.60 | 1040.90 | .. |
| Factor Services | 42.40 | 45.50 | 49.30 | 55.70 | 66.10 | 80.60 | 83.00 | 75.40 | 90.60 | 100.10 | 148.50 | 166.50 | 148.60 | 148.30 | 242.40 | 196.00 | 247.30 | .. |
| Long-Term Interest | 6.90 | 8.60 | 8.70 | 10.30 | 11.10 | 12.40 | 14.70 | 19.90 | 32.70 | 48.20 | 59.60 | 63.40 | 78.80 | 88.90 | 95.30 | 115.90 | 155.60 | .. |
| Current Transfers, net | 17.50 | 25.30 | 30.00 | 42.40 | 55.40 | 77.80 | 198.80 | 95.70 | 115.40 | 126.80 | 109.70 | 91.00 | 62.70 | 30.50 | 28.80 | 19.80 | 74.50 | 191.00 |
| Current Account Balance | -7.90 | -49.20 | -11.50 | 7.70 | -103.10 | -65.70 | -77.70 | -31.80 | -264.40 | -205.00 | -163.90 | -588.20 | -403.60 | -223.40 | -381.60 | -240.40 | -11.40 | -368.00 |
| Long-Term Capital, net | 53.80 | 39.20 | 25.50 | 49.40 | 58.10 | 148.30 | 83.10 | 197.70 | 284.20 | 241.60 | 239.40 | 400.20 | 339.90 | 284.50 | 195.70 | 244.20 | 3.90 | 178.00 |
| Direct Investment | 29.40 | 28.60 | 15.90 | 34.80 | 47.40 | 80.00 | 12.50 | 97.40 | 127.50 | 117.10 | 110.80 | 127.60 | 78.30 | 44.90 | 38.00 | 60.80 | 67.30 | 73.00 |
| Official Capital Grants | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Long Term Loans | 21.10 | 13.80 | 5.30 | 28.20 | 29.30 | 49.70 | 45.10 | 108.70 | 156.20 | 184.00 | 92.40 | 279.70 | 278.70 | 224.90 | 92.00 | 111.00 | 25.30 | .. |
| Disbursements | 43.10 | 36.30 | 44.30 | 47.20 | 60.80 | 72.30 | 74.50 | 141.70 | 202.70 | 248.90 | 170.00 | 344.30 | 337.40 | 313.50 | 254.40 | 264.60 | 162.20 | .. |
| Repayments | 22.00 | 22.50 | 39.00 | 19.00 | 31.50 | 22.60 | 29.40 | 33.00 | 46.60 | 84.90 | 77.60 | 84.80 | 56.70 | 61.60 | 153.60 | 136.90 | .. | .. |
| Other Long-Term Capital | 3.10 | -3.20 | 4.30 | -13.60 | -18.60 | 16.60 | 25.50 | -8.40 | -19.60 | -59.50 | 35.20 | -7.10 | -15.10 | 14.70 | 85.70 | 72.40 | -88.70 | .. |
| Other Capital, net | -30.40 | 20.10 | 25.10 | 23.80 | 33.90 | 23.60 | 213.90 | 15.90 | 68.80 | -55.10 | -332.50 | -113.10 | 18.40 | -56.40 | 202.80 | 103.50 | 118.60 | .. |
| Change in Reserves | -15.30 | -10.10 | -39.10 | -80.90 | 11.10 | -104.20 | -219.80 | -181.80 | -68.60 | 18.50 | 256.00 | 301.10 | 45.30 | -1.70 | -16.90 | 107.30 | -109.10 | .. |
| Memo Items: | | | | | | | | | | | | | | | | | | |
| Int'l Reserves Excluding Gold | 60.80 | 74.70 | 116.20 | 191.30 | 181.30 | 283.80 | 491.00 | 688.90 | 741.50 | 698.30 | 444.70 | 149.70 | 112.20 | 210.00 | 274.40 | 300.90 | 362.10 | .. |
| Conversion Factor (Annual Avg) | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.70 | 2.10 | .. |
| (Guatemalan Quetzales per US dollar) | | | | | | | | | | | | | | | | | | |
| EXTERNAL DEBT | (Millions of US dollars, outstanding at end of year) | | | | | | | | | | | | | | | | | |
| Public/Publicly Quar. Long-Term | 120.30 | 134.30 | 139.60 | 165.90 | 195.20 | 243.30 | 286.60 | 632.00 | 813.00 | 1039.80 | 1165.90 | 1284.30 | 1537.10 | 1799.40 | 2378.50 | 2578.80 | 2601.00 | .. |
| .. | 108.30 | 113.70 | 109.10 | 115.90 | 120.20 | 143.30 | 168.60 | 217.00 | 304.00 | 426.60 | 548.90 | 806.60 | 1143.90 | 1388.10 | 1982.80 | 2131.50 | 2187.00 | .. |
| SOCIAL INDICATORS | | | | | | | | | | | | | | | | | | |
| Infant Mortality Rate | 100.20 | 97.60 | 95.00 | 92.40 | 89.80 | 87.20 | 84.60 | 82.00 | 79.60 | 77.20 | 74.60 | 72.40 | 70.00 | 68.30 | 66.70 | 65.00 | .. | .. |
| Life Expectancy at Birth | 52.10 | 52.80 | 53.60 | 54.30 | 54.70 | 55.20 | 55.70 | 56.20 | 56.70 | 57.20 | 57.70 | 58.20 | 58.60 | 59.30 | 59.80 | 60.20 | .. | .. |
| Food Production, p.c. ('79-81-100) | 93.90 | 93.60 | 96.60 | 99.60 | 98.20 | 102.30 | 103.70 | 103.70 | 101.70 | 99.10 | 99.50 | 101.40 | 105.40 | 101.70 | 99.70 | 97.30 | 93.90 | .. |
| Labor Force, Agriculture (3) | 61.30 | 60.90 | 67.40 | 60.00 | 59.50 | 59.10 | 58.60 | 58.20 | 57.70 | 57.30 | 56.80 | .. | .. | .. | .. | .. | .. | .. |
| School Enroll. Ratio, primary | 57.00 | .. | .. | .. | .. | 61.00 | 61.00 | 63.00 | 65.00 | 67.00 | 69.00 | 72.00 | 74.00 | 75.00 | 76.00 | .. | .. | .. |

Source: The World Bank "World Tables, 1987", Washington, 1988.

a/ Estimates from ECLAC/CEPAL data.

b/ GNP per capita in US\$ is calculated using an alternative conversion factor.

c/ GDP by industrial origin data for at least some years are in purchaser values and not at factor cost.

Table C.4

HONDURAS: MACROECONOMIC ACCOUNTS

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 ^{a/} | |
|--------------------------------------|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|--------------------|--|
| CURRENT GNP PER CAPITA (US\$) | 270.00 | 280.00 | 290.00 | 320.00 | 340.00 | 350.00 | 390.00 | 460.00 | 520.00 | 590.00 | 630.00 | 670.00 | 680.00 | 670.00 | 700.00 | 720.00 | 740.00 | .. | |
| POPULATION (THOUSANDS) | 2639.00 | 2724.00 | 2812.00 | 2903.00 | 2996.00 | 3093.00 | 3204.00 | 3320.00 | 3439.00 | 3563.00 | 3691.00 | 3822.00 | 3957.00 | 4094.00 | 4232.00 | 4383.00 | 4529.00 | 4656 | |
| ORIGIN AND USE OF RESOURCES | (Millions of current Honduran lempiras) | | | | | | | | | | | | | | | | | | |
| Gross National Product (GNP) | 1400.60 | 1501.60 | 1628.00 | 1828.00 | 2087.20 | 2163.40 | 2510.00 | 3122.00 | 3643.80 | 4137.20 | 4669.00 | 4986.40 | 5174.80 | 5583.40 | 5940.00 | 6334.80 | 6816.20 | .. | |
| Gross Domestic Product (GDP) | 1446.00 | 1551.00 | 1683.00 | 1895.00 | 2114.00 | 2241.00 | 2826.00 | 3320.00 | 3814.00 | 4378.00 | 4978.00 | 5293.00 | 5582.00 | 5901.00 | 6290.00 | 6724.00 | 7235.00 | 7757.6 | |
| Indirect Taxes Net | 139.00 | 143.00 | 151.00 | 169.00 | 199.00 | 219.00 | 286.00 | 413.00 | 413.00 | 496.00 | 544.00 | 502.00 | 564.00 | 618.00 | 698.00 | 808.00 | .. | .. | |
| GDP at factor cost | 1307.00 | 1408.00 | 1532.00 | 1726.00 | 1915.00 | 2022.00 | 2540.00 | 2907.00 | 3401.00 | 3882.00 | 4432.00 | 4891.00 | 5018.00 | 5283.00 | 5601.00 | 5919.00 | .. | .. | |
| Agriculture | 424.00 | 458.00 | 492.00 | 562.00 | 593.00 | 597.00 | 722.00 | 964.00 | 1048.00 | 1135.00 | 1263.00 | 1319.00 | 1381.00 | 1450.00 | 1527.00 | 1607.00 | .. | .. | |
| Industry | 290.00 | 307.00 | 331.00 | 387.00 | 466.00 | 512.00 | 570.00 | 682.00 | 845.00 | 1008.00 | 1142.00 | 1189.00 | 1284.00 | 1347.00 | 1442.00 | 1470.00 | .. | .. | |
| Manufacturing | 181.00 | 198.00 | 218.00 | 245.00 | 280.00 | 318.00 | 363.00 | 436.00 | 517.00 | 602.00 | 681.00 | 718.00 | 784.00 | 785.00 | 831.00 | 898.00 | .. | .. | |
| Services, etc. | 593.00 | 643.00 | 709.00 | 777.00 | 856.00 | 913.00 | 1048.00 | 1261.00 | 1508.00 | 1739.00 | 2027.00 | 2189.00 | 2383.00 | 2486.00 | 2632.00 | 2836.00 | .. | .. | |
| Resource Balance | -69.60 | -11.00 | 16.60 | -16.60 | -247.00 | -202.00 | -120.10 | -147.60 | -175.00 | -194.20 | -369.70 | -353.90 | -187.10 | -224.00 | -340.80 | -287.70 | .. | .. | |
| Domestic Absorption | 1535.60 | 1582.40 | 1646.40 | 1911.60 | 2361.00 | 2443.00 | 2746.10 | 3467.60 | 3969.00 | 4582.20 | 5345.70 | 5646.90 | 5749.10 | 6128.00 | 6439.80 | 7011.70 | 7370.6a | 7498.43 | |
| Consumption | 1233.60 | 1312.40 | 1410.40 | 1563.60 | 1819.00 | 2041.00 | 2297.30 | 2848.00 | 3001.90 | 3469.70 | 4054.40 | 4556.80 | 4943.10 | 5195.00 | 5384.80 | 5948.70 | 6313.6a | 6428.27 | |
| Gross Domestic Investment | 302.00 | 250.00 | 256.00 | 348.00 | 542.00 | 401.10 | 448.80 | 619.00 | 967.10 | 1092.50 | 1291.30 | 1090.10 | 806.00 | 930.00 | 1255.00 | 1183.00 | 1057.1a | 1070.16 | |
| Fixed Investment | 268.00 | 253.00 | 245.00 | 325.00 | 433.00 | 478.10 | 549.80 | 710.00 | 941.10 | 1003.50 | 1223.30 | 1016.10 | 947.00 | 1074.00 | 1198.00 | 1177.00 | .. | .. | |
| Nett Items: | | | | | | | | | | | | | | | | | | | |
| Gross Domestic Saving | 212.40 | 238.80 | 272.60 | 331.40 | 295.00 | 199.10 | 326.70 | 671.40 | 812.10 | 908.30 | 921.60 | 736.20 | 638.90 | 708.00 | 914.20 | 875.80 | .. | .. | |
| Gross National Saving | 166.40 | 202.80 | 230.60 | 279.80 | 333.40 | 176.70 | 239.30 | 561.70 | 678.20 | 708.30 | 657.60 | 484.30 | 291.50 | 477.30 | 715.10 | 736.10 | .. | .. | |
| Gross National Product | (Millions of 1980 Honduran lempiras) | | | | | | | | | | | | | | | | | | |
| | 3020.90 | 3179.00 | 3303.30 | 3480.00 | 3579.10 | 3427.90 | 3639.00 | 4036.20 | 4316.30 | 4588.90 | 4669.00 | 4748.00 | 4573.30 | 4653.90 | 4780.10 | 4900.80 | 5042.80 | .. | |
| DOMESTIC GDP DEFLATOR | 46.40 | 47.20 | 49.30 | 52.50 | 56.80 | 64.00 | 69.40 | 78.70 | 84.20 | 90.40 | 100.00 | 105.20 | 113.00 | 110.80 | 124.70 | 129.40 | 135.30 | 139.22 | |
| MONEY HOLDINGS | (Millions of current Honduran lempiras) | | | | | | | | | | | | | | | | | | |
| Money Supply, Broadly defined b/ | 300.30 | 333.10 | 378.50 | 460.60 | 474.40 | 532.00 | 692.60 | 839.40 | 1008.70 | 1107.20 | 1212.40 | 1321.00 | 1579.20 | 1651.70 | 2056.40 | 2011.20 | 2702.00 | 2992.18 | |
| Money as Means of Payment | 158.90 | 169.40 | 192.90 | 238.40 | 242.40 | 262.70 | 361.00 | 411.30 | 480.40 | 545.60 | 610.30 | 637.40 | 716.90 | 814.90 | 846.00 | 855.60 | 953.20 | 1156.41 | |
| BALANCE OF PAYMENTS | (Millions of current US dollars) | | | | | | | | | | | | | | | | | | |
| Exports of Goods & Services | 198.60 | 217.70 | 237.40 | 297.60 | 338.90 | 350.80 | 453.20 | 593.60 | 706.50 | 858.90 | 967.40 | 903.40 | 783.40 | 815.00 | 863.10 | 934.10 | 1029.20 | 977 | |
| Exports of goods & MF Services | 198.50 | 215.40 | 234.90 | 293.70 | 331.80 | 344.40 | 453.60 | 593.60 | 687.30 | 837.70 | 941.60 | 883.70 | 786.80 | 801.00 | 847.30 | 919.20 | 1016.10 | .. | |
| Factor Services | 2.30 | 2.30 | 2.50 | 3.90 | 5.10 | 6.40 | 9.60 | 13.20 | 19.20 | 21.20 | 25.80 | 19.70 | 16.60 | 14.00 | 15.80 | 14.90 | 13.10 | .. | |
| Imports of Goods & Services | 269.20 | 247.20 | 256.70 | 339.00 | 474.60 | 490.80 | 581.40 | 736.70 | 681.00 | 1071.70 | 1305.80 | 1233.40 | 1041.70 | 1078.70 | 1259.60 | 1268.20 | 1312.50 | 1345.81 | |
| Imports of goods & MF Services | 244.30 | 220.10 | 228.80 | 301.90 | 455.40 | 445.60 | 514.00 | 654.90 | 776.60 | 996.50 | 1128.60 | 1080.70 | 822.90 | 912.40 | 1068.00 | 1063.00 | 1089.00 | .. | |
| Factor Services | 24.90 | 27.10 | 27.90 | 37.10 | 19.20 | 35.20 | 67.40 | 81.80 | 104.40 | 141.20 | 179.20 | 172.70 | 218.80 | 166.30 | 193.60 | 205.20 | 223.50 | .. | |
| Long-Term Interest | 3.70 | 5.00 | 6.50 | 9.60 | 12.10 | 16.30 | 21.80 | 30.60 | 43.10 | 60.00 | 63.50 | 96.30 | 112.60 | 97.90 | 90.20 | 104.50 | 117.20 | .. | |
| Current Transfers, net | 6.60 | 6.60 | 6.50 | 6.90 | 32.60 | 17.60 | 13.30 | 14.10 | 17.20 | 20.40 | 21.60 | 27.40 | 29.90 | 44.50 | 80.00 | 123.50 | 126.70 | .. | |
| Current Account Balance | -63.60 | -22.70 | -12.60 | -34.50 | -105.10 | -112.40 | -104.90 | -128.80 | -157.30 | -192.40 | -316.60 | -302.60 | -228.40 | -219.20 | -316.50 | -210.60 | -154.60 | -214 | |
| Long-Term Capital, net | 40.10 | 35.30 | 23.50 | 32.30 | 63.10 | 131.50 | 103.60 | 148.70 | 175.70 | 180.00 | 266.20 | 209.30 | 169.30 | 147.70 | 274.20 | 252.90 | 96.50 | .. | |
| Direct Investment | 8.40 | 7.30 | 3.00 | 6.60 | -1.20 | 7.00 | 5.20 | 6.90 | 13.10 | 28.20 | 5.90 | -3.70 | 13.60 | 21.00 | 20.50 | 27.50 | 30.00 | 36 | |
| Official Capital-Grants | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | |
| Long Term Loans | 32.20 | 29.40 | 24.70 | 4.20 | 67.60 | 98.60 | 98.20 | 139.50 | 181.90 | 159.60 | 263.60 | 216.10 | 146.50 | 198.00 | 220.10 | 285.00 | 115.40 | .. | |
| Disbursements | 38.50 | 37.80 | 37.70 | 20.90 | 89.20 | 127.80 | 135.70 | 199.70 | 236.30 | 278.70 | 351.10 | 313.90 | 238.90 | 278.90 | 303.90 | 369.60 | 224.30 | .. | |
| Repayments | 6.30 | 8.40 | 13.00 | 16.70 | 21.60 | 29.70 | 37.50 | 60.20 | 74.40 | 119.10 | 87.50 | 97.80 | 92.40 | 80.90 | 83.80 | 84.30 | 108.90 | .. | |
| Other Long-Term Capital | -0.50 | -1.40 | -4.20 | 21.50 | -3.30 | 26.70 | 0.40 | 0.30 | 0.70 | -7.80 | -3.30 | -3.10 | 5.00 | -71.30 | 33.80 | -54.90 | -46.90 | .. | |
| Other Capital, net | 11.40 | -13.50 | 1.00 | 10.70 | 23.90 | 34.60 | 38.70 | 46.80 | -8.80 | 32.20 | -27.30 | 19.50 | 5.60 | 28.10 | 27.20 | -30.90 | 84.60 | .. | |
| Change in Reserves | 12.30 | 0.90 | -11.70 | -8.50 | 16.40 | -53.70 | -37.60 | -66.20 | -0.60 | -19.80 | 77.90 | 73.80 | 54.50 | 43.40 | 15.10 | -11.40 | -26.50 | .. | |
| Nett Items: | | | | | | | | | | | | | | | | | | | |
| Int'l Reserves Excluding Gold | 20.10 | 21.80 | 35.10 | 41.70 | 44.30 | 97.00 | 130.80 | 179.80 | 184.40 | 209.20 | 149.80 | 101.00 | 112.20 | 113.60 | 128.20 | 105.80 | 111.30 | .. | |
| Conversion Factor (Annual Avg) | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | .. | |
| EXTERNAL DEBT | (Millions of US dollars, outstanding at end of year) | | | | | | | | | | | | | | | | | | |
| Public/Publicly Guar. Long-Term | 109.40 | 138.50 | 163.90 | 196.00 | 2281.10 | 379.60 | 478.00 | 732.50 | 932.50 | 1182.00 | 1467.20 | 1690.70 | 1798.80 | 2084.40 | 2321.10 | 2711.10 | 2862.90 | .. | |
| | 90.20 | 102.20 | 119.30 | 138.60 | 171.40 | 284.20 | 344.10 | 457.60 | 594.50 | 760.10 | 969.10 | 1231.30 | 1386.30 | 1612.00 | 1854.20 | 2177.00 | 2341.60 | .. | |
| SOCIAL INDICATORS | | | | | | | | | | | | | | | | | | | |
| Infant Mortality Rate | 115.20 | 112.60 | 110.00 | 107.00 | 104.00 | 101.00 | 98.00 | 95.00 | 92.40 | 89.80 | 87.20 | 84.60 | 82.00 | 80.00 | 78.00 | 76.00 | .. | .. | |
| Life Expectancy at Birth | 52.50 | 53.10 | 53.80 | 54.40 | 55.00 | 55.60 | 56.20 | 56.80 | 57.40 | 57.90 | 58.50 | 59.10 | 59.60 | 60.10 | 60.60 | 62.00 | .. | .. | |
| Food Production, p.c. ('79-81=100) | 108.50 | 113.00 | 114.90 | 108.20 | 99.20 | 88.60 | 94.40 | 99.10 | 103.30 | 94.70 | 101.60 | 103.70 | 95.60 | 86.70 | 83.60 | 84.90 | 88.40 | .. | |
| Labor Force, Agriculture (M) | 64.90 | 64.50 | 64.00 | 63.60 | 63.10 | 62.70 | 62.30 | 61.80 | 61.40 | 60.90 | 60.50 | .. | .. | .. | .. | .. | .. | .. | |
| School Enroll. Ratio, primary | 87.00 | .. | .. | .. | .. | 88.00 | 88.00 | .. | 89.00 | 89.00 | 95.00 | 94.00 | 99.00 | 101.00 | 102.00 | 102.00 | .. | .. | |

Source: The World Bank: "World Tables, 1987", Washington, 1988.

a/ Estimates from ECLAC/CEPAL data.

b/ Money supply reflects total liquid liabilities.

Table C.5

NICARAGUA: MACROECONOMIC ACCOUNTS

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 ^{a/} |
|---|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|--------------------|
| CURRENT GNP PER CAPITA (US\$) b/ | 380.00 | 390.00 | 400.00 | 430.00 | 560.00 | 650.00 | 710.00 | 750.00 | 730.00 | 580.00 | 690.00 | 760.00 | 800.00 | 820.00 | 800.00 | 770.00 | 770.00 | .. |
| POPULATION (THOUSANDS) | 2053.00 | 2120.00 | 2188.00 | 2259.00 | 2332.00 | 2403.00 | 2477.00 | 2547.00 | 2620.00 | 2694.00 | 2771.00 | 2864.00 | 2955.00 | 3056.00 | 3162.00 | 3272.00 | 3378.00 | .. |
| ORIGIN AND USE OF RESOURCES | (Billions of current Nicaraguan Cordobas) | | | | | | | | | | | | | | | | | |
| Gross National Product (GNP) | 5.26 | 5.66 | 5.93 | 7.31 | 10.19 | 10.73 | 12.44 | 14.24 | 13.36 | 13.80 | 20.54 | 23.08 | 26.58 | 31.09 | 42.71 | 107.09 | 404.36 | .. |
| Gross Domestic Product (GDP) | 5.44 | 5.79 | 6.17 | 7.65 | 10.65 | 11.14 | 12.94 | 14.78 | 14.08 | 14.51 | 21.89 | 24.48 | 28.35 | 32.87 | 45.02 | 115.41 | 435.74 | 4403.65 |
| Indirect Taxes Net | 0.46 | 0.50 | 0.53 | 0.76 | 1.07 | 1.03 | 1.20 | 1.49 | 1.34 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| GDP at factor cost c/ | 4.98 | 5.28 | 5.64 | 6.89 | 9.58 | 10.11 | 11.73 | 13.27 | 12.75 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Agriculture | 1.35 | 1.43 | 1.53 | 1.89 | 2.57 | 2.49 | 2.92 | 3.59 | 3.70 | 4.11 | 4.95 | 4.96 | 5.91 | 7.57 | 11.00 | 26.15 | .. | .. |
| Industry | 1.40 | 1.52 | 1.67 | 2.05 | 2.94 | 3.28 | 3.65 | 4.21 | 4.07 | 4.15 | 6.61 | 8.05 | 9.13 | 10.10 | 14.36 | 38.52 | .. | .. |
| Manufacturing | 1.11 | 1.21 | 1.31 | 1.62 | 2.16 | 2.46 | 2.69 | 3.08 | 3.24 | 3.57 | 5.49 | 6.53 | 7.47 | 7.97 | 11.43 | 31.74 | .. | .. |
| Services, etc. | 2.68 | 2.64 | 2.97 | 3.71 | 5.13 | 5.38 | 6.36 | 6.95 | 6.31 | 6.25 | 10.14 | 11.48 | 13.32 | 15.20 | 19.66 | 50.73 | .. | .. |
| Resource Balance | -0.13 | -0.13 | 0.35 | -0.73 | -1.44 | -0.99 | 0.15 | -0.84 | 0.47 | 2.02 | -3.96 | -4.97 | -4.27 | -5.72 | -7.92 | -24.13 | .. | .. |
| Domestic Absorption | 5.57 | 5.92 | 5.82 | 6.39 | 12.09 | 12.13 | 12.79 | 15.59 | 13.60 | 12.50 | 25.85 | 29.45 | 32.62 | 38.59 | 52.94 | 139.53 | .. | 5240.41 |
| Consumption | 4.56 | 4.89 | 5.03 | 6.55 | 8.73 | 9.75 | 10.55 | 11.58 | 11.75 | 13.33 | 22.46 | 23.58 | 27.29 | 31.19 | 43.34 | 117.67 | .. | 4513.10 |
| Gross Domestic Investment | 1.01 | 1.02 | 0.79 | 1.84 | 3.35 | 2.38 | 2.24 | 4.02 | 1.85 | -0.83 | 3.36 | 5.78 | 5.32 | 7.40 | 9.60 | 21.67 | .. | 727.31 |
| Fixed Investment | 0.89 | 0.90 | 0.93 | 1.48 | 2.80 | 2.51 | 2.61 | 3.58 | 2.13 | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Memo Items | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Gross Domestic Saving | 0.88 | 0.90 | 1.15 | 1.10 | 1.91 | 1.39 | 2.39 | 3.18 | 2.32 | 1.18 | -0.60 | 0.81 | 1.06 | 1.68 | 1.68 | -2.46 | .. | .. |
| Gross National Saving | 0.74 | 0.73 | 0.95 | 1.16 | 1.57 | 1.09 | 1.98 | 2.74 | 1.68 | 1.32 | -0.70 | 0.09 | -0.20 | 0.70 | 0.35 | -8.11 | .. | .. |
| Gross National Product | 19.38 | 20.29 | 20.83 | 21.44 | 24.59 | 25.56 | 26.63 | 26.82 | 24.59 | 18.53 | 20.54 | 20.72 | 20.49 | 21.60 | 21.34 | 20.29 | 20.20 | .. |
| DOMESTIC GDP DEFLATOR | 27.00 | 27.40 | 28.40 | 33.80 | 41.30 | 42.30 | 46.70 | 52.90 | 54.20 | 72.90 | 100.00 | 111.70 | 130.40 | 144.80 | 201.10 | 529.60 | 2008.30 | 20297.1 |
| MONETARY HOLDINGS | (Billions of current Nicaraguan Cordobas) | | | | | | | | | | | | | | | | | |
| Money Supply, Broadly defined | 0.83 | 0.95 | 1.23 | 1.73 | 2.02 | 2.03 | 2.77 | 2.86 | 2.65 | 3.43 | 5.75 | 7.93 | 9.90 | 15.19 | .. | .. | .. | .. |
| Money as Means of Payment | 0.58 | 0.62 | 0.75 | 1.15 | 1.31 | 1.26 | 1.62 | 1.70 | 1.58 | 2.65 | 4.10 | 5.21 | 6.55 | 10.94 | .. | .. | .. | .. |
| BALANCE OF PAYMENTS | (Millions of current US Dollars) | | | | | | | | | | | | | | | | | |
| Exports of Goods & Services | 217.80 | 224.40 | 290.80 | 322.60 | 447.60 | 457.90 | 629.70 | 732.90 | 731.90 | 683.20 | 514.00 | 581.60 | 455.50 | 477.50 | 426.90 | 363.80 | 247.20 | 280.80 |
| Exports of goods & N/Services | 213.10 | 220.10 | 285.90 | 315.80 | 436.70 | 446.70 | 615.60 | 719.30 | 720.20 | 672.20 | 494.80 | 553.30 | 446.80 | 471.00 | 422.20 | 362.20 | 245.90 | .. |
| Factor Services | 4.70 | 4.30 | 4.90 | 6.80 | 10.90 | 11.20 | 14.10 | 13.60 | 11.70 | 11.00 | 19.20 | 29.30 | 8.70 | 6.50 | 4.60 | 1.60 | 1.30 | .. |
| Imports of Goods & N/Services | 263.40 | 273.90 | 297.20 | 446.00 | 720.40 | 659.50 | 678.30 | 926.00 | 773.90 | 694.60 | 1049.30 | 1343.50 | 1020.90 | 1118.90 | 1182.20 | 1204.00 | 1082.70 | 1068.62 |
| Imports of Goods & N/Services | 228.50 | 237.80 | 255.70 | 390.40 | 648.70 | 588.50 | 592.40 | 841.30 | 665.30 | 510.70 | 905.60 | 1031.40 | 726.00 | 901.00 | 925.00 | 952.80 | 826.50 | .. |
| Factor Services | 34.90 | 36.10 | 41.50 | 55.60 | 73.70 | 71.00 | 85.90 | 84.70 | 108.60 | 63.90 | 143.70 | 212.10 | 194.90 | 217.90 | 237.20 | 251.20 | 256.20 | .. |
| Long-Term Interest | 6.80 | 7.90 | 10.90 | 18.00 | 29.20 | 35.60 | 40.90 | 51.70 | 50.40 | 37.00 | 37.90 | 90.50 | 109.20 | 37.50 | 34.20 | 20.40 | 21.40 | .. |
| Current Transfers, net | 6.10 | 5.00 | 7.10 | 57.50 | 18.50 | 16.60 | 9.40 | 11.20 | 9.50 | 91.80 | 123.90 | 70.20 | 51.50 | 79.30 | 89.90 | 94.90 | 63.40 | .. |
| Current Account Balance | -39.50 | -44.50 | 21.70 | -85.90 | -257.20 | -185.00 | -39.30 | -181.90 | -24.90 | 180.20 | -411.40 | -591.50 | -513.90 | -582.10 | -565.40 | -745.30 | -742.10 | .. |
| Long-Term Capital, net | 45.90 | 51.40 | 50.50 | 112.10 | 173.50 | 178.20 | 38.40 | 211.00 | 135.00 | 122.50 | 573.40 | 619.10 | 626.10 | 719.30 | 552.10 | 345.00 | -300.10 | .. |
| Direct Investment | 15.00 | 13.30 | 10.00 | 13.20 | 13.60 | 10.90 | 12.90 | 10.00 | 7.00 | 2.80 | .. | .. | .. | 7.80 | 1.80 | .. | .. | .. |
| Official Capital Grants | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Long Term Loans | 27.50 | 32.40 | 46.20 | 98.10 | 127.70 | 141.20 | 57.60 | 192.90 | 87.20 | 97.00 | 221.60 | 295.00 | 240.60 | 271.80 | 348.20 | 541.10 | 520.10 | .. |
| Disbursements | 43.70 | 55.20 | 66.20 | 147.90 | 147.40 | 160.20 | 91.70 | 239.50 | 134.60 | 112.40 | 266.10 | 365.00 | 294.30 | 316.80 | 378.40 | 563.10 | 530.70 | .. |
| Repayments | 16.20 | 22.80 | 20.00 | 49.80 | 19.70 | 19.00 | 34.10 | 48.60 | 47.40 | 15.40 | 44.50 | 70.00 | 53.70 | 45.00 | 30.20 | 22.00 | 10.60 | .. |
| Other Long-Term Capital | 3.40 | 5.60 | -5.70 | 0.70 | 32.00 | 26.10 | -34.20 | 8.10 | 40.80 | 22.70 | 351.80 | 524.10 | 385.50 | 439.70 | 202.10 | -198.10 | -820.20 | .. |
| Other Capital, net | 2.30 | -1.40 | -48.80 | 19.00 | 49.50 | 48.70 | -1.10 | -25.80 | -163.60 | -305.40 | -363.60 | -260.50 | -112.90 | -14.40 | 417.30 | 363.90 | 998.10 | .. |
| Change in Reserves | -8.70 | -5.40 | -23.40 | -63.10 | 34.20 | -41.90 | 4.00 | -9.30 | 73.50 | 2.70 | 201.50 | 33.90 | 0.70 | -142.60 | -304.00 | 36.40 | 46.10 | .. |
| Memo Items: | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Int'l Reserves Excluding Gold | 48.60 | 58.10 | 60.10 | 116.30 | 104.50 | 121.60 | 146.10 | 148.30 | 80.80 | 146.60 | 64.50 | 111.40 | 171.20 | 174.70 | .. | .. | .. | .. |
| Conversion Factor (Annual Avg) | 7.00 | 7.00 | 7.00 | 7.00 | 7.01 | 7.03 | 7.03 | 7.03 | 7.03 | 9.28 | 10.05 | 10.05 | 11.70 | 13.20 | 18.52 | 40.30 | 150.00 | .. |
| EXTERNAL DEBT | (Millions of US dollars, outstanding at end of year) | | | | | | | | | | | | | | | | | |
| Public/Publicly Guar. Long-Term | 154.70 | 180.80 | 234.30 | 339.00 | 465.30 | 610.60 | 861.70 | 1273.90 | 1429.30 | 1487.20 | 2170.70 | 2572.20 | 3138.80 | 4015.80 | 4875.00 | 5746.40 | 6686.90 | .. |
| | 146.70 | 178.90 | 225.30 | 324.20 | 453.00 | 592.50 | 851.60 | 844.50 | 941.70 | 1084.90 | 1661.40 | 2076.50 | 2487.50 | 3282.90 | 4010.20 | 4769.40 | 5343.30 | .. |
| SOCIAL INDICATORS | .. | | | | | | | | | | | | | | | | | |
| Infant Mortality Rate | 106.00 | 103.00 | 100.00 | 98.60 | 97.20 | 95.80 | 94.40 | 93.00 | 89.60 | 86.20 | 82.80 | 79.40 | 76.00 | 73.20 | 70.40 | 69.00 | .. | .. |
| Life Expectancy at Birth | 53.20 | 53.80 | 54.40 | 54.90 | 55.20 | 55.50 | 55.80 | 56.10 | 56.60 | 57.30 | 58.00 | 58.80 | 59.60 | 59.90 | 59.90 | 59.20 | .. | .. |
| Food Production, p.c. ('79=81=100) | 113.80 | 112.00 | 107.60 | 102.60 | 104.30 | 113.00 | 115.00 | 115.00 | 122.60 | 126.80 | 84.70 | 88.50 | 87.30 | 84.70 | 78.50 | 77.20 | 72.50 | .. |
| Labor Force, Agriculture (%) | 51.50 | 51.00 | 50.50 | 50.10 | 49.60 | 49.10 | 48.60 | 48.10 | 47.60 | 47.10 | 46.60 | .. | .. | .. | .. | .. | .. | .. |
| School Enroll. Ratio, primary | 80.00 | .. | .. | .. | .. | 82.00 | 88.00 | 87.00 | 84.00 | 90.00 | 99.00 | 104.00 | 100.00 | 103.00 | 99.00 | 101.00 | .. | .. |

Source: The World Bank: "World Tables, 1987", Washington, 1988.

a/ Estimates from ECLAC/CEPAL data.

b/ GNP per capita in US\$ is calculated using an alternative conversion factor.

c/ GDP by industrial origin data for at least some years are in purchaser values and not at factor cost.

Table C.6

CENTRAL AMERICA: CENTRAL GOVERNMENT DEFICITS (-)
(As percentages of GDP)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987a |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------|--------|--------|--------|--------|--------|--------|
| COSTA RICA | | | | | | | | | | | | | | | | | | |
| Deficit/GDP | -1.01 | -3.99 | -4.33 | -3.74 | -0.67 | -2.20 | -3.40 | -3.11 | -4.99 | -6.77 | -7.40 | -2.67 | -0.89 | -2.05 | -0.73 | -1.26 | -4.45 | -2.69 |
| Total Revenues/GDP | 14.95 | 14.12 | 15.33 | 15.94 | 16.53 | 16.01 | 17.64 | 16.66 | 19.06 | 18.27 | 17.61 | 17.66 | 17.46 | 22.25 | 22.32 | 21.31 | 22.02 | 23.27 |
| Total Expenditures/GDP | 15.96 | 18.12 | 19.67 | 19.68 | 19.20 | 20.22 | 21.05 | 19.79 | 24.05 | 25.04 | 25.20 | 20.73 | 18.35 | 24.30 | 23.05 | 22.59 | 26.29 | 24.21 |
| EL SALVADOR | | | | | | | | | | | | | | | | | | |
| Deficit/GDP | 0.04 | -1.12 | -0.84 | 0.35 | -1.38 | -0.55 | -0.38 | 2.51 | -1.59 | -1.42 | -4.45 | -5.35 | -6.77 | -3.20 | -3.28 | -1.34 | 0.21 | 0.17 |
| Total Revenues/GDP | 11.05 | 11.01 | 11.33 | 12.10 | 12.36 | 12.97 | 14.11 | 17.53 | 13.63 | 13.61 | 11.54 | 12.35 | 12.17 | 12.39 | 13.50 | 13.27 | 14.28 | 11.44 |
| Total Expenditures/GDP | 11.02 | 12.13 | 12.17 | 11.75 | 13.75 | 13.52 | 14.49 | 15.03 | 15.22 | 15.02 | 15.99 | 16.70 | 16.94 | 15.59 | 16.73 | 14.62 | 15.78 | 12.19 |
| GUATEMALA | | | | | | | | | | | | | | | | | | |
| Deficit/GDP | -0.69 | -1.52 | -2.15 | -1.48 | -1.44 | -0.84 | -2.55 | -0.93 | -1.17 | -2.16 | -3.90 | -6.22 | -4.78 | -3.51 | -4.4a | -2.6a | -3.0a | -2.69 |
| Total Revenues/GDP | 8.68 | 8.74 | 8.71 | 8.26 | 8.64 | 8.98 | 9.39 | 10.76 | 10.90 | 9.66 | 11.23 | 10.44 | 10.11 | 9.66 | 8.1a | 9.3a | 10.7a | 12.42 |
| Total Expenditures/GDP | 9.36 | 10.25 | 10.86 | 9.74 | 10.28 | 9.82 | 11.93 | 11.69 | 12.07 | 11.82 | 15.13 | 16.66 | 14.90 | 13.17 | 12.9a | 11.5a | 14.5a | 13.39 |
| HONDURAS | | | | | | | | | | | | | | | | | | |
| Deficit/GDP | -2.72 | -2.88 | -2.70 | -0.84 | -0.26 | -2.12 | -1.15 | 0.08 | -0.78 | -1.79 | -2.76 | -2.60 | -6.59 | -6.14 | -4.33 | -5.56 | -6.56 | -5.62 |
| Total Revenues/GDP | 12.30 | 11.67 | 11.46 | 11.56 | 12.16 | 12.00 | 12.98 | 13.60 | 14.47 | 14.62 | 14.87 | 13.30 | 13.37 | 12.65 | 14.68 | 15.31 | 15.40 | 23.06 |
| Total Expenditures/GDP | 15.02 | 14.55 | 14.16 | 12.43 | 12.42 | 14.12 | 14.13 | 13.52 | 15.25 | 16.41 | 17.63 | 15.90 | 19.95 | 18.79 | 19.01 | 20.67 | 21.99 | 21.54 |
| NICARAGUA | | | | | | | | | | | | | | | | | | |
| Deficit/GDP | -0.97 | -2.37 | -3.08 | -1.77 | -5.80 | -5.69 | -3.91 | -6.75 | -5.87 | -6.46 | -8.50 | -10.19 | -19.34 | -25.32 | -23.56 | -21.94 | -14.73 | -12.89 |
| Total Revenues/GDP | 12.27 | 12.72 | 12.54 | 14.04 | 13.91 | 13.97 | 14.00 | 14.01 | 13.27 | 14.78 | 22.72 | 27.23 | 27.61 | 33.46 | 40.34 | 37.63 | 37.61 | 36.11 |
| Total Expenditures/GDP | 13.25 | 15.09 | 15.62 | 15.81 | 19.71 | 19.65 | 17.91 | 20.75 | 19.14 | 21.24 | 29.22 | 37.41 | 47.14 | 58.77 | 63.90 | 59.57 | 52.33 | 47.41 |

Source: International Monetary Fund: "International Financial Statistics". Several issues.

a/ Estimates from ECLAC/CEPAL data.

Table C.7

CENTRAL AMERICA: CURRENT ACCOUNT DEFICIT OF THE BOP
(Percentage of GNP)

| YEAR | COSTA RICA | EL SALVADOR | GUATEMALA | HONDURAS | NICARAGUA |
|--------|------------|-------------|-----------|----------|-----------|
| 1970 | -7.64 | 0.85 | -0.42 | -9.11 | -5.26 |
| 1971 | -10.77 | -1.33 | -2.53 | -3.02 | -5.58 |
| 1972 | -8.34 | 1.09 | -0.56 | -1.56 | -5.26 |
| 1973 | -7.55 | -3.33 | 0.31 | -3.78 | -6.31 |
| 1974 | -16.37 | -8.62 | -3.31 | -9.96 | -17.69 |
| 1975 | -11.46 | -5.26 | -1.84 | -10.27 | -12.12 |
| 1976 | -8.60 | 1.04 | -1.81 | -10.00 | -2.22 |
| 1977 | -7.52 | 1.09 | -0.59 | -8.09 | -8.98 |
| 1978 | -10.62 | -9.45 | -4.38 | -8.64 | -1.31 |
| 1979 | -14.36 | 0.63 | -2.98 | -9.29 | 12.09 |
| 1980 | -14.32 | 0.87 | -2.10 | -13.57 | -20.13 |
| 1981 | -17.56 | -7.43 | -6.92 | -12.14 | -25.78 |
| 1982 | -12.54 | -4.52 | -4.69 | -8.82 | -22.62 |
| 1983 | -11.70 | -1.04 | -2.53 | -7.86 | -23.87 |
| 1984 | -8.14 | -1.36 | -4.12 | -10.65 | -25.69 |
| 1985 | -8.75 | -0.78 | -3.77 | -6.65 | -28.05 |
| 1986 | -2.50 | 1.00 | -0.16 | -4.55 | -27.53 |
| 1987a/ | -5.14 | .. | -4.91 | .. | -25.10 |

Source: The World Bank. "World Tables, 1987" Washington, 1988.

a/ Estimates from ECLAC/CEPAL data.

Table C.8

CENTRAL AMERICA: Real and Nominal Exchange Rate Series

REER = Real Effective Exchange Rate Index

ERI = Nominal Exchange Rate Index (U.S. price of domestic currency)

| DATE | COSTA RICA | | EL SALVADOR | | GUATEMALA | | HONDURAS | | NICARAGUA | |
|-------|------------|----------|-------------|----------|-----------|----------|----------|----------|-----------|----------|
| | REER-AVG | ERI-AVG | REER-AVG | ERI-AVG | REER-AVG | ERI-AVG | REER-AVG | ERI-AVG | REER-AVG | ERI-AVG |
| 76.00 | 87.5726 | 100.0000 | 92.4200 | 100.0000 | 105.1302 | 100.0000 | 98.0573 | 100.0000 | 97.1708 | 142.3220 |
| 76.25 | 86.9789 | 100.0000 | 93.5608 | 100.0000 | 104.9784 | 100.0000 | 96.6338 | 100.0000 | 96.7606 | 142.3220 |
| 76.50 | 86.2126 | 100.0000 | 94.9518 | 100.0000 | 102.3886 | 100.0000 | 95.8535 | 100.0000 | 87.9794 | 142.3220 |
| 76.75 | 85.6555 | 100.0000 | 94.1904 | 100.0000 | 101.4323 | 100.0000 | 92.1576 | 100.0000 | 89.4928 | 142.3220 |
| 79.00 | 87.3311 | 100.0000 | 95.6236 | 100.0000 | 102.6615 | 100.0000 | 95.6712 | 100.0000 | 91.6859 | 142.3220 |
| 79.25 | 89.5704 | 100.0000 | 95.8887 | 100.0000 | 102.7428 | 100.0000 | 94.2442 | 100.0000 | 82.5200 | 101.6980 |
| 79.50 | 91.5331 | 100.0000 | 94.9490 | 100.0000 | 101.2254 | 100.0000 | 95.3106 | 100.0000 | 93.4263 | 99.5020 |
| 79.75 | 95.2522 | 100.0000 | 96.2015 | 100.0000 | 102.7620 | 100.0000 | 97.8032 | 100.0000 | 93.1879 | 99.5020 |
| 80.00 | 98.0273 | 100.0000 | 97.1673 | 100.0000 | 101.3018 | 100.0000 | 100.5955 | 100.0000 | 98.4336 | 100.0000 |
| 80.25 | 98.9061 | 100.0000 | 109.1926 | 100.0000 | 100.1689 | 100.0000 | 100.9833 | 100.0000 | 99.5108 | 100.0000 |
| 80.50 | 99.9598 | 100.0000 | 100.0120 | 100.0000 | 98.8260 | 100.0000 | 98.9823 | 100.0000 | 97.5431 | 100.0000 |
| 80.75 | 103.5066 | 100.0000 | 102.0253 | 100.0000 | 99.7033 | 100.0000 | 99.4370 | 100.0000 | 104.5125 | 100.0000 |
| 81.00 | 67.0038 | 57.6131 | 108.8737 | 100.0000 | 106.4918 | 100.0000 | 103.7232 | 100.0000 | 117.4848 | 100.0000 |
| 81.25 | 64.9489 | 45.7857 | 113.5448 | 100.0000 | 110.3421 | 100.0000 | 107.9913 | 100.0000 | 119.8763 | 100.0000 |
| 81.50 | 72.4249 | 45.4000 | 116.2100 | 100.0000 | 110.9827 | 100.0000 | 109.6820 | 100.0000 | 126.7022 | 100.0000 |
| 81.75 | 49.8439 | 25.1529 | 117.4077 | 100.0000 | 110.8028 | 100.0000 | 112.9895 | 100.0000 | 121.5379 | 82.7800 |
| 82.00 | 58.7673 | 24.3053 | 120.0264 | 100.0000 | 113.7211 | 100.0000 | 115.2217 | 100.0000 | 127.0825 | 82.7800 |
| 82.25 | 64.4526 | 23.7243 | 123.5753 | 100.0000 | 113.7947 | 100.0000 | 118.8886 | 100.0000 | 133.3863 | 82.7800 |
| 82.50 | 80.7376 | 22.5308 | 121.8983 | 95.8743 | 112.5896 | 100.0000 | 117.4762 | 100.0000 | 123.0649 | 82.7800 |
| 82.75 | 81.0723 | 21.3494 | 122.3536 | 95.2870 | 112.2726 | 100.0000 | 118.8886 | 100.0000 | 133.3863 | 82.7800 |
| 83.00 | 83.4574 | 21.2922 | 123.3051 | 92.0264 | 112.6162 | 100.0000 | 120.0598 | 100.0000 | 140.8164 | 77.6400 |
| 83.25 | 85.1033 | 21.2665 | 125.4629 | 91.5750 | 117.3336 | 100.0000 | 123.9138 | 100.0000 | 147.7268 | 77.6400 |
| 83.50 | 84.0067 | 20.9919 | 132.5066 | 91.5750 | 123.9456 | 100.0000 | 127.6582 | 100.0000 | 155.5162 | 77.6400 |
| 83.75 | 80.9701 | 20.1572 | 138.1692 | 91.5750 | 120.8395 | 100.0000 | 128.7590 | 100.0000 | 168.3470 | 77.6400 |
| 84.00 | 80.5089 | 19.7461 | 136.9792 | 89.2045 | 120.2263 | 100.0000 | 128.9781 | 100.0000 | 164.4026 | 66.0500 |
| 84.25 | 81.6716 | 19.6879 | 138.1983 | 89.1806 | 120.2210 | 100.0000 | 129.4807 | 100.0000 | 157.1297 | 66.0500 |
| 84.50 | 83.5793 | 19.3753 | 142.4625 | 88.9680 | 120.0172 | 100.0000 | 133.1918 | 100.0000 | 171.7387 | 66.0500 |
| 84.75 | 81.8351 | 18.2612 | 145.2579 | 87.0898 | 118.1210 | 92.9757 | 135.6032 | 100.0000 | 211.7612 | 66.0500 |
| 85.25 | 82.8774 | 17.3214 | 158.7487 | 79.5056 | 85.9584 | 64.0787 | 138.6142 | 100.0000 | 227.2162 | 32.1933 |
| 85.50 | 80.3308 | 16.7161 | 144.0228 | 67.8376 | 78.0003 | 52.9607 | 138.4356 | 100.0000 | 254.7850 | 27.0200 |
| 85.75 | 76.4104 | 16.2230 | 145.6624 | 66.0800 | 77.2797 | 50.1533 | 134.7981 | 100.0000 | 300.6114 | 27.0200 |
| 86.00 | 73.5528 | 15.8754 | 121.2499 | 54.2713 | 68.8405 | 53.5860 | 130.9881 | 100.0000 | 228.6054 | 13.0010 |
| 86.25 | 73.0985 | 15.5023 | 118.0429 | 50.0000 | 67.5365 | 48.6133 | 130.7206 | 100.0000 | 237.9582 | 5.2970 |
| 86.50 | 72.6423 | 15.1529 | 124.3128 | 50.0000 | 80.9074 | 44.0530 | 129.5118 | 100.0000 | 328.5467 | 4.6157 |
| 86.75 | 71.4750 | 14.7753 | 129.8731 | 50.0000 | 82.5800 | 44.7897 | 128.6168 | 100.0000 | 371.1625 | 3.6737 |
| 87.00 | 68.6138 | 14.4319 | 132.7081 | 50.0000 | 82.7843 | 44.7163 | 125.1407 | 100.0000 | 291.0388 | 2.2810 |
| 87.25 | 66.8928 | 13.9754 | 137.7665 | 50.0000 | 81.7900 | 44.9037 | 123.1087 | 100.0000 | 348.9099 | 1.4690 |
| 87.50 | 66.0894 | 13.5206 | 141.9059 | 50.0000 | 81.8296 | 44.8830 | 123.6435 | 100.0000 | 537.7217 | 0.9337 |
| 87.75 | 62.4152 | 12.8099 | 141.8707 | 50.0000 | 80.7742 | 43.0417 | 120.4815 | 100.0000 | 476.5320 | 0.4020 |
| 88.00 | 60.1173 | 11.7837 | 145.6727 | 50.0000 | 83.4994 | 43.2537 | 119.5081 | 100.0000 | 479.0912 | 0.1447 |
| 88.25 | 60.0463 | 11.5044 | 147.7198 | 50.0000 | 83.5011 | 43.2500 | 118.6308 | 100.0000 | 504.1208 | 0.0870 |

Source: IMF

Table C.9

CENTRAL AMERICA: SECTORAL SHARES IN GDP
(Percentages)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| COSTA RICA | | | | | | | | | | | | | | | | | |
| Gross Domestic Product (GDP) a/ | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Agriculture | 22.55 | 20.17 | 19.46 | 19.29 | 19.06 | 20.36 | 20.36 | 21.88 | 20.40 | 18.51 | 17.60 | 23.01 | 24.49 | 22.00 | 21.21 | 19.97 | 20.74 |
| Industry | 24.23 | 25.21 | 25.30 | 25.30 | 27.08 | 27.38 | 27.47 | 28.17 | 28.07 | 28.46 | 28.97 | 26.62 | 25.74 | 28.61 | 29.38 | 29.08 | 28.83 |
| Manufacturing | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. | .. |
| Services, etc. | 53.37 | 54.62 | 55.23 | 55.41 | 53.86 | 52.32 | 52.18 | 51.96 | 53.53 | 53.06 | 53.23 | 50.37 | 49.78 | 49.39 | 49.41 | 50.96 | 50.43 |
| EL SALVADOR | | | | | | | | | | | | | | | | | |
| Gross Domestic Product (GDP) a/ | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Agriculture | 28.43 | 26.96 | 26.26 | 27.67 | 25.33 | 22.96 | 28.29 | 33.12 | 28.64 | 29.14 | 27.81 | 24.36 | 23.14 | 21.40 | 20.52 | 18.65 | 20.29 |
| Industry | 23.34 | 23.82 | 24.71 | 23.08 | 23.20 | 24.90 | 21.84 | 20.76 | 21.63 | 21.51 | 20.70 | 21.36 | 21.15 | 21.55 | 21.40 | 21.63 | 20.68 |
| Manufacturing | 18.86 | 19.19 | 19.54 | 18.34 | 17.93 | 18.56 | 16.35 | 14.61 | 15.67 | 15.55 | 15.02 | 15.72 | 15.41 | 15.58 | 15.61 | 15.67 | 15.48 |
| Services, etc. | 48.23 | 49.22 | 50.03 | 49.22 | 51.47 | 52.14 | 49.86 | 46.10 | 51.73 | 49.36 | 51.49 | 54.27 | 55.71 | 57.05 | 58.08 | 59.72 | 59.02 |
| GUATEMALA b/ | | | | | | | | | | | | | | | | | |
| Gross Domestic Product (GDP) a/ | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Agriculture | 27.32 | .. | .. | .. | .. | 28.05 | 27.29 | 26.31 | 25.84 | 25.38 | 24.85 | 24.99 | 25.13 | 25.34 | 25.68 | 25.77 | .. |
| Industry | 18.66 | .. | .. | .. | .. | 18.49 | 20.10 | 20.89 | 21.20 | 21.52 | 21.99 | 21.75 | 21.24 | 20.60 | 19.73 | 19.77 | .. |
| Manufacturing | 15.79 | .. | .. | .. | .. | 15.14 | 15.57 | 15.99 | 16.21 | 16.35 | 16.65 | 16.03 | 15.75 | 15.65 | 15.63 | 15.80 | .. |
| Services, etc. | 54.02 | .. | .. | .. | .. | 53.46 | 52.60 | 52.81 | 52.96 | 53.09 | 53.16 | 53.27 | 53.63 | 54.16 | 54.59 | 54.47 | .. |
| HONDURAS | | | | | | | | | | | | | | | | | |
| GDP at factor cost | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Agriculture | 32.44 | 32.53 | 32.11 | 32.58 | 30.97 | 29.53 | 30.85 | 33.16 | 30.61 | 29.24 | 28.50 | 27.99 | 27.52 | 27.45 | 27.28 | 27.15 | .. |
| Industry | 22.19 | 21.80 | 21.61 | 22.42 | 24.33 | 25.32 | 24.36 | 23.46 | 24.85 | 25.97 | 25.77 | 25.35 | 25.59 | 25.50 | 25.75 | 24.90 | .. |
| Manufacturing | 13.85 | 14.06 | 14.23 | 14.19 | 14.62 | 15.63 | 15.51 | 15.00 | 15.20 | 15.51 | 15.37 | 15.26 | 15.03 | 14.88 | 14.84 | 14.16 | .. |
| Services, etc. | 45.37 | 45.67 | 46.28 | 45.02 | 44.70 | 45.15 | 44.79 | 43.38 | 44.34 | 44.80 | 45.74 | 46.66 | 46.89 | 47.06 | 46.99 | 47.95 | .. |
| NICARAGUA | | | | | | | | | | | | | | | | | |
| Gross Domestic Product (GDP) a/ | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Agriculture | 24.82 | 24.70 | 24.80 | 24.71 | 24.13 | 22.35 | 22.57 | 24.32 | 26.28 | 26.33 | 22.61 | 20.26 | 20.85 | 23.03 | 24.43 | 22.66 | .. |
| Industry | 25.74 | 26.25 | 27.07 | 26.80 | 27.61 | 29.44 | 28.21 | 28.52 | 28.91 | 29.60 | 31.11 | 32.88 | 32.20 | 30.73 | 31.90 | 33.38 | .. |
| Manufacturing | 20.40 | 20.90 | 21.23 | 21.18 | 20.28 | 22.08 | 20.79 | 20.67 | 23.01 | 24.60 | 25.08 | 26.67 | 26.35 | 24.25 | 25.39 | 27.50 | .. |
| Services, etc. | 49.26 | 49.05 | 48.14 | 48.50 | 48.17 | 48.29 | 49.15 | 47.09 | 44.82 | 43.07 | 46.32 | 46.90 | 46.98 | 46.24 | 43.67 | 43.96 | .. |

Source: The World Bank: "World Tables, 1987" Washington, 1988.

a/ Sectoral GDP by sector of origin are at market values and not at factor costs.

b/ The source for this data is the Bank of Guatemala.

Table C. 10

SHARE OF INTRA-UNION TRADE AS PERCENTAGE OF EXPORTS

| Economic Grouping | 1960 | 1970 | 1976 | 1980 | 1983 |
|--|-------------|-------------|-------------|-------------|-------------|
| European Economic Community <u>a/</u> | 34.6 | 48.9 | - | 52.8 | 52.4 |
| Assoc. of South-East Asian Nations | 21.7 | 14.7 | 13.9 | 17.8 | 23.1 |
| Customs and Econ. Union of Central Africa | 1.6 | 3.4 | 3.9 | 4.1 | 2.0 |
| Central American Common Market <u>b/</u> | 7.5 | 26.8 | 21.6 | 22.0 | 21.8 |
| Caribbean Community | 4.5 | 7.3 | 6.7 | 6.4 | 9.3 |
| Latin American Integration Association | 7.7 | 10.2 | 12.8 | 13.5 | 10.2 |
| West African Economic Community | 2.0 | 9.1 | 6.7 | 6.9 | 11.6 |
| Economic Community of West African States | 1.2 | 2.1 | 3.1 | 3.9 | 4.1 |
| Econ. Comm. of Great Lakes Countries | 0.0 | 0.2 | 0.2 | 0.2 | 0.2 |
| Mano River Union | 0.0 | 0.1 | 0.2 | 0.1 | 0.1 |

a/ Includes the original six members up to 1970 and nine members after 1980.

b/ The figures used here for the CACM are from a different source and vary slightly from those provided in the text.

Source: Robson, Peter. The Economics of International Integration.
(London: Allen & Unwin, 1987)

Table C. 11

CENTRAL AMERICA: The Role of Trade in GDP

| <u>Total Exports</u> ¹ / <u>GDP</u> (percentages) | (based on current prices) | | | | | | (based on constant 1980 prices) | | | | |
|---|---------------------------|-------------|-------------|-------------|-------------|-------------|---------------------------------|-------------|-------------|-------------|-------------|
| | <u>1968</u> | <u>1975</u> | <u>1980</u> | <u>1983</u> | <u>1985</u> | <u>1986</u> | <u>1975</u> | <u>1980</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
| Costa Rica | 28.2 | 30.4 | 24.8 | 36.0 | 32.0 | 32.6 | --- | 26.5 | 32.6 | 32.3 | 33.0 |
| El Salvador | 25.5 | 33.1 | 34.1 | 23.6 | 23.7 | 24.9 | 31.6 | 34.2 | 34.9 | 33.4 | 35.5 |
| Guatemala | 16.7 | 21.4 | 22.0 | 12.9 | 17.8 | 15.7 | 23.7 | 22.0 | 19.1 | 15.9 | 18.0 |
| Honduras | 29.9 | 30.7 | 37.8 | 27.1 | 27.3 | 28.1 | 24.3 | 36.6 | 35.5 | 33.8 | 34.5 |
| Nicaragua | 26.5 | 28.2 | 22.7 | 18.9 | 12.6 | 8.5 | 26.2 | 24.2 | 18.6 | 15.4 | 15.8 |
| Total CACM | 23.7 | 27.3 | 26.6 | 20.8 | 22.4 | 21.7 | --- | --- | --- | --- | --- |
| | | | | | | | | | | | |
| <u>Total Imports</u> ¹ / <u>GDP</u> (percentages) | (based on current prices) | | | | | | (based on constant 1980 prices) | | | | |
| | <u>1968</u> | <u>1975</u> | <u>1980</u> | <u>1983</u> | <u>1985</u> | <u>1986</u> | <u>1975</u> | <u>1980</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
| Costa Rica | 32.8 | 38.7 | 34.3 | 36.5 | 33.5 | 31.4 | --- | 36.8 | 28.8 | 30.5 | 32.6 |
| El Salvador | 27.2 | 37.6 | 32.8 | 28.7 | 31.0 | 31.3 | 32.0 | 33.2 | 33.5 | 33.6 | 32.3 |
| Guatemala | 18.4 | 23.6 | 24.9 | 14.5 | 19.2 | 13.9 | 24.3 | 24.9 | 16.8 | 15.7 | 20.7 |
| Honduras | 31.4 | 39.8 | 45.3 | 30.9 | 31.6 | 30.1 | 33.2 | 44.5 | 35.0 | 35.9 | 34.5 |
| Nicaragua | 30.2 | 37.2 | 41.6 | 36.2 | 33.3 | 28.5 | 22.7 | 43.3 | 33.8 | 29.1 | 28.2 |
| Total CACM | 26.1 | 32.9 | 32.6 | 25.0 | 28.1 | 24.9 | --- | --- | --- | --- | --- |

¹/ Refers to goods and non-factor services.

Sources: Figures based on current price data are from IBRD, Report No. 23256-CA and World Tables, 1988;
Figures based on constant prices are from data provided by ECLAC.

Table C. 12

CENTRAL AMERICA: Principal Exports as Share of Total Merchandise Exports
(period average in %)

| | <u>Coffee</u> | <u>Bananas</u> | <u>Meat</u> | <u>Cotton</u> | <u>Sugar</u> | <u>Wood</u> | <u>Shrimp</u> |
|--------------------|---------------|----------------|-------------|---------------|--------------|-------------|---------------|
| Costa Rica | | | | | | | |
| 1978-1980 | 31.1 | 20.7 | 7.6 | — | 2.6 | — | — |
| 1981-1984 | 25.9 | 25.1 | 5.5 | — | 3.1 | — | — |
| 1985-1987 | 34.3 | 20.3 | 5.6 | ... | 2.2 | ... | ... |
| El Salvador | | | | | | | |
| 1978-1980 | 44.2 | — | 1.3 | 11.2 | 2.5 | — | 1.3 |
| 1981-1984 | 38.6 | — | — | 8.3 | 4.1 | — | 3.8 |
| 1985-1987 | 66.4 | — | — | 1.8 | 3.0 | ... | 2.4 |
| Guatemala | | | | | | | |
| 1978-1980 | 36.2 | 2.8 | 2.6 | 12.9 | 4.6 | — | — |
| 1981-1984 | 26.9 | 4.6 | 2.0 | 6.8 | 6.0 | — | — |
| 1985-1987 | 42.5 | 7.1 | — | 3.8 | 5.0 | — | ... |
| Honduras | | | | | | | |
| 1978-1980 | 28.6 | 27.4 | 7.5 | 1.9 | 2.2 | 5.1 | 3.0 |
| 1981-1984 | 23.4 | 31.1 | 4.8 | 1.1 | 4.2 | 5.1 | 5.1 |
| 1985-1987 | 28.1 | 33.6 | 2.3 | — | 2.1 | 4.0 | 5.8 |
| Nicaragua | | | | | | | |
| 1978-1980 | 31.8 | 1.2 | 13.6 | 18.6 | 3.6 | — | 3.8 |
| 1981-1984 | 31.2 | 4.5 | 5.9 | 26.1 | 4.3 | — | 3.7 |
| 1985-1987 | 43.8 | 5.7 | 3.8 | 21.9 | 4.6 | — | 4.4 |
| CACM | | | | | | | |
| 1978-1980 | 34.7 | 10.1 | 5.7 | 8.7 | 3.2 | 1.0 | 1.6 |
| 1981-1984 | 28.1 | 14.2 | 3.7 | 6.5 | 4.5 | 1.0 | 2.3 |
| 1985-1987 | 41.4 | 15.1 | 2.5 | 3.1 | 3.2 | 0.9 | ... |

Notes: (—) = figures less than 1%. (...) = figures unavailable.

Source: SIECA, Series Estadísticas Seleccionadas de Centroamérica, June 1987 (for data up to 1984).
ECLAC, Mexico City (for figures after 1984).

Table C. 1)

CENTRAL AMERICA: Structure of Imports (CIF)
(percentual composition)

| | <u>Consumer Goods</u> | <u>Intermediate & Raw Materials</u> | <u>(of which Petroleum)</u> | <u>Capital Goods</u> | <u>Total</u> |
|--------------------|---------------------------|---|---------------------------------|--------------------------|--------------|
| <u>Costa Rica</u> | | | | | |
| 1980 | 25.5 | 53.2 | (13.2) | 21.3 | 100.0 |
| 1985/86 | 21.3 | 56.2 | (13.1) | 22.4 | 100.0 |
| <u>El Salvador</u> | | | | | |
| 1975 | 24.6 | 50.7 | (7.7) | 25.7 | 100.0 |
| 1980 | 31.9 | 56.6 | (15.7) | 11.6 | 100.0 |
| 1985/87 | 24.5 | 54.2 | (11.0) | 21.3 | 100.0 |
| <u>Guatemala</u> | | | | | |
| 1975 | 22.5 | 53.9 | (14.0) | 23.6 | 100.0 |
| 1980 | 21.6 | 60.2 | (21.2) | 18.2 | 100.0 |
| 1985/86 | 19.9 | 67.5 | (23.3) | 12.6 | 100.0 |
| <u>Honduras</u> | | | | | |
| 1975 | 24.0 | 51.2 | (16.0) | 24.2 | 100.0 |
| 1980 | 23.3 | 50.9 | (16.8) | 25.8 | 100.0 |
| 1985/87 | 26.3 | 53.4 | (13.7) | 20.3 | 100.0 |
| <u>Nicaragua</u> | | | | | |
| 1975 | 23.6 | 53.3 | (14.1) | 23.1 | 100.0 |
| 1980 | 29.0 | 58.6 | (19.6) | 12.4 | 100.0 |
| 1985/87 | 20.0 | 55.0 | (17.3) | 25.0 | 100.0 |
| <u>Total CACM</u> | | | | | |
| 1985/86 | 23.2 | 56.7 | (15.5) | 20.1 | 100.0 |

Source: ECLAC data based on official figures.

Table C. 14

INTRA-REGIONAL EXPORTS IN THE CACM, SELECTED YEARS

| | <u>1960</u> | <u>1968</u> | <u>1970</u> | <u>1973</u> | <u>1976</u> | <u>1980</u> | <u>1983</u> | <u>1986</u> | <u>1987</u> ^{1/} |
|--------------------------------|-------------|-------------|-------------|-------------|--------------|--------------|--------------|--------------|---------------------------|
| A) Value (US\$ million) | | | | | | | | | |
| Guatemala | 7.3 | 77.5 | 106.4 | 137.6 | 189.1 | 403.7 | 308.2 | 192.0 | 230.6 |
| El Salvador | 12.7 | 84.9 | 75.0 | 106.8 | 176.0 | 295.8 | 168.1 | 86.7 | 117.2 |
| Honduras | 7.4 | 31.3 | 19.1 | 13.3 | 37.7 | 83.9 | 61.4 | 18.8 | 25.0 |
| Nicaragua | 3.4 | 26.9 | 49.9 | 61.5 | 119.1 | 75.4 | 33.0 | 15.2 | 14.4 |
| Costa Rica | <u>1.9</u> | <u>37.7</u> | <u>48.7</u> | <u>69.2</u> | <u>134.9</u> | <u>270.3</u> | <u>187.1</u> | <u>100.5</u> | <u>104.7</u> |
| CACM | 32.7 | 258.3 | 299.1 | 388.2 | 656.8 | 1129.2 | 757.7 | 413.3 | 491.9 |
| B) Structure (%) | | | | | | | | | |
| Guatemala | 22.4 | 30.0 | 35.6 | 35.4 | 28.8 | 35.8 | 40.7 | 46.5 | 46.9 |
| El Salvador | 38.8 | 32.9 | 25.1 | 27.5 | 26.8 | 26.2 | 22.2 | 21.0 | 23.8 |
| Honduras | 22.6 | 12.1 | 6.4 | 3.4 | 5.8 | 7.4 | 8.1 | 4.5 | 5.1 |
| Nicaragua | 10.4 | 10.4 | 16.7 | 15.9 | 18.1 | 6.7 | 4.4 | 3.7 | 2.9 |
| Costa Rica | <u>5.8</u> | <u>14.6</u> | <u>16.3</u> | <u>17.8</u> | <u>20.5</u> | <u>23.9</u> | <u>24.7</u> | <u>24.3</u> | <u>21.3</u> |
| CACM | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

^{1/} Preliminary

Source: IBRD, Report No. 23256-CA; SIECA

Table C. 15

CENTRAL AMERICA: The Share of Intra-Regional Trade in Total Trade
(percentages)

| | <u>1968</u> | <u>1975</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <u>Exports to CACM/Total Exports</u> | | | | | | | | | | |
| Costa Rica | 21.3 | 21.7 | 27.0 | 23.6 | 19.2 | 22.7 | 19.2 | 15.5 | 9.3 | 7.7 |
| El Salvador | 40.3 | 27.6 | 41.1 | 42.1 | 42.7 | 35.2 | 25.4 | 15.7 | 12.1 | 19.4 |
| Guatemala | 31.2 | 27.0 | 27.4 | 32.0 | 29.5 | 27.6 | 26.1 | 20.7 | 17.7 | 21.8 |
| Honduras | 17.3 | 9.1 | 10.3 | 9.2 | 7.9 | 9.3 | 6.8 | 3.0 | 2.6 | 2.9 |
| Nicaragua | 15.2 | 24.7 | 17.3 | 14.2 | 12.8 | 7.8 | 9.6 | 8.8 | 6.6 | 7.5 |
| Total CACM | 23.5 | 23.3 | 25.4 | 24.5 | 22.4 | 21.6 | 18.9 | 13.9 | 10.4 | 11.9 |
| <u>Imports from CACM/Total Imports</u> | | | | | | | | | | |
| Costa Rica | ... | 16.5 | 14.4 | 12.6 | 12.6 | 12.2 | 10.5 | 8.4 | ... | ... |
| El Salvador | ... | 22.9 | 32.8 | 29.2 | 27.6 | 24.2 | 19.1 | 19.6 | 17.2 | 18.3 |
| Guatemala | ... | 14.1 | 10.0 | 11.5 | 15.5 | 19.9 | 12.9 | 7.7 | ... | ... |
| Honduras | ... | 12.8 | 10.3 | 12.5 | 12.5 | 12.7 | 12.2 | 8.6 | ... | ... |
| Nicaragua | ... | 21.8 | 33.9 | 21.1 | 15.1 | 15.3 | 9.0 | 5.3 | 5.0 | 4.6 |
| Total CACM | 21.3 | 17.6 | 18.5 | 16.7 | 16.9 | 17.1 | 13.2 | 9.9 | ... | ... |

Source: IBRD, Report No. 2325b-CA for 1968 figures; SIECA, Series Estadísticas Seleccionadas de Centroamérica, June 1987 for figures up to 1985; ECLAC for 1986/1987 figures

Table C. 16

CENTRAL AMERICA: TRADE RATIOS IN MANUFACTURING,^{a/} 1970-1985
(percentages)

| | <u>Intra-regional imports</u> | | | | <u>Intra-regional exports</u> | | | | <u>Extra-regional imports</u> | | | | <u>Extra-regional exports</u> | | | |
|----------------------|-------------------------------|------|------|------|-------------------------------|------|------|------|-------------------------------|------|------|------|-------------------------------|------|------|------|
| | Apparent Consumption | | | | Production | | | | Apparent Consumption | | | | Production | | | |
| | 1970 | 1975 | 1980 | 1985 | 1970 | 1975 | 1980 | 1985 | 1970 | 1975 | 1980 | 1985 | 1970 | 1975 | 1980 | 1985 |
| Total | 17.5 | 9.5 | 10.3 | 6.4 | 16.0 | 12.6 | 14.3 | 9.0 | 32.8 | 35.4 | 34.6 | 34.4 | 9.1 | 14.1 | 9.0 | 6.6 |
| Total Less Food | 12.7 | 10.3 | 11.4 | 7.3 | 21.7 | 17.1 | 18.7 | 12.0 | 41.1 | 42.6 | 41.3 | 42.1 | 3.2 | 4.7 | 3.5 | 4.7 |
| Industry | | | | | | | | | | | | | | | | |
| Food | 7.5 | 6.4 | 6.2 | 3.7 | 6.4 | 4.8 | 5.5 | 3.5 | 6.1 | 7.2 | 10.0 | 10.8 | 19.0 | 30.5 | 19.9 | 14.0 |
| Beverage | 1.0 | 0.6 | 1.0 | 0.5 | 1.0 | 0.6 | 1.0 | 0.5 | 4.2 | 5.2 | 4.1 | 3.4 | 0.0 | 0.0 | 0.0 | 0.1 |
| Tobacco | 4.7 | 1.8 | 0.4 | 0.7 | 4.6 | 1.8 | 0.4 | 0.6 | 0.3 | 0.2 | 0.2 | 0.1 | 1.1 | 4.4 | 3.6 | 4.2 |
| Textile | 28.0 | 22.9 | 34.2 | 15.8 | 38.1 | 28.5 | 42.9 | 20.7 | 27.5 | 23.6 | 25.2 | 32.5 | 1.3 | 5.0 | 6.0 | 11.0 |
| Garment/Shoe | 14.1 | 10.9 | 16.6 | 8.7 | 14.6 | 11.0 | 17.2 | 8.7 | 4.1 | 3.5 | 5.6 | 4.9 | 0.8 | 2.8 | 1.7 | 5.4 |
| Leather | 19.3 | 9.6 | 11.7 | 6.3 | 21.1 | 9.6 | 11.4 | 6.4 | 8.7 | 4.9 | 4.9 | 5.6 | 0.5 | 4.4 | 7.8 | 4.2 |
| Wood | 10.6 | 12.9 | 7.9 | 6.8 | 7.7 | 9.1 | 6.4 | 4.9 | 3.6 | 6.4 | 3.0 | 2.8 | 28.8 | 34.3 | 20.8 | 29.5 |
| Furniture | 9.8 | 7.4 | 4.1 | 2.1 | 10.1 | 7.4 | 3.9 | 2.0 | 3.1 | 1.6 | 2.1 | 0.9 | 0.4 | 1.5 | 6.2 | 7.0 |
| Paper | 9.5 | 11.4 | 13.9 | 8.0 | 18.6 | 20.4 | 27.1 | 12.8 | 49.1 | 45.5 | 47.5 | 38.1 | 0.1 | 2.5 | 1.9 | 1.2 |
| Printing | 8.1 | 7.1 | 7.2 | 3.5 | 9.5 | 8.4 | 9.1 | 4.4 | 13.7 | 16.2 | 19.9 | 20.0 | 0.2 | 0.8 | 0.3 | 0.8 |
| Chemical | 20.3 | 15.3 | 19.3 | 12.7 | 39.5 | 29.9 | 40.8 | 28.4 | 49.5 | 52.3 | 55.4 | 58.5 | 3.5 | 6.6 | 5.5 | 5.8 |
| Petrol der. | 4.1 | 3.1 | 2.7 | 3.8 | 5.0 | 3.9 | 3.9 | 5.8 | 25.2 | 25.0 | 30.2 | 35.0 | 7.2 | 2.8 | 0.9 | 2.7 |
| Rubber | 22.9 | 22.2 | 19.3 | 11.8 | 30.8 | 28.8 | 23.9 | 15.4 | 28.3 | 23.4 | 21.6 | 25.6 | 0.7 | 0.7 | 2.3 | 3.4 |
| Non-metallic mineral | 10.0 | 11.3 | 11.1 | 7.3 | 27.5 | 14.0 | 13.6 | 8.9 | 23.8 | 21.3 | 19.8 | 20.0 | 0.2 | 1.5 | 1.5 | 2.1 |
| Metal and prod | 13.5 | 11.5 | 13.1 | 8.4 | 32.8 | 27.0 | 31.3 | 19.4 | 60.4 | 58.9 | 60.4 | 59.4 | 3.1 | 2.4 | 4.3 | 5.1 |
| Machinery | 7.9 | 6.4 | 7.4 | 4.5 | 39.8 | 36.4 | 32.8 | 19.4 | 80.5 | 83.1 | 78.9 | 77.8 | 1.7 | 3.5 | 5.7 | 3.4 |
| Transport equipment | 1.2 | 1.4 | 1.2 | 2.0 | 7.1 | 8.2 | 5.6 | 13.8 | 83.1 | 83.0 | 78.1 | 65.3 | 0.2 | 0.4 | 1.0 | 2.2 |
| Other | 8.2 | 10.1 | 12.2 | 6.9 | 14.6 | 20.4 | 29.1 | 14.7 | 44.5 | 50.4 | 58.5 | 54.4 | 1.2 | 1.6 | 3.0 | 3.4 |

^{a/} Intra-regional trade includes Panama.

Source: ECLAC estimates based on official statistics, reproduced in Willmore, L. "Export Promotion and Import Substitution in Central America's Manufacturing Sector" (CEPAL/MEXICO, 22/06/83)

(D-279b)

Table C. 17

CENTRAL AMERICA: Intra-Regional Balance of Trade, 1979-80
(U.S.\$ millions)

| 1979 (reporter) | (partner country) | | | | | Total |
|--------------------|-------------------|-------------|-----------|----------|-----------|--------|
| | Costa Rica | El Salvador | Guatemala | Honduras | Nicaragua | |
| Costa Rica | | | | | | |
| Exports | - | 48.0 | 61.8 | 26.1 | 39.5 | 175.4 |
| Imports | - | -70.2 | -86.2 | -15.1 | -42.2 | -213.7 |
| Trade Balance | - | -22.2 | -24.5 | 11.0 | - 2.7 | - 38.4 |
| El Salvador | | | | | | |
| Exports | 67.8 | - | 175.4 | 0 | 23.5 | 266.7 |
| Imports | -50.2 | - | -180.7 | 0 | -26.0 | -256.9 |
| Trade Balance | 17.6 | - | 5.4 | 0 | - 2.6 | 9.7 |
| Guatemala | | | | | | |
| Exports | 69.5 | 147.5 | - | 48.1 | 30.2 | 295.3 |
| Imports | -50.4 | -104.9 | - | -28.7 | -23.5 | -207.5 |
| Trade Balance | 19.0 | 42.6 | - | 19.4 | 6.7 | 87.8 |
| Honduras | | | | | | |
| Exports | 14.1 | 0 | 31.7 | - | 14.2 | 60.0 |
| Imports | -29.5 | 0 | -50.9 | - | -17.4 | -97.8 |
| Trade Balance | -15.4 | 0 | -19.2 | - | - 3.2 | -37.8 |
| Nicaragua | | | | | | |
| Exports | 42.2 | 20.2 | 24.2 | 15.0 | - | 101.6 |
| Imports | -45.1 | -26.4 | -41.8 | -14.8 | - | -128.1 |
| Trade Balance | - 2.9 | - 6.2 | -17.6 | 0.3 | - | - 26.4 |
| <hr/> | | | | | | |
| 1980 (reporter) | (partner country) | | | | | Total |
| | Costa Rica | El Salvador | Guatemala | Honduras | Nicaragua | |
| Costa Rica | | | | | | |
| Exports | - | 52.8 | 66.0 | 28.7 | 127.5 | 275.0 |
| Imports | - | -67.8 | -101.0 | -18.8 | - 33.1 | -220.7 |
| Trade Balance | - | -15.0 | - 35.0 | - 9.9 | - 94.5 | 54.3 |
| El Salvador | | | | | | |
| Exports | 67.5 | - | 173.6 | 0 | 54.7 | 295.8 |
| Imports | -55.4 | - | -253.6 | 0 | -11.4 | -320.4 |
| Trade Balance | 12.1 | - | - 79.9 | 0 | 43.3 | - 24.6 |
| Guatemala | | | | | | |
| Exports | 82.8 | 182.1 | - | 56.5 | 83.3 | 404.7 |
| Imports | -45.1 | - 61.4 | - | -32.1 | -16.7 | -155.3 |
| Trade Balance | 37.7 | 120.7 | - | 24.3 | 66.6 | 249.3 |
| Honduras | | | | | | |
| Exports | 16.5 | 0 | 38.1 | - | 29.3 | 83.9 |
| Imports | -31.4 | 0 | -57.7 | - | -14.5 | -103.6 |
| Trade Balance | -14.8 | 0 | -19.6 | - | 14.8 | - 19.7 |
| Nicaragua | | | | | | |
| Exports | 36.7 | 10.0 | 16.2 | 12.5 | - | 75.4 |
| Imports | -116.3 | -50.4 | -102.0 | -30.4 | - | -299.1 |
| Trade Balance | - 79.6 | -40.5 | - 85.8 | -17.8 | - | -223.7 |

Notes: Exports are FOB and Imports are CIF. This is one reason why matrix is not diagonal. Another reason is that the exports reported by one country and the imports reported by the recipient may differ due to errors or omissions.

Source: IMF, Direction of Trade Statistics.

Table C. 18

**Unweighted Mean Nominal Tariff Rates for Various Countries, 1986
(% ad valorem)**

| | Economy-wide | Manufacturing |
|------------------|---------------------|----------------------|
| Yugoslavia | 11.5 | 19.2 |
| Senegal | 12.1 | - |
| Hungary | 15.1 | 12.6 |
| Poland | 16.9 | - |
| Mexico | - | 22.4 |
| Argentina | 22.0 | 31.7 |
| CACM avg. | 23.1 | 23.5 |
| Philippines | 27.9 | 28.0 |
| Egypt | 30.2 | 31.5 |
| Sri Lanka | 30.8 | 33.0 |
| Ecuador | 33.3 | 41.8 |
| Venezuela | 33.5 | 34.1 |
| Gabon | 33.6 | - |
| Turkey | - | 37.9 |
| Thailand | 33.8 | 38.3 |
| Kenya | 37.2 | 40.1 |
| Morocco | - | 43.1 |
| Madagascar | 45.5 | - |
| Peru | 63.0 | 64.0 |
| Pakistan | 66.7 | 80.9 |
| India | 99.8 | 137.7 |

Source: IBRD (IENIN), SINTIA Country Tariff files.

Table C. 19

CENTRAL AMERICA: Frequency Distribution of Legal Import Tariff Rates, 1987
 (percent of total tariff positions within a given range)

| | <u>Costa Rica</u> | | <u>El Salvador</u> | <u>Guatemala</u> | <u>Honduras</u> | <u>Nicaragua</u> |
|-----------------------------|-------------------------------|-------------------------------|--------------------|------------------|-----------------|------------------|
| Total # of Tariff Positions | 1828 | | 1902 | 1885 | 1714 | 1880 |
| Tariff Range (%) | (excluding tariff surcharges) | (including tariff surcharges) | | | | |
| 0 - 5.0 | 45.2 | 2.7 | 44.2 | 7.4 | 38.5 | 45.4 |
| 5.1 - 10.0 | 7.0 | 35.5 | 6.8 | 39.6 | 17.7 | 6.6 |
| 10.1 - 20.0 | 10.0 | 15.3 | 10.5 | 7.7 | 11.3 | 10.8 |
| 20.1 - 30.0 | 11.4 | 11.2 | 11.5 | 10.6 | 11.6 | 12.1 |
| 30.1 - 40.0 | 9.2 | 12.5 | 9.2 | 12.4 | 7.9 | 9.0 |
| 40.1 - 50.0 | 9.2 | 8.4 | 8.3 | 7.3 | 7.0 | 8.2 |
| 50.1 - 60.0 | 4.2 | 5.9 | 4.2 | 6.5 | 2.6 | 4.2 |
| Greater than 60.0 | 3.8 | 8.5 | 5.3 | 8.5 | 3.4 | 3.7 |
| | <u>100.0</u> | <u>100.0</u> | <u>100.0</u> | <u>100.0</u> | <u>100.0</u> | <u>100.0</u> |

Notes: Except where noted otherwise, all figures are based on legal customs tariffs excluding tariff surcharges.

Source: Same as Table 2.2; IBRD staff calculations using SINTIAT.

Table C. 20

COSTA RICA: The Value of CATs Granted Per Annum, 1980-85
(in Costa Rican Colones)

| | Total Value of CATs | Share (in %) of Central Government: | |
|------|---------------------|-------------------------------------|----------------------|
| | | Current Revenues | Current Expenditures |
| 1980 | 83,033,459 | 1.6 | 1.3 |
| 1981 | 169,671,754 | 2.2 | 2.0 |
| 1982 | 383,348,104 | 2.7 | 2.5 |
| 1983 | 382,248,865 | 1.8 | 1.8 |
| 1984 | 640,357,243 | 2.4 | 2.4 |
| 1985 | 963,130,144 | 3.0 | 3.2 |
| 1986 | 1,553,782,707 | 4.1 | 4.2 |
| 1987 | 2,030,454,608 | 4.6 | 4.7 |

CATs denotes Certificado de Abono Tributario, and are described in chapter VI.

Source: CENPRO; Banco Central de Costa Rica. IBRD calculations.