Economics: Background Paper on Central America

Prepared for the National Bipartisan Commission on Central America

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September 1983

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Introduction

Weak economic conditions prevail throughout Central America today, reflecting the difficult international economic environment of the past several years, the effects of political instability and the consequences of poor domestic economic management. Economic and political stability are intertwined. Without a reduction in the levels of violence, economic recovery is almost impossible; without economic growth, the social and political pressures underlying some of the tensions in the region will inevitably increase.

This paper does not pretend to solve this dilemma. Its purpose is to describe and explain current economic conditions, derive from that analysis the key issues which need to be addressed, and suggest alternative conceptual structures through which the United States could help the Central American countries improve their economic performance.

The paper is divided into several sections. The first deals with the evolution of the economic situation in the region, highlighting the major sources of the current economic distress and focussing on the external debt situation and the role of foreign assistance. The second section identifies critical economic needs of the region and raises several issues for further discussion including short-term economic stabilization and the future of regional integration. Finally, the last section of the paper deals with policy options for the United States. In addition, the appendix summaries individual country situations and presents summarized country economic statistics.

Economic Conditions*

The economy of Central America has been badly affected by the international economic and financial crisis of the past several years. Adverse external conditions, compounded by poor management and structural economic weaknesses, have produced high inflation, economic stagnation, and debt service problems throughout the region. Although individual country experiences have differed marginally, the same general pattern has prevailed: since 1979 real gross domestic product of the Central American countries has tended to stagnate or contract (See Table 1).**

TABLE 1

Change in Real GDP

(Percent)

	1979	1980	1981	1982
Costa Rica	4.9	0.8	-4.6	-8.8
El Salvador	-1.7	-9.0	-9.5	-5.4
Guatemala	4.7	3.7	0.9	-3.5
Honduras	6.2	2.9	0.2	-1.2
Nicaragua	-26.4	10.0	8.5	-1.4
Panama	4.5	6.0	4.3	4.1

* Data in this paper are drawn from International Monetary Fund, World Bank, Inter-American Development Bank, U.S. Government, the Bank for International Settlements, and national sources. These data often conflict and are partially estimated; the data which have been used are judged to be the most accurate information available.

** See the Appendix for notes on individual countries and country data sheets.

Changes in economic activity per capita have been even weaker in recent years (Table 2). However, during the years between 1960 and 1975, per capita growth was quite strong, reflecting the dynamism of the world economy and the positive effects of sharply increased regional trade under the auspices of the Central American Common Market (CACM). (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua formed a trade and payments union in 1960.) Economic activity declined sharply in Nicaragua (reflecting the effects of the massive earthquake and the struggle to overthrow President Somoza) and El Salvador after 1975. During 1980-82, economic activity in Costa Rica, El Salvador, Guatemala, and Honduras declined in per capita terms. Only Panama was able to maintain its economic growth momentum, at least through 1982. (In 1983, though, real economic activity is reportedly declining in Panama.)

Table 2: Changes in Per Capita Real GDP

(Annual average percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Costa Rica	2.7	3.4	2.6	-9.2
El Salvador	2.1	2.3	-2.8	-10.6
Guatemala	2.2	2.1	2.5	-4.2
Honduras	1.5	-0.1	2.5	-4.0
Nicaragua	3.7	2.1	-7.7	0.2
Panama	4.8	1.6	1.5	1.6

The differences among the Central American economies are almost as important as the similarities. Per capita GNP ranges between $600 in Honduras to $1900 in Panama. Population growth varies from around 2.3% in Panama to 3.9% in

Nicaragua; El Salvador, whose population of almost five million is increasing 2.9% annually, faces serious population pressures on its land and resource base. The distribution of income within these countries is typically unequally distributed and the economic decline of the past several years probably worsened this distribution. The Economic Commission for Latin America (ECLA) has estimated that in 1980, the 20 percent of individuals with the highest incomes captured between 49 percent of the total (Costa Rica) and 66 percent (El Salvador); and the bottom 50 percent of individuals between 21 percent (Costa Rica) and only 12 percent (El Salvador).

There are differences in the economic structure of these countries, although agricultural production plays an important role in the exports of all of them. While there has been a relative increase in the past two decades in the manufacturing sectors in all of the countries, they remain predominantly exporters of primary agricultural products. About 90 percent of the value of Honduras' exports are primary products; among the five member countries of the CACM, the share is lowest for Costa Rica, at 75 percent. Excluding re-exports, Panama's exports are roughly 70 percent primary products.

Despite these and other differences, these six countries--and especially the members of CACM--have much in common. They have faced similar external pressures, and have formulated similar policy responses. And, as indicated above, all now face the challenge to reactivate economies which have performed badly in recent years.

The stagnation and decline thoughout the region can be traced to several factors:

1. <u>High oil prices, prolonged world recession, and weak demand/prices for commodity exports</u>.

All of the countries in the region were badly affected by the sharp rise in oil prices during the 1970s. Oil imports in 1981, after the second round of price rises and before the collapse of Central America's exports, were equal to more than one-fifth of export revenues.

Moreover, slack world demand for Central America's key export products (coffee, bananas, cotton, sugar, and meat) coupled with inflation-driven increases in prices of their imports, led to a drastic deterioration of the region's terms of trade (the relationship between their export and import prices) starting in 1977. Between 1977 and 1982 the terms of trade fell 41%; the index (1970=100) dropped from 121 in 1977 to 71 in 1982. The significance of this deterioration is that the quantity of exports must increase in reverse relationship to the decline in the terms of trade just to import the same quantity of goods. However at the same time that the export-import price relationship was deteriorating for these countries, the importers of their products were also demanding less in volume terms.

Since each of these countries has a relatively open economy in which exports of goods and nonfactor services account for 25 to 40 percent of GDP, the shortfall in export earnings reduced the ability to import raw materials, spare parts, and other capital and consumer goods, contributing to the economic slowdown (Table 3).

Table 3: Trade Performance, 1960-1982

(Average annual percent growth rate)

	1960-1970	1970-1975	1975-1980	1980-1982
Costa Rica				
Exports	10.3	16.4	15.2	-6.5
Imports	11.2	16.9	17.0	-25.0
El Salvador				
Exports	8.7	17.7	12.7	-19.3
Imports	4.7	23.1	10.5	-4.2
Guatemala				
Exports	9.9	16.6	18.9	-11.1
Imports	7.9	20.3	17.0	-6.8
Honduras				
Exports	10.9	11.7	21.9	-10.8
Imports	12.2	12.9	20.7	-15.7
Nicaragua				
Exports	10.8	15.9	3.7	-4.0
Imports	12.3	21.9	10.7	-5.3
Panama				
Exports	12.8	20.5	2.5	-7.6
Imports	11.7	20.0	10.3	5.3

2. Intra-regional tensions and political unrest.

The conflict between El Salvador and Honduras in 1969 adversely affected cooperation among the CACM countries and began a process which gradually undermined the dynamics of the common market. Nevertheless, intra-regional trade, largely in manufactured goods, continued to grow until 1980. Since 1980 political unrest in Nicaragua, El Salvador and Guatemala and the financial problems of all the CACM countries led to a sharp decline in intra-regional trade: the value of such trade fell by almost one-third between 1980 and 1982. This collapse of intra-CACM trade--in part because of the accumulation of serious trade imbalances

between Costa Rica and Guatemala with surplusses on the one hand and Nicaragua, El Salvador, and Honduras on the other--contributed to the region-wide economic contraction.

Another economic consequence of political conflict--besides the destruction of economic infrastructure--has been commercial bank and investor retrenchment. Private sector confidence, both in and outside Central America, has been shaken; domestic and foreign investment has declined and capital flight has been substantial. Although accurate measurements of capital flight are unavailable, balance of payments data imply that some $2.5 to $3.0 billion in private capital flowed out of the six countries between 1979 and 1982.

3. Weak economic management.

The Central American countries had traditionally been characterized by sound economic management as evidenced by their relatively good inflation performance. However, they shifted policies after the second oil shock, the sharp increase in interest rates and the onset of recession in the United States. Each of the countries increased public sector spending in an attempt to sustain domestic economic activity; larger public sector deficits led to higher inflation (especially in Costa Rica) and increased foreign debt (especially in Costa Rica and Panama). In 1980, inflation in all of the countries was in double digits and, between 1975 and 1980, external debt in the region increased more than 200%.

4. Commercial bank retrenchment.

With the beginning of the international financial crisis in 1982, the Central American countries lost their limited access to the international commercial banking market. Trade finance lines were cut and public and private sector borrowers were unable to raise new funds. To some extent, this reinforced the drop in imports and the decline in economic activity, even though increased official assistance more than offset the decline in commercial bank credits.

The legacy of these developments is economic stagnation--with attendant widespread unemployment, declining real incomes, and declining trade--and a significant accumulation of external debt. The size of the debt and the burden of servicing this debt, relative foreign exchange earnings, are highest in Costa Rica, Nicaragua, and Panama.

Total disbursed debt of the five CACM countries was estimated at $11.0 billion at the end of last year; including Panama, the debt total was $14 billion. (The debt figures in Table 5 probably underestimate short term and private sector indebtedness.) About 40% of this debt has been borrowed from commercial banks.

Table 5: External Debt Data

	Total Debt (end 1982)	Banks as % of Total	1982 Debt Service Ratio*
Costa Rica	$3.6 billion	36	57
El Salvador	1.2	26	8
Guatemala	2.0	58	9
Honduras	1.7	28	21
Nicaragua	2.5	38	37
Panama	3.1**	58	31

*As % of merchandise exports and non-factor service earnings.
**Public debt only.

Although debt service burdens are less than those of countries like Mexico and Brazil, all of the countries in Central America are having difficulty maintaining timely debt service payments. Costa Rica, and Panama are currently restructuring their external debt. Nicaragua is presently in arrears on debt which was restructured in 1980 and 1981. Guatemala, Honduras and El Salvador are also having difficulty meeting debt payments.

Faced with these conditions, all of the Central American countries--except Nicaragua which may enter into negotiations with the Fund during the fall--have adopted IMF sanctioned stabilization programs. The programs aim at reducing public sector deficits and slowing rapid money supply growth in order to reduce inflation, while at the same time stabilizing the balance of payments. There have already been some successes: inflation has fallen sharply in all of the countries; in Costa Rica, where inflation was 90% last year, prices rose at an annual rate of 20% in the first half of 1983.

These programs probably imply continued economic stagnation for at least 1983-84, until international economic and financial conditions improve. Despite the industrialization efforts of the past two decades--which were largely aimed at the regional market--the economic recovery of Central America basically rests on higher commodity prices and increased demand. Around 70% of the extra-regional exports of the six Central American countries are accounted for by six commodities: coffee, bananas, cotton, meat, shrimp, and sugar. Coffee and sugar seem to be in structural oversupply and, as a result, prices remain weak. Prices of the other key export commodities have also not performed well. Thus, the terms of trade and, ultimately, the earnings of the region have not yet benefitted from economic recovery in the United States. As a result, imports (and, hence, economic activity) are constrained by the availability of foreign finance and the need to devote foreign exchange to debt service.

More generally, the region's external performance will be largely determined by the developments in three key variables: dollar interest rates, oil prices and commodity prices. The sensitivity of the balance of payments to these variables can be easily summarized. Because of the large share of generally fixed interest rate and lower cost official finance in the region's total foreign debt, a one percentage point rise in average interest rates costs Central American countries about $60 million per year. A 10% rise in oil prices costs some $100 million. And a 10% rise in the prices of the region's commodity exports would produce added annual revenues of at least $350 to $400 million for the six countries as a group.

The importance of these key variables should not be underestimated; in both the short and medium run, their performance will largely determine the external financial needs of the countries. A healthy world economy

characterized by moderately increasing prices for the region's main commodity exports, stable or lower interest rates, and stagnant or declining oil prices would considerably ease the balance of payments problem and exert a positive influence on economic activity in the region.

Nevertheless, the overall financing requirement for the region will remain large. Specific forecasts have not yet been prepared, in part because of the many political uncertainties which crucially affect economic variables. In the short run, the bulk of new financing will come from official sources since commercial lenders are unwilling to extend new credits outside of so-called "involuntary" lending in the context of formal restructuring agreements. For example, last year commercial banks covered only about 13% of the net financing requirement of the region compared to about 31% in 1980. (The data in Table 6 underestimate the role of the banks in 1982 since some of the identified principal and interest arrears were owed to them.)

Table 6: Central America's Net Financing Requirement

	1980	1982
Net Requirement*	$2.5 billion	$2.8 billion
Sources of Finance	100%	100%
Direct investment	9	8
Commercial banks	31	13
IMF	0	3
U.S. Government	8	13
Other official grants and loans	31	35
Arrears	2	22
Reserve usage	13	-3
Unidentified	6	9

* Defined as the sum of the current account deficit plus estimated capital flight.

More than half of the borrowing requirement was met by lending or grants from official sources, including the U.S. government, the IMF, the World Bank, and the IDB. Although data are not strictly comparable, U.S. financial assistance (including development assistance, economic support funds) PL430 and CCC guarantees) of some $370 million accounted for about 13% of the region's financial needs last year. Combined Venezuelan and Mexican assistance, through the concessional oil facility, totalled around $200 million.

Without a significant increase in financing--in particular, lower cost, longer term credits which reinforce economic restructuring programs contribute to an improvement in debt structure, and ease debt service payments--imports will remain depressed and economic recovery will be delayed. However, unless the private sector--both foreign and domestic--begins investing, any improvement in near-term economic conditions financed by higher levels of official financial support will be short lived--and could lead to renewed capital flight.

Critical Economic Issues

A number of issues are critical to the economic evolution of the region. In the short and medium term, the key economic needs of the Central American countries are:

-- to halt economic deterioration;

-- to contain inflation;

-- to reduce balance-of-payments deficits and to regularize debt service;

-- to look beyond short-term stabilization and to reinvigorate economic growth on a sustainable basis;

-- to stimulate private investment, both from internal and external sources;

-- to reduce high population growth rates and to create jobs for rapidly growing labor forces;

-- to revitalize regional economic institutions in order to mitigate the problem of small national markets;

-- to eliminate and reverse capital flight;

-- to restore political and economic confidence in order to end the flight of human capital;

-- to diversify the underlying economic structures and export bases in order to reduce the vulnerability to commodity price cycles;

-- to promote a more equitable distribution of income.

Many of these problems have a one to two year time horizon, such as stabilization, while others can be dealt with only over the medium term, such as reinvigorating the CACM, stimulating new investment, and promoting sustainable economic growth. The different time horizons are crucial to the development of any economic program. Similarly, it seems clear that none of these problems can be addressed effectively during a military conflict. Until political stability returns to the region economic performance will remain weak at best.

For each of these issues, there are different tactics which should be discussed. It is not the purpose of this paper to develop these issues, but several key factors should be highlighted for discussion.

1. Short term economic stabilization

The dominant objective in the short-term has to be to halt the economic deterioration and lay the ground work for future economic growth. In this context the role of IMF sanctioned stabilization programs will need to be

addressed. There is considerable disagreement over IMF conditionality. Some observers claim that the Fund's approach is unduly harsh and costly in terms of economic growth; while others argue that in the absence of IMF credit and policy guidance, the economic adjustment would be even sharper.

2. The need for debt relief

In a sense, only Costa Rica, Panama and Nicaragua have significant debt problems, and, as indicated above, changes in interest rates have a relatively minor effect on the balance of payments. Nevertheless, the debt burdens of these countries may be significant constraints on economic recovery and expansion. Although these debt problems are no different than those which exist throughout the Hemisphere, there may be a need to develop mechanisms for extraordinary debt relief, including concessional terms for public sector reschedulings, lower interest costs on private sector debt, long-term debt restructuring, or interest cost subsidies. At the same time, such proposals should be examined in the context of the broader debt problem, with particular reference to Latin America.

3. Commodity price stabilization

Under almost any realistic scenario, the region will remain dependent on a handful of commodities for its export earnings. The prices of these commodities tend to move in concert and, to some extent, are affected by business cycles in the industrial economies. However, the steady decline in the terms of trade in recent years may suggest structural, rather than cyclical, weaknesses.) Volatility in export earnings has a powerful impact on

economic performance. Proposals to mitigate the impact either through commodity price stabilization schemes (almost certainly unworkable for the region's particular exports) or special assistance payments triggered by price declines (like the IMF's Compensatory Finance Facility on the European Community's STABEX scheme) might be considered.

4. The future of regional integration

One of the most important questions over both the short-and medium-term is the future of CACM. The Consultative Group initiative being discussed in Brussels during September 13 to 15 has as its centerpiece a proposal to reinvigorate existing regional economic structures. This raises financial questions about relations between creditor and debtor countries within the region, political questions about the role of Nicaragua and its relations with other CACM members, and economic questions about the long-run viability of a regionally focussed economic development strategy. In the short-run, any progress in rebuilding intra-regional trade would contribute to economic recovery; however, there are differences of opinion about the extent to which the benefits of integration were exhausted by the end of the 1970s. Indeed, the Caribbean Basin Initiative (CBI) effectively proposes an alternative model of development, one which is extra-regionally (i.e., towards the U.S.) oriented.

5. The relative roles of the public and private sectors.

With the decline in private sector investment and development of significant capital flight, efforts to resuscitate the economies in the region have tended to focus on the public sector. The national authorities have relied on public sector investment to provide jobs; official financial assistance tends to flow

through public sector institutions in recipient countries; and even where official monies are available to encourage private sector initiatives, investor reluctance because of political and economic conditions results in underutilization of programs. As long as the region remains dependent on official financial flows and preoccupied with political instability, these problems will remain acute.

Any discussion of future economic assistance programs will have to address the impact of such flows on economic structures and, inparticular, the public private trade-off. In a similar vein, there may be differing views of the capacity of existing public sector institutions in the region to absorb significant incremental amounts of financial assistance.

Policy Options

The United States is presently a major source of financial assistance to Central America; our assumption is that this role will continue and perhaps expand in the coming years in an effort to help these countries address their economic problems. The economic and political issues are intertwined. Without economic recovery, the political and social conflicts will tend to worsen. Without a reduction in the levels of violence, sustainable economic recovery--at least in some of the countries and perhaps in all of them--is unlikely.

As mentioned earlier, we have not attempted to quantify the region's financial needs or its ability to use productively additional assistance. Nevertheless, on the assumption that large-scale assistance will continue, the following

discussion lays out alternative conceptual, organizational and substantive patterns which the United States might employ to encourage achievement of economic (and other) objectives. They are not necessarily mutually exclusive.

1. <u>The United States can grant a series of bilateral economic concessions and encourage other countries to do the same.</u>

This, essentially, is current policy. The Caribbean Basin Initiative had three elements, the first two of which seem to be prospering: increased aid; one-way free trade; and tax concessions for new U.S. investment in CBI beneficiary countries. The U.S. has encouraged other countries in the Western Hemisphere (Canada, Mexico, Colombia, and Venezuela) to provide concessions of their own. Antedating the CBI, Mexico and Venezuela agreed to provide oil to countries in the Caribbean Basin on concessional terms. The Inter-American Development Bank is sponsoring a group designed to seek aid for Central American countries. (The World Bank chairs an aid group for countries in the Caribbean.) Other specific concessions can be considered. These might include setting up a trade-financing facility supported by public funds; helping to fund a CACM payments facility; removing the CBI trade restrictions; providing tax concessions for holding conferences in Central American countries; increasing the Overseas Private Investment Corporation's attention to Central America; promoting trade by developing a small loan facility within the Export-Import Banks; and providing generous restructuring of public debt owed official U.S. agencies. More generally, a dramatic increase in bilateral economic assistance through traditional vehicles like aid programs could be used to facilitate the economic adjustment process.

The advantage of this approach is that it is specific and the benefits, while often uncertain as to magnitude, are tangible. This approach to policy requires no new institutions, and for the most part does not require new legislation. When concessions are granted bilaterally, the United States can discriminate among countries, which it may wish to do on human rights grounds, because of political hostility to particular countries, or for other reasons. This policy already exists, with many specific elements in place, and additional concessions can be added at U.S. discretion and at U.S. timing.

Its major disadvantage is that it is an accumulation of concessions without any structure to translate concessions into sustainable economic development. Its dynamism, therefore, may depend on adding new concessions from time to time, while hoping that past concessions will promote economic progress thereby making further concessions redundant. Its major shortcoming is that most of the specific concessions are handouts requiring little in return from recipient nations. Although this is not uniformly the case, since aid can be withheld on various grounds or be granted only for specific projects which carry their own conditions, it is generally true. The piece meal approach lacks an overall motivating force and has no definable targets. Hence, sustaining political support in the U.S. and other donor countries is difficult; moreover, the strong bilateral flavor of the programs may fail to attract multilateral support. The result could be less economic (and political) support than might otherwise be possible.

2. <u>In order to correct the structural shortcomings of the pure specific-concession option, a regional framework might be constructed which makes concessions to specific countries conditional on counterpart actions by them.</u>

Analogies are dangerous because the circumstances and substance differ from case to case, but this option is closely related to the model of the Alliance for Progress. The broad understanding under which U.S. aid was granted during the Alliance and the conditions imposed on recipient countries were set forth in the Charter of Punta del Este. The framework was given operational content by the Nine Wise Men and later the CIAP structure (the Inter-American Committee for the Alliance for Progress); these mechanisms involved dispassionate appraisals of national development programs by experts from throughout the Hemisphere. Those who were involved in the Wise Men or the CIAP process speak well of each of them primarily because the expertise was perceived as genuine, the appraisal friendly if rigorous, and the context multilateral--thereby avoiding the conflicts which inevitably arise in a bilateral U.S.-recipient relationship. The framework succeeded for a time and probably contributed to the impressive economic performance throughout Latin America during the 1960s and 1970s.

The analogy presupposes a multilateral framework involving at a minimum the United States and all the recipient nations. The membership could be expanded to include other donor nations. The broader it gets, however, the more it resembles a pure aid program, a sort of World Bank for Central America.

The advantage of this approach have been stated. It imposes a structure on specific concessions; it can add an appraisal process to assess country behavior as a condition precedent to providing concessions; and it can reduce the friction inherent in a purely bilateral process. The Alliance analogy can be carried one step further, by adding economic growth and social targets, and this might add specificity and a time frame to the structure, although targets should be exhortative rather than precise.

The disadvantages are those of the analogy. Whatever one's view of the success of the Alliance, it is hard to resurrect a 1960s structure on a more limited group of countries in the 1980s. In addition, the Alliance was essentially an aid program and may not be an appropriate framework to address trade and other issues which are critical today.

3. <u>The U.S. and others could forego a new structure and seek to revitalize existing institutions</u>.

The Consultative Group for the Caribbean, which has been successful in mobilizing financial support to assist economic restructuring efforts, is an example of a sub-institution with a special regional focus established within an existing institution. The Consultative Group on Central America, sponsored by the IBD, is a first step in this direction for the five CACM countries.

The advantage of this approach is that it avoids establishment of a completely new institution. Depending on the membership, the consultative group concept minimizes bilateral frictions. Aid givers and recipients are familiar with the procedure since it is used in many contexts as a way to raise aid funds

and to comment on recipient-country economic development programs. The disadvantage is that it is essentially an aid grouping, but without the drama attendant on a new strucutre and therefore unlikely to arouse much aid-giving passion. Moreover, the consultative group mechanism can be bulky and ineffective if it lacks strong donor support and aggressive leadership.

4. <u>The U.S. and other creditors could go beyond the aid-giving framework and develop a structure focussed on regular appraisals and consultations on overall development programs as well as policies in specific sectors (trade, investment, agriculture, energy, etc.)</u>.

The analogy here is that of the Lome agreement between the European Economic Community (EEC) and the African-Caribbean-Pacific (ACP) countries. At periodic intervals, usually five years, the EEC and the ACP countries sign an agreement setting forth mutual responsibilities (up to here, this is like the Charter of Punta del Este) and EEC aid programs are then committed over this time frame. In addition to this aid aspect, policy-level officials meet periodically on the problems, prospects and needs of different sectors. There--could and probably should--also be an annual meeting at ministerial level to appraise the progress of all the countries under the agreement. The structure also incorporates a mechanism which triggers additional financial assistance if commodity prices decline.

Although it would be difficult for the United States to make a five-year aid commitment since Congress has not normally been amenable to long-term commitments, this may not be out of the question and would encourage the Central American countries to develop programs that have an extended time

frame. The congressional problem could be handled as it was under the Alliance, as a five-year best-efforts endeavor rather than as an obligation. And the donor group could be defined to include the U.S., Canada, Mexico, Venezuela and the perhaps other major Latin American countries if they are prepared to provide economic assistance.

The main advantage of this structure is that it builds in periodic (semi-annual or annual) sectoral policy reviews. In the absence of this attention-getting device, the tendency for the U.S. Government is to pay attention to Central America when a crisis is at hand, to look for concessions, and then to forget the region when a crisis erupts elsewhere. The periodic meetings may also obviate the need to amass concessions ab initio since they can emerge from the circumstances at the time of these regular meetings.

The disadvantage of this structure is that, without an on-going major political commitment, over time the official representation at regular regional meetings will probably diminish, especially on the part of the United States. The meetings could deteriorate into demand-and-reject sessions or efforts to force U.S. officials to design new compromise concessions, rather than joint efforts to address pressing macro- and micro-economic issues. This would be particularly true if the statements at the meetings were publicized in recipient countries for political purposes, although this does not seem to have been a major problem for the EEC.

Conclusion

It is impossible to divorce the medium-term economic problem--and to identify possible solutions--from current economic conditions. Over the short-term, the thrust of U.S. economic and financial assistance will inevitably be to reverse the economic decline and to reinforce on-going stabilization and restructuring efforts. Over a longer time horizon U.S. policy can facilitate the development of stable, expanding economies which are less vulnerable to the vagaries of international economic conditions.

In other words, the kinds of U.S. policy efforts which are appropriate today and which will be needed in three to five years (at least if economic stabilization efforts are successful) are different. For example, balance of payments assistance should become less critical, while unimpaired access to the U.S. market will take on added importance for the Central American economies.

The structures which are used to deliver U.S. assistance should be designed in the context of both present problems and future prospects. They should encourage economic stabilization efforts now, but anticipate the re-emergence of rapidly growing, export oriented economies over the course of the decade. The experiences of 1960 through 1975 suggest this is a realistic goal; the experiences of the past several years suggest it should be an imperative of American foreign policy.

Appendix: Country Detail

It is important to highlight differences in economic conditions among the Central American countries. The country notes presented here summarize some of the key developments in each of the six countries. The data tables were prepared from a variety of sources including IMF, World Bank, IDB, ECLA, U.S. Government and Bank for International Settlements documents. Note that the calculations of debt service ratios are based on interest and amortization payments on public sector debt and the export of goods and non-factor services. As such, in countries where there is private sector debt and especially where significant arrearages have accumulated, these ratios are understated.

Costa Rica

Between 1965 and 1977, real GDP in Costa Rica more than tripled. There was reasonably wide sharing of the benefits of this growth, as measured both in improved income distribution and in improved social indicators for health and education. The economy underwent considerable diversification. For example, exports of manufactures increased during those years from 9 to 29 percent of total exports. Net export growth in manufacturing (that is, gross exports less imported inputs) was less spectacular; over the years in question, the value of exports grew eleven times and of imported inputs seven times. Growth in the agricultural sector was also less impressive. Agriculture's contribution to GDP declined from 24 to 21 percent during the 1970s. In 1980, agricultural exports still constituted 63 percent of the value of all merchandise exports, but the need to import agricultural products for domestic consumption increased.

By the late 1970s, Costa Rican export growth slowed because of the world and regional economic slowdown. The public sector deficit showed steady increases in the latter 1970s; by 1980 it exceeded 10 percent of GDP and reached 13 percent of GDP in 1981. Partly as a result, traditionally low inflation (less than 5 percent a year in the early 1970s) reached 90% in 1982.

Costa Rica thus faced typical stabilization problems: an unsustainable balance of payments deficit, inability to meet debt service, a burgeoning fiscal deficit, and the beginnings of runaway inflation. The country reached agreement with the IMF in late 1982 on a stabilization program, and has made significant progress in restructuring its debt payments. On present trends, Costa Rica could regain the late 1970s level of real per capita income in 1985.

El Salvador

Like the rest of the region, El Salvador had satisfactory overall economic growth from 1960 through the late 1970s. However, this performance did not translate into improved income distribution. What ECLA has called "extreme poverty"--the inability to obtain a food basket necessary to sustain minimum biological-nutritional levels--affected about 50 percent of El Salvador's population in 1980. This was comparable to the percentage in Honduras, but higher than other Central American countries; by contrast, the ECLA calculation for Costa Rica in 1980 was less than 14 percent.

During the almost two decades of strong growth El Salvador developed an efficient industrial base, at least by Central American standards. Indeed, its manufactured exports during the 1970s within the CACM were second in value only to those of Guatemala. One weakness of this export pattern, however, was

that almost 80 percent of El Salvador's manufactured exports went to other CACM members and these exports inevitably suffered as real incomes declined in the region. The agricultural sector also experienced satisfactory levels of growth during most of the 1970s; in the ten years from 1970 through 1979, growth in this sector was 41 percent, or about 3.6 percent a year.

The economy turned down in 1979 because of the combination of internal political conflict, decline in demand of other CACM countries, and the deterioration in the terms of trade. Fixed investment, which was as high as 26 percent of GDP in 1978, declined sharply in 1979 and has since been between 10 and 12 percent. The public sector deficit, which was between 1 and 3 percent of GDP before 1979, has averaged around 10 percent in recent years. The economic prospects of El Salvador are hostage to the domestic political situation; continuing economic stagnation or decline seems likely in the near future.

Guatemala

Guatemala is the most populous Central American country and the one which should have had the most promising economic potential in light of its resource base. Indeed, its annual average GDP growth rate for most of the 1970s, around 5.75 percent, exceeded that of most of Latin America. It has the most extensive and competitive manufacturing base of any of the CACM countries and a diversified agricultural sector whose contribution to GDP has depended mainly on the key export crops: coffee, cotton, sugar, bananas, and beef. Like El Salvador, land ownership has been highly concentrated.

The downturn in Guatemala's economy began in 1978, and the decline has since continued. A good part of the work force, around 40 percent, is estimated to be unemployed or engaged in only part-time activities. Like all of the Central American countries except Nicaragua, Guatemala is implementing an economic stabilization program, supported by the IMF.

Honduras

Honduras has the lowest GDP per capita of the CACM countries and the highest levels of infant mortality and illiteracy. Except for the adverse effects in 1974 and 1975 from Hurricane Fifi, its GDP growth rates were high until about 1980 and all major sectors shared in this growth. The problems faced by the Honduran economy, apart from the political uncertainty which the entire region faces, are its limited export base (the main agricultural exports are bananas and coffee), the severe decline in the terms of trade starting around 1979, and the under-developed nature of its industry, which involves little value added in the country. Only about 7 percent of Honduras' exports go to other CACM countries, the lowest percentage of any of the CACM members.

Nicaragua

Real GDP growth in Nicaragua averaged between 5.5 and 6.5 percent annually between 1960 and 1975. Among the reasons for this growth were the expansion of cotton production and the stimulus received from trade within the CACM. The turnaround in Nicaragua's economy followed the military conflict of 1978-79, which interrupted the agricultural cycle, destroyed many industrial establishments, and led to a 27% decline in real GDP in 1979. Ever since,

Nicaragua's relative role in the CACM has declined and its fiscal and balance-of-payments deficits have burgeoned. It rescheduled its external debt on relatively favorable terms in 1980 and 1981 (the country committed itself to pay only 7% interest, but agreed to capitalize the balance of market determined interest costs; the deal was completed because the Sandinista regime initially indicated it would not seek additional bank credits), but has recently been unable to make scheduled payments. Although the country has no IMF program the government is seeking to bring public spending into line with available resources. Even more than the other countries of the region, its public sector has grown and credit to the private sector has been sharply curtailed.

The country's future is highly uncertain. It must overcome a shortage of foreign exchange for necessary inputs to agriculture and industry, and must either provide more incentives for private sector investment or (more likely) replace the shortfall in private investment by public investment. The latter strategy is complicated by the fiscal austerity imposed for stabilization reasons. Nicaraguan authorities are now considering an approach to both the IMF and the World Bank for balance of payments assistance.

Panama

Panama is not a member of the CACM and its economy is more heavily service oriented than the other Central American countries. At present, agriculture contributes about 10 percent to GDP (compared with Guatemala at 25 percent and Cost Rica and Nicaragua, both over 20 percent); manufacturing about 10 percent; and services, including construction, the rest.

Panama had uneven growth during the 1970s, but then rebounded sharply in 1978. Its pattern, therefore, has been somewhat different from the other countries, resuming growth as their declines began and remaining positive, although at a declining rate, through 1982. This performance reflected the positive affects on investor confidence of the signing of the Panama Canal Treaty, as well as aggressive counter-cyclical policies. As a result of the latter, inflation increased sharply in 1979 and 1980, and the current account deficit reached almost 11% of GDP in 1979. However, the extreme openness of the Panamanian economy tends to prevent economic policy from diverging for long from international conditions. Since Panama is essentially a dollar based economy, the fiscal deficit must be finanaced in the dollar capital markets, and access to foreign credit directly determines the stance of economic policy.

Panama has been less affected than many Latin countries by the debt crisis, although it and is currently impleting a debt restructuring agreement.

Costa Rica

Population:	2.3 million	Population growth rate (1970-81):	2.8%
GDP (1981):	$2.6 billion	Labor force growth rate " :	3.9%
GNP/capita (1981):	$1,430	Labor force in agriculture:	29%
		Literacy rate:	90%

Historical Economic Performance

(average annual rate, percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Gross Domestic Product (GDP)	6.1	6.0	5.3	-6.7
GDP per capita	2.7	3.4	2.6	-9.2
Consumer prices	2.3	13.7	8.1	61.4
Exports	10.3	16.4	15.2	-6.5
Imports	11.2	16.9	17.0	-25.0
External Public Debt	--	13.0	33.8	19.6

Recent Domestic Economic Performance

(percent)

	1979	1980	1981	1982
GDP	4.9	0.8	-4.6	-8.8
GDP per capita	2.5	-1.7	-7.1	-11.3
Public Sector Deficit/GDP	13.5	11.2	14.3	9.1
Consumer Prices	9.2	18.1	37.1	90.1
Unemployment Rate	4.9	5.9	8.7	8.9
Real Wages	4.8	-2.9	-9.1	-19.9

External Economic Performance

	1979	1980	1981	1982
Colones per US$ (yr avg)	8.6	8.6	21.8	37.6
Terms of Trade (% change)	-8.7	-0.5	-13.0	-8.1
		($ millions)		
Exports, fob	942	1001	1003	876
Imports, cif	-1397	-1528	-1213	-860
(Oil)	(190)	(229)	(205)	(193)
Trade Balance	-455	-527	-210	16
Current Account Balance	-559	-664	-426	-241
Total Reserves (ex gold)	103	146	131	226
Total Debt	1911	2522	3119	3552
public term debt (incl. IMF)	1474	1860	2468	2671
other	437	662	651	881
owed to:				
commercial banks*	1055	1370	1299	1261
bondholders*	20	141	458	502
other official	779	953	1110	1266
IMF	57	58	104	93
interest arrears**	0	0	148	430

*There may be double counting in these two categories.
**Principal arrears are included in appropriate debt totals.

Debt Burden Indicators

(percent)

Public Debt Interest/Exports	10	15	25	35
Public Debt Int. + Amort./Exports	32	33	52	57
Total Debt/Exports	169	203	255	312
Total Debt/GDP	87	101	119	142

El Salvador

Population:	4.7 million	Population growth rate (1970-81):	2.9%
GDP (1981):	$3.6 billion	Labor force growth rate " :	2.8%
GNP/capita (1981):	$650	Labor force in agriculture:	50%
		Literacy rate:	62%

Historical Economic Performance

(average annual rate, percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Gross Domestic Product (GDP)	5.6	5.5	0.8	-7.5
GDP per capita	2.1	2.3	-2.8	-10.6
Consumer prices	0.7	8.6	13.0	13.2
Exports	8.7	17.7	12.7	-19.3
Imports	4.7	23.1	10.5	-4.2
External Public Debt	--	17.4	21.0	21.9

Recent Domestic Economic Performance

(percent)

	1979	1980	1981	1982
GDP	-1.7	-9.0	-9.5	-5.4
GDP per capita	-3.7	-11.2	-11.7	-7.8
Public Sector Deficit/GDP	NA	7.1	8.0	7.2
Consumer Prices	15.9	17.4	14.7	11.7
Real Wages (minimum wage)	-16.6	15.3	-12.9	NA

External Economic Performance

	1979	1980	1981	1982
Colones per US$ (yr avg)	2.5	2.5	2.5	2.5
		($ millions)		
Exports, fob	1129	1072	794	738
Imports, cif	-1024	-972	-986	-930
Trade Balance	105	100	-192	-192
Current Account Balance	35	-15	-274	-270
Total Reserves (ex gold)	140	78	72	109
Total Debt	798	894	1090	1227
public term debt	405	516	708	863
other	393	337	316	364
owed to:				
commercial banks	410	349	328	317
official creditors	388	497	652	742
IMF	0	7	44	107
arrears	NA	41	66	61

Debt Burden Indicators

(percent)

Public Debt Interest	2	2	3	4
Public Debt Int. + Amort./Exports	3	3	5	8
Total Debt/Exports	61	73	117	138
Total Debt/GDP	23	25	31	33

Guatemala

Population:	7.5 million	Population growth rate (1970-81):	3.1%
GDP (1981):	$8.7 billion	Labor force growth rate " :	3.2%
GNP/capita (1981):	$1,140	Labor force in agriculture:	55%
		Literacy rate:	47%

Historical Economic Performance

(average annual rate, percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Gross Domestic Product (GDP)	5.5	5.6	5.7	-1.3
GDP per capita	2.2	2.1	2.5	-4.2
Consumer prices	0.8	8.5	10.7	5.8
Exports	9.9	16.6	18.9	-11.1
Imports	7.9	20.3	17.0	-6.8
External Public Debt	--	8.1	33.4	34.1

Recent Domestic Economic Performance

(percent)

	1979	1980	1981	1982
GDP	4.7	3.7	0.9	-3.5
GDP per capita	1.6	0.7	-2.1	-6.3
Public Sector Deficit/GDP	3.2	4.4	7.1	5.1
Consumer Prices	11.5	10.7	11.4	0.4
Real Wages	1.9	-9.6	6.4	NA

External Economic Performance

	1979	1980	1981	1982	
Quetzales per US$ (yr avg)	1.0	1.0	1.0	1.0	
Terms of Trade (% change)	--	0.1	-11.8	-3.2	
		($ millions)			
Exports, fob	1241	1520	1299	1200	
Imports, cif	-1513	-1598	-1673	-1388	
Trade Balance	-272	-78	-374	-188	
Current Account Balance	-176	-176	-565	-371	
Total Reserves (ex gold)	696	445	150	112	
Total Debt	1087	1203	1426	1955	
public term debt (incl. IMF)	586	692	1046	1349	
other	501	511	380	606	
owed to:					
commercial banks	585	678	864	1133	
official creditors	502	525	449	373	
IMF	0	0	113	105	
commercial arrears	0	0	0	344	350

Debt Burden Indicators

(percent)

Public Debt Interest/Exports	2	2	3	4
Public Debt Int. + Amort./Exports	5	4	6	9
Total Debt/Exports	74	70	98	150
Total Debt/GDP	16	15	17	22

Honduras

Population:	3.8 million	Population growth rate (1970-81):	3.4%
GDP (1981):	$2.4 billion	Labor force growth rate " :	3.1%
GNP/capita (1981):	$600	Labor force in agriculture:	63%
		Literacy rate:	60%

Historical Economic Performance

(average annual rate, percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Gross Domestic Product (GDP)	4.7	3.1	5.9	-0.5
GDP per capita	1.5	-0.1	2.5	-4.0
Consumer prices	2.4	6.3	9.4	9.6
Exports	10.9	11.7	21.9	-10.8
Imports	12.2	12.9	20.7	-15.7
External Public Debt	--	24.0	30.0	19.0

Recent Domestic Economic Performance

(percent)

	1979	1980	1981	1982
GDP	6.2	2.9	0.2	-1.2
GDP per capita	2.6	-0.7	-3.2	-4.7
Public Sector Deficit/GDP	5.2	9.2	8.6	8.3
Consumer Prices	12.1	18.1	9.4	9.9

External Economic Performance

	1979	1980	1981	1982
Lempiras per US$ (yr avg)	2.0	2.0	2.0	2.0
Terms of Trade (% change)	-13.7	-4.2	-2.7	-7.9
		($ millions)		
Exports, fob	756	850	784	677
Imports, cif	-852	-1040	-975	-739
Trade Balance	-96	-190	-191	-62
Current Account Balance	-192	-317	-302	-219
Total Reserves (ex gold)	209	150	101	112
Total Debt	1150	1362	1552	1661
public term (incl IMF)	760	996	1261	1492
other	390	366	291	169
owed to:				
commercial banks	557	570	575	469
official creditors	593	777	939	1086
IMF	0	15	38	103
interest arrears (principal arrears are included in appropriate debt total)	0	0	0	3

Debt Burden Indicators

(percent)

Public Debt Interest/Exports	6	7	11	14
Public Debt Int. + Amort./Exports	12	13	17	21
Total Debt/Exports	134	141	172	212
Total Debt/GDP	53	55	59	59

Nicaragua

Population:	2.8 million	Population growth rate (1970-81):	3.9%
GDP (1981):	$2.6 billion	Labor force growth rate " :	3.8%
GNP/capita (1981):	$860	Labor force in agriculture:	43%
		Literacy rate:	90%

Historical Economic Performance

(average annual rate, percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Gross Domestic Product (GDP)	6.4	5.5	-3.2	3.4
GDP per capita	3.7	2.1	-7.7	0.2
Consumer prices	NA	NA	19.1	24.3
Exports	10.8	15.9	3.7	-4.0
Imports	12.3	21.9	10.7	-5.3
External Public Debt	--	32.6	23.2	22.1

Recent Domestic Economic Performance

(percent)

	1979	1980	1981	1982
GDP	-26.4	10.0	8.5	-1.4
GDP per capita	-32.8	6.4	5.0	-4.4
Central Government Deficit/GDP	6.7	9.0	10.4	12.1
Consumer Prices	48.1	35.3	23.9	24.8

External Economic Performance

	1979	1980	1981	1982
Cordobas per US$ (yr avg)	10.1	10.1	10.1	10.1

($ millions)

	1979	1980	1981	1982
Exports, fob	616	450	500	415
Imports, fob	389	803	922	720
(Oil)	(60)	(148)	NA	NA
Trade Balance	227	-353	-423	-305
Current Account Balance	180	-407	-521	-452
Total Reserves (ex gold)	NA	NA	NA	NA
Total Debt	1410	1745	2046	2548
public term (incl IMF)	1169	1745	2000	2548
other	241	0	46	0
owed to:				
commercial banks	639	743	792	975
official creditors	715	952	1229	1554
IMF	56	50	25	19
arrears	NA	NA	NA	NA

Debt Burden Indicators

(percent)

	1979	1980	1981	1982
Public Debt Interest/Exports	6	8	17	26
Public Debt Int. + Amort./Exports	8	15	34	37
Total Debt/Exports	206	349	372	548
Total Debt/GDP	81	80	79	96

Panama

Population:	1.9 million	Population growth rate (1970-81):	2.3%
GDP (1981):	$3.9 billion	Labor force growth rate " :	2.4%
GNP/capita (1981):	$1,910	Labor force in agriculture:	27%
		Literacy rate:	85%

Historical Economic Performance

(average annual rate, percent)

	1960-1970	1970-1975	1975-1980	1980-1982
Gross Domestic Product (GDP)	8.0	4.9	4.5	4.2
GDP per capita	4.8	1.6	1.5	1.6
Consumer prices	1.3	7.2	6.8	5.7
Exports	12.8	20.5	2.5	-7.6
Imports	11.7	20.0	10.3	5.3
External Public Debt	--	36.4	23.9	10.9

Recent Domestic Economic Performance

(percent)

	1979	1980	1981	1982
GDP	4.5	6.0	4.3	4.1
GDP per capita	1.9	3.4	1.7	1.6
Public Sector Deficit/GDP	11.8	5.2	5.4	11.0
Consumer Prices	8.0	13.8	7.3	4.2
Unemployment Rate	8.8	8.2	NA	NA
Real Wages	-1.6	-4.3	-3.3	NA

External Economic Performance

	1979	1980	1981	1982
Balboas per US$ (yr avg)	1.0	1.0	1.0	1.0
Terms of Trade (% change)	-4.8	-1.9	-7.4	-1.5
		($ millions)		
Exports, fob	453	526	494	449
Imports, fob	-1094	-1343	-1470	-1489
Trade Balance	-625	-816	-976	-1040
Current Account Balance	-296	-271	-429	-474
Total Reserves (ex gold)	119	117	120	101
Total Public Debt	2168	2401	2603	3106
Term (including IMF)	2104	2286	2453	2864
Short-term	64	115	150	242
owed to:				
official creditors	944	1001	1095	1233
commercial banks	1183	1377	1414	1789
IMF	41	23	94	84

Debt Burden Indicators

(percent)

Public Debt Interest	17	16	17	21
Public Debt Int. + Amort./Exports	35	30	27	31
Total Public Debt/Exports	185	154	159	187
Total Public Debt/GDP	77	68	67	74