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AGENCY FOR INTERNATIONAL DEVELOPMENT

DEVELOPMENT ASSISTANCE PROGRAM

CENTRAL AMERICA

BOOK 1

Chapters I - VI

Regional Overview and ROCAP

DEPARTMENT OF STATE

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LIST OF ACRONYMS

ROCAP:

BANVI	-	Banco Nacional de la Vivienda (Guatemala)
CABEI	-	C.A. Bank for Economic Integration
CACM	-	Central American Common Market
CATO	-	C.A. Travel Organization
CIAP	-	Committee of the Alliance for Progress
COCESNA	-	C.A. Corporation of Air Navigation Services
CONDECA	-	C.A. Defense Council
CSUCA	-	Confederation of C.A. Universities
CTC	-	Central American Tourism Council
CTCA	-	Confederation of Central American Workers
FECAICA	-	Federation of C.A. Associations and Chambers of Industry
FEDEPRICA	-	Federation of Private Entities
FEHCOVIL	-	Honduran Cooperative Housing Federation
FNV	-	National Housing Bank (El Salvador)
FUPAC	-	Federation of C.A. Private Universities
GDP	-	Gross Domestic Product
GOBH	-	Government of British Honduras
HIG	-	Housing Investment Guaranty
HLC	-	High Level Committee

HUD	-	Housing Urban Development
IBRD	-	International Bank for Reconstruction and Development
ICAITI	-	C.A. Institute of Research and Industrial Technology
ICAP	-	C.A. Institute for Public Administration
IICA/ZN	-	Interamerican Institute for Agricultural Sciences (Northern Zone)
IDB	-	Interamerican Development Bank
INCAE	-	C.A. Institute of Business Administration
LAAD	-	Latin American Agribusiness Development Corporation
MDCC	-	Mission Directors Coordinating Council (AID)
NAUCA	-	C.A. Uniform Customs Nomenclature
NHI	-	National Housing Institutes
ODECA	-	Organization of Central American States
OIRSA	-	Regional International Organization for Animal and Plant Sanitation
PCCMCA	-	C.A. Cooperative Program for Basic Food Crop Improvement
PROMECA	-	Center of Export Development for Central America
SIECA	-	Permanent Secretariat of the General Treaty of Central American Economic Integration
SITCA	-	Secretariat for C.A. Tourism Integration
TSO	-	Technical Service Organization

Guatemala:

APROFAM	-	Asociación Pro-Bienestar de la Familia
BANDESA	-	National Agriculture Development Bank
CNPE	-	National Economic Development Planning Council
DIGESA	-	Directorate of Agricultural Services
GAFICA	-	FAO Advisory Group for C.A. Integration
GOG	-	Government of Guatemala
ICTA	-	Institute of Agriculture Science and Technology
ILPES	-	Latin American Institute for Economic and Social Planning
INAD	-	Institute for Development Administration
INDECA	-	National Institute of Agricultural Marketing
INFOM	-	Institute for Municipal Development
INTA	-	National Institute of Agrarian Transformation
IRS	-	Internal Revenue Service (U.S.)
OAS	-	Organization of American States
PAHO	-	Pan American Health Organization
UNICEF	-	United Nations Childrens Fund

El Salvador:

CENTA	-	National Center for Agricultural Technology
CONAPLAN	-	Central Planning Organization

FEDECACES	-	Federation of Credit Unions
GOES	-	Government of El Salvador
ICR	-	Rural Colonization Institute
IRA	-	National Marketing Institute
ISSS	-	Salvadoran Social Security Institute
ITV	-	Instructional Television
MAG	-	Ministry of Agriculture
MOD	-	Ministry of Defense
MOE	-	Ministry of Education
MOH	-	Ministry of Health
SDA	-	Salvadoran Demographic Association
UNDP	-	United Nations Development Project
WFP/FAO	-	World Food Program, Foreign Agriculture Organization

<u>Honduras</u>:

ANACH	-	Honduran Campesino Association
BANMA	-	National Autonomous Municipal Bank
BNF	-	National Development Bank
CCTI	-	Technical-Industrial Cooperative Center
CNAN	-	National Nutrition Council
ENEE	-	Electricity Enterprise
ESP	-	Teacher Training Institute

FACACH	-	Savings & Loan Federation
FECOAGROH	-	Agricultural Cooperative Federation
GOH	-	Government of Honduras
IDA	-	International Development Association
INA	-	National Agrarian Institute
INCAP	-	Nutrition Institute for Central America and Panama
INFOP	-	National Institute of Professional Formation
SANAA	-	Public Water Enterprise

Nicaragua:

ADN	-	Nicaraguan Demographic Association
BANVI	-	National Housing Bank
BNN	-	Nicaragua National Bank
DAS	-	Development Advisory Service (Harvard University)
ECLA	-	Economic Commission for Latin America
EDUCREDITO	-	Education Credit Organization
ENALUF	-	National Power & Light Company of Nicaragua
EXPORTEMOS	-	Export Promotion Agencies of the Chamber of Industry
GON	-	Government of Nicaragua
HIG	-	Housing Investment Guaranty
INCAE	-	Central American Graduate School for Business Administration

IAN - Agrarian Reform Agency

INCEI - Institute for Exterior and Interior Commerce

INFONAC - National Development Institute

IPPF - Institute for Family Planning

MOH - Ministry of Health

MRDA - Municipal and Regional Development Agency

NEC - National Emergency Committee

NPO - National Planning Office

SALA - Southwest Alliance for Latin America

SERN - National Nutrition Rehabilitation Service

Costa Rica:

ADP - Agricultural Development Program

ALCOA - Aluminum Company of America

BCCR - Central Bank of Costa Rica

CAN - National Agricultural Council

CARE - Cooperative for American Relief Everywhere

CARITAS - Catholic Service Organization

CESPO - Center for Population and Social Studies

CIF - Center for Family Integration

COF - Center for Family Orientation

CONAPO - National Coordinating Committee for Population and Sex Education

CRDA	-	Costa Rican Demographic Association
GOCR	-	Government of Costa Rica
IFAM	-	Municipal Development Institute
INFOCOOP	-	Cooperative Development Institute
MAG	-	Ministry of Agriculture
MCH/FP	-	Maternal Child Health/Family Planning
MOE	-	Ministry of Education
MOH	-	Ministry of Health
PIMA	-	Integrated Agricultural Marketing Project
POP/FP	-	Population/Family Planning
SSI	-	Social Security Institute
UCR	-	University of Costa Rica

CHAPTER I

GROWTH TRENDS IN THE CENTRAL AMERICAN COMMON MARKET (CACM), 1960-1972

A. Introduction

Central American integration is a complex undertaking. Since their independence in the 1820's, the five Central American Republics have made periodic efforts to unify politically or to formalize Isthmus-wide cooperation -- only to flounder when critical local interests became threatened. Their latest effort is the Central American Common Market (CACM) -- a vehicle designed in the early 1960's to use intraregional free trade and development as the building blocks for regional integration.

The five countries were and are at different stages of economic, social and political development. The quality and scope of their institutional and physical infrastructure was and remains basically disparate, ranging in some countries from inadequate to relatively appropriate to their needs in others. Organization of urban and rural productive sectors was and is fundamentally different from country to country; in some, resources were and are concentrated in a limited number of families whose roots run to the Spanish colonial period, while in others a relatively broader distribution of control has facilitated broader participation. The ethnic composition of the five countries -- and the values and traditions of the people -- is in no sense homogeneous. The political structures and systems equally reflect basically different approaches to social organization and government action.

In this context, the effort made over the past twelve years to develop an operative and viable economic integration movement in the area has been formidable. Intra-regional trade, based largely on the import substitution syndrome which permeated Latin American development thinking in the 1950's and early 1960's, provided the initial impulse for CACM development. An integration psychology has emerged in the organized public and private sectors of the five countries -- although not yet felt meaningfully at the grass-roots where in some countries 50% of the people remain outside of the cash economy. But, as the experiment moved forward, it became clear that effective, long-term integration had to be built of sturdier stuff and requires the tackling of economic, social, institutional and human problems which many had hoped would resolve themselves in the wake of expanded trade. Stated differently: in the past, economic integration has been synonymous with free trade; now, the concept must be expanded to include integration in a much broader context -- economic, social, and human.

A small but growing body of political leaders, supported by integration technocrats, has begun serious consideration of the critical issues impeding integration. If these issues can be favorably resolved, and the integration movement reconstituted, the CACM will have overcome a major obstacle in its path, and should be able to resume the pre-1966 growth rate. The following is an examination of the initial progress of the integration movement and the difficulties it encountered.

B. <u>Economic Trends, 1960-1972</u>

The CACM countries have experienced substantial growth since the General Treaty on Central American Economic Integration was signed in December of 1960. The period witnessed the abolition of internal tariffs on some 97% of all products in the NAUCA nomenclature, the adoption of a uniform outside tariff, a significant increase in the growth rate of the Gross Domestic Product (GDP), a substantial expansion in both private and public investment and a stunning growth rate in intraregional trade.

These conclusions apply to growth over the period 1960-72 as a whole. Some slowdown set in after 1966, which will be discussed in a later section.

(1) <u>GDP and Per Capita Income</u>: The growth rate of the Gross Domestic Product of Central America, measured in constant 1960 prices, increased from an average annual rate of only 4.5% during the decade of the 1950's to 5.7% during the twelve-year period 1960-72. The growth rate of the real per capita GDP increased from 1.2% during the 1950's to 2.5% over the recent twelve-year period.

At present, the combined GDP of all five Central American countries is about $6 billion (in current prices), while per capita GDP is about $375. The per capita income for Central America is slightly below the median for all 18 Latin American countries.

It should be borne in mind that there are very substantial disparities in per capita incomes, living standards, degree of industrialization and growth rates among the five Central American countries. Thus, Costa Rica's per capita income is over double that of Honduras; and total value added by Honduran manufacturing industry is less than half the average of its four C.A. partners.

(2) Change in Structure of GDP: The composition of the GDP in 1960 and 1971, is summarized in Table 1. With respect to sector of origin, the only significant change is the decline in the share of agriculture and the growth of manufacturing. The share of agriculture declined from 31% of the GDP in 1960 to 27% in 1971; while the share of manufacturing industry increased from 13% to 17% over this period.

With respect to the breakdown of GDP by final expenditures, there was a slight increase in the share of investment (from 14% to 16% of GDP) and a much more significant increase in the share of exports of goods and services. Exports increased from only 18% of GDP in 1960 to 22% in 1971, reflecting the fact that exports of goods and services increased at an average annual rate of 8.1%

Table 1

Gross Domestic Product of Central America

(In Millions of C.A. Pesos - 1960 Constant Prices)

A. By Sector of Origin

	1960	%	1971	%	Average Annual Growth Rate 1960-71
Total GDP, 1960 Constant Prices	2796.9	100.0	5152.4	100.0	5.7
Agriculture, Forestry & Fishing	855.5	30.6	1386.6	26.9	4.5
Mining	14.8	0.5	22.4	0.4	3.8
Manufacturing Industry	369.4	13.2	885.3	17.2	8.3
Construction	74.0	2.6	140.5	2.7	6.0
Electricity, Gas & Water	32.8	1.2	97.2	1.9	10.4
Transport, Storage & Communication	136.9	4.9	267.2	5.2	6.3
Commerce	637.4	22.8	1227.8	23.8	6.1
Banking and Insurance	44.9	1.6	117.2	2.3	9.1
Housing Property	217.5	7.8	303.8	5.9	3.1
Public Administration & Defense	200.9	7.2	325.5	6.3	4.5
Services	213.0	7.6	378.9	7.4	5.4

B. By Final Expenditures

	1960	%	1971	%	Average Annual Growth Rate 1960-71
Total GDP, 1960 Constant Prices	2796.9	100.0	5152.4	100.0	5.7
Consumption	2508.3	89.7	4394.5	85.3	5.2
Public	268.8	9.6	497.2	9.7	5.7
Private	2239.5	80.1	3897.3	75.6	5.5
Gross Domestic Investment	383.0	13.7	821.4	15.9	7.2
Public	77.6	2.8	185.5	3.6	8.2
Private	280.6	10.0	543.4	10.6	6.2
Increase in Inventories	24.8	0.9	92.5	1.8	-
Export of Goods & Services	492.5	17.6	1155.1	22.4	8.1
Less					
Imports of Goods & Services	578.4	20.7	1230.2	23.9	7.1
Statistical Discrepancy	- 8.5	-	11.6	-	-

SOURCE: División de Desarrollo SIECA "Cuentas Nacionales", original data supplied by Central Banks.

compared with an increase in the GDP growth rate of 5.7%[1/]. The share of imports also increased from 21% to 24% of the GDP. On the other hand, the share of private consumption declined from 80% to 76%.

(3) Intraregional Trade: Total intraregional trade increased dramatically following the establishment of the Common Market -- from a mere CA$33 million in 1960 to about CA$305 million in 1972, an average annual compound rate of growth of 21% over this twelve-year period (see Table 2). According to our estimates, manufactured exports other than foodstuffs and beverages constitute at least three-fourths of total intraregional trade. It is clear that the growth of intraregional trade and the development of manufacturing are closely linked, and that a substantial degree of import substitution has occurred in manufacturing.

(4) Extraregional Exports: Exports to the outside world grew at an average annual compound rate of 6.8% over 1960-71, a substantially lower growth rate than for intra-regional trade, though still higher than the growth rate

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1/ All growth rates are in terms of constant 1960 prices.

Table 2

Intraregional Trade for Central America, 1960-72

(In Millions of C.A. Pesos)

	Intraregional Exports	
	Total	Exports of Manufactured Goods*
1960	32.7	N.A.
1962	50.8	N.A.
1966	174.7	113.0
1968	258.3	172.6
1969	249.0	183.1
1970	299.1	217.6
1971	270.4	209.6
1972 E	305.0	229.0
Average Annual Growth Rate		
1960-72	20.0	-
1966-69	12.5	17.5
1969-72	7.0	7.7

E: Preliminary estimate by ROCAP

SOURCE: SIECA: Indicadores Económicos No. 13. Cuarto Compendio Estadístico C.A. Statistical Annex No. 125, 126 and 132.

* Estimated as the sum of the following NAUCA categories: Chemical Products, Manufactured Goods classified by material, Machinery & Transport Equipment, and Miscellaneous Manufactured Products. Foodstuffs & Beverages were omitted.

of the real GDP. Approximately 74% of the area's total exports consists of the four major primary products, i.e. coffee, cotton, bananas, and sugar. Exports of non-primary products (all other) to third countries increased at an average annual compound rate of 11.4% over this eleven year period, and as a proportion of the area's total exports, increased from 16% to 26%. Export trends, potential, and problems are dealt with in greater detail in Part C of Chapter IV.

(5) Gross Domestic Investment: Public plus private investment, measured in constant prices, increased at an average annual compound rate of 7.2% between 1960 and 1971. Fixed public investment increased significantly faster than fixed private investment (8.2% versus 6.2% a year). However, account must be taken of the fact that private investment increased very unevenly over the period. During the formative years of the CACM (1960-66), private fixed investment increased at the relatively high rate of 7.6%, then dropped back to 4.5% over 1966-71 for reasons that will be discussed in Part C.

(6) Shortage of Domestic Resources: The shortage of resources for development purposes has been exacerbated by the reluctance of the Central American countries to adequately tax in order to generate resources. Available data (CAPTO CIRCULAR A-47 of December 1, 1972) indicates that central government revenues expressed as a percent of GNP were 11.7% in 1971 for Central American as compared to 13% for all 18 Latin American countries. Of the five C.A. countries the ratio was highest for Costa Rica (16.3%) and lowest for Guatemala (8.8%).1/ The long-term trend of the ratio has been upward, but the rise has been very slow and gradual. Further, in C.A. as a whole current expenditures have increased faster than current revenues (8.4% for expenditures and 8.0% for revenues).

SIECA has been critical of the revenue performance of the Region in recent years because the increases in the surplus of the current budget have been modest in absolute terms and have provided only a fraction of the

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1/ In ranking the 18 L.A. countries, Venezuela is first (24.9%), Costa Rica is sixth (16.3%), El Salvador is eighth (13.5%), Honduras is eleventh (12.5%), Nicaragua is sixteenth (10.0%) and Guatemala is last (8.8%).

investment requirements of the central government's budget. As a result, the C.A. governments were compelled to resort to substantial increases in foreign and domestic borrowing.

(7) Monetary and Fiscal Policies: The question of fiscal conservatism on the generation of internal resources is a complex one and hard conclusions are difficult to draw. Generally, the region has followed monetary policies which place greater importance on internal price stability and balance of payments equilibrium than on the need to generate development resources. Specifically, relatively conservative monetary and credit policies were followed by at least three of the CACM countries in recent years: Guatemala, Nicaragua and El Salvador; Costa Rica followed a conservative credit policy through 1969, but permitted the rapid expansion of both commercial and central bank credit thereafter. Honduras expanded both commercial and central bank credit rapidly throughout 1966-71, but succeeded in limiting the adverse balance of payments effects of its credit policies in 1971 by establishing restrictions on imports. These results underscore the difficulty of striking a balance between price and balance of payments stability and

of using credit policies to generate development resources. Guatemala, Nicaragua and El Salvador have followed policies which probably have been too conservative, while Honduras and Costa Rica have followed expansionary policies.

C. Factors Explaining Accelerated Growth

The following factors appear to be chiefly responsible for the rapid growth of the five Central American countries over 1960-71:[1/]

(1) The establishment of the CACM gave a substantial boost to manufacturing industry and private investment. The removal of trade barriers within the CACM combined with the erection of the uniform -- and higher -- tariff wall had the effect of encouraging a substantial degree of import substitution for Central American manufacturing industry. The creation of a wider market promoted a more efficient allocation of resources and permitted exploitation of economies of scale. Moreover, foreign firms hustled to get in under the tariff umbrella. The annual inflow of

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1/ For an analysis of industrial development, industrial policies and the framework of industrial finance in C.A. see the "Report of the Industrial Finance Mission to Central America", 1972, IBRD Report No. PI-7a.

direct foreign investment more than tripled between 1960 and 1966.

(2) The creation of the CACM was accompanied by a large increase in public investment as AID and the international lending agencies stepped up their long term loans. Total net official loans increased from CA$52 million in 1964 to CA$160 million in 1971.

(3) Finally, there were some contributory factors unrelated to the establishment of the CACM. Extraregional exports of the four major primary products[1/] and meat increased significantly, particularly during the period 1960-66 which witnessed a substantial expansion in cotton production. Substantial expansion was also obtained for bananas, sugar, and meat. Total earnings from exports of primary products and meat increased at an average annual compound rate of 8.8% over 1960-66.

D. Deceleration of the Growth Rate After 1966

The average annual growth rate of GDP declined from 6.0% over 1960-66 to 5.4% over 1966-72. There were also

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1/ Coffee, cotton, sugar and bananas.

declines in the growth rate of value added by manufacturing, public and private investment, and exports of goods and services.

The main factors which explain the reduction in the growth rate in recent years include:

(1) The El Salvador-Honduras war which ended trade between the two countries, led to the closing of the Pan American Highway, and undermined investor confidence.

(2) The suspension by Honduras of free trade with the CACM which further increased investor uncertainty, discouraged the inflow of foreign capital, and reduced the volume of intraregional trade.

(3) The fact that manufacturing production in C.A. is directed overwhelmingly toward intraregional trade, together with a gradual reduction of new opportunities for import substitution.

(4) The very rapid expansion in cotton production which contributed greatly to the increase in income of the Area over 1960-66, could not be continued after that year.

In fact, cotton exports declined in absolute amounts after 1965.

(5) Expansion of trade was severely hampered because the integration movement did not address traditional socio-economic problems of the marginal farmer and urban unemployed. These groups represent 50% of the population and have virtually no purchasing power. By not bringing them into the money economy, the integration movement denied itself 50% of its own internal market - a group whose marginal propensity to consume is traditionally very high.

In the first 10 years this was less serious in macroeconomic terms (though no less serious for the farmer) because the integration of the urban-industrial sectors of the region was proceeding apace and they became effectively integrated to the accompaniment of 500% increase in intraregional trade, and an average 65% growth rate. Since 1971, however, these growth rates have slowed because urban-industrial integration reached saturation point. The pace of the sixties can be resumed only by (1) expanding the internal market by bringing in the small farmers; and (2) in long-term by increased exports outside the area.

E. Disparities in the Growth Pattern Among the Five C.A. Countries

The moderate decline in the average annual growth rate of GDP in C.A. as a whole during 1966-72 should not obscure the fact that the growth pattern in the five C.A. countries shows substantial disparities in recent years. These are summarized in Table 3.

Table 3

Average Annual Compound Growth Rate of GDP in Central America

	C.A.	Guate.	El Sal.	Hond.	Nica.	C.Rica
1960/66	6.0	5.3	6.9	5.0	9.0	4.7
1966/69	5.4	5.7	4.0	5.4	4.2	7.7
1969/71	5.3	6.1	3.6	4.9	5.3	5.8

Calculations based on SIECA's data.

Note that there has been a sharp decline in the average annual growth rate of GDP for El Salvador and Nicaragua after 1966, in contrast to increases in Guatemala and Costa Rica. The growth rates for Honduras remained approximately the same (about 5%). The decline in El Salvador was related mostly to the loss of the Honduran market, the closing of the Pan American Highway and possibly the reduction in import substitution opportunities within the CACM; for Nicaragua, the main reason is the absolute decline of cotton exports between 1965 and 1972.

Both Costa Rica and Guatemala experienced increases in their investment spending, and both benefited from significant increases in the value of their primary export products.

CHAPTER II

MAJOR CURRENT DEVELOPMENTS AND FUTURE PROSPECTS OF THE CACM

A. Growth of GDP, Exports and Investment

On the basis of preliminary indicators available to date, 1972 was a good year for four of the C.A. countries as far as growth is concerned. The growth rates in Table 1 were estimated by ROCAP on the basis of reports by embassy economic officers and preliminary estimates by the central banks.

Table 1

Estimated Average Annual Growth Rates of GDP

	1970/71	1971/72
Central America	5.4	5.4
Guatemala	5.8	6.0
El Salvador	4.3	4.5
Honduras	6.0	4.3
Nicaragua	5.7	6.0
Costa Rica	5.0	5.4

The main factor accounting for this relatively satisfactory performance is the behavior of the export sector, particularly exports to the rest of the world.

Exports of the four primary products to the rest of the world are estimated to have increased by about C.A. $100 million in 1972, or almost 16%, due to improvements in the price of coffee, and to a combination of increases in prices and volume of output for the other three products.

Intraregional trade also made satisfactory progress during the year, though not as dramatically as exports to the rest of the world. Total intraregional trade in 1972 amounted to about C.A. $305 million, up from C.A. $270 million in 1971, an increase of 13%. All Central American countries other than Honduras experienced moderate to substantial increases in their intraregional exports. However, to place the 1972 intraregional trade performance in perspective, one must recall that the level of trade achieved in 1972 (C.A. $305 million) is only slightly above the 1970 level (C.A. $299.1 million), owing to the significant reduction that occurred in 1971. With respect to the pattern of intraregional trade balances, it is to be noted that only Guatemala and El Salvador had substantial favorable balances in 1972. Costa Rica experienced a substantial trade deficit of C.A. $29 million with the rest of the CACM.

The area's sharp increase in exports to the rest of the world resulted in a substantial increase in the level of its international reserves, money supply and bank liquidity. The area's gross international reserves increased from C.A. $267 million at the end of 1971 to C.A. $372 million on December 31, 1972, an increase of 39%. They experienced a further substantial increase during the first quarter of 1973, and stood at C.A. $430 million on March 31.

There are still no reliable data with respect to the behavior of investment in 1972. Preliminary observations indicate that while public investment expenditures continued to increase (except in Honduras), private investors are still behaving cautiously in view of the difficulties the common market experienced in recent years. This caution applied to investment in industry only. In the area of residential construction, strong activity continued over most of the area.

B. Costa Rica's Balance of Payments Problem

On August 31, 1972, Costa Rica's central bank precipitated a CACM crisis by announcing the decision that exchange rate preferences for the CACM would be ended. The decision restricted the use of the official rate (U.S. $1 = ¢6.65) to a limited list of "essential" products while other imports were at the official rate of U.S. $1 = ¢8.57. Since the action taken was unilateral, the other CACM countries reacted by imposing a 30% tax on their imports from Costa Rica. The result was a substantial reduction in Costa Rica's trade with its CACM partners during the ensuing two months.

Costa Rica was facing a serious balance of payments problem. Its negative balance on current account had increased by 43% in 1970 and by another 54% in 1971. It stood at -$114 million in 1971. A sharp decline in international reserves was avoided in 1971 only through a substantial increase (C.A. $64 million) in short-term supplier credits.

The GOCR primarily blamed exchange and trade preferences with the CACM for its balance of payments difficulties, and believed the situation could be corrected by applying the free market rate to most of Costa Rica's transactions with the CACM. Costa Rica's CACM partners and the Monetary Council felt that Costa Rica's expansionary credit and investment policies were mostly to blame, and that any corrective measures would have to include adoption of a comprehensive stabilization program encompassing restrictive credit and fiscal policies as well as adjustments in the exchange rate. The GOCR has effected a stabilization program primarily based on a more prudent rate of credit expansion which has helped slow resulting import demand. Moreover, significant relief for Costa Rica's balance of payments problem has occurred as a result of a substantial increase in its exports of primary products and meat to the rest of the world. The country's total exports during 1972 increased from CA $225 to CA $273 million, or by 21%. Thus, the 1972 Costa Rican balance of payments crisis was eased through de facto devaluation, increased extraregional export earnings, and short-term loans from the other C.A. Central Banks.

Maintenance of current credit and fiscal practices is essential; for a return to the irresponsible policies of

1971-1972 could cause the Costa Rican balance of payments problem to recur and to continue to disrupt intraregional trade. Costa Rica's balance of payments difficulties have triggered CACM crises in 1967 and 1972.

C. Bilateral Treaties with Honduras

We regard the negotiation of bilateral treaties by Honduras with three of its CACM partners a most significant factor in the increase in intraregional trade; hopefully, this limited resumption of free trade will be the first step in the normalization of relations between Honduras and the CACM and lead eventually to the full restoration of free CACM trade. Honduras has negotiated bilateral trade treaties with Nicaragua (August, 1972), with Guatemala (February, 1973) and with Costa Rica (May, 1973).

On December 31, 1970, the Government of Honduras issued Decree No. 97 suspending free trade with the CACM. The measure followed the failure of the negotiation of the Modus Operandi which attempted to restructure the CACM following the disruption caused by the El Salvador-Honduras war. The Decree's main purpose was to put an end to trade deficits which Honduras had with the CACM; these had increased from CA $13 million in 1966 to CA $36 million in 1970. The decree succeeded in effecting a drastic reduction in Honduran imports and of trade deficits with the CACM. Honduras exports to the CACM, consisting mostly of manufactured goods, also declined, however, and there was a widely held feeling that Honduras' practical isolation from CACM trade was adversely affecting the country's development. On the other hand, Honduras did not consider itself ready to face the full force of C.A. competition. By way of compromise, Honduras negotiated a series of bilateral treaties that provided free trade in some products, enabled Honduras to impose various duty rates on others, and accorded preferential treatment to Honduras' exports to other C.A. countries.

While the treaties between Honduras and Nicaragua, Guatemala and Costa Rica differ in detail, the main points are:

i. With respect to basic grains (corn, beans, rice and sorghum), trade will be regulated by the grain price stabilization and marketing agencies to prevent interference of shipments with domestic production. While all grain shipments require approval, imports will be free of duty.

ii. All items on which agreement is reached will be imported free of duty by the other party, while a number of products entering Honduras will be subject to an import duty varying from 5% to 25%.1/

The trade deficits of Honduras with the CACM are nevertheless expected to increase as a result of these treaties. Honduras is expecting this development, but hopes that these deficits can be held to levels significantly below those attained in 1969 and 1970.

We estimate that intraregional trade resulting from all three bilateral treaties will expand by at least CA $20 million in 1973 and by CA $25 to CA $30 million the following year.

Some integrationists regard the signing of the bilateral treaties as a move institutionalizing the disruption of the Common Market. Such a conclusion arises

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1/ However, such rates can never exceed 50% of the duty rates in force in Honduras before December 31, 1970, nor exceed the rates presently in force.

from a comparison with the ideal situation. However, the more relevant comparison is between the prevailing situation in the CACM in 1971 (following Honduras' abrupt suspension of all free trade with the CACM), and the status of the CACM in 1973.

The significance of the impact of Honduras' suspension of free trade with the CACM is reflected in the data in Table 2A. Note that Honduras' exports to the CACM declined from CA $19 million in 1970 to only CA $5.4 million in 1971, while its imports from the CACM declined from CA $55 million to only CA $16 million. Total intraregional trade (exports of all CACM countries to one another) declined from CA $299 million to only CA $270 million during this interval.

In its last presentation to the Subcommittee of the Alliance for Progress (CIAP), the Honduran delegation acknowledged that the country's loss of its principal market (El Salvador) and its limited access to the markets of the other CACM countries resulting from Decree 97 were, in large part, responsible for Honduras' lower GDP growth rate and the lack of dynamism of private investment activity

Table 2

Honduras Trade with the CACM Region
(In millions of CA Pesos

	Honduras' Exports to CACM	Honduras Imports from CACM
1968	31.3	48.7
1969	23.9	44.0
1970	19.1	54.9
1971	5.4	16.2
1972	6.7	22.4

Total Intraregional Trade
(In millions of CA$)

1968	258.3
1969	249.0
1970	299.1
1971	270.4
1972	304.7

in recent years. It is this recognition which led to the negotiation of the bilateral treaties which, according to our estimates, will restore the level of Honduras' trade with three of its CACM partners to about half the level that would have prevailed if Honduras had remained a full-fledged member of the CACM.

In conclusion, while integration admittedly has made little or no progress since 1968, the bilateral treaties represent a step forward in relation to the situation that prevailed in 1971, when Honduras had practically isolated itself from its previous CACM partners.

D. The Managua Earthquake

The earthquake that hit Managua on December 23, 1972, was a major catastrophe for the country. The damage is estimated at $300 to $500 million.[1/] Even if the lower figure is used, this would amount to roughly 30% of the country's annual Gross Domestic Product. The hardest affected sectors were private residential housing and commerce.

1/ Replacement costs are apt to be substantially higher.

(1) Impact on Nicaragua:

a. The complete destruction of Managua's commercial center created large-scale unemployment[1/] and disrupted normal channels of distribution. Nevertheless, following rapid recuperation, revised projections from Ministry of Economy show an increase of 2,8% in the 1973 GDP, in real terms. While this is still lower than recent years, it now appears that a previously predicted GDP decline is not likely to occur.

b. Nicaragua will require considerable reconstruction loans on concessionary terms, particularly for the 40-50,000 housing units destroyed. While assistance has already been offered by AID, IBRD, BID and CABEI, a substantial gap remains if the capital is to be rebuilt over a five to seven year period.

c. Even if the necessary resources are forthcoming, the earthquake is likely to slow the country's economic development. While the construction industry is expanding rapidly, it still may not be able to meet the

1/ It is estimated that 50,000 lost their job at least temporarily in the capital.

heavy reconstruction requirements in addition to the country's normal requirements. Moreover, the country's limited supply of qualified technicians and administrators will be heavily taxed.

d. Reconstruction loans will further add to the debt service burden after expiration of the grace period, and may thus interfere with the country's ability to borrow for normal development purposes. The country's external debt service charges are projected to constitute 15 to 18% of total exports of goods and services over 1973-75.

On the positive side, the intensive activity in the construction and manufacturing industries and the indirect income and employment effects generate, will be a partial offset to the negative factors described above. Other positive factors include the large capital inflows that Nicaragua is experiencing as a result of foreign insurance payments, private capital inflows under the AID Housing Investment Guarantee Program and the substantial capital inflows on official account. From the economic standpoint, it is also fortunate that the earthquake occurred at a time when Nicaragua found itself in a relatively strong balance of payments position.[1/] Finally the initial position of Nicaragua that regional considerations would be overshadowed by national rebuilding problems has been reversed by a recent statement by General Somoza and by the fact that Nicaragua hosted and took an active role in the recent Managua CACM meetings (July [illegible]).

(2) Impact on Other Central American Countries

a. A substantial increase in the demand for construction materials may be expected over the next few years. On the other hand, a reduction in the demand for consumer goods should be expected in 1973.

1/ Nicaragua's exports increased by 23% in 1972, and are projected to grow by another 20% in 1973. Its gross international reserves increased from $46 million at the end of 1971 to $89 million by December 31, 1972, and to $150.7 million as of April 30, 1973. The sharp increase after the earthquake has been due to a combination of factors, including a precipitate drop in imports accompanied by substantial increases in exports of cotton and beef, a low level of public sector spending and the slowness after the earthquake to expand credit.

b. Some delay in considering SIECA's proposal to restructure the CACM is probable since Nicaragua's authorities can be expected to continue to show greater concern for their own problems, with integration taking the back seat.

3. <u>The Drought</u>

A serious drought occurred in 1972 which had a substantial impact on the area's production of basic grains (corn, beans, rice and sorghum) and cotton. It is expected that the drought will have a significant impact on the area's balance of payments in 1973 both on account of increased import requirements of basic grains to replenish depleted inventories and losses in cotton exports.

The impact of the drought on basic grains and export products, as estimated by SIECA, is summarized in Table 3. Note that the output of basic grains -- which constitute the primary elements in the Central American diet -- registered losses which amounted to 22% of expected corn and bean production, 20% of expected rice production and 11% of expected sorghum production.

With respect to export products, cotton was the item most seriously affected, particularly in Costa Rica, Nicaragua and Honduras. SIECA estimates that the drought-induced loss amounts to 19% of the expected cotton output. However, greater than expected plantings reduced the impact of this loss in Nicaragua. In the case of coffee, the loss is estimated at about 6%; however, the suspension of the International Coffee Agreement Quotas has permitted countries to dispose of stocks at record high prices, thereby easing the negative effects of the drought on exports.

Aggregating losses resulting from the production of basic grains (C.A. $49.4 million) coffee and cotton (C.A. $39.6 million), and other products (particularly meat, owing to the destruction of pasture) total losses for C.A. in 1972/73 are estimated at about $95 to $100 million. On the basis of this estimate, the effect of the drought would be a reduction in the real GDP growth rate for C.A. of about 1¼%. This impact will be spread over 1972 and 1973.

Table 3

Preliminary Evaluations of Central America's Drought

in Terms of Volume and Value of Production 1972 73

	(1) Normal Production Expected	(2) Losses in Production	(3) Losses as % of Output 2/1	(4) Losses in $ C.A. Millions
Basic Grains (Thousands of Quintales (46 Kg.)				
Corn	40,050.8	8,719.6	21.8	29.1
Beans	4,756.1	1,055.9	22.2	11.8
Rice	4,371.7	898.0	20.5	6.6
Sorghum	6,417.4	671.3	10.5	[illegible].9
				19.4
Export Products				
Cotton	4,030.3*	770.8	19.1	21.6
Coffee	6,426.3*	377.0	5.9	[illegible]
Cotton Seed	-	1,281.7	-	[illegible]

* Production in 1971

SOURCE: SIECA, "Efectos de la Sequía en la Producción y Abastecimiento de Granos Básicos y en Otros Artículos del Sector Agropecuario Durante el Ciclo Agrícola 1972-73", Tables No. 1 and 8.

SIECA has made no estimate of the total balance of payments impact of the drought. However export losses due to losses in cotton and coffee exports alone are estimated at about CA $40 million, which amounts to 3.6% of the area's total 1971 exports. The balance of payments impact will be felt mainly in 1973 as higher grain imports (to replenish inventories) and lower exports will be concentrated in that year.

Fortunately, there are important offsetting effects: the strong demand and favorable price outlook for the area's principal products, particularly coffee, meat, sugar and bananas.

F. Restructuring the CACM

Between October 1972 and March 1973, SIECA issued a comprehensive twelve volume study entitled "Integrated Central American Development During the Current Decade". The study reviews the progress achieved during the decade of the sixties, identifies major problem areas and bottlenecks that have developed and proposes a program of action for the seventies. The study:

i. Makes a strong plea for much greater degree of integration in the future;

ii. advances a radical proposal for the restructuring of the CACM; and

iii. proposes a set of objectives and general policy guidelines in areas such as agriculture, industrial development, formation of a customs union, tax reform and monetary integration.

The major problem areas and bottlenecks highlighted by the SIECA study are as follows:

(1) Economic problems: While SIECA notes the satisfactory growth rate achieved by the GDP of the CACM countries during the sixties, it notes that a number of serious problems and strains have developed. These include balance of payments difficulties, high vulnerability to price fluctuation of primary products, insufficient domestic savings, considerable open and disguised unemployment, unequal benefits from economic integration, and unequal participation by the various social classes in the benefits of development. SIECA also finds that some factors which considerably boosted the growth of the CACM economies

during the sixties are not likely to continue to do so in the future, including the broad scope for the development of import substitution industries in 1960 and the relatively favorable market conditions for the area's primary products over the recent decade. SIECA believes that a new engine of growth can be found only in continued integration. Their analysis suggests that the GDP of the CACM can be expected to grow at an average annual rate of 6.5% with integration, but only at 4.2% without.

(2) Policy coordination: Very little progress has been made in the area of integration or harmonization of monetary and fiscal policies, in the coordination of national development policies -- particularly manufacturing industry and agriculture -- and in the area of promoting the free mobility of the factors of production.

(3) Shortcomings in the integration machinery: SIECA found serious deficiencies in the current integration machinery, including substantial delays in obtaining the approval and ratification of treaties and protocols by the five governments; the difficulty of gaining approval for measures that adversely affect some powerful interest

group; and the fact that the integration bodies have almost no power to make independent decisions. Their position is further undermined by their lack of financial independence and irregular government contributions. SIECA also notes that the existing separation between political and economic integration institutions (i.e., ODECA, SIECA, etc.) further weakens their effectiveness.

To remedy these various shortcomings, SIECA has proposed nothing less but the formation of a full-fledged Central American Economic Community (CAEC). The main features of the proposals are as follows:

i. Formulation and ratification of a new treaty setting up the CAEC;

ii. creating a permanent regional entity (Permanent Commission) that would reflect the regional interest.

iii. set up an automatic and continuing source of financing for all CAEC institutions.

At the apex of the SIECA proposed structure would be the Council of Ministers which would formulate policy at the highest level. Its decisions would be carried out by the Permanent Commission which would represent the regional interest, have executive as well as research functions, be able to take the initiative on integration matters and have discretionary powers based on the new treaty; it would also coordinate the activities of the specialized institutions.

The various SIECA annexes also include specific proposals designed to bring about the planned regional development of agriculture, special measures to promote industrial and export development, the formation of an area-wide customs union, the harmonization of tax measures, the continued development of an integrated physical infrastructure, and in the area of monetary integration, a blueprint that would eventually lead toward the formation of a full monetary union.

G. Prospects for Restructuring the CACM

Prospects for restructuring the CACM depend in large part, on what is meant by restructuring and the time span that is envisaged. There is a great deal of lip-service given to the need to restructure the CACM, widespread newspaper coverage of newsworthy events related to the CACM, a broad public awareness (at least in the cities) of the existence of the CACM, and a feeling that it has brought economic benefits to Central America.

As the above analysis of economic trends of the CACM indicates, the past ten years have been a period of great economic growth for the Central American nations, even if the pace has fallen off somewhat since 1966. Although most countries have individual problems (e.g. Honduras' slow rate of growth, Costa Rica's balance of payment problems, El Salvador's great dependence on intraregional trade and Nicaragua's need to recuperate from the earthquake), the exports of primary commodities and intraregional trade are holding up very well.

As a result of a widespread awareness of the slowing of economic growth, the stalling of the integration process and the shortcomings of the existing integration machinery, pressures for restructuring have developed. On the other hand, most of the countries are becoming increasingly concerned with internal political problems. With elections in Costa Rica, Guatemala and Nicaragua scheduled within the next eighteen months, the tendency to focus on internal affairs will probably grow stronger through 1974. While SIECA and the High Level Committee can lay the groundwork for restructuring and make progress in some areas, the likelihood of a major breakthrough over the next two years is not great.

The members of HLC have been appointed by their respective Presidents; and, at the CACM meetings in Managua, July 23-25, 1973, the HLC was given official authorization to proceed with its work. All five countries participated in the Managua meetings, and Honduras played an active and constructive role in the deliberations -- hopefully marking the end to her self-imposed isolation from CACM policy-making. While the shadow of the El Salvador-Honduras conflict still hangs over the CACM, the five governments are now actively seeking, through the HLC, a blueprint for new social, economic, trade and political policies to govern the CACM and the appropriate structure to carry them out. The governments also set up an interim committee made of the Vice-Ministers of Economy of the five countries to plan and supervise the implementation of a short-term program to re-vitalize the CACM, pending the recommendations of the HLC.[1] These long-awaited actions are but the first step in a long process, and it is much too early to anticipate the ultimate shape of a reformed CACM that will emerge from the work of the HLC.

An important related question is the kind of restructuring that is being considered. If it is merely a reincorporation of Honduras into intraregional trade, the signing of the bilateral treaties is a major step forward; if we are speaking of redistributing investment funds within the CACM to speed Honduras' growth or help Nicaragua recover from the earthquake, the prospects become more remote; and if we mean a "radical" restructuring of the CACM which involves integration of the marginal populations into the market economy, the revamping of incentives to make CACM industry competitive in the world market, attacking land-distribution problems and unemployment, the present prospects are dimmer still. For any restructuring of this sort gets increasingly close to a radical revamping of the present economic and social system -- with its implications for radical political change. The integrationists realize

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1/ For more details see CAPTO CIRC. A-27 of August 9, 1973.

this and will move slowly and cautiously in attacking these more fundamental problems.

In conclusion, the prospects for major reforms of the CACM through 1974 are not promising under present conditions. Any one, or a combination, of the following factors might affect the results favorably: first, the long-awaited settlement of the Honduras-El Salvador border dispute could provide a breakthrough that might open a new period of collaboration and desire to deal with economic and social problems throughout the area. Second, the emergence of more dynamic top level integrationist leadership at both the national and regional levels. While at various times one or another CA President (most notably President Somoza) has taken the lead in attempts to restructure the CACM, there has been little concerted effort at the Presidential level. While both SIECA and CABEI are competently led, neither appears to have the prestige or drive to mobilize forces on behalf of restructuring. For the foreseeable future, ODECA will play no role. Third, there is the possibility of an economic crisis that will jar the fuerzas vivas and the national leaders into a recognition that the CACM's economic house must be put in order. While problems of over-capacity do exist, so long as exports and intraregional trade hold up, there is little likelihood of a major economic crisis which could provide a catalyst for restructuring the CACM.

On balance then, while the long-run prospects for restructuring the CACM may be promising, we should not expect significant breakthroughs over the next few years. Progress will probably be slow and halting, with the prospects best in fields where powerful economic and political interests are not directly attacked or too much asked of governments in terms of financial sacrifice or loss of sovereignty. The implications for U.S. regional aid programs (particularly under the low-profile concept) are that we should concentrate our moderate support for regional integration in the most promising regional institutions (e.g. SIECA and CABEI) to lay the necessary groundwork for restructuring, while supporting those sectors with the best prospects for contributing to economic growth (e.g. agricultural diversification, export promotion and tourism, and needed physical infrastructure.)

H. Growth Prospects

In 1973, the GDP for the CACM as a whole is projected to grow at about 4.5% in real terms. Growth prospects appear favorable for Guatemala (projected to grow at 5.7%), and reasonably satisfactory for Costa Rica (5.0%). GDP growth for El Salvador and Honduras was projected at 4.5%. The decline in GDP projected for Nicaragua, mainly as a result of the earthquake and the drought, was revised by the Ministry of Economy, to indicate a 2.8% increase in real GDP for 1973. Thus, Central America's GDP can be expected to grow at a rate of about 4.5% in 1973, slightly below the growth trend of recent years. The GDP growth rate since 1970 together with projections for 1973 for each of the C.A. countries is summarized in Table 4.

Table 4

GDP Growth Rates 1970-1973
(In Constant Prices)

Period	C.A.	Guate.	El Salv.	Hond.	Nica.	C.Rica
1970/71	5.4%	5.8%	4.3%	6.0%	5.7%	5.0%
1971/72	5.4%	6.0%	4.5%	4.3%	6.0%	5.4%
1972/73	4.5%	5.7%	4.5%	4.5%	2.8%	5.0%

The major positive factors stimulating growth are as follows:

a. Good export prospects for primary products: the outlook is for continued favorable prices for coffee, cotton, meat, sugar and bananas and for a continued good production response to favorable prices.

b. Intraregional trade expanded by about 13% in 1972 and is expected to continue to rise in 1973. Intraregional trade will be stimulated by the three bilateral treaties negotiated by Honduras which are expected to expand the level of intraregional trade by 7% to 8%.

c. Public investment is expected to increase in all five C.A. countries.

The negative factors include, first and foremost, the Managua earthquake which is expected to depress Nicaragua's GDP. Other factors include the 1972 drought, the impact on private investment of continuing uncertainty over the future of the CACM, the rural poverty problem, and a possible resurgence of Costa Rica's balance of payment crisis. Finally, regional growth and integration cannot achieve its full potential until the Honduras/El Salvador border problem is resolved. Unfortunately, the near term prospects of such a settlement are not encouraging.

Beyond 1973, we see a continuing favorable world demand and price outlook for the area's principal primary products. Coffee prices are likely to be favorable for several more years owing to the substantial disruption of Brazilian coffee production resulting from coffee rust which is likely to depress that country's output and raise its production costs over a period of several years. The outlook for meat is excellent, and prospects are for continuing strong demands for bananas and sugar. Tourism and new exports (particularly fresh and processed fruits and vegetables, furniture, and apparel), also hold great promise, but the success of these efforts will depend on the vigor and imagination with which the Central Americans develop the necessary policies and programs.

Intraregional trade cannot be expected to provide in the future the same powerful stimulus it has contributed in the past, owing to the reduction in new import substitution opportunities. The major imponderable is the behavior of private and public investment. The volume of public investment will depend in part on the ability of governments to raise the level of public savings by improving their tax collection apparatus and enacting new revenue measures, and on their ability to continue to secure substantial loans on concessionary terms from the international lending institutions. The behavior of private investment will depend in large part on the continued success of the integration movement, the maintenance of political stability in the area, the measures taken by the governments to promote development, and above all, by the ability of the governments to inspire the confidence of both foreign and local investors. In our judgment, the outlook is for a growth rate of 4% to 4.5% in real terms without a serious effort to boost investment and carry further the integration process; and a growth rate of 5.5% to 6.0% over the next three to five years with a vigorous and well-conceived approach.

CHAPTER III

MAJOR PROBLEMS FACING THE CACM IN THE DECADE OF THE 1970s

A. Problems of Economic Integration

The major factors that impede rapid progress toward greater economic integration are:

(1) **Nationalism**: The strength of nationalist sentiments contributed to the El Salvador-Honduras war, the closing of the Pan American Highway, the separation of Honduras from the CACM free trade area, the refusal to grant real power to the integration institutions, and the slow progress in the area of coordinating monetary, fiscal and exchange policies.

(2) Understandable Preoccupation with trade balances: Honduras, Nicaragua and Costa Rica have at one time or another experienced serious negative trade balances with the rest of the CACM. These negative balances have generated a great deal of concern and have prompted the feeling that integration was promoting the interest of Guatemala and El Salvador at the expense of the other three CACM members. Honduras's peak deficit balance of $36 million in 1970 played a key role in the promulgation of Decree

No. 97, while Costa Rica's deficits gave rise to several CACM crisis in recent years.

(3) Conflicts in development philosophy: Guatemala, El Salvador and Nicaragua have pursued more conservative monetary-fiscal policies than Costa Rica in recent years. Costa Rica's expansionary policies, without added revenue and more efficient management, contributed significantly to her balance of payments problem and devaluation. To sustain its serious commitment to provide increased public sector services, however, will require more thoughtful financing to avoid further monetary friction within the CACM.

(4) Sharing of benefits: Perhaps the most important problem in the area of integration is the strongly held feeling that benefits from integration are not being equitably shared by all CACM members. This feeling is induced both by negative regional trade balances, and by Honduras's relatively low level of industrialization. Value added by Honduras's manufacturing industry is 28% of that of Guatemala's, 44% of El Salvador's, 49% of Costa Rica's, and 54% of Nicaragua's. Nor is there any evidence that Honduras

is catching up. In fact, the industrialization gap between Honduras and its CACM partners has tended to grow despite more liberal fiscal incentives granted to Honduras. Demands for preferential treatment by both Honduras and Nicaragua can be expected to remain a continuing source of conflict within the CACM, as well as an obstacle to the restructuring of the Common Market.

(5) Subsistence Family: Failure to include the subsistence farm family in either their own national economies or in the integration program even though such families make up 1/2 of the population of the region and their failure to participate in the money economy is an albatross the CACM has had to bear.

While these difficulties are real enough, they are not insurmountable over the long run. There is a growing commitment to the cause of C.A. integration by the younger technocrats. As these are assuming increasingly important positions, a gradual shift in the policies of the C.A. governments can be expected. The fact that SIECA has formulated so radical a restructuring proposal and that this proposal is being seriously studied and debated is an encouraging sign, though prospects for rapid results are slim.

B. Fundamental Economic Problems

The following are the emerging major problem areas to which national and international development programs must be directed during the seventies:

(1) Rural Backwardness: Agriculture employs about two-thirds of the economically active population; yet the average rural income is estimated to be only about 40% the regional average. Unemployment, illiteracy, malnutrition and mortality rates are all much higher in the rural areas. Moreover, during the decade of the sixties, value added by agriculture (in real terms) increased at an average annual rate of only 4.4%, compared with 5.7% for the GDP.

(2) Unemployment and High Rates of Population Growth: SIECA estimates open unemployment at 8% to 15%. If allowance is made for under-employment and the very low level of productivity induced by surplus labor, the figure might rise to at least 30%. The long-run outlook for reducing unemployment will most likely be dismal if the countries of Central America do not alter their tax, tariff and wage

policies and are not successful in curbing their population growth rate which, except in Costa Rica, has shown no sign of declining.1/ While all C.A. countries have family planning programs implemented by their ministries of health and private groups, these have not been measurably successful so far (see Part e of Chapter IV and country discussions of obstacles to success in family planning programs.)

(3) Maldistribution of Income: A recent estimate by the FAO advisory group for Central American integration (GAFICA) estimated that the poorest 50% of the Central American population had a median per capita income of CA$90 and commanded only about 15% of the GDP; while at the other end of the income scale, the richest 5% of the population enjoyed a median per capita income of about $1800 and accounted for almost 30% of the total GDP.

(4) Poor Nutrition and High Illiteracy Rates: While this problem is most serious in the rural areas, it is by no means absent from the cities. Infant mortality rates

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1/ There are of course many other factors which affect unemployment.

are particularly high in Honduras and Nicaragua. With respect to illiteracy, only Costa Rica has a very low rate (15%). The rate for the other four countries ranges between 40% and 60%.

(5) <u>Excessive Dependence on Primary Exports</u>: Exports to the rest of the world are still undiversified. In spite of the substantial progress made in developing manufacturing industry over the last decade, Central America's exports of coffee, bananas, cotton and sugar still account for some 75% of its total extraregional merchandise exports. In fact, only about 2% of the area's total exports to the outside world consists of manufactured goods (See Part C of Chapter IV).

(6) <u>Management Capacity</u>: Over and above specific sectoral issues, there also exist the general and elusive problems of inefficient public sector management throughout the region. The lack of modern management systems, the traditional over-centralization of authority, and archaic administrative practices are factors which constrain effective mobilization of development resources and the decision-making process at the national and regional level. Changing

public sector attitude towards more responsive and efficient management is a priority the region must address; but rapid improvement is unlikely and a broad attack on the problem is probably unwarranted until better assistance methodology is developed to deal with public sector management weaknesses.

C. Development Goals for the 1970's

SIECA has proposed the following major objectives for Central America's economic development in its study on "Integrated C.A. Development During the Current Decade":

A GDP growth rate of 6.5% in real terms; a better distribution of income among the social classes; an improved distribution of the benefits from integration among the countries of the area; creation of additional employment opportunities.

SIECA proposes to achieve this rapid rate of growth through integration, far reaching institutional and policy changes and balanced development. Integration, in SIECA's view, involves the removal of all restrictions on intra-regional trade, the free movement of capital and labor, the integration of monetary institutions and policies, the harmonization of tax systems and the coordination of development plans. With respect to economic development, SIECA places considerable stress on the development of agriculture, non-traditional industry and exports, and on the continued development of a well-integrated regional infrastructure.

The national development plans do not place as much emphasis on integration as SIECA. However they agree with the SIECA emphasis on the development of the rural economy, and with the recommendation that special preference be given to small and medium-size farmers. There is a consensus that the accelerated growth of agriculture would not only stimulate the region's development, but would also contribute to improving income distribution by raising the living standards of the lower income groups. Both SIECA and the national development plans stress the need for a greater role by the public sector to develop agriculture, improve the level of education and nutrition of the lower income groups, generate employment and reduce income inequality. Other SIECA objectives that enjoy full support in the national development plans include the promotion of manufacturing industry, a move away from assembly operations and into the manufacture of intermediate products, and the development of exports of non-traditional products to markets outside the region.

D. CACM Policy Toward the Industrial Sector

The uniform tariff schedule of the CACM places low import duties on machinery and equipment and relatively high import duties on many categories of intermediate goods, raw materials and, particularly, finished consumer goods. The policy of placing low duties on machinery and equipment has recently aroused criticism by those who argue that this policy stimulates the substitution of capital for labor, thus contributing to the already high level of unemployment. The AID/El Salvador Mission has urged that duties on capital goods imports be raised significantly to encourage the adoption of more labor intensive techniques.

Priority must indeed be given to the generation of employment opportunities, and the adoption of more labor intensive techniques should be encouraged whenever these can be applied without significantly raising costs. Measures that increase the cost of capital while simultaneously lowering the labor costs per unit of output would indeed have the desirable effect of encouraging the substitution of labor for capital. However, higher duties on capital goods inputs may encourage the desired factor substitution, but may at the same time discourage the development of manufacturing activity owing to higher total production costs since it is obviously impossible to reduce wages or fringe benefits while increases in labor productivity are hardly encouraged by higher duties on capital goods inputs. As a result, the effect of the policy on total employment may be neutral. The impact on value added is likely to be negative. Moreover, the effects on exports must also be considered: measures that increase production costs further increase the difficulty of developing extraregional exports. Theoretically, this latter problem could be avoided by exempting extraregional exports from the payment of the duty, but it is difficult to justify a policy that simultaneously increases duties and duty exemptions, as this would only complicate the already difficult task of tax administration.

In conclusion, the policy of raising tax rates on capital goods imports should be supported by further study and investigation before recommending it to the Central American governments. Such a study should be part of a comprehensive re-examination of the uniform CACM tariff schedule. This schedule accords a high degree of protection to Central American industry. It was not developed on the basis of a careful analysis, but is rather the product of innumerable *ad hoc* decisions, often in response to demands for protection by various pressure groups. The other criteria -- i.e., serving the interests of the final consumer and maximizing government revenues -- were often sacrificed to demands for protection. The policy has produced a number of over-protected and some relatively inefficient industries that have difficulty competing outside the CACM.

At the same time, a large number of manufacturing enterprises were granted exemptions from payment of income taxes and import duties on parts and materials under the fiscal incentives law for industrial development, leading to substantial losses in government revenues. It is estimated that revenues foregone as a result of tax exemptions amounted to C.A. $42 million in 1967, which constituted about 10% of total central government revenues and 40% of total import duty collections.[1/] The tariff policy pursued in Central America has been clearly self-defeating: relatively high duty rates were imposed upon several categories of intermediate goods imports, while at the same time a general policy of tax exemption was pursued that waived payment of such duties.

A strong case can be made for a) lowering tariffs on many classes of consumer goods and on some intermediate goods, and b) reducing the scope and duration of tax examptions. The re-examination of the uniform tariff schedule and fiscal incentive law has been recommended by many experts, including SIECA. The advisability of also altering duties on machinery and equipment with the view of promoting the adoption of more labor-intensive techniques should be undertaken as part of this comprehensive review.

1/ Clark Joel, "Tax Incentives in Central American Development", Economic Development and Cultural Change, January 1971, Table 4.

CHAPTER IV

REGIONAL SECTOR DISCUSSION

The ensuing sectoral discussions provide the setting for the ROCAP effort in support of regional economic integration. In the decade since the creation of the CACM, a juridical and institutional framework has evolved to carry out the decision of the five Central American republics to accelerate regional development through free trade among themselves. The unresolved conflict between El Salvador and Honduras has inhibited free trade, but it has not resulted in either the abrogation of the CACM or the withdrawal of Honduras or El Salvador from the key institutions created to promote regional development. Hence, analysis of regional conditions in sectors key to development through integration remains a critical element in the definition of ROCAP programs over the DAP time frame.

A. Agricultural Development - Regional

1. Introduction:

Central American development during the first 12 years of the common market in certain sectors has increased dramatically. This evolution has been most notable in infrastructure and manufacturing, however, the CACM agriculturewise must be considered a major failure. Certain overall indicators are noteworthy. The GDP in 1960 was CA$ 2,796.9 million while in 1971 it increased to CA$5,152.4 million evolving at an annual rate of 5.7% in real terms. Investments during the same period in the region more than doubled which compounded annually, shows a gross increase in investment of 7.2%. Manufacturing, the area in which most striking changes have taken place, increased from CA$369.4 million to CA$885.3 million during the 11 year period 1960 to 1971 providing an annual compound rate of growth of 8.3%. Total commerce, regional as well as international, grew from CA$ 637.4 million in 1960 to CA$ 1,227.8 million in 1971 showing an annual rate of growth of 6.1%. These overall figures are noteworthy, however they fail to tell the entire story.

Regional trade - the area in which the common market has been most effective and has made the most dramatic increases- grew from CA$ 32.7 million in 1962 to an estimated CA$305.0 million dollars in 1972. This expansion of almost 10 times the 1960 level of commerce has resulted in a compound growth rate of approximately 21% over the 12 year period. Manufactured goods, other than foodstuffs accounted for more than 3/4's of this entire increase. Due to favorable tax incentives, availability of technology, facility provided by the CACM in the acquisition of capital for investments, availability of aggressive private sector management and regional import tariffs - basic elements supporting the overall CACM policy- provided the incentives and the market for an impressive development in the industrial and manufacturing field.

Total exports resulting from almost continuously increasing industrial development and sporadically favorable prices for traditional agricultural products resulted in an overall annual compound growth rate of 8.8% increase in exports between 1960 and 1971. Seventy-four percent of the area's total foreign exchange derived from exports resulted from the production and sale of only 4 commodities -all agricultural products- coffee, cotton, bananas and sugar. The big four in traditional exports have recently been augmented in number, through favorable world market prices for cattle. The latter commodity has grown at a very significant rate during the last 5 years. At the same time, non-primary exports, largely processed products, have also increased at an even faster rate than the primary traditional products increasing by 11.4% annually during the period under study, however, they started at an almost insignificant level in 1960.

Unfortunately, due to price inclemencies, agricultural output increased at a significantly lower rate than the other above indicators. In 1960, total production of agricultural commodities was CA$ 885.5 million and in 1971 it had increased to CA$1,386.6 million showing an annual compound rate of only 4.2% during the 11 year period. Data on exports of agricultural products underscores the slow growth of the sector. While exports of manufactured goods grew at an estimated annual rate of 27% between 1960 and 1971, exports of non-manufactured goods grew at an annual rate of only 6.6% while the 6 major traditional agricultural products (coffee, cotton, bananas, sugar, livestock and meat, and wood) grew at only 6.5% annually. This is a totally unsatisfactory situation in view of the fact that approximately 65% of the area's population derives their income directly from agriculture.

2. Problems Resulting from Past Policies

As a result of the significant changes that have taken place in the structure and operation of the Central American common market during the initial 11 years of its existence, a growing number of extremely serious problems are facing national governments and the CACM organization itself during the next decade. A number of these concerns include:

1) External debt incurred by the 5 countries in Central America has increased over 16% annually during 1966 to 1971;

2) Past Central American policies which favored industrial and infrastructure development did not also generate similar policies for the rural sector;

3) The per capita growth rate of GDP has decreased from 2.6% during the 1960-66 period to 2.1% during the 1966-71 period - the initial dynamics of the initial thrust of the CACM are slowing down;

4) The benefits of the past decade appear to have significantly increased the disparity between rich and poor. Although reliable data to confirm this observation does not appear available at this time;

5) Wide disparities exist in per capita income. While the overall per capita income for Central America was CA$355.00 per year in 1971, approximately 80% of the population had a per capita income level of only $148 a year. The rural sector generally has received an income, on a per capita basis, of from 1/3 to 1/4 that of the urban industrial and service sectors (see table on 1970 per capita income levels in Central America)

6) Total population in the CACM area is increasing at the very rapid rate of 3.2% overall and over 4.0% in the rural sector in some countries.

TABLE 1

Median Per Capita Income and Percent of the GDP Accruing to Each of Four Income Groups in 1970
(in 1960 C.A. Pesos)

	First Group: Poorest 50% of the population		Second Group: next to poorest 30% population (70% of Population)		80%	Third Group: next higher 15% of population		Fourth Group: Richest 5% of the population	
	CA$	%	CA$	% GDP	Ave.	CA$	%	CA$	%
Guatemala	73	13	228	24-37	131	543	28	2,028	[illegible]
El Salvador	81	16	213	24-40	130	568	33	1,442	27
Honduras	52	13	164	24-37	96	401	30	1,349	35
Nicaragua	91	15	248	25-40	150	627	32	1,643	28
Costa Rica	152	18	366	26-44	232	750	27	2,478	[illegible]

Source: FAO Advisory Group for C. A. Integration (GAFICA)
Plan Perspectivo para el Desarrollo y la Integración de la Agricultura en Centroamérica, Guatemala: Documento GAFINT, March 1972, Page 33. Reproduced on page 25 of SIECA study, El Desarrollo Integrado de Centroamérica en la Presente Década, October, 1972

Further emphasis on birth control programs in the rural sector appear indispensible.

7) Unemployment and underemployment appear to be rapidly increasing throughout the Central American Common Market area;

Rural underemployment which commonly may run from 15% to 25% has been estimated as high as 50% during peak periods in at least one country. Unfortunately, urban industrialization does not appear capable of offsetting the total employment problem since during the 11 years of Central American industrialization, only 160,000 new jobs have been created. Too, sector analysis and other studies appear to indicate that self-sufficiency in food production -assuming a continuation of present dietary habits- will provide work for less than one half of the new people entering the labor force annually.

Unemployment and underemployment during the next decade will mount at alarming rates if major changes are not made in the rural sector. Using 1970 estimates of Central American males in different age categories (including a percentage of women in the labor force would further expand the estimated total labor force) without reducing the existing numbers for deaths during the 1970/98 period will provide a reasonable estimate of the size of the problem (see graph on page IV-10)* If it is assumed further that if the percent of the CACM population in the rural areas remains constant, we can expect an estimated 2,346,000 males all presently alive, will enter the rural labor force in Central America during the next ten years. In fact, rural urban migration is already beginning to increase at a rate beyond the capability of present urban capacity to absorb them.

8) Nationalistic trends appear on the increase. The lack of dynamic regional policies, especially in the agricultural sector, are causing governments to feel they must become more self-reliant. This appears especially true in the basic food crops area. The recent drought, felt throughout most of Central America during

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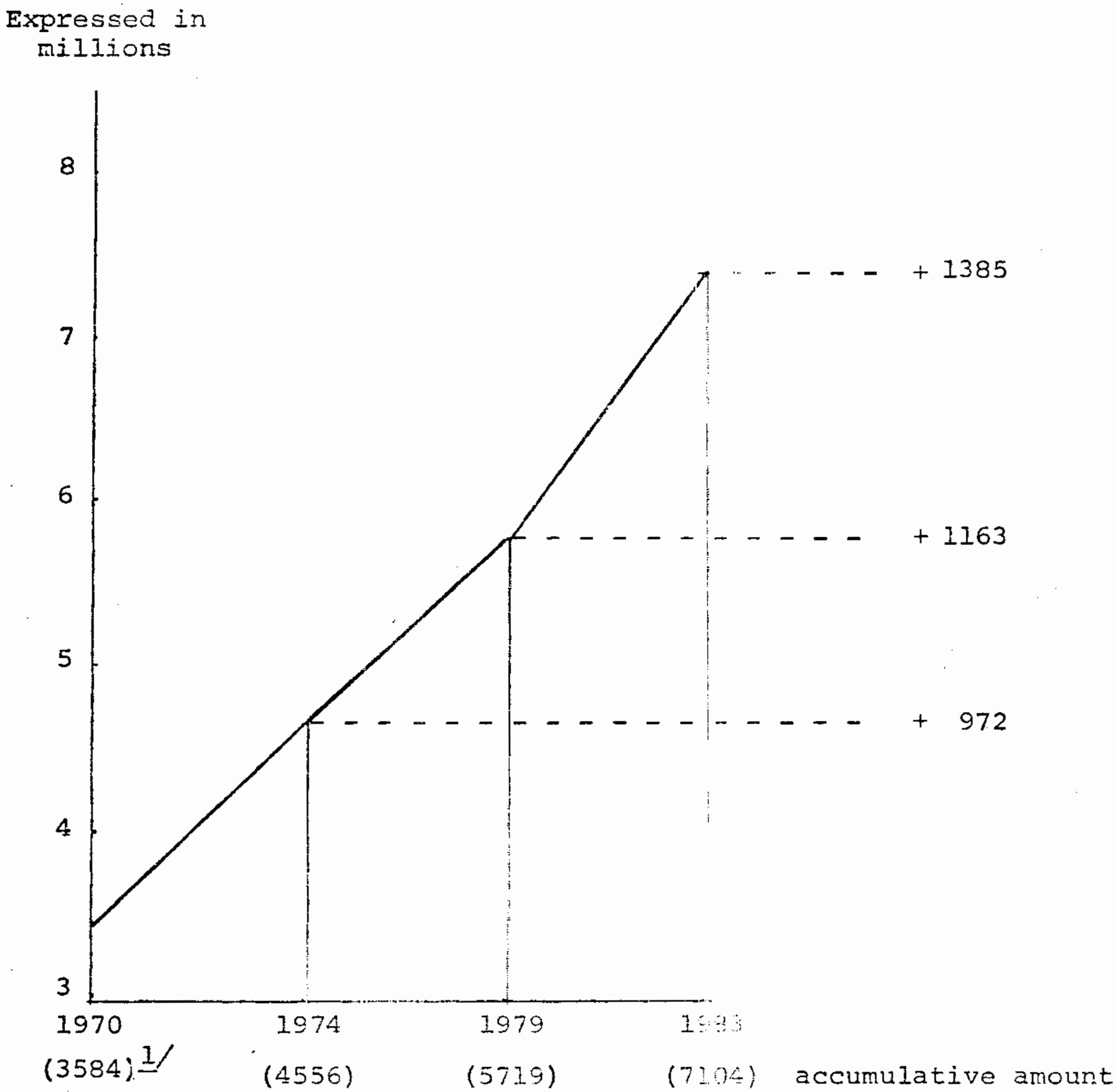
* Source: SIECA Estadística Social 1970

IV-10

23 YEAR TREND IN NUMBERS OF MALES ENTERING LABOR FORCE IN CENTRAL AMERICA *



* Estimates based upon number of males reaching 15 years of age as full participants in the labor force.

1/ 15 to 55 year economically active age

Source: SIECA *Estadística Social* 1970

the past 2 years, has totally drawn down the small stocks of basic food crops existing in the Central American countries. This, coupled with possible continued restrictions in US exports of corn, beans, rice and other essential food commodities are causing Central American governments to review intensively their agricultural policies and programs and place a much greater emphasis on meeting domestic needs almost without regard to the cost per unit of production and ignoring the consequences in terms of best use of capital and natural resources. Representatives of the national planning councils in several countries have commented to ROCAP that they recognize that this situation may delay their real desire to concentrate on more labor-intensive agricultural programs. However, due to the lack of confidence in the world situation, and their inability thus far to evolve workable alternatives among their neighboring countries they feel forced to adopt policies during the next several years which may stimulate production of basic food crops.

9) <u>Recognizing the population problem, the past use of key resources - land, capital and water - has served as a major constraint to rural development</u>.

In the rural sector, the available basic resources for rural development are already limited and unless used more effectively in the future can serve as a major deterrent to providing employment and distributing income within the rural sector. Land, as an example, of a quality to support intensive labor use comprises only 12.7 percent of Central America. If this figure is expanded to include the land area capable of supporting extensive field crops and perennial tree crops only 37% of the total land area is useable for producing food and fiber within the CACM. Presently there are approximately 2.6 people per hectare -considering the areas total available land. In some areas (e.g. El Salvador) there are already an estimated five people per arable hectare (see table page IV.13).

Capital is and is expected to continue to be a major limiting factor for priming rural development. Not only is the total amount limited but its use is primarily

CENTRAL AMERICAN LAND USE POTENTIAL

Land Use Potential	Km^2	Approximate percent By intensivity use sub group	Approximate percent By major use group
Intensive use - annual crops	34,338		
Intensive use - perennial crops	16,476	15%	
Extensive use - annual crops	8,973		
Extensive use - perennial crops	88,406	22%	
Intensive/Extensive crop sub-total	148,193		37%
Forests and mangles	154,542	39%	
Pasture land	96,131	24%	
Perennial forest and pasture land sub-total	250,673		63%
TOTAL	398,866 Km^2	100%	

directed toward traditional exports. In most of the Central American countries over 80% of the total investment capital available to agriculture is presently concentrated in traditional agricultural production. Too, due to the lack of land titles and alternate mechanisms to guarantee the banking system against loss, there can be little expected increase in the use of new technology for crop diversification.

In many tropical areas, water is a limiting factor for the most efficient use of land and sunlight. While rainfall levels are often considerably higher than the U.S. the periodicity of the wet season prohibits crop production during certain months of the year. Presently, the Central American countries are utilizing only a fraction of their available groundwater and tubewater as a source for irrigation is almost unknown. In order to provide employment and better utilize the region water resources considerable development of irrigation districts must be undertaken during the decade ahead and much more efficient utilization of existing systems will be necessary.

10) <u>No viable mechanism exists in the CACM for the development of constructive agricultural policies</u>.

The five Central American countries all appear to recognize the need for greater dialog in the agricultural sector. This weakness in the past structure of the CACM has also been pinpointed in the 12 volume study[1] on the Central American Common Market prepared by Dr. Gert Rosenthal and presently being utilized by the Ministries of Economy and SIECA as the basis for discussions on the restructuring of the central american regional mechanism itself. It is noteworthy that under the previous organization of the CACM, the Ministers of Agriculture in Central America have formally met under regional auspices only once since 1965, to discuss regional policy issues.

11) <u>SIECA and other regional integration institutions have been unsuccessful in proposing policies adequate to deal with the rural sector problem</u>.

At the present time, other than the Limon Protocol which calls for consultation on the production and marketing of basic food crops and periodic meetings held

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1/ El Desarrollo Integrado de Centro América en la Presente Década - SIECA - Oct. 1972 to establish import levels for certain agricultural commodities, no overall Central American agricultural strategy based on sound economic and social bases has yet evolved. SIECA has been extremely concerned by this very serious deficiency in the CACM and has attempted to utilize its small agricultural economic and agronomic staff on a myraid of individual agricultural projects. Unfortunately, this agricultural group is poorly staffed and inadequately trained for the enormous task confronting it. The group has had difficulty in developing a dialog with national interests as the basis for determining the key elements or goals to be achieved in the rural sector. Thereafter, a systematic collection and study of existing information which would logically be followed by the proposal of several alternate strategies to the Central American governments for their consideration. Too, SIECA as well as the other regional institutions working in the agriculture field have not coordinated their efforts with nor drawn upon the existing technical talent available throughout the region. Even more serious, they have not developed a forum for the discussion of key problem issues, among political, technical and other public and private sector groups in the CACM.

11) <u>The lack of a well organized Common Market Agricultural network for policy determination, research, promotion, education, credit or marketing are deterring action.</u>

The only significant exceptions to this fact are the PCCMCA or basic grains research coordinating council and CSUCA, the regional higher education coordinating committee. The former, meeting only annually, reports results of research but does not make policy in this field and the latter presently comprised of only three country members (Guatemala, Honduras and Costa Rica) are not developing regional university schools specialized in specific fields of agriculture as was originally envisioned in a manner conducive to prepare future technical personnel adequately to solve the region's immense agricultural problems.

3. CRITICAL GOALS FOR RURAL DEVELOPMENT

Since 1970, regional attention has increasingly been focused on the fundamental role rural agricultural development has in future Central American socio-economic evolution. There is a serious need for agricultural policies which focus simultaneously on employment, improved income distribution, productivity and marketing. Towards this objective, key institutions, at both national and regional levels, and key policy makers, must become aware of the magnitude of the problem and learn ways in which national and regional action programs can bring about a meaningful change. This must be undertaken through collaborative economic and social analyses, seminars, workshops and formal regional and national consultative mechanisms in order that the region's decision makers can exchange views and arrive at effective approaches to the solution of the rural problem.

SIECA and CABEI, in collaboration with other Central American government institutions are just beginning to systematically analyze several critical areas of the sector. These regional agencies, however, have not yet developed a meaningful dialog with public sector political leaders, planners and programmers. Problem analysis should be preceeded by the definition of goals and joint regional-national cooperation and coordination must be forged before meaningful regional policies can take shape.

SIECA has already initiated this long term process by recognizing explicitly that agriculture must play the major regional role in any accord to restructure the common market. Considerable action among the CACM countries will be required during the next several years. The 1972 SIECA/UNCTAD decade study directed by Dr. Gert Rosenthal on the future of the Central American Common Market, identified agriculture and the rural sector as essential for further regional integration and sets forth two primary goals for SIECA in the decade ahead;

1) increasing the capacity of agriculture to become a more powerful growth force in the region through raising productivity and outputs; and

2) improving the general income levels and quality of life in the rural sector.

Country rural development programs in all of the five republics focus on a similar set of objectives and it is believed that, although the countries may differ in the proposed approach, all are in agreement that rural development through raising productivity, improving the general income level and the quality of rural life is the key to the future of the CACM.

4. ELEMENTS AFFECTING THE NEW POLICY DIMENSION

The mounting problems which have been identified in section 2 above bring into sharp focus the problem facing the CACM and the rural sector in particular. Lack of institutional capability and yet inadequate focus on national policies coupled with an evolving new structure for the regional institutions make the development of a new focus to regional policy definition within the next several years both imperative and timely. There appears to be growing realization by the CACM member nations of the complexity of the problem but the effects of not addressing themselves to its solution are even more unsavory both politically as well as economically.

ROCAP and the USAIDs, since 1970, have more sharply focused their programs in the agricultural sector around the above goals, concentrating their efforts on the needs of small and subsistence farmers and are supporting the expansion of institutional capacity, qualitatively and quantitatively improving the technological base, providing credit, encouraging identification of new market mechanisms and opportunities and augmenting the rural delivery systems necessary at both regional and country levels to incorporate large numbers of low income rural people into the cash economy.

Each Central American country has primary responsibilities for integrating its rural population into its money economy and for assuring that its rural population will share in the benefits of national as well as regional economic growth. There must at the same time, be compatible regional policies to complement national ones in order to achieve better utilization among all of the countries of existing land, labor, technical and capital resources.

The key to US assistance for agricultural development in the future will rest on finding means to support the development of regional and national policies and programs to effectively assist large numbers of subsistence and small size farm operators produce more efficiently and market more profitably as well as expand the employment opportunities for rural laborers. Within this context, related agricultural development activities including extension, cooperative promotion and other types of group action, agricultural research, credit, education, land tenure, taxation and improved factor product markets will require much more sharply focused consideration due to the numbers involved and the limitation of available outside resources.

The regional agricultural sector studies project begun by ROCAP in FY 1973 will permit SIECA, CABEI and IICA/ZN and other regional institutions working directly with national agencies and the private sector develop guidelines for defining several key elements of a long range regional sector strategy based upon the employment and income distribution guidelines identified above. The short run focus will be upon expanding the capacity of regional and national institutions to work effectively in close day to day collaboration with national agencies on specific problems, jointly collecting the necessary base line information required for sound economic, social and technical analyses leading to the evolution of alternate strategies for rural development. These strategies after joint national and regional political study would ultimately result in regional and national policies with subsequent adoption of appropriate action programs. An essential consideration in the conduct of the first initiatives which ROCAP is supporting SIECA, CABEI and IICA/ZN to undertake, is in giving extremely close attention to the socio-economic implications within the context of the studies themselves. Thus, rural employment, income distribution, productivity and marketing become the long range course of our future support actions and the barometer of the effectiveness of our programs.

The problem of regional rural evolution within the framework of improved quality of life for rural people has already been initiated through sector analyses and sector programs in Guatemala and Costa Rica supported by the USAIDs in these countries. El Salvador, Honduras and Nicaragua are embarked on similar studies and operational programs are expected to be started by FY 1974 in all of the Central American countries. Any regional sector analysis and regional policies adopted in the future must be built upon and complement these extremely important national initiatives. To do otherwise would conflict with existing national efforts and increase confusion rather than increase logical AID area-wide support to the rural sector. These national sector analyses and the resulting programs will make a regional analysis significantly more complex, but the changes contemplated in public sector institutional organizations will probably counterbalance the analytical problems through facilitating implementation of any regional policies developed as a consequence of the FY 1975-77 regional effort.

Although ROCAP and the USAIDs will not become directly involved in dealing with policy matters related to traditional agriculture, we will constantly bring to the attention of SIECA and the CACM Ministries of Agriculture that it is essential to an evolving strategy that policies ultimately be developed within Central America for traditional agricultural crops as these may relate to benefiting more broadly the rural labor force working on these commodities. Well over one third of the total rural labor force in Central America is directly or indirectly involved with traditional crop production, processing, marketing and transportation. Unfortunately, laborers working on these commodities, are not sharing equitably in the fruits of recent price increases being received by producers of cotton, coffee, sugar, bananas and cattle. The five CACM countries must consider policies which raise minimum wages for salaried labor, improve living conditions, and taxation measures required to spread the benefits of the income generated from expanded exports to a significantly greater portion of the Central American population.

National and regional strategies within the framework of the goals set out in section 2 above, must also focus on agro-industry in areas having favorable regional or international markets, provide a multiplier factor in the employment and income distribution and maximize capital and natural resources use efficiency. In certain areas of Central America, where seasonable unemployment is high, joint study will be necessary by regional and national institutions to ascertain whether introduction of specific types of agro-industry provide alternate employment opportunities and utilize available investment capital wisely. Agro-industrial transformation of products into forms having increased storage life, broader acceptability by consumers, and reaching into new world-wide consumer groups will be extremely useful.

Within the context of the new goals that will evolve through the next several years in Central America, international institutions, including AID, must allocate capital and technological transfers from the US system much more carefully than it has in the past. Examples of previous misallocations might include loans for extensive production of agricultural products on land useful for intensive agriculture, major expenditures for industrial development in the areas where the cost of generating an employment unit far exceeds other alternatives, and production enterprises in the rural sector which benefit very small numbers of farm operators in contrast to promoting mass participation.

Additional research or adaptation from other areas appears essential to improve the utilization of capital transfers from more developed nations in providing credit, technical assistance, inputs and marketing of products produced by large numbers of rural people <u>at lower per unit cost</u> than have been prevalent thus far. It is essential that throughout the region, sharper focus be drawn upon short run programs and projects for AID grant and loan assistance which support an evolving CACM strategy and consider seriously the best use of land, capital, human and natural resources available to the rural sector.

5. NEED FOR A NEW STRATEGY FOR RURAL DEVELOPMENT IN CENTRAL AMERICA

Serious problems have developed as a result of past policies. These now require urgent solutions because of the growing expectations in the evolution of the rural and urban sectors within the region. External debt increases, increased disparity between rich and poor, the continuing explosion in population, ever expanding unemployment and nationalistic trends call for new policies, organizations and action programs at both the regional and national levels. Present negotiations for the reconstitution of the Central American Common Market offer promise that a new, more workable national/regional mechanism may evolve and that both Central American countries and the region as a whole will increasingly depend upon agriculture as the principal generator of employment, improved income distribution and the improvement of the quality of rural life.

It is essential for AID support to expand assistance in areas which help to evolve a Central American Common Market solution to their own problems. This will require further reorientation and possibly expansion of our technical assistance, as well as augmenting capital and other inputs in carefully delineated strategies in order that the CACM may evolve meaningful policies and an effective strategy for the rural sector. The process must be politically, socially and economically supported by all of the Central Americans themselves, and therefore, they too, must become involved at all levels in this process. This new approach must deal in extremely large numbers of prople at levels of society and stress the cohesiveness of the Central American Common Market in confronting the problem and generate broad confidence in the fact that solutions exist and must be put into action.

The short run prospects for expanded production of traditional food products based on present world market situation seems extremely promising. This can and will generate increased capital within the area with which future activities based on carefully developed policies can evolve. Since the reorganizing of the CACM may take from two to three years there is time, if this time is well spent, to develop the institutional and technical capabilities at both the regional and national levels required to undertake the mammoth task ahead.

The USAID programs started in Guatemala and Costa Rica during 1969 and 1970 and those under way at present in Honduras, Nicaragua and El Salvador will all call for the expansion and reorganization of public sector institutions in order that these might deal with larger numbers of people more effectively in the future. An equal strengthening of the regional institutions is urgently needed in order that these agencies may serve as the fundamental regional building blocks for project and sector analyses, formulation of alternate development strategies and appropriate regional policies and development of coordinated C. A. operational mechanisms.

The time required for the development of regional institutional capacity to deal with these complex new factors does not mean that action toward improved employment and income distribution will be postponed. On the contrary, through existing efforts of national programs to assist the rural area, as well as the regional sector studies presently under way, considerable progress is being made throughout the region. While national institutions are evolving and their technical capacities are being expanded to cope with rural sector problems including the incorporation of large numbers into the national economy, regional agencies will increasingly be called upon to expand meaningful dialog among all those concerned with the rural sector. This must focus on surfacing key problems with which a new integrated strategy must deal. Indeed, the base must be built now for more dynamic CACM action during the decade ahead.

6. IMPLICATIONS OF A NEW STRATEGY - A TECHNICAL DISCUSSION

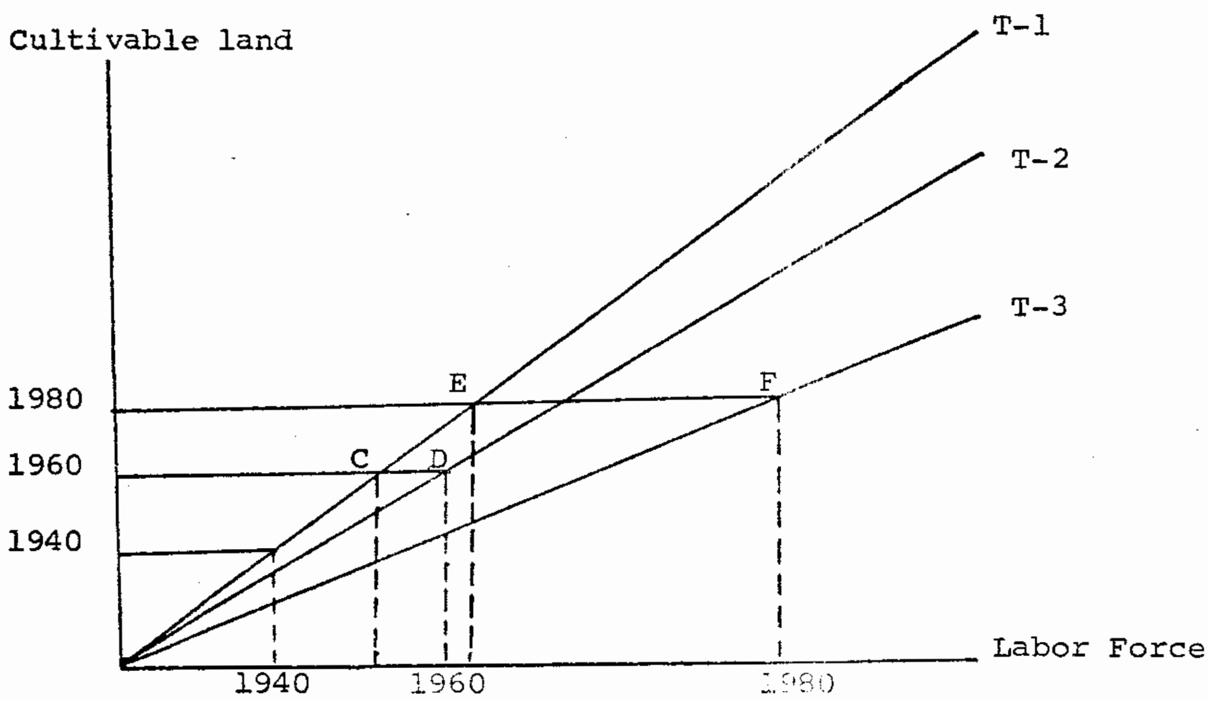
What must be done to assure that agricultural development in more equitable social terms will accompany agricultural growth?. At present, the region is trying to augment agricultural production which generally employ its rural work force by using technologies that require factor proportions characteristic of economies with relatively abundant land and capital resources compared to labor. No such technology could be more ill-adapted to the realities of Central America which, with the exception of Haiti, Trinidad and Jamaica, is unmatched in Latin America for its high man-land ratio.

Central America's agricultural technology problems can be partially conceptualized in the diagram on page IV-34. On the two axes, land and labor are presented. The lines T-1, T-2 and T-3 which originate at the origin correspond to agricultural technologies that employ different proportions of land and labor in production. The more vertical the technology line is, the more land that is employed in relation to labor in agriculture production. (The technology lines correspond to weighted average of proportions of land and labor in the cultivation of the sum-total of the agricultural commodities produced in the region.) On the horizontal axis is indicated the size of the rural labor force for the years 1940, 1960 and 1980. On the vertical axis is indicated the amount of cultivable land available for the same periods.

According to the diagram, in 1940 the available land was adequate to employ the entire labor force utilizing technology T-1. In 1960 as a consequence of an increase in the labor force that was much greater in percentage terms than the increase in available land, it was not possible to sustain full employment using technology T-1. Using this technology, a share of labor force equivalent to the distance C - D would be left unemployed.

A new technology was required to achieve full employment of available labor in 1960. Line T-2, corresponds to a greater labor-to-land relationship in agricultural production and employs all available labor. For the year 1980, the same trend is noticeable, but in a much more marked form, since the increase in the labor supply proceeds at an extremely high rate while cultivable land increases at a significantly lower pace. Given constraints on capital and manpower, the adoption of a new relatively more labor-intensive technology such as T-3 would make it impossible to provide full employment of the rural labor force on available land in 1980. Continued use of technology T-1 would leave E - F of labor unemployed in 1980.

LAND, LABOR AND CHOICE OF TECHNOLOGY



T-1, T-2, T-3 = Alternative Production Technologies.

C - D Distance corresponds to the amount of workers unemployed in 1960 due to continued use of Technology T-1

E - F Unemployment in 1980 due to continued use of Technology T-1.

The technology consistent with available labor resources in Central America in the next decade, therefore, is a technology that will require use of a higher proportion of abundant and rapidly increasing labor in relation to land. Labor saving technologies are, however, justified in those cases where seasonal demand exceeds the short term availability of labor.

In order to determine production technologies more suitable for Central America, it is worthwhile to examine more closely the production technologies currently employed in the region. To identify existing production technologies, it is illustrative to turn upside down traditional views of the relationship between man and land. The traditional view usually expresses persons per area of land as a measure of population density. When the abundant factor, labor, is taken as the base and the less abundant factor, land, as the dividend, one can more easily see production technologies in terms of the amount of land required to provide a unit of employment. The basic analytical unit then becomes a man-year of employment, and the analytical question becomes: For a given crop or cultivation practice, what land area is required to provide one man-year of employment? Expressed in this form the goal becomes that of determining the mix of agricultural production practices and agricultural products which will minimize the area of land necessary to provide maximum number of man-years of employment, while recognizing constraints of capital availability, market demand, and regional profitability per employment unit.

Knowing, for example, that there are approximately 100,000 new rural workers entering the labor force each year and that the additional new lands will be more costly than changing technology and cropping patterns, the problem is one of choosing the mix of cultivation practices and agricultural products which will require the least land for a given level of employment generation or which will offer the greatest employment and income potential.

Abstracting for a moment from important climatic, land quality, marketing and other conditions, the basic information necessary to focus on this problem can be found in cost-of-production and income studies undertaken by the Agriculture Ministries and Agricultural Banks in Central America for purposes of planning and evaluation. In addition to input costs, operating expenses, and fixed investments by crop, such production cost accounts often include information on the number of man-days of labor required for each production practice --planting, cultivating, harvesting, etc. (Information regarding labor requirements is usually expressed in terms of man-days of work for a given cultivated area).

For the selected crops represented in Table 1, there is a wide variation in the use of labor in culti-

Table 1

Average Labor Requirements in Central America for Producing Selected Crops

Crop 1/	Man-Days per Hectare	Man-Years per Hectare 2/	Hectares per Man-Years 3/	Order of Priority
		(Horticultural Crops)		
Strawberries	796	3.18	0.31	(1)
Okra	343	1.37	0.73	(2)
Tomatoes	267	1.07	0.93	(3)
Cabbage	255	1.02	0.98	(4)
Onions	166	0.66	1.52	(7)
Cucumbers	155	0.62	1.61	(8)
Red Peppers	144	0.58	1.72	(10)
Potatoes	134	0.54	1.85	(12)
Garlic	123	0.49	2.04	(13)
Watermelon	90	0.36	2.78	(20)
		(Traditional Export Commodities)		
Coffee	199	0.79	1.26	(6)
Cotton	119	0.48	2.11	(14)
Sugar	143	0.57	1.74	(11)
		(Basic Grains)		
Domestic Corn (Unmechanized)	85	0.34	2.94	(23)
Domestic Corn (Mechanized)	75	0.30	3.33	(25)
Hybrid Corn (Unmechanized)	92	0.36	2.72	(19)
Hybrid Corn (Mechanized)	87	0.35	2.87	(21)
Sorghum	66	0.26	3.79	(30)
Beans	96	0.38	2.60	(18)

.../...

1/ Assumes one crop only per year; figures are much higher where multiple cropping is feasible.

2/ It is assumed that one man-year of labor equals 250 working days.

3/ The inverse of Column 2.

Continuation Table 1

Crop1/	Man-Days per Hectare	Man-Years per Hectare2/	Hectares per Man-Years3/	Order of Priority
Beans (with corn)	113	0.45	2.21	(16)
Dryland Rice	104	0.42	2.40	(17)
Irrigated Rice	147	0.59	1.70	(9)
		(Fruit Crops)		
Citrus Fruits	86	0.33	2.92	(22)
Mango	68	0.26	3.68	(29)
Avocado	69	0.26	3.66	(28)
Coconut	48	0.19	5.32	(32)
Bananas	64	0.25	3.91	(31)
Pineapple	114	0.46	2.19	(15)
		(Miscellaneous Crops)		
Sesame	72	0.26	3.47	(27)
Soya	73	0.26	3.42	(26)
Kenaf	84	0.33	2.97	(24)
Tobacco	250	1.00	1.00	(5)
Pastures for Livestock	25	0.10	10.00	(33)

Source: Weighted averages calculated from C.A. country crop production cost data on a primary employment basis only. Rankings assume crop activities are profitable under normal conditions and at going wage rate for labor.

1/ Assumes one crop only per year; figures are much higher where multiple cropping is feasible.

2/ It is assumed that one man-year of labor equals 250 working days.

3/ The inverse of Column 2.

This table underestimates the importance of some crops (mainly horticultural crops) as opportunities for remunerative employment because, with the exception of strawberries, in many areas in Central America they often lend themselves to two, three and even four plantings per year. Calculating relatively more harvests per year, horticultural crops emerge as the most use of land which makes a maximum contribution to the employment of additional labor. Maximization of profits and the share of income going to labor are other factors which must be considered in addition to employment. It is clear that in the absence of profitable market incentives, production of horticultural crops is not an option for employment generation. Further, to determine how increased production will influence the income of the rural sector, further study needs to be done on the share of output that will go to labor and the returns on investment realized by landholders. Estimates of wages per hectare per man year and profit per hectare for selected crops will be part of ROCAP's continuing research of the agricultural sector. For the present,

Table 1 should be considered as a preliminary indication of employment creating activities assuming acceptable profit levels and given current labor costs (Emphasis added)

It should not be surprising that traditional export crops should embody large amounts of labor given the region's comparative advantage of abundant and inexpensive supplies of unskilled rural workers. It follows that it would not be advisable to reduce the production of coffee, cotton, sugar and bananas in the short run without seriously aggravating the problem of unemployment and further deteriorating rural welfare. Policies worth examining in relation to the traditional export crops would include higher minimum wages for salaried rural workers, better working conditions for migratory workers and their families, and tax measures to spread more evenly the benefits of income generated from the export of these crops. Caution is required, of course, not to overburden these commodities with taxes that would reduce their price competitiveness in world markets, reduce output and put laborers out of jobs.

In the case of basic grains there is a wide variation in the requirements of labor per unit of land according to the type of production technology used. In the case of corn, for example, mechanization often permits two crops per year, thus at times increasing the total amount of labor required during the production year and spreading employment over a longer period. In other crops such as sorghum and beans, mechanization results in a reduction of the amount of labor used. Selective mechanization might be justified if increased yields permit releasing land from the production of sorghum and beans for cultivation of more labor-intensive crops so that there is a net increase in the amount of labor used on the total land area.

Those agricultural activities which have the lowest requirements for labor too often are those which have been expanding the most in recent years. In particular pasture land for cattle raising and fattening has continued to displace other types of cultivation and absorb a good share of new land being reclaimed and colonized. A more sound policy might entail efforts to expand feedlot production of these products using basic food crops and agro-industrial wastes and determining minimum farm size for a viable economic unit. Of course, the production of animal protein and dairy products must continue if the region is to meet the increased demand for these products which comes with higher incomes.

Table 2 indicates for each major commodity group the amount of land required to employ the 100,000 new rural workers available each year in the region. Of the roughly 10 million hectares of land under cultivation in Central America less than 30,000 hectares (0.3%) are presently planted in labor-intensive horticultural crops. The potential for converting lands into use for such crops is tremendous, once marketing and variety adoption problems can be solved.

Table 2

Area Required to Achieve Full Employment 1/ of 100,000 Rural Workers in the Cultivation of Selected Commodity Groups

Crop	Hectares per Man-Year 2/	Total Area Required to employ 100,000 Workers
Vegetables		
Three crops per year	0.4 Ha	40,000 Ha
Two crops per year	0.8	80,000
One crop per year	1.2	120,000
Tobacco	1.0	100,000
Export Commodities	1.5	150,000
Fruit Crops	2.0	200,000
Basic Grains	3.5	350,000
Pasture for Beef Cattle	10.0	1,000,000

1/ Full employment defined as 250 working days per year.

2/ From Table 1, expressed as averages

B. Low Cost Housing

(1) Introduction:

In 1960, the Central American countries had only a minimal financial or technical capability to deal with the housing sector. Costa Rica and El Salvador had public housing agencies which built a limited number of middle income dwellings per year, and private banking institutions provided limited mortgage money on commercial terms, usually 50% down and six to eight years at high interest rates for the balance. Studies made in 1961 by the IDB under the Social Progress Trust Fund identified the shortage of housing as one of the most critical social problems facing Central America; it was estimated that two-thirds of the urban and rural middle, lower-middle and lower-income population was inadequately housed. And, the demand for adequate housing by these groups was a strong source of social unrest.

The strategy over the past ten years followed by ROCAP and USAIDs has been to support Central American regional and country efforts to build an institutional infrastructure capable of progressively increasing the supply of adequate housing for these income groups. This ten-year effort has concentrated on creating and developing the following institutional framework:

- Mortgage Insurance (HA) systems (Guatemala, Nicaragua, Costa Rica)
- Savings & Loan Systems (all C.A.)
- Demonstration Large Scale Housing Projects (all C.A.)
- Regional secondary-mortgage market (CABEI)
- Improved intra-regional transfer of technological and urban development skills.

In addition, IDB has provided financial and technical assistance to public housing agencies for strengthening their competence and broadening the scope of their programs.

As a result of these efforts, the supply of shelter to these groups representing approximately 20% of the population will hopefully make positive inroads into the deficit. Imbalance still exists, especially for lower income groups. Programs now planned or underway in Honduras and post-earthquake Nicaragua, are expected to help alleviate the problem in those countries. Nevertheless, the task of developing systems to increase Central American capability to build sufficient houses is formidable and compelling.

The institutional framework which has been developed with AID and IDB assistance is approaching realization. In four of the five countries, national housing banks, FHA systems, and strong savings & loan systems or mortgage banking institutions are attracting internal capital as well as channelling external capital into middle income housing. Even in the fifth country, Honduras, a fledgeling savings and loan system has been started and will soon be vastly strengthened by the adoption of new legislation creating a National Housing Bank and FHA Institution.

In addition, non-profit private sector institutions engaged in low-cost housing development exist in Honduras, Costa Rica and El Salvador, and negotiations are going forward with BANVI in Guatemala to create such an institution in that country.

(2) Strategy:

ROCAP strategy for 1974 and beyond is to complete the development of the institutional framework described above and to build on that framework an integrated housing construction industry capable of providing shelter for all of those people who need, want, and can afford to pay for it.

Such an integrated housing construction industry would include four basic components: a self-sustaining housing finance system, an adequate skilled labor force, maximum production of indigenous construction materials, both raw and finished, and the technology required to utilize such labor and materials in the most efficient manner.

The lower income group, which needs, wants, and can afford to pay for shelter and which is the target of our strategy, represents approximately 40% of the C. A. population. The attack on the problem of financing adequate shelter for this segment of the population has two major thrusts, the first on a regional basis through the Housing Finance Department of CABEI; and the second on a bilateral basis directly to institutions in each country.

The CABEI program will involve the use of both housing investment guarantee (HIG) resources and a small amount of concessional loan funds. An amount of their second HIG loan, presently under study, will be earmarked for the purpose of purchasing lower income mortgages (below $3,000) utilizing the same mechanisms developed for their middle income secondary market operations, i.e. mortgages originated by the savings and loan and mortgage finance institutions of each country. As an incentive to these institutions to encourage origination of lower-income mortgages, CABEI will be allowed to purchase 100% of the mortgage value rather than the maximum of 80% permitted at present.

The bilateral programs will involve a greater technical assistance input since it is planned to create substantial new programs involving innovative departures from the traditional use of HIG and development loan re-

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sources, such as: experimental projects involving rental-purchase programs and advanced technology; instituting support for low-cost housing activities of the national housing institutes and secondary level governments; strengthening instituional capability in the private sector, witn special attention to housing cooperatives, by financing projects for existing institutions and by creating technical service organizations (TSO's) in those countries where such organizations are nascent or missing (Guatemala, El Salvador, Costa Rica, Nicaragua).

ROCAP strategy to support development of the other essential elements of an integrated housing construction industry in Central America including the development of a C. A. HUD Institute, the improvements in construction technology, and the utilization of indigenous materials, is more fully described in Chapter VI.

(3) Why Low-Income Shelter is Important:

ROCAP has selected low-income shelter as a priority development target 1/ because:

Los-income families in Central America are living in almost sub-human conditions. Both from humanitarian and practical political points of view, this explosive situation must be ameliorated.

The migration of people from rural to urban areas is continuing at a rapid pace. Urban populations are increasing at a rate of approximately 7% per year. Provision of adequate low-cost housing in the rural sectors in conjunction with agricultural development programs, can help slow the rural-urban migration, and similar programs in the urban areas are necessary to house those already there.

Population growth has been described as "explosive". It is estimated that between 20 and 40 percent of the population now live in squatter areas on the periphery of urban centers, and that these squatter areas will double in the next 10 years as rural to urban migration and population growth continue.

1/ For more details see paper developed for the Mission Directors Coordinating Committee entitled Housing in Central America or Can We reach the Little Guy? prepared in March 1973.

National governments throughout the Region have recognized the enormity of the problem and have established low-cost housing for both rural and urban areas as a top priority.

(4) <u>The Institutional Framework:</u>

Historically, both external assistance for housing and national government housing programs have been directed primarily at housing for lower-middle and middle income groups, "the emerging middle class". This may be seen in the tables on page IV-54.

Since the late 1950's AID has supported with both grants and seed capital loans the development of mortgage insurance (FHA) and savings & loan systems in Guatemala, El Salvador *, Costa Rica and Nicaragua, and has provided technical assistance to start a saving & loan system in Honduras. We have encouraged the development of a national housing bank and FHA system in

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* The FHA system in El Salvador, although created within the law regulating the Savings & Loan System, has not been implemented.

Honduras as well. The result of this effort has been the attraction of internal savings amounting to approximately $60,000,000 throughout the region. At least one country (Guatemala) has become self-sufficient in mortgage finance resources for middle-income housing.

An institutional secondary mortgage market has been created with AID support for the C.A. region through the infusion of a soft loan and HIG resources into CABEI. Mortgages totalling nearly $30 million have been discounted by CABEI, and applications are pending for another $30 million. CABEI is issuing bonds to support this market with an initial $15 million in September 1973.

Technology for the development of housing projects with one hundred or more units has been demonstrated through the financing of private housing development such as those under the HIG program. ROCAP, working with SIECA, originated the Permanent Central American Conference on Housing & Urban Development which has become self-sufficient after its second conference in June 1973 in Guatemala. Through this conference, representatives of all major sectors concerned with housing and

TABLE 1

External Assistance to Housing in C.A. through 1972

Country	Total IDB Loans	Average Unit Cost	AID-Total Soft Loans	Average Unit Cost	AID-Total Grants	Average Unit Cost	AID-Total HIG Loans	Average Unit Cost
Costa Rica	7,100,000	2,630	1,000.000	6,000	2,000,000	1,250	12,600,000	5,500
El Salvador	12,100,000	2,410	6,100,000	8,000	-	-	6,049,250	8,720
Guatemala	5,300,000	2,041	-	-	3,800,000	-	7,817,000	6,200
Honduras	10,000,000	2,000	2,400,000	5,810	-	-	10,581,332	5,940
Nicaragua	10,000,000	2,650	3,700,000	2,230	450,000	-	10,926,000	9,800
CABEI	-	-	10,000,000	6,250	-	-	10,000,000	8,330
	44,500,000	2,500	23,200,000	5,042	6,250,000	-	57,973,582	7,325

TABLE II

Projects of National Housing Institutes

1963-1972

COUNTRY	TOTAL INVESTMENT	AVERAGE UNIT COST
Costa Rica	$ 28,310,558	$ 2,500
El Salvador	$ 26,644,596	$ 2,380
Guatemala	$ 32,420,114	$ 2,995
Honduras	$ 12,202,030	$ 2,030
Nicaragua	N/A	N/A

urban development are brought together to interchange technology and planning concepts with each other and with outside experts.

The cumulative outcome of these initiatives has been a great improvement in satisfying the effective demand for middle income housing throughout the region. Institutional capability to provide adequate levels of mortgage finance for middle-income housing has been created both regionally (CABEI) and nationally, with the exception of Honduras.

Nicaragua is, of course, a special case and very large supporting assistance programs are now being designed with ROCAP help for early implementation. Completion of the Honduras system for both mortgage insurance and savings and loans is a priority target for the near future.

As the middle-income housing problem has approached resolution, national government attention has turned more and more toward lower-income housing. At many levels in all five C. A. countries, examination of the problem and of potential sources of financing is under way. In Costa

Rica, the Vice-President of the Republic is charged with the responsibility for action in this area. In Guatemala, the President is spurring action by the National Housing Institute. In Honduras, the military government has shaken up the National Housing Institute and brought in new and aggressive management. In El Salvador, the President has designated housing as a top priority of government and a new law is being proposed to Congress to restructure the National Housing Bank (FNV) so as to provide a more effective program for lower-cost housing. In Nicaragua, more than 25,000 low-cost units are being planned through a cooperative effort of AID, the World Bank, IDB, and the Government of Nicaragua.

Each country has at least one governmental institution (NHI) charged with theresponsibility for low-cost housing. These institutions vary in quality, but most have been bureaucratic and unimaginative. Nevertheless, in the majority of the C.A. countries these institutions offer the best hope for exercising unified control of governmental low-cost housing programs for the following reasons:

1) The NHI staff represents in general the most experienced national body of technicians in the field of low-cost housing;

2) In nearly every NHI, there is at least one intelligent and energetic administrator who, with the proper support, would be able to administer programs for low-cost housing financed by external as well as internal resources;

3) The NHI has good potential for coordinating both their traditional IDB loan support and new AID HIG loans in the area of low-cost housing;

4) Foreign currency obligations of the NHI's are foreign currency obligations of the Government.

However, to supplement the government institution efforts in this field, ROCAP also plans to channel resources to private sector institutions involved in low-cost housing in each country, such as:

Costa Rica:	Oficina de Vivienda Industrial (OVI)
El Salvador:	Fundación pro Vivienda Mínima
Guatemala:	Fundación del Centavo TSO in process of organization

Honduras: Federación Hondureña de Cooperativas de Vivienda Ltda. (FEHCOVIL)
Fundación Hondureña para el Desarrollo

Nicaragua: Fundación Nicaragüense para el Desarrollo

Each of these private sector organizations (except FEHCOVIL) is starved for both operational funds and long-term financing funds. The HIG program can be effectively utilized to provide both, through loans which advance disbursements for working capital to develop specific projects and administrative fees (for the institution) built into the homebuyer's payments. Other ideas which will be explored include sale of units prior to construction of a housing project, pre-saving of down payments, and rental-purchase of housing for selected income levels. Studies are now planned to identify constraints other than financial on low-cost housing development. These studies will cover manpower considerations, design acceptability, and technology considerations.

Adequate technical assistance must also be provided to enable the institution to cope with AID requirements in the legal, financial, and technical aspects of the project.

Sub-loans to the institutions embodying the same provisions can also be channelled through CABEI and/or the national housing banks. The latter system has the advantage that small projects (less than $1 million) can be developed by the institution concerned which would be impractical for direct HIG's.

Little or no action in housing is expected from IBRD. It is expected that IDB will continue to be active in providing concessional loan funds for infrastructure, sites and services, and some low-cost housing. With the proper coordination, AID efforts in the low-cost housing field can be tremendously benefitted when combined with the IDB assistance.

C. Export Diversification

(1) Background

Although the CACM was based on import substitution as a means of expanding the local market and developing manufacturing industry, there has been increasing realization that the potential limits for import substitution are being reached and that other approaches must be tried. One approach is to expand the market by drawing in substantial numbers of near-marginal agriculturists. Another is to increase extra-regional exports, particularly of new1/ products.

The four major primary products of coffee, cotton, bananas, and sugar still constitute 75% of total extraregional exports. Coffee is by far the most important, though it increased at only a very moderate rate (2.4% a year) over 1960-71. Cotton increased very dramatically over 1960-66, but declined in absolute terms thereafter. Bananas rank second in importance, and increased at an average annual compound rate of almost 10% over 1960-71. Sugar increased at an annual rate of almost 20% over this 11-year period. Exports of the

1/ i.e., other than the four major primary exports of coffee, cotton, bananas, and sugar.

four major primary products combined increased at an average annual rate of 5.6% during the period 1960-71, which is approximately equal to the growth rate of real GDP over this period.

Total intraregional exports increased much more rapidly than extraregional exports, and were highly concentrated in manufactured goods.

In 1971, manufactured products other than foodstuffs and beverages accounted for 77% of total intraregional exports. On the other hand, almost no manufactured products were exported to third countries.

The shift in the relative importance of the "new" (i.e., non-primary) exports compared with the exports of the four major primary products in total extraregional trade is illustrated in Table 1. Note that the share of the "new" products rose from only 15% of total extraregional exports in 1965 to 26% in 1971 and to an estimated 29% in 1972.

The twelve most important new product groups are listed in Table 2. They include meat ($79 million in 1971), wood, ($23 million) and crustaceans and mollusks ($19 million). The growth in meat exports is particularly dramatic, the

TABLE 1

Value and Percentage of Major Primary & New Extra-regional Central American Exports

(In Millions of Dollars)

	Total Extra-Regional Exports		Exports of Major Primary Products		"New" Exports	
	Value	Percent	Value	Percent	Value	Percent
1965	$626	100	$533	85	$ 93	15
1966	662	100	553	84	109	16
1967	643	100	522	81	121	19
1968	693	100	563	81	130	19
1969	723	100	555	77	168	23
1970	799	100	625	78	174	22
1971 (est)	838	100	620	74	220	26
1972 (est)	1014	100	720	71	294	29

Source: SIECA Indicadores Económicos No.12 (October,1972) Tables 31 and 51. For 1972 ROCAP estimations based on Central Banks data.

TABLE 2

CENTRAL AMERICA VALUE OF EXPORTS TO OUTSIDE THE AREA OF MAJOR NON-PRIMARY PRODUCTS

In Millions of CA $

	Products	1963	1967	1971	Average Annual Growth Rate (%) 1963/67	1967/71	1963/71
	Total Extraregional Exports of Non-Primary Products.	87.7	120.6	219.7	8.3	16.2	12.2
	Total 12 Products	68.1	105.1	161.2	11.5	11.3	11.3
1.	Fresh Refrigerated or Frozen Meat	20.7	33.5	78.9	12.8	24.0	18.2
2.	Wood	10.5	13.9	23.1	7.3	13.5	10.3
3.	Fresh Crustaceans and Mollusks	8.3	11.9	19.4	9.4	13.0	11.2
4.	Minerals of Common Non-Ferrous Metals	3.0	11.6	8.6	40.2	-7.2	14.1
5.	Plants, Seeds, Flowers and other Parts of Medicinal or Perfume Plants.	1.8	3.2	4.3	15.5	7.7	11.5
6.	Natural Gums, Resins, Balsams and Lacquers	1.7	2.8	3.3	13.3	4.2	8.6
7.	Animal Foodstuffs Products	3.0	6.7	5.0	22.2	-7.0	6.6
8.	Coffee Extracts and Soluble Coffee	5.2	3.2	3.6	-11.4	3.0	- 4.5
9.	Rough Tobacco	0.6	3.0	4.7	49.5	11.9	29.3
10.	Oil Seeds, Nuts and Almonds	10.5	10.2	4.4	- 0.7	-18.9	-10.3
11.	Minerals and Concentrates of Silver Minerals.	2.8	3.6	3.4	6.5	- 1.4	2.5
12.	Preserved Fruits and Fruit Preparations (Except juices)	*	1.5	2.5	-	13.6	-

* Less than $CA 10 thousands.

SOURCE: For 1963 PROMECA "Valor de las Exportaciones de C.A. Fuera de la Región"
For 1967 and 1971 SIECA C.A. Statistical Yearbook of Foreign Trade.

average annual compound rate of increase being 18% over the 8-year period in 1963-71. Note the acceleration during 1967-71 compared with 1963-67. This trend is likely to continue in the foreseeable future in view of persistent meat shortages and high prices in the U.S. market.

With respect to the destination of Central American exports, the shift has been slight. Table 3 shows that there has been a slight increase in the share going to the U.S. (up from 45% over 1963-65 to 48% in 1971) and a decline in the share going to Western Europe (from 35% to 31%) and to Japan (from 16% to 11%).

While coffee and banana exports hold continuing promise for growth, there is nevertheless a strong case for diversification. In the first place, all primary products are subject to very low price elasticities. This means that a bumper crop resulting in lower prices is likely to induce only a very small increase in quantity sold, so that the total revenue collected by the exporting countries declines. Secondly, these commodities are also subject to relatively low income elasticities, which means that demand will, at best, do no more than keep pace with population growth.

TABLE 3

Value of Exports to Extra-Regional Markets
(Millions of US$ and Percentages)

	1963-65		1969-70		1971	
	Value	%	Value	%	Value	%
Total Extraregional Exports	$573	100	$767	100	$838	100
United States	255	45	353	46	406	48
W. Europe	198	35	271	35	262	31
Japan	89	16	82	11	91	11
Caribbean	9	2	19	3	26	3
Other L.A.	4	1	14	2	25	3
Canada	7	1	7	1	12	1

Source: PROMECA and SIECA, Indicadores Económicos No. 13

Oct. 1972

Thirdly, and perhaps most importantly, countries depending on primary exports are apt to experience sharp year-to-year fluctuations in their foreign exchange earnings depending on weather and growing conditions, both at home and abroad. For example, Nicaragua can suffer a sharp reduction in its foreign exchange earnings as a result of either a drought curtailing its cotton production, or of a bumper crop in the U.S. which depresses cotton prices. There is a strong consensus that Central America must reduce its dependence on its four major primary exports.

(2) Obstacles to More Rapid Expansion

A series of problems exist which have prevented a more rapid expansion of new exports.

The development of a manufacturing sector fundamentally oriented to take advantage of the captive market created by the economic integration treaties has resulted in the development of industries that, in a number of cases, cannot compete in world markets; fiscal and tariff incentives for industrial development granted by the treaties and conventions have, in some cases, resulted in firms with excess productive capacity. Even though this idle capacity has the potentiality for exports, the high protective tariffs often have caused a lack of interest on the part of the manufacturers in increasing operating efficiency to the level needed to compete in the world market; the tendency toward high-protectionism and toward commercial bilateralism evidenced by the major developed countries in some product lines (e.g. textiles); difficult access to foreign markets because of fierce competition in many lines of light manufacturing (e.g. shoes, apparel); the lack of some types of financing for new exports; the lack of commercial exporting companies, trading firms and other intermediate agents, freight forwarders and shippers with experience in off-shore shipping, as well as a lack of management expertise generally in the area of selling abroad; shortages of adequate physical infrastructure for exports, particularly for the shipment of perishable products or merchandise that requires special handling; high cost and limited availability of air transport; and the absence of strong and efficient export promotion institutions at both the national and regional levels capable of providing information, technical assistance and financing required.

(3) Factors in Favor of New Products

The obstacles described above are surmountable. There are many economic and geographic factors that support the development of new export products and industries.

These include:

- Nearness to the United States;

- Stable exchange rates in relation to the U.S. dollar. All C.A. countries with the exception of Costa Rica have traditionally maintained a stable exchange rate with the dollar and free convertiblity for commercial transactions. All C.A. countries followed the U.S. dollar in its recent devaluation, thus encouraging exports to non-dollar block countries;

- Excellent resource potential for agriculture, wood and livestock products. Soils are productive and well suited for the growing of fruits and vegetables, while differences in altitude and climate enable C.A. to produce a broad variety of crops. Perhaps most importantly, C.A. enjoys a combination of climatic conditions that permit the production of fruits and vegetables at times of the year when such products are scarce or unavailable in the U.S. market;

- Adequate lands, the proximity to the US market, and freedom from Aftosa provides an obvious comparative advantage in meat production. However, it should be noted that the high man/cultivable land ratio argues against devoting extensive areas to grazing;

- Labor is abundant and wages are low. The labor force is easily trainable and not highly unionized. Wages are likely to remain low for a number of years in view of the rapid growth rate of the labor force.

(4) Specific Areas of Exceptional Potential

Studies have shown that Central America has, or can easily develop, a comparative advantage in the following areas:

(a) Agro-business:

Vegetables:[1/] tomatoes, cucumbers, garlic, onions, okra, avocados, asparagus, artichokes and peppers.

Fruits:[1/] mainly papayas, melons, cantaloupes, mangoes.

1/ There is an excellent market in the US for both fresh and processed fruits and vegetables. It has been estimated that, if properly developed, vegetables and fruits exports (other than bananas) may increase from $5.3 million in 1971 to at least $100 million by 1985.

Meat, especially beef, both fresh and processed.

Fish, fresh and processed.

Spices, including cloves, cinnamon, vanilla, cardamon and ginger.

Nuts, especially cashew and almonds.

Flowers and ornamental plants, of which there is great variety and which can be produced year-round.

(b) Furniture and Related Wood Products: The furniture industry has experienced very rapid growth over the last decade, while several lines have already found favor in the American market. The availability of a broad variety of woods, the labor intensiveness that characterizes the furniture industry, the availability of cheap labor, and particularly proximity to the US market, give Central America a strong comparative advantage.

(c) Electronic Assembly, including radios, television sets and medical electronic equipment.

(d) Clothing and Apparel: There is a strong market in the U.S. for clothing though international competition is severe. However, Central America has demonstrated the capability of producing good quality clothing and shoes at competitive prices, and is aided by rising labor costs in Japan, Taiwan and Hong Kong.

(5) Regional Strategy

The main thrust of past ROCAP efforts was to encourage existing institutions to develop specific "pilot" export projects in the belief that private enterprise would pick up the ball and run with it. Institutional development was a by-product. Private enterprise has not responded as expected because, in many cases, there was not a sufficiently developed institutional base to help them solve problems.

The present plan places emphasis on the development of the regional and national institutions into an integrated system capable of furnishing the essential services needed by exporters and potential exporters in the areas of finance, transportation, product adaptation, research and marketing, among others.

The strategy for development of such a system involves the staff upgrading and the furnishing of technical assistance through principal regional institutions, PROMECA, CABEI, ICAITI and SIECA, and the National Export Centers.

The role of PROMECA has been recast. Under new leadership it is well on the way to becoming a true service organization with an "action" orientation. Its principal clients will be the National Export Centers. Among other things, PROMECA will be the repository of the Export Information Data Bank which will provide information to the Information Centers in CABEI and each of the National Centers; it will arrange for technical assistance needed by the National Centers; it will sponsor training activities, product sales and adaptation clinics; and perform an essential "linking" function between potential exporters, sales outlets in foreign countries and the National Centers.

CABEI has substantial resources under A.I.D. Loan 596-L-010. The systemization of export diversification activity including the direct tie-in with the PROMECA data bank through its information center will enhance CABEI's ability to move ahead with investment opportunities.

ICAITI has augmented its staff with an industrial engineer who can be made available to PROMECA and the National Centers for problem solving. As a technique, it is probable that ROCAP will limit its direct support of

ICAITI while making funds available to PROMECA and the National Centers to employ the services of ICAITI for applied research, testing services, quality control etc. In this manner, it is hoped that ICAITI will be more directly responsive to the needs of the regional export system.

SIECA, through its intimate relationship with PROMECA, will be the forum to encourage sound legislative programs designed to encourage exports.

Finally, the system envisions a markedly closer working relationship between the National Centers and the regional organizations because of the client relationship created by the redirection of the latter towards a service function.

Simply stated, our strategy is to create a regional system based on a concept of service to the national centers and through such service enhance and foster the integration process.

D. Tourism

(1) Background

Tourism is possibly the most important underdeveloped industry in Central America. While world tourism is booming, the share of foreign income earnings going to Central America is small. Yet Central America has the potential to become a major tourist attraction. Perhaps no other industry in Central America shows as much promise.

Over the period 1950-1972, expenditures abroad by U.S. residents increased at an average annual compound rate of 8.7%, a rate which remained unchanged over the recent 12-year period 1960-1972. The major beneficiaries of these expenditures were Western Europe, Canada and Mexico. In 1972 total expenditures by U.S. residents were $7.4 billion; of the $475 million spent in the West Indies and Central America in 1972, 66% went to Bermuda, the Bahamas and Jamaica alone. Only a minor fraction went to Central America.

While the growth rate of visitor arrivals (from all countries) in the five Central American countries has kept pace with that of Mexico (12% to 13% a year), visitors to Central America from outside the region constituted only 15%

of total visitors to Mexico in 1971; and 8.5% of visitors to the Bahamas, Jamaica and Puerto Rico combined in 1968 (see Table 1).

Central America's failure to exploit its tourism potential is even more apparent when we compare total visitor expenditures in Central America with those in Mexico and the Caribbean (Table 2). In 1968, Central America's direct revenues from tourism amounted to only $49 million, compared with $480 million for the Bahamas, Jamaica and Puerto Rico, and $1,145 million for Mexico. Thus Central America received only 4.3% of total visitor expenditures in Mexico, and 10% of visitor expenditures in these three Caribbean countries.

A striking feature in this comparison is that the discrepancy between visitor expenditures is much greater than that between visitor arrivals. Thus, in 1971, 6.8 times as many visitors arrived in Mexico as compared with Central America, while the visitor expenditure ratio between Mexico and Central America in that same year was 23.6 to 1. This reflects both the shorter average stay and the lower daily expenditure of visitors in Central America as compared with Mexico.

TABLE 1

VISITOR 1/ ARRIVALS IN MEXICO, THE CARIBBEAN, BERMUDAS AND CENTRAL AMERICA
(In Thousands)

		1963	1965	1967	1968	1969	1970	1971	Average Annual Compound Growth Rate 2/
1.	Mexico	940	1,199	1,445	1,664	1,818	2,227	2,500	13.0
2.	Selected Carib. Countries.	1,406	1,938	2,745	3,169	-	-	-	17.7
	Bahamas	399	495	915	1,072	1,332	-	-	22.0
	Jamaica	81	189	235	258	277	-	-	23.0
	Puerto Rico	926	1,254	1,595	1,839		-	-	14.7
3.	Bermudas	142	187	237	267	281	-	-	12.0
4.	Central America (Extraregional Visitors)	-	-	(233)^{E}	(270)^{E}	(282)^{E}	(293)^{E}	(370)^{E}	(12.3)^{E}
	Guatemala	-	66	83	90	97	92	134	12.5
	El Salvador	-	-	(45)4/	50	50	44	53	2.0 3/
	Honduras	-	-	30	(33)4/	(36)4/	(40)4/	44	10.0
	Nicaragua	-	-	25	42	41	51	60	24.5
	Costa Rica	-	38	50	55	58	66	79	13.0
5.	Total (1 + 2 + 3 + 4)	-	-	4,6[illegible]	5,37[illegible]	-	-	-	-
6.	C.A. as % of Mexico	-	-	16.1	16.2	15.5	13.2	11.8	-
7.	C.A. as % of Caribbean Countries.	-	-	8.5	8.5	-	-	-	

1/ People staying in the country for more than 24 hours regardless of purpose of visit.
2/ Calculation based on data for first and last years available.
3/ For 1968-71.
4/ Interpolated figures.

E = Estimated

SOURCES: For Mexico, Bermudas and Caribbean Countries: SITCA, Turismo: Solución Inmediata, Managua, September 1971; and Economic Research Associates, Tourist Survey and Development Plan for the Pan American Highway in C.A. and Panama, April 4, 1973, Table 2.

For Central America: Compton Advertising, Inc., Marketing Action Plan for the Development of Tourism in Central America, Dec. 1969; and SITCA, Report No. 20, March 1973, p. 85.

TABLE 2

TOTAL ESTIMATED VISITOR EXPENDITURES IN MEXICO, THE CARIBBEAN, BERMUDAS AND CENTRAL AMERICA

(In Millions of Dollars)

		1963	1965	1967	1968	1969	1970	1971 P	Average Annual Compound Growth Rate 1/
1.	Mexico	657.0	782.0	963.0	1,145.0	1,289.0	1,454.0	1,580.0	11.6%
2.	Selected Carib. Countries.	171.4	244.0	407.7	479.5	-	-	-	23.0%
	Bahamas	48.9	60.0	160.0	190.0	-	-	-	31.6%
	Jamaica	37.8	64.7	79.9	87.8	93.5	95.5	109.0	14.2%
	Puerto Rico	84.7	119.3	167.8	201.7	-	-	-	18.9%
3.	Bermudas	35.5	38.5	51.9	62.6	-	-	-	12.0%
4.	Central America (All Visitors)	23.4	30.1	43.7	48.8	49.9	60.1	67.0	14.0%
	Guatemala	4.0	5.9	5.5	6.5	9.2	12.1	13.6	16.5%
	El Salvador	4.9	6.1	8.3	9.9	8.1	8.5	8.4	6.9%
	Honduras	1.4	2.9	3.7	4.1	3.8	4.2	4.5	15.7%
	Nicaragua	3.2	4.8	12.5	11.8	11.4	13.2	15.1	21.5%
	Costa Rica	9.9	10.4	13.7	16.5	17.4	22.1	25.4	12.5%
5.	Total (1 + 2 + 3 + 4)	887.3	1,094.6	1,466.2	1,735.9	-	-	-	
6.	C.A. (as % of Mexico	3.6	3.9	4.5	4.3	3.9	4.1	4.2	
7.	C.A. as % of Caribbean Countries	13.7	12.3	10.7	10.2	-	-	-	

1/ Calculation based on data for first and last years available. P = Preliminary

SOURCES: For Mexico and Jamaica: Secretaría General de la Organización de los Estados Americanos, América en Cifras, Vol. 4, for years 1967 and 1972.

For other Caribbean Countries and Bermudas: SITCA, Turismo: Solución Inmediata, September 1971.

For Central America: Central Banks of Central America, as reported by SIECA in Indicadores Económicos, No. 13, October 1972.

There is no sign of a slow-down in the growth rate of international tourism. In 1972, air passenger departures from the US toward LA increased by 25%. Continued rapid growth of GNP and per capita income in the U.S. and Western Europe, combined with the high income elasticity of demand for tourism, should assure a growing influx of tourists into any region that has good attractions and the facilities needed to accommodate the inflow.

The tourism industry is characterized by relatively high income and employment multipliers. A study by the Bank of Mexico estimated that, in the short run, the GNP increases by $3 for every dollar of tourist expenditures. This estimate abstracts from the long-term effect of tourism revenues on private investment. Moreover, the amount of capital needed to generate a given amount of employment is lower in tourism than it is in almost all major Mexican industries. Among the 14 major industries in Mexico, only agriculture and textiles require less capital per job created. With respect to labor intensity, the study indicated that for every million Mexican pesos invested in tourism, 45.6 jobs were created: 20 in direct tourism services, 18 in agriculture, 2.3 in textiles, 1.5 in foodstuff and 3.8 in other economic sectors.

The tourism industry is credited with having given a substantial boost to the development of the Mexican economy. Foreign visitors are estimated to have spent $1.4 billion in Mexico in 1971, a figure which represents 110% of the country's commodity exports, 70% of public investment or 37% of private investment. While it is not expected that Central America can duplicate the Mexican experience, the Mexican results show what benefits can be obtained from a well-planned and financed tourism development program with respect to foreign exchange earnings, income growth and employment generation.

(2) <u>Factors Favoring the Tourism Industry in Central America</u>

Central America has excellent potential for tourism development. Its major assets include closeness to the United States (by far the major potential market); ideal year-round weather in most of the area; plenty of sun and sea (although few beaches in the area can compete with the Caribbean); the outstanding Maya ruins at Tikal and Copán; and distinctive folklore, customs, and artifacts (particularly in Guatemala). Moreover, tourism in Central America is being greatly helped by the ever-increasing crowding of Europe, the negative attitude of many Europeans toward foreign tourists, and sharply rising costs in most European capitals owing both to rapid inflation and to the recent devaluations of the dollar.

National tourism programs have been initiated, and a regional institution (SITCA) has been created to coordinate the national tourism development programs and to promote tourism to Central America on a regional basis. SITCA, with AID/ROCAP financing, has developed a hotel and restaurant guide for Central America, issued literature and films to advertise Central America in major foreign markets, promoted package tours and financed the development of a tourism survey and development plan.

Until recently, it was difficult to interest governments to assign priority for tourism development. Indeed, it seemed paradoxical to the government of many a poor developing country that it should be advised to invest large sums and provide special incentives for the development of facilities designed to cater to well-heeled foreigners. However, governments are now increasingly convinced that tourism has a significant impact on the living standards of the lower income groups.

These efforts have undoubtedly contributed to the rapid increase of tourism in Central America, though the results achieved so far have only begun to develop the industry's potential, and SITCA remains a weak organization. Future efforts aimed at reorganizing SITCA should endeavour to firmly establish it as a nonprofit business-oriented enterprise, forming a link between selected sectors of the tourism industry (tour operators, travel agents and airlines) in the United States, Canada and European countries, and the Central American Tourism Institutes and tourism industry.

(3) Constraints:

Obstacles to be surmounted include the scarcity of hotel facilities, particularly outside the capitals where many tourist attractions are located (this is particularly evident in Guatemala andCosta Rica --the hubs of C. A. tourism development-- where available lodging facilities are inadequate to even satisfy current demand); high air transportation costs from the U. S., etc., particularly in comparison with rates to Europe; the fact that Guatemala alone among the Central American countries offers exceptional cultural attractions that have wide visitor appeal; scarcity of capital, entrepreneurship and trained personnel; the actuality of governments assigning a high priority to the development of tourism in their development plans and in their policies toward the private sector; and, finally, the difficulties in getting the tourist organizations of Central America to collaborate with each other.

(4) Regional Strategy

The development of tourism as a major industry in Central America will not occur automatically. A concerted, well-planned effort is required, in which the Pan American Highway is bound to play a determinant role as a link between outstanding Central American tourism circuit points.

The AID regional strategy includes a series of coordinated actions directed towards the development of infrastructure (paved roads, modern airstrips, water and sewerage), new tourism attractions, low interest loans, special incentives to private industry, stronger tourism development organizations, programs to promote tourism to Central America on a package tour basis, reduced air fares and special policies designed to encourage extraregional tourism.

ROCAP strategy to accomplish the above objectives has been to provide financial and technical assistance in a manner which forces the institutions needed for tourism development, both public and private, to work together.

The National Planning Organizations; the Central American Tourism Council (CTC) which consists of the Tourism Directors of the five C. A. countries and Panama, and SITCA, the secretariat of the CTC, have formally designated CABEI as their "financial agent" for tourism development.

AID Loan 596-L-013 to CABEI ($15 million plus a $5 million Central American contribution) provides financing for tourism infrastructure which must, under the terms of the loan, be directly tied in with private investment in hotels and recreational facilities. It also provides financing for programs of training, promotion and technical assistance formulated jointly by CABEI, CTC, SITCA and the National Planning Organizations of the five countries.

AID Loan 596-L-010, also to CABEI, has $7,500,000 earmarked for loans to private enterprise, particularly for hotel construction outside the capital cities.

ROCAP is furnishing grant assistance to SITCA in the form of budget support and to finance contracts designed to create various types of "package tours" to C. A. from the United States and Mexico. In addition, a ROCAP financed study is underway to examine the need for and possible structure of a strictly private sector regional tourism organization (CATO) which, hopefully, can become an effective self-financed lobby of persons involved in the tourism industry who can influence governmental actions favorable to the industry.

The combination of CABEI, the CTC, SITCA, CATO and the National Planning Organizations, in our judgment, represent the essential inputs needed for the successful and rapid development of the tourism industry.

E. Trade Union Development Overview and Strategy

A truly independent free labor movement in Central America is still in an incipient stage. Leadership capabilities, educational levels and technical skills still fall far short of those required for strong national labor organizations and competitive, ideologically-oriented labor unions divide the already weak labor movement. Resistance to organized labor and its aims is still strong on the part of government and in businesses in all sectors of the economy. Many of the Labor Ministries continue to be politically motivated in their hindrance of the growth of independent labor. Nevertheless, progress has been made by the labor movement in increasing recognition of its right to organize. The number of collective bargaining contracts has grown and the Confederation of Central American Workers (CTCA) is gradually becoming an effective representative of labor organizations in the integration process.

CTCA, which is currently made up of six national confederations with a membership of some 300,000 workers, will ultimately act as the spokesman for C. A. organized labor in defining and advancing labor's role in the economic integration of the area. Among other activities directed at this end, CTCA is developing an educational capacity to train labor leaders; is offering technical assistance to national federations and is editing and publishing labor news bulletins.

ROCAP had funded AIFLD support of CTCA until the hemisphere-wide activities of AIFLD were consolidated into one regional contract administered by AID/W.

F. Overviews of Health and Population, Education and Infrastructure

Introductory Statement

Although no ROCAP programs are planned in the field of Health and Population or Education, because it is believed that these programs are best dealt with on a bilateral basis, there are certain characteristics, trends, and problems which are generally true throughout Central America. Therefore, brief overviews have been prepared on these sectors in order to provide a regional perspective. They are also dealt with in greater detail in each of the country sector analyses. Also, an overview has been prepared on Infrastructure which, although not a sector *per se*, is an important activity in support of some national and regional integration goals.

(1) Health and Population Overview

(a) Introduction

Uncontrolled population growth, lack of environmental hygiene, malnutrition, the diseases of poverty and high infant mortality account for the majority of premature deaths and the tide of ill health that is the heritage of the rural population. For most Central American countries, health delivery services and health planning are accorded a relatively low priority as evidenced by government per capita expenditures in this sector. In general the approach of Ministries of Health continues to center around the provision of more doctors, nurses and hospital beds, and/or preventive medicine campaigns, including immunization programs which are seen frequently as vehicles for generating political capital.

El Salvador, in particular, is faced with an acute problem of population density for which no effective safety-valves currently exist. If none is developed in the next 10 years, severe problems of domestic instability and possible severe tensions with other Central America countries can be expected.

Despite general acceptance of family planning programs in the Central American countries, the impact upon population growth continues to be small with little or no appreciation by country governments that widespread acceptance of family planning services depends largely upon the context in which these services are offered. In certain of the Central American countries the existing family planning programs tend to remain isolated functions of private associations, and, in consequence, are susceptible to attack, misunderstanding and suspicion. It is essential that ultimately these services be integrated into health care programs of Ministries of Health and Social Security agencies through maternal and child health services. In this way nutrition education, ante- and post-natal care and social and preventive pediatrics, together with family planning services should be combined in a single program, the objectives of which are clearly and unmistakably dedicated to the well-being of the child, its mother and the family.

(b) Health Indicators

Infant mortality (deaths between 7 days and 1 year) in Central America is at least ten times higher than corresponding figures for the United States, although deaths under 7 days are not appreciably different. Thus the diseases of early infancy are seen to take their toll rather than the hazards of the perinatal period. While life expectation at birth has increased by about five years during the period 1961-1970, there are acute differences when Indian and non-Indian populations are separated. For example, in Guatemala, the over-all life expectancy at birth is 53 years (1970) -- but it is only 45 years for Indians versus 60 years for non-Indians.

In each Central American country 45% or more of all deaths occur among children under five, while in the whole population gastritis and enteritis, pneumonia and diseases of early infancy predominate and are the major causes of mortality. Only Costa Rica, with the highest per capita income and the lowest Indian population, now includes two of the "diseases of development" -- arteriosclerosis and malignancies -- in the first five principal causes of death. Malnutrition, despite the intensive research in recent years to produce low-cost, protein sources, continues to pose a more serious, and up to now, insuperable problem. In Guatemala, for example, it has been calculated that 80% of all children under 5 suffer from protein-calorie malnutrition.

The paucity of potable water systems in the urban areas and the almost total absence in the rural areas, clearly precipitates the high mortality rate caused by the water-borne diseases. Deaths attributable to such diseases range from 57/100,000 in Nicaragua to 268/100,000 in Guatemala -- in contrast to 4/100,000 in the United States.

(c) Health Manpower

The absolute shortages, as well as the

maldistribution of medical and paramedical workers are notorious in the developed as well as the developing countries. Although each of the Central American countries has a Medical School, the doctor/population ratio varies from 2.2 doctors per 10,000 people in Honduras to 4.5 per 10,000 in Costa Rica, compared with 14 per 10,000 in the United States. In terms of distribution, between 50% and 78% of the doctors are in the capital city, leaving the rural areas with from 0.5 to 2.3 doctors per 10,000 population.

The shortages of dentists and professional nurses are, if anything, more acute than that of doctors. Nursing auxiliaries, trained and untrained, constitute the backbone of the medical services, especially in the rural areas. Indeed, the auxiliary nurse is often the only health worker who can be found to staff the smaller health units.

(d) Problems of Health Care Delivery

The major problems of health care delivery in the Central American countries resolve themselves into two principal issues: (1) how to educate the population to make better use of the facilities that are available, limited though they may be; and (2) how to extend the outreach of health care to the non-urban areas.

The first line of defense is the home remedy, then the pharmacist (all drugs, excluding narcotics but including antibiotics, are on sale to the public without prescription) or the witch doctor. Only later when these have failed or in the case of acute trauma, is orthodox medical care sought. The smaller rural health units, posts, dispensaries and centers are often ignored by the populace who seek care from the hospital, often located hours away and reached after considerable expense and effort. It is easy to understand why hospitals are looked upon as places to go to die.

Attempts to provide health care to the rural areas involving extensive use of doctors and registered nurses should be abandoned. No Central American country has succeeded in resolving the problem by this means. The number of doctors needed and the level of support in terms of personnel and facilities required to enable them to practice the level of medicine for which they have been trained, makes this approach unfeasible. In any case, where the major problems are best addressed by health education of the community, improved levels of sanitation, and increased agricultural productivity to combat malnutrition, a conventionally trained doctor (particularly one of a different race and social class) is probably least useful. In fact, the chain leading to rural health care must begin and not end in the community.

The developed countries have, in general, failed to develop an effective system analysis and approach, but have succeeded to some extent in buying their way out. In Central America, the resources are unavailable to backstop defective planning. Slender financial resources, further dissipated by duplication of health services, manpower trained for tasks unrelated to the major needs and the special characteristics of the population to be served, stand as three of the major barriers to progress.

(e) Family Planning

All of the Central American countries have family planning programs conducted in government clinics. El Salvador and Nicaragua also offer family planning services through their social security programs. In addition, each country with the exception of Nicaragua has a private Family Planning Association, affiliated with the International

Planned Parenthood Federation. In the 5 countries of the region, some 360 health units offer family planning services. The demand for services is steadily increasing, with preferential use of oral contraceptives. Attitudes of governments, community and church leaders continue to become more favorable, while the concern of the Catholic Church appears to relate to methodology rather than to the principle of birth control per se.

(f) Summary and Conclusions

In brief, the major conclusions which must influence AID strategies are as follows:

Health and health planning have relatively low priority for the regional institutions and most C. A. governments. More effective planning and low-cost experimental approaches must be sought.

Curative medicine (hospital treatment by trained doctors and nurses) is inefficient, expensive and can be provided only to limited numbers in cities. Campesinos have virtually no access to modern medical care. There is little prospect that appreciable numbers of highly-qualified medical personnel will ever leave the cities to practice in rural areas and, in any case, they appear to be less effective in dealing with the health needs of rural people.

Major problems include (a) educating the authorities and general population to make better use of the limited facilities that are available, and (b) to extend preventive health programs and medical care to the non-urban areas.

Family planning programs will have little impact until they can be integrated into Ministries of Health and Social Security agencies, and national population policies developed and accepted by C. A. governments.

Therefore, health programs in C.A. (a) must be low cost; (b) must focus on preventing diseases in the first place (primarily through education and improved water supply and sewage disposal); (c) must involve community education and awareness; (d) must rely on early diagnosis and referral to prevent minor illnesses becoming major hospital cases; (e) must make maximum use of paramedical personnel for both community education and first-level treatment.

(2) Education Overview

Over the past ten years all Central American countries (in common with other Latin American countries) have shown substantial improvement in school enrollments, number of graduates at the various levels, and investments in school construction and equipment. Central government expenditures for education now average about 20% of total expenditures (as compared with 13% for Latin America as a whole), making it difficult in some countries to maintain current levels of expenditures. (See Table 1). While improvements in the management and quality of education have varied widely between country educational systems, the critical deficiencies in these areas reflect the most urgent needs.

Among the severe problems confronting education in Central America are (1) with partial exceptions in El Salvador and Guatemala, the lack of experimentation and innovative programs aimed at lowering the unit costs of education; (2) the lack of training opportunities for out-of-school youth, i.e. non-formal education; (3) the urgent need to increase educational opportunities in rural areas; (4) the lack of a sufficiently relevant curriculum at all levels; and (5) the critical need for coordination between the various educational programs and activities.

The vast majority of educational programs are formal or traditional in nature and operate under the direction of a politically oriented Ministry of Education. In all countries

TABLE 1

INDICATORS	COSTA RICA 1960	COSTA RICA 1971	EL SALVADOR 1960	EL SALVADOR 1971	GUATEMALA 1960	GUATEMALA 1971	HONDURAS 1960	HONDURAS 1971	NICARAGUA 1960	NICARAGUA 1971	CA TOTAL 1960	CA TOTAL 1971
Primary												
1) Enrollment in Primary Schools (000)	203	375	321	566	278	570	205	393	145	310	1152	2214
2) % Population 5-14 Yrs. Enrolled in Primary School	56.5	68.7	47.4	56.9	25.4	38.3	38.4	53.1	35.2	50.8	37.5	50.5
3) % Population 5-14 Yrs. not enrolled in Primary School	43.5	31.3	52.6	43.1	74.6	61.7	61.6	46.9	64.8	49.2	62.5	49.5
4) Graduates of Primary Schools	11962	37400	12978	47000	13031	32000	6252	24565	4194	18323	48417	159208
5) Primary School Classrooms Constructed	100	315	0	249	87	389	354	283	24	381	565	1617
Secondary												
Enrollment in all Secondary Schools (000)	28	85	34	90	27	80	15	46	12	55	116	356
% Prescribed Secondary School Age Population enrolled.	19.7	37.6	12.9	22.7	5.3	11.0	7.6	14.3	7.7	21.9	9.2	18.6
Graduates of all Secondary Schools	1269	5400	1516	NA	1871	5800	1909	NA	761	NA	7325	NA
Higher Education												
Enrollment in Higher Schools	6800	17000	2204	9310	5238	17358	1760	5621	1207	9381	17272	58670
Graduates of Higher Schools	449	1350	62	520	159	589	115	410	60	400	845	3269
CENTRAL GOVERNMENT EDUCATION EXPENDITURES (1961-1970)												
% of GNP	3.6	4.8	2.8	3.6	1.9	1.8	2.1	3.1	1.4	2.2	2.3	2.9
% of Total expenditures	20.8	24.6	18.6	23.1	20.8	15.9	16.5	18.7	13.4	14.5	18.8	19.6

the Ministries of Education have assigned priority to the expansion of primary education. Some of the Ministries have made considerable effort to provide free textbooks in the primary grades; but educational opportunity, as well as modern teaching materials fall far short of the rapidly expanding school population needs. Primary education is still not available to a substantial number of school-age children, and the high drop-out at all levels represents a great waste of scarce resources. Indeed, while the percentage of children attending enrolled in schools has increased dramatically over the past ten years, the absolute number of children not enrolled has also increased. The salary of primary school teachers consumes approximately 95% of the public education budget, notwithstanding the fact that most teachers still follow inefficient rote learning methods.

It is under these difficult conditions that innovative approaches involving non-traditional methods must be developed. The current percentage of government budgets now being expended on traditional programs cannot significantly be increased or, in some cases, even maintained. Ways must be found to divert an increasing proportion of these funds to more productive and effective approaches. Innovative education must be introduced to the formal as well as non-formal educational systems -- thus the existing formal education system should be involved in lowering the unit cost of education. Since there will continue to be trade-offs between political and educational objectives, a sine qua non for AID assistance for additional classrooms should involve managerial and qualitative improvements, including innovative programs aimed at lowering unit costs.

Over the past five years the USAIDs have signed education loans with each of the Central American countries with the exception of Costa Rica. While the major part of these funds is designated for construction and equipment, the loans do involve provisions for some innovative approaches. As an example, in Guatemala the focus is on rural education, involving experimental schools with a practical rural curriculum. In El Salvador,the current loan program is concerned with the provision of school plant facilities needed to expand the experimental ETV program which was launched with AID grant and loan assistance. In Nicaragua, the recently negotiated education sector loan makes provision for experimentation as well as managerial and qualitative improvements.

Any future loans should focus on introducing additional innovative activities or techniques.

Pursuant to the FY 1974 program submission, the Mission directors and AID/W agreed that education is principally a national concern and that no new activities should be planned at present for implementation by ROCAP. It was further agreed that future AID assistance should involve innovative programs directed to the reduction of unit costs, and involving experimentation, with special emphasis on the needs of the small farmer and rural youth. It was also recognized that AID/W may have to assume a more active role particularly in the areas of research and the introduction of innovations. The Basic Village Education program in Guatemala illustrates a collaborative effort by AID/W, the USAID, and a national government to test and evaluate innovative techniques in non-formal education.

Assistance from multilateral lending institutions is also expected to increase considerably over the next few years. It is anticipated that IBRD will expand its loan programs to include the primary level as well as the traditional secondary and vocational areas; and that IDB will increase its loan portfolio at the vocational-technical and higher education levels. From all indications UNESCO and UNDP programs will also increase substantially during FY 1974. Thus, there is a need for improved coordination of AID programs with other international donors.

(3) Infrastructure Overview

Infrastructure is not regarded as a sector *per se*; rather, it is a supporting activity to help achieve other sector goals. Thus, school construction can be justified on the basis of educational sector needs, feeder roads within an agricultural sector analysis and loan, or water and sewage within a program aimed at municipal development. The exception to this general approach is when infrastructure can make a key contribution to regional integration. Thus, the AID assistance to intra-regional highways has made a great contribution to the regional objective of increased intra-regional trade and tourism and also will facilitate exports outside the region.

It is also anticipated that AID loan funds will continue to be severely restricted and that relatively little will be available for infrastructure activities, particularly in comparison with IDB and IBRD. Thus the AID role will concentrate on feasibility studies and limited construction activities when they are essential to meeting other sector goals or speeding regional integration.

Recently Capital Development and Engineering Officers of the six C. A. Missions met to identify programmed infrastructure projects for the period 1973-1980, take into consideration the plans of other aid donors, and make recommendations on the role AID should play. The results of this meeting are contained in CAPTO CIRC A-20 dated 6/13/73. They identified a total of $1.7 billion in planned infrastructure activities, as follows:

		By Field (in millions of dollars)
Transportation		908.4
Highways	(648,8)	
Ports	(106.0)	
Inland Waterways	(39.5)	
Railroads	(79.8)	
Airports	(34.3)	

Communications	130.1
Electric Power	323.8
Water Supply	105.4
Sewage & Waste	32.7
Drainage, Flood Control, Irrigation	23.4
Tourism	29.1
Miscellaneous	169.0
Total	1,721.9

By Country (Excludes Miscellaneous)
(in millions of dollars)

Guatemala	466.6
Honduras	245.4
El Salvador	295.1
Costa Rica	374.0
Nicaragua	171.8
Total	1,552.9

It was recognized that these planned investments are probably overstated, particularly in the highway sector, and that a more realistic projected 1973-1980 total would be about $1 billion.

It is felt that future highway construction should be provided by IDB and IBRD, with the exception of farm-to-market and access roads which may be justified within AID agricultural sector analyses and loans. Similarly, the AID role in ports, railroads and airports should be limited to feasibility studies (assuming sufficient funds for feasibility studies are not available from the IDB and IBRD). Depending on the results of SIECA/CABEI transportation studies, there may be a role for AID financing for inland waterways which could link and open up the east coast of Central America -- particularly connections between Costa Rica and Nicaragua.

The strong growth of the Central American highway system during the past few years has forced the five countries to give the highest priorities to the expansion and improvement of their highway maintenance departments. Technical and financial assistance amounting to over 30 million for the improvement of the physical as well as operating efficiency of the respective departments has been received from AID, EXIM, IDB, IBRD and CABEI over the past three years. Covenants in all highway construction loan agreements require that the borrower shall maintain satisfactory maintenance programs, budgeting and execution capabilities during the life of the loan.

The financing for communications and electric power generation should also come from IDB and IBRD, although financing of electric power inter-connections which cut across national boundaries might be financed by ROCAP through CABEI when it will further regional integration, and financing of electrical distribution coops may fall within agricultural sector programs. AID assistance to water supply, sewage and waste disposal, drainage, flood control and irrigation should be limited to feasibility studies, with the exception of those programs justified within municipal development and agricultural development programs.

Finally, we anticipate the need for continued assistance to private tourism efforts and tourism infrastructure, which promise to be major investment areas. These programs should be carefully coordinated with IDB and IBRD; but it is anticipated that total demand will exceed their ability and/or willingness to provide financing.

Thus, the AID role in new infrastructure financing over the next five years is seen as quite limited and justified in terms of national sector programs and programs which will further regional integration. Should a major breakthrough in CACM restructuring occur which would justify, for example, major port expansion requiring combined financing by IDB, IBRD and AID, such programs will be presented as an exception to the general approach set forth above.

CHAPTER V

RELATIONSHIP OF ROCAP TO THE USAIDS AND COORDINATION WITH OTHER DONORS

A. Background

Central American integration for development remains the "raison d'etre" of ROCAP. The United States has long supported the integration movement, recognizing that it offers the greatest potential for the economic development of the small Central American nations by broadening the markets available to the region's products and achieving economies of scale. And, the integration movement remains a basic force in Central American development despite the problems which have constrained its growth over the past several years.

These problems, as reflected in the preceding four chapters, have complex social, economic and political roots and are not susceptible of easy, short-term solution. They result from nearly a decade of experience with intraregional trade and economic cooperation which reflect (1) the weaknesses in the initial approach to the CACM, (2) the disparities in stages of growth, social structures, administrative capability and skill levels in the five countries and (3) an inequitable sharing by the countries of the costs and benefits of the integration movement.

That the five countries continue to participate in the economic, trade and technical institutions of the CACM and in the efforts to restructure it provides ample evidence of the importance they attribute to regional economic integration. The Presidents of the five Republics appointed the High Level Committee in mid-1973 to find a basis for restructuring and for accommodating their differences at the same time that prospects for political integration have substantially diminished. The regional political organization ODECA, essentially moribund since the 1969 War, was on July 3, 1973 relegated by its remaining country members to a housekeeping body pending agreement on the restructuring of the CACM.

The High Level Committee is drawing on the Economic Integration Secretariat (SIECA) for the policy studies and program documents needed for its deliberation. The other institutions of the CACM also continue their work, with varying degrees of effectiveness and, as the analyses in the preceding four chapters indicate, intraregional trade remains a critically important factor in the region's development. At the national level in all five countries, development plans and programs continue to be worked out which deal with not only the unique problems of each country but also issues related to the integration process.

ROCAP is the US Mission responsible for carrying out USG policies and programs in support of Central American economic integration. It is accredited to the Organization of Central American States (ODECA) and, through ODECA, to the CACM component institutions and to the five member countries. In carrying out its responsibilities, ROCAP works closely with the Embassies and USAIDs accredited to the five Republics in (1) the analysis of regional and bilateral activities which bear on economic integration, (2) the recommendation of lines of action for the USG to follow in relation with the CACM and (3) the implementation of approved USG policies and programs. In this context, ROCAP is responsible for reporting on regional development and integration progress, trends and problems and for keeping the Ambassadors and Mission Directors fully informed of regional planning and programs. In turn, ROCAP looks to the Ambassadors for policy guidance in assessing the compatibility and impact of integration efforts on US interests in their respective countries. ROCAP is further charged with the responsibility for facilitating coordination with the five Embassies and USAIDs on reporting and program matters which grow out of USG support for regional integration. Informal and formal mechanisms effect this cooperation, ranging from systematic staff contacts and work sessions to the Mission Directors Coordinating Council (MDCC) which meets at least quarterly and in which the Ambassadors at their option participate.

One of the primary tasks which the Ambassadors and ROCAP should address is the preparation of a regional CASP as a complement to the regional DAP. There has been no high level assessment of USG policy on the CACM since before the Salvador/Honduras War. And, given the substantial changes in the Central American community since 1969, it is opportune to review established USG policy and program guidelines and to define and publicly state those new and amended policies and lines of action appropriate to the mid-1970's.

B. Relationship and Roles of ROCAP and the USAIDs

As is apparent throughout the DAP, there are common problems in most of the countries. Inequitable distribution of development benefits, non-incorporation of the subsistence sector into the rural economy, unduly high rates of population increase, diversification of regional exports, unemployment and inadequate delivery systems for development programs are common to all five Republics. Some are best tackled in the context of regional integration -- e.g., planning and execution of a road network physically unifying the Isthmus, exploitation of the area's tourist potential, extraregional exports or eradication of the Mediterranean fruit fly. Ethnic social, institutional and development differences require that others be planned and executed as national programs -- e.g., family planning and public safety -- can only be carried out at the country level. Still others are most effective and lend themselves to coordinated action at national and regional levels -- e.g., grains production, credit, local marketing and service delivery systems for subsistence and small farmers can optimally be promoted at the national level while economic and social research, achievement of comparative advantage in crop production, diversification of regional exports and mechanisms for the free movement of production and produce throughout the area demand regional planning and inter-country cooperation.

The relationship between ROCAP and the USAIDs -- and the respective role of each -- is built around these programmatic considerations which formed the basis for the recommendation of the 1972 AID Task Force on AID organization in Central America to continue both ROCAP and the USAIDs. The Task Force concluded that no other arrangement was as effective or viable for AID support of development in the Isthmus. It examined the concept of a single mission for Central America and the concomitant possibility for substantial reductions in personnel but found that "given the kind of programs we can expect in Central America for the foreseeable future, and particularly in the light of the emphasis on sector analysis and programming and their significant requirement for relationships with host country institutions, we believe that there is a hard-core (bilateral) mission which cannot be further reduced without running significant risks for the quality of program design and the success of implementation". The implementation of the recommendations has resulted in the clarification of ROCAP and

USAID functions and relationship, with appreciable reductions in personnel. Through program rationalization, personnel savings were effected; for example, ROCAP eliminated education and family planning projects since they could be better addressed in the bilateral context. The housing of ROCAP and USAID/Guatemala in the same building permitted further personnel savings by forming a single executive office and controller to serve both missions.

Over the DAP time frame, the USAIDs will concentrate their efforts on support of country development. As integral parts of the country team serving under the guidance of the Ambassador, the USAIDs further not only US bilateral interests in each country but also the in-country institution building and development programming which serve as the foundation for any functioning regional system such as the CACM. The USAIDs are better able to tailor their assistance mix to the particular need of the individual countries; this flexibility, in turn, is enhanced by the technical and analytical resources readily available through ROCAP. The lessons of the last five years demonstrate that the CACM cannot prosper with weak national members and emphasize the importance of consistent country-level efforts to help the weaker members achieve performance consistent with their partners.

In the same time frame, ROCAP will continue its support and encouragement of the economic integration movement by providing coordinated assistance to regional institutions charged by the member states with advancing the cause of the CACM. This focus for ROCAP follows from, and provides on-going evidence of, US support for the CACM. The importance of US support was noted by the AID Task Force when it concluded: "We judge ROCAP's relationships with these institutions have a measurable contribution to their growth; and so long as the CACM is viewed as important to the achievement of our objectives in Central America, we believe that continuation of these relationships is important".

The problems currently facing the CACM can only be solved by the member countries themselves by hard political decisions. ROCAP can continue to work with regional institutions, especially SIECA, in their efforts to provide appropriate frameworks for governmental action through the High Level Committee and to broaden the regional - country dialog on macro and sectoral development. The bilateral missions working with the

Ambassador can assist the governments in weighing alternatives. ROCAP can also keep international agencies informed of regional developments and encourage them to provide regional and country level support for resolving the crucial problems currently facing the CACM. Such a course of action requires the closest cooperation and coordination among the ROCAP and the bilateral missions. The mechanism for this cooperation and coordination, the Mission Directors Coordinating Council (MDCC), was set up at the recommendations of the AID Task Force. And, it will be ROCAP's role to nurture "regional thinking" in the various US and international programs affecting Central America.

In addition, ROCAP will provide support to the USAIDs in those areas where full time country technical competence cannot be justified.

ROCAP provides certain support services for which there is not sufficient demand in any single USAID for a full-time employee, but for which there is a need for one or more full-time employees working throughout Central America. Examples include legal services, engineering, housing and financial analysis. These individuals work, in a sense, both for ROCAP and for the individual USAID Directors. They are area specialists who uniquely combine subject matter expertise with in-depth knowledge of the conditions and customs of the area. They complement the USAID core staff and facilitate the effective use by USAIDs and ROCAP of technical and consultant resources available through AID/W. This consensus reflects our experience to date that this expertise is not always available on a timely basis from AID's central services groups. Nonetheless, staffing limitations prevent ROCAP from broadening its services other than through contracts or PASAs.

The AID Task Force recognized an increasing need to provide economic, program, and agricultural analysis in addition to that which must be available at the national level. They concluded it is "highly important that there be a regional capacity to help countries analyze trends, problems, and opportunities in Central American agriculture....(and) a strengthened economic analysis capacity at the regional level will be of benefit, as a source of consultation, both to the USAIDs and to Embassy Economic Officers". The ROCAP Economic Advisor has developed regional analyses valuable to the bilateral missions as well as ROCAP and played a major role in developing the recent reconstruction loan to Nicaragua. ROCAP agricultural technicians have also worked closely with bilateral missions in their sector analyses and loan proposals.

In this context, the relationship and roles of ROCAP and the USAIDs are based on the most viable and effective functional distribution of responsibilities to achieve US interests in support of regional economic integration and country development. As is apparent in the following chapters of this DAP, programs are being concentrated on a smaller number of sectors and programs. The ROCAP and USAID presentations highlight those actions needed in their respective functional areas to deal with the critical development problems facing Central America at the national and regional levels. With proper coordination through the MDCC, the regional thrust of ROCAP can reinforce the national programs of the USAID to achieve an optimum return for the US effort expended.

C. Coordination with Other International Donors

As the MDCC has facilitated improved AID coordination in Central America, the Mission Directors have become increasingly concerned over the need to improve coordination by other international donors working in the area -- coordination with AID and with each other. This was a major issue raised by the Directors in the August 1972 review hearings; it remains so.

The past year has shown a significant but still insufficient, improvement in the situation. Within AID/W frequent contacts have been held between LA/CEN and LA/MRSD and other aid donors, particularly the IDB and CIAP. In addition, meetings were held both in New York and at a MDCC meeting with the U.N. Resident Representative for Central America, and with other appropriate officials. However, in part because of an internal reorganization of the IDB, it has not been possible to schedule a meeting of the MDCC with responsible IDB officials to discuss common problems. Field contact with the IBRD has been sporadic.

In view of the increased resources and expanding scope of IDB, IBRD and UN activities in the area and given the importance CA countries attribute to CIAP, the MDCC recommends that AID take the initiative in improving communications among major aid agencies. The MDCC is convinced that this communication and hopefully project and program coordination could be best achieved through an informal consultative group for Central

America, made up of headquarters and field representatives of the participating organizations. Meetings could be held periodically in connection with CIAP annual review in Washington, New York or Central America. If such a consultative group should not prove feasible, then the MDCC suggests the scheduling of appropriate periodic meetings with all or each of these aid agencies.

The Mission Directors are convinced that it is now timely to set up such an informal consultation arrangement. The IDB and IBRD are both reappraising their traditional policy of working on a "country only" basis in Central America. IDB plans in FY 1974 to send several survey teams to the area to study the feasibility of regional approaches to agriculture, tourism, human resource development, transportation, power and other sectors. In July - August 1973, IDB and IBRD have fielded their first joint team to study regional agricultural development in Central America, which included a ROCAP representative only because of a fortuitous contact. It was also learned informally that the two banks are discussing joint action on regional power generation and distribution, a sector in which CABEI has approached ROCAP for financial assistance.

If their and our efforts are to be coordinated, thereby reducing the chances for program duplication or inconsistency, a regular forum is needed in Washington and the field for discussing the respective programs plans of the various donors and for jointly evaluating alternate approaches in those sectors which all of us assign high priority. Such a forum would also permit a joint review of Central American regional economic integration and country development problems and hopefully facilitate the evolution of a common strategy for helping the Central American nations attain their regional and national development goals.

CHAPTER VI

AREAS OF CONCENTRATION

A. Introduction

The thrust of the ROCAP program continues to be support of Central American efforts for regional development through integration. Over the past decade, the five governments concentrated their energies on building a regional institutional system and the essential infrastructure for expanding intraregional trade; and ROCAP provided financial and technical assistance for this building process. Throughout the 1960's AID alone among the major international lending agencies provided sustained aid to the Central American integration movement.[1/]

Beginning in the late 1960's, even before the Honduras-El Salvador conflict and the CACM crisis, the Central Americans began broadening the focus of their attention from trade *qua* trade to the development problems which impeded further expansion of trade. Various CACM institutions started to look seriously at the causes for trade imbalances and to analyze

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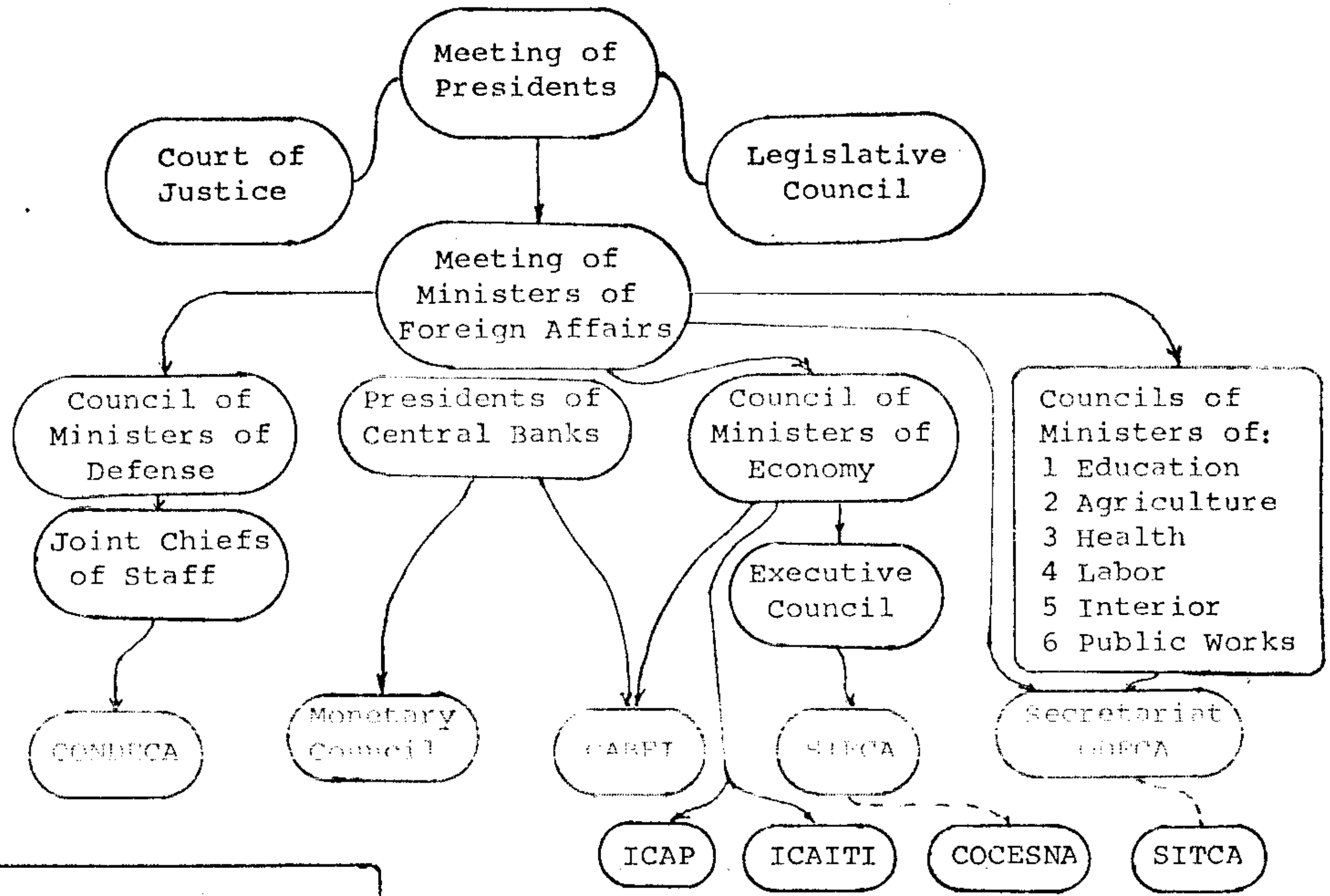
1/ See Chart, Page VI-2, for diagram of the CACM Integration System.

C.A.C.M. INTEGRATION SYSTEM



NON TREATY ORGANIZATIONS

CSUCA - Higher Education
OIRSA - Livestock
INCAP - Nutrition
FECAICA - Private Sector

new courses of action needed to overcome them. This process has now been formalized by the decisions of CACM partners to set up the High Level Committee to prepare a blueprint for restructuring the market and to define new ground rules for regional cooperation in all of its dimensions, not merely in trade.

It is expected that the restructuring process may take up to two years. The HLC is now being organized and should begin its analytical work in September 1973. It will then turn to preparing policy recommendations on industrial, agricultural, trade, monetary and social development of the Common Market partners. These recommendations will then be submitted to the review of and action by the five member countries. And, in this process, the HLC is authorized to draw on the technical and analytical resources of all the CACM component organizations.

It is in this context that the strategy and programs of ROCAP for the DAP time frame has been shaped. Over the next two to three years, the most critical need of the Central Americans as they evaluate the political, economic and social options open to them is the availability of the tools for analyzing their realities and finding appropriate answers to their current dilemmas. And, these tools should be afforded in a way that they can be institutionally available in Central America to permit them to deal with future problems as they arise. Hence, ROCAP's first priority for at least the next two years is discrete support for selected CACM component institutions.

At the same time, three sectors will receive major program attention -- and, activities in all three sectors are designed to reinforce our first priority:

1. Agriculture -- with special focus on the employment and income dimensions as they relate Isthmus-wide to the needs of the small and subsistence farmer;

2. Housing -- adapting the regional and national infrastructure of the construction industry to meet the needs of the low-income families; and

3. Diversification of the employment base and foreign exchange earnings for the region through export promotion and tourism.

The selection of program areas for regional concentration reflects not only the importance attributed to a particular development sector, but also its current susceptibility to effective ROCAP support. The absence of ROCAP programs in human resource development, family planning and health results from our experience to date that, under present socio-political conditions in the Isthmus, effective action in these sectors can only be carried out at the country level and that effective inter-country cooperation must be carefully nurtured by the various CA regional institutions. ROCAP foresees over the DAP time frame that its efforts in these sectors will be limited to funding selected social development studies by appropriate Central American institutions which ROCAP and USAIDs, through the MDCC, deem especially conducive to longer-term inter-country cooperation.

Outside of these areas of program concentration, but intimately related to our first priority, ROCAP will selectively fund social development research and evaluation projects, continue its assistance to CABEI in regional infrastructure development and monitor as required the regional AIFLD program aimed at strengthening a Central American free labor movement. (N.B. No program section was included on labor since this activity is now funded for all LA by AID/W.) ROCAP finally will continue to administer the AID program in British Honduras although it falls outside the integration focus of the rest of the ROCAP program.

B. Support for CACM Institutions

ROCAP will continue its support for key regional institutions. Our assistance is geared to enhancing their capacity to deal with critical integration problems, not as budget support. Our goal is self-reliant, regionally-supported bodies which have established access to non-AID resources for carrying out their programs.

ROCAP support will be directed primarily to and through CABEI, ICAITI, SITCA, PROMECA and SIECA. ROCAP will also continue to work with the Monetary Council and draw on its competence as needed. These entities all earned a vote of confidence from the Central American governments in July 1973 at the same time that they determined to suspend the operations and activities of the regional political organization, ODECA. All five governments continue to participate in the work of these entities and to provide them financial support. These are then the CA organizations which the governments recognize as key to their cooperative effort.

ROCAP loan, HIG technical and management assistance to CABEI will be continued for infrastructure, tourism, export diversification, housing and agriculture; and our support for CABEI will be described as part of the relevant sector discussions below. ICAITI will continue to receive technical and grant assistance to carry out specific technological research and experimentation projects of priority to the diversification of regional exports; our assistance is elaborated in Section E of this Chapter. SITCA will be provided grant and technical assistance, and our support is detailed in Section F. PROMECA will be extended grant and technical assistance for export promotion; our support is spelled out in Section E. The Monetary Council has received a ROCAP loan for building up its capability to support monetary stability in Central America; and, since it is now financially supported by the CA Central Banks and receives IMF technical and management assistance, no further AID support over the DAP time frame is deemed necessary at this time.

The fifth entity, SIECA, will receive specifically designed grant and technical assistance designed to enhance its capacity to provide technical leadership for Central

American integration. As the Secretariat for the integration movement as well as the HLC, SIECA is the catalyst and promoter of regional economic and social cooperation for development. It is to SIECA that the five governments look for analysis of and recommendation on key integration policies such as tariff, industrialization, agriculture, customs operations and export promotion. To the extent that SIECA is capable of presenting realistic, viable options for the member states to weigh and act on, it plays a pivotal role in helping the countries shape the future of their economic community.

ROCAP grant assistance to SIECA over the DAP period will be channeled specifically to:

(1) improving its analytical and technical competence to deal with key sectoral problems through a working association with the Brookings Institution, participant training and policy research projects in agriculture and social development (see sections C below for discussion of agricultural studies and section G-1 for social development);

(2) up-grading the quality and scope of its statistical program under the Brookings contract, selected studies and participant training; and

(3) promoting and sponsoring seminars, conferences and informal meetings of regional and national policy-makers, technicians and planners on those sectoral issues key to expanded Central American integration. This range of activities is designed to overcome the present lack of effective communication as well as diagnostic and policy dialogue between those working at the regional level and those at the country level. Integration of five sovereign states cannot be imposed from above; it must emerge from the accommodation of five systems to a common norm -- and that entails a broad base of understanding of each other's needs and interest as well as common desire to find solutions. SIECA has come to recognize the importance of overcoming this isolation syndrome, and limited ROCAP aid is designed to help SIECA facilitate inter-country communication and dialogue on priority sectoral problems.

Specifically, through the Brookings arrangement and sectoral studies, ROCAP will provide SIECA with access for high-level consultants for the analysis and definition of policies on tariff, customs, industrialization, rural development and export promotion. The Brookings contract is particularly oriented to helping SIECA with the research needed for the five governments in assessing the desirability of converting the CACM into a Customs Union which could set up a common customs administration and would permit free trade in all products entering and produced in the region. As the Secretariat to the High Level Committee of five Presidential appointees charged with preparing the blueprint for restructuring the Common Market, SIECA needs to draw on prestigious resources beyond its present staff to supply the inputs required of it for the Committee; and ROCAP through the Brookings arrangement and other consulting services seeks to assure the availability of these resources when needed.

Directly complementing this policy input is the need for a well-organized data and relevant statistical databank, currently in only a formative stage. As a result, over the DAP period, ROCAP will continue support of SIECA efforts to develop uniform national systems and methodology for the collection and publication of key economic and social data.

ROCAP assistance to SIECA should gradually decline over the next several years. We project $275,000 in FY 1975 as compared to $373,000 in FY 1970, all directed to specific program activities -- not institutional or budget support. Current planning foresees ROCAP grant aid as no more than 20% of the funds needed by SIECA to carry out its responsibilities. However, since the CACM is now entering the decisive phase of its restructuring process and the new organic system, if any, will not take shape until probably CY 1975, it may be necessary over the DAP period to re-assess the nature and dimensions of AID support to SIECA and the other CACM institutions.

C. Agriculture

1. Introduction

Based on the sectoral discussion in Chapter IV, the ROCAP agriculture program over the DAP period will be designed to deal with the employment, income, productivity and marketing needs of the small and subsistence farme in Central America.

Our strategy will be to support the development of regional institutional capability to formulate and implement policies and programs suited to deal with these needs. ROCAP will provide technical and financial assistance required for the studies, training and activities essential for sound policy definition, selection of optimum courses of action, encouragement of compatible regional and national programming, and stimulation of private sector participation in the definition of policies and programs.

ROCAP will, in addition, provide region-wide services to the agriculture programs of USAIDs as requested. The ROCAP agricultural team will become fully conversant with the national agricultural programs of the five Republics and the USAID assistance efforts in support of these programs. It will seek appropriate means for encouraging effective regional-national cooperation in the agricultural sector and broaden the areas of accommodation between national and regional programs.

2. FY 1973-1976 Short-Run ROCAP Program

a. Developing Regional Institutional Capacity and Leadership for Policy Formulation

As described in the agricultural sector discussion, the primary regional institutions, SIECA, CABEI and IICA/ZN assigned responsibility for providing guidance on rural sector problems do not now have the organization, technical talent, experience nor the national collaboration required to develop and promote meaningful regional/national agricultural policies, programs, and project alternatives for the member nations consideration. Due to the complexity of this sector and the region's dispersion of institutions, information and understanding of the basic problems, the strategy in the short run, will be concentrated on several carefully selected problems in order to complete the necessary groundwork for a regional agricultural sector assessment and analysis planned for FY 1975 - 1977. They should provide the framework for broad new policies and programs for Central American agricultural development, to meet the critical area problems spelled out in Chapter IV, toward the end of the DAP period. And, should provide the basis for appropriate ROCAP financial and technical assistance for the FY 1977 - 1978 time-frame.

The short-term ROCAP agricultural activities are geared to preparing for the sectoral assessment and analysis through staff work, studies and critical projects. ROCAP will assist regional institutions in FY 1973 - 1974

(1) to collect key data, which will be facilitated by our FY 1974 - 1975 target activities -- discussed below -- to set up the Regional Information and Data Center and to conduct the basic grains and crop diversifications studies; (2) the study of alternative analytical approaches; (3) the definition of the most appropriate organization of and management for the analysis; and (4) the identification of political, economic and social constraints requiring special attention. At the request of the CA regional institutions, ROCAP plans in FY 1974 to contract with a US university to study and define appropriate methodical approaches, to suggest the most effective use of regional and national talent and to articulate with precision the specific benefits to Central American agriculture that the studies can engender.

In this process, ROCAP will encourage regional institutions to involve appropriate national public and private organizations in the planning and preliminary work. This effort for involvement will not be limited to only the sector assessment and analysis. ROCAP proposes during FY 1974 - 1976 to provide grant support for SIECA and other regional institutions for their programs of regional - national seminars, workshops and policy discussions. Experience indicates that regional-national cooperation can promote the cross-utilization of ideas, concepts, experience and knowledge; improve regional-national coordination and cooperation; and expand Isthmus-wide appreciation of the advantages of joint action to solve common problems.

A PROP will be submitted for AID/W approval in the first quarter of CY 1974 to provide not only grant assistance for effecting this involvement, but also contract technical support for regional actions programs to deal with constraints identified by the basic grains and diversification studies, such as basic food crop marketing, crop forecasting, price reporting, grain standards and research coordination.

Since the last quarter of FY 1973, steps have been taken to develop cooperation and coordination among interested regional institutions. Using the need for improved capability to carry out agricultural studies as the catalyst, a regional agricultural coordinating council with subject matter steering committees, has been created. This group now meets at least monthly and is composed of the senior agricultural officer of SIECA, CABEI, IICA and ROCAP. Projects to be undertaken are studied by each institution and approved by this council before being funded. As these studies are implemented, other regional institutions will be incorporated into the council, and new steering committees appointed. This mechanism has already demonstrated its usefulness by promoting interagency focus on specific problems, such as the pooling of the technical talent of SIECA, CABEI, IICA/ZN and most recently INCAP and ICAITI. This procedure requires the regional agencies to consult with and call for the collaboration of national planners, Ministries of Agriculture, USAID Missions and the private sector. In FY 1973-4, technical and financial support will be provided to these regional institutions to build their capacity in systematic analysis for problem solving and expand their outreach to and collaboration with national public and private agencies in four key areas which the national governments themselves have specifically requested study within a regional context. These areas are:

1) <u>Basic Food Crop Production and Marketing</u>

Although basic food crops, in particular basic grains, do not provide as much employment per unit area of land as many other agricultural commodities, they nevertheless deserve high priority in a regional agricultural development strategy, because the majority of the small farmer population is very heavily dependent on the production and consumption of basic grains. An increased supply of basic grains in the region, at more stable prices can reduce small farmer's risk in participation in diversification. Unless basic grain production yields are raised, when land is diverted to diversified crops a reduction of basic grains output will occur - a situation politically untenable at the present for the region.

Sector studies that SIECA and CABEI conduct, will seek to identify within the region those areas with the greatest potential for raising basic grain yields and therefore promote diversified crop production. This will entail, with the direct participation of national entities, careful analysis of what lending, technical assistance, and mechanization policies should be proposed to national government representatives for their consideration and approval, to avoid unnecessary labor displacement, or biases against small-farm participation.

Basic grains cost and price performance; introduction of non-traditional agricultural commodities; national grain price stabilization programs; warehousing legislation with a view to establishing a regional bonded warehouse system are scheduled for study by the three regional agencies involved at this time.

It is also important to have a marketing system that can inspire confidence that an adequate supply of essential food products at reasonable prices will be available to both rural and urban consumer at all times. ROCAP will encourage the regional agencies in consultation with appropriate national officials to prepare guidelines for national and regional grain marketing coordination with the objective of stabilizing year-round grain prices within acceptable ranges while developing larger regional markets.

ROCAP, as a result of the studies to be conducted in FY 1974, has programmed an estimated $10.0 million loan for a Regional Basic Grains Stabilization Fund and development of a regional public bonded warehouse program including warrant lending against warehouse receipts.

2) Diversified Crop Production

In order to foster diversification of agricultural production into those crops that promise the greatest increases in production, employment, incomes, and export earnings at the lowest per unit cost, technical and financial assistance will be provided SIECA to direct and coordinate regional analyses of key economic, institutional and technological constraints on production and marketing of new crops. It is expected that regional agencies, national planners, promotion agencies, researchers and other public and private sector organizations will directly participate in this work.

High priority crops will be selected that have superior market potential and maximize employment in specific geographical areas having major socio-economic problems. At the same time, collaborative efforts will be undertaken by SIECA, CABEI, ICAITI, IICA/ZN and other public and private organizations to provide assistance to agricultural planning offices and lending institutions on methods of promoting small farmers participation. Perhaps one of the greatest difficulties for accelerating agricultural diversification research in the region is the wide range of commodities that show potential for commercial expansion. Almost every type of micro-environmental condition can be found in Central America. These regional analyses, therefore, will emphasize establishing development criteria for selecting the most promising new diversified crops and identifying technologies which can be applied on small production units, with the minimum use of mechanization, maximum use of agricultural labor, but with improved systems of marketing.

A specific constraint to crop diversification is the expanding threat posed by the Mediterranean Fruit Fly. This pest, now found in Nicaragua, Costa Rica and Panama, attacks almost one hundred economic agricultural commodities. Any country having this pest within its borders is prohibited from exporting the susceptible commodities to the remaining MedFly free countries in C.A., the U.S. and many European and Asian nations, the pest first found in Costa Rica in 1952 has expanded its area of devastation in spite of efforts to control it by national governments and the UN Special Fund MedFly sterilization project. It presently infects over 14,000 square kilometers in Central America. Three outbreaks which occurred in the United States during the last fifteen years are believed to have started by the transport of flies in infested fruit shipped from the CACM. These outbreaks were eliminated at a total cost of approximately $40.0 million.

OIRSA, the Central American regional agency responsible for plant and animal sanitation was formally requested by the CACM countries to make this problem a major element in its program in 1971. ROCAP provided financing for a USDA technical team to study the possibility of eradicating the pest in CY 1971-2 at OIRSA's request. These conclusions and a suggested approach to an eradication program have been incorporated in a report prepared by the Plant Sanitation Officers of Central America, Panama and Mexico during a special technical level meeting sponsored by OIRSA in May 1973. The recommendations of this Commission are presently under study by the respective governments. OIRSA expects these replies to be favorable and is expected to request support from several international agencies including ROCAP to assist them in the development of a detailed technical feasibility study and a loan proposal for a region-wide eradication program. Should this materialize ROCAP will, within its financial and technical capability, consider appropriate assistance to control this serious problem.

3) <u>Agricultural Information and Data Center</u>

AID is not the only agency which can be accused of an inadequate memory system and under-utilization of existing knowledge in the agricultural sector. Central America has for the last twenty five years conducted technical and economic research and area development studies on almost every production problem imaginable. In addition, census data, wholesale and retail commodity prices, soil fertilizer response studies, crop production statistics, etc. are constantly accumulating, but are not systematically cataloged nor registered in a form readily usable throughout Central America for economic, social and technical studies and programs. As a result, national sector analysis in one country may not take into consideration the competitive forces and implications of the program thrusts being developed in neighboring nations. Researchers constantly duplicate work previously carried out by colleagues in their own or other CACM countries and the lack of effective and timely flow of market price information, crop prediction data, etc. hampers expansion of regional and international commerce in agricultural commodities.

IICA/ZN with ROCAP support in FY 1974-75 will initiate a program to collect, codify, evaluate the utility of and facilitate to regional and national institutions information they require to improve the quality and coordination of regional and national planning, research and commerce. As an initial supplement to other ROCAP technical assistance, a portion of the time of one of the LA/DR NCSU soil fertility specialists will be provided to IICA/ZN under this program to bring together, interpret and systematize known work in this field as the basis for further integrating and making more effective the efforts of public organizations throughout the CACM.

4) Higher Agricultural Education

ROCAP will terminate at the end of FY 1974 its support of the IICA/ZN program to improve the quality of higher agricultural education in the area. Through a contract with the University of Puerto Rico, Puerto Rican professors have been replacing professors from Central American Faculties of Agronomy while Central American counterparts (13 in FY 1974) secure higher degrees in Puerto Rico, the United States and third countries. Only El Salvador, Honduras and Nicaragua continue to participate in this program.

A major reason for AID support was the agreement in principle -- although not carried out in fact -- by the CACM universities to specialize in different agricultural disciplines. Due to limited budgets, greater demand for technical and managerial talent and the small number of qualified professors in the region, each of the CACM Faculties of Agronomy recognized that, as a practical matter, they could not develop departments in all specialized disciplines needed to meet future demand. Their agreement calls for each one to select a specific technical discipline in which they would specialized, in addition to their general training program. The agreement contemplates that students in all of the five countries could complete their first two years of study under a standard study program in all five Faculties and then transfer to the appropriate "regional schools" which covers their selected specialty (agricultural economics, pest management, livestock husbandry, veterinary medicine or agronomy) for the remaining three years.

The IICA/ZN will continue to support this program in future years but further ROCAP assistance is not contemplated so long as the regional agreement is not implemented. Any future ROCAP assistance will require detailed justification in the light of other regional agricultural priorities flowing from the sector studies.

3. Provide Requested Support and Assistance to USAID and Through Them to National Institutions

During FY 1974-1975, ROCAP will make its technical staff available to work with USAIDs at the request of the USAIDs, for (a) agricultural economic studies, (b) consultation on specific problems on which ROCAP has the requisite expertise and (c) review of agricultural sectoral strategies in connection with sectoral studies and analyses, program development, review of loan papers and evaluation of project plans. The ROCAP staff will also facilitate the flow of program data and information among the Central American Missions.

Three examples of this ROCAP-USAID cooperation are:

a. Basic Food Crops and Agricultural Diversification Technical Support

USAIDs requiring assistance in the areas of grain storage and marketing as well as agricultural diversification can call upon the team of USDA experts which ROCAP has available to assist the regional institutions in these fields. Though their work is principally at the regional level, they are increasingly able to provide cross fertilization of technical knowledge, to share regional and third country experiences which facilitate the solution of problems at the regional level and to serve as the channel for reflecting national experiences to regional counterpart organizations. This experience has already been extremely useful in sensitizing the regional agencies - particularly SIECA and CABEI - to the realities of national programs and problems and provide contacts at the national level with which regional technical personnel can work.

b. North Carolina State University Soil Fertility Technical Support

This Latin American Bureau-supported program presently has three specialists working in Central America.

In May 1973, ROCAP was requested by LA/DR to coordinate the activities of the regional soil fertility specialists assigned to work with the national soils departments in Guatemala, El Salvador and Honduras.

In August 1973, LA/DR requested that ROCAP consider financing the program starting in FY 1975. USAIDs are now being consulted as to whether this project should be continued and, if so, funded as a charge to each USAID's budget or ROCAP's. If the program is regionally financed, an additional dimension would be added, namely, increasing concentration on the collection, packaging and evaluation of production technology as part of the IICA/ROCAP program for a regional/national information clearinghouse in support of programs in basic grains, crop diversification and sector analysis. This would be a natural evolution of the project and would actually decrease.

c. Regional Technical Studies Support

Two short-term studies funded in FY 1973 will be implemented during early FY 1974. IICA/ZN will serve as coordinator of these activities. The work to be performed, as approved by the CA Food and Agriculture Officers at their

April 1973 quarterly meeting, will concentrate on basic food crop seed production and marketing (Mississippi State University) and Fertilizer Marketing with special attention to supplying these inputs most economically to small farmers (Tennessee Valley Authority).

D. Low Cost Housing

The Sector Discussion identified low-income shelter as a high priority development program for ROCAP during the period immediately ahead, and indicated that ROCAP planned to encourage development of an integrated housing industry with the capacity and the sources of financing necessary to attack the vast and growing need for low-cost housing.

The ROCAP Low-Cost Housing Program proposes a unique mixture of regional and bilateral projects which if successfully carried out would eliminate the need for external assistance in the housing field beyond 198?.

The Program comprises the following elements:

(1) Advancing development of the CABEI regional secondary mortgage market in the middle-income sector to a self-sustaining operation, and initiating a new CABEI program of financing low-income mortgages which would also become self-sustaining

(2) Channelling financial resources either from CABEI or via direct HIG loans to existing private sector non-profit institutions concerned with low-cost housing development,and encouraging establishment of such institutions where they do not now exist.

(3) Providing direct HIG loans to public sector institutions such as national housing institutes (NHI's) or national housing banks (NHB's) to provide financing for demonstration projects of low-cost housing developed on urbanized sites provided by the municipal governments.

(4) Initiating studies leading to reduction or elimination of non-financial restraints on low-cost housing production.

1. <u>Support for the Regional Home-Finance Activities of CABEI</u>

As noted in the Sectoral Discussion, the regional secondary mortgage market operations of CABEI have become an important factor in the middle-income housing field in Central America. By mid-1973 CABEI had financed mortgages to a value of nearly $30 million and had received applications for another $30 million.

ROCAP is presently reviewing a new HIG to support this middle-income housing market, while at the same time responding to a CABEI initiative to make resources available to the low-cost housing sector. The new FY 1974 HIG is estimated at $46 million broken down approximately as follows (in millions): Conventional (middle-income) program $30.0; new (lower-income) program $16.0 million. As stated earlier, the latter program would be directed toward outright purchase of lower-income mortgages generated by mortgage finance institutions.

In addition CABEI has requested, and ROCAP has programmed, a concessional loan in the amount of $5.0 million (the same $5 million loan mentioned in the section on private non-profit institutions discussed later) to provide a permanent mechanism for subsidizing interest rates on low-cost housing mortgages. This proposal contemplates CABEI issuance of housing bonds for the program at a cost of roughly 8% (the actual interest rate on the proposed CABEI bond issue will of course depend on market rates at the time of sale) and negotiating the AID loan for $5 million mentioned above at an interest rate of 3%. CABEI would immediately invest the loan in middle income mortgages paying approximately 12%. The interest spread thus accrued would be utilized to cover a differential between the cost of the bond money (8%) and a subsidized rate for low-income mortgages (6%). The loan would thus provide subsidy for more than $20 million for low-income housing finance generated by CABEI from other sources.

It should be noted that rising long-term interest rates in the U.S. during the first quarter of FY 1974 will affect the feasibility of certain portions of the HIG program while awaiting a decline in such rates expected to occur in the first or second quarter of FY 1975.

2. The Private Non-Profit Institutions

As indicated in the Sector Discussion, private non-profit institutions involved in low-cost housing development already exist in each country, and additional ones are planned (e.g. Guatemala). These institutions are, however, generally marginal operations due to the lack of long-term financing for projects, which in turn leads to a dearth of income to cover administrative expenses.

ROCAP proposes to make funds available through direct HIG's for financing low-cost housing projects to be developed by these institutions, and to provide the short-term technical assistance necessary to assure that the sub-borrower institutions take advantage of the available resources in an organized way.

The long-term financing resources would be made available to the institutions under terms and conditions which would assure:

(a) Disbursements for working capital in advance of the completion of dwelling units;

(b) very low or no down payments by homebuyers;

(c) technical standards which take into account the realities of low-cost housing.

The rental-purchase plan more fully discussed in the MDCC low-cost housing paper can also be effectively utilized by these institutions in selected urban environments.

ROCAP plans $20 million in HIG contracts in FY 75 for this activity supported by a related FY 74 $5 million loan through CABEI for regional home-financing. A substantial portion of these resources will be earmarked for low-cost housing cooperatives. For the development of successful housing cooperatives, the existence of a technical services organization (TSO) has been found to be mandatory. Such a TSO exists in Honduras (FEHCOVIL) and plans are under way for the creation of the second in Guatemala, while exploratory talks have been held with interested agencies and individuals in El Salvador and Costa Rica. ROCAP proposes to devote substantial technical assistance effort to the development of the TSO's in Guatemala, El Salvador, and Costa Rica.

3. Support to Public Sector Institutions in the Development of Innovative Low-Cost Housing Programs

ROCAP proposes to support throughout the C. A. region the initiative developed in Honduras and Costa Rica for cooperation between secondary-level governments and the country's National Housing Institute or National Housing Bank.

Under this plan, municipalities within the various countries, with the advice and assistance of their respective national housing institutes (NHI's) or National Housing Bank (NHB) would select sites for low-cost housing projects in the areas over which they have jurisdictional control.

Utilizing their own funds or monies obtained from their respective Central Governments, each municipality would purchase project sites varying from as few as ten units to as many as several thousand. In some instances, the local government would already own or control such sites.

The individual NHI or NHB, utilizing resources obtained from external lenders, as required, would then complete infrastructure and construct the housing units for sale. Target re-payments by homebuyers would be not to exceed ten dollars per month for not to exceed fifteen years, including amortizing the value of the land and payment of reasonable interest rates. ROCAP anticipates an $18 million HIG contract in FY 74 for this activity with disbursements estimated at approximately $12 million by the end of FY 75. (An additional HIG of $37 million coupled with a $25 million concessional loan outside the ROCAP program, but related to the overall regional requirement is contemplated for Nicaragua). ROCAP will request no loan funds for NHI activity, but will provide grant technical assistance.

The ROCAP supported program would produce an estimated 24,000 units (Nicaragua program not included), a substantial majority of which would be outside capital cities.

4. <u>Technological and Other Non-Economic Restraints on Low-Cost Housing</u>

Under ROCAP's proposed technical support activity for the research and evaluation of C. A. social development problems, ROCAP proposes to initiate studies leading to reduction or elimination of the non-economic restraints on low-cost housing in the C. A. region, including technological, social, and legal restraints.

These studies will evaluate some of the suggestions contained in the MDCC low-cost housing paper[1/]: (a) technical innovations (such as pre-fabricated components) which can reduce housing construction costs; (b) loans for construction and repairs; (c) using the HIG program to finance rental housing (with an option to buy); (d) development of technical service organizations which will wish to address problems

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1/ Housing in Central America or Can We Reach the Little Guy?

of low-cost housing; and (e) evaluation of the effects of proposed changes in HIG policies. An initial activity will be to examine the feasibility of adapting "manufactured housing" or "systems building" techniques to the C. A. housing construction industry. A low-cost housing study to identify specific pilot projects will be accomplished during the second quarter of FY 1974 at no cost to ROCAP.

Although no funds are presently programmed for the activity, ROCAP will also consider the desirability of collaborating in the development of a C. A. Regional Housing and Urban Development Institute, the need for which was expressed by resolution of the delegates to the First C. A. Conference on Housing Technology and Urban Planning, an earlier ROCAP initiative.

The Regional HUD Institute would provide technical assistance to local entities in both public and private sectors for the following purposes:

(a) Promulgation and standardization of building codes recognizing the latest advances in construction technology consistent with the realities of housing, especially low-cost housing, within the region;

(b) improvement of housing technology and urban planning;

(c) regional standardization of building modules and components;

(d) development of training courses for skilled and semi-skilled construction labor;

(e) accumulation and dissemination of literature on all aspects of housing and urban development, including the technical, legal and social aspects.

E. Tourism

Given the potential benefits of tourism, as well as current problems, ROCAP proposes to support the Central American tourist organizations over the DAP period in planning and carrying out their program aimed at: 1) adoption of uniform or similar legislative and administrative measures to facilitate tourist travel - e.g. border crossing procedures, customs inspection, etc.; 2) promotional activities at both the national and regional level (in order to attract tourists to the area and retain them for longer periods); 3) strengthening of official tourist organizations as well as private groups interested in tourist promotion; and 4) provision of financing for the private and public infrastructure needed to expand tourism.

ROCAP will continue to provide technical assistance as necessary in tourism promotion and organization. It is proposed that ROCAP provide such assistance to national, as well as regional organizations, after appropriate consultation with the USAIDs. ROCAP also proposes to finance selected public and private infrastructure needs and, in view of the tremendous demand from the private sector, plans a $20 million loan to CABEI in FY 75 to finance additional private tourism investment. It is anticipated that tourism infrastructure needs will not require additional financing until at least FY 1976.

Proposed grant activities for FY 74-75 include the strengthening of the present regional tourist organization and/or the establishment of a wider-base new one. The present regional tourist organization (SITCA) is weak and does not enjoy the full confidence of the directors of the national tourism programs. Thus, some sort of reorganization is required, as well as consideration of the desirability of establishing an association of private tourism organizations in the area; and, ROCAP is prepared to provide grant and technical assistance to SITCA once its directing council has defined the basis for strengthening its program. In any case, ROCAP will continue to finance technical assistance to stimulate promotional activities since tourism is perhaps the most promising new industry in Central America for creating large scale employment and foreign exchange earning opportunities. If the public and private sectors give tourism the priority it deserves, the other international aid donors should respond with technical assistance and substantial loans on concessionary terms, lessening the need for AID financing. Both BID and IBRD have recently evidenced interest in this sector.

F. Export Development

ROCAP will provide grants to enable PROMECA and ICAITI to perform on a regional basis a number of essential services as indicated below. The national export development centers will also be assisted, primarily through PROMECA, so that they may perform similar services within their respective countries.

The financial assistance provided by ROCAP will enable the export development institutions to perform the following basic services: the promotion of business relationships between

Central American manufacturers and foreign buyers in high potential areas (fruit and vegetable production and processing, electronics, furniture and related wood products, clothing); the financing of pre-feasibility studies to investigate other product areas offering relatively great export potential (e.g. leather products, household furnishings, business machines, meat products); the participation by C. A. producers in "product adaptation clinics" to introduce Central American products and provide the opportunity for adaptations needed to permit these products to break into the markets of the developed countries; technical assistance to the national export centers and producers with export potential to resolve technical difficulties in production, packaging, transportation and marketing; training courses on export development and marketing operations, export center operations, and food processing; quality control: product standards and a quality testing service; and export information system; economic and technical research directly related to the expansion of C. A. non-traditional exports; actual export field trials with the private sector; and a food technology extension service.

Among its other activities PROMECA will also identify loan prospects to CABEI, and advise SIECA on obstacles to the development of exports. It is envisaged that PROMECA will be primarily a service organization, which with the centers will perform an essential "linking function" between Central American exporters and potential importers. Policy studies and recommendations in the field of commercial activity including export incentives, will be responsibility of SIECA.

Depending on CABEI's success in implementing Loan 010 and LAAD's ability to identify export projects in the agribusiness field, ROCAP will consider additional loan financing for exports. ROCAP lending in this field will, of course, be influenced by the intentions of other international aid donors.

G. Areas Outside Fields of Concentration

Over the past several years ROCAP has taken steps to reduce assistance to activities outside its priority fields of concentration. Thus, all new funding for ODECA activities (labor, legal, education and health and population) has ceased, as has assistance to FEDEPRICA (an association of private sector elements in support of the CACM), FUPAC (the association of Central American Private Universities), and grant assistance to INCAE (the Central American Business School). In the process of limiting its programs, ROCAP has also phased out projects in Health and Population and Human Resources.

1. Research and Evaluation of Social Development Problems

In order to conduct research and evaluation directed specifically at Central American social development problems, it is proposed that a fund be established within ROCAP's allotment, but which will be utilized in accordance with decisions of the MDCC. To the maximum extent, TAB assistance will be utilized in the conduct of these activities, particularly in the design stages.

Initial analysis and design of proposed activities will determine the method of implementation, financial and technical requirements and the basis for evaluating pilot-project results. Activities selected will be limited to those which appear to have potential applicability to more than one country of C.A.

Project design and evaluation will identify changes needed before the activity can be applied on a broad scale either within the country or, with modifications, in other countries in Central America. When the pilot project has been evaluated and it is determined that major investments are needed, ROCAP will generally no longer be actively involved in the project and the appropriate USAID(s) will undertake prime responsibility for follow-through.

Initial activities envisioned are the pilot testing of innovative techniques for developing low-cost education, health systems, and housing:

The education activity would emphasize controlled experiments which would place heavy emphasis on investigating and evaluating the potential for such ideas as (a) year-round schools; (b) educational supplements and low-cost school texts; (c) radio programs for training of illiterate adults in remote areas; (d) the effects of nutrition on learning among pre-school and primary school children; (e) vocational and agricultural training for military recruits; and (f) various approaches to reducing school drop-out rates.

Health delivery system research and evaluation might initially determine to what extent the approach of the rural health program in Panama might be adopted to Central America. Some features of that program are (a) use of local community health organizations for self-help, as well as health and family-planning education activities; (b) the use of the aqueduct program to make running water for disease prevention available in or very near every home; (c) the use of community vegetable plots to improve nutrition.

Research and evaluation activity contemplated in the housing field is described in the strategy statement for low-cost housing.

Up to $200,000 in both FY 1974 and FY 1975 has been set aside within ROCAP's Technical Support to undertake research and evaluation activity in the various fields indicated.

2. Infrastructure

Although substantial progress has been made over the past decade in building the transportation, communications and power infrastructure of Central America, critical gaps remain to be filled before the physical integration of the area can be deemed adequate to development needs. ROCAP's strategy in this sector does not contemplate major new AID investments over the DAP period, but rather providing a technical resource for the SIECA and CABEI in upgrading and strengthening their competence in infrastructure planning, administration and evaluation. Providing backstopping for already approved regional projects and for the engineering components of country programs, ROCAP engineers will demonstrate sound norms and procedures for developing and carrying out infrastructure programs and projects, thereby helping to train an expanding cadre of technically competent Central Americans in this field.

Of special importance in this ROCAP strategy is the role of CABEI as the Central American specialist in financing infrastructure development. With ROCAP assistance over the last decade, CABEI has become recognized in the international lending community as a sound administrator of infrastructure projects. As the ROCAP loans now being disbursed are drawn down, ROCAP-CABEI technical cooperation should help up-grade and strengthen CABEI's competence in infrastructure administration and evaluation. With this improvement in CABEI's capability, Central America will have in place the mechanism capable of attracting resources from other IDI's to meet future infrastructure needs. And, AID can indeed become a funder of last resort for those occasional high priority transport, power or other infrastructure projects in which other IDI's show no interest.

In backstopping infrastructure components of USAID programs, the ROCAP engineering staff will provide technical advice and backstopping at planning, implementation and completion stages. In working with country officials responsible for these activities, the ROCAP staff will work toward standardizing planning and operations norms and procedures in order to facilitate the emergence of compatible standards at regional and national levels in Central America.

With respect to infrastructure requirements, ROCAP anticipates a program limited to projects with the greatest potential for regional integration. No further loans to CABEI for highway construction are planned; however, such items as electric power connections, tourism infrastructure, inland waterways connecting countries and, possibly, telecommunications may merit possible future loans through CABEI. Consideration will also be given, under appropriate circumstances, to the financing of feasibility studies only for ports, railroads and airports. However, for the foreseeable future, it is anticipated that sufficient funds will be available for feasibility studies under AID bilateral loans or the recently signed IDB loan to CABEI.

Depending on results of feasibility studies, progress made in restructuring the CACM, and the lending intentions of other aid donors, ROCAP tentatively plans a $15 million infrastructure loan in FY 1975 for electric power interconnections and/or inland waterways.

3. Management Skills

Although not an area of concentration per se, the problem of ineffective and archaic public administration and management systems will need to be given a special priority by AID in Central America in the future. In the short term, ROCAP and the USAIDs will continue to deal with the management issue by sector and by agency until a more coordinated and broader-based assistance policy can be followed. Specifically, development of modern management systems will be included in AID assistance programs during FY 74-76 by means of a) small AID contract management advisory services for recipient and institutions and b) a technical assistance component in the sub-regional development activity to be carried out in Guatemala, Costa Rica, Nicaragua and Honduras.

Nevertheless, the MDCC considers the "management constraint" to be of sufficient importance to require an additional chapter to this DAP at a later date, once a case review has been undertaken and a precise policy identified.

4. British Honduras

Although ROCAP continues to feel that this activity bears no relation to the Central American regional program, we have assumed responsibility for the project upon request of AID/Washington although we believe that the small British Honduras program could best be administered directly by the U.S. Consulate General in Belize or by AID/W. Until such action is taken, the following ongoing program is proposed:

The major component is aimed at assisting the Government of British Honduras to improve the calibre of its Civil Service through appropriate training in key technical or administrative positions. Additionally, ROCAP plans to continue providing funds for a contract with a U.S. firm who will train GOBH employees assigned to the newly-created Investment Promotion Office. A small special projects fund allowing the U.S. Consul General to respond to high impact activities involving local initiative is also contemplated.

H. Likely Requirements for ROCAP Inputs FY 75 - 80

Manpower

An important role is seen for ROCAP in providing services in specialized fields on a timely basis throughout Central America, as is already being done extensively in the fields of engineering, housing, legal services, and financial analysis; and as is planned for expansion in agriculture and economic analysis. In many cases, the full-time assignment of an expert to an individual mission is not necessary or can not be justified on the basis of local workload requirements. Nevertheless, the services of a technically competent expert intimately familiar with, and immediately available within, the region is often required in a particular field to furnish common services to more than one USAID.

It is felt that the availability of ROCAP experts in various vields would be beneficial to the region as a whole even if ROCAP were not involved in operational programs in a given field. This could be particularly true with respect to the implementation of a research and evaluation activity concerning social development problems in Central America.

Taking the above into consideration, it is anticipated that ROCAP will probably require five or six additional technicians in such fields as soils, seeds, fertilizers and research and evaluation. To the maximum extent possible, such technicians will be obtained by Personal Services Contracts or PASA's, thereby keeping the number of Direct Hire personnel below twenty-five.

Grants

Taking into consideration increased project activity in agricultural sectoral development on a regional basis, and some increased role for ROCAP in providing technical services throughout the region, which will be offset by the phasing down or out of project activities outside the main areas of concentration, it is anticipated that ROCAP grant requirements will remain fairly constant for the next five years at approximately the $2.5 to $3.2 million annual level.

Loans

It is anticipated that requirements for loans in the priority areas of agricultural development, non-highway infrastructure directed toward regional integration, regional telecommunications, and the stimulation of tourism will average \$20 - \$30 million for the foreseeable future. This figure will be influenced, of course, by decisions by other aid donors on whether or not to increase their levels of lending through CABEI.

HIG

ROCAP anticipates that HIG contracts in FY 74/75 of \$84 million will substantially finance most housing activities now contemplated; additional HIG's in the foreseeable future will be limited to approximately \$6 million in FY 76/77 to support national housing institutes in the development of innovative low-cost housing programs and approximately \$30 million in FY 78/80 for the support of CABEI regional home-finance activities.

ROCAP

TABLE I

SUMMARY OF COMMITMENTS BY APPROPRIATION CATEGORY
(In $ thousands)

	FY 1973 Actual	FY 1974 Estimate	FY 1975 Request
1. Development Loans	40,000	25,000	35,000
Project Loans	(40,000)	(25,000)	(35,000)
Sector Loans	-	-	-
Program Loans	-	-	-
2. Technical Assistance	2,523	3,165	3,000
Sub-Total	42,523	28,165	38,000
7. Housing Investment Guarantee	15,600	64,000	20,000
TOTAL COMMITMENTS	58,123	92,165	58,000

ROCAP TABLE II

SUMMARY OF COMMITMENTS BY WORLDWIDE AREAS OF EMPHASIS AND OTHER ACTIVITIES
(In $ Thousands)

	FY 1973 Actual	FY 1974 Estimate	FY 1975 Request
A. Food Production			
1. Grants - Subtotal	554	825	650
a. Agric. Education 596-11-660-012.1	(334)	(320)	(100)
b. Ag. Research Coord. 596-11-140-026.2	(210)	(350)	-
c. Ag. Diversification 596-11-150-047	-	(155)	(300)
d. Ag. Sector Analysis 596-11-190-055	-	-	(250)
2. Loans - Sub-Total	-	20,000	5,000
a. Grain Stabilization	-	(10,000)	-
b. Med Fly	-	(10,000)	-
c. LAAD	-	-	(5,000)
B. Population and Health	-	-	-
C. Education and Human Resources			
1. Grants - Subtotal	82	-	-
a. FUPAC Regional Inst. 596-11-660-012.2	(82)	-	-

TABLE II

	FY 1973 Actual	FY 1974 Estimate	FY 1975 Request
D. Power, Transportation and Industry			
1. Grants - Subtotal	593	815	825
a. Export Promotion 596-11-260-033	(561)	(565)	(575)
b. Reg Tourism Expansion 596-11-240-034	(32)	(100)	(150)
c. Housing Tech. Asst. 596-11-830-058	-	(150)	(100)
2. Loans - Subtotal	40,000	5,000	30,000
a. Tourism Infrastructure	(15,000)	-	-
b. Highway Infrastructure	(25,000)	-	-
c. Private Tourism	-	-	(15,000)
d. CABEI/Power Waterways	-	-	(15,000)
e. Housing	-	(5,000)	-
3. HIGs - Subtotal	15,600	64,000	20,000
E. Program Assistance			
F. Activities Outside Above Areas			
1. Grants - Subtotal	337	375	325
a. SIECA Inst. Assistance 596-11-755-040	(297)	(300)	(275)
b. Human Resources-Belize 596-11-660-100	(40)	(75)	(50)

TABLE II

	FY 1973 Actual	FY 1974 Estimate	FY 1975 Request
G. Technical Support 596-11-999-000			
1. Grants - Subtotal	967	1,150	1,200
Total Commitments			
Grants	2,523	3,165	3,000
Loans	40,000	25,000	35,000
HIGs	15,600	64,000	20,000