Integration

The Central American Common Market

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

The Starting Point of the Scheme

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

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

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

Politically Balanced Regional Development

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

Contrary to many other economic integration schemes involving underdeveloped countries, at no time did the builders of the CACM consider the freeing of intra-regional trade and the equalisation of external national tariffs as an end in itself. From the
beginning their main concern was how to establish prerequisites—politically acceptable to all the participating countries—for accelerated diversification and industrialisation of the region's economy, or, in other words, how to guarantee a certain degree of politically balanced regional economic development.

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

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

Industrial Cooperation Instruments
Aware of political realities and the intangible political value attached by any developing country to industrialisation, the builders of the Central American integration scheme introduced at an early stage—concurrently with the Multilateral Treaty of 1958—a mechanism known as the Regime for Integration Industries. The purpose of that intra-regional industrial licensing system was to distribute—by inter-governmental agreements—new manufacturing activities that would require access to the markets of all member-countries of the CACM and to grant these activities special privileges and incentives under specifically stipulated conditions. The higher purpose of the system was to ensure for the participating countries a relatively equal share in the benefits of industrialisation. The Regime for Integration Industries was not able to work successfully, because, among others, of the US negative attitude which translated itself into the denial of external financial aid to industrial enterprises interested in special tariff preferences and other incentives available under that Regime. But the industrialisation of the area received considerable help through other regional industrial cooperation instruments and agencies. Perhaps one of the most important is the Central American Integration Bank (CABEI), established in 1960 to provide financing for infrastructure projects and productive activities of regional interest. During the six years of its existence the CABEI loaned to the public and private sectors of the area close to $100 million. Moreover, since the establishment of the CACM, the area received another $200 million of private foreign investment largely because of the fusion of five minuscule national markets into one.

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

CACM at a Point of No Return
The non-trade mechanisms and institutions supporting the CACM have brought about considerable improvement in the region's physical infrastructure and quality of human resources. The impressive increase in the use of potentially available factors of production, in both the agricultural and industrial sectors, helped to mitigate somewhat the perennial problem of disguised unemployment in Central America. Furthermore, the effect of integration on the social structure of the area is also felt, although to a limited degree. For the first time in its history Central America today has a thin layer of entre-