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CENTRAL AMERICAN COMMON MARKET

Report by the Permanent Secretariat of the General Treaty of Central American Economic Integration

In accordance with the Calendar of Biennial Reports with respect to regional agreements adopted by the Council (L/5158), the Permanent Secretariat of the General Treaty of Central American Economic Integration (SIECA) has submitted the following report.

In response to your letter (reference: XXIV/208), I have the honour to forward to you herewith a document entitled "Developments in the Central American economy: 1978-1980". This document, prepared by this Permanent Secretariat for the governments of the member countries of the Central American Common Market, reflects the economic situation prevailing in the sub-region in recent years. Accordingly, we believe it meets the requirements of your letter and we would be glad if it could be reproduced in full for the information of the contracting parties to GATT.

DEVELOPMENTS IN THE CENTRAL AMERICAN ECONOMY: 1978-1980

INTRODUCTION

On 4 May this year a Meeting of Ministers responsible for Central American economic integration was convened in San José, Costa Rica; the Ministers of Costa Rica, El Salvador and Nicaragua attended the meeting which, in view of the fact that the Ministers of Guatemala and Honduras were unable to be present, did not have the formal character originally envisaged in the invitation sent out by the Minister of Costa Rica.

On that occasion, the Ministers present requested the secretariat to prepare certain documents to serve as background material on the basis of which the Meeting of Ministers responsible for Central American economic integration could adopt measures and make arrangements to reactivate and strengthen the Central American Common Market and adapt it to present realities in the sub-region. Those documents are:

1. A study on the current economic situation of the five countries concerned, and

2. An analysis of economic defence and balance-of-payments measures adopted unilaterally by the Central American countries in order to determine their effects on interregional trade.

The present document presents the study on the present economic situation of the Central American countries; in this connexion the secretariat wishes to make the following comments regarding the characteristics of this document and the general conclusions to be drawn from its content.

First of all, this study is based on extensive statistical data that is reproduced in an annex, bringing together in one document valuable material allowing more detailed analysis of the economic realities of Central America. In order to present an up-to-date picture of the economic situation of the Central American countries, in accordance with the terms of reference, a special effort has had to be made to assemble the necessary statistics and focus the analysis on the last three years, i.e. 1978-80. This has been achieved, *inter alia*, with assistance and collaboration from the national entities and bodies concerned.

In the second place, as regards the methodology followed, the examination moves from the general to the particular and the document is in three parts, as follows:

I. Analysis of the situation and outlook for the international economy, as a necessary general framework within which Central America is situated; the information and comments presented here underline the factors decisive for the sub-regional economy, in particular those that are closely related to the international economic situation.

II. Analysis of the Central American economy in the three-year period 1978/1980; with references back to earlier years when considered necessary, the study presents macro-economic comments and evaluations are on the principal variables of the sub-regional economy, in particular those aspects most closely linked to the integration process, such as producing sectors (agriculture and industry) and interregional trade; in addition consideration is given to certain other aspects which, although they affect the individual economies of the countries concerned, should nevertheless be seen in a regional perspective in respect of their common elements: the external sector and the balance of payments, the tax situation, the monetary scene, and two crucial problems that in present circumstances are decisive for the economic situation and outlook of the member countries - the inflationary process and the energy problem, both of which are having a heavy negative impact on the economic development of Central America.

III. Analysis of the economy of each of the Central American countries - as a supplement to the two first parts of the study - underlining the specific problems of each of them and their particular characteristics with a view to identifying, in each case, the quality differences between one national economy and another, while highlighting problems that are common and can be remedied or at least eased through similar action.

This study is fundamentally conceived as a conjunctural analysis. Accordingly, it contains no elements that constitute a structural analysis of the economies of the Central American countries even though some evaluations are made in that sense, primarily in order to explain economic phenomena that are chronic and have cumulative effects over time.

SIECA considers, furthermore, that notwithstanding the limitations it has encountered, this study fulfils the mandate defined by the Ministers since it contains a general survey of the national economies in both the sub-regional and the world context, underlining the most acute problems that are affecting them and the region as a whole.

SECTION I

1. SITUATION AND OUTLOOK FOR THE INTERNATIONAL ECONOMY

The Central American States are neighbouring countries that are highly susceptible to outside factors and their economy is vulnerable to any conjunctural fluctuations or cyclical movements in the developed countries, though the impact is felt with some time-lag. In times of recession, and as in the case of other under-developed countries, the economies of the region have very limited capacity for reacting and defending themselves, so that the negative impact is felt very strongly, coupled with strong structural pressures at the internal level.

Accordingly, in examining the Central American economic situation one must also analyse the economy of the major developed countries, in particular those variable factors which have the strongest and broadest impact, in order to explain certain past situations and evaluate their effects on the economies of the region.

Although the present analysis is limited to the three-year period 1978-1980, mention must also be made of certain events that have caused a radical change in international economic relations and set new limitations on growth possibilities of the non-industrialized countries.

In the 1970s a very critical international economic situation developed, reflected in:

(i) grave monetary problems between 1973 and 1975 which brought fundamental changes in the system established at Bretton Woods, directly affecting the structure of world trade;

(ii) the emergence of a generalized and increasing inflationary process causing high rates of unemployment, and

(iii) the worldwide and increasingly severe energy crisis resulting from constant increases in the price of petroleum and petroleum products.

In addition to making new readjustments necessary in the world economy, the above-mentioned factors have checked the economic growth of poor countries that are not petroleum producers and seriously limited their growth prospects.

This situation has been made still bleaker by progressive deterioration of the North-South dialogue which is virtually stagnating.

Following the period 1973-1975, slow recovery could be seen in the developed countries until the early months of 1979, since when economic recession has started up again in the industrialized countries, accompanied by renewed inflationary pressures.

For the seven major OECD countries[1] taken together the real growth rate of gross domestic product has declined progressively, from 4.3 per cent in 1978 to 3.4 and 0.6 per cent respectively in 1979 and 1980. Japan is the only country where steady growth has continued and those most affected by the recession are the United States and Great Britain, in that order, as may be seen from the table below:

TABLE 1

Rates of Annual Variation in Real Gross Domestic Product of OECD Member Countries, 1978-1981
(Percentages)

	1978	1979	1980	1981 1/
Germany, Federal Republic of	3.5	4.4	2.0	2.0
Canada	3.4	2.9	1.0	2.8
United States	4.4	2.3	-1.7	0.6
France	3.3	3.2	2.0	1.5
Great Britain	3.5	1.7	-1.5	0.4
Italy	2.6	5.0	2.0	0.5
Japan	6.0	5.9	5.0	4.5
Seven major countries:	4.3	3.4	0.6	1.7
Other countries	2.2	3.0	1.4	1.6
TOTAL OECD	3.9	3.3	0.7	1.7

1/ Estimates

Source: UNCTAD, interdependence of problems of trade, development finance and the international monetary system (TD/B/803/Add.1, 1980).

[1] Organization for Economic Co-operation and Development. The seven major countries are: Federal Republic of Germany, Canada, United States, France, Great Britain, Italy and Japan.

Furthermore, inflation has been directly reflected in high consumer prices which in the seven major countries increased by 6.5 per cent in 1978, 8.1 per cent in 1979 and 10.7 per cent in 1980 (Table 1 of the Statistical Annex[1]). This average level should nevertheless be taken with some reserve because of wide variations in inflation rates from one country to another, ranging in 1980 from a minimum of 5 per cent in the Federal Republic of Germany to a maximum of 19 per cent in Great Britain and Italy.

Unemployment rates in the countries considered have also reflected the effects of recession and in general have been steadily increasing since 1978. In the United States, the unemployment rate rose from 6 per cent to 7.2 per cent between 1978 and 1980; over that same period, unemployment increased from 5.2 to 6.7 per cent in France, 7.2 to 8 per cent in Italy and 5.6 to 6.6 per cent in the United Kingdom, while modest reductions were recorded in the other countries considered (Table 2 of the Statistical Annex).

These two phenomena, together with unstable rates of exchange and intensified protectionist policies, have had a direct impact on the volume of world trade which increased by only 3 per cent in 1980.

The rising cost of energy has also been a contributory factor in deterioration of the balance of payments on current account of the seven major industrialized market-economy countries, and their aggregate balance has dropped back from a surplus of $24,800 million in 1978 to a deficit of $30,000 million in 1980. In the latter year, the United States was the only one of those countries that recorded a surplus, totalling $3,400 million (Table 3 of the Statistical Annex).

The main economic prospects of the developed countries for 1981 and their probable repercussions on the Central American economies are indicated below:

(a) Prospects:

Slight recovery in the growth rate of real gross domestic product is forecast for the seven major market-economy countries, estimated overall at about 1.7 per cent for 1981;

The rate of inflation is expected to reach 9.6 per cent in 1981, i.e. 1 per cent below the preceding year's level;

Unemployment rates are expected to rise in the major OECD countries, in particular the United States, France and Great Britain, following the introduction of anti-inflation policies (Table 2 of the Statistical Annex);

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[1] The Statistical Annex may be consulted at the secretariat, Development Division, office 2010.

International trade is expected to expand at the same rate as in 1980 i.e. 3 per cent while the terms of the trade of the least-developed countries that are not petroleum exporters are likely to deteriorate still further in 1981;

On the basis of the foregoing, one can expect high levels of economic protectionism in the developed countries in 1981 and thereafter.

(b) Repercussions:

The developments mentioned above make up an international background that is unfavourable for the Central American economies. Recovery in the GDP of the undustrialized countries for 1981 is too modest to justify any hope of favourable consequences for the economies of the region, and furthermore any positive effects resulting from increased activity in the industrialized countries are hampered by factors at the internal level.

Higher levels of inflation are likely in Central America due, inter alia, to a shortage of important intermediate goods and primary products, the possibility of higher prices for petroleum and petroleum products, increased maritime transport tariffs and the high interest rates prevailing in international financial markets.

In addition to the foregoing, account must be taken of the fact that slow growth of the developed economies coupled with the possibility of intensified trade protectionism on their part will adversely affect Central American exports, through compression of external demand, difficulties in opening up new markets and deterioration of terms of trade.

Ultimately, this latter factor will cause a steep increase in the balance-of-payments deficit on current account for countries of the region which will have to be covered through capital movements, so that the foreign indebtedness of these countries is likely to increase substantially. Similarly, the low level of economic activity will be directly reflected in higher unemployment, despite the efforts that governments are making through public expenditure policy.

All the foregoing seems to indicate that economic recovery of the five countries is a long-term undertaking during which development policies will have to be pursued in a climate of inflation, in other words the results of the economic adjustment process must be evaluated not only in relation to global financial equilibrium, but also in terms of real growth of the economy.

II. CENTRAL AMERICAN ECONOMY, 1978-1980

A. Regional trends

1. Production

Under the combined influence of various internal factors and an unfavourable international economic situation, over the past three years gross domestic product in the region, in terms of 1970 constant prices, was expanding at an average annual rate of barely 1 per cent, i.e. considerably below the population growth rate. This regional average was further affected by an economic downturn in Nicaragua and El Salvador, which recorded negative rates of 6.1 per cent and 5 per cent respectively in the period 1978-1980. Nevertheless, in the last year considered, the Nicaraguan economy recovered substantially with a growth rate of 18.9 per cent while El Salvador recorded a further decline of the order of 8.7 per cent, as may be seen from the following table.

TABLE 2

CENTRAL AMERICA: GROWTH RATES OF GDP, 1978-1980
(At 1970 constant prices)

	1978	1979	1980	1978-1980
Guatemala	5.0	4.5	4.0	4.2
El Salvador	4.0	-1.1	-8.7	-5.0
Honduras	7.0	6.7	2.0	4.4
Nicaragua	-7.1	-25.8	18.9	-6.1
Costa Rica	6.3	3.3	1.7	2.5
Central America	3.6	-0.4	2.3	1.0

Source: Tables 5 to 10 of the Statistical Annex.

For the other countries too, weakening of the economy is quite evident, and GDP growth has clearly slipped back though without reaching negative rates. Since 1978 the rate of economic expansion has been steadily declining in Guatemala, Honduras and Costa Rica, more particularly in 1980 for the last two of those countries.

Economic activity in the region continued sluggish especially in the agricultural, industrial and commercial sectors which together account for approximately 64 per cent of total value added. In the last three years, performance in these sectors has been deteriorating appreciably, particularly in the agricultural sector where the growth rate has dropped back from 5.4 per cent in 1978 to 0.6 per cent in 1979 and -1.9 per cent in 1980, with the exception of Guatemala which recorded 2.5 per cent expansion in this sector.

TABLE 3

CENTRAL AMERICA: GROWTH RATES IN THE MAIN ECONOMIC SECTORS, 1978-1980
(At 1970 constant prices)

	Central America	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
I. AGRICULTURE						
1978	5.4	3.2	10.0	4.3	5.6	6.6
1979	0.6	3.4	2.0	7.5	-13.8	-1.1
1980	-1.9	2.5	-8.3	-2.0	-7.4	-2.7
1980-78	-0.7	2.9	-3.4	2.7	-10.7	-1.9
II. INDUSTRY						
1978	4.0	6.5	-3.4	9.3	-0.8	8.2
1979	-2.4	5.5	-3.3	7.9	-28.3	1.3
1980	1.9	6.3	-16.8	5.4	15.4	1.9
1980-78	-0.1	5.9	-10.3	6.7	-9.0	1.6
III. TRADE						
1978	1.7	4.5	1.3	12.4	-14.9	4.2
1979	-3.0	3.1	-4.8	8.3	-40.0	2.0
1980	1.3	2.6	-10.3	3.4	28.5	-2.2
1980-78	-0.9	2.8	-7.6	5.8	-12.1	-0.1

Source: Tables 5 to 10 of the Statistical Annex.

Over the period considered, in the remaining sectors that account for gross domestic product, with the exception of public administration and mining and quarrying, the rate of activity was increasing slowly. As regards the last sectors mentioned, public administration continued active and its contribution to GDP increased from 7.4 per cent in 1978 to 8.5 per cent in 1980, in which year it recorded a growth rate of 12.4 per cent, still in terms of 1970 constant prices. Mining and quarrying has increased its rate of activity considerably, but is still of no great significance in GDP. This sector recorded a steady growth rate of 22 per cent in 1979 and 25.1 per cent in 1980, thus increasing its contribution to GDP from 0.3 to 0.5 per cent between 1978 and the last year considered. This trend is basically due to Guatemala, which had growth rates of 87.5 and 57 per cent in 1979 and 1980 respectively, boosting from 20.1 per cent in 1977 to 39 per cent in 1980 its contribution to total value added generated by Central America in this sector.

We shall examine below in greater detail the two most important sectors of the region's economy, namely agriculture and industry which together contribute 44 per cent to GDP.

1.1 Agriculture

Development in this sector, which is the most important source of employment, income and foreign exchange in the Central American economy, has been seriously hampered by a number of structural and conjunctural factors. The structural factors include in particular the specific characteristics of land utilization and tenancy, a low investment level for basic social capital, lack of an effective tariff policy to ensure adequate conditions for the development process, and the lack or ineffectiveness of State action to furnish the back-stopping needed for dynamic development, mainly in the form of an employment policy and fair incomes for the rural sector. Among the conjunctural factors, wide fluctuations in international prices of the principal traditional export products are hampering medium- and long-term economic programming in this sector and in the national economies concerned. Another factor is the impact of inflation process on inputs needed by the sector together with intensified economic protectionism on the part of developed countries in their trade relations with under-developed countries. To this picture as a whole one must add the lack of regional policies, whether joint or harmonized.

Given all these circumstances, agriculture is one of the sectors most seriously affected by the present Central American crisis. In 1980 growth in this sector was declining at by about 1.9 per cent, and only Guatemala achieved a positive growth rate of 2.5 per cent. As a result, this sector's contribution to GDP was slipping back in the last year considered. With the exception of Nicaragua which in general is maintaining an upward trend, since 1970 the relative significance of this sector has been slowly declining in the national economies of the region, particularly in Costa Rica and Honduras as may be seen from the following table.

TABLE 4

CENTRAL AMERICA: RELATIVE SHARE OF THE AGRICULTURAL SECTOR IN GDP, 1970, 1978-1980
(In percentage terms and at 1970 constant prices)

	1970	1978	1979	1980
Guatemala	27.5	26.1	25.8	25.4
El Salvador	28.4	25.1	25.9	26.0
Honduras	32.5	27.9	28.1	27.0
Nicaragua	24.9	27.0	31.3	24.4
Costa Rica	22.5	17.7	17.0	16.5
Central America	27.1	24.6	24.9	23.8

Source: Year 1970: Macro-economic Statistics for Central America 1970-1979, SIECA, September 1980.
Years 1978-1980: Tables 5 to 10 of Statistical Annex.

The principal export crops are the mainstay of the Central American economy. Five of them - coffee, cotton, bananas, bovine meat and sugar - account for the major part of foreign exchange earnings from the region's total exports, reaching 63 per cent in 1979. In relation to 1971, export trade still depends to a great extent on those same five products, while their aggregate share in the total has been increasing steadily:

TABLE 5

CENTRAL AMERICA: SHARE OF EXPORTS OF COFFEE, COTTON, BOVINE MEAT, BANANAS AND SUGAR IN TOTAL EXPORTS
(In percentage terms)

	1971	1979
Guatemala	56.1	58.5
El Salvador	56.6	68.3
Honduras	64.2	62.4
Nicaragua	62.2	75.5
Costa Rica	68.3	55.8
Central America	61.4	63.0

Source: SIECA, based on official national statistics.

At the country level, Honduras and more particularly Costa Rica have managed to reduce this dependence through increased marketing of other agricultural products and a greater relative share of manufactures. In Guatemala the share of the five products in the country's total exports has increased by slightly more than 2 per cent, despite efforts to promote non-traditional exports. In both El Salvador and Nicaragua this trade dependence is very pronounced; in Nicaragua in particular, exports of the five products accounted for nearly 76 per cent of that country's aggregate exports in 1979.

It is important to consider, nevertheless, that in the case of these two latter countries the situation in 1979 was undoubtedly influenced by a slowdown in industrial output which dropped back by 3.3 per cent in El Salvador and 28.3 per cent in Nicaragua, causing a decline in the relative importance of industrial exports.

Of the five products mentioned, coffee is the leading traditional crop and in the last three years it accounted for more than 45 per cent of agricultural output in Central America. El Salvador is the largest producer in the region with nearly 37 per cent, followed by Guatemala with 32 per cent, Costa Rica with 15 per cent, Nicaragua with 10 per cent and Honduras with 6 per cent of the total.

Although the area under coffee in Central America has been expanding only moderately - by 17 per cent from 1970/71 to 1979/80 - production has risen by 44 per cent, mainly due to substantially increased productivity.

Exports of unroasted coffee have developed in parallel with production, except in the case of El Salvador which in 1978 held down its exports to 50 per cent of domestic availabilities (Table 18 of the Statistical Annex). Prices of the region's coffee exports averaged $CA 2,914.17 per metric ton in 1979 and $CA 3,178.79 in 1980, representing an increase by 9 per cent (Table 24 of the Statistical Annex).

Cotton is in second place in the primary production sector and in foreign exchange earnings.[1/] In addition, although on a seasonal basis, cotton production employs a large number of workers and supplies all the natural fibre needed by the textile industry of the region as well as a high proportion of the raw material required by the vegetable oil sector of the Central American countries.

Due in particular to a sharp reduction in the area under cultivation, which for the five countries taken together has declined from 417,900 ha. in 1978/79 to 277,700 ha. in 1979/80[2/], regional production of cotton has fallen by 33.2 per cent, with a corresponding reduction of 20.4 per cent in exports. At the country level, Nicaragua was most affected by this situation with a reduction of nearly 78 per cent in the area cultivated, so that Guatemala has become the major fibre producer in the region and has the highest unit yield.

Accordingly, for the region as a whole, cotton exports dropped back from a value of $CA 417.1 million in 1979 to $CA 332.1 million in 1980, despite a considerable increase in the average selling price of this product - from $CA 1,247.31 per metric ton to $CA 1,570 per metric ton in the years considered.

Bananas are in third place among exportable products of the primary sector in Central America. They are in second place for Costa Rica and Honduras, the largest exporters in the region.

[1/] Normally the countries of the region export about 96 per cent of their output.

[2/] The area under cultivation has diminished from 125,800 to 104,800 ha. in Guatemala, from 102,100 to 91,000 ha. in El Salvador and from 173,400 to 38,200 ha. in Nicaragua. There was a slight increase in Honduras, from 12,100 to 12,200 ha., and no change in Costa Rica (10,500 ha.).

Foreign sales by Central America totalled $CA 372.9 million in 1979, and were up 16 per cent in 1980, with a 6 per cent increase in the volume of exports - from 247,700 metric tons to 257,600 metric tons - and a 10 per cent increase in selling prices (Table 19 of the Statistical Annex).

In Central America, bovine meat has been increasing in importance as a source of foreign exchange earnings; nevertheless, in view of its significance for regional food requirements, this is one of the products whose development and perspectives have to be kept under review in order to ensure adequate supplies for domestic consumption and regional industry.

Over the period 1978-1980, production of bovine meat in Central America increased by about 1 per cent, from 282,100 metric tons to 287,100 metric tons. At the country level, there were pronounced increases in El Salvador, Honduras and Costa Rica, which latter country became the principal producer in the region in 1980, displacing Nicaragua. In this way, after having been the leading meat exporter in Central America, in 1980 Nicaragua dropped back to third place with 24,000 tons while Honduras became the principal supplier, with 37,000 tons followed by Costa Rica by 29,400 tons (Table 21 of the Statistical Annex). The region's average export values increased slightly in 1980, reaching $CA 2,583.89 per metric ton as against $CA 2,539.13 per metric ton in 1979 (Table 24 of the Statistical Annex).

Despite the importance of bovine meat for domestic consumption requirements, the export increase has reduced availabilities for domestic consumption. Indeed, out of total boned meat output in 1979 and 1980, 52.2 and 49 per cent respectively went to domestic consumption.[1]

In the last two years Nicaragua and Costa Rica had the highest per capita consumption, averaging respectively 9.9 and 9.4 kgs. annually, followed by Guatemala with 4.8, Honduras with 3.2 and lastly El Salvador with 2.8 kgs. (Table 23 of the Statistical Annex).

Sugar-cane cultivation in Central America has been boosted by growing foreign demand for sugar, resulting in considerably increased international prices.

The area under sugar-cane has been expanding rapidly and reached 232,100 ha. in the 1979/80 season, 3.1 per cent above the level in the preceding crop year. Nevertheless, sugar production dropped back from 1,209,200 metric tons in 1979 to 1,178,100 metric tons in 1980, due partly to a reduction in crop area in El Salvador, Nicaragua and Costa Rica together with an appreciable decline in yield per hectare in the two latter countries. As a result, exports are estimated to have declined in 1980 from 501,500 metric tons to 460,400 metric tons. Because of higher international prices, however, nearly all the countries can expect larger export earnings than in 1979, totalling for the region as a whole $CA 221 million in 1980 as against $CA 129.7 million in 1979.

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[1] As against 61.2 per cent in 1971.

As regards products for domestic consumption, it is particularly important to examine rice, maize, beans and grain sorghum, known in Central America as "basic cereals", because they are staple items in the national diet. In addition, these crops occupy a very substantial area - mainly small-holdings - and their cultivation is labour-intensive. Nevertheless, the total area under these crops has been gradually declining, particularly in the past two seasons. While productivity of these cereals has improved appreciably, it is also a fact that the increased yield has not offset the decline in acreage because, with the exception of rice, the harvest is not sufficient to meet consumption requirements and the deficit is tending to increase.

As may be seen from the following table, the area under these basic cereals in recent crop years has been smaller than in 1970/71.

TABLE 6

Central America: Area Sown and Production of Basic Cereals
1970/71 - 1978/79 - 1979/80 and 1980/81

	AREA SOWN (hectares)	PRODUCTION (metric tons)
1970/71	2,209,059	2,521,300
1978/79	2,383,399	3,346,239
1979/80	2,158,083	3,085,983
1980/81	2,111,346	3,062,677

Source: Tables 25 and 26 of the Statistical Annex

As may be seen from the above table, in 1979/80 and 1980/81 aggregate production of these cereals was down by 7.8 and 1.1 per cent respectively. For the 1979/80 crop year, according to latest consumption statistics, maize production was sufficient to cover 93.6 per cent of demand, grain sorghum 86.4 per cent and beans only 77.6 per cent, while there was a rice surplus (Tables 25 and 27 of the Statistical Annex).

As regards the share of each cereal in the total area under cultivation in Central America, there have been some changes except in respect of maize: (i) beans have been declining in importance, the relevant share having dropped back from 16.8 per cent in 1970/71 to 11 per cent in 1980/81; (ii) for the same crop years, the share of rice increased by 1 per cent but yield was up by two thirds in relation to 1970/71 because of substantially improved technology applied in rice cultivation; (iii) the share of grain sorghum also increased, from 11.3 per cent to 15.7 per cent in the crop years considered. Nevertheless, despite this moderate relative increase in the area under grain sorghum, productivity increased by more than 100 per cent and has been reflected in an annual average growth rate of 4.3 per cent in production between 1970/71 and 1980/81.

TABLE 7

Central America: Share of each Crop in Relation to Total Area Under Basic Cereals 1970/71, 1978/79 and 1980/81

(in percentage terms)

	TOTAL	MAIZE	BEANS	RICE	GRAIN SORGHUM
1970/71	100.0	64.7	16.8	7.2	11.3
1978/79	100.0	65.4	13.7	7.0	13.9
1980/81	100.0	65.1	11.0	8.2	15.7

Source: Table 26 of the Statistical Annex.

Maize is the basic cereal of greatest importance in the region in relation to the area sown, although this has varied from a share of nearly 84 per cent in Guatemala to 17.1 per cent in Costa Rica in the 1980/81 crop year. Regional output fell short of demand by 6.4 per cent in the 1979/80 crop year, when El Salvador was the only self-sufficient country and accumulated surpluses equivalent to 13 per cent of production. In the other countries, the production shortfall reached 3 per cent in Honduras, 6 per cent in Costa Rica, 11.6 per cent in Guatemala and 24 per cent in Nicaragua (Tables 25 to 27 of the Statistical Annex).

Special mention should be made of bean cultivation in Central America. This crop is the most important source of protein for the population and yet the area cultivated has declined from a total of 371,356 hectares in 1970/71 to 231,613 hectares in 1980/81 with a corresponding decline in production from 210,000 to 181,300 metric tons. In the last two crop years, 1979/80 and 1980/81, production of beans has dropped back by 21.7 and 10.4 per cent respectively, mainly due to substantial declines in Guatemala and Nicaragua. In the first of these countries, production was down from 80,500 to 57,900 metric tons between 1978/79 and 1980/81, while Nicaragua's output slumped from 76,000 to 28,000 metric tons. The production decline in these two countries is mainly attributable to a reduction in the area cultivated, yield having remained unchanged at 800 kgs. per hectare in Nicaragua and 900 in Guatemala; this latter country has the highest productivity in the area (Table 28 of the Statistical Annex).

In the 1979/80 crop year, with the exception of El Salvador and to a less extent Honduras - in which countries the bean crop was sufficient to meet 99 and 97 per cent respectively of consumption requirements - the shortfall for this cereal was of the order of 24 per cent in Nicaragua, 27.[illegible] per cent in Guatemala and more than 62 per cent in Costa Rica so that supplies had to be imported from third countries; beans are one of the few foodstuff products for which world supply barely meets apparent demand, and unless appropriate economic policy measures are taken in respect of this crop, within a very short time it might become unavailable on the international market.

All the Central American countries are self-sufficient in respect of rice; production is more and more in excess of regional demand so that increasing surplus amounts have become available for export and have been sold abroad with highly satisfactory results. This situation is basically due to greatly improved productivity which for the region as a whole increased from 1,535 kgs. to 2,474 kgs. per hectare, in conjunction with an increase in the area cultivated, resulting in a rise in production from 241,700 to 426,600 metric tons between 1970/71 and 1980/81 respectively. This last production figure is a little more than double regional consumption, estimated at around 200,000 metric tons (Table 27 of the Statistical Annex).

The major rice producer in the area is Costa Rica with 51.3 per cent of total output in 1980/81, whereas at the beginning of the decade Nicaragua had been in first place. Productivity in the region is highest in El Salvador at 3,700 kgs. per hectare, followed by Costa Rica and Honduras with 2,400 kgs. each (Table 28 of the Statistical Annex).

In Central America, the area under grain sorghum totalled 250,100 hectares in 1970/71 and 331,600 in 1980/81. Over the period considered, production rose from 274,600 to 418,100 metric tons. In the period 1978/79 to 1980/81, there was no change either in the area cultivated or in production, although the latter increased slightly because of higher productivity (Table 28 of the Statistical Annex).

With the exception of Nicaragua, which is self-sufficient in this product, and Honduras which has a declining deficit, production in the other countries fell short of requirements: by 10.9 per cent in El Salvador, 20.4 per cent in Guatemala and 31.8 per cent in Costa Rica in the crop year 1979/80 (Tables 25 and 27 of the Statistical Annex).

It is important to note that over the past ten years total output of basic cereals has been growing more slowly than population growth, highlighting the need to implement well-defined economic policies in this area, in order to reduce in the short term the relative dependence on supplies from third countries and, in the medium term, to achieve a better self-sufficiency ratio in the region as a whole.[1]

Notwithstanding the situation just described, some caution is appropriate in appreciating these phenomena, since production, distribution and consumption of basic cereals are affected by a number of variable factors that are not clearly visible in the statistics available, making it difficult at any given moment to discern the particular situation of each country and each of the cereals mentioned, since in respect of both of these factors there are undoubtedly circumstances of shortage and high prices that are not apparent from the statistical data utilized.

1.2 Industrial Sector

Industry has become one of the most important activities for the Central American economy. Because of its increasing rôle in generating earnings and employment, and above all its reactivating effect on the economy it is in a preferential situation in national economic policies.

In earlier decades, the idea of industrialization was so enthusiastically received that many developing countries embarked on an import substitution process for manufacturers without taking their limitations into account and without taking the appropriate steps to ensure a sound industrialization process.

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[1] Over the ten-year period 1970/1980 the average annual increase in imports of basic cereals reached a value of $CA 30 million.

Without attempting here to evaluate industrial development in Central America[1], in this chapter we shall outline the present situation of the sector, taking 1978-1980 as a reference period.

Industrial growth. Over the above-mentioned period, for the first time in twenty years growth in the Central American industrial sector was virtually stagnant. This situation, in contrast with the vigorous activity recorded in the early 1970s and more particularly in the 1960s, can be attributed to the following factors:

- Great political instability prevailing in the Central American region in the three years under review, which affected the climate of industrial investment as well as intra-regional trade and the integration process.

- Reduced purchasing power of the population in some countries, which is the main basis for growth in this sector, because of internal factors and the difficult conjunctural situation at world level.

- Widespread inflation, increased prices of petroleum and of a great many industrial raw materials which the sector imports from abroad. In addition, domestic inflation and the rise in prices of fuel have also been reflected in much higher domestic prices of intermediate goods, basic materials and services, thus raising production costs and limiting domestic demand for home-produced products.

- A sharp decline in Nicaragua's industrial activity in 1979 because of partial destruction of its industrial equipment during the period of hostilities, together with reduced activity in the manufacturing sector of El Salvador.

- One should also underline disruption of marketing channels in the most difficult months of fighting in these two countries, and partial interruption of their trade flows.

- Lastly, the inhibiting effects of many of the tax, monetary and exchange measures introduced by the countries over this period because of the conjunctural crisis that the region was experiencing, and the substantial outflow of capital from the Central American countries in recent years, together with payment difficulties in the reciprocal trade of those countries.

Over the period considered, the situation was not uniform in all the countries. While El Salvador recorded declining and negative growth, Nicaragua after some strong industrial contraction in 1979 reverted in 1980 to a growth rate that was the highest recorded for the countries of the region in the

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[1] SIECA is preparing an evaluation of the import substitution process which gave rise in Central America to the regional integration scheme.

three years considered, although without matching the levels of earlier years. Guatemala maintained a level of 6 per cent, while in Honduras and Costa Rica there was a downturn but no negative rates were reached.[1]

Industrial sector and regional economy. The contribution of manufacturing activity to regional value added has been rising over the 1960s and 1970s. Nevertheless, because of the difficulties mentioned in the preceding chapter, in recent years industry and the national economies have entered a period of recession and as a result that contribution remained stable at 18 per cent between 1978 and 1980. The level reached by the manufacturing sector in 1980 was higher than that recorded in 1960 (13 per cent) and 1970 (17 per cent). Slower industrial activity in all the countries of the region is being affected by the conjunctural problems already mentioned and also by some weakening of the import substitution process, particularly in respect of finished consumer goods. Statistics on the regional supply situation show that already in 1978 a high percentage of regional demand for industrial goods was being met by Central American industry. Within the region, self-sufficiency is particularly important in respect of foodstuffs, beverages, tobacco, footwear and clothing, wood and wood products, furniture and accessories for which the relative share is in excess of 85 per cent. This situation is causing a major problem for the import substitution process in that saturation is being reached in typical traditional activities, and a change of strategy will be necessary if the manufacturing sector is to continue to develop at high rates with incentive effects on the regional economy. In other words, in the period under consideration the industrial sector was at a crossroads because, in addition to the conjunctural limitations, of the relative stagnation of demand that has been accumulating over the past twenty years, mainly due to inadequate distribution of income and resources.[2]

The stagnation mentioned in the preceding paragraph is reflected in the fact that real value added for the industrial sector remained stable at a level slightly over 1,500 million during the three years considered. The country distribution of that value added was: 35 per cent for Guatemala, 24 per cent for Costa Rica[3], 17 per cent for El Salvador, 13 per cent for Nicaragua and 11 per cent for Honduras as may be seen from the following table:

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[1] See Table 3 on page 9.

[2] As a result of changes in income distribution that are being implemented or proposed by some countries in the region, it will be possible to expand internal demand for industrial products and encourage the sector, particularly in basic traditional activities such as foodstuffs, footwear, clothing, etc. at relatively low cost and using idle capacity at present available in these industries, improving their internal profitability and securing better utilization of manpower.

[3] For Costa Rica, industrial value added includes mining and quarrying.

TABLE 8

Central America: Value Added and Industrial Structure, by Country

1978 - 1980

	1970	Value added 1978	1979	1980	Average 1978-80	1970	1978	1979	1980	Average 1978-80
		$CA million					Percentage			
		(at 1970 prices)								
Central America	937.2	1,531.8	1,500.8	1,529.9	1,520.8	100.0	100.0	100.0	100.0	100.0
Guatemala	304.6	500.8	528.4	561.5	530.2	32.5	32.7	35.2	36.7	34.9
El Salvador	193.9	283.7	274.3	228.2	262.1	20.7	18.5	18.3	14.9	17.2
Honduras	100.1	158.1	170.6	179.9	169.5	10.7	10.3	11.4	11.8	11.1
Nicaragua	158.7	235.0	168.6	194.6	199.4	16.9	15.4	11.2	12.7	13.1
Costa Rica 1/	179.9	354.2 2/	358.9 2/	365.7 2/	359.6	19.2	23.1	23.9	23.9	23.7

1/ Includes "mining and quarrying"

2/ Rate of Exchange: $CA 1 = 6.625 Colones

Source: SIECA based on official national statistics.

It is interesting to consider the industrial situation of Central America in relation to the population of the various countries; in this case, Costa Rica is in a favoured position.

While in absolute figures Guatemala has a clear advantage over the other countries, in per capita terms Costa Rica is in the lead and well above the Central American average. Next, Nicaragua and Guatemala have per capita industrial values that are practically equivalent to the regional average, and while El Salvador and Honduras are below that average;

TABLE 9

Central America: Industrial value added per capita

(Average, 1978-1980)

$CA (at 1970 prices)

Central America	75.8
Costa Rica	166.0
Nicaragua	75.8
Guatemala	75.3
El Salvador	56.3
Honduras	32.0

Source: SIECA, Table 37 of Statistical Annex.

The relative positions mentioned above have remained unchanged the past two decades with fairly pronounced movements in per capita values: these have trebled in Costa Rica, doubled in Guatemala and Nicaragua, in El Salvador they have increased by 1.7 times and in Honduras by 1.3 times.

Concentration of industrial production. Within the Central American industrial process, manufacturing activity has continued to focus on consumer goods, in particular foodstuffs, beverages, textiles, footwear and clothing, which in 1978 together accounted for more than half of total value added. This situation is more or less similar in all the countries though with some structural differences in certain industrial sectors. That is the case for the chemical industry in Nicaragua, El Salvador and Costa Rica, for wood, wood products and non-metallic ores in Honduras, and for metal products in Guatemala (Table 38 of Statistical Annex).

Geographical concentration of industry. Just as regional industrial activity is concentrated on a few sectors, so industrial investment is located in a few urban centres, in the capitals and major cities of the country. Although this situation is not the most desirable from the point of view of productive activity in the various regions of national territory, the size of markets obliges industry to concentrate on the centres of densest population that are largely concerned with production of consumer goods to meet basic needs of the population. On the other hand, the basic infrastructure and services necessary for economic and efficient operation of industrial plant are found in the densely populated centres. During the period considered the Central American countries were making efforts and enacting legislation to encourage real geographical decentralization of industry.

Industrial foreign trade. Progress of industry from such very low levels to a point where it has become a strategic sector for internal growth of the countries in the region has been encouraged by formation of the Common Market, and intraregional trade reflects that reality. In 1978, exports of industrial goods accounted for 40 per cent of total exports by the Central American countries. Three quarters of all manufactures were sold within the region and the rest was despatched to third countries[1] (Table 39 of Statistical Annex).

This is a positive aspect of the Common Market in that it has allowed export diversification and limited to some extent the dependence of regional economies on the industrialized countries.

In addition, the Common Market has allowed competitive industries to be established through instruments such as the common tariff and the free-trade area, and has made possible some savings of foreign exchange through the Central American Chamber of Compensation.[2]

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[1] Based on ISIC

[2] SIECA studies indicate that many industries are producing and marketing their goods in Central America at competitive prices, showing up certain excessive rates in protectionist tariffs. This underlines the need and possibility to adapt the tariff profile to conditions of greater internal and external competitiveness for the benefit of the Central American consumer.

The interaction of trade flows within the region is considered seperately in the following section; in addition, the Statistical Annex (Tables 47 to 95) gives a detailed picture of the performance of each country in regional trade, with a breakdown by exports and imports, countries of origin and destination, NAUCA headings, principal products, quantity and value. The data cover the years 1978, 1979 and 1980.

The pattern of industrial exports by branches and sectors corresponds to the structure of production. Nevertheless, in considering performance of industrial exports, one must also take into account certain variable factors extraneous to domestic economies such as the situation in external markets, demand elasticity, competitive capacity in terms of prices and qualities, etc. In the period 1978-1980, production developed somewhat differently from exports. In addition, the difficult internal situation within the region has been an incentive to develop sales in foreign markets which, despite certain difficulties, offer the advantage of yielding foreign currency in exchange for products. This is particularly attractive in times when foreign exchange is scarce and internal prices are rising.

As regards industrial imports, it is interesting to note that about 90 per cent of Central American purchases is made up of manufactures (Table 40 of Statistical Annex). The value of these has increased four-fold in recent years and the trend is expected to continue. High price levels in the developed countries, already mentioned in the first chapter of this document, and the prospect of rising petroleum costs, examined in the chapter on energy, further support this expectation. This difficult situation underlines the need for integrated industrial development.

Lastly, one should underline certain developments of particular relevance in the industrial sector in the period 1978-1980. These include: a substantial qualitative change in the manufacturing sector of Nicaragua, following the victory of the Sandinist revolution; the search for new markets in which Guatemala and other countries in the region are engaged, particularly in the Caribbean area; and the growing flow of industrial trade between Costa Rica and Nicaragua. It is also relevant to mention the tax, monetary and credit measures adopted by the countries of the region in recent years[1], which have brought some elements of uncertainty into the manufacturing sector, and the relative stagnation of industrial investment in the area as a whole, except in Honduras.

The industrial situation in Central America in the past few years, together with the international economic situation, the state of gross domestic product and of the regional agricultural sector have largely determined the situation in regard to foreign trade, the balance of payments, financial and monetary matters; these are examined in the ensuing paragraphs.

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[1]SIECA is drawing up a document that examines all these measures and their possible impact on regional trade.

2. External sector

2.1 External sector and balance of payments

As already mentioned, the Central American economy is outward-looking and consequently very sensitive to changes and problems in the rest of the world. A rigid import structure as required by the development model pursued by the region, complicates the picture still further, because it does not readily allow any drastic reduction in imports - given the high imported content of production - in order to remedy severe balance-of-payments problems and sharp variations in the terms of trade.

Indeed, at present raw materials and capital goods for industry make up more than 50 per cent of Central America's imports; raw materials for the manufacturing sector account for 36 per cent of total imports and in addition to linking production and employment very closely to imported supplies, this situation constitutes one of the most direct means through which inflation in the industrial countries is carried into the region.

As regards its economic transactions with third countries, between 1970 and 1980 the Central American region accumulated a deficit on current account in excess of $CA 6,000 million largely due to the deficit in the services account.

Deterioration in the region's external sector became more pronounced in the period 1978-1980 when due to more rapid import growth and slower export expansion, the traditional deficit on current account, after having dropped back substantially in 1979 from the preceding year's level, climbed in 1980 to $CA 1,573 million, the highest level ever recorded in the history of Central America.

TABLE 10

Central America: Balance of Payments, Current Account
1978-1980

- $CA millions

Year	Central America	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
1978	-1,050.9	-267.9	-238.6	-157.2	-25.0	-363.1
1979	-661.5	-196.5	131.6	-198.5	160.8	-558.0
1980	-1,573.0	-154.1	-94.2	-323.3	-382.0	-619.4
			- Breakdown (%)			
1978	100.0	25.4	22.7	14.9	2.4	34.6
1979	100.0 1/	20.6	-	20.8	-	58.6
1980	100.0	9.8	6.0	20.5	24.3	39.4

1/ Calculated solely as aggregate for countries in deficit.

SOURCE: Table 46 of Statistical Annex

As may be seen from the above table, at the country level the largest negative balances have been recorded by Costa Rica, which in 1980 accounted for 39.4 per cent of the total Central American deficit on current account. In that same year, both Honduras and Nicaragua also had substantial deficits, more particularly the second country which in 1979 had recorded a considerable surplus for the first time since 1972. Although El Salvador also had a substantial negative balance, its situation is similar to that of Nicaragua since in 1979 it had also ended with a surplus. Guatemala, like Honduras and Costa Rica, has remained constantly in deficit although the latter has been declining, from $CA 267 million in 1978 to $CA 196.5 million and $CA 154.1 million in 1979 and 1980 respectively.

In the years considered and despite preventive measures taken, capital outflow was substantial, mainly for non-economic reasons. As a result, Central America has been resorting more frequently to external financing, more particularly in the public sector, despite increasingly severe contractual terms and loan conditions. Since the capital account has not sufficed to cover the deficit on current account, it has been necessary to draw on external reserves which have been declining steadily and in 1980 reached the lowest level recorded to date.[1]

As regards the net balance on capital account which from 1970 to 1977 had never been in deficit in any Central American country, with the exception of El Salvador in the last year mentioned, a sudden reverse trend has developed since 1978. The net balance was in deficit in 1978 and 1979 for Nicaragua, likewise for El Salvador in 1979, and in 1980 for Guatemala as well as El Salvador. Honduras and Costa Rica had positive balances in the years considered. This situation is basically due to a contraction in private capital, in respect both of direct investment and loans, so that despite an increase in government and bank capital, the capital account is insufficient to offset the increasing deficit on current account. As a result the region's external monetary reserves dropped back by $CA 129 million in 1978, $CA 183.6 million in 1979 and $CA 887.6 million in 1980 - this latter figure being unprecedented.

2.2 Regional trade

We shall examine below trends in regional trade from 1978 to 1980 and the present structure of this trade by sector, type of product, country and trade régime.

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[1] As we shall see later, this has caused a delicate situation for settlement of debit balances within the Central American Common Market.

The creation of the Central American Common Market, through the establishment of a common external tariff and a free-trade area, has had such an incentive effect on the import replacement process that from 1960 to 1969 the cumulative annual growth rate of regional trade reached 27 per cent.

From 1969 to 1971, due to the special situation of Honduras in the free-trade régime and resulting uncertainty this growth rate dropped back to 5 per cent. Once trade flows had been readjusted and bilateral agreements concluded between Honduras and the other countries, except El Salvador, expansion resumed and from 1971 to 1977 showed a rate of 21 per cent.

From 1978 to 1980 the pattern of regional trade was different. Central America is going through a period of great political agitation, there are financial difficulties in all the countries, inflation and higher petroleum prices have reduced the purchasing power of the population, investment prospects are unfavourable and prices of raw materials are rising in international markets.

These and the other problems examined in the preceding sections are in contrast with the encouraging situation and economic and financial stability prevailing in the 1960s and part of the 1970s, when the Central American Common Market was being structured and the import replacement process began. Taking into account these elements, the 16 per cent growth rate recorded in regional trade in this three-year period can be deemed satisfactory. In terms of value, it represents an increase by $CA 300 million, raising the level of regional trade to an amount in excess of $CA 1,000 million.

In 1980, trade between countries of the region accounted for more than one fifth of total exports by Central America, i.e. three times more than in 1960.

This rapid growth in trade between countries of the area, which from 1960 to 1980 multiplied by thirty-eight, is one of the main achievements of the economic integration programme. The dynamism and present importance of this trade bears witness to the high degree of inter-dependence existing between the Central American countries, underlining the need to take fuller account of this reality in the economic and social development programmes of each of the States of the region.

Similarly, the great importance of regional trade in the economic life of these countries reflects the integration achieved by the various producing sectors of the area, in particular in respect of industrial, commercial and financial activities. This situation and the bleak growth prospects that the world market offers to the external sector, conditioning growth of the countries concerned, and above all the far-reaching changes that have taken place in the economies of the area, point once more to the need for joint

action, based on inter-action and complementarity between sectors and countries, if Central America is to find a solution to the difficult economic situation and, through concrete achievements, undertake the necessary reactivation of the Central American Common Market. In this way efficacious and balanced use could be made of its great growth potential.

Commodity composition of regional trade. In the three-year period 1978-1980, manufactures continued to account for 95 per cent of Central American regional trade. In this percentage, chemicals are in first place, with one quarter of trade, followed by textiles with one sixth and in third place come foodstuffs, with one seventh of this trade. Next in order of importance are footwear and clothing, paper products, machinery and miscellaneous articles.

As already stated in connexion with the industrial sector, the substantial share of manufactures from traditional industries in regional trade reflects the fact that the import replacement process has been focussed basically on producing final consumption goods and some industrial raw materials. These two categories of goods together represented three quarters of intra-regional trade in 1980, with foodstuffs and clothing in first place, followed by chemical and pharmaceutical products.

Regional trade by country. In the three-year period under examination, the situation of individual countries in regional trade was as follows:

- Guatemala increased its positive balance five-fold, reaching $CA 223 million, the largest surplus achieved by any country within the regional market over its two decades of existence. This favourable position is attributable to extraordinary expansion of its sales to the Common Market, while maintaining relatively stable purchase levels. Indeed, this country's exports to the Common Market were up from $CA 255 to $CA 441 million while its imports from Central America increased by only $CA 10 million.

  Guatemala is the only country that has had positive balances with all the members of the Common Market since 1975, and at increasingly high levels. Its surplus for 1980 was made up as follows: El Salvador 43 per cent, Nicaragua 36 per cent, Costa Rica 11 per cent and Honduras 10 per cent.

- El Salvador, for its part, maintained steady export growth during the period under consideration, although at rates less spectacular than Guatemala. Nevertheless, its purchases were abnormally high in 1980, totalling $CA 63 million and resulting in a deficit of $CA 29.4 million as against a surplus of $CA 7 million in 1979.

- Honduras has performed satisfactorily; its deficit has gradually been reduced from $CA 42 million in 1978 to $CA 38 million in 1979 and $CA 20 million in 1980, with parallel but favourable increases in both exports and imports.

- As regards Costa Rica, like Guatemala and Honduras this country has improved its balance with Central America considerably, and in 1980 its exports totalled $CA 91 million while imports continued at a fairly low level. The resulting positive balance totalled $CA 47 million, whereas this country had traditionally been a debtor rather than a creditor.

Nicaragua is currently in the most unfavourable situation over its twenty years of trade with Central America. Whereas it had a positive balance in 1978, it recorded a deficit of $CA 21 million in 1979 which increased ten-fold in 1980 to the level of $CA 225 million. This situation is attributable to two circumstances: first, a decline in exports from $CA 146 million to $CA 75 million and second, an increase in purchases from neighbouring countries, in particular Costa Rica and Guatemala. In other words, while its sales dropped back by about 50 per cent in three years, its purchases more than doubled. It should be underlined that Nicaragua's trade balance with Central America is strongly affected by the substitution effect of extra-regional trade by Central American trade; this situation deserves more detailed analysis.[1]

[1] As regards the situation by country, it should nevertheless be underlined that a surplus of one country in its regional trade does not necessarily imply that it is in a better situation than another that has a deficit, since what really matters is the value added that these countries are managing to generate through intraregional trade.

TABLE 11

CENTRAL AMERICA: REGIONAL TRADE BY COUNTRY

($CA million)

	1978	1979	1980
GUATEMALA			
Exports	254.9	310.3	440.8
Imports	207.6	207.5	217.8
Balance	+47.3	+102.5	+223.0
EL SALVADOR			
Exports	233.6	263.6	289.3
Imports	239.9	256.9	318.7
Balance	-6.3	+6.7	-29.4
HONDURAS			
Exports	49.2	59.8	83.9
Imports	91.5	98.5	103.5
Balance	-42.3	-38.7	-19.5
NICARAGUA			
Exports	146.3	90.1	75.4
Imports	138.9	111.2	300.6
Balance	+7.4	-21.1	-225.2
COSTA RICA			
Exports	178.6	175.4	266.4
Imports	203.0	211.7	219.3
Balance	-24.4	-36.3	+47.1

Source: Tables 47, 48 and 51 of Statistical Annex.

Present situation of regional trade according to trade régime. In accordance with the legal framework in regard to economic integration, natural or manufactured products originating in the member States enjoy free trade, subject to the exceptions stipulated in Annex A of the General Treaty. It is estimated free trade covers 90 per cent of products; those listed in Annex A are excluded in general or partially or are subject to compliance with certain conditions.

Another exception to unrestricted free trade is the case of products included in a system of voluntary quantitative restraint, being sensitive items: textiles, footwear and clothing. These articles were brought under quotas by Costa Rica in 1971, but these have been eliminated, and then by Nicaragua.

Special mention should be made - because they are not covered by that legal framework - of the bilateral agreements that Honduras has concluded with three countries of the area.[1]

In the last two years imports by Honduras from Central America reached a value of $CA 99 and $CA 103 million respectively, 74 per cent of these purchases being under those agreements.

In 1979 and 1980, the value of exports by Honduras to countries in the region totalled $CA 60 and $CA 84 million respectively. More than 92 per cent of these amounts were covered by bilateral agreements.

The present situation of intra-regional trade in Central America brings out differences of treatment in regard to products traded within the area, ranging from free trade to import quotas, and including transit régimes, tariff surcharges and bilateral agreements.

This situation highlights the need to bring order into the free-trade area in order to adjust the various trade régimes to present realities and establish for the parties subject to the integration process - governments and individual persons - clear rules of the game and centralized institutions for their efficient operation.

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[1] In the very near future, following negotiations between the Governments of El Salvador and Honduras trade between the two countries will be restored through signature of a bilateral agreement.

3. Financial situation

Three well-defined stages can be discerned in the 1970s in regard to public finance of Central America. The first stage comprises the three first years of the decade, characterized by moderate growth of both revenue and expenditure. The second stage covers the next five years (1973-1977), when as a result of tax reform measures and dynamic performance of the economies, revenue was increasing at an annual rate in excess of 20 per cent. The third stage comprises the latter part of the decade (1978-1980) when, due basically to a progressive slowdown in economic activity within the region, the public finance situation was deteriorating seriously. As a result, while current revenue was increasing at an annual average rate of 12.1 per cent between 1978-1980, current expenditure was rising by 16.5 per cent so that the surplus on current account dropped back by 63.8 per cent over the period considered.

TABLE 12

CENTRAL AMERICA: CURRENT GOVERNMENT REVENUE AND EXPENDITURE, 1978-1980

	1979	1980	1980-1978
1. Current revenue			
Guatemala	0.9	12.2	6.4
El Salvador	16.1	-13.6	0.2
Honduras	19.0	19.8	19.4
Nicaragua	-8.3	91.2	32.4
Costa Rica	5.7	23.4	14.2
Central America	6.3	18.1	12.1
2. Current expenditure			
Guatemala	13.4	30.5	21.7
El Salvador	4.7	3.4	4.0
Honduras	1.1	13.7	6.6
Nicaragua	-9.8	70.6	24.1
Costa Rica	16.3	23.4	19.8
Central America	7.4	26.3	16.5

Source: Table 99 of Statistical Annex.

As a result, for the region as a whole the surplus on current account dropped back from $CA 168.7 million in 1978 to $CA 158.5 million and $CA 22.1 million in 1979 and 1980 respectively.

The countries most affected were Nicaragua and Costa Rica, which in the three years considered had a deficit in current budgetary expenditure by the central government, particularly in Costa Rica where the deficit is increasing rapidly, while Nicaragua's deficit has been rising more slowly in absolute figures.

As regards operations on capital account, income has remained virtually stationary while expenditure has increased considerably as a result of an expansion policy in regard to public expenditure aimed at maintaining adequate levels of investment and employment. The net balance of capital expenditure was up 15.5 per cent in 1979 and 49.1 in 1980, in which year it totalled $CA 1,312 million for the region as a whole.

The high level of expenditure and the substantial deficit on current account together made up an aggregate operational budget deficit that was increasing at an average annual rate of 47.5 per cent from 1978 to 1980. The most rapid growth in the negative balance was in Guatemala, where the budget deficit increased from $CA 9.6 million in 1978 to $CA 179.2 million in 1979 and $CA 385 in 1980.

The budgetary deficit of this country became particularly acute in 1980, reaching a level 78.8 per cent above that of the preceding year, as may be seen from the following table:

TABLE 13

CENTRAL AMERICA: CENTRAL GOVERNMENT BUDGETARY DEFICIT, 1978-1980

($CA million)

	1978	1979	1980
Guatemala	9.6	179.2	385.0
El Salvador	109.6	52.4	156.4
Honduras	104.2	95.9	186.5
Nicaragua	164.4	70.1	188.6
Costa Rica	205.4	323.9	373.4
Central America	593.2	721.5	1,289.9
Guatemala	1.6	24.8	29.8
El Salvador	18.5	7.3	12.1
Honduras	17.6	13.3	14.5
Nicaragua	27.7	9.7	14.6
Costa Rica	34.6	44.9	28.9
Central America	100.0	100.0	100.0

Source: Table No. 100 of Statistical Annex.

Unlike the situation during most of the 1970s, in the last three years the budget deficit has been financed to an increasing extent out of domestic resources. This indicates that since possibilities of finding external resources are becoming increasingly limited, the countries are resorting to internal indebtedness, giving rise to considerable monetary expansion. Even where resources have been obtained in the form of bonds issues, most of these have not been sold to the public but have had to be taken up by the central bank, with the risk that this mode of financing could encourage and intensify the inflationary process.

In this way, the share of external resources in financing the budgetary deficit has gradually dropped back from 54.1 per cent in 1978 to 42.2 and 33.9 per cent respectively in 1979 and 1980 for the region as a whole (Table No. 100 of the Statistical Annex).

4. Monetary situation

As regards the financing of economic activity in the period 1978-1980, two very important facts can be seen. First, a relative increase in means of payment because of a larger liquidity coefficient (ratio between means of payment in circulation and GDP at current prices) and second, that the increase in means of payment is largely of domestic origin and is used to finance public administration, while credits intended for financing private activities have developed more slowly.

The liquidity coefficient for the region as a whole reached 13.1 per cent in 1978, 14.1 per cent in 1979 and 13.4 per cent in 1980. There were considerable variations at country level, from a low of 9 per cent for Guatemala in 1980 to a high of 26.2 per cent for Nicaragua in 1979, as may be seen from the following table:

TABLE 14

CENTRAL AMERICA: LIQUIDITY COEFFICIENT 1978-1980
(Percentage)

	1978	1979	1980
Guatemala	10.3	10.0	9.0
El Salvador	14.0	15.1	15.0
Honduras	13.1	12.5	11.8
Nicaragua	12.6	26.2	19.5
Costa Rica	17.5	16.9	17.3
Central America	13.1	14.1	13.4

Source: Tables No. 101 and 106 of Statistical Annex.

It should be noted that any increase in the liquidity coefficient and means of payment can further aggravate inflation.

As regards internal assets, loans granted to various foreign economic agents increased from $CA 4,420.7 million in 1978 to $CA 7,474.4 million in 1980, i.e. at an average annual rate of 30 per cent. Although the major part of these credits went to the private sector, the latter is declining in relative importance. Indeed, while credits to this sector showed an average increase of 13.2 per cent between 1978 and 1980, credits for the public sector were up by 89.3 per cent, so that for the region as a whole the share of the latter sector rose from 16.8 per cent to 35.5 per cent over the period considered.

It should be noted that in this case the average for the region conceals a broad fork of percentage shares: whereas in 1980 the public sector of Guatemala took up 23.5 per cent of total internal credit, in Costa Rica this share reached 52.8 per cent (Table 101 of Statistical Annex).

For the region as a whole, since having reached a peak in 1977 ($CA 1,214.3 million), net external reserves have been progressively declining and in 1980 reached a negative level of the order of $CA 37.5 million. Indeed, the situation of these reserves is so serious that in 1980 only two countries, Guatemala and Honduras, had a positive balance, as may be seen from the following table:

TABLE 15

CENTRAL AMERICA: NET EXTERNAL RESERVES

($CA millions)

	1978	1979	1980[1/]
Guatemala	743.7	650.8	370.3
El Salvador	234.4	126.3	-69.9
Honduras	133.2	116.2	55.1
Nicaragua	-225.4	-274.3	-362.8
Costa Rica	191.3	117.0	-30.2[2/]
Central America	1,077.2	736.0	-37.5

[1/] Preliminary figures

[2/] Including $CA 65.3 million of exchange rate differences

Source: Central American Central Banks.

B. Special problems in the recent economic development of the region

1. Inflationary process

For many years, prices were rising moderately in Central America, in parallel with the trend in industrialized countries. Since about 1973 this situation has changed and has required increasing attention from the governments of the region.

One of the characteristics of the current inflationary process is that it is general in the western world. Another important aspect is that in earlier periods inflation, which mainly affected a few Latin American countries, was in general accompanied by stagnation of foreign trade whereas now, on the other hand, it develops in periods of rapid international trade expansion and follows trends in import and export prices. In recent years international trade has been showing clear signs of weakness since the industrialized countries, or at least the principal ones, have entered a phase of economic recession, but prices have continued to rise and one of the economic policy objectives of those countries is to slow down the increase.

In Central America, apart from specific structural pressures on the economy, inflation is "imported" to some extent because of the degree to which the economies are outward-looking; in other words, foreign trade has been a carrier for inflation. One could say in brief that in Central America the impact of this inflation has been seen in one or other of the following forms:

- in the first place, sudden increases in prices of imports have been carried into internal price systems, all the more so because the Central American economies are outward-looking and these countries are net importers of petroleum. Nevertheless, the inflationary impact has been less pronounced than in the more industrialized Latin American countries because, as experience has shown, inflation indices have been lower in the countries where the more backward sectors of the economy are predominant or of considerable significance and the sectoral relationships are weaker;

- in the second place, the price increases recorded in certain years for export products have also had inflationary effects because foreign exchange purchases by the Central Bank have increased liquidity in the economies of the region, while domestic supply of goods has not been able to respond soon enough to increasing demand. Similarly, increased purchasing power of exporting sectors has strengthened pressure on the domestic market, and in particular on demand for imported products.

In this way, because of continuing increases in the consumer price index, the various Central American currencies are gradually losing their purchasing power, in other words the purchasing power of money is declining. The following table shows trends in the purchasing power of each of the currencies of the area, calculated according to the general consumer price indices used by each country.

TABLE 16

CENTRAL AMERICA: Index of purchasing power of currency

1975 - 1978

1975 = 100

	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
1975	1.00	1.00	1.00	1.00	1.00
1976	0.91	0.93	0.95	0.97	0.97
1977	0.81	0.84	0.88	0.87	0.93
1978	0.75	0.74	0.83	0.84	0.87
1979	0.67	1/	0.76	0.56	0.80
1980	0.61	1/	0.65	.46 2/	0.68

1/ El Salvador has discontinued this index, replacing it by a new one that does not match the data of the preceding series.

2/ Average January-March 1980

Source: Table No. 17 of Statistical Index.

As may be seen, currency depreciation became more rapid from 1978 on and has been particularly pronounced in Nicaragua, where in March 1980 the purchasing power of a córdoba of 1975 was only C$0.46 centavos.

One last remark regarding the increasing rôle being played in the region by domestic financing of the budgetary deficit of the central governments which, as stated in the section on public finance, is contributing to spread and speed up the inflationary process by expanding money supply.

2. Energy problem

Over the past decade, demand for energy in Central America has been growing in step with output, and in a proportion of slightly more than 1.3 in relation to the production growth rate.

This demand has been met primarily through consumption of vegetable fuels - wood, charcoal and bagasse - used mainly in the rural areas for household and subsistence needs; petroleum and petroleum products, largely imported except for small production in Guatamala that started four years ago; hydro-electricity; and thermal electricity, production of which utilises more than 20 per cent of the petroleum-based fuels.

In Central America, more than 54 per cent of consumer requirements are met by vegetable fuels, approximately 42 per cent by petroleum and petroleum products, and 4 per cent by hydro-electricity.[1]

In 1979, consumption by the region comprised 16 million tons of wood with a calorie value equivalent to 5,334,000 tons of petroleum equivalent; 4,091,000 tons of petroleum and petroleum products to which Guatemala's domestic production contributed 80,000 tons. 6,751 million KWH were generated of which 4,073 million of hydraulic origin and 392 million of geothermic origin. Total electric energy generated was equivalent to 578,000 tons of petroleum while electric energy of hydraulic and geothermic origin was equivalent to 381,000 tons of petroleum equivalent.

Energy marketed comprises a small share of wood and charcoal, used in bakeries and small local industries producing lime, bricks and salt as well as hydro-electric and geothermal energy of local origin.

Expenditure in the energy sector is mainly in respect of imports of petroleum and petroleum products, at greatly increased prices due to the world market situation. In the Caribbean area the average price of hydro-carbons has risen from $3.50 per barrel in 1973 to $34 at the end of 1980, representing a ten-fold increase. In 1979 the c.i.f. value of petroleum imports was $840 million.

For the future, assistance is expected under the Energy Co-operation Programme set up under the agreement with Venezuela and Mexico which guarantees supply in the short term for the Central American and Caribbean countries and grants them credits for payment over a five-year period of up to 30 per cent of their petroleum bills at 4 per cent interest. When utilized for development projects, mainly in the energy sector, these credits can be converted into twenty-year credits at 2 per cent interest.

As regards petroleum prospection in Central America, Costa Rica and Nicaragua are launching research activities through State bodies, with the aid of the Governments of Mexico and Venezuela, through PEMEX and the Venezuelan Petroleum Corporation. In Costa Rica, drilling of a prospection well is to begin shortly in the Talamanca region.

Honduras has concluded three research contracts with transnational companies for offshore prospection near Trujillo.

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[1] This percentage varies from country to country: 12 per cent in Costa Rica but less than 2 per cent in Guatemala.

In Guatemala, five research contracts have been concluded with transnational companies which have found productive wells in the Tortugas, Rubelsanto, Chinajá, Yalpemech and Xan oilfields. Two of these oilfields have officially been declared commercially exploitable and are now in production; in 1980, approximately 200,000 tons of petroleum were exported, and 82,000 tons were consumed domestically.

As regards short-term prospects, the rise in petroleum prices, together with the cost of investments in hydro-electric projects, have in general tended to reduce the relationship between the increase in production and in consumption of energy; in the short term, therefore, imports of petroleum and petroleum products are likely to continue at the current level, but the value of imports will increase to the extent that the world market price of petroleum rises still higher. This year, a slight downward trend can be seen but this will be reversed at the beginning of winter in the northern hemisphere because of increased demand and the agreements that members of OPEC are endeavouring to conclude in order to align production with demand.

Furthermore, several major hydro-electric projects will come into operation in the near future at Chixoy (Guatemala), El Cajón (Honduras), San Lorenzo (El Salvador) and Corobicí (Costa Rica). The energy they produce will meet increased demand for electricity and replace thermo-electric energy, reducing consumption of hydrocarbons by this sector.

Consumption of vegetable fuels will continue to rise in step with population increase, causing and intensifying what is already termed "the second energy crisis" because of the disastrous effects on the environment of uncontrolled exploitation of forest resources resulting in "desertization" and the loss of soil and water resources, with unfavourable effects on climate. Carefully planned action will be needed to rationalize wood consumption by using higher-yield stoves and planting rapid-growth trees so as to increase resources, together with the introduction of processes using agricultural and forest residues in order to reduce pressure on the limited forest resources.

As regards the increase in petroleum prices in the countries of the region, experience over the past decade shows that aggregate demand for energy has been elastic in relation to prices. In other words, this demand has increased following the production growth, although prices have continued to rise. This has not been the case in respect of certain products such as petrol, of which the volume consumed has declined because of price elasticity.

Central America has had to make a considerable effort to adjust to new conditions for purchasing energy from third countries. Experience of earlier years shows that the adjustment capacity of the region has been greater than was initially expected, because the rise in prices of petroleum and petroleum

products coincided with an increase in the value of exports. On the other hand, Central America has resorted increasingly to external indebtedness in order to cover its trade deficit to a greater extent and safeguard its international reserves.

For financing external indebtedness, the region has received co-operation from the Venezuelan Investment Fund under the assistance agreement signed by that Fund with the central banks of the Central American countries in order to help them face their balance-of-payments problems.

The situation today is very different and will remain so in coming years; this must be taken into account. On the one hand, recent increases in petroleum prices have not coincided with corresponding increases in export prices, and do not seem likely to in the short term. On the other hand, Central America is very close to the limit of its external indebtedness possibilities, not only because of the total amount of that indebtedness, but also because its structure has changed over the past decade because of the tapping of resources, loans having been contracted for shorter periods and at higher interest rates. Difficulties not encountered in the past can be expected for obtaining new credits in future.

One is bound to conclude that Central America does not now have the same adjustment capacity as in the 1970's, and so long as consumption of imported hydrocarbons is not reduced, which will only be possible in the long term, and at the cost of considerable investments, its foreign trade and payment capacity vis-à-vis the rest of the world are likely to be subject to much greater pressure.

Nevertheless, this situation may be eased to some extent through the Energy Co-operation Programme provided for under the Agreement concluded with Mexico and Venezuela which ensures supplies for the countries concerned and grants them credits on very favourable terms for the payment of 30 per cent of their petroleum bill. Furthermore, since petroleum production is likely to develop in Guatemala, and prospection in Costa Rica, Honduras and Nicaragua has yielded promising results, the adverse effects of the petroleum crisis for the region may be eased in the medium term.

Similarly, the major investment efforts for the construction of hydro-electric power stations are beginning to yield results and the region will become less dependent than at present on hydrocarbons for generating electricity.

Lastly, action is essential in order to develop the tapping of new and renewable energy sources, and encourage demand to rationalize consumption, so that the countries of the region may be less dependent on imported hydrocarbons.

PART II

III. COUNTRY NOTES, 1978-1979[1/]

This section briefly outlines recent economic trends in each of the Central American countries. This is not a detailed analysis, the latter having been made in the preceding chapter, which considers the Central American economy as a whole; we shall now merely underline certain phenomena specific to each country, examining the possible causes determining present overall growth rates and trends in the various economic aggregates.

A. Guatemala

The economy of Guatemala was formerly characterized by sustained activity that was reflected in favourable economic growth rates. Since 1978, this trend has slowed down abruptly, due to factors of non-economic origin as well as the speeding up of inflation, which has progressively impaired the purchasing power of the national currency because of the increase in the general price index.

The economic recession that the country has been experiencing in recent years is reflected in the development of overall supply and demand. In terms of 1970 prices, demand progressed by only 2.3 per cent between 1978 and 1980, following the decline in gross fixed capital investment reflected, in the private sector, in stagnation of consumption and a slowdown in exports of goods and services in 1980.

As regards overall supply, one should note in particular the progressive decline in imports of goods and services, from $CA 602 million in 1978 to $CA 513 million in 1980. This trend is largely attributable to the economic and political uncertainty prevailing in the region, which, in addition to diminishing external financing opportunities, including supplier credits, has resulted in a reduction in purchases of capital goods abroad. In addition, one should take into account that the increase in world market prices, in conjunction with the decline in imports of non-essential articles, can in part account for the decline in imports.

Domestic supply, i.e. gross domestic product, increased moderately between 1978 and 1980 (by 4.2 per cent annually on average). As a result, GDP[2/] was stagnating over this period.

The situation has been declining progressively in the major sectors of the economy, with the exception of the industrial sector, where relatively rapid expansion is largely attributable to pronounced growth of exports of manufactures to other member countries of the Central American Common Market.

[1/] This analysis is based on the country tables included in the Statistical Annex.

[2/] Per capita

In the agricultural sector as in that of trade, the growth rate is constantly declining and in the former is even lower than population increase. On the other hand, growth of the extraction industries, although this sector is less important than those just mentioned, was substantially stronger during the years considered, because of commercial exploitation of oilwells. In 1980 growth was also vigorous in the construction sector (11.6 per cent).

Over the period considered, the consumer price index was rising rapidly and at the end of 1980, the quetzal had a purchasing power equivalent to 61 centavos of 1975. Among the prices included in that index, the largest increase was in housing, followed by clothing.

Economic relations with other countries are unfavourable to Guatemala. In 1980, despite a slight reduction in the deficit on current account due to a small surplus in the net trade balance, the balance on capital account was negative for the second year running, due partly to capital outflow and to a reorientation of public sector demand for credit towards internal indebtedness; this development, in conjunction with a considerable deficit on short-term private credit, resulted in a decline in international reserves of the order of $CA 15.1 million in 1979 and $CA 249.2 million in 1980.

It is beyond doubt that in 1979 and 1980 Guatemala pursued a sustained policy of expanding public expenditure to offset the slowdown in foreign investment and private local investment. Accordingly, capital expenditure (net investment) by the central government increased by 15.5 per cent in 1979 and nearly 50 per cent in 1980 when it totalled $CA 1,312 million. Because of this expansion of investment and the impossibility of financing it out of savings on current account, the State budget was increasingly in deficit; in 1980, contrary to what had happened in earlier years, this deficit was largely financed (66.1 per cent) out of funds of domestic origin.

As regards the monetary aspects, the most important development was the establishment of exchange control in April 1980 to check capital outflow and the consequent drain on international monetary reserves. In addition it is important to note that the liquidity coefficient (ratio between money in circulation and gross domestic product at current prices) dropped back from 10.3 per cent in 1979 to 9 per cent in 1980.

B. El Salvador

The social and political events that are causing disturbance in this country are the main cause of the increasingly severe deterioration in its economy.

Indeed, with the exception of imports of goods and services in 1980, all the macro-economic aggregates have been showing a quantitative reduction from 1978 to date. Accordingly, in constant prices of 1970, aggregate demand in 1980 was equivalent to 85 per cent of demand in 1977. This deterioration is the result of a continuing decline in consumption and private investment, because clearly the public sector has endeavoured to maintain a certain level of economic activity through its expenditure, its efforts being reflected in positive growth rates for the two variables concerned, in particular 1980 when public consumption increased by 4.2 per cent and investment by 10.6 per cent, while the corresponding rates in the private sector were -11.6 and 49.1 per cent respectively.

Exports of goods and services have also dropped back appreciably; they had increased by 24 per cent in 1979, but declined by 31.0 per cent in the following year.

As regards global supply, both domestic and external, the trend has been downward. Imports of goods and services fell back from $CA 574.4 million in 1978 to $CA 405 million in 1980. This trend is probably attributable not only to the contraction in private consumption but also to the effects of the Law on International Transfer Control which was promulgated by Decree No. 128 of 22 February 1980 and introduced import restrictions.

Following the decline in activity in the two main economic sectors, gross domestic production, which had progressed in real terms by 4 per cent in 1978, dropped back by 1.1 per cent in 1979 and 8.7 per cent in 1980. The trend was not uniform in all sectors; industry was the most affected by the recession and showed an average annual decline of 10.3 per cent between 1978 and 1980, while over the period considered activity fell back by 3.4 per cent in agriculture and 7.6 per cent in trade. As a result, per capita product declined sharply, from $CA 431 pesos in 1978 to $CA 296 pesos in 1980, the lowest figure in the region.

On the other hand, inflationary pressures are being felt increasingly in the economy of El Salvador and this, in conjunction with an increase in unemployment because of the slowdown in economic activity, is resulting in an increasingly difficult social and economic situation which is complex to solve.

During the years considered, balance-of-payment disequilibria also became more pronounced, in particular because of a deficit on capital account that was largely attributable to private capital outflow, ultimately causing decapitalization of the economy and progressive draining of the country's international liquidity. As a result, El Salvador's overall transactions have shown increasing deficits that have resulted in a loss of external monetary reserves of the order of $CA 108.1 million and $CA 196.2 million in 1980.

Furthermore, following the slowdown in economic activity, current receipts by the Central Government, which had increased by a little more than 16 per cent in 1980, fell back by a like proportion in 1980; the

situation was further aggravated by a 3.4 per cent increase in operational expenditure so that the surplus on current account in the Government budget, which had sufficed to finance nearly 70 per cent of capital expenditure in 1979, covered only 20 per cent in 1980. It should also be noted that public investments increased considerably in 1980 and that the fiscal deficit almost trebled in relation to 1979.

Because of its political and social situation, El Salvador is having increasing difficulty in obtaining the external credits it needs to revive the national economy, so that a growing part of the budget deficit has had to be financed by domestic loans, and foreign financing has dropped back from 48.3 per cent in 1979 to 13.2 per cent in 1980.

As a result, net internal credit granted to the public sector has expanded from $CA 78.4 million in 1978 to $CA 215.5 million in 1979 and $CA 670.6 million in 1980, in the context of a policy of boosting public expenditure in order to maintain acceptable levels of investment and employment.

C. Honduras

From 1976 to 1979, the economy of Honduras was very active with a GDP growth rate in excess of 6 per cent in real terms in each of the years considered. Various factors contributed to this trend, in particular sustained expansion of exports of goods and services and increasing private investment, particularly in the construction sector.

One can say that, social and political tensions in the country being less strong than in other countries of the region, Honduras has enjoyed a favourable climate for national investment, and also for inflow of foreign capital and to a less extent Central American capital. Nevertheless, in 1980 economic activity slowed down as a result of a 2 per cent decline in agriculture, the most important sector, which accounted for 28.1 per cent of GDP in 1979. This situation was also attributable in great part to a slowdown in industry and trade in particular, growth in the latter having declined from 8.3 per cent in 1979 to 3.4 per cent in 1980.

As a result, the real growth rate of GDP was barely 2 per cent in 1980, reflected in a reduction of 4 pesos in per capita product, from $CA 302 in 1979 to $CA 298 in 1980.

Overall demand developed slowly in 1980, basically because of the contraction in exports of goods and services (-0.8 per cent) and the decline in investments, which were down 0.3 per cent from the preceding year's level. In this connexion one may note that public investment was relatively active and increased by 2.7 per cent in 1980, after having dropped back by more than 5 per cent in 1979. Nevertheless, public investment was not sufficient to offset the decline in private investment in 1980 (2 per cent) which is attributable both to non-economic factors - social and political tensions in the region - and to stagnation of credits granted to the private sector, which were barely 1.6 per cent above the preceding year's level.

The expansion of public expenditure on fixed capital investments is the result of a well-defined incentive policy for internal demand; nevertheless, in this way the public sector is strongly increasing internal indebtedness which has risen by nearly 15 per cent in relation to 1979. It should be noted that this policy of internal indebtedness allows the public sector to contribute more to total internal credit; thus its share increased from 16.5 per cent in 1978 to 18.9 per cent in 1979 and 28.2 per cent in 1980; this trend is also attributable to the fact that, despite the strong increase in the surplus on the current account of the central government budget in 1979 and 1980, the considerable amount of investments made has caused increasing budget deficits which are more and more being financed with internal credits (23.5 per cent in 1978 and nearly 35 per cent in 1980).

The deterioration in the external relations of Honduras is becoming increasingly serious. The balance on current account, which is traditionally in deficit, reached a record level in 1980 with a negative balance of $CA 323.3 million after having been increasing at an average rate of nearly 44 per cent between 1978 and 1980.

Net capital movements are increasing, although less rapidly than the deficit on current account and this situation accounts for the progressive decline in external monetary reserves, by $CA 17 million approximately in 1979 and $CA 61.2 million in 1980. This unfavourable situation in the external sector is directly reflected in the monetary liquidity of the economic structure which has been falling off progressively in recent years, thereby further accentuating the trend towards recession in the economy of Honduras.

Since 1977 inflation has been rising, in particular in the clothing and foodstuff sectors. The effect of the increase in prices on the loss in purchasing power of the lempira can be evaluated if one considers that in 1980 the lempira had lost 35 per cent of its purchasing power in relation to 1975.

It is clear from the general picture described in the preceding paragraphs that the economy of Honduras is having to face not only problems of internal origin but also strong pressures resulting from the unfavourable international conjunctural situation and from tensions caused by social and political instability in the region.

D. Nicaragua

Three well-defined stages can be discerned in the recent development of Nicaragua's economy:

- The first covers the two-year period 1976-1977 during which the economy was relatively active, although the level of external indebtedness was rising;

- the second stage was marked by serious armed conflict within the country in 1978 to 1979, resulting in heavy material losses for the country's production apparatus. In this period, the contraction of economic activity was so strong that in 1979, real gross domestic product fell back to a level lower than in 1971;

- the third stage corresponds to the substantial relative recovery in 1980. In that year, there was strong expansion in the principal sectors of the economy, though without reaching the levels recorded in 1978 and this recovery was achieved despite a downward trend in agriculture which in turn was reflected in a decline by nearly 17 per cent in Nicaragua's exports of goods and services.

An analysis of these two last stages, i.e. the period 1978-1980, shows that the effects of the strong recession in the first two years considered - during which GDP in constant prices of 1979 fell back by 7.1 per cent and 25.8 per cent respectively - will continue to have a negative impact on the country's economy. Accordingly, real GDP which in 1980 was up by 18.9 per cent, can be expected to continue to develop at the same rate for two further years to reach a level slightly above that recorded in 1977, which year is considered as "normal" for the Nicaragua economy.

Nevertheless, aggregate demand progressed by nearly 43 per cent in 1980, because of an increase in consumption of the order of 46.7 per cent attributable both to active public consumption, which doubled in relation to the preceding year, and to private consumption which was up by 31.7 per cent. Gross fixed capital investment also doubled, entirely as a result of activity in the public sector, while private investment dropped back for the second consecutive year. It is important to note also that in 1980, for the first time since 1977, some formation of stocks was possible, reaching a value of $CA 20.5 million.

External relations deteriorated between 1978 and 1980 due to the general downturn in economic activity which, combined with increasingly rapid expansion of domestic consumption, led to a substantial deficit on current account in 1980 of the order of $CA 382 million. It should be underlined that in the preceding year the country had recorded a surplus of $CA 160.8 million, basically due to sharp contraction of imports, by nearly 30 per cent. The balance on capital account, after having been in deficit for two consecutive years, improved substantially in 1980 because of increasing reactivation of the economy by the public sector; as a result, it moved from a deficit of $CA 129.7 million in 1979 to a surplus of $CA 213 million in 1980. Nevertheless, the balance of payments showed a substantial deficit in 1980, causing a decline in international monetary reserves by $CA 188.6 million. It should be noted that this deficit in the balance of payments is financed to an increasing extent from external credits, the share of which increased from 5.6 per cent in 1978 to 35.5 per cent in 1979 and 58.9 per cent in 1980.

As regards public finance, current receipts increased appreciably in 1980, largely due to rising tax revenue, as a result of higher rates of certain export charges and also rationalization measures applied in order to reduce tax evasion. Accordingly, current receipts which had dropped back by $CA 19.6 million in 1979 (-8.3 per cent) increased by nearly $CA 200 million in 1980, reaching a record level in absolute terms of $CA 415.4 million.

This increased revenue largely offset the rise in current expenditure in 1980, so that for the third consecutive year the deficit on current account of the central government declined, from $CA 38.9 million in 1979 to $CA 21.6 million in 1980. Capital expenditure by the government, which had dropped back considerably in 1979, progressed substantially in 1980, nearly fivefold, within the context of an expansion policy for public expenditure designed to offset sluggishness in the private sector and thus allow the maintenance of minimum employment and investment levels.

The increase in public expenditure was largely made possible through increased recourse to domestic credit, on the part of both the central government and other public institutions. This credit expanded by 42.7 per cent in 1979 and 44.5 per cent in 1980 and was reflected in a substantial increase in payment resources, from about 6.1 per cent in 1979 to nearly 61 per cent in 1980. Money in circulation increased considerably in 1979 and more slowly in 1980, so that the monetary liquidity coefficient of the economy fell back from 26.2 per cent to 19.5 per cent from one year to the next, easing in 1980 the internal pressures that had been aggravating the problem of domestic inflation. Nevertheless, between 1975 (base year) and March 1980, the cordoba lost 54 per cent of its purchasing power.

E. Costa Rica

Since the 1960s, important factors of domestic origin have been negatively affecting the country's economy and, in conjunction with the disequilibrium generated by the international economic situation in recent years, can be considered responsible for the chronic economic problems that are facing Costa Rica.

This is confirmed if one considers that, with better income distribution which has encouraged development of the middle class and an upswing in consumption, domestic supply has not been sufficient to meet demand; accordingly, the country is increasingly having recourse to external supply to meet consumer requirements and investment needs, and to maintain or increase existing production levels.

The situation of Costa Rica's economy has been further aggravated by the unfavourable level of international economic activity, particularly between 1973 and 1975. Nevertheless, the country was able to meet these difficulties, because of higher world prices for coffee, its principal export product, following a marked economic recovery in the period 1976-1978, which resulted in high annual growth rates of real gross domestic product.

In recent years, 1979 and 1980, the country's economic activity has slowed down somewhat because of domestic problems relating to the real economy and also an aggravation of financial problems, in conjunction with a re-emergence of recessionist trends in the world economy and uncertainty regarding the social and political situation of other countries of the region.

As a result, overall demand, which had been rising slowly in 1979, virtually levelled off in 1980, bec[illegible] ross fixed capital investment was falling back and also because th[illegible] irtually no change in the level of public and private consumption [illegible] one year to the next. Exports of goods and services were down 2.7 per [illegible] in 1980, despite increasingly active sales to the Central American C[illegible]mon Market and in particular to Nicaragua, which has been Costa Rica's principal client since 1979.

Notwithstanding the fact that in the period under consideration, exports of goods and services were developing at the same rate as imports, the absolute amount of the latter was the cause of substantial deficits on current account, of the order of $CA 558.9 million in 1979, and $CA 619.4 million in 1980. These two deficits together account for a little over 52 per cent of the aggregate deficits recorded for Central America as a whole in these two years.

Notwithstanding that the net balance on capital account continues to be traditionally in surplus in Costa Rica, international monetary reserves are declining from year to year because of increased foreign indebtedness of the government and banking sectors; the losses reached $CA 40.9 million in 1978, $CA 74.5 million in 1979 and $CA 212 million in 1980.

As regards public finance, both receipts and operating costs were increasing steadily from 1978 to 1980 although the increase was more rapid in operating costs, and as a result the central government deficit on current account progressed from $CA 42.6 million in 1978 to $CA 123.9 million in 1980, representing an average annual increase of more than 70 per cent.

In addition, increasing expenditure on capital goods needed to offset the trend towards recession has further accentuated serious disequilibrium in the current account, resulting in substantial budget deficits which of the order of $CA 205.4 million in 1978, $CA 323.9 in 1979 and $CA 373.4 million in 1980.

Since it is increasingly difficult to obtain foreign credit, and other countries are waiting to see how the social and political situation develops in Central America, these budgetary deficits are being financed primarily out of domestic credit, in a proportion that has increased from 49.3 per cent in 1978 to 80.6 per cent in 1980.

The policy of expanding public expenditure, as pursued during the main part of 1980, has strongly affected the level of total domestic credit; the share of the public sector has increased from 28.6 per cent in 1978 to nearly 53 per cent in 1980. It should be noted that in September 1980, having regard to the worsening economic recession in the country, the Government of Costa Rica adopted a series of measures that are reflected in practice by a de facto currency devaluation, and the introduction of economic mechanisms designed to reactivate the national economy.[1]

[1] See "Algunas Consideraciones sobre las Medidas adoptadas por Costa Rica en Septiembre de 1980". SIECA/XXIV/RMRIECA/D.1.2, November 1980.

IV. SOME PRELIMINARY CONSIDERATIONS REGARDING 1981

As this study shows, for some time past inflation and recession have been causing grave problems for the economy of Central America. That is why it must be considered essential that the economic policy options to be taken allow a balance to be restored between these two destabilizing elements, because in many cases anti-recession policies can aggravate inflation and vice versa.

As can be seen, the economy of the Central American countries has deteriorated rapidly, and extrapolations of the principal macro-economic variables as well as performance of the economy in the early months of 1981 show that a difficult economic and financial situation still lies ahead for the region.

As a result, the downturn observed in the period 1978-1980, which has been examined in earlier sections of this report, will continue in 1981 even with some aggravation in certain cases, causing increased economic imbalance and complicating still further the situation already described.

Accordingly, a slowdown in economic activity is expected in nearly all the countries of the region in 1981, because of lower prices of export products and the persistence of disruptive non-economic factors of domestic origin. In addition, larger budgetary and balance-of-payments deficits are expected, with higher rates of inflation and heavy drainage of international monetary reserves.

Because of the persistence of these adverse factors in 1981 and the relative similarity of some of the problems facing countries of the region, there is need for a joint approach to those problems and for the adoption of co-ordinated or regional measures in order to avoid further deterioration of the living conditions of the Central American peoples.