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AGRICULTURAL DEVELOPMENT
AND THE CENTRAL AMERICAN COMMON MARKET

by

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All views, interpretations, recommendations, and conclusions are those of the author and not necessarily those of supporting or cooperating organizations.



TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
CHAPTER I AGRICULTURAL DEVELOPMENT AND ECONOMIC INTEGRATION	2
Formation of the Central American Common Market	3
Effects of Integration on Agricultural Development	6
A. Expansion of Market Demand	6
B. Regional Specialization and Production Efficiency	8
C. External Economies	9
D. Export Diversification and Improved Bargaining Position	10
E. Possible Detrimental Effects on Agricultural Development	11
Dependency of Economic Integration on Agricultural Development	16
Integration and Agricultural Development Policy	19
CHAPTER II TRADE, THE COMMON MARKET AND AGRICULTURAL DEVELOPMENT	21
Part I The Evolution of Common Agricultural Policies	21
Tariff Equalization in Agricultural Products	21
Free Trade in Agricultural Products	22
Regional Coordination of Production and Import Policies	25
Other Areas of Regional Policy and Economic Cooperation	29
Part II The Evolution of Agricultural Trade in the Common Market	31
Part III The Effects of the Common Market on Agricultural Production and External Trade	40
Intraregional Trade and Export Diversification	40
Import Substitution in Agricultural Products	43
Tendencies toward Production Specialization	48
Part IV Conclusion: Some Policy Problems and Issues	52

INTRODUCTION

This study is an attempt to evaluate the development process in Central America in the light of the possibilities of accelerated growth offered by the current movement toward multinational economic integration. In particular, this study will examine the effects of the Central American Common Market on agricultural growth and development.

The nature, evolution, and goals of the Common Market program for economic integration are stated briefly in Chapter I, along with an extended analysis of the potential role of agriculture in this program. Chapter II deals with policies enacted to incorporate agriculture into the Common Market, and evaluates the effect of economic integration on agricultural production and trade. The conclusion points to some broader policy issues and problems stemming from the ongoing development process fostered by the Common Market, a process in which agriculture plays a major role.

CHAPTER I
AGRICULTURAL DEVELOPMENT AND ECONOMIC INTEGRATION
IN CENTRAL AMERICA

This chapter will analyze briefly the historical development of the Central American Common Market and the implications of its programs for the role of agricultural development.

In the early 1950's, the first steps toward integration and economic diversification based on import substitution industrialization were taken because of serious concern about development possibilities offered by the traditional pattern of growth. Industrialization based on import substitution provided both a ready-made demand and the means and objectives for a policy of economic diversification. Given the small size of the national markets, the establishment of a regional economy became a necessity. Thus, the development of a diversified economy required the formation of a common market--free trade and tariff protection. Fiscal incentives would create an investment climate conducive to industrial investments and would attract foreign capital and technology.¹ The good performance of the export sector contributed to accelerating industrialization and economic integration in Central America. Rising export revenue not only avoided

¹Central America has been successful in this latter pursuit. Private long-term capital inflow averaged \$20.0 million annually during 1956-59, rose to \$46.6 million during the period 1960-64, and from 1964 to 1967 has averaged \$89.2 million per year. International Monetary Fund, Balance of Payments Yearbooks for individual years and countries. The book value of direct United States investments in Central America between 1955 and 1965 increased from \$57 to \$241 million in the industrial sector, from \$95 to \$127 million

balance of payments difficulties but also helped improve real incomes in the face of trade diversion effects. Furthermore, export revenues buffered the unbalancing effects on government finance of foregone revenues due to free internal trade, preferential capital and raw material imports, and fiscal incentives for industrialization.²

The Formation of the Central American Common Market

The favorable conditions in international markets for Central American export products in the post-World War II period were an instrumental factor in allowing the five countries to take progressive steps toward economic integration. The first stage of this process, between 1951 and 1958, consisted of a tight network of bilateral trade agreements. These were superceded by multinational trade agreements subscribed to in the 1958-1960 period, which also saw the formulation of many norms and prescriptions for the achievement of higher degrees of integration. With the Central American Treaty on Tariff Equalization (1959) and the General Treaty of Central American Economic Integration (1960), the present structure of the Central American Common Market was established. At present, 96.3 percent of the goods recognized by the Central American Uniform Nomenclature (NAUCA)

in public utilities, and from \$155 to \$168 million in the remaining sectors. See Miguel S. Wienczek, "La Inversión Privada Norteamericana en el Desarrollo de Mesoamerica," Comercio Exterior (Agosto 1968), p. 680.

²The cost of industrial protection has been estimated at about 1.37 percent of GNP or 1.07 percent of the value added in industrial production, depending on the definition of cost utilized. In 1966, based on these estimates, the cost of protection ranged from \$55 to \$75 million. Jeffree B. Nugent, "La Estructura Arancelaria y el Costo de la Producción en América Central," Trimestre Económico, Vol. 35, No. 4 (Octubre-Diciembre 1968), pp. 762-63.

have unrestricted free trade among member nations. Uniform tariffs apply to 97.3 percent of the items in that classification.

The common market stage of economic integration has virtually been achieved. At present, the immediate objective of the integration process is formation of a customs union and achievement of free factor movements. The longer term objective is formation of an economic union among the five member nations. This objective is clearly defined in existing treaties and in the duties assigned to the central agencies of the Central American integration movement--the Economic Council, the Executive Council, and the Permanent Secretariat of the Central American Treaty of Economic Integration (SIECA).

Economic integration is not an end in itself, but a means to achieve economic development. Acceleration of economic growth and the transformation of production and trade patterns are the fundamental motive as well as the criterion for regional economic integration.

As suggested earlier, the small national markets and the nature of industrial production make economic integration a necessary condition for development of a modern industrial sector and its correlative process of import substitution; hence, there is a direct connection between regional integration and industrial development. It is more difficult, however, to define the role of agriculture in the process of integration, or to define the scope of regional policies for agricultural development. Because of the nature and structure of agricultural production in Central America--including lack of complementarity--regional integration is not a sine qua non condition for agricultural development.

This problem is further complicated by the lack of an adequate

theoretical frame of reference. The theory of the customs union utilizes the classical assumptions of full employment, perfect competition, and diminishing or constant returns to analyze the welfare losses or gains of trade diversion and trade creation.³ Some attention has been given to economies of scale, terms of trade, and changes in market structure. Recent refinements have related the theory of the customs union to regional integration movements among less developed countries.⁴ Despite these innovations, this theory was never intended to apply to an agricultural development situation characterized by economic and technological dualism, extreme specialization in export production, rapid population growth, and widespread unemployment.

The role of agriculture in the regional integration of Central America can be examined from two different viewpoints: one, inquiry into the potential benefits (or losses) which integration may create

³Trade creation refers to the welfare effects on prices and resource allocation in a shift from a high cost producer to a low cost producer. Trade diversion applies to the reverse situation: a shift from a low cost producer, presumably in a non-member nation, to a high cost supplier within the union.

⁴A good survey of the theory of the customs union is presented by R. G. Lipsey, "The Theory of Customs Union: A General Survey," Economic Journal (September 1960). More recent attempts to enhance the relevance of the theory to arrangements among developing nations are presented by Raymond F. Mikesell, "The Theory of Common Markets as Applied to Regional Arrangements among Developing Countries," in R. Harrod and D. C. Hague (eds.), International Trade Theory in a Developing World (London: Macmillan, 1963); C. A. Cooper and B. F. Massell, "Toward a General Theory of Customs Unions for Developing Countries," Journal of Political Economy (October 1965); and Hiroshi Kitamura, "Economic Theory and the Economic Integration of Underdeveloped Regions," in Miguel Wionczek (ed.), Latin American Economic Integration: Experiences and Prospects (New York: Frederick A. Praeger, 1966).

for agriculture; two, determination of the extent to which integration and development depend on the agricultural sector.

The Effects of Integration on Agricultural Development⁵

A. The Expansion of Market Demand

The enlargement of the market for agricultural products is closely related to the development of non-agricultural sectors and the possibilities of import substitution. Because of population growth, rising incomes, and urbanization, increased demand for agricultural products can be expected even in the absence of economic integration. Nevertheless, income growth and urbanization have been accelerated by the process of integration via industrialization, the level of investment, and the growth of modern service and trade sectors. Hence, economic integration may be credited with a significant portion of the increase in the demand for food and fiber.

Moreover, the total market for selected agricultural products is expanded by the introduction of certain commodities not previously available or not previously consumed in commercial volumes in individual national markets (e.g., various tropical fruits). The internal market for agriculture is also enlarged by the possibilities of import

⁵The arguments presented in this and the following sections represent an expansion of some of the ideas originally contained in the author's "La Orientación y Programación de la Política Regional de Desarrollo Agropecuario en el Mercado Comun Centroamericano," Memoria del Seminario sobre Programación y Desarrollo Agropecuario de las Antillas (Santo Domingo, República Dominicana: Secretaría de Agricultura e Instituto Interamericano de Ciencias Agrícolas, OEA, Mayo de 1967). This presentation, however, benefits from some of the considerations presented by Montague Yudelman and Frederic Howard in Agricultural Development and Economic Integration in Latin America (Washington, D. C.: Inter-American Development Bank, April 1969).

substitution for previously imported processed consumer goods which utilize food and fibers as raw materials. Regional production could also satisfy temporary shortages in a member country. In addition, the existence of a common market avoids the need for member countries to rid themselves of temporary surpluses in international markets, often at subsidized prices.⁶

Thus, integration offers the opportunity to normalize agricultural markets and supply over time and space, to avoid temporary surpluses or deficits, and to define areas of import substitution. This normalizing tendency may have beneficial effects on production by reducing the amplitude of sharp price fluctuations, thus reducing risk and uncertainty. In essence, import substitution and the growth of non-agricultural activities and employment create a higher level of demand for agricultural products. Hence, the formation of a regional economy should increase both the size and the extent of the market. Even without agricultural economies of scale,⁷ a larger market stimulates both investment and more efficient use of previously underemployed resources. These, in turn, lead to productivity gains and economic growth in agriculture.⁸

⁶The dilemma of more permanent surpluses is considered later.

⁷The issue of economies of scale in agriculture is discussed in great detail by Yudelman and Howard, op. cit., pp. 103-113.

⁸This is essentially the same argument held by Rosenstein-Rodan and Nurkse on the process of cumulative growth, resting on the mutual dependency of the extent of the market and the inducement to invest. Their theory holds that the inducement to higher investment levels generates a larger market--either because of disguised unemployment or because investment increased productivity--and this larger market in turn reinforces the inducement to invest. Thus, investment and more efficient use of resources leads to sustained growth through the

B. Regional Specialization and Production Efficiency

Closely related to the above argument is the theoretical prediction that free trade should lead to greater specialization based on comparative advantage (i.e., relative costs), leading to more efficient use of resources, technological change, and increased productivity.

In spite of competition between agricultural economies in Central America (economies that produce essentially the same goods), there are differences between countries and regions which can induce considerable specialization gains.⁹ First, considerable differences exist in the distribution of ecological zones. For instance, Costa Rica and Guatemala have a natural advantage in the production of temperate climate fruits and vegetables. Second, considerable differences exist in the infrastructure serving natural regions and in the economic distances between production areas and regional markets. Third, the great diversity of man-land ratios and the quality of available resources, including farming traditions of rural people, also limit competition.

Altogether, these factors result in a great diversity of production costs which would tend to favor production specialization with its attendant benefits.

mutually supporting intersectoral demand and productivity increases. See Paul N. Rosenstein-Rodan, "Problems of Industrialization of Eastern and South-Eastern Europe," Economic Journal (June-Sept. 1943), pp. 250-257; Ragnar Nurkse, Problems of Capital Formation in Underdeveloped Countries, 2 ed. (New York: Oxford University Press, 1963), pp. 12-31.

⁹Although the limit of complementarity of agricultural production should not be underestimated. This feature is discussed in the next chapter in connection with rising economic rationalism.

Economic distances may impose barriers to free trade in certain agricultural commodities and induce an indirect form of specialization. Thus, intra-regional trade and specialization may occur in the processed or manufactured form of the particular agricultural commodity, rather than in its fresh or raw form.

C. External Economies

Integration of agricultural research and training at the regional level should not only avoid needless duplication but should also lead to a more intensive use of available resources, including rather scarce human skills. This in turn should lead to a faster accumulation of knowledge and facilitate the dissemination of technology for modernization. In fact, various processing industries have established technical assistance programs for their suppliers in an effort to improve productivity, reduce costs, and standardize output. Manufacturing industries which produce agricultural inputs of capital goods can be instrumental in perfecting capital factor markets for the farm sector. For instance, a regional manufacturer of fertilizers has established, parallel to its regular distribution channels, a program of technical assistance specially designed for small subsistence farmers.¹⁰ In various countries, this program has surpassed in resources and coverage the services offered by government agencies.

¹⁰The Engro Agroservicios program operated by Fertilizantes de Centroamerica S. A. (FERTICA).

Regional investments in communications and road construction will not only integrate the different natural regions but could lead to lower transport costs, reduced marketing margins, and higher prices at the farm level. Direct investments in marketing facilities, such as a regional grain storage network, will have essentially the same effects.

D. Export Diversification and Improved Bargaining Position

The existence of an integration movement facilitated the adoption of a common commercial policy which may considerably increase the bargaining power of Central American countries in international markets. The breakdown of multilateralism in the world economy gave rise to bilateralism as the principle governing commercial relations and to regulation by agreement of many international commodity markets. It also made commercial relations among countries subject to negotiation and consent. Note the cases of coffee in the international coffee agreement, of the sugar quota to the United States market, and of banana exports to the European Common Market.

Although individually the Central American countries are minor producers of their major export crops, their importance as world producers greatly increases when they are taken as an integrated block. Common market countries taken together are the world's leading producer and exporter of bananas. In coffee exports they are second only to Brazil and Colombia, and are the fifth major

world exporters of cotton (third on the American continents¹¹).

A unified policy and a common position should enhance the bargaining power of the Central American nations as long as its major export crops remain competitive in international markets, improving income terms of trade if not barter terms of trade. Moreover, this bargaining power also applies to freight and insurance rates and to other negotiable charges.

Formation of a regional economy may prove a necessary condition for the diversification of exports by creating the necessary infrastructure to allow non-traditional commodities to reach international markets. Central American exports of new commodities have been stymied frequently by the inability of individual countries to meet the shipping volumes or standardization requirements of foreign demand transactions. A larger market and the creation of permanent trade flows can overcome or minimize this barrier. If relative prices are an impediment to agricultural export diversification, possible effects of the common market on production and productivity, previously discussed, may prove effective in cutting costs.

E. Possible Detrimental Effects on Agricultural Development

In the course of agricultural development, the internal terms of trade are likely to turn against agriculture. If the process

¹¹ Central America stands in fifth place as a cotton exporter, after the United States, the Soviet Union, the United Arab Republic, and Mexico in that order of importance. See International Cotton Advisory Committee, Cotton: World Statistics (Washington, D. C. : January 1969).

of import substitution entails unduly high prices for capital and manufactured goods purchased by the farm sector, agricultural development is depressed, either through reduced effective demand or through reduced incentives to invest in productivity-raising capital goods. One immediate outcome may be rising prices and inflationary pressures accentuating the existing disequilibrium between prices within and outside the region. Although this will tend to redress the balance of trade terms in favor of agriculture, longer term productivity gains in agriculture may offset the income effects of adverse terms of trade. This, however, may create serious distributive effects on development gains for the agricultural sector unless industrial efficiency and productivity is expanded to keep a certain balance of relative prices in the regional market.¹²

Adverse consequences such as disruptive imports, unemployment and lower incomes may also result from efficiency and productivity differentials. These same issues acquire a different perspective when the existing technological and economic dualism within agriculture is considered. The traditional agricultural sector employs the vast majority of the rural population and is organized around mostly subfamily-sized farms. It is technologically backward and only partially integrated into the economic system. As a result,

¹²The effects of deteriorating internal terms of trade will follow essentially the same pattern as the one described by the argument concerning development gains from international trade between "center" and "peripheral" countries in the international economy. See Gerald M. Meier, Leading Issues in Development Economics (New York: Oxford University Press, 1964), pp. 339-343.

the traditional sector is rather unresponsive to changes in prices and market opportunities.

The commercial sector, having more command over physical, financial, and technological resources, can react more rapidly to price changes and production opportunities, either by rapidly increasing output in response to rising prices or by shifting resources to alternative uses when the situation is reversed.¹³

Under conditions of free trade, these differences in productivity and command over resources may result in the seizure by the commercial agricultural sector of most of the opportunities created by economic integration. In the face of expanding markets, this seizure could be accomplished by: a) expanding output and productivity at a faster rate than the traditional sector and thus claiming a larger share of the regional market; b) making faster productivity gains to claim a larger share of the national market; and c) shifting resources to alternative uses where the commercial sector may eventually attain specialization gains in new productive activities.

If output and productivity in the traditional sector lag behind, it may result in a less than proportional increase or a decline in its share of the regional market, or even in a declining share of the national market caused by greater production from the commercial sector or by cheaper imports from member countries.

¹³This greater elasticity of supply is not present in the case of coffee or other tree crops. However, it is applicable to the parts of the commercial sector engaged in the production of cotton for export or other annual crops for the domestic market.

an additional adverse factor. Nevertheless, significant advances have been made in establishing a regional grain storage system with funds allocated by the Central American Bank of Economic Integration (BCIE). Likewise, a plan for the establishment of a regional

Under the existing duality, it is likely that these outcomes may occur in one or more countries, and lead to unemployment, lower incomes, or a reversion to complete self-sufficiency in the traditional sector so long as employment opportunities are limited elsewhere in the economy. Even if specialization gains and market shares among the two sectors of agriculture cause no serious disruptions, prices are likely to decline for the region as a whole as resources are used more efficiently. Aside from the possibility of compensating for lower prices via reallocation or productivity changes, commercial producers have more alternatives and a greater buffer margin in terms of total output, so that a drop in prices will not necessarily lead to lower levels of living. In contrast, given limited alternatives and the narrow margin between incomes and subsistence needs, price declines will cause lower levels of living in the traditional sector. Since deterioration of the already precarious living standards will induce migration out of agriculture or retard the adoption of technology and the use of modern inputs.

These effects could be avoided through sustaining high prices for agricultural staples to protect small farmers. The social cost of such a policy, however, is bound to be too high for developing countries to afford. If adopted unilaterally, under conditions of free trade, it could only lead to disruptive imports. If upheld regionally, it would amount to windfall gains for the more efficient commercial producers. Furthermore, such a policy is feasible only as long as there are no regional surpluses. Otherwise surpluses too would be exported at subsidized prices, thus further increasing social costs.

The most efficient way to reduce the vulnerability of traditional agriculture is by increasing productivity and restructuring opportunities for small farmers. Significant and sustained increments in productivity and output can be achieved if land, financial services, technical knowledge, and the necessary infrastructure can be provided or made more accessible to the traditional sector. Such provision would entail a reorganization of the existing system and a reorientation of public policy which hitherto has perpetuated the existing duality in agriculture.

The need for such changes is more pressing in view of the high rates of growth in the labor force, inability of non-agricultural sectors to create sufficient employment opportunities, and displacement of workers either by expansion or by capital intensive technology in export production. Thus, the income and employment effects of economic integration on the traditional sector would add to the existing problem of labor absorption in the economic system.

Encroachment upon the subsistence sector had been the traditional pattern of expansion. While the commercial sector concentrated its efforts on export, the domestic market provided an economic refuge for traditional subsistence farmers. However, the traditional sector is no longer protected by a de facto separation of markets, nor is the commercial sector confined to production for international markets. Two interrelated factors are primarily responsible for this change: 1) the common market, with rapid urbanization and rising incomes, has removed the demand limitation of the domestic

market; and 2) the stagnation of the traditional sector, together with slowly evolving demand and recent price declines for export commodities, has turned relative prices in favor of production for the regional market.

Rice production in El Salvador, Nicaragua, and Costa Rica is already dominated by large-scale enterprises. Between 1964 and 1966, rice imports jumped from 9 to 21 percent and prices increased from \$239 to \$267 (U.S.) per ton, but for the agricultural year 1968/69, these three countries had a total surplus of roughly 42,000 tons and average prices declined to \$256 per ton.¹⁴ Similarly, "egg factories" have taken over the regional market in all of the five member countries. To a lesser extent, large-scale enterprises are capturing the corn market from the traditional farming sector in Costa Rica and El Salvador; the production of certain vegetables in Costa Rica and Guatemala; and tobacco in Honduras and Nicaragua.

The Dependency of Economic Integration on Agricultural Development

In an economy where agricultural exports provide 95 percent of total foreign earnings--78 percent of this total coming from coffee, cotton, and bananas alone--the capacity to import and the stability of external balances are closely related to the agricultural

¹⁴ Prices are moving averages of monthly prices, as compiled by SIECA, some of which have appeared in its Carta Informativa. Surpluses are estimated by SIECA, "Informe sobre el Arroz en Centro-america" (Guatemala: 1968).

export sector. In the foreseeable future financing of development will largely depend on the ability of the traditional export sector to improve its competitive position in international markets and maximize earnings. To the extent that industrial goods are not likely to become a significant source of foreign exchange,¹⁵ the burden of creating new sources of foreign exchange and of reducing external vulnerability will fall upon agriculture. Second, should agriculture fail to expand output and productivity, rising prices or shortages are likely to lead to food imports (and a foreign exchange drain) or inflationary pressures having detrimental effects on the competitive position of exports in international markets.

Thus, agriculture will play a significant if not crucial role in maintaining internal growth and balance of payments stability within the Common Market. Should agriculture fail, balance of payments difficulties will lead to exchange controls and restrictions which directly affect the process of integration and the Common Market. Corrective policies (i.e., exchange controls and revaluations, taxation or manipulation of tariffs) cannot be applied unilaterally by member countries without breaking integration

¹⁵Two factors seem to limit this possibility. Internal costs and tariff protection on the part of importing countries are likely to keep industrial goods from being competitive in international markets. Also, international corporations which have taken over the modern industries in Central America are more interested in taking advantage of a captive market than in finding foreign markets for domestic production. Industrial goods accounted for only 5.2 percent of the total value of exports in 1965-67.

agreements or causing distortion of prices and costs seriously affecting regional commercial flows and production.

The dependency of economic integration on agriculture also rests on the demand impact of agricultural development. As long as industrial production is not competitive in international markets, the strengthening of internal demand becomes the crucial element in a growth scheme based on import substitution industrialization. In fact, the progressive expansion of substitution possibilities, the realization of scale economies, and the avoidance of excess capacity and high industrial costs will depend largely on expansion of internal market demand. Central America is a small market of 13 million people; moreover, half of its population and labor force are only marginal participants in the economy as either producers or as consumers. No significant expansion of effective demand is likely unless this half of the labor force and population, whose annual per capita incomes of \$45 to \$130 derived from subsistence farming and employment on plantations, become more effective participants in the economy.¹⁶

¹⁶In 1964, census figures showed a total labor force of 3.7 million people of which 2.2 million were in agriculture; 1.4 and 0.5 million workers were in sub-family farms and were landless workers, respectively. Population figures roughly correspond to this breakdown. The average annual family income for sub-family farm workers ranges from \$220-908 in the various Central American countries. Comparable figures for landless workers range from \$229-727 per family. The per capita estimates given above assume families of five members. See Comite Interamericano de Desarrollo Agrícola (CIDA/CAIS), Características Generales de la Utilización y Distribución de la Tierra en Centroamérica (Informe Preliminar, 1969), Tables 13, 19.

When considering only the supply side of the market, it could be argued that a takeover of production by the commercial sector can be justified as long as the production needs of the economy are more efficiently met. When considering the demand aspects, however, the argument is considerably weakened, given the existing distribution of wealth, internal demand, and availability of employment elsewhere in the economy. The incorporation and modernization of the traditional sector cannot be ignored by public policy, save at the expense of widespread unemployment, the proletarianization of a majority of the population, and the eventual decline in the growth rate of industry and tertiary sectors.

Integration and Agricultural Development Policy

According to the foregoing analysis, the following areas fall within the scope of agricultural development policy in the integration process:

- 1) Coordination of production and trade policies for the joint defense of traditional export products in international markets and agreements;
- 2) Encouragement and development of new agricultural exports;
- 3) Achievement of regional self-sufficiency and adoption of measures leading to import substitution of competing agricultural products;
- 4) Encouragement of regional specialization of production;
- 5) Incorporation of the traditional sector and of rural laborers as effective producers and consumers in the economy;
- 6) Coordination of technical services in agriculture to serve regional needs;
- 7) Completion and perfection of the common market for agricultural products.

Since integration is a development scheme aimed at a union of five economic systems, these common problems become regional problems which require varying degrees of coordination of planning and policy actions. Not all regional (common) problems require regional actions;¹⁷ however, regional and national efforts should be complementary.

¹⁷Two forms of regional action have been used in the Central American Common Market. Joint action cedes a national public power to a regional authority. Because of their nature, regional actions require subscription to multilateral legal instruments which define the duties and prerogatives of the regional authority. Coordinated actions do not attempt to jointly exercise a public function but rather to organize national action so that it will be affected according to criteria, guidelines, or coordinating instruments multinationally agreed upon by member nations. For fuller discussion see Naciones Unidas, Comisión Económica para América Latina, Evaluación de la Integración Económica en Centro America, 66. II. G. 9 (New York: 1966), pp. 83-84. As opposed to joint actions, which usually require ratification by national legislative assemblies, coordinated actions usually fall within the normal executive jurisdictions of public agencies.

CHAPTER II

TRADE, THE COMMON MARKET AND AGRICULTURAL DEVELOPMENT

PART I — THE EVOLUTION OF COMMON AGRICULTURAL POLICIES

Although agricultural development is one of the avowed goals of economic integration, neither the General Treaty nor any of the other treaties and protocols define the objectives or programs of a common agricultural policy. Existing agricultural policy stems directly from the general provisions of operational necessities of the Central American Common Market--that is, from provisions concerning free trade and the equalization of tariffs.

Tariff Equalization in Agricultural Products

Tariff equalization is of prime importance within a common market not only because it is a usual precondition for free trade, but also because it is the basic protective mechanism for the inducement of import substitution.

Between 1960 and 1969, the Central American Agreement on Tariff Equalization and subsequent protocols stipulated the immediate equalization of tariffs for 265 agricultural products, 89.2 percent of all raw and processed agricultural products in the Central American Uniform Tariff Nomenclature (NAUCA). During the same period, tariffs of 29 agricultural products were progressively equalized. Only tallow is still undergoing this process.

National tariffs remain in operation indefinitely for three agricultural products: wheat, wheat flour and cloth made of jute,

sisal or other vegetable fibers. Wheat and wheat flour are the main agricultural imports of Central America, amounting to \$20 million in 1968. The value of sisal, jute and other vegetable fiber imports was \$1.4 million in 1968, of which only \$220,000 was imported from non-member countries.¹

Ninety-nine percent of all agricultural products have a uniform external tariff. Total imports of these products amounted to \$22 million in 1968, 35 percent of total agricultural imports in that year (raw and processed) and 2 percent of the total value of all imports.

Free Trade in Agricultural Products

Bilateral trade agreements of the 1950's established free trade among two or more countries for many agricultural products.

The General Treaty, incorporating these agreements, generalized trade of these commodities to the whole region and enlarged the number of products covered. All agricultural commodities were classified as follows:

- A. Products for which free trade was granted automatically when the General Treaty became effective in June 1961;

¹ SIECA, Estado Actual de la Equiparación Arancelaria y el Libre Comercio de Productos Agrícolas en el Mercado Común Centroamericano. (SIECA, GT-RMECA-III/D.I., 29), Octubre 1970. This document discusses the principal obstacles and the possibilities of accomplishing total free trade and tariff equalization for all agricultural products in the Common Market.

- B. Commodities for which trade restrictions were progressively eliminated during a transitional five-year period which expired in June 1966;
- C. Commodities for which free trade depended either on special protocol to regulate regional commerce or on the achievement of tariff equalization; and
- D. Products subject to restrictions by national legislation for an indefinite period.²

Two hundred fifteen commodities (72.4 percent of all agricultural products) had immediate free trade by 1961 under the provisions of the General Treaty. The transitional period affected 55 products (18.5 percent of the total), of which the more important ones were fresh meat, fresh and processed milk and cream, eggs, lumber and vegetable oils and fats.

When the transitional period ended in 1966, the four categories were reduced to two--commodities exempted from free trade for an indefinite period, and those for which free trade depended on the enactment of a special regulatory protocol or on the achievement of tariff equalization.

²A detailed account of the evolution of trade flows in the four product categories during the 1960-66 period can be found in SIECA, El Comercio Regional de los Productos Agrícolas en el Mercado Común Centroamericano, (SIECA/69/V-4/40), Mayo de 1969.

The 1965 Special Protocol for Basic Grains (Limón Protocol), which became effective in October 1967, established the conditions for free trade in corn, rice, beans and sorghum. At present, only trade in wheat, wheat flour, tobacco, tobacco products and cane sugar depends on special protocols. In the case of wheat and its bi-products, protocols must regulate trade, equalize existing tariffs and regulate imports from non-member countries. Tobacco and tobacco products trade is restricted only between Costa Rica and the remaining member countries. The removal of this restriction, however, requires the enactment of a regional agreement to regulate and coordinate production, price and import policies. Free trade in cane sugar is dependent on the adoption of a special protocol to coordinate foreign trade policies.

Free trade restrictions on a regional or multilateral basis for an indefinite period cover most of the main export products in their processed and unprocessed forms--cotton, coffee, beef cattle, and cheese and curd. Many of these have free trade between two or more countries, but not among all of them.³ Trade restrictions include a variety of mechanisms such as import quotas or import and export taxes.

In short, 90.9 percent of all agricultural commodities had free trade in the Central American Common Market by 1969. The remaining 9.1 percent (mainly the more important export crops and a few domestic market commodities) represent slightly above

³For a detailed account of particular inter-country restrictions to free trade, see: SIECA, Op. cit.

13 percent of the value of intraregional trade in agricultural commodities which in 1968 reached \$64.2 million.

All capital goods for agriculture have free trade and a common external tariff against non-member countries. In 1968, the value of trade among the Central American countries in these capital inputs was close to \$13.0 million.⁴

Regional Coordination of Production and Import Policies

Regional coordination of agricultural production and import substitution programs has been limited to the four basic grains and dehydrated milk products. Provisions for the coordination of these policies stem respectively, from the Limón Protocol and the special dispositions concerning powdered milk products of the 1962 Protocol to the Central American Agreement of Tariff Equalization (San José Protocol).

The 1965 Limón Protocol (effective 1967) was designed to establish and regulate free trade in rice, beans, corn and sorghum within the Central American Common Market. It also involved: (a) coordinating production and supply policies; (b) coordinating marketing and price support programs; and (c) limiting the volume of basic grain imports from non-member countries through quotas. To administer and enforce such agreements, the Protocol created a Central American Marketing and Price Stabilization Commission (CCMEP) under the Central American Economic Council. The

⁴ SIECA, Anuario Centroamericano de Comercio Exterior, 1968 (Guatemala, 1970).

executive directors of national price stabilization agencies serve as ex-officio members of this Commission.

At present, none of the Central American countries have been able to comply with all of the stipulations of the Limón Protocol. Although an adequate regulatory instrument, it has failed to fulfill its original purposes⁵ because of both substantive and operational constraints. Coordination of production policies assumes that national policies conform to regional goals and guidelines for production. At present, the absence of a regional agency with the responsibility and the authority to coordinate agricultural planning together with the lack of an adequate enforcement mechanism make the coordination of production policies virtually impossible.

The CCMEP has the formal responsibility for coordination of production policies but no authority over regional planning, and only limited authority over planning and coordination of production policies at the national level. Coordination of policies at the regional level would require the participation of policy makers of the various national agencies. The present structure of the Common Market does not allow for this.

Regional coordination of marketing policies has been hampered by the failure of the CCMEP to design a harmonious system of price supports. The inability of various countries to extend the coverage of their marketing and price support programs has been

⁵A conclusion reached by the Special Commission on Agricultural Policy of the Meeting of Ministers of Economics (Economic Council). See Acta del Segundo Periodo de Sesiones (SIECA/GT-RMECA-III/DI 35) Octubre 1970.

an additional adverse factor. Nevertheless, significant advances have been made in establishing a regional grain storage system with funds allocated by the Central American Bank of Economic Integration (BCIE). Likewise, a plan for the establishment of a regional financial fund for the support of national marketing programs is in its final stages.⁶

Regional efforts have been more successful with contingency import quotas for basic grains, although import quotas are still not always in agreement with existing market conditions. National marketing agencies can import basic grains under tariff franchises when regional supplies of comparable quality and price are not available. The CCMEP stipulates that national agencies must pay the national treasury a total sum equal to the price differential between the c.i.f. warehouse price of the shipment and the corresponding support price in the country. Private individuals may import basic grains subject to the regional tariffs. Given existing levels of protection, this is tantamount to an internal monopoly by the price stabilization agencies.⁷

⁶ See: SIECA, Informe del Banco Centroamericano de Integración Económica sobre el Estado de Avance del Programa Regional Silos (SIECA/GT-RMECA-III/DI 25), Octubre de 1970. SIECA, Informe sobre el Estado Actual y Perspectivas de la Solicitud que Han Presentado los Gobiernos al Programa Mundial de Alimentos de las Naciones Unidas para Constituir un Fondo Centroamericano de Regulación de Precios de Granos Básicos (SIECA/GT-RMECA-III/DI 26), Octubre de 1969. SIECA, Proyecto de Reglamento del Fondo Centroamericano de Regulación de Precios de Granos Básicos (SIECA/BCIE/GAFICA/GT-III/D.T. 31), Octubre de 1970.

⁷ A more detailed analysis of the application of the Limón Protocol which also summarizes the existing documentation on this

Coordination of production and import policies also concern dehydrated milk products. To arrive at a uniform tariff structure providing incentives for import substitution without detrimental effects on regional availability, a system of import quotas tied to the evolving plant and production capacity was agreed upon. Tariff equalization was stipulated through the 1962 Protocol to the Central American Agreement on Tariff Equalization. Uniform tariffs (10 percent ad-valorem and \$0.15 per gross kilogram) were reached progressively during a five-year period beginning in 1964. The first quota went into effect in 1969 and the third one, corresponding to 1971, has been negotiated. These annual import quotas are determined by the Economic Council for member nations with surpluses distributed according to past and projected internal consumption and past and actual plant production capacity. Price levels are regulated. The 1962 Protocol includes a detailed system of import licenses and registration. Funds for new plants were made available through the Integration Bank. A technical commission to aid the Executive Council in determining import quotas is being established at present. Dehydrated milk and basic grains constitute the only instances where regional action concerning production coordination based on existing treaties and agreements has been undertaken.

topic is found in: SIECA, Analisis de los Problemas que se Enfrentan en la Aplicación del Protocolo Especial sobre Granos (SIECA/GT-RMECA-III/DT 14), Octubre de 1970; and SIECA, Analisis del Status Actual de los Programas de Estabilización de Precios en Centro-america (SIECA/GT-RMECA-III/DI 24), Octubre de 1970.

Other Areas of Regional Policy and Economic Cooperation

Functional (as opposed to formal or legal) coordination stems from:

- A. Administrative necessities and resolution of conflicts that arise within the common market; and
- B. Operations and initiatives taken by regional agencies.

In the former case regional action constitutes a response to preserve the ongoing system (i.e., free trade or tariff equalization); in the latter, it represents the seizure of opportunities to further economic integration and development.

Classification of market reporting and information services for basic grains, sanitary legislation for vegetable and livestock products, and production, classification and certification of improved seeds falls within category A. This uniform classification, however, has yet to be formally adopted.

Economic integration agencies have ventured into many other areas of policy coordination but with limited success. The Joint Planning Mission (SIECA, OAS, Inter-American Development Bank) established in 1964 was the first attempt to coordinate economic planning and programming and to incorporate regional guidelines in national development efforts. While the Mission was successful in developing and strengthening national and sectoral planning offices, it failed to integrate regional and national development efforts, due to the reluctance of both national planning agencies

and national governments to cede their prerogatives. The Joint Planning Mission was absorbed by SIECA as its Development Division in 1967.

A Central American Program for Fishery Development was established in 1967 as a joint program between the Common Market nations and the United Nations Special Development Fund (UNDP) under a direct contract between UNDP and the Economic Council. The Program is directed by a Central American Fishery Commission which, in practice, is totally separated from the main integration agencies and programs.

A permanent Commission of Agricultural Research and Extension, established in 1966, was recognized by the Economic Council as an advisory body with SIECA as its Secretariat. However, none of its recommendations have been considered because of the conflict of authority between the Ministers of Agriculture, who control the implementation of agricultural research and extension policies, and the Ministers of Economics, who as members of the Economic Council constitute the highest authority on economic integration policy. Since the enactment of the General Treaty in 1961, the Ministers of Agriculture and the Economic Council have had only one joint meeting (in 1965, for the adoption of the Limón Protocol) to discuss economic integration policies in agriculture. In 1968, the Ministers of Foreign Relations created a Central American Agricultural Council whose members are the Ministers of Agriculture. However, this council has never functioned due to legal questions concerning its legitimacy since, according to the General Treaty, the Economic Council is the supreme authority in the Common Market.

These cases illustrate some of the notable obstacles of the existing institutional structure to a common or coordinated agricultural policy. However, member countries have participated in coordinating policies in other areas. For instance, in 1968, SIECA and the Central American Integration Bank (BCIE) established a regional program for the development and promotion of non-traditional export products to be funded by the BCIE. In 1971, for the first time, the BCIE began to finance agricultural investment within the Common Market.

SIECA has also been active in promoting the main agricultural exports of Central America in international markets where ad-hoc agencies do not exist, such as banana exports to the European Economic Community and beef and sugar cane import quotas to the United States, to name two examples. Considerable advances have also been made in coordinating foreign assistance to the Central American countries and in influencing credit policies by international financing agencies.

Thus, it is evident that although integration agencies have been active, concrete realizations have concentrated on internal free trade and a uniform protective tariff against non-member countries.

PART II — THE EVOLUTION OF AGRICULTURAL TRADE IN THE COMMON MARKET⁸

The enactment of the General Treaty in 1961 and the process of tariff equalization had a decisive influence in expanding trade

⁸This section and the following one are largely based on information contained in SIECA, Patrones y Tendencias del Comercio

and market demand for agricultural products in the five Central American nations. Regional agricultural trade increased from \$8.6 to \$17.5 million between 1955 and 1961. By the end of the transitional period of trade liberation in 1966, agricultural trade rose to \$46.3 million. In 1968, when 91 percent of all agricultural commodities had complete mobility and 99 percent, a common protective tariff, agricultural trade reached \$64.2 million. Between 1960 and 1968, regional agricultural trade grew at an average annual rate of 18 percent, manufactured goods at a 30 percent annual average. In consequence, the proportion of agricultural commodities within total intraregional trade declined from 40.9 to 25.4 percent between 1960 and 1968. This is a reflection of the increasing industrialization induced by the Central American Common Market. Industrialization is also evident in intraregional agricultural trade. Trade in agricultural processed commodities grew at an annual average rate of 23 percent per year in the 1960-68 period while the corresponding rate for unprocessed commodities was 15 percent annually. By 1968, processed commodities represented half of the total trade in agricultural products.

de Productos Agrícolas en el Mercado Común Centroamericano y su Relación con el Comercio Exterior (SIECA/GT-RMECA-III/D.T. 28/Rev. 1), Octubre de 1970. This document, which represents a more detailed study of intraregional trade in agriculture, was elaborated under the responsibility and supervision of the author in his capacity as Chief of the Agricultural Development Section of SIECA. Because of this connection, the document utilized the methodology and most of the information originally developed for this paper.

Agriculture and livestock products represented 62.4 and 29.8 percent respectively of the total sectoral trade in 1968. Forestry and fishery products jointly represented 8.3 percent in that year. Since 1965, processed products have dominated intraregional trade in the livestock subsector of agriculture. At present, half (49.6 percent) of the total trade in agricultural products are unprocessed commodities originating in the agricultural and livestock subsectors, while 42.1 percent are processed products of these two subsectors.⁹

Basic grains constitute the single most important item in intraregional trade, despite the fact that the Central American economies are highly competitive in these commodities. In 1968, trade in basic grains reached a value of \$13.8 million, representing 21.5 percent of the total trade for that year. Edible fats and oils--a processed product--is the second most important regional agricultural trade item with a value of \$12.3 million in 1968. These two commodity groups represent 40.5 percent of the 1968 value of agricultural regional trade. All other commodities have trade values much inferior to those of basic grains and fats and oils. Basic grains, fruits, and vegetables, commodities that typically originate in the small farm sector, are actively traded within the common market. In 1968, their trade value reached

⁹All the above figures are from SIECA, Patrones y Tendencias . . . Ibid., Table 11.

\$22.8 million and represented 35.5 percent of the total trade in agricultural commodities.¹⁰

The basic pattern of intraregional trade consists of two interlocking poles--Guatemala, Honduras and El Salvador on the Northern side, and El Salvador, Nicaragua and Costa Rica on the Southern side. This "triangulation of trade" within the Common Market is also demonstrated by agricultural trade flow. In the 1965-68 period, the Northern triangle countries accounted for 64.5 percent of the total intraregional agricultural trade (76.3 percent in 1960-64), while the Southern triangle represented 21.8 percent (19.4 percent in 1960-64). The relative decline in the proportion of the total agricultural trade of the Northern triangle has been due largely to the rapid increase in trade between Nicaragua and Costa Rica (in the Southern triangle) and the relative decline in trade between El Salvador and Honduras (in the Northern triangle). Reciprocal trade among the outermost countries (Guatemala - Honduras and Costa Rica - Nicaragua) represented only 13.7 percent in this period, however. (See Table 2.1)

This phenomenon can be explained by the physical location of the bordering Northern countries and the distance that separates them from their common market partners to the south. Also, Guatemala, Honduras and El Salvador had established informal economic relations long before the formation of the Common Market and were first to engage in free trade under the bilateral trade

¹⁰Ibid., Table 1.4. See this Table for more complete figures.

Table 2.1

Central America: Bilateral Flows in Intraregional
Trade of Agricultural Products,
1960-64 and 1965-68

Percentages Based on c.i.f. Values

<u>Bilateral Trade</u>	<u>1960-1964</u>	<u>1965-1968</u>
Guatemala - El Salvador	24.3	25.1
Guatemala - Honduras	10.4	11.2
Guatemala - Nicaragua	1.5	3.5
Guatemala - Costa Rica	0.9	4.1
El Salvador - Honduras	41.6	28.2
El Salvador - Nicaragua	8.7	6.6
El Salvador - Costa Rica	6.4	5.4
Honduras - Nicaragua	0.9	2.0
Honduras - Costa Rica	1.0	4.1
Nicaragua - Costa Rica	<u>4.3</u>	<u>9.8</u>
Total Central America	100.0	100.0

Source: SIECA, Patrones y Tendencias del Comercio de
Productos Agrícolas en el Mercado Común
Centroamericano y Su Relación con el Comercio
Exterior (SIECA/G.T.-RMECA-III/D.T. 28/Rev 2),
Table 3.3, p. 49.

agreements of the 1950's. This is an economic advantage not shared by Nicaragua and Costa Rica.

In considering the geographic orientation of agricultural trade flows for the 1960-64 and 1965-68 periods,¹¹ the most notable change has been the considerable decline of exports to El Salvador by the four remaining countries. Otherwise, only the proportion of Guatemalan exports to Honduras has declined in any appreciable degree. All other bilateral trade flows have increased, most notably between Nicaragua and Costa Rica.

A country by country breakdown follows:

Guatemala: The best markets for Guatemala's exports are El Salvador and Honduras (57.0 and 25.8 percent of the country's exports respectively). Guatemala shows a tendency to expand its exports to Nicaragua and Costa Rica.

El Salvador: The main market for Salvadorian products are Honduras and Guatemala (43.7 and 38.7 percent of its exports respectively). El Salvador's exports to Costa Rica and Nicaragua are fairly static.

Honduras: Sixty-one and two-tenths percent of Honduras' exports are shipped to El Salvador; an additional 24.7 percent to Guatemala. Honduras' exports to Nicaragua and Costa Rica have increased considerably their relative importance since 1960-64.

¹¹Ibid., Table 1.5, p. 15.

Nicaragua: The main market for Nicaraguan exports of agricultural commodities is Costa Rica (42.4 percent of the total). El Salvador imports an additional 31.8 percent of this country's export trade.

Costa Rica: This country shows the greatest geographic dispersion in its regional trade of agricultural commodities. However, Nicaragua and El Salvador absorb 40.1 and 24.7 percent of the country's exports. The remaining 25.1 percent is divided equally between Guatemala and Honduras.

Thus, we see a grid of strong bilateral trade flows among member countries. Strongest among these are the currents between Guatemala and El Salvador, El Salvador and Honduras, and Costa Rica and Nicaragua.

Table 2.2 shows the relative importance of individual countries as intraregional agricultural exporters and importers for selected years. Guatemalan and Costa Rican exports have risen since 1960; El Salvador's have declined since that time and Honduras' likewise since 1962. The main exporting countries in 1968 were Guatemala, Honduras and El Salvador.

Honduras and Nicaragua have been increasing their imports since 1960, Costa Rica, since 1965. El Salvador has been decreasing regional imports since 1962, and Guatemala, since 1965. The main import markets for Central American agricultural products are El Salvador, Costa Rica and Honduras.

Table 2.2

Central America: Structure of Intraregional Trade
of Agricultural Commodities by
Countries, Selected Years 1960-68

Percentages Based on c.i.f. Values

Country		1960	1962	1965	1968
Guatemala :	Imports	16.6	11.4	18.9	11.1
	Exports	15.2	17.7	21.3	29.0
El Salvador:	Imports	52.3	62.5	49.7	39.3
	Exports	29.9	23.6	20.7	18.6
Honduras :	Imports	12.1	10.2	14.6	15.6
	Exports	35.0	46.7	42.3	26.1
Nicaragua :	Imports	4.3	7.7	8.1	14.0
	Exports	17.3	9.3	7.2	14.5
Costa Rica :	Imports	14.6	8.1	8.5	20.0
	Exports	2.6	3.4	8.4	11.8

Source: SIECA, Patrones y Tendencias del Comercio de Productos Agrícolas en el Mercado Común Centroamericano y Su Relación con el Comercio Exterior (SIECA/G.T.-RMECA-111/D.T. 28/Rev 2), Table 2.1, p. 24.

Agricultural trade balances for the five Central American countries for the period 1960-1968¹² show that Guatemala has maintained a generally favorable position; since 1965, however, the tendency has been to accumulate increasing surpluses. El Salvador has had a deficit since 1960, stabilizing at the 1964 level. Like Guatemala, Honduras' trade balance has been favorable, but since 1964, with a declining size of trade surplus. Nicaragua has maintained a balance. Except for the 1963-65 period, Costa Rica has had a deficit; since 1966, its negative trade balances have increased.

The foregoing analysis demonstrates that formation of the Central American Common Market has resulted in an expansion of the regional market for agricultural products and in a normalization of supply over time and space. These two factors have contributed to the relative stability of price levels in this period of rapid economic growth. The growth and increasing proportion of processed agricultural products in intraregional trade provides indirect evidence of the impact of the Common Market on the industrialization of agricultural production. Bilateral trade flows show that considerable changes have resulted from country adjustments to supply and demand conditions, which, however, have not been strong enough to change the basic "triangulation of trade" pattern.

¹²Ibid., Table 4.1, p. 55.

PART III THE EFFECTS OF THE COMMON MARKET ON AGRICULTURAL
 PRODUCTION AND EXTERNAL TRADE

Intraregional Trade and Export Diversification

Central American countries need to diversify their agricultural exports abroad and to increase foreign exchange receipts, particularly those paid in hard currencies.

Since the production of major export crops is so large relative to the internal market, it is likely that intraregional trade in these commodities has little influence on exports to world markets. The case is not so clear for non-traditional export commodities.

The existence of a larger regional market may help to integrate supply areas and to stimulate the creation of marketing channels and institutions for non-traditional exports. Thus, when internal prices do not limit exports, regional pooling of agricultural commodities may overcome the standardization and volume requirements typical of international transactions. In the longer run, if unfavorable internal prices present a barrier to exporting, trade and production specialization may overcome such a limitation.

In addition, free trade can make specialized production more feasible. Countries can commit resources to the production of new exportable commodities while relying on the regional market to supply other commodities, or even to make up the deficit of the products being exported. Also, the larger market can absorb, with less risk of a severe price decline, the sizeable surplus

of agricultural produce that does not normally meet export standards. Indirectly, the process of industrialization inherent in the Common Market may increase the range of goods available for export or increase the value added in exportable agricultural commodities.

Thus, in the context of the Central American economies, the Common Market may well be a necessary condition for the diversification and encouragement of non-traditional exports.

In addition, the positive effects of integration on incomes and on internal demand may create competition between internal consumption and exports abroad. In the short run, this will result in either a decline in intraregional trade or in a decline in exportable surplus. It can be hypothesized that intraregional and foreign trade for non-traditional commodities is complementary if these two flows are positively related, and competitive if the reverse is true. They are independent if no correlation exists between these flows. Different degrees of complementarity and competitiveness can be ascertained from the value of the correlation coefficient as it varies from its limits of plus one and minus one.

It can be observed (Table 2.3) that of the 19 products selected whose value of trade averaged \$21.5 and \$57.5 million annually in 1966-68, 13 were complementary, four were relatively independent and only two were competitive. Among highly complementary products, only tobacco products and feed are processed commodities. The economic significant of the complementarity in rice is nil since

Table 2.3

Central America: Correlation Between Intraregional and Rest of the World Exports of Non-Traditional Agricultural Commodities, 1960-1968^a

<u>Type of Association</u>	<u>Correlation Coefficient</u>	<u>Significance Level of r^b</u>
<u>I. Complementary</u>		
1. Tobacco Products	0.878	99.5
2. Ornamental Plants and Flowers	0.870	99.5
3. Rice	0.784	99.0
4. Raw Hides	0.728	97.5
5. Tobacco	0.675	95.5
6. Fresh Shellfish	0.640	95.0
7. Animal Feedstuffs	0.622	97.5
8. Spices	0.561	90.0
<u>II. Relatively Complementary</u>		
1. Citrus Fruits	0.479	89.0
2. Natural Honey	0.479	86.0
3. Vegetable Oils	0.459	85.0
4. Lumber Planks	0.424	97.5
5. Edible Nuts	0.311	85.0
<u>III. Relatively Independent</u>		
1. Natural Glues and Resins	0.136	65.0
2. Other Flowers and Plants ^c	0.101	95.5
3. Oil Seeds	0.025	99.5
4. Processed Fruits	0.000	99.5
<u>IV Relatively Competitive</u>		
1. Timber	-0.461	87.0
2. Finished Lumber ^d	-0.287	97.5

Source: SIECA, Patrones y Tendencias ..., Table 7.9, p. 97 (Revised).

a: Includes only those commodities whose value of extra-regional exports exceeded \$200,000 in 1968.

b: The correlation coefficients for products in Classes I, II, and IV were tested under the null hypothesis that they were not significantly different from zero.

c: For medicinal or perfumery uses.

d: Excluding furniture.

exports made outside the area were heavily subsidized. Complementarity is also very high in fresh fishery products, tobacco, ornamental plants, flowers, and raw hides.

All commodities in the moderately complementary groups are processed products. The commodities that were found to be relatively independent are all highly specialized products, those for which the internal market is very small, or by-products of major export crops.

Competitive products are unprocessed lumber and finished lumber--a raw material and a finished product--for which internal demand is very strong.

Thus, there is a substantial degree of complementarity between intraregional trade and non-traditional exports to the rest of the world. In addition, complementary commodities represented over 65 percent of the value of non-traditional exports to the rest of the world during the 1966-68 period.

Import Substitution in Agricultural Products

Given the rapid growth in population and GNP, a constant or declining import rate from the rest of the world can imply, though crudely, import substitution--provided that the commodity or commodities in question are not being eliminated from consumption. Under these assumptions, even a positive rate of growth in imports can be taken as evidence of substitution as long as intraregional trade is growing at a faster rate. Accordingly, the rate of growth in the volume of intraregional trade in agricultural products

(24.0 percent annually) more than doubled that of imports from abroad (10.4 percent).¹³ However, this method of measuring import substitution is not directly related to either consumption or production, and may simply mean that needs are being satisfied through internal production, not necessarily that imports are being replaced by regional production.

A second measure frequently used to detect import substitution is the ratio of imports to GDP. This aggregate index has the shortcoming of assuming a constant marginal propensity to import and incorporating trade creation effects as well. Import-GDP ratios have declined from 6.3 to 4.4 percent for processed agricultural products (excluding wheat flour) between 1960-64 and 1965-68. (See Table 2.4) Nevertheless, the ratios corresponding to unprocessed agricultural products (excluding wheat) have increased from 0.8 to 1.2 percent over the same period. Thus, it can be inferred that import substitution has taken place in processed agricultural commodities but not in unprocessed ones.¹⁴ This

¹³Computed from official trade statistics according to the PATYEB classification. The corresponding growth rates for value were 17.6 and 6.9 percent per year for intraregional trade and foreign imports, respectively.

¹⁴These results are in general agreement with the prior ones showing that the growth rate in the volume of intraregional trade in processed commodities is four times larger than the growth of imports from outside the common market area (18.9 vs 5.0 percent annually) while in unprocessed commodities, the rate of growth in intraregional trade is only 1.4 times faster than that of imports from abroad (27.5 vs 18.7 percent per year).

Table 2.4

Central America: Value of Extraregional Imports as a Proportion
of Gross Domestic Product, 1958 and 1960-1968

Percentages

Year	Agricultural Commodities						Non Agricultural Commodities	Total
	Unprocessed 1		Processed 2		Total 3		4	5
	A	B	A	B	A	B		
1958	1.5	1.1	12.8	9.5	4.3	3.2	27.6	19.6
1960	1.4	0.8	10.9	7.9	3.9	2.7	25.5	18.5
1961	1.6	0.7	9.0	6.7	3.6	2.3	23.4	16.9
1962	1.6	0.9	8.0	5.9	3.5	2.3	22.9	16.7
1963	1.6	0.7	7.7	5.9	3.4	2.2	25.1	18.2
1964	2.1	1.1	6.9	4.5	3.6	2.4	27.1	19.9
1965	2.4	1.2	6.1	4.4	3.6	2.4	27.3	20.3
1966	2.5	1.4	5.8	4.4	3.7	2.6	24.1	18.8
1967	2.5	1.0	5.1	4.5	3.4	2.3	24.9	19.3
1968	2.6	1.1	4.3	4.4	3.2	2.2	22.2	17.4
1960-64	1.7	0.8	8.5	6.3	3.4	2.4	28.8	18.0
1965-68	2.5	1.2	5.3	4.4	3.5	2.4	24.6	18.9

Source: Author's Ph.D. thesis, "Agricultural Development and Economic Integration in Central America" (Department of Agricultural Economics, University of Wisconsin, Madison, 1971), Tables A-9 and A-26.

1: To express imports as a proportion to GDP, the following aggregate output estimates were utilized: Agricultural GDP for Column (1); the combined GDP in Agriculture and in Manufacturing Industry for columns (2) and (3) and Total GDP minus its agricultural component for column (4). Total GDP for all economic sectors was used in column (5).

A: Including wheat and wheat flour in the corresponding class.

B: Excluding wheat and wheat flour in the corresponding class.

tendency remains even when wheat and wheat flour imports are included in the ratios (Column A).

The tendency toward import substitution is proportionally much greater in processed agricultural commodities than in industrial production, possibly reflecting industrialization induced by the Common Market, where the foreign component in industrial production is much greater in non-agricultural products than in the agricultural ones.

Table 2.4 also shows the high degree of self-sufficiency in agricultural and food production that the Central American countries have sustained. In the 1965-68 period, food imports represented only 1.2 percent of the agricultural GDP; non-agricultural imports represented 24.6 percent. (Wheat and wheat flour imports constituted 31.0 percent of the total volume of agricultural imports from abroad).

The measurement of import substitution becomes more meaningful when applied to individual commodities or commodity groupings. Measuring the relative participation of these trade flows in the total regional import trade gives an index of trade displacement and reflects the process of import substitution.

When such an index was applied to the most important commodities included in the DATTIER classification for agricultural products, it was found that the regional component in total agricultural trade tended to increase for all products, with the exception of corn, beans and agricultural feedstuffs. Between 1960-64

and 1966-68, the foreign component in the total imports increased from 57.2 to 75.2 percent for corn; from 2.4 to 5.1 percent for beans; and 41.3 to 67.0 percent for feedstuffs.¹⁵ Corn and beans are the single most important commodities produced by the traditional small farm sector; corn is the most important raw material in feedstuffs. Hence, the growth of the foreign imports of these commodities is a reflection of the production effects on the small farm sector.

A third and more refined index of import substitution is the foreign component in consumption. This index has the limitation of requiring time series estimates of internal consumption, which are available for only a limited number of commodities in Central America. Decline in the foreign component for consumption of rice, fresh fruits and vegetables, potatoes, tobacco and margarine indicates that import substitution has taken place. The rapid substitution of rice imports by regional production is largely due to the emergence of largescale commercial production. This index also indicates dependency on foreign imports to meet the growing demand for corn and beans.¹⁶

In short, these indices indicate that the Central American Common Market has induced an appreciable degree of import substitution in agricultural products. As a result, agricultural

¹⁵ Author's Ph.D. thesis, "Agricultural Development and Economic Integration" (Department of Agricultural Economics, University of Wisconsin, Madison, 1971), Table A-28, based on material in SIECA, Patrones y Tendencias ..., op. cit.

¹⁶ SIECA, Patrones y Tendencias ..., op. cit., Table 5, p. A 15.

imports have been almost static around \$66.5 million annually from 1966 to 1968, after having increased consistently in previous years.¹⁷ The tendency toward import substitution seems to be stronger for processed agricultural commodities, a result inherent in economic integration and development. Nevertheless, product indices coincide in their indication that substitution has also occurred in rice, tobacco, potatoes, and fresh fruits and vegetables.

On the basis of these product indices and specific studies on internal demand and supply conditions of particular commodities conducted by SIECA and ICAITI, it is possible to determine the potential for import substitution in agriculture. (See Table 2.5) It can be deduced from this table that half of the value of agricultural imports in the 1966-68 period is made up of commodities that are feasible to substitute by regional production.

Tendencies Toward Production Specialization

The lack of more complete statistics on agricultural commodities in regional trade forces the use of relatively simple indices to determine specialization induced by free trade and tariff protection. Two estimators were devised. First is an index of net intraregional exports of a particular country for a given commodity relative to the total regional trade for that commodity.

¹⁷ See author's Appendix, Table A-27, op. cit. This plateau in agricultural imports coincides with the beginning of the consolidation period of the common market in 1966.

Table 2.5

Central America: Margins and Feasibility for Import
Substitution in Agricultural
Commodities

Products and Average Annual Values of
Extraregional Imports in 1966-68

<u>Margin and Feasibility</u>	<u>Millions of Dollars</u>
I. <u>High Margin High Feasibility</u>	<u>16.7</u>
Edible Fats and Oils	4.8
Rice	2.6
Raw and Tanned Hides	2.5
Feedstuffs ^a	2.2
Corn	1.9
Processed Fruits	1.6
Tobacco and Tobacco Products	1.1
II. <u>High Margin Medium Feasibility</u>	<u>9.9</u>
Dehydrated Milk Products	7.8
Feedstuffs ^b	2.1
III. <u>Medium Margin High Feasibility</u>	<u>2.5</u>
Meat Products	0.9
Processed Vegetables	0.9
Finished Lumber	0.7
IV. <u>Medium Margin and Feasibility</u>	<u>3.8</u>
Vegetable Fibers	1.8
Fresh Fruits	1.0
Spices	1.0
V. Total	<u>32.9</u>

Source: Import Substitution Indexes, Table A-26 (author's Ph.D. thesis, "Agricultural Development . . .," op. cit., and Specific Studies by Product.

a: Of vegetable origin.

b: Animal by-products.

Assuming no leakages (i.e., imports from abroad that filter directly or indirectly into regional trade), a country's share of net exports within an expanding trade flow growing at a faster rate than the flow itself constitutes evidence of production specialization. This indirect measure is called the "net trade index."

The second index involves the ratio of total exports to the regional market of a commodity by a given country to the commodity's internal production. The advantage of this "production index" is that it may detect production specialization even if the country is not a net exporter of the particular commodity.

These two indices were applied to the pertinent data for the countries in Central America. Since production data were unavailable for all the commodities recorded, the absence of any particular commodity does not necessarily mean a discrepancy due to the nature of the indices. Second, given the existing triangulation of trade patterns, two or more countries may show tendencies to specialize in the same commodity. Third, the products included are those for which the indices show a consistent upward trend through 1960-69, excluding products where specialization is more recent. Fourth, the commodities are those for which the indices represent tendencies only; thus, they do not establish order or magnitudes either among countries or among products. Finally, the countries and products listed are those showing tendencies that are significant at the regional level. Consequently, it excludes some of the

specialization tendencies originating from strong bilateral trade flows.¹⁸

Both production and trade indices are consistent in identifying specialization tendencies. Combining their results shows that Guatemala and Costa Rica tend to specialize in the production of vegetables for the regional market due to favorable ecological conditions.

Nicaragua and Guatemala, the two largest cotton producers in Central America, seem to be expanding markets for cotton by-products (cotton seed). Guatemala also appears to be industrializing fresh vegetable output since it also tends to specialize in processed vegetable and vegetable oil production.

With optimum ecological conditions for bean production, Honduras tends to specialize in its regional export (with some degree of specialization in neighboring Nicaragua and El Salvador). Honduras also specializes in bananas, probably for internal consumption in El Salvador and Nicaragua.

Costa Rica's highly developed dairy industry yields a dehydrated milk specialization for export. Both Costa Rica and El Salvador specialize in margarines and vegetable fats; however, El Salvador utilizes internal supplies of cottonseed while Costa Rica imports

18

For a more detailed analysis which overcomes some of the limitations mentioned above, the reader should refer to the text and the data results contained in the original document; SIECA, Patrones y Tendencias ..., op. cit.

its supplies to complement its growing production of African palm oil.¹⁹

El Salvador is the only country specializing in poultry exports for the regional market. Nicaragua produces eggs along with El Salvador.

In general, it can be concluded that in spite of the high degree of competitiveness of the agricultural economies of Central America, the formation of a common market has induced production specialization and a consequent complementation of regional supplies in a considerable number of commodities and countries.

PART IV CONCLUSION: SOME POLICY PROBLEMS AND ISSUES

As we have seen, the Common Market has induced an appreciable process of production specialization in certain agricultural commodities. However, within the existing structural and functional organization of the agricultural sector, specialization in the larger regional market has created many problems by removing traditional limitations that kept large-scale commercial enterprises confined to export crops. These factors, together with changes in relative prices that favor domestic production, have induced large-scale producers to compete in the domestic market with a technology that is not available to the small farm sector. The industrialization of agriculture induced by the common market has given rise to direct connections between processing plants and large-scale producers,

¹⁹This information is shown very clearly from the behavior of bilateral trade flows.

bypassing small farms lacking technology and resources to meet the requirements for industrial processing. This has resulted in a takeover of some of the traditional sector by large-scale agriculture in the domestic market. In this manner, the formation of the Common Market has intensified existing economic polarization in the organization of agriculture.

The Common Market has also been affected by these changes. For instance, in 1968, the emergence of a rice industry in El Salvador threatened to disrupt the internal markets in Costa Rica and Nicaragua, resulting in the interruption of free trade and inducing retaliation measures on the part of El Salvador. The development of the poultry industry in that same country adversely affected Honduras. Similar conflicts of interest have affected trade flows between Nicaragua and Costa Rica.

These cases illustrate some of the recent problems in the Common Market with temporary or persistent regional surpluses due to lack of regional coordination and planning of production and marketing policies. This inability to coordinate agricultural policies stems in part from the existing institutional organization of the Common Market and in part from the existing economic structure in Central American nations where the domestic market sector is neglected by implicit public agreement. Hence, even when these agricultural policies are coordinated, their implementation is often hampered by lack of financial resources, political will, or by the interplay of vested interests.

These developments were not so much the result of the implementation of public policy in the pertinent areas as they were the outcome of market forces operating under the inducement of free trade and tariff equalization. In this situation, some unfulfilled opportunities and even some detrimental effects have become apparent, such as stagnation in some countries of certain industries unable to meet regional competition and the tendency for the appropriation by large-scale commercial agriculture of many market opportunities at the expense of the small farm sector. Likewise, ample margins for import substitution and production complementarities remain after almost a decade of integration. This is largely due to the virtual absence of a regional policy or institutional organization directly linking the process of economic integration with that of agricultural development.

Various factors can be cited to explain the absence of an institutional structure for the design of a regional agricultural policy and its implementation. Since the common market stage of integration entails only free trade and tariff equalization, common agricultural policy has been limited to those measures that would ensure product mobility among member nations. Likewise, institutions designed to administer the regional movement were more capable of dealing with the problems of industrial development than with those of agriculture.

Factors operating at the national level also have an important bearing on these issues. The general weakness and diffuseness of domestic market policy for agriculture in member nations inhibited

the design of a more comprehensive regional policy. Similarly, the large number of agencies with responsibilities for the formulation and implementation of agricultural policy made it difficult to establish a more complete and functioning organization at the regional level.

One of the failures of regional policy was its inability to establish direct linkages between agricultural development and economic integration. Common market problems are mainly trade problems that generate policy measures conceived within a competitive, efficient commodity approach to development. These procedures tend to result in policies which largely circumvent the basic issues of agricultural development, i.e., questions of employment, income distribution, and the democratization of economic opportunities. Indeed, these broader development problems, while common to all countries, seldom arise as common market issues in spite of their crucial importance and ultimate bearing on common market problems.

Nevertheless, these basic development problems become central to regional policy if a more advanced stage of economic integration, as envisioned by Resolution 44 of the Economic Council (labor mobility) or the General Treaty (economic union), is to be reached. Considering these objectives, it is not premature to bring the basic issues of agricultural development into the realm of regional policy.

This was officially recognized at the meetings of the Ministers of Economics (i.e., the Economic Council) which took place from

September to December of 1970. At that time, a modus operandi was sought for an immediate plan of action to counterbalance the economic, institutional and political anomalies created by the 1969 conflict between Honduras and El Salvador. Furthermore, the modus operandi agreements would restore the institutional functioning of the common market while a more complete plan for restructuring the entire economic integration movement was developed.

The agreements prescribed programs dealing with:

- 1) Perfecting the common market for agricultural products so as to guarantee free trade within the region;
- 2) Development and training of human resources and the balance between population and other available resources;
- 3) Adoption of a common commercial policy toward non-member countries and other economic blocks;
- 4) Coordination of national economic and social development programs in agriculture, according to the principle of balanced growth;
- 5) Technification of agriculture and the encouragement of internal and extraregional trade so as to provide a more adequate utilization of human and natural resources;
- 6) Increase in income and employment levels and the improvement of living conditions in the rural sector;
- 7) Harmonization of economic incentives and legislation concerning agricultural development;

8) Creation of an institutional structure and mechanisms to coordinate, implement and evaluate the regional agricultural policy.²⁰

They also proposed the establishment of an Agricultural and Industrial Development Fund, a financial mechanism designed to compensate for trade imbalances and to induce balanced growth among member countries. Accordingly, above a minimum and equal contribution, member countries would participate in the capitalization of the Fund in direct relation to the benefits derived from the process of integration. Conversely, they would have drawing rights on Fund resources for direct investment in agriculture or industry, in inverse proportion to such benefits. These in turn were measured according to a composite index which included trade balances and direct foreign and domestic investment among other factors.²¹ This mechanism was a major institutional development.

²⁰ SIECA, Acta des Quinto Periodo de Sesiones de la Tercera Reunión de Ministros de Economía de Centroamérica (11 de Noviembre de 1970), p. 136 and Annex 7, pp. 2-3. The reader should consult the original document on other aspects of the regional agricultural policy which have been omitted in the above discussion. Such is the case of the immediate plan of action of the Marketing and Price Stabilization Coordinating Commission and certain priorities assigned to particular programs. Two additional documents are particularly pertinent to the topic under consideration: SIECA, Elementos para la Formulación de la Política Agrícola Regional del Mercado Común Centroamericano (SIECA/GT-RMECA-III/D.T. 15 Rev. 1) Octubre de 1970; and SIECA, Consideraciones sobre la Formulación de una Política Agrícola Regional en los Países del Mercado Común Centroamericano (SIECA/GT-RMECA-III/D.C. 27), Octubre de 1970.

²¹ See: SIECA, Fondo de Fomento Industrial y Agrícola (SIECA/RMECA-III-5/D.T. 39), Noviembre de 1970 and SIECA, Modus Operandi del Mercado Común Centroamericano, Proyecto de Resolución (SIECA/RMECA-III-5/D.T. 43), Diciembre de 1970.

Unfortunately, the modus operandi agreements were not enacted because of the reluctance of one of the member governments to participate in the Fund.²² Although this was a major setback, it is generally believed that the substantive aspects of the modus operandi agreements will become an integral part of the restructured plan for the regional integration movement.²³

The modus operandi agreements represent the first formal manifestation of the need and consent on the part of member countries to define and incorporate an inclusive agricultural policy to the institutional milieu of the integration movement. (In contrast to the Rome Treaty or the Cartagena Agreement, the General Treaty contains no reference to such policy.) In the second place, the proposed agricultural policy includes not only the natural or theoretical areas for regional action, but also the basic distributional problems of agricultural development, thus opening the way for combining the commodity approach to development (necessary to administer the common market) with the issue approach required to achieve higher degrees of development through progressive integration.

²²See: SIECA, Acta Final de la Tercera Reunión de Ministros de Economía de Centroamérica (11 de Diciembre de 1970).

²³In Decree 97 of January 1, 1971, Honduras applied, among other restrictions, the common external tariff to most goods produced in the remaining countries of the common market. This decree is tantamount to a de facto withdrawal of Honduras from the scheme. The restructuring of the Central American integration movement is the condition Honduras has imposed for its de jure return to the common market.

By and large, coordinated action seems certain to be the procedure for the execution of regional agricultural policies. Experience in the administration of the common market also indicates that coordination is the operational norm even when formal treaties or protocols specify joint regional action in certain areas of policy.

In view of these considerations, to conceive of regional agencies empowered with supranational authority in policy decision-making and implementation appears to be a politically unfeasible alternative at this stage of economic integration. More appropriately, regional agencies can be conceived as multi-national policy design and coordination bodies whose powers stem from the willing participation of member nation states. The adoption of a regional agricultural policy of the nature described would require that regional agencies be created or modified to allow: a) a wider participation in regional affairs of the various national agencies empowered to formulate and implement development policies and programs in their respective countries, and b) a more direct participation in regional policy design and coordination at the sectoral level.

Within this conception of the problem, integration agencies would have to perform two kinds of interrelated functions. One function would deal with the definition of guidelines, criteria and mechanisms to organize, coordinate, and strengthen national action in regional policy areas. The second function would be

concerned with policy design in areas to be brought into the regional domain, either to avoid conflict or to advance to higher stages of integration. This function would also involve the review of national policies influencing economic growth and the common market.

The degree or pace at which effective coordination can be achieved and new development areas brought into regional action would depend on the leadership and guidance provided by executive and administrative agencies (such as SIECA), as well as on the kind of participation that such leadership may elicit from member nations.

Implicit in this approach is the assumption that the primary and ultimate responsibility for solving development problems and capturing opportunities remains with member nation states. Nevertheless, unless the basic development problems are analyzed with regional criteria and national policies are reoriented and progressively coordinated, the process of integration will stagnate and gradually regress.

The conflictive nature of this task cannot be underestimated. Since the traditional pattern of growth will prevail in the foreseeable future, agricultural exports to extraregional markets will continue to be more important to overall growth than possible developments within the region.²⁴ Hence, economic and political

²⁴This does not imply the continued dependence on the traditional export crops. Indeed, in recent years there has been a considerable degree of export diversification which is likely to

interests operating within individual member countries are likely to resist deep institutional changes or the adoption of more inclusive development policies. However, if the distributional mechanisms of this traditional pattern and its supporting institutions remained unaltered, the growth potential of the inward-directed development pattern provided by the integration scheme will be substantially inhibited.²⁵

This is indeed a basic policy issue and a current dilemma. New directions in national and regional policies and in the design of economic institutions are required to establish a mutual and reinforcing interdependency between development and integration so as to restructure opportunities and procure a more equitable distribution of benefits among nations and among participants in the economy. This implies a more complete system of economic and political integration than the one currently in existence.

be accelerated in the near future. Nevertheless, this expansion and diversification is more likely to occur in non-traditional fresh products or in processed and manufactured agricultural goods than in industrial goods of different origin. Currently, the latter type of goods represent about eight percent of total regional exports to international markets.

²⁵A quantitative account of these distributional inequities can be found in Jeffrey B. Nugent, A Study of the Effects of the Central American Common Market and of the Potential Benefits of Further Integration (Final report to the Agency for International Development/ROCAP, 1971).