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TRANSLATION

CENTRAL AMERICA AND PANAMA PRIVATE SECTOR ASSESSMENT

Carried out by the Private Sector Commission

Under the Direction of FEDEPRICA

With INCAE Technical Support

and

Sponsored by AID/ROCAP

Central America, November 1981

## C O N T E N T S

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## P R O L O G U E

The Central American Private Sector Assessment is divided into three volumes. The first volume is an "Integrated Report" of the most urgent problems of the Private Sector from a regional viewpoint, and the corresponding solutions. The other two volumes (Volume I and Volume II) include respectively: "The Analysis by the Central American Commission" of each country, based on the results of surveys, hearings, interviews, and collection of secondary data for the study, and "Results Obtained from Hearings and Surveys, and the Methodology Adopted and Focus of the Study".

This document contains only the integrated report of problems and solutions, from a regional viewpoint.

## INTRODUCTION

During the period May-August, 1981, and sponsored by the Regional Office for Central America and Panama (ROCAP), of the U.S. Agency for International Development (AID), a Central American Private Sector Commission composed of a representative from each one of the six countries of the Isthmus, appointed by the Central American Federation of Private Enterprises (FEDEPRICA), made an assessment of the status of the private sector in the area. The Commission received technical support from a group of consultants who are members of the faculty of the Central American Institute for Business Management (INCAE).

### PURPOSE OF THE ASSESSMENT

The purpose of the assessment was to carry out an updated survey of the private sector, including their opinions, perceptions and expectations regarding three main issues:

Identity and Functions of the Private Sector: What is the private sector, who belongs to it and what is its role in Central American society?

Constraints and Problems Facing the Private Sector: Which are the factors that presently constrain its development in the region?

Problem-oriented Solutions: In what ways can the international assistance agencies (bilateral and multilateral), the governments and the private sector itself, help resolve the present problems of the private sector.

## METHODOLOGY

The INCAE consultant group designed a research methodology for the survey which would permit separation of two kinds of data: the information obtained from entrepreneurs and executives surveyed - the report - and the analysis prepared by the members of the Commission based on information collected and their own experience and knowledge. The survey was carried out using two means: a written questionnaire, obtaining 83 responses which involved the participation of more than 300 entrepreneurs and executives from the region, and a series of 33 hearings carried out by the Commission in the countries of the area, with the participation of 211 members of the private sector. The purpose of the questionnaire was to prepare the ground for the hearings and obtain detailed information on several specific areas. The purpose of the hearings was to permit a broad examination of the perceptions and expectations of the private sector and serve as forum for the generation and preliminary discussion of promising ideas for improving the development of the private sector in the region.

The following types of information have been obtained from the research and analytical process: the opinions given by the members of the private sector in the questionnaires, the opinions expressed by entrepreneurs and executives at the hearings, the analysis by Commission members, the

analysis by the INCAE Faculty Consultant Group, and statistical information. Throughout this report, an effort has been made to identify the nature and origin of the information utilized in order to provide a useful document to entities interested in improving their knowledge of private sector problems and in collaborating in the development of the private sector and of the region.

The opinions of members of the private sector were given by representatives from the following groups:

<u>SECTOR</u>	<u>QUESTIONNAIRES</u>	<u>HEARINGS</u>
Agricultural	21	42
Industrial	31	38
Service	21	51
Other*	<u>10</u>	<u>80</u>
	83	211

\*Includes: Small and medium enterprise, professionals, political parties, unions and government.

The Commission which made the Private Sector Assessment was formed by the following persons:

<u>NAMES</u>	<u>COUNTRY</u>	<u>MAIN AREA OF ACTIVITY</u>
José Luis Bouscayrol	Guatemala	Agroindustry (sugar)
Manuel Enrique Hinds	El Salvador	Private Consultant
Enrique Bolaños	Nicaragua	Agriculture (cotton)
Francisco Terán	Costa Rica	Industry

Rolando Reyna	Panama	Private Consultant
Leonardo Gody	Honduras	Agroindustry and Commerce

The INCAE Faculty consultant Group was integrated by: Julio Sergio Ramírez, Noel Ramírez, José Danilo Gutiérrez and Benito Cobb.

An INCAE Faculty Committee was also appointed to collaborate in the original research design and in the analysis of the problems of the private sector and the region, and possible solutions to them.

#### ASSESSMENT LIMITATIONS

This is an assessment of the Central American private sector; therefore, it is not a study which covers the entire range of economic, political or social problems of the region, but it is rather the result of a self-examination carried out by active elements of Central America's private initiative. Therefore, its approach is necessarily limited and partial and its specific value is mainly to express the feelings of private business leaders. This assessment tries to present the private sector problems as perceived by its members and it is hoped that it will be an efficient instrument in directing foreign assistance to the region and in helping the most important national personalities in making future decisions in each one of the countries of the area.

Aside from the presentation of the private sector's perceptions on its identity, problems and possible solutions, an analysis by the INCAE Faculty Group of the same themes also been included in this report as another information element to facilitate a better understanding of current problems.

CHAPTER I

THE IDENTITY OF THE PRIVATE SECTOR

Who forms the Private Sector

One of the ways in which the private sector describes itself includes all productive segments of the country excluding the government.

Among those surveyed there is a tendency to include within the private sector a large diversity of social non-governmental groups, despite their recognition that those who consider themselves as the organized private sector directly represent only a fraction of the so defined private sector.

<u>GROUP</u>	<u>Percentage of replies to the questionnaire which include this group in their conception of the Private Sector</u>
Medium and Large Enterprise	100%
Small Enterprise	60%
Executives and Professionals	33%
Independent Workers	33%
Labor Sector	19%
Non-profit trade associations	23%
Other non-profit associations	14%

Who Should Integrate the Private Sector

However, there is the perception that many of the groups which the persons surveyed consider as part of the private sector do not consider themselves as such.

<u>Group</u>	<u>Percentage of replies to the questionnaire which mentioned groups that belong to the private sector but do not consider themselves as such</u>
Small Enterprise	43%
Executives and Professionals	33%
Independent Workers	47%
Labor Sector	19%
Non-profit trade associations	15%
Other non-profit associations	16%

### Isolation of organized groups

The organized private sector, whose representatives integrate the entrepreneur-management group, directly represent a fraction of the non-governmental productive sector and feel the lack of links with other social groups as shown by their proposals of improving their ties with such groups. This difference between what is really covered by the organized private sector and what it believes it should cover is of special importance in present circumstances, as the private sector feels weak before actions of government and others, and isolated from other social groups it wishes to mobilize in its defense.

### Percentage of those surveyed which feel that the organized Private Sector:

Does not include a great number of small and medium enterprises	Close to 50%
Requires a closer relationship to productive segments not presently linked to Private Sector organizations	A great majority
Is weak, fragmented, divided, inefficient	Close to 50%

This separation between the entrepreneur-management group and the rest of the productive private sector is also perceived by small entrepreneurs who, in turn, consider themselves left out by the entrepreneur-management group and more identified with other social groups.

Proportion of medium and small entrepreneurs surveyed who:

Feel involved in private sector organizations	A Minority
Feel left out by private sector organizations	A Majority
Feel that they are called upon to participate in private sector organizations when it is convenient for large enterprises	A great majority
Are interested in a closer relationship with organized private sector	A majority
Have no interest in closer ties with organized private sector	A minority

Conclusion

From the above, it can be concluded that the broad coalition of the productive sectors implicit in the first definition of the private sector does not really exist and that the present entrepreneur-management nucleus perceives this separation as damaging to its objectives given present circumstances.

CHAPTER II

MAIN CONCERNS OF THE PRIVATE SECTOR

Political Problems

In the first place, emphasis should be given to the high preponderance given by those surveyed to political concerns (instability, violence, role of the State in the economy, etc.) over those of an economic-financial nature (financing, costs, foreign exchange, productivity, etc.)

<u>Nature of the Concern</u>	<u>Frequency with which it was mentioned in the surveys</u>	
	<u>As most important</u>	<u>As important</u>
Political	90%	100%
Economic-financial	10%	60%
Other		60%

There is besides great concern about the survival of the private sector system.

	<u>Proportion of participants in hearings who expressed concern for survival of the system</u>	
	<u>In the short-term</u>	<u>In the medium-term</u>
Nicaragua and El Salvador	Unanimous	Unanimous
Rest of the region	A minority	Almost half

This concern for survival is supported by the perception, widespread among the private sector, that there is an international conspiracy against it. This perception is particularly high at the trade association level.

Proportion of those surveyed who mentioned the existence of an international conspiracy against the Private Sector

In questionnaires	Almost half (mainly in Guatemala, El Salvador and Nicaragua)
At hearings	The majority (in Nicaragua and El Salvador it was almost unanimous)

The Role of the State

There are strong objections on the part of the private sector to the role of the State in the economy, which are consistent with and reinforce its concern for survival.

Proportion of those interviewed at hearings who criticize the role of the State in the economy due to:

<u>Excessive Control</u>	<u>Excessive Size</u>	<u>Polit. Econ.</u>	<u>Nationalization</u>
The great majority	The majority	The majority	The majority

Labor Environment

Strangely enough, there is little perception of labor problems.

Frequency of its mention in the surveys

<u>Nature of Concern</u>	<u>As important</u>	<u>Simply included</u>
labor	minority	minority
Other enterprise concerns, not labor	majority	majority

The Social Dimension

There is equally little concern among those surveyed about possible roots of a social nature which might have generated or contributed to the critical situation of the Private Sector according to its own perception.

Percentage of those surveyed who indicated concern for possible social causes of the crisis affecting the region

Mentioned prominently	Less than 10%
Some mention	Approx. 15%

The Exodus of Entrepreneurs

Another important concern, particularly due to its impact on the organized private sector's ability to survive, is the exodus of entrepreneurs which has taken place in recent years, especially in Nicaragua and El Salvador (about which it was not possible to obtain reliable figures) and particularly the potential future exodus.

Proportion of those interviewed at hearings who mentioned concern for the exodus of entrepreneurs

<u>Countries</u>	<u>For Past Exodus</u>	<u>For Future Exodus</u>
Nicaragua and El Salvador	Almost all	A great majority
Other countries	A third	A slight majority (55%)

On several occasions those interviewed at the hearings, mainly in Nicaragua, El Salvador and Guatemala (in that order), mentioned an intention to personally contribute to that exodus in the event of an eventual deterioration (irreversible to some)

of the internal situation of their respective countries. An entrepreneur expressed the feelings of the group which accompanied him in the following manner: "Each one of us has its list of signals to leave and checks it continuously."

It is necessary to note that the latent exodus of entrepreneurs does not have the unanimous and open support of those surveyed, and that many of them even indicated that they are ready to fight and remain to the end directing their enterprises. Others think otherwise. The flight of human resources (as well as capital flight) in the enterprise sector is a matter which creates great controversy, as in times of crisis there may be notable differences between individual interests (pro-exodus) and collective interests (group reinforcement).

#### Capital Flight and Private Investment

Another important concern of the private sector is that related to the halt in private investment and capital flight. Although nobody expressed openly that they were exporting capital or were thinking of doing so in the future, a high percentage of those surveyed indicated that the climate was not favorable for investment and that they therefore were not investing or were doing it at a minimum level required to remain competitive.

Percentage of those interviewed at hearings who mentioned specific intentions of investing in their businesses

<u>All the area</u>	<u>Excluding Panama</u>
Close to 10%	Almost nobody

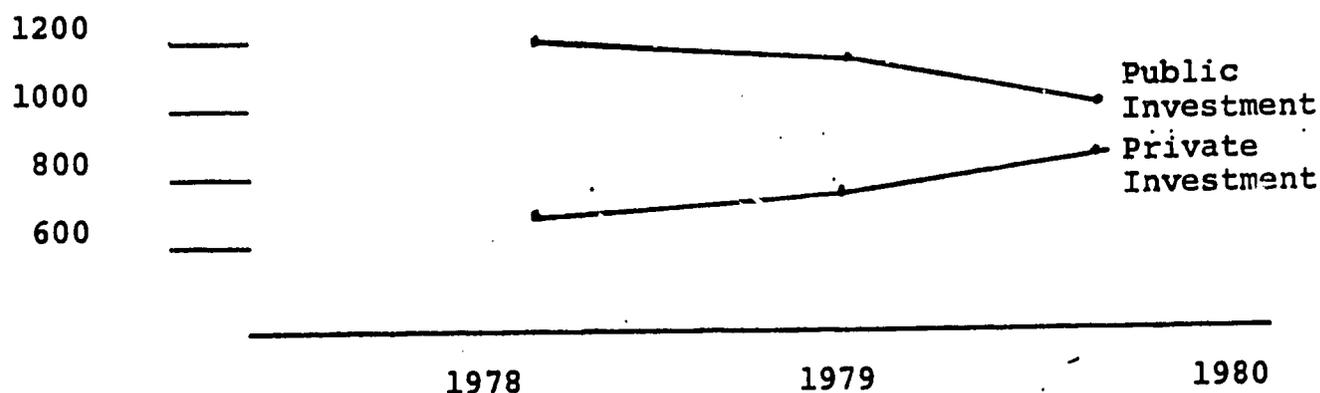
From other sources consulted, it can be noted that available figures on the amount of private and public investment show a declining tendency in the former and a significant increase in the latter, during the past three years.

GROSS INVESTMENT IN CENTRAL AMERICA AND PANAMA, 1978-1980

(In millions \$CA 1970)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>78-80</u>
Private investment	1154.6	1084.9	876.9	
Public investment	637	656.3	731.2	
Private Investment Increase	7.8%	-6%	-19%	-24%
Public Investment Increase	-2.8%	+3%	+11%	+15%

Graphically, investment behavior can be observed as follows:



Undoubtedly, there is a brake on private investment in the region. It is necessary to note that the phenomenon is common to all the region, with the exception of Panama: in each one of the remaining five countries the amount of gross private investment in 1980 was less than in 1978.

Besides, the movement of private capital from the region to other countries increased notably during the period 1976-1980.

<u>Year</u>	<u>Movement of Private Capital (short term)</u> <u>in millions C.A. \$</u>
1977	- 84.1
1978	-281.1
1979	-524.1
1980	<u>-516.1</u>
	-1405.2

The relationship between gross private investment and movement of private capital during the period 1978-1980 clearly shows a tendency towards substitution of capital exports for private investment.

PRIVATE FUNDS USED FOR CAPITAL INVESTMENT

<u>Year</u>	<u>As Gross Internal Private Investment</u>		<u>As Capital Exports</u>		<u>Totals</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
1978	1154.6	80	281.1	20	1435.7	100
1979	1084.6	67	324.1	33	1609	100
1980	876.9	63	516.1	37	1393	100

It is interesting to note that of the total availability of the private sector for financial capital investments only 20% was being transferred to other countries as capital exports and debt repayment in 1978, whereas this figure has almost doubled for 1980 (37%).

#### The Common Market

The Common Market is seen by the private sector as one of the institutions which have significantly favored the development of the region's private sector. It is also observed that the private sector believes that one of the obstacles to its development has been the stagnation of the Central American Common Market, as a consequence of its being based on an import substitution scheme for a market which is too small. The private sector also considers that the instability of the Central American Common Market and the unilateral measures taken by the countries have deteriorated its initial objectives.

It is also noteworthy that, despite the fact that they consider the stagnation of the Common Market as one of the obstacles to the development of the private sector, very few of those interviewed indicated any hope that a reactivation of the Central American Common Market could be achieved in the short or medium term, which would facilitate the solution of the crisis currently being faced by the region's private sector.

Conclusion

The private sector is greatly concerned over political matters and in particular for its survival. It feels that the State is assuming roles in the economic field which do not belong to it; nevertheless, the private sector is consciously and gradually reducing its participation in the economy, despite its perception that the exodus of private human and financial resources, which has been affecting the region in recent years, will reduce its possibilities for survival and future development. However, it has expressed that it is not willing to take concrete measures to restrain the flight of capital and entrepreneurial talent unless the environment for private investment improves substantially.

### CHAPTER III

#### THE COMBINATION OF FACTORS

According to the opinion of those surveyed, the Central American private sector sees itself today as facing the challenge of survival and the perspective of a limited and uncertain future.

In the judgment of those interviewed, a combination of adverse forces and factors has been gradually debilitating the private sector in recent years. Future perspectives do not permit foreseeing important changes which ameliorate the negative pressures on the private sector, unless a strategy is developed oriented specifically towards improving its possibilities to successfully overcome the present threat against its own existence, as the basic form of organization of productive activities in the Central American region. These pressures and threats are not perceived as being uniform in the whole area, nor are they considered generated by the same combination of factors in each particular case. Those interviewed consider that the problem has reached highly critical levels in Nicaragua and El Salvador; intermediate levels in Guatemala and Honduras, and lower levels in Costa Rica and Panama.

In those countries where immediate concern for survival is less acute, the private sector sees itself facing the problem of present stagnation, a gradual shrinking and an eventual disappearance in the longer term.

### The Four Groups of Factors

Adverse pressures on the Private Sector, as identified throughout the survey, can be examined in the perspective of four groups of factors. The macroeconomic context, the political context, the internal situation of the private sector and external factors.

In the macroeconomic field the private sector considers (and figures confirm it) that the region is going through a period of unequal and significative empoverishment in some countries and in others economic stagnation accompanied by an increasing role of the State in management of the economy and even of production.

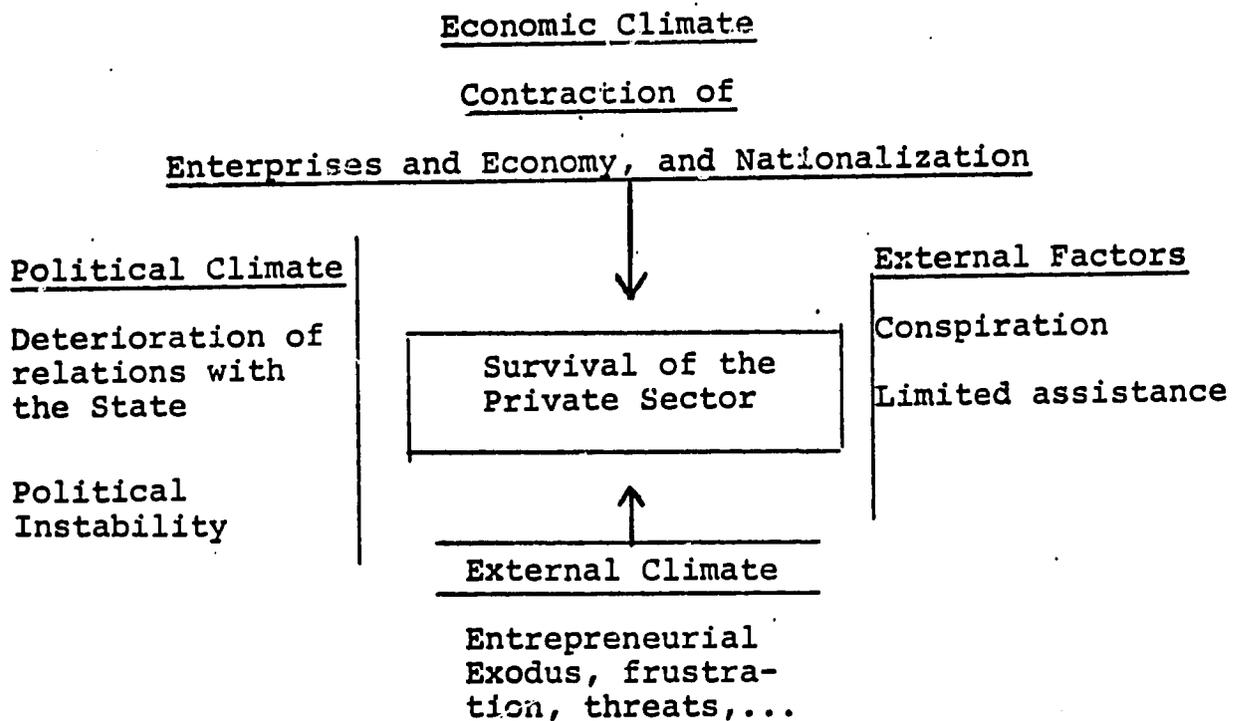
In the political field, the private sector feels that the region is going through a period of increasing political instability and violence, and a gradual deterioration (in some cases total) of the relationship between the State and the private sector.

The internal situation of the private sector is characterized by a notable increment of feelings of personal insecurity and frustration, and an economic weakening at the firm level.

In the opinion of the private sector, external factors are also unfavorable: it believes that active external support is being provided to subversive groups opposed to the existence of the private sector contrasted with the limited availability

of assistance from foreign allies and friends of the private sector.

Therefore, the private sector considers that its existence is threatened by the economic contraction and political instability and violence in the region, its own internal crisis and the adverse effect of external factors.



A more detailed examination of each one of the groups of factors is presented below.

The Economic Climate

The economic contraction which has affected the region in the last three years of the last decade has been characterized by:

a) A decline in the economy and private sector investment.

<u>Year</u>	<u>GDP Growth Rates (at cost factors)</u>		<u>Gross Investment Growth Rates</u>	
	<u>GDP</u>	<u>GDP/Capita*</u>	<u>Private</u>	<u>Public</u>
1976	6.4	3.5	9.2	19.3
1977	6.9	4.0	11.4	25.8
1978	3.8	0.9	7.8	-2.8
1979	-0.2	-3.1	-6.0	3.0
1980	0.8	-2.1	-19.0	11.0
Total accumulated growth for period 1975-1980	18.7%	3%	0%	67%
Average growth rate for period 1975-1980	3.5	0.6%	0	10.9%

\*The estimated annual population growth rate for all the region is 2.9%.

b) A cut off of external financial assistance to the private sector, and the hardening of payment terms demanded by foreign suppliers.

According to Central American entrepreneurs, excluding Panama, during the last three years foreign credit sources have been drying up. Commercial supplier credits have diminished notably and supplier delivery and payment terms are more stringent. For example, they require advanced payment through a draft or a confirmed letter of credit, instead of a draft against documents or payment 30, 60, or 120 days after shipment.

c) Unemployment Increase

It is not feasible to obtain reliable figures on unemployment; however, it is clear that in the past three years there has been a notable increase in rural as well as urban unemployment in Guatemala, El Salvador, Nicaragua, and Costa Rica. It is estimated that in the first three countries mentioned, open unemployment is not below 20% of the labor force, and the figure for El Salvador is considerably higher. The decline in coffee and sugar prices has caused a considerable reduction in seasonal agricultural employment in Guatemala and the deterioration of agricultural and industrial production in El Salvador and Nicaragua have had a negative effect on employment.

d) Capital flight: Estimates of the total amount from the beginning of 1978 to date for the entire region, fluctuate between one and two billion dollars.

As it was previously mentioned, during the past two years (1979-1980) capital flight exceeded one billion dollars (the estimate is 1,040 million) and there is no indication that it is diminishing, except for the obvious fact that as more capital is being moved the remaining amount available for future transfer diminishes and eventually the rhythm of capital flight will decrease. In 1980 private capital flight probably equalled or exceeded net private investment in the region, representing an equivalent amount of 60% of

gross private investment (\$516 million of \$876 million).

- e) The deterioration of the external sector of Central American economies: the growing balance of payments deficit, the slump in prices of traditional export products, the reduction in private capital flows, the increasing use of official capital flows and a drop in international reserves.

CENTRAL AMERICA AND PANAMA

EXTERNAL SECTOR EVOLUTION 1978 - 1980  
(In millions of C.A.\$)

<u>CONCEPT</u>	<u>Y E A R S</u>		
	<u>1978</u>	<u>1979</u>	<u>1980</u>
Balance of Payments Deficit	-1020	-738	-1546
Changes in the ratio of trade prices (non-weighted average of the six countries)	-10.5	-12%	-6.4%
Net private capital flow	-281.1	-524.1	-516
Public external debt	3701	4528	6020
Change in international reserves	159	-295	-860
Total foreign debt service payments	410	384	475
Debt service increase/GDP increase	31%		165%

SOURCE: CEPAL, based on official figures

It is important to note that in 1980 the increase in foreign debt service was already \$91 million, which represented 165% of GDP increase at cost factors, which was \$55 million for the entire region.

.f) The Central American Common Market Crisis

Despite the fact that intraregional trade has had an annual growth rate above 10% during the period 1976-1980, future perspectives are most uncertain due to the increasing political polarization of the region and the exchange crisis faced by current members of the Central American Common Market, which have created serious regional trade difficulties in the current year.

g) The increasing role of the State in the economy

To the factors mentioned above we must add the effect on the private sector of the growing role of the State in the economy. This can be seen in the increase in public investment vis a vis private investment in the area and from the nationalization of enterprises in Nicaragua - 40% of the GDP was directly controlled by public enterprises in 1980 - the nationalization of banking and foreign trade in El Salvador, increasing government participation in the distribution of basic products in Honduras and in industrial investment in Honduras and Costa Rica. Aside from Nicaragua, where the percentage of public sector participation in the GDP is 40%, there are no available figures which include the magnitude of the public sector's productive activity in the economy, although it has clearly risen, as illustrated by examples given above, and as inferred from the multiple complaints of organized private sector against State "enterprise" and "unfair" competition by State enterprises mainly in marketing basic products.

h) Effect on private sector business profitability

There is no data available on profits obtained by private businesses, which allow us to measure the effect of political and economic conditions on private sector profitability. In general, the main fears expressed by entrepreneurs and managers of private business are related more to their future expectations than to present profits from their businesses. From this

could be inferred that businesses have been relatively successful in adjusting to more adverse conditions prevailing in recent years.

### The Political Climate

In the opinion of the private sector, political violence and instability have been the most notable and unfavorable aspects which have hindered its development in Central America in recent years.

Within the political context special mention is made of:

- a) Gradual growth of tensions between the private sector and the State

With the exception of Guatemala, the relationship between the private sector and the State has deteriorated in recent years in the entire region. In Nicaragua, for example, COSEP (the country's umbrella entrepreneurial association) has made strong accusations against the Government regarding its political orientation and the Government, in turn, has jailed several COSEP leaders who signed the accusing letter and subjected them to trial. In El Salvador many entrepreneurs feel that the Government, and in particular the Christian Democratic Party, have done more damage than the guerrillas, and the Government has accused ANEP (the umbrella entrepreneurial association of being subversive and promoting a coup d'etat. In Honduras, COHEP (the umbrella entrepreneurial association) has held a very

critical position regarding the Government's economic policy, and in Costa Rica and Panama (to a lesser degree in the last one) the private sector has accused the Government several times of being incompetent to manage the country's economy.

b) Subversion and armed struggle

Since 1978 an armed struggle of a political nature has swept the region. The civil war in Nicaragua and El Salvador and increasing guerrilla activity in Guatemala are the clearest cases of escalation of political violence in the region, which has been limited almost exclusively to those three countries.

c) Increasing intraregional tensions

After the Sandinista triumph in Nicaragua, relations between the governments of the so called Northern triangle (Guatemala, El Salvador and Honduras) and the Government of Nicaragua have deteriorated significantly. There have been multiple mutual accusations of intervention and support to antigovernment armed groups and there have been frequent border incidents between Honduras and Nicaragua. The Costa Rican government has also seen a deterioration of its relationships with the governments of Guatemala and El Salvador due to its support to the Sandinista Front in its fight against the Somoza regime.

d) Intervention of foreign agents and governments

There are multiple accusations by the different factions and governments involved in the area's political conflicts regarding intervention by extraregional participants in the armed encounters. Besides, it is publicly known that several extraregional governments are actively supporting different groups or governments involved in the area's military-political conflicts.

Internal Climate

Many of the members of the private sector feel that they have a low degree of accomplishment, influence and achievement. Individual expectations of entrepreneurs and businessmen indicate consideration of contingency plans which under specific circumstances would increase the already notorious entrepreneurial exodus. They feel that this has weakened the private sector's leadership.

There is lack of confidence in government and in the activities of foreign participants. The economic weakening of some enterprises and the perception of personal threats, insults and open hostility has caused pessimistic feelings and an impression of being "under siege". The degree of cohesion of the private sector at the national as well as the regional level is considered limited, although the presence of a common enemy has generated actions which tend to unite the private sector nationally and regionally. There seems to be a

considerable degree of unawareness of political, social and economic issues among private sector members and there is a tendency to behave by reaction. Also, few were the times that the private sector indicated that it had been innovative and had promoted socio-political changes which tend to maintain equitable social progress.

As mentioned by some sources in El Salvador, it is estimated that in the past three years entrepreneurs have had to pay ransom money in an amount of approximately \$30 million, which is more than 2% of the annual GDP. A comparative figure in the United States would be in the range of \$50 billion or more. On the other hand, a great number of Nicaraguan and Salvadoran entrepreneurs indicated that they felt trapped and threatened and deeply resented the insults and threats they frequently received.

#### External Climate

##### Risk Perception

Central America is rated by other countries as a high investment risk area, with the exception of Costa Rica and Panama (before the death of General Torrijos). The foreign private sector is cautiously awaiting developments and an almost total stagnation of foreign investment and a generalized hardening of the region's commercial and banking credit terms have occurred.

The external evaluation of political risk in the area indicates that it is considered that Nicaragua and El Salvador pose a very high level risk; the risk in Guatemala and Honduras is rated as relatively high and moderate in Costa Rica and Panama.

At a seminar sponsored by the Council of the Americas in March 1981, with the participation of 52 executives from United States multinational companies which operate in Central America, the following response was obtained to a question regarding what they would recommend with respect to investment in Central America during the period 1981-1986:

<u>Country</u>	<u>Investment Recommendation*</u> (percentage by country)	
	<u>Increased</u>	<u>Decreased</u>
Guatemala	8%	11%
El Salvador	0	47
Honduras	19	8
Nicaragua	0	54
Costa Rica	20	0

\*The remaining percentage recommended maintaining the status quo.

The expectations of that group about future business climate for the period 1981-1983 indicate that they foresee a further deterioration.

<u>Country</u>	<u>Business Climate Expectations</u> <u>Period 1981-1983</u> (Percentage by Country) *	
	<u>Improvement</u>	<u>Deterioration</u>
Guatemala	17	40
El Salvador	23	57
Honduras	17	31
Nicaragua	14	60
Costa Rica	8	34

\*The remaining percentage does not expect important changes.

### External Assistance

As stated by several international organization officers during the visit of the FEDEPRICA Commission to Washington, the region has little capacity to generate and implement projects, which has limited the actual flow of available funds.

Assistance available from the United States seems to be greatly restricted due to internal budget issues, and U.S. Department of State officials emphasized that the Caribbean Basin Initiative (C.B.I.) is not to be considered a Mini-Marshall Plan. According to them, there is a predisposition on the part of the United States to channel C.B.I. efforts mainly through three areas of the private sector, which in order of importance are: increased trade, increased investment, and direct assistance. They have emphasized that all assistance schemes must have important multiplier effects, so that the assistance will be the "seed" of reactivation of the private sector.

### External Conspiracy

One of the most disturbing factors for the region's private sector is the external support given to violent opposition groups, interested in producing radical economic and socio-political changes in the region in a direction which would have a negative effect in the future development of the private sector and could cause its virtual extinction in one or several countries of the area. This external support is seen as continuous and increasing and it is believed to be motivated by strategic goals of world competition between the two military superpowers.

CHAPTER IV

PRIVATE SECTOR PROPOSALS

New Ideas on Productive Activities

Throughout the survey (questionnaires and hearings), special emphasis was made on the need to identify new and promising ideas which contribute to solve the problems faced by the private sector. It was found that it is easier to identify problems than solutions and few promising ideas on private productive activities were obtained.

Proportion of persons surveyed  
who suggested new private  
productive activities

In questionnaires	A minority
At hearings	A minority

Business Association vs. Productive Action

Most of the strategies suggested for strengthening the private sector are predominantly business association actions - as a pressure group - instead of productive (investment, productivity). The defense of the system is conceived more as a political struggle - and even military - rather than a productive task.

Proportion of persons surveyed who suggested  
strengthening the private sector through:

Business Association action	Unanimous
Productive action	A minority
Governmental action	A majority
External support	A majority

### Government Policies

A high portion of the proposals dealt with suggested change in government policies. The most controversial government policies identified, and for which the private sector proposes favorable changes, are:

- a) Economic regulation and control: prices, credits, foreign trade.
- b) Nationalization of the economy, nationalizations and confiscations.
- c) Competition between State and private enterprises.
- d) Lack of clear and consistent rules: monetary and fiscal policy; investment incentives; and, labor laws.
- e) Bureaucracy, favoritism and corruption

The proposals of the private sector are:

- a) Economic liberalization and greater autonomy in market operations.
- b) That the Government reduce its taking over private enterprises.
- c) That the Government leave productive tasks in the hands of the private sector
- d) That the Government's economic policy be stabilized.
- e) That public expenditure be reduced.
- f) That the private sector be allowed to participate actively in the Government's economic policy.

### Other Proposals

There were numerous suggestions involving large scale financing, and in commercial and agricultural export sectors considerable emphasis was made to liberalize trade (the first of imports, the second of exports).

.Other proposals frequently mentioned in questionnaires and hearings were:

- ✓ a) Industrialization oriented towards international market competition.
- b) Promote foreign investment in the area.
- c) Massive foreign financing directly to the private sector.
- d) Integration of other productive sectors to private sector institutions.
- e) Carry out publicity campaigns to promote the private enterprise concept.
- f) Restructure the CACM.
- ✓ g) Reduce barriers to Central American exports (mainly in the United States).
- h) Reform Labor Codes

#### Minority Proposals

Some interesting minority proposals were:

- a) Reduce paternalistic protection of the private sector
- b) Autonomy of the Central Bank
- c) That U.S. and Western Europe entrepreneurs visit the area and give information about the institutional frame of their operations and how they manage to keep their businesses going.
- d) That U.S. assistance be mainly one of attitude.
- e) Stimulate political parties which have ideologies favorable to the private sector.
- f) Broaden the agricultural borders instead of agrarian reform.
- g) Establish a private financial network in Central America.
- h) Promote the free flow of factors in Central America, starting with labor.

CHAPTER V

REGIONAL SOLUTIONS

A. Creation of a Fund for Reinvestment and Loans:

The creation of an immediate assistance Fund has been proposed, with contributions from international credit organizations, foreign assistance entities and extra-regional governments who wish to support the Central American private sector, with the following fundamental characteristics:

1. Contributions to the fund will be in freely convertible currency;
2. It can be established as a regional fund or as a fund for each country of the region as deemed more convenient;
3. The fund will be managed by the sponsoring organizations with the collaboration of private sector entities of each country;
4. The initial purpose of fund resources will be to finance the purchase of raw materials and inputs essential for productive activities of the private sector in each country.
5. The fund will make direct foreign currency loans to productive enterprises (preferably or exclusively to those belonging to the private sector) which will be payable in each country's local currency, at

currency exchange rates to be negotiated at the time the loan is made and at interest rates and terms to be determined for each transaction, according to regulations to be established for administering the fund;

6. The owner of the company requesting the loan would be required to make a capital investment in his own company as a counterpart contribution. The amount of the counterpart contribution will be determined by the fund managers in each case, as well as the schedule of contributions (which might come in part from withholding future profits). The counterpart contribution could be in the form of a capital contribution to the local currency loan fund which will be gradually generated.
7. The fund could be administered by one or several of the existing regional institutions, such as BCIE, through special agreements with the sponsoring entities and would imply the creation of an organizational and implementing capacity. At this stage of the study it is not pertinent to go into further details in this respect.

Advantages of the Mechanism

It allows the short-term reactivation of the private sector.

As indicated by the surveys and evidences in almost all the region, and as confirmed by statistics related to the external sector of the economies of the area, one of the greatest obstacles to the reactivation of production in Central America is the acute shortage of foreign currency to import raw materials and inputs. It is therefore reasonable to expect that the Economic Reactivation Fund will be immediately used in full and will be an important factor for such reactivation.

It promotes local private investment. Due to the requirement for counterpart investment, the fund will not become a unilateral disbursement mechanism, but it will rather stimulate additional local private capital contributions which will be required for granting the loans. Eventually, it will be necessary to monitor future dividend or equivalent payments so that the counterpart capital contributions will not become unoperational as a mechanism to increase local private investment.

It channels assistance directly and immediately to the private sector. It avoids intermediate steps and negotiations with government entities which could prolong the time needed for granting and disbursing of loans. This is in agreement with private sector opinion about the delays in negotiations with government entities, particularly to obtain foreign currency.

Details on the operation of the fund appear at the end of this document as an Appendix, and may be considered as the illustration of one of the options for operating the fund.

B. Popularization of the Private Sector.

Establish a task force with financial support from foreign assistance entities, to examine and propose specific mechanisms to the private sector and study's sponsors, which may be utilized to spread private ownership of the means of production.

Specifically, mechanisms such as the following may be examined:

1. Sale of company shares to workers, financed by sources not related to the company.
2. Sale to the public of shares of government companies.
3. Systems similar to the Costa Rican solidarity movement.
4. Establishment of retirement funds by private companies, which in turn become investors in the company.

Advantages of Private Property Popularization

- a) It is an efficient mechanism of redistribution of wealth and income, as it implies a lower social cost than other redistribution alternatives.
- b) It effectively promotes savings and capital formation among middle and low income levels.
- c) It allows a reduction of existing hostile feelings against the private sector and owners/managers.
- d) It provides a useful element for the elaboration of a new social contract.

C. Regionalization and Internationalization of Private Investment

In order to ameliorate the impact of political and economic changes on private enterprises and at the same time promote the integration and union of the region's productive sectors, the following mechanisms for the formation of regional private enterprises are proposed:

- a) Merger of companies of the different countries of the area.
- b) Exchange of shares among companies of the different countries of the area.
- c) Formation of regional investment groups, which operate at the regional level.
- d) Exchange of shares between enterprises of the region and transnational companies.

The task force which develops the mechanisms to popularize private enterprise can also undertake the development of regionalization and internationalization mechanisms.

D. Programs to Provide Political and Economic Instruction to Owners/Managers

With support from foreign assistance entities, it is proposed that instruction courses and seminars be conducted for company owners and managers, in such fields as political and economic analysis. Major emphasis should be given to the understanding and examination of local and regional problems. Top private sector organizations of the area would coordinate such events, which would be designed and conducted at the highest professional and academic level. It is expected that this training will enable organized private sector to develop creative solutions to environmental changes which are apparently adverse to their goals.

E. Trade Promotion

Organize and finance the establishment of a high level regional task force to promote the region's exports, which would:

1. Identify the region's key products which would have a marketing potential in countries outside the region.
2. Negotiate terms of trade of key products with countries which are potential or current purchasers, in order to reduce any existing obstacles to such trade.
3. Promote the establishment of national and regional trade companies to export such key products.
4. Establish the bases for the creation of a Regional Data Bank on market conditions and provision of key products.

F. Foreign Investment Promotion

Organize and finance the establishment of a regional high level task force to promote foreign investment in the area, which would:

1. Promote investment treaties among the countries of the area and the governments of the United States and other developed countries.
2. Develop a more active and closer relationship with the International Financial Corporation.

3. Negotiate an improvement of OPIC (Overseas Private Investment Corporation) conditions for investment guaranties in each one of the countries of the region.
4. Establishment of an updated Data Bank on available national, regional and international sources of financing.
5. Promote the exchange of shares between the region's enterprises and foreign enterprises.

G. Improvement of the Political Climate

In this field possibilities are highly limited and the needs are greatest. The political climate is considered by the private sector to be the most important problem. It is therefore necessary to make special efforts to improve the political climate for the private sector by firmly supporting activities which, although they may not bring any personal or immediate benefit, could help reduce over the medium term the acute political tensions and conflicts which have created an unfavorable, and frequently unbearable, climate not only for private sector activities in several countries of the area but also for the great majority of the population.

Recommendations in this field are the hardest to make and could be the least practical. An attempt has been made to outline specific mechanisms which, although they may not

solve the political environment problem by themselves, could be the seed of initiation of a gradual political broadening which allows the incorporation of more participants and resources, and could eventually produce a significant improvement in the region's political environment and its deteriorated image in foreign countries. Therefore, the following recommendations are but a first step towards improvement of the political environment.

1. Establishment of a High Level Committee to study the political problems of the region as a whole and of each one of the countries. This Committee should be integrated by representatives of each country's private sector, government and other national and regional sectors, which should be included for the role they play in society and their possible human resource contribution to the Committee.

The members of the Committee should be persons of the highest moral and professional qualifications and be especially qualified for the task because of their capacity and/or experience.

Due to the complexity and sensitivity of the tasks, the activities of the Committee should be kept away from the public light, publicity or proselytistic campaigns. Its members should abstain from seeking public

opinion, under all circumstances, until the examination and analysis process has finished and the Committee has reached a basic consensus about the course to be followed.

The establishment of the Committee is not considered an easy task, nor are the problems the Committee will study. Notwithstanding, emphasis should be made on the need to actively support this initiative, setting aside temporary complaints, and claims no matter how just they are, so that this necessary and difficult process of political broadening of the region can be initiated.

2. Initiation of a public campaign to reduce violent political antagonism, with the objective of promoting a change in the population's attitudes which favors solution of political conflicts and differences through means which will be of general benefit to the Central American population.

#### H. Government Policy Changes

The list of government policy changes which would improve the status of the private sector in the region would be too large. Therefore, we are proposing some key changes in government policies which would be most important.

- ✓ 1. Clear definition and equitable application of the rules of the game by the government.
  - ✓ 2. Careful examination of governmental controls which regulate the economy, in order to eliminate or modify those which do not promote the balanced development of the country.
  3. Restrain the tendency of the State to nationalize productive activities and return to the private sector those which are not of a strategic or monopolistic nature.
  - ✓ 4. Reduction of public expenditure.
  - ✓ 5. Greater use of public bids for granting government contracts.
  - ✓ 6. Review of government policies regarding managing the balance of payments, including monetary and credit policies.
- I. Improvement of Internal Environment for the private sector
1. Actively promote the increase of the membership of private sector organizations and its participation in matters of common interest.
  2. Utilize more frequently private sector trade associations in dialogues with the government and other national and regional sectors.

3. Channel more real resources (financial and others) through the private sector trade associations in order to strengthen them and increase their influence.
4. Develop activities in the private sector trade organizations which generate benefits for members in sensitive (and sometimes intangible) areas in order to increase their cohesion.

CHAPTER VI

ANALYSIS OF THE COMMISSION

Introduction

The following is a summary of each country's analysis by the Commission. This analysis was based on results obtained from surveys and questionnaires. This summary presents only the basic issues addressed in the analytical studies, which are included in their entirety in Volume I of this study: "Analysis by the Central American Commission".

COMMISSION'S SUMMARY ANALYSIS

GUATEMALA

The participation of the State in economic activities is increasing steadily; import, export and price controls damage free enterprise. The high level of public debt to cover the increment of public expenditure has contributed greatly to inflation. The slump in export prices, lack of financing, the terrorist campaign and attacks on the private sector are factors which have promoted a decline in investment. Capital flight is stimulated by the marxist-leninist subversion and low interest rates in comparison with those paid in foreign countries. It should be noted that the international campaign to damage Guatemala's image has greatly prejudiced the country's economic development; this campaign has been developed mainly by U.S. press. The boycott to tourism, resulting from the same campaign to damage the country's prestige, has caused a considerable drop in that important source of foreign exchange. The deterioration of the CACM has also had a negative effect on the Guatemalan economy. Politicized labor pressures and personal insecurity, added to above mentioned factors, are causing the problems affecting the private sector; however, it is believed that there is a positive reaction to fight and make every effort to face these obstacles, staying and fighting for free enterprise principles.

With respect to presentation of solutions, the one mentioned as most important is the reestablishment of a climate of peace and tranquility which allows a revival of confidence and security for the private sector and a reactivation of economic, cultural and social activities.

It is suggested that extensive, long-term, low-cost financing be provided mainly by foreign countries and through direct foreign investment. Many public programs should be turned to the private sector which would administer them in a better way, and, finally, greatest effort should be made to reactivate the Central American Common Market and improve the relationships with the U.S. and other developed countries, in a just and equitable form.

COMMISSION'S SUMMARY ANALYSIS

EL SALVADOR

The terrorist plan to destabilize the country has caused a climate of great political and economic uncertainty and has resulted in investment stagnation, capital flight, unemployment and low economic growth rates. U.S. political measures have greatly influenced the adoption by the government of measures which are detrimental to the private sector. Lack of a legal and institutional base increases the feeling of mistrust and insecurity expressed by the private sector. The government is completely separated from the private sector and dedicated to political trash and demagogy. Nationalization and bad government policy have contributed to economic chaos.

Shortage of foreign currency and contraction of internal and external sources of financing are forcing enterprises to close their operations.

On the other hand, the lack of political awareness of the private sector, a feeling of helplessness and its socio-political vision have caused the problems it is facing. The private sector has little influence, is not united, particularly with respect to the relationship between small and medium enterprise, and has little popular support. They have no participation or influence in government.

To solve above mentioned problems, the following suggestions have been made: develop an international campaign to improve the country's image; develop an economic recovery plan based on the potential of the private sector, with the private sector participating in its formulation and execution from government positions; associate the private sector with unions and campesino organizations to achieve social understanding; give more attention to the recovery of agricultural and cattle-raising production, with emphasis on employment creation. Finally, an economic assistance plan is required oriented to and through the private sector.

COMMISSION'S SUMMARY ANALYSIS

HONDURAS

In general terms, the Government has maintained a closed attitude towards the private sector, adopting unilateral measures which have affected its development. Current legislation does not meet present needs and is applied in an anarchical and demagogical manner. The private sector feels, as in other countries, that sources of foreign financing have declined and internal sources are too rigid, bureaucratic and untimely. The impact of political problems of the other countries of the area have undermined the Honduran economy because of its close ties with the rest of the region. The interference of the State in areas which pertain to the private sector has caused great damage to the economy because they have been managed inefficiently. There are no adequate incentives to export promotion nor top level channels to implement an international trade system.

In order to find an integrated solution to the problems of the private sector and the country's economic problems, the participation of the private sector in formulating and implementing the country's socio-economic plans should be stimulated. A climate of confidence is essential and the government must so understand if it expects a full utilization of productive sectors for the benefit of the nation.

Developed countries must undertake broader and faster action in economic assistance. The private sector and the country need broader terms of massive foreign assistance by means of soft loans. Financial assistance must be provided directly to the private sector without government intervention. Technology transfer and broader markets are conditions required to reactivate the private sector.

The current structure of the Honduran private market is weak and divided. If problems are to be solved and the destabilization process of Central Central is to be fought against, strengthening of association awareness and broadening of private sector bases should be propitiated, trying to achieve vertical (including small organizations) as well as horizontal (with associations of friendly countries) integration.

Central American trade must be conceived more as an integration process than a common market operation. The idea of obtaining new markets outside the area should also be promoted.

Promote the organization of a big raw material purchasing center at the regional level. Signature of a formal agreement by the countries of the region to absorb proportional quotas of overpopulation. Integration of pilot projects in each country of the region for agro-industrial exploitation with the joint participation of private capital from all the countries and from the region's labor unions.

COMMISSION'S SUMMARY ANALYSIS

NICARAGUA

The government's policy of giving more attention to the service sector, neglecting the productive sector, particularly the private sector which has the highest percentage, constrained economic growth. Even though 112,300 new jobs were created in 1980, only 53% of these were in the productive sector, and this contributed to inflation. The enormous amount of fixed State investment evidences the government's nationalization process, together with confiscations and land expropriation. The system is totally repressive of the private sector, and in the opinion of many entrepreneurs the strategy is one of survival, facing an uncertain future, as they believe the private sector will tend to disappear in the next 10 years. The above is further enhanced by insufficient financial assistance to replace assets lost during the war, thereby being unable to become a mechanism of economic recovery. The private sector has been given financing for equipment but no investment, which creates a gradual loss of productive capacity and a tendency to disappear.

Despite these adversities, the private sector has shown a spirit of fighting for survival and for an amelioration of the risk of extermination. General opinion among entrepreneurs is that the present system has a marked totalitarian tendency

of a marxist-leninist nature, and is a very strong enemy of the private sector, which makes the struggle difficult and dangerous in the economic sense as well as regarding physical safety. Despite the positive spirit of the private entrepreneur, uncertainty due to lack of definition of the rules of the game does not permit effective economic planning but rather promotes disinvestment and capital flight.

In the face of this adverse situation, private enterprise must strengthen and broaden the bases of its associations, trying to achieve unification with external organizations and promoting, through a Central American common front of private associations, dissemination of free enterprise principles and objectives and the sad truth of what is happening in Nicaragua.

With respect to agrarian reform, the private sector recommends an expansion of agricultural frontiers, given the existing large extension of land in proportion to the population, instead of redistributing the same land to non-productive hands with resultant negative consequences.

Massive and soft financing is needed, channeled through the private sector itself, to avoid political manipulation. Finally, entrepreneurs must broaden their social horizon, support unions, and achieve the integration of workers into the productive process. Social consciousness must be promoted so that it really contributes to the country's socio-economic development.

COMMISSION'S SUMMARY ANALYSIS

COSTA RICA

The country is facing socio-economic, political, monetary and fiscal problems which greatly affect the private sector's development and profitability. The deterioration of the Central American Common Market has caused further detriment to private economy. The notorious increase in public investment, contrasted with the decline in private sector investment, is part of a process of nationalization, price control, export restrictions, etc. and unfair government competition in utilization of financial resources. In 1980 the Central Bank assigned only 13% of resources to the private sector. Shortage of foreign currency and the fluctuating rate of exchange of the colon has not allowed the replacement of spare parts, raw materials, etc., nor appropriate economic planning by enterprises.

One of the main problems has been lack of confidence in government due to lack of clear economic policies and rules of the game in general. Public administration deficiencies and the nationalization tendency have contributed to increase the feeling of mistrust.

The private sector demands greater participation in the economic decisions of the country. Technical assistance and incentives are needed, especially in the agricultural

and cattle-raising sector. The slowness of government, due to present bureaucracy, constrains the solution of problems and the adjustment of free enterprise to the changing situation.

To solve these problems, the following have been suggested: long-term, low-cost massive financing; definition of economic policy; export promotion; improvement of trade terms; fixed exchange rate for the colon; strengthening of the Central American Common Market; technical assistance and training for technicians; study new types of labor/management relations.

COMMISSION'S SUMMARY ANALYSIS

PANAMA

Although public sector attitude towards the private sector is not ideal, there is no feeling of open hostility; however, the private sector requests that the State do not interfere in areas which the private sector can develop more efficiently. Price controls and labor policies are disincentives to production and investment. From a credit standpoint, Panama is a financial center. Commercial banks operate for profit and not for development of the country. This causes financial problems to many companies, particularly small ones, and if they obtain financing the cost is extremely high. Commercial banks give little attention to agricultural and cattle-raising projects.

They support the Central American Common Market, but with certain reservations given the peculiarities of Panamanian economy.

The private sector requires more expeditious credits, adequate to each sector, especially to employment generating areas; and greater incentives to small industry.

The organizations and trade associations must be united in their actions, defending the principles of free enterprise and not personal interests. In this manner they could obtain participation in the formulation and implementation of socio-economic policies which result in free enterprise development and solutions to social problems.

## CHAPTER VII

### A NEW SOCIAL CONTRACT

#### INTRODUCTION

For the purpose of initiating the process of discussion of the issues generated by the study, a group of entrepreneurs and INCAE faculty members have expressed their points of view with respect to private sector problems.

Their opinions are presented in this chapter, as another element of judgment generated by this research effort.

Political military events which have swept the region in recent years suggest that there is a rupture of the basic social contract among the principal social groups in Central America. The basic agreement needed among the different social groups on how society must be directed and which are the roles of each participant does not exist. Even more, there is an increasing degree of disagreement and antagonism among adversary groups. The high level of political violence and active campaigns by the different groups in conflict to eliminate and subjugate their opposers are the clearest symptoms of a rupture of the social contract of the region.

#### PRIVATE SECTOR PERSPECTIVE

If we consider the private sector in the broader terms suggested by the survey, including in it all non-governmental productive sectors (profit or non-profit), then this study of current private sector problems contains an examination of the situation mainly in the perspective of one segment included in the broader definition of the private sector: the segment of owners and managers.

Clearly, the perspective from the point of view of owners and managers is very valuable and necessary to understand the private sector's present situation. However, it is necessary to note that, given the great diversity of interests of the groups included in the broad definition of the private sector, private sector leaders organized into top level entrepreneurial associations are not fully representative of non-governmental productive groups.

#### THE POLITICAL DIMENSION

In the political field, the following problems and obstacles which deteriorate the quality of life in the region stand out:

- a) Excessive mistrust and suspicion among the main participants in national activities: organized private sector, government, political parties and labor sectors.
- b) Increasing antagonism among principal groups, and the different coalitions which operate in each country and they are seen as frequently becoming involved in an open and violent fight for power.
- c) There are no established dialogue mechanisms which are respected by the participants. Although there are some formal dialogue mechanisms (forums, assemblies, bipartite meetings, etc.) their effectiveness is minimal.
- d) Low level of legitimacy: the different groups interchange accusations of low representativity and the

process for selecting leaders of the different fields (especially in the political field) have frequently been plagued with irregularities, protests and accusations of fraud by groups which have not been favored by the official results.

#### THE ECONOMIC DIMENSION

These last years have been ones of stagnation and empoverishment for the region as a whole. The following economic factors can be identified as contributors to that situation:

- a) The wrong economic strategy or the urgent need to change it.

The Central American region is currently suffering the consequences of an inadequate economic strategy, which Latin America as a whole has followed since the end of World War II: growth through import substitution and State protection of incipient industrialization with the guaranty of small national markets (or regional as in Central America). To some the economic strategy of Central America has not been wrong as it demonstrated a capacity to generate a stage of economic growth without precedent in the last three decades, although they do recognize the need for acute changes in said strategy.

- b) Incoherent economic policies

The role of the State in the economies of Central America has frequently been unsuccessful and at times it has intensified the crisis: Capital flight has not only been promoted by political instability but also by the setting of inadequate low interest rates and exchange policies which have tended to overvalue local currency. Increasing difficulties with price control systems, excessive utilization of funds for military

purposes and an increasing direct involvement of the State in productive tasks frequently with unsatisfactory results, illustrate the inefficiency of economic policies in assigning resources.

c) Unfavorable external factors (specially since the energy crisis started) for which the region has not found an adequate solution. Clearly the economic strategy of internal growth has not given favorable results in these circumstances.

#### THE SOCIAL DIMENSION

The economic growth strategy of the region has caused important social unbalances as there has been an inequitable distribution of growth benefits during short periods of prosperity. Although there isn't much information, the few available figures (usually social security figures) tend to indicate that for the period between the mid-sixties and the mid-seventies, as the product per capita increased the real salary of workers affiliated to social security decreased. In the case of Nicaragua, for example, its increase of 25% per capita GDP in the decade was accompanied by a reduction of almost 30% of the real salary of urban workers affiliated to social security.

There is also an acute problem of unsatisfied expectations among broad sectors of the population. The process of

creating the CACM and the economic results at the aggregate level obtained during very prosperous periods, generated a significant rise in the expectations for improvement of the quality of life, the majority of which have not yet been satisfied.

#### THE OVERALL PROBLEM

The private sector problems must thus be considered within an overall context: the current crisis which has swept the region affects not only the private sector but all sectors. It must be accepted that real conditions have changed considerably during the past decades and particularly during the last decade, and it must be recognized that we are in a new, and not the old world. Therefore, we must seek new social, political and economic mechanisms which can be utilized to obtain a new agreement among social groups: a new social pact.

#### IN SEARCH OF SOLUTIONS

It would be naive to recommend to the private sector to dialogue with its adversaries under the presumption that there are not among them groups interested in destroying or controlling the private sector. It would be equally naive to recommend a similar action to the other groups. If the need for a new social pact has been emphasized so far, now we must ask, how can it be done? How can a new social pact be obtained?

The lessons of history can be useful. Let's take the case of Japan: during the period 1948-1952 Japan was undergoing an acute crisis: strikes, lockouts, severe labor conflicts, shortage of resources, shortage of foreign currency, inflation, impoverishment of the country. Many experts then affirmed that there was no way the country could get ahead. A tripartite social pact was reached with the participation of the government, the private sector and unions through which, among other points, were defined the country's strategy for economic growth (with emphasis on exports) and employment conditions: permanency of employment (life-long employment) and a transfer of productivity increases to salaries. The measures and details of the agreements were much more complex than those mentioned above and a subsequent detailed examination of the Japanese experience will be of great assistance in the search of practical steps to follow.

There are other experiences of deeply divided societies which have been able to develop efficient mechanisms for regulating problems between groups or sectors in conflict. The cases of postwar Austria, Belgium and Holland at the beginning of the century, Malaysia after its independence and Colombia in the period 1948-1960, are practical examples of successful regulation of acute political and social conflicts.

Mentioning above examples does not imply that there are easy solutions such as "signing a new pact". It is necessary to make a much deeper examination of the nature of the acute social and political problems which exist in several countries of the region, in order to present more objectively the different and changing nature of deterioration of agreements, roles, institutions, regulations, expectations, attitudes and rules, formal as well as informal, which are part of the social pact or contract.

If deemed convenient, however, initial steps must be taken towards a reestablishment of basic agreements among social groups, and in order to achieve it the first step needed would be the creation of awareness of the nature and extent of the problem.

SOME INITIAL STEPS

a) Promote Awareness

Historical examples are unanimous in their indication that the only ones who can positively contribute to the successful regulation of acute conflicts are the leaders of the groups in conflict. Therefore, one of the first steps to achieve the new social pact will be to promote awareness and instruction of the leaders of the different social sectors.

This can be done through courses and seminars, presenting to the participants a broad and detailed perspective of the present situation so that, through an understanding of the different points of view, the need is recognized to change attitudes and acquire new vision. In this stage it will be essential to have the assistance of authorized regional as well as extraregional representatives of great moral qualities and experience, so that they can present and interpret the present situation and act as catalysts in the process of changing attitudes and accepting a new perspective.

This training and consciousness raising phase can also include the organization of symposiums with entrepreneurs from capitalist and socialist countries from outside the region, with international political figures (i.e. Henry

Kissinger, Willy Brandt, Felipe González, López Portillo) and with well-known scholars in the areas of economy and political science.

b) Establishment of a Center of Economic, Social and Political Studies in Central America.

The establishment of a Central American Center of Studies (think tank) is proposed as a technical assistance entity for the formulation of regional strategies, particularly for the development of definite projects for negotiating the new social pact. Besides, this group will take the initiative in promoting and directing the process towards new social pacts, for which it must have the support and orientation of personalities who participate in the process in the symposium phase.

Financing for the activities of this group must be obtained from foreign assistance agencies and entities representative of the different social sectors of the region.

THE FUTURE OF THE PRIVATE SECTOR

Apparently, the future of the private sector in the region is not very promising. In the first place, entrepreneurs perceive these tendencies and therefore fear that the decline in private investment of past years will continue in the near future, as well as private capital flight.

In the second place, the factors which are presently deteriorating the private sector's position are mostly structural and do not show a tendency to diminish their influence in the near future.

Despite the above mentioned perception, there are still possibilities for the private sector to play an important role in the region and achieve a healthy growth in years to come. A good part of future responses depend on actions which the private sector may take and the reactions of the other key sectors of the countries of the area. The forecast about the disappearance of the private sector is self-attainable to a good degree: a social group - the private sector - by its own decision (not agreed collectively, but as a result of a large number of individual decisions) reduces its participation in the country's productive activities - through stagnation of private investment, capital flight, and talent flight for example - and at the same time estimates that its survival is at stake and its influence will be greatly reduced in the future, is therefore actively participating in helping those expectations to become a reality.

#### CONCLUSION

The Central American private sector is facing a crisis in which structural and exogenous factors have combined to intensify it, thus endangering the survival of the private sector in more than one country of the region.

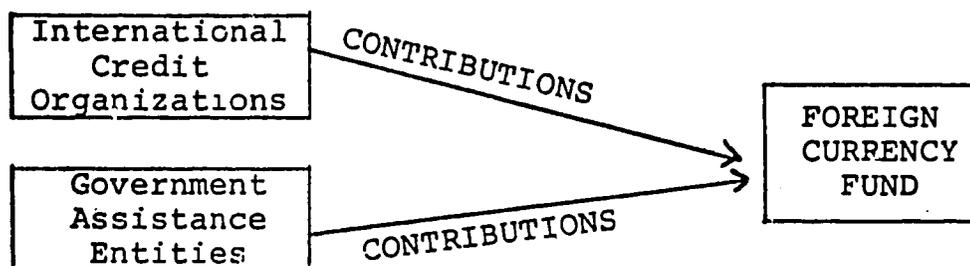
The private sector urgently needs financial support and encouragement, but in order to obtain external support it will have to prove the urgency of its current needs and

the importance of its role for the region. It will also need to show: in the first place, its intention to restrain capital and human flight. In the second place, its ability to take joint and effective actions to reactivate its productive tasks through private investment. In the third place, its capacity to develop creative initiatives which result in a better adjustment to the processes of political and social change which affect the region. Finally, its ability to interpret environmental changes and obtain for itself a role it can play in society, through an agreement with the other social sectors, mainly the labor sector and the government, which will permit its successful survival in a new perception of itself and its country.

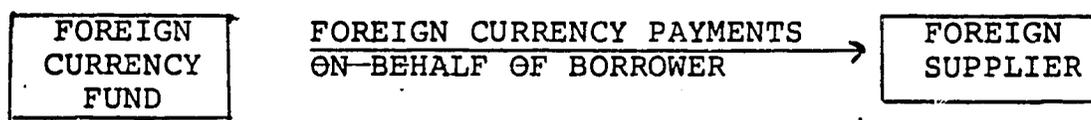
APPENDIX

LOAN AND REINVESTMENT FUND

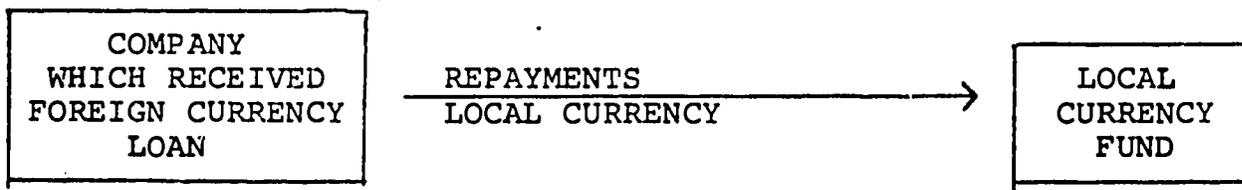
FIRST PHASE: CREATION OF A FOREIGN CURRENCY FUND



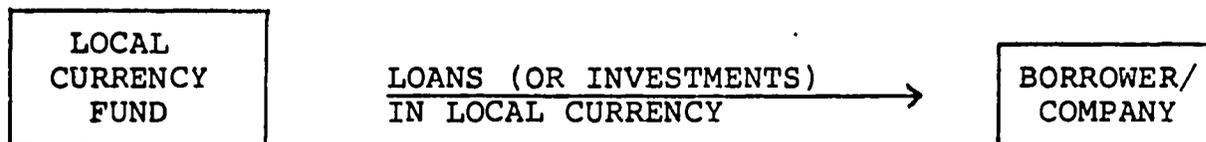
SECOND PHASE: DISBURSEMENT OF FOREIGN CURRENCY LOANS



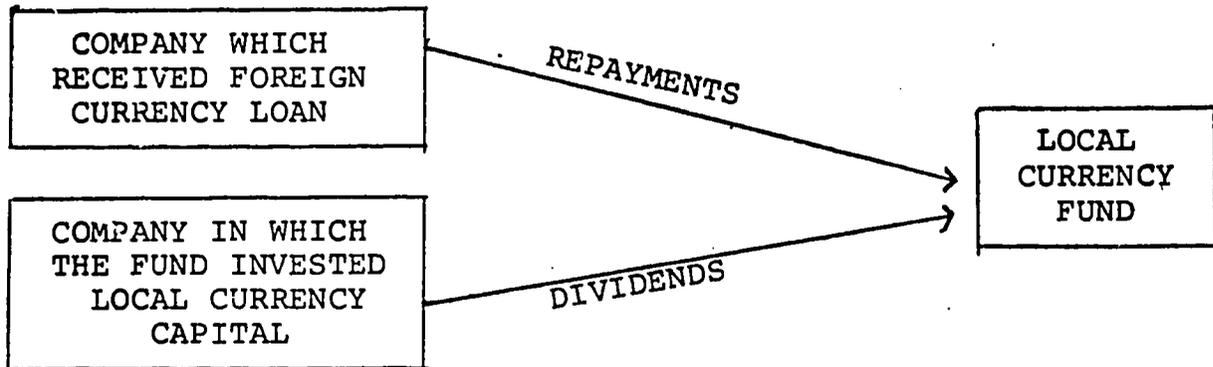
THIRD PHASE: REPAYMENTS IN LOCAL CURRENCY (AND/OR COUNTERPART CONTRIBUTIONS TO THE FUND IN LOCAL CURRENCY)



FOURTH PHASE: DISBURSEMENT OF LOCAL CURRENCY LOANS OR INVESTMENTS



FIFTH PHASE: LOAN REPAYMENTS (OR INVESTMENT PROFITS) IN LOCAL CURRENCY



SIXTH PHASE: CONVERSION OF LOCAL CURRENCY FUND INTO FOREIGN CURRENCY FUND



EXPLANATION OF THE FUND'S OPERATIONAL PHASES

First Phase: Creation

The Fund's sponsoring entities make foreign currency contributions.

Second Phase: Foreign currency loans

The Fund makes foreign currency payments to foreign suppliers on behalf of the companies to which loans have been granted.

Third Phase: Repayments and Counterpart Contributions

A local currency fund is created with resources obtained from local currency repayments of loans made in foreign currency and with resources obtained from counterpart local currency contributions.

Fourth Phase: Local Currency Loans and Investments

The local currency fund places its resources locally through local currency loans and investment in local companies.

Fifth Phase: Repayments and Profits

The local currency fund recuperates loans made in local currency and receives investment dividends.

Sixth Phase: Reconversion into Foreign Currency

Finally, when money exchange conditions of the country or countries in question permit it, the necessary reconversion of the local currency fund into a foreign currency fund will be made.

It should be noted that:

- a) The foreign currency fund will gradually convert into a local currency fund.
- b) The fund will initially be oriented to serve as a mechanism for immediate assistance and short-term economic reactivation of the private sector.
- c) The money exchange risk is assumed by the fund and not by local borrowers.
- d) There are no guarantees for reconverting local currency into foreign currency. However, if there are extraregional organizations who are interested in helping reactivate the private sector and the economies of the area, it is assumed that their interest is based on their belief that such a reactivation is feasible. Therefore, if

they expect that eventually such reactivation will occur, they will be willing to manage the fund's local currency resources in each country during the process of reactivation and until the time when the countries' economies have recovered and can reconvert local currency resources into foreign currency. If the entities which wish to contribute to the economic recovery of the area consider that future reconversion of the fund is improbable, it means that they believe that the economic recovery of the area is also improbable and that they are interested in undertaking a futile task.

- e) There is a probability that existing regulations of the different international credit and foreign assistance organizations will prevent their participation in a fund of such a nature as that herein proposed.