CENTRAL AMERICAN MONETARY UNION

JOHN PARKE YOUNG

UNITED STATES DEPARTMENT OF STATE
Agency for International Development
Regional Office, Central America
and Panama Affairs

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Preface

With the encouraging progress toward Central American integration, the possible creation of a Central American Monetary Union has become a matter for practical consideration instead of a distant ideal. This report discusses the problems, and measures which will need to be taken in order to establish an effective monetary union. It presents the outlines of a comprehensive program for monetary unification, including alternative courses, which might be achieved by stages at such pace as the countries find feasible.

Central American economists, particularly in the central banks, have given considerable thought to the problems and possibilities of monetary union, and have contributed greatly to the evolution of thinking and action in this field. The Presidents of the central banks, Francisco Aquino h., Alvaro Castro Jenkins, Francisco J. Lainez, Arturo Pérez Galliano and Roberto Ramírez, have provided far-sighted initiative and leadership, as have other officials, especially Abelardo Torres, Minister of Economy of El Salvador, and the other Ministers of Economy and Finance.

Valuable studies have been prepared, notably by Jorge Sol Castellanos, Jorge González del Valle, Mario R. Gómez V. and Guillermo González Truque. Others who have contributed to progress in this field include Guillermo Bueso, Carlos Enrique Castro Garay, Carlos Cordero d'Aubuisson, Rolando Duarte F., Francisco Fernández Rivas, Salvador Gómez, Armando González Campo, Ernesto F. Hollman, Tomás Medina, Manuel Méndez Escobar, José Molina Calderón, Santiago Morera, Jorge Papadópolo, Carlos Paredes Luna, Alvaro Porta, Alvaro Sancho, Mario Ugalde, Jenaro Valverde, Alvaro Vargas and Cecilio Zelaya Lozano.

Grateful acknowledgment is made for the invaluable help rendered by these and other persons both official and private. Some have contributed extensively of their experience, judgment and time to the furtherance of this undertaking. Appreciation is also expressed to the United States Embassies and AID Missions in Central America, Panama and Mexico, especially ROCAP in Guatemala, for their generous assistance.

Finally, recognition is made of the contribution and counsel of Marie S. Young, who collaborated in the preparation of this report.

John Parke Young

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Summary

The Central American countries have made good progress in establishing a Common Market wherein trade is now largely free; work on a common external tariff is well advanced. Joint institutions in a variety of fields are functioning successfully. In the financial field, the countries have declared their intention to establish a monetary union and have taken steps in this direction.

The essence of a monetary union is the general acceptability and free circulation of currency across borders. A union of existing Central American currencies is not feasible in view of the diverse values of the currency units. These currencies cannot well circulate outside their own countries; hence a single or common currency is necessary for a meaningful union.

Advantages of a Common Currency

A common currency offers many advantages for the economic and social development of Central America. Separate currency systems are an obstacle to trade, investment and to integration generally. Traders and investors are now faced with the complications, uncertainties and costs of currency conversions, and of marketing, pricing goods and extending credit in other currencies. The necessary procedures under five different currency systems discourage maximum trade, the establishment of new enterprises, and the regional distribution of industrial and agricultural products.

By simplifying the making of payments a single currency would encourage trade, investment and other transactions among the countries. It would facilitate the movement of goods, labor and investment capital. A major advantage would be the psychological stimulus to economic and political integration. It would help to bind the countries more closely together and promote stability.

A single currency is well-nigh essential to the permanence of free trade within the region, and thus to the success of the Common Market.

With separate currency systems one or more of the countries is likely sooner or later to experience inflation, balance of payments difficulties or divergent price and cost movements. Such developments in a country could lead to exchange restrictions, import quotas or some other form of restraint upon imports; devaluation might even become necessary. Exchange restrictions imposed by a member country would need to apply to trade and other transactions with the rest of the Central American countries; otherwise funds could escape into and through these countries. Luxury and other goods, the purchase of which might be restricted, could leak into the country imposing restrictions.

The other Central American countries could thus not be exempt from the restrictions so that free trade would no longer exist. Freedom of trade requires freedom of payments. Under a common currency, restrictions on payments to other members obviously could not be imposed, although the region as a whole could, of course, experience external payments problems with the rest of the world, as can any country.

A main objective of the integration movement is the development of the entire region's resources, thereby raising living standards. Elimination by means of a common currency of legal, procedural and psychological barriers to the flow of the factors of production would promote diversification and expansion of production, and would accelerate the economic and social development of the region. Only a common currency can guarantee to investors and traders, from within or outside the region, the continued absence of disturbing monetary conditions among the countries, and that a free common market is here to stay.

Two Approaches to Monetary Union

There are two principal approaches to monetary union and a common currency in Central America: (1) the introduction of similar currency systems in each of the individual countries; or (2) the issuance of Central American pesos, or whatever their name might be, on a gradually increasing scale against a central fund administered by a regional body.

Under the first approach the countries would all adopt identical monetary units which could circulate throughout the region. The currencies would continue to be national rather than regional, but would be of the same gold value and of similar denominations and appearance. The new money could be introduced gradually and circulate alongside of existing money, the complete conversion of the old to the new to take place later, and at rates involving no loss to the public. Eventually the similar national currency systems would be merged into a unified system for the region.

Under the second approach to a common currency the central banks or governments would establish a joint fund, which could be small at the outset, and which would serve as backing for the new peso, issued to them according to their subscriptions to the fund. Subscriptions would be to a large extent in foreign exchange. The pesos would circulate initially alongside of existing money, eventually replacing the latter. A gradual introduction would give the public an opportunity to become familiar with the value of the new money and to adjust prices accordingly in terms of pesos. Bank accounts could be maintained in terms of regional pesos and payments made by check anywhere in the region. Traders in the different countries could thus do business with each other in terms of a single strong currency, similarly as transactions are conducted in pesos by the Central American Clearing House.

These are essentially the only feasible approaches to a common currency; variations are possible. Timing could be flexible and adjusted to circumstances and needs.

Financial Coordination

The first step toward monetary union is to develop further close consultation and working relations among the central banks, which is being undertaken, and also close consultation among the Ministries concerned with fiscal matters. A main purpose is cooperation and coordination of monetary and fiscal policies of the different countries. In the period before a common currency is fully achieved it is important that each existing currency continue strong and stable. If policies are coordinated and prices in all the countries move more or less in harmony, exchange rate stability is more likely than if independent policies are pursued. Coordination of policies, however, cannot guarantee that balance of payments difficulties will not arise from non-monetary sources and lead to monetary and exchange problems among the currencies. Structural changes might thus cause balance of payments and exchange rate difficulties.

To facilitate coordination of policies and monetary stability, regular comprehensive reviews of each country's economic and financial position, conducted jointly by the Monetary Council and Ministries responsible for fiscal affairs, would be helpful. The review would result in specific comments and recommendations to each country in question. Consultations of this type are carried out regularly by the European countries and the United States, Canada and Japan through the Organization for Economic Cooperation and Development (OECD), also by members of the European Economic Community (EEC).

The Central American countries might also usefully agree not to undertake any important action in the monetary, exchange or fiscal field without previous discussion of the proposed action with the other countries, unless under exceptional circumstances.

Pooling Reserves

The nature of the second stage toward monetary union would depend partly on whether the first or second plan was followed. In either case it would involve a partial pooling of reserves in a central fund. The amount each country would subscribe to the fund would be based on various criteria, such as GNP, population, foreign exchange holdings, etc. The fund could be available, (1) to help stabilize exchange rates among the Central American currencies during the interim period before a single currency is fully established, or (2) to constitute resources against which Central American pesos could be issued. If the first approach were pursued, namely, the issuance of similar currencies by the individual central banks, such a fund would be especially useful in helping to keep the different national currencies in a fixed relationship.

In place of a stabilization fund, or perhaps in addition thereto, the pooled reserves or a portion of them could serve as backing for the issuance of regional currency, according to the second approach. A central fund would make possible the issuance at an early date of a certain amount of regional pesos; the amount could expand as conditions indicate. In either case, the fund would eventually serve as a reserve for the regional currency.

A stabilization agreement could be entered into either as an alternative to a stabilization fund or supplementary thereto. It could provide a declaration by the countries of intention to assist each other in maintaining stable exchange rates, and make provision for the extension of credit, under specified conditions, to a country in difficulty.

The First Approach: Similar National Currency Systems

According to the first approach the central banks would commence issuing currencies of identical value and similar appearance to circulate throughout all the countries. They would circulate alongside of existing currencies and be designed gradually to replace these currencies. As a check against over-issue by any one country, all money received by a central bank other than its own would be returned to the country of issue for credit through the Clearing House.

Since the currencies of the different countries would be interchangeable, it would be necessary that the countries have uniform exchange regulations. For example, if one country had exchange restrictions and others did not, funds from such country could readily move to the others where external payments were free, and the restrictions could thus be evaded.

While there is much to be said for such an approach to monetary union, it is not free from possible difficulties. Separate currency systems would be subject to separate forces and policies. If one of the countries, for example, experienced inflation, balance of payments difficulties or price movements different from the other countries, its currency might become out of line with the others and be rejected by the public or accepted at a discount. Maintenance of the parity of such a currency might become costly or in fact impossible. A political crisis might also bring a currency into disfavor. Workability of the plan would be prejudiced if people in receiving money felt that in each case they should examine it to see whether to accept it.

Thus monetary union based on similar national currencies, each subject to separate conditions, is inevitably insecure, although with coordination of monetary and fiscal policies, political stability in all the countries, and a strong Central American Monetary Council, it might endure for a considerable time. This approach obviously would not in itself create a permanent system for a unified Central American currency.

The Second Approach: A Single Regional Currency

The second approach to a common currency would involve the issuance of Central American pesos against a central fund established by the participating countries. Such a joint fund could be small at the outset and expand as conditions make possible. Regional pesos would be issued against these resources to each central bank or government in amounts equal to their respective subscriptions to the fund. The central banks would then be in a position to meet demands for Central American pesos on the part of the commercial banks, the business world or public.

Subscriptions to the fund would be according to quotas based on various criteria as noted. If a central bank needed more pesos, it could purchase them from the central fund, or Monetary Board as it might be called, paying for them partly in foreign exchange or gold and partly in its own currency at a specified ratio. This ratio might initially be 50 percent or more in foreign exchange or gold, and the balance in its own currency in the form of interest bearing short term renewable notes with a gold guarantee. The peso would need to be of unquestioned strength with ample external resources and available credits behind it, such as from the International Monetary Fund.

The amount of pesos each central bank would be allowed to buy, paying partly in its own interest bearing notes, would be limited by ceilings established by the Monetary Board. These ceilings would be flexible and subject to change as the Board felt desirable in light of demand for pesos, financial stability and the economic growth and development of the countries of the region. In addition to ceilings the Board could utilize other means to control the issuance of pesos, such as variable interest rates charged the central banks.

During this transitorial stage the central banks would continue to operate to a large extent as at present. They and the commercial banks could maintain accounts for their depositors in terms of pesos which could be transferred by check anywhere within Central America. Also travelers checks could be issued in pesos.

This system could be commenced by two or three countries with the door left open for other countries to participate at such time as they wished. Whether or not all countries participated at the outset, a joint fund could be established at an early date on a modest scale, and the Central American peso, issued against the fund, could make its way into the channels of trade as circumstances determine. Such a peso would be little affected by political difficulties in any one country and, assuming it were adequately backed by external resources, would provide business with a strong currency unit in which to conduct operations.

A Unified Monetary and Banking System

The final stage in establishing a unified Central American monetary and banking system would involve the conversion of all national currencies, whether existing money or identical national pesos, into Central American pesos issued by the regional institution. National currencies would be exchanged for Central American pesos at rates involving no loss to the public. The Central American Monetary Board would take over all national currencies and the assets behind them. The Board would become the sole currency issuing body. The central banks would then acquire pesos or peso credits from the Board as needed according to the procedures noted above.

A common currency system, at such time as it is fully operative, would require each country to relinquish to a central body a large measure of control over its domestic monetary and fiscal policies. A regional system requires that it be managed by a central institution. The prospect of monetary mismanagement by the central body appears fairly remote in view of the record of competent monetary management and price and exchange stability in all the Central American countries. None of these countries during the past decade has had a rise in domestic prices averaging over two percent a year.

When Central America is ready for complete unification of the national monetary and banking systems the Monetary Board would become a central reserve bank, and the existing central banks would become inherent parts and branches of the central institution. This institution would be given all the necessary powers of a modern central bank. It and its branches would doubtless be staffed by personnel from the present central banks.

Fiscal coordination among the countries, important to financial stability and economic development, would be achieved during the transitional stages through regular consultation among the Ministries with fiscal responsibilities and the Monetary Board. Budgetary surpluses and deficits and the way they are financed affect internal liquidity and monetary conditions. Unless fiscal policies are properly controlled, inflation and other difficulties could cause serious problems for a fully operative monetary union. At such time as political union is achieved and fiscal administrations consolidated, authoritative control over the countries' fiscal policies could be undertaken. In the meantime as firm coordination as is politically feasible is needed.

The present strength of all the Central American currencies provides a good background for monetary union. For several years, in most cases many years, prices and exchange rates have remained relatively stable. It is well that the Central Americans are utilizing the present generally favorable economic and financial situation to move forward with plans for monetary union.

I.

Introduction

THE five countries of Central America, Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, once united under Spain, after independence in 1821 formed the Republic of Central America. Due to poor communications and dissension among state and federal officials, the union gradually fell apart. The last federal congress in 1838 declared that the states might govern themselves as they saw fit. From that date forward, however, the countries have had aspirations for reunification.

These aspirations have finally taken definite form and, according to a series of treaties and agreements adopted during the 1950's and thereafter, the countries have made good progress in reuniting their economies. Internal tariff and other trade barriers within the region have largely been removed and work on a common external tariff is well advanced. Joint institutions in a variety of fields have been established and are functioning successfully.

In the financial field these countries desire to establish a monetary union. This objective was stated in the Declaration of Central America, signed in San Jose, Costa Rica in March 1963 by the Presidents of all the Central American countries. According to the Declaration, "The Presidents of the Republics of Central America, convinced that the best hope for the development of the region is through economic integration, ... pledge to their peoples: ... To establish a monetary union and common fiscal, monetary and social policies within the program of economic integration." The aim of monetary union was again stated in the Monetary Agreement among the five central banks signed in San Salvador in February 1964, which established procedures to work toward this goal. While no formal determination has yet been made as to the nature of the monetary union sought, a single currency for the region is commonly mentioned by officials as the ultimate goal.

A common currency offers many advantages and can, as the Central Americans well appreciate, make a major contribution to the realization of a united and strong Central America, a more effective utilization of the rich resources of the region, and the urgently needed economic and social advancement of its people. It will not only facilitate trade and investment but will tie the countries more firmly together and provide a sense of unity to all classes of Central Americans.

Moreover, such a currency is essential if there is to be assurance of no interference with free trade among the countries and the continuing success of the Common Market; freedom of trade requires freedom of payments, which might not exist if a national currency experienced difficulties, such as inflation, price movements different from those in other countries, and balance of payments deficits. Currency convertibility, which now exists, is not enough since convertibility can disappear. It is desirable therefore that progress in monetary integration proceed parallel with progress in the removal of trade barriers and the development of the Common Market generally. Monetary union is basic to economic union.

The present convertibility and strength of all the Central American currencies provide a good background for monetary union. For several years, in most cases many years, prices and exchange rates in all the Central American countries have remained relatively stable. These countries, moreover, have a number of fundamental similarities, which constitute a logical basis for economic integration and monetary union. United they can become one of the strong and prosperous countries of the Hemisphere.

The Central American countries not only have a common history, language, religion and many institutional similarities, but are confronted with the same economic and social problems. Despite a number of differences they are in relatively similar stages of economic and social development; the per capita GNP in 1963 varied from \$217 in Honduras to \$373 in Costa Rica. They have plans for balanced economic development of the region, aimed at elevating per capita GNP to an average of \$376 in 1974, and at the same time reducing the gap between the lowest and highest level of development through especially rapid growth of the lowest.

The countries are roughly of the same size and have similar exports, such as coffee, cotton, bananas, sugar, beef, etc. Their populations are growing rapidly as the result of a birth rate which is among the highest in the world. Production, however, is keeping a step ahead of population growth so that per capita GNP is improving. Comparative economic data are shown in Appendix B.

Unification of the five different monetary systems is a complicated process, with ramifications into the banking structure, credit policies, taxation and fiscal affairs of each country. There are also political aspects of the problem since a certain amount of national authority needs to be shifted to a central institution if a meaningful union is to be established.

A common currency, despite the difficulties, is a feasible and realistic goal, although it cannot be achieved overnight. A large amount of work lies ahead in arriving at agreement on basic principles, working out details, drafting specific treaties and agreements, and obtaining legislative authority. The difficulties should not be minimized and the road to complete monetary unification could be a long one. Substantial progress, however, is being made, aided by the determination of financial and other leaders to establish a strong Central American economy. The achievements in the Common Market to date, which have attracted the attention of the world, and the initiative and competence of the central banks in planning monetary union, indicate that formidable difficulties can be overcome. As Central America moves forward with its plans for monetary union, its experience may be of value for other regions.

II.

Problems of Monetary Union in Central America

A. Monetary Union an Evolutionary Process

ANY realistic program for Central American monetary integration must be flexible and consist of a number of stages, thereby enabling the countries to proceed as rapidly or as slowly as circumstances permit. The ultimate goal is a common currency for the entire region; yet this objective obviously cannot be realized at a single stroke. Since 1838 the Central American countries have existed as separate political entities with national economic and financial institutions and loyalties. The development of an effective monetary union, therefore, must be adapted to economic and political realities and approached as an evolutionary process, culminating in a single currency for the entire region. Recent progress toward economic and financial integration has been especially good and indicates that a common currency can be more than a dream.

Until a single currency is achieved a number of measures can be taken which will link the Central American currency systems more closely together, promote a unified Central American common market economy, and constitute steps toward a single currency for the region at such time as the countries elect. Since such a currency can make a major contribution to Central American integration and to the economic and social development of the region, rapid progress is highly desirable.

This study outlines a program consisting of four stages, aimed toward complete monetary unification; these stages could be compressed or extended. Central American officials have mentioned 1970 as a date when a common currency might be achieved, or a treaty providing for such currency submitted to the governments for adoption. The extent to which the Central American countries will be ready for monetary unification by 1970 -- the target date for completion of the Customs Union -- will depend in large measure upon progress in economic and political integration generally, and especially upon the development of a broad regional rather than a national approach to problems. A program of public education regarding the advantages of monetary unification and what is involved, including the difficulties, would be helpful.

B. Types of Monetary Union

VARIOUS types of monetary union are possible, from loose cooperation among separate currency systems to a single currency system for the region managed by a central authority. The essence of a monetary union is the general acceptability and free circulation of currency across borders. Unless regional acceptability and circulation are achieved, the union would have little substance and be a union largely in name.

The so-called Latin Monetary Union among Belgium, France, Italy and Switzerland, organized by treaty in 1865, was based upon separate currency systems with identical monetary units, called a franc in Belgium, France and Switzerland and a lira in Italy. The coins were not only identical in metallic content but similar in appearance. The money of the different countries circulated freely in all these countries. The Union was based upon the bimetallic standard, wherein both gold and silver could be presented freely at the mints for coinage. It broke down when the price of silver declined in the 1870's and the countries all shifted to the gold standard. The Union became a dead letter.

The Scandinavian Monetary Union among Denmark, Norway and Sweden was formed by treaties of 1873 and 1875. It was based on the gold standard and identical monetary units. The money of each country circulated freely in the other countries. During the First World War, due to the strong demand for Swedish money the flow of Norwegian and Danish gold into Sweden was halted. The currencies of Norway and Denmark thereupon became depreciated in Sweden and the Union broke down. Large quantities of the fiduciary silver coins of Denmark and Norway had been shipped to Sweden to acquire Swedish money, and were bought back by Denmark and Norway at considerable expense.

The experiences of these countries illustrate the difficulties and insecurity of a union among independent currency systems, each subject to different economic and political forces. One reason these earlier unions lasted as long as they did was because at that time countries did not attempt to manage currency systems from the standpoint of full employment, price stability and economic growth. They did not pursue national monetary and fiscal policies oriented toward these objectives, but left matters largely to the automatic forces determined by balance of payments developments and the flow of gold and silver. Corrective monetary actions to promote balance of payments equilibrium took place more or less automatically, regardless of their effects upon economic activity and employment.

A union among separate currency systems is inevitably subject to the constant threat and consequences of divergent balance of payments trends, internal price and cost movements, different monetary and fiscal policies directed toward national objectives, and possible political crises. These developments could affect the validity of prevailing exchange rates and the acceptability of the currency of a particular country; they could lead to the imposition of exchange restrictions and interfere with the interchangeability of the currencies at the established rates. They could thus disrupt the monetary union. Such a union is therefore inherently unstable, and its continued success cannot be assured. While it might under fortuitous conditions continue for a considerable time, sooner or later it is likely to break down. The extent to which coordination of monetary and fiscal policies might or might not promote the success of a union among separate currency systems is discussed in Section V.A.1.

C. Union Based Upon Existing Currencies

SOME of the discussions of a Central American monetary union visualize a union based upon the indefinite retention of existing currencies. Such a union, however, involving the continued use of the present national currencies, would have little substance as a union, except insofar as it was a stepping stone to further progress and a single currency for the region. Regional circulation of the present divergent currency units is not feasible; their fractional relationship complicates conversion and the making of change, except in the case of the money of Guatemala, Honduras and Panama.[1] This type of so-called union although politically less difficult than a more substantive union, would not be very different from the present system wherein the currencies are all essentially convertible, exchange rates stable, and central bank balances cleared through the Central American Clearing House.

A monetary union involving the continued use of national currencies would be meaningful only if the individual currencies were

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1/ Panama is not a member of the Central American Common Market, but since Panama may eventually become a member, the present discussion includes Panama. The question of Panama's possible participation in the monetary union is discussed in Annex I.

similar and could circulate interchangeably in the different countries and without a discount. The national currencies for this type of union would need to be essentially identical in value and appearance. A monetary union involving the continuance of existing currencies would, therefore, be little more than close monetary relations, and without much meaning as a union. Any union of national currencies would, moreover, be insecure for reasons mentioned above and discussed further in the next section. This stage, while perhaps useful as a preliminary step, would necessarily be temporary if a union of substance is to be established.2/

The currency units of Guatemala and Panama, both worth one United States dollar, are identical in value, and that of Honduras, worth fifty cents, is sufficiently adaptable that a meaningful union of these three existing currencies would be feasible. The currencies of El Salvador and particularly of Costa Rica and Nicaragua, however, involve arithmetic computations which would militate against their wide acceptance by the public in the other countries. In view of these difficulties, an effective monetary union requires the introduction of similar currency units in all the member countries. The similar currencies could be separate national currencies, or they could be a single regional currency issued by a central institution. A single currency is preferable as a permanent currency for Central America as discussed below.

D. Advantages of a Common Currency

THE advantages, tangible and intangible, which would accrue to Central America from a common currency are substantial. A single strong convertible currency for the entire region would bind the countries more closely together, help unify the region and materially advance the objectives of the Central American Common Market. It would encourage trade and other regional transactions by simplifying the making of payments. By removing the difficulties and costs of converting one currency into another, it would facilitate the free movement of goods, labor and investment capital.

2/ Press comments about Central American economic integration sometimes confuse financial cooperation and monetary union. Financial cooperation of various types and joint actions, such as in the case of the Clearing House, central bank relations with foreign banks, a Central American capital market, etc. offer considerable benefits, but such cooperation is not a monetary union. A monetary union, however, would contribute materially to these various forms of financial cooperation.

A common currency in Central America is in fact essential to effective economic integration. The conduct of trade and the flow of funds within the Common Market is handicapped because of five separate currencies. Traders and investors are faced with the complications, uncertainties and expense of currency conversions, marketing and pricing of goods regionally, extension of credit to purchasers in other countries, bank charges and burdensome paper work. While experienced buyers and sellers have learned how to do business under present conditions, the cumbersome procedures discourage maximum trade and the expansion of business within the region. They add to costs, affect distribution of industrial and agricultural products, discourage new enterprises and are an obstacle to integration. Even with trade barriers removed, these currency difficulties would remain. The money of one country is not acceptable in the shops, markets, taxis, etc. in other member countries. A few leading hotels may accept money from some of the other countries, but usually reluctantly and at a discount. A single currency for the region would remove these difficulties which bar effective integration. Payments anywhere within the region could then be made as simply as within a single country.

A major advantage of a single currency would be the psychological stimulus to economic and political integration. The public in all the Central American countries would have tangible evidence, which they could see and feel, that economic integration was more than official pronouncements and governmental agreements. It would make clear to persons who may regard integration as something nebulous and of little substance that the Common Market is real and a going concern.

A common currency, moreover, is well-nigh essential to the permanence of free trade within the region, namely, the continued absence of tariffs and other trade barriers, and thus to the success of the Common Market. If the member countries, for example, continued to maintain separate currency systems and one or more of these countries experienced balance of payments difficulties, such difficulties could lead to exchange restrictions, quotas or some other form of restraint upon imports; devaluation of a particular currency might become necessary. Developments of this kind would obviously interfere with the unrestricted movement of goods, services and capital among the countries, which is the essence of the Common Market.[3/]

3/ Bilateral balance of payments deficits among the countries would not require imposition of exchange restrictions since a deficit with one Central American country might be offset by a surplus elsewhere, anywhere in the world, and the total position of the country be strong; but an external deficit of an individual country with the rest of the world could lead to the restrictions noted.

Exchange restrictions imposed by a member country in balance of payments difficulties would need to apply to trade and other transactions with the rest of the Central American countries; otherwise funds could escape into these countries, and luxury and other goods, the purchase of which was restricted, could leak into the country imposing restrictions via the other countries. Capital could also escape. These leakages or uncontrolled transactions would, through Clearing House compensations, draw down the foreign exchange reserves of the country imposing restrictions. Whether these goods were foreign or Central American, the deficit would be aggravated, and the exchange restrictions undermined. The other Central American countries could thus not be exempt from these restrictions. If direct import controls were also imposed, and applied to the other members in order to prevent this traffic, such action would violate the basic principle of the Common Market. Furthermore, exporters in the other Central American countries might not wish to sell to a country imposing exchange restrictions because of difficulties in getting paid in their own currency.

Trade with other members of the Common Market, therefore, could not well continue free if one member, with its separate currency system, experienced serious balance of payments problems, inflation or price movements different from those in the other member countries. Under a common currency, exchange restrictions against other members obviously could not be imposed. There would no longer be a national system with exchange rates to be maintained and reserves which could be depleted. The region as a whole could, of course, and probably would from time to time experience external payments problems, as do all countries. This problem is discussed further in Section V.C.2. in connection with the need for uniformity of any exchange restrictions which might be imposed by members of the union.[4/]

4/ Balance of payments disequilibrium of a Central American country could still exist, apart from the balance of payments position of the region as a whole. A common currency would not in itself remove an imbalance in a country's external payments. Under a common currency, a member country which suffered a crop failure, low prices for its exports, or some other condition which under a national currency system would have led to a balance of payments deficit and inconvertibility, would not be free from trouble. Such a country under a common currency would experience a contraction of incomes and depressed conditions. The situation would not be unlike that of a state or region in the United States which suffers when its products are depressed. There would, however, be no exchange rate problem to add to the difficulty, although the local trouble could contribute to a regional balance of payments and exchange rate problem.

(Continued on page 10)

One of the main objectives of the economic integration movement is the development of the entire region's resources, industrial, agricultural, mineral and other, thereby expanding production, consumption and exports, and raising living standards. Elimination by means of a common currency of legal, procedural and psychological barriers to the flow of the factors of production throughout the region would promote realization of this goal. While a common currency would not increase the basic resources of Central America, it would materially assist in their development through facilitating mobility of the factors of production and their application in accordance with natural advantages as reflected in investment opportunities. A common currency would thus promote the diversification and expansion of production. It would accelerate the economic and social development of the region and help to elevate the less developed parts of Central America.

Achievement of this objective and the full benefits therefrom requires not only freedom of trade and movement of the factors of production within Central America, but the investment of capital. The decisions by investors of such capital are necessarily of a long run nature, and take into consideration the prospects for an extensive and permanent common market. Investors, both regional and foreign, therefore, need assurance that a free Central American market will not be disrupted by trade barriers, exchange restrictions or exchange rate revisions -- disturbances which commonly result from balance of payments and currency difficulties of individual countries. In view of the uncertainties surrounding any currency, only a common currency for all of Central America can provide a firm guarantee of the continued absence of disturbing monetary conditions among the countries, and that a free Central American Common Market is here to stay.

In the case of the larger countries of the world, disequilibrium of a region within a country tends to be removed by the classical forces of capital movements, reduction of incomes, unemployment and depression; exchange rate movements obviously can play no part in the adjustment process. National governments commonly provide relief to depressed regions through government spending and in other ways thereby helping adjustment to equilibrium. Adjustment of a regional disequilibrium, however, takes place largely in accordance with these semi-automatic forces, which are directed toward equilibrium on the basis of structural change and comparative advantage. The hardships on the depressed community may be reduced by the ability of inhabitants to migrate freely to more prosperous regions, although this may not take place on a large scale or over a short period.

In Central America, if a member country under a common currency system experienced payments disequilibrium or depression, the regional monetary authority, discussed in Section V.E.2., in cooperation with the member government and its central bank, would presumably seek to facilitate recovery and balance.

Apart from the need for assurance of a broad common market which will not be disrupted by national currency problems, investors shy away from a country which restricts payments. They want to be able to withdraw their funds and remit interest and dividends without restrictions or loss from exchange rate movements or possible devaluation. Under a single currency Central American investors could have the entire region in which to invest free from currency problems. Unless payments among the countries are free and secure, neither trade nor investment can flow freely throughout the Common Market.

It is sometimes said that so long as the individual currencies are convertible, a monetary union would add little benefit. Such a statement overlooks the fact that convertibility can cease to exist, as experience shows. It also overlooks the various advantages of a common currency. Once a common currency is introduced, regional movements of funds cannot be restricted any more than can the transfer of money between New York and California. Inconvertibility within the region could no longer occur or threaten.

A common currency would be of substantial assistance in the development of a Central American capital market. Securities could then be denominated in a single Central American currency rather than in one of the present currencies. A single currency would broaden the regional market for the securities and make them more attractive to potential purchasers. It would also facilitate the sale abroad of Central American securities and help attract foreign investment. Such a currency would not only be better known in world financial centers than the present individual currencies, but would inspire greater confidence among foreign investors. It would doubtless be a strong currency in view of the record of currency stability in all the countries, and the competent management of the central banks.

In a variety of ways it can be seen that a common currency is of basic importance to the Central American Common Market, its further development and security from disruption. A common currency would materially hasten the urgently needed economic and social development of the Central American countries.

Along with a statement of the advantages of a common currency the question arises as to possible disadvantages. While there are necessary adjustments to be made by the participating countries, and difficulties to be overcome, there are few if any significant aspects of a common currency which could properly be called disadvantages, certainly not in the net.

Under a common currency system each country would be required to relinquish a large measure of control over its domestic monetary policies. Such control would necessarily rest with the regional monetary authority, since a regional system requires that it be managed by a central institution; otherwise the system would be unable to function effectively. Fiscal policies would also need to be centrally supervised to a considerable extent, since fiscal policies affect monetary stability.

The limitations on a member government's freedom to determine its own monetary and fiscal policies might affect the types of measures undertaken to relieve depression and payments imbalance, as noted above (see footnote number 4 on page 9), but it is not to be assumed that the results would be basically less advantageous to the country in question. The regional authority would doubtless pursue policies, or enable the individual governments and central banks to pursue policies indicated by conditions in each of the countries as well as by conditions in the region as a whole. Apart from the possibility of an exchange revision to remove an imbalance, or the imposition of exchange restrictions, the situation might not be very different from that under a national currency. It does not follow that the shift of supervision over monetary and fiscal policies from a national to a regional basis would have deleterious economic effects upon a country, although the adjustment process to an equilibrium position might not be the same. There could be a difference of opinion as to which measures would be preferable; for example, whether an exchange revision, not possible under a common currency, would have been the preferable solution. The country concerned, as a member of the regional authority, would participate in the determination of appropriate remedial measures.

The prospects of monetary mismanagement by the central body, and resulting currency inflation or other difficulties, appear fairly remote in view of the record of competent monetary management and price stability in all the Central American countries. None of these countries during the past decade has had a rise in domestic prices averaging over two per cent a year.[5/] The regional body would doubtless consist of representatives from the central banks, which on the whole have managed their own national affairs successfully.

5/ As noted below, in Central America an excessive expansion of the money supply tends to result in increased imports and a worsening of the foreign exchange position, rather than higher domestic prices. Major swings in the balance payments, however, have been the result to a large extent of non-monetary factors, such as movements in the production and price of coffee.

Under a regional monetary system a national government, in light of the centralization of control, would not be able to compel its central bank to extend credit to it, except perhaps within certain limits. An irresponsible government desiring to obtain funds by exploiting the monetary system might consider this a disadvantage. At the present time the central banks are protected through laws and in other ways from being required to loan unduly to the government; further protection of this nature, which would result from a regional monetary institution exercising general supervision over central bank lending, would be in the direction of economic stability. The individual central banks, however, would retain considerable discretion as to loans which they might make to their governments and to the private sector. While the regional monetary authority would necessarily establish procedures, such as credit ceilings, to prevent abuse in the extension of credits, each bank would presumably enjoy considerable latitude in its lending policy as in other matters, especially during the early stages. Restraints might seldom be needed. In actual operation the situation regarding extensions of credit might not be very different from that which prevails at present, since central bank policies are now guided by criteria devised in the interest of financial stability and economic development.

From the political standpoint, the shifting of a certain amount of authority to a regional body might be questioned on nationalistic grounds. The trend of affairs in the advanced countries all over the world, however, is to yield varying amounts of authority to international bodies in recognition of the growing interdependence of nations in economic affairs and thus the need for cooperation and coordinated policies. The International Monetary Fund is a noteworthy example in the monetary field. The economic and financial relations among countries have become so interrelated and the countries so interdependent that firm cooperation is essential to economic growth and development.

Regional integration in Central America, as elsewhere, is part of this world wide movement toward broader areas of authority. Such integration if it is to be meaningful requires strong regional institutions with sufficient authority to carry out their functions and responsibilities. These institutions, moreover, are accountable to their member governments. The adjustments noted above which are required by monetary integration are thus basically constructive measures rather than disadvantages. The advantages to Central America of a common currency are, in fact, considerable.

III.

Balance of Payments and Monetary Union

A. Exchange Stability and Balance of Payments

STABLE exchange rates are obviously essential to any monetary union which involves the continued use of national currencies and their free interchangeability, pending the introduction of a single currency for the entire region. If the road to monetary union selected should be the issuance by each country of identical currencies, firmly established exchange rates would be necessary or the currencies would not be accepted with confidence in the different countries, nor could they enjoy wide regional circulation. Stable exchange rates among the Central American countries, moreover, facilitate the flow of trade, capital investment and other transactions which promote integration and development of the economies of the Central American countries.

Once a single regional currency has been introduced and replaced national currencies, there are no intra-regional exchange rates to be stabilized. Stability of the exchange rate of the regional currency vis-a-vis foreign currencies is, however, of considerable importance to the continued progress of the Common Market.

Maintenance of exchange rate stability, whether among national currencies during an interim period, or of a single regional currency. is closely related to the balance of payments position of the member countries, individually and as a group. If a member country, for example, experienced large and continuing balance of payments deficits, its foreign exchange reserves would be under a strain and the maintenance of its currency at a parity with the other currencies might become difficult, perhaps impossible. Furthermore, the currency of a country confronted with balance of payments difficulties and declining reserves might be accepted with reluctance or be rejected by the public in the different countries, including the home country; such a currency could go to a discount in terms of the other currencies thereby disrupting the monetary union.

If a single regional currency for all of Central America had replaced national currencies, a severe and persistent balance of payments deficit in one or more of the member countries would put heavy demands upon the external resources of the regional monetary authorities; a situation of this kind could threaten stability of the regional currency. The problem in both cases would be particularly troublesome if the balance of payments deficits were the result of fundamental disequilibria, whether monetary or structural in origin, and not readily reversible.

At the inception of a monetary union among national currencies the different exchange rates would need to represent a value relationship of the currencies which is sustainable, and which thus reflects a balance of payments position not in serious imbalance, that is a position which is not far from underlying equilibrium apart from temporary fluctuations, or which could be brought into approximate equilibrium without undue difficulty or delay. Overvaluation of a currency at the prevailing exchange rate, as indicated by persistent and sizeable balance of payments deficits, might require an initial exchange adjustment to bring the currency into a sustainable value relationship with the other currencies. Such an adjustment would be necessary before the currency could be accepted into a monetary union. At the present time no problem of serious overvaluation of any currency is apparent.

The balance of payments position of the different countries of the region, and prospects for the future according to projections by the Joint Planning Mission for Central America (JPM) are discussed in the next section.

B. Balance of Payments Trends and Monetary Union

THE Central American countries as a group have generally had trade deficits with the outside world, although the experience of individual countries has varied. El Salvador has consistently had an excess of exports over imports, except for the year 1960; the experience of Honduras varies. The trade deficit in 1963 of the combined countries with the rest of the world was $63 million.[6] The following table shows the trade of the Central American Common Market with the rest of the world, also intra-regional trade, and the percentage intra-regional trade is of the former:

[6] This deficit is on the basis of exports f.o.b. and imports c.i.f. as in the case of other trade balances referred to in this section; data are not available for calculation of the trade balances consistently on an f.o.b. basis. The trade balance for the region on an f.o.b. basis would be a deficit of approximately $10 million in 1963, as derived from International Monetary Fund data.

TRADE OF CENTRAL AMERICAN COMMON MARKET

(millions of dollars)

Year	Trade With Rest of World 1/ Exports	Imports	Intra-Regional Trade 2/	Percent Intra-Regional is of Trade With Rest of World Exports	Imports
1958	428.4	480.5	20.5	4.8	4.3
1959	403.4	436.8	28.0	6.9	6.4
1960	405.6	481.0	32.7	8.1	6.8
1961	412.8	458.9	36.8	8.9	8.0
1962	460.2	498.0	50.4	11.0	10.1
1963	518.5	580.8	66.2	12.8	11.4

1/ Exports are f.o.b.; Imports are c.i.f.
2/ Exports of one country are imports of another; therefore only a single figure for trade within the region is shown. The figure could be considered either intra-regional exports or imports.

Source: IMF, International Financial Statistics. SIECA.

Intra-regional trade has been rising sharply, particularly since the reduction of trade barriers under the General Treaty on Central American Economic Integration, which became operative in June 1961. The percentage intra-regional trade is of total Central American external trade, however, is a relatively small figure in view of the similarity of the economies and production of the Central American countries. Industrialization and diversification are expected to alter this situation.

Exports of the Central American countries expanded rapidly after the second World War, until 1958, as a result both of increased volume and high prices of export commodities. These large export earnings made possible substantial growth in most sectors of the economy. Savings were available for increased investment so that both public and private investment increased without serious inflationary pressures. In 1958 and 1959 the prices of coffee and cotton declined so that the period 1958-

61 was one of depressed export earnings, budgetary difficulties and weakened foreign exchange reserves.

Recovery took place in 1962 and the years since then, reflecting both increased volume of exports and better prices. While exports have increased, imports have also increased so that the trade deficits continue. The growth of export earnings, which has covered a large portion of the increased imports, has permitted a resumption of healthy economic expansion.

The Gross National Product (GNP) of the region has benefited by the recovery in exports, and increased from $2,774 million in 1960 to $3,282 million in 1963. On a per capita basis the figures are $258 and $281 for 1960 and 1963, respectively, with considerable variation among the countries. The lowest per capita GNP for 1963 was $217 in Honduras, and the highest was $373 in Costa Rica.

In addition to the trade deficits of the region, service transactions for the countries as a group, and in most cases individually, also show sizeable deficits. The service deficits of the individual countries are largely the result of transactions outside the region, similarly as in the case of the trade deficits, and thus contribute to a regional deficit; intra-regional travel, however, is fairly extensive and increasing with the development of the Common Market. The goods and services deficit for the region in 1963 was $91 million.

The deficits of goods and services in the balance of payments for the region are financed by the receipt of foreign private investments, and by governmental grants and loans. These receipts increased materially in 1962 and 1963, and more than offset the deficits in goods and services. Increased foreign exchange receipts thus permitted an increase in external reserves. Combined reserves which had declined from the high point of $157 million at the end of 1957 to $111 million at the end of 1961 increased to $239 million in May 1964; there was subsequently a seasonal decline.

The growth in new private foreign investments, from approximately $26 million in 1961 to approximately $90 million in 1963, reflects not only the improvement in economic conditions in Central America and confidence therein, but a desire on the part of investors to take advantage of the broadening common market. A substantial increase in governmental financial assistance also took place in 1963. The following Table shows the balance of payments position of the region for the years 1960-1963:

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS

(millions of dollars; minus sign indicates debit)

	1960	1961	1962	1963
Goods and Services 1/	-81.7	-53.0	-66.6	-90.5
Transfers				
Private	.7	4.0	3.1	9.9 2/
Government	24.5	29.9	18.9	11.8
Capital n.i.e.				
Private	31.4	26.1	64.5	89.7 3/
Government	3.3	-10.6	7.0	17.4
Commercial Banks				
Assets	3.3	-.3	.7	-.6
Liabilities	7.0	-.2	8.1	12.8
Monetary Authorities	22.5	30.3	-2.2	-32.1
Net IMF Position	6.2	7.7	-5.8	13.5
Monetary Gold	.3	12.3	-	.8
Foreign Exchange	-5.2	-2.7	-2.7	46.0
Other Liabilities	21.2	13.0	6.3	-.4
Net Errors and Omissions	11.0	26.2	33.5	-18.4

1/ Comparable country data for the component items are not available.
2/ Costa Rican net transfers in 1963 amounting to $5.4 million are not separated between Government and Private; in the above figures for 1963 they are arbitrarily assumed to be 2/3 Government, roughly in accord with past experience. The figures are thus only approximate.
3/ Costa Rican net capital imports in 1963 amounting to $25.1 million are not separated between Government and Private; in the above figures for 1963 they are arbitrarily assumed to be 1/5 Government, roughly in accord with past experience. The figures are thus only approximate.

Source: IMF, International Financial Statistics.

The Joint Planning Mission for Central America (JPM) has prepared balance of payments projections for the region for the years 1965 through 1974. These projections, shown in Appendix B, are based upon historical analyses of the component items for the individual countries; they are made in accordance with uniform standards which facilitate country comparisons. The projections are not intended to be forecasts of expected balance of payments results. They are, on the contrary, offered as targets to be sought by self-help measures and external assistance. Since they are, however, based upon past trends and are in general realistic goals, they are useful in considering possible balance of payments developments and their relation to monetary union. Many uncertainties, of course, exist such as the future prices of coffee, cotton and other export commodities, as well as the state of business activity in the United States and other major importing countries, which will affect the results actually realized.

The projections show continued expansion of exports and imports, continuing the trend of past years. Exports of goods and services, excluding intra-regional trade, rise from $666 million in 1965 to $846 million in 1969 and $1,193 million in 1974. In 1962 they amounted to $593 million. In 1969 there is shown a slight deficit in exports of goods and services, amounting to only $2.3 million. In 1974 goods and services show a surplus of $220.1 million. This surplus is intended to be achieved in large part through increased industrialization and import substitution. Increasing tourism to Central America should also be a factor in growing foreign exchange receipts.

Net capital receipts by the region from abroad, public and private, are shown as $130 million in 1965, increasing to $139 million in 1966, but gradually declining thereafter to $22 million in 1974. Absolute amounts of capital receipts, however, increase from $250 million in 1965 to $256 million in 1974 Since capital payments rise from $120 million in 1965 to $234 million in 1974, they reduce the net figure of foreign capital to the above figure of $22 million in 1974. The net amount of capital receipts over payments is, of course, the significant figure from the standpoint of the balance of payments and its relationship to exchange rate stability and monetary union.

Service on foreign capital, namely, interest payments and amortization of the principal of foreign loans, together with remission of earnings on direct investment, thus becomes a sizeable item in the balance of payments. So long as large receipts of new capital continue, no serious problem is to be anticipated from this source. Moreover, the continued growth of exports of goods and services is a relevant factor as regards the burden of servicing foreign capital.

To the extent that the above balance of payments projections are realized, the results would be favorable to the maintenance of monetary union on a stable and secure basis. Since the projections are goals and not forecasts they are to be interpreted accordingly. Unpredictable and disturbing factors will doubtless occur and cause balance of payments fluctuations around the indicated trends, perhaps major fluctuations. These countries, however, have exhibited ability to weather balance of payments difficulties in the past and to maintain exchange stability. This was the case for example during the period of depressed export earnings of 1958-61 when, with the aid of the International Monetary Fund, they were able to maintain stable exchange rates -- with the exception of Costa Rica which, due to special difficulties, altered its par value by approximately 15 percent in 1961.7/

The present absence of serious balance of payments problems -- although some countries are in a stronger position than others -- together with relatively strong reserves, provides a healthy background and opportune time for inauguration of a currency union. Since the balance of payments position of the member countries, individually and of the region as a whole, is a matter of considerable consequence to the establishment and continued success of a monetary union, it is well that the Central Americans are utilizing the present generally favorable situation to move forward with plans for monetary union.

C. Effects of Integration on Balance of Payments

THE pattern of trade among the Central American countries, as well as trade with the rest of the world, is being altered by the elimination of intra-regional tariffs and other trade barriers and the establishment of a common external tariff. Economic integration is also affecting service transactions and capital movements. The changes affect the balance of payments position of the countries individually and as a group, both bilateral and global. The effects are in process of development and will so continue for a number of years; the effects of new investment upon trade, encouraged by Common Market developments, are especially slow in making themselves felt.

As a result of the removal of intra-regional tariffs a member country may experience an increase in its imports from other Central American

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7/ El Salvador, Guatemala and Honduras have not altered their exchange rates since before the second World War. Nicaragua changed its par value in 1955 and Costa Rica in 1961. All the countries are under Article VIII of the International Monetary Fund.

countries; at the same time its exports to other countries in the region might not increase correspondingly. If these increased imports represent a shift in the source of imports from the United States or elsewhere outside the region to a Common Market country, the over-all balance of payments position of the importing country is not worsened by this shift; its bilateral balances, however, are altered. Foreign exchange formerly paid to an outside country would now be paid to countries within the region. The change would thus not involve a net loss of reserves by such country but merely a shift in the recipient of the foreign exchange.

Insofar as Common Market integration conserves foreign exchange for the region through import substitution (on an economic basis without undue protection), it is constructive and reduces the possible needs for external balance of payments assistance from the standpoint of the region as a whole. Integration may, however, put additional pressure on individual country reserves to finance the internal shifts in trade, namely, an increase in imports which does not represent import substitution, and which calls for a payment of foreign exchange by one member country to another through the Central American Clearing House, discussed in Section IV.C.

All the Central American countries have experienced an increase in their regional exports and imports since the lowering of trade barriers was undertaken. Intra-regional trade has increased more rapidly than has global trade. Guatemala and Costa Rica have improved their regional trade balances, that is, they have experienced a net increase in exports over imports in their trade with the other Common Market countries, whereas Honduras, Nicaragua and El Salvador have experienced a net increase in their imports from within the region. Up to now the greatest increase in exports has been in the case of Guatemala followed by Costa Rica, while the greatest increase in imports has been in the case of Honduras followed by Nicaragua and El Salvador.

The shifts in regional trade, however, have been relatively small factors in the countries' global trade balances, except in the case of Guatemala, which enjoyed a $6.5 million regional surplus in 1963, and to a lesser extent in the case of Honduras, whose previous regional surplus averaging about $3 million annually, was eliminated in 1963. The development of the countries' trade, regional and global, under the system of regional free trade is still in its early stages, and some types of trade within the region are still subject to restrictions so that it is premature to draw conclusions as to the ultimate effects of the removal of trade barriers on the trade of individual members of the Central American Common Market, particularly as industrialization and diversification proceed.

The trade of Honduras illustrates the changes which are taking place. Exports from Honduras to all the Common Market countries in 1963 increased by $5.2 million over the average for 1958-61, a pre-Common Market period for trade, 8/ whereas imports into Honduras from all Common Market countries during 1963 increased by $8.2 million, an excess of imports amounting to $3 million. 9/ The large increase in imports of Honduras from the other Central American countries resulted in elimination of the trade surplus which Honduras had enjoyed with the other member countries as a group; this surplus for the years 1958-61 amounted to an average of $2.9 million per year. In 1963 the exports and imports of Honduras with the other Common Market countries as a group were alsmot exactly in balance.

During 1963 imports of Honduras from all countries outside the Central American Common Market increased by $18.9 million over the 1958-61 average, whereas exports to all such countries increased by only $8.3 million. The net trade position of Honduras thus worsened, not only regionally but globally. Honduras had a global trade deficit in 1963 of $12.9 million, including Central American trade, whereas global exports and imports for the oombined years 1958-61 were almost exactly in balance. Of this global deficit, about $2.9 million might appear attributable to elimination of Honduras' average trade surplus with the other Common Market countries; however, it is questionable practice to attribute the deficit to any one item, since all transactions on both sides of the ledger go to make up the net result. Furthermore, Honduras had a substantial increase in global imports in 1963, accompanying a considerable increase in money supply in 1962 and 1963; the money supply was almost constant during 1958-61, and its increase was doubtless a factor in the global deficit.

Trade is, of course, only one aspect of economic integration, and its growth reflects only part of the many benefits therefrom. The following table shows the changes in the regional trade of the individual countries:

8/ The General Treaty became operative in June 1961, but the effect upon trade for 1961 was not great.

9/ Imports into Honduras from Guatemala in 1963 amounted to $4.6 million compared to an annual average of $.8 million for the period 1958-61, an increase of $3.8 million. Exports from Honduras to Guatemala in 1963 amounted to $2.0 million compared to an annual average of $.9 million in 1958-61, an increase of $1.1 million. Imports of Honduras from El Salvador in 1963 amounted to $7.9 million compared to an annual average of $4.0 million for the period 1958-61, an increase of $3.8 million. Exports to El Salvador in 1963 amounted to $10.8 million compared to an annual average of $6.4 million in 1958-61, an increase of $4.4 million.

TRADE OF THE CENTRAL AMERICAN COMMON MARKET COUNTRIES
INTRA-REGIONAL AND REST OF WORLD 1/

(millions of dollars)

	Intra-Regional						Rest of World					
	1958-1961 Average			1963			1958-1961 Average			1963		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
Costa Rica	1.7	3.1	-1.4	4.3	4.0	.3	82.9	101.7	-18.8	90.7	119.9	-29.2
El Salvador	10.7	12.8	-2.1	23.9	27.9	-4.0	105.6	96.9	8.7	129.9	123.9	6.0
Guatemala	6.6	5.5	1.1	20.7	14.2	6.5	104.5	133.3	-28.8	133.3	151.3	-18.0
Honduras	8.0	5.1	2.9	13.2	13.3	-.1	60.7	62.9	-2.2	69.0	81.8	-12.8
Nicaragua	2.5	3.1	-.6	4.0	6.9	-2.9	58.8	69.6	-10.8	95.6	103.9	-8.3

1/ Exports are f.o.b.; Imports are c.i.f.

Source: IMF, International Financial Statistics.
SIECA.

IV.

Movement for Monetary Union in Central America

A. Economic Integration Treaties

FROM the outset of the movement to establish a Central American Common Market and integrate the economies of the Central American countries, the governments and their central banks have been aware that close monetary relations, or some form of monetary union, are implicit in regional economic integration. Each of the economic integration treaties concluded since 1950, when the historical movement for regional unification shifted its focus primarily to the economic sphere, accordingly has incorporated provisions dealing with monetary and exchange matters.[10/]

During the decade of the 50's, bilateral commercial agreements between Central American countries endeavored to assure free currency convertibility between the signatory countries. They thus provided for cooperation to prevent exchange restrictions or discriminatory treatment in the transfer of funds among the countries.

In view of the importance to integration of exchange rate stability and currency convertibility, especially within the Central American region, provisions dealing with these matters were included in the Multilateral Treaty on Free Trade and Central American Economic Integration, signed in Tegucigalpa on June 10, 1958 by representatives

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10/ The present movement for Central American economic integration had its beginnings in July 1950 when the five Central American countries requested the United Nations Economic Commission for Latin America (ECLA) to study the possibilities of regional economic development in Central America. In October 1951 the five countries signed the "Charter of San Salvador" which established the Organization of Central American States (ODECA), directed to the "eventuol consolidation of Central Americon activities and possibly even political union." In June 1952 the Central American Economic Cooperation Committee was established consisting of the Ministers of Economy of the five countries. The Mexico City office of ECLA served as its Secretariat. A program for the economic integration of Central America was developed by this Committee, in conjunction with its six sub-committees in the fields of trade and tariffs, statistics, transportation, electricity, agriculture, and housing.

of the five governments. The Treaty thus provided that the five central banks should cooperate closely in regard to balance of payments difficulties that might arise in the case of any country, and in efforts to maintain stable exchange rates and currency convertibility. In this connection the Treaty provided for joint study of serious balance of payments problems likely to affect monetary and payments relations among the countries, and for recommendations to the Governments looking to solutions which would be compatible with the multilateral free trade regime.

The Treaty of Economic Association among the Republics of Honduras, Guatemala and El Salvador, signed in Guatemala City on February 6, 1960, included in its basic principles the statement that the Contracting Parties shall endeavor to maintain free convertibility of their currencies, and shall see that no legislative or administrative provision unduly impedes the free movement of persons, goods, and capital between any of them.

The basic treaty on integration, namely the General Treaty on Central American Economic Integration, signed in Managua on December 13, 1960, and subsequently ratified by all five governments,[11] incorporated almost verbatim the monetary and exchange provisions of the 1958 treaty. It provided that the Central American Executive Council, in place of the Central American Trade Commission mentioned in the 1958 treaty should, in cooperation with the central banks, immediately study any serious balance of payments problems and make recommendations compatible with the multinational free trade regime. The provisions of the General Treaty take precedence over all earlier Central American economic integration treaties, bilateral or multilateral, except for provisions not covered in the General Treaty.

The Central American Economic Council, the senior body in charge of economic integration, at its second Extraordinary Meeting, held in Managua August 1962, adopted a resolution (no. 7) whereby it was agreed: 1) that it is in the interest of Central American economic integration that mechanisms be established to assure the continuous and permanent coordination of monetary and exchange policies of the member states, including the expansion and improvement of the present system of multilateral compensation of payments; and 2) to request the central banks of the member states promptly to study the mechanisms

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11/ The Treaty became operative in June 1961. Costa Rica, the last country to ratify, completed its adherence to the Treaty and other regional conventions in 1963.

referred to in the previous paragraph, and to present to the Executive Council firm proposals for an agreement among the governments in order fully to achieve the indicated objectives.

The Declaration of Central America, issued by the five Presidents when they met in San Jose, Costa Rica in March 1963, gave further impetus to monetary integration. The Presidents included in the Declaration a pledge, "to establish a monetary union and a common fiscal, economic and social policy within the Program of Economic Integration." 12/

B. Agreement for Establishment of Central America Monetary Union

PARALLEL with the development of the economic integration treaties, the central banks have been planning and developing increasingly close consultation and cooperation. Since 1952 they have been holding meetings to consider their monetary and exchange problems and means of coordinating their activities. They have in recent years discussed measures and made plans looking toward monetary union. Thinking among central bank and other officials as to the type of monetary union to be sought has tended to crystalize on an eventual single currency for all of Central America, although no formal decision to this effect has been made. These officials realize that introduction of such a currency is a complicated process and not easily achieved.

Planning for some type of monetary union culminated in adoption by the central banks of the Agreement for the Establishment of a Central American Monetary Union, signed in San Salvador February 25, 1964 by the heads of the five central banks and subsequently ratified by their respective Boards of Directors. The main objective stated in this Agreement is to create the basis for an ultimate Central American monetary union. The Agreement, accordingly, established machinery and procedures to study and develop a program of monetary union.

12/ In connection with current plans for monetary union it is of historical interest that in 1907 a conference was held in Washington, and subsequent conferences in Tegucigalpa and San Salvador in 1909 and 1910, where agreements were signed by representatives from the five countries looking toward unification of their currencies. The conferences recommended that each government take measures necessary to establish a uniform currency for Central America, and outlined the general nature of this currency. The recommendations, however, were never put into force.

The Agreement, which became effective March 20, 1964, created 1) the Central American Monetary Council, consisting of the heads of the five central banks, 2) a number of Committees for consultation or action, and 3) an Executive Secretariat. The Monetary Council was given broad powers and exercises general supervision over the work of the Committees and the Secretariat. It was instructed, among other things, to study all aspects of the problem of monetary union, to make recommendations and propose draft agreements. Francisco Aquino h., President of the Central Reserve Bank of El Salvador, was named the first President of the Council, and Roberto Ramírez, President of the Central Bank of Honduras, the Executive Secretary.

Four Committees have been established, and additional ones may be set up by the Council as needed. The Chairmen of the Committees are distributed among the central banks, where the principal work of the Committees is carried on. These Committees and their locations are: 1) Committee for Monetary Policy, Costa Rica; 2) Committee for Financial Operations, Nicaragua; 3) Committee for Legal Studies, Guatemala; and 4) Committee for Exchange and Clearing Policies, Honduras. 13/

The Monetary Council held its first meeting in April 1964, and promptly undertook an active program of work. It approved the regulations and general outline of work by the Committees and made funds available to the Secretariat, provided by the central banks, to build a staff and carry on its activities. The Secretariat has established headquarters and been provided offices in the Central Reserve Bank of El Salvador. The central banks have assigned staff members to work in San Salvador with the Secretariat.

The Monetary Council, its Committees and the Secretariat have undertaken a broad program of studies regarding various aspects of the problem of establishing an effective monetary union in Central America. Among its early studies is that for the improvement and standardization of statistical data, since such data are essential to economic analysis. In the Central American integration movement, the Monetary Council is the main agency responsible for developing plans for monetary union.

In addition to the Monetary Council, the Ministers of Economy, who constitute the Central American Economic Council, have taken a special interest in achieving a monetary union, as has also the Secretariat of Central American Economic Integration (SIECA). The Central

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13/ For a statement of the functions of the Committees see Appendix A.

American Bank for Economic Integration (CABEI), which was established by the five governments in May 1961 to help finance regional economic development, is also interested in monetary union since its objectives and activities would be facilitated by such a union.

C. Central American Clearing House

IN order to facilitate payments among the Central American countries, and thereby promote regional trade and other transactions, the Central American Clearing House was established by an agreement of July 1961 signed by representatives of the five central banks. It was promptly ratified by the central banks of Guatemala, Honduras and El Salvador, and clearing operations commenced October 1, 1961 among the central banks of these countries. Nicaragua ratified the Agreement in February 1962, and Costa Rica in 1963.

The main purpose of the Clearing House is to promote intra-Central American trade by facilitating regional payments and the settlement of balances owing among the countries. It thus provides for the settlement of amounts owed by the central banks to each other by offsetting debits and credits and settling the resulting net balances. It encourages the use of Central American currencies in regional transactions, and in many cases eliminates exchange commissions.

All operations of the Clearing House are carried on in terms of a unit called the Central American peso, $CA, which is equivalent to one dollar of United States money. The agreement provides for this unit of account and for the conversion of national currencies into pesos at the parity declared by each central bank for its currency. The central banks guarantee the convertibility of their Clearing House balances into United States dollars at the declared parity.

Each member bank normally extends credit to the other members up to a total of US$500,000. These automatic credits, available to settle balances resulting from the compensation of current debits and credits, represent, however, a relatively small portion of the amounts cleared. Member banks may and in fact do require reimbursement in United States dollars of amounts owed them in excess of the credit. For this purpose member bank positions are calculated and settled weekly. Ordinary liquidation settlements of the automatic credits take place every six months, June and December, when the debtor member banks make payments in United States dollars to creditor member banks of net amounts owed.

The Clearing House is located in the Central Bank of Honduras in Tegucigalpa and is managed by the Executive Secretary of the Monetary Council. The Committee for Exchange and Clearing Policies advises on Clearing House matters.

In August 1963 the Bank of Mexico entered into a special agreement with the Central American Clearing House, and opened a credit for the clearing of payments between the Bank of Mexico and the Central American member banks. Other countries are interested in establishing similar relations with the Clearing House and plans for its expansion are being considered.

The Clearing House has compensated increasingly large sums of money, and is currently clearing some 85 to 90 percent of visible Central American trade. By facilitating payments for trade and other transactions it is making a significant contribution to Central American economic integration. It has also economized the use of foreign exchange in consumating settlements.

In June 1962 the central banks entered into an agreement to create an interbank instrument known as a Central American check, "Cheque Centroamericano." This check, put into circulation for the first time in July 1964, is similar to a cashier's check. It is drawn by a central bank in terms of its own currency and sold without an exchange commission. The banking commission is standardized at 1/4 of one percent with a maximum of $CA 25.00. The check may be cashed without charge at any central bank or commercial bank in Central America and is negotiable.

The check is intended to simplify payments among the Central American countries by providing the public an instrument which is readily acceptable at all banks and can be cashed at its face value without any deduction. It is thus a move in the direction of a par collection system for Central America. It is hoped that the checks will also be used as travelers checks.

V.

A Program for Central American Monetary Union

A. Approaches to a Common Currency

THERE are two principal approaches to monetary union in Central America leading eventually to a common currency for the region. The first is the introduction of similar currency systems in each of the individual countries, namely, the harmonization of the different national systems. Each country would adapt its own currency to an agreed pattern, so that the countries would all have identical monetary units. The currencies would continue to be national rather than regional, but could circulate throughout the region.

For example, if the peso of the Central American Clearing House, worth one United States dollar, were the accepted unit, Guatemala would change the name of the quetzal to a peso, Honduras would call the lempira half a peso and issue pesos equivalent to two lempiras. The other countries would convert their existing currencies to the peso basis by exchanging the present money for new pesos, which they would issue in exchange for the old at a rate determined by the value of the existing money; the rate would be such that the public would not lose in the conversion. The countries could, if they wished, issue pesos to circulate alongside of existing money, the complete conversion to take place later. Eventually, the similar national currency systems would be merged into a unified system for the region.

The second approach to a common currency is through the issuance of Central American pesos against a central fund administered by a regional institution. These pesos, obligations of the regional institution issued perhaps through the central banks, would make their way into the different countries, circulating alongside of existing money, similarly as the United States dollar circulates in a number of countries alongside of and interchangeable with national money. The pesos of the central body would be issued on a gradually increasing scale and be intended eventually to replace the national currency, which would be withdrawn in exchange for the new. The conversion could, of course, take place promptly without the period of parallel circulation, if this were desired, although a gradual introduction would give the public an opportunity to become familiar with the new money and its value, and to adjust prices accordingly in terms of pesos. Moreover, an initial small fund, which could expand as conditions indicate, would be a simple way to introduce the Central American peso and facilitate its use in the channels of trade.

Since the indefinite continuance of existing currencies is not possible if a monetary union of substance is to be established, these are essentially the only feasible approaches; variations are possible. The timing could be flexible and adjusted to circumstances.

The following sections discuss the necessary measures and possible stages for an effective monetary union, involving eventually a common currency for Central America. The timing of the different stages could be adjusted to progress in integration generally, and public support for the necessary measures. An agreed time schedule among the Central American countries, with specific dates as targets for the different stages, would be helpful. The stages, however, might overlap or in some cases be combined.

B. Stage One: Financial Coordination

1. Coordination of Monetary and Fiscal Policies

THE first step toward monetary union and a common currency for Central America is to develop frequent and close consultation and intimate working relations among the central banks, as is being done, and also among the Ministries concerned with fiscal matters. A main purpose of these consultations is cooperation and the coordination of the different countries' monetary and fiscal policies; also to help the countries get accustomed to working more closely together in the financial field.

In the stages before a common currency is fully achieved, regardless of which course is pursued, it is important that the existing national currencies continue strong and stable, so that price and cost relationships, which have become fairly well adjusted, are not disturbed. It is desirable also that these currencies continue to enjoy the confidence of the business world, and that they be freely accepted in each country at leading stores, hotels, etc. at firmly established exchange rates without question and without a discount. The latter situation does not exist at present except on a limited scale, due largely to unfamiliarity and conversion problems.

The objective of regional price and exchange rate stability requires, among other things, that there be close working relations and effective coordination of monetary and fiscal policies. For example, an unduly easy monetary policy of a member country, or budgetary deficits and heavy government borrowing from banks, may lead to excessive credit expansion, high prices and balance of payments deficits. It may cause such country's prices and costs to become out of line with those of the other countries, thereby complicating monetary union, perhaps even necessitating a devaluation before a union could be consumated. Excessive monetary expansion in Central America tends, as noted, to result in increased imports, and a worsening of the foreign exchange position, rather than in higher domestic prices. If an inflationary situation of this kind developed in any member country, the other countries of the region would be called upon to support the currency of the inflating country in order to keep it freely interchangeable with the other currencies and to avoid exchange restrictions or devaluation. Such support, if extended, might become excessively burdensome. Developments of this kind would complicate and deter monetary union.

If monetary and fiscal policies are coordinated, and if prices in all the countries move more or less in harmony, exchange rate stability, the ready interchangeability of the currencies and progress toward union are less likely to be disturbed than if each country pursues an independent policy. The countries might, of course, all experience balance of payments deficits with the outside world even though policies were well coordinated.

If the approach to monetary union elected is the issuance of identical monetary units, and their free circulation in each other's territory, coordination of policies during this stage would be essential to the assured continuance of such free circulation. In the event, for example, that exchange restrictions or devaluation became necessary, or even threatened a particular currency, the public would not with to hold the currency of the country in trouble. Such currency would accumulate in the hands of the other member countries, or if rejected by them, go to a discount. The monetary union would be in difficulty.

Efforts to coordinate monetary and fiscal policies may run into the difficulty that divergent policies are needed in the different countries for reasons of national economic interest. Such divergent policies would not facilitate stable monetary and exchange relations among the countries. For example, one country might need to tighten credit in order to check incipient inflation, whereas another country might not need to tighten credit; it might be experiencing depression and unemployment, and an easy money policy might be in order. The latter country, with lower interest rates, might lose foreign exchange as funds flowed to countries with higher interest rates. These difficulties, more of a problem as economic development is achieved, illustrate the instability of a union based upon national currencies, including identical national pesos.

Coordination of monetary and fiscal policies, even though feasible and successful, cannot guarantee that troublesome balance of payments deficits will not ari e from non-monetary sources, such as a shift in foreign demand for a country's major export or some other structural change, due perhaps to a technological development, for example, competition from a synthetic product. Balance of payments deficits due to structural changes may cause the breakdown of any monetary union based on national currencies, including national pesos, for the reasons noted above. If structural changes should require or threaten imposition of exchange restrictions or alteration in the pattern of exchange rates among the member countries, i.e., devaluation, this would be well-nigh fatal to the union. The similarity of the exports of the Central American countries reduces the likelihood of such a structural change affecting only one or two countries, but does not remove the possibility over an extended period, particularly as diversification of production proceeds.

These difficulties make clear the fact that the permanence of a union based on national currencies cannot be assured, although with good fortune it might continue for a considerable period of time.[14/] Despite these difficulties coordination of monetary and fiscal policies is, nevertheless, a necessary preliminary to monetary union.

The present Central American Monetary Council, created in February 1964 and consisting of the heads of the five central banks, brings together several times a year the principal Central American officials concerned with monetary matters. Its meetings permit an informal exchange of views and an opportunity to consider together common problems and to coordinate policies. Furthermore, the four Committees of

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14/ The situation would, of course, be different if the national currencies were in fact inherent parts of a common currency system and were national only in name, i.e., were subdivisions of a regional unit but retained their original names. For example, the Honduran lempira worth 50 cents in United States money, could in fact be half of a regional Central American peso worth one dollar, and continue to be called a lempira; it could even have distinctive Honduran insignia, although the greater uniformity the better from the standpoint of general regional acceptability.

the Monetary Council, namely those on Monetary Policy, Financial Operations, Legal Studies, and Exchange and Clearing Policies, provide for frequent association among other senior officers of the central banks. In addition, the Secretariat is a focal point for further contacts among central bank and other officials. These various meetings and contacts, formal and informal, represent a constructive step in bringing about the exchange of information, closer association and cooperation among the Central American monetary authorities.

While a good start has been made in central bank consultation, nevertheless, even more frequent meetings of senior officials and closer coordination of policies are needed. These will doubtless develop, according to present plans.

In the field of fiscal affairs, no provision presently exists for meetings of the Ministers of Finance and thus for consultation and coordination of fiscal policies, important to monetary union. In El Salvador, Honduras, and until recently in Costa Rica, the Ministries of Finance and Economy are combined into one Ministry. The Ministers of Economy of the Central American countries, with varying degrees of responsibility over fiscal matters, get together as members of the Central American Economic Council. They also meet as Governors, along with the central bank presidents, of the Central American Bank for Economic Integration (CABEI), and again as Directors of the Central American Institute of Industrial Technology and Research (ICAITI). Joint meetings of the Ministers of Economy and Finance are planned to discuss harmonization of taxes.

Coordination of fiscal policies, along with that of monetary policies, is necessary since price and exchange stability are dependent upon fiscal as well as monetary policies. There is need for regular consultations on fiscal matters by the appropriate officials. Machinery for this needs to be established, and to be coordinated with that for consultation among the central banks. A Budget Policy Committee might be established to examine national budgeting in its early stages form the standpoint of effects upon the Common Market and monetary conditions.[15/] To achieve joint consideration of both monetary and fiscal policies the Monetary Council might from time to time hold joint meetings with the Budget Policy Committee, if established, or with the Ministers of Finance or Economy, depending upon their national responsibilities over fiscal affairs.

15/ The Council of the European Economic Community in April 1964 established a Budgetary Policy Committee to study member's budgetary policies and formulate opinions. See Annex II.

While the Ministers of Finance and of Economy have responsibilities over the executive budget and other fiscal matters, they do not have authority over the large budgets of the autonomous agencies. Centralization of such authority within the individual governments is needed to facilitate effective coordination of fiscal policies among the Central American countries. Such centralization, however, will probably not be easily achieved. The central banks, in addition to their monetary responsibilities, are influential in the fiscal field and try to see that fiscal policies do not undermine monetary stability. Nevertheless, a gap presently exists in the field of fiscal consultation which needs to be remedied in some manner, perhaps as noted in the next section.

2. Annual Country Reviews

A regular and comprehensive review, conducted jointly by the Monetary Council and Ministers of Finance or Economy (or Budget Policy Committee if there were one), of each country's economic and financial position and policies would facilitate coordination and help to keep the countries' currencies in a consistent and harmonious relationship. Each country's financial position and monetary and fiscal policies under such an arrangement would be subjected to a critical and detailed review normally once a year, but more frequently in special cases. The review would be based upon an analysis prepared by the Secretariat in cooperation with the individual country, and be made available to members of the Council and Ministries well in advance of the meeting. Much of the material needed for such analyses is already regularly compiled; it is furnished to the International Monetary Fund for their annual consultation reports. This material could be readily adapted to the needs of the Council and Ministers. The review by the Council and Ministers would result in specific recommendations to the country in question.

The members of the Monetary Council and the Ministers have a background and understanding of each other's problems, both economic and political, and are in a position to make constructive recommendations; these recommendations might support actions which the country authorities already desired to take, and would strengthen their hands in taking such actions. If formal recommendations were not feasible for one reason or another, the consultations nevertheless could make known informally and confidentially to a country the views of the others. Consultations of this type are carried out regularly for the European countries, the United States, Canada and Japan by Working Party 3 of the Economic Policy Committee of the Organization for Economic Co-operation and Development (OECD). They are also carried out by the member countries of the European Economic Community (EEC). Such consultations and confrontations, in addition to promoting coordination of policies, would tend to draw the Central American countries more closely together and be a significant move toward monetary union.

3. Prior Consultation on Specific Actions

In addition to the type of consultations discussed above, the countries could usefully agree not to undertake any important action in the monetary, exchange or fiscal field without previous discussion of the proposed action with the other members of the Monetary Council. Each country, however, could reserve the right, at least in the early stages, in the event of an emergency or special situation to act without such prior consultation. The kinds of actions subject to prior consultation would be such as drawings on the International Monetary Fund, other external borrowing for balance of payments reasons, raising or lowering the central bank discount rate, altering reserve requirements, altering the exchange rate or exchange margins, applying exchange restrictions or modifying them materially, and taking important fiscal actions.[16/]

A country contemplating an action of this nature would not relinquish its right to act on its own as it saw fit, but would agree to notify the other members in advance and provide them an opportunity for comment before the action was taken -- except in special cases. Such prior consultation with respect to important actions should take place, if feasible, in a meeting of the Monetary Council where discussion would be possible. If no meeting of the Council were imminent and the matter was urgent, such as in the case of an exchange crisis and the possible introduction of exchange restrictions or an exchange devaluation, a special meeting of the Council might be called. In order to avoid speculation regarding a possible forthcoming action, as well as for other reasons, the Council could develop the custom of holding special meetings occasionally in addition to the regular meetings. A special meeting would thus not attract undue attention. More frequent meetings would help to develop intimate relations among the central banks and are desirable in themselves.

16/ Members of the International Monetary Fund may change the par values of their currencies only after consultation with the Fund, and if more than ten percent of the initial par value, only with the approval of the Fund. All the Central American countries are under Fund Article VIII, and therefore may impose exchange restrictions on current international transactions only with Fund approval.

If a meeting of the Council were not feasible, or were not considered necessary in light of the nature of the proposed action, prior consultation could take place by correspondence, telephone or telegraph. Several of the central banks are now connected by private telephone lines, and plans are underway to include the others. After such consultation, and with the views of the other members of the Council before it, the proposing central bank would be free to act as it considered desirable; it would do so with awareness of the impact of its action on regional economic objectives. In assuming the obligation of prior consultation a participating country would thus not relinquish the right to go ahead with a measure which it considered to be necessary, regardless of the views advanced by others, and would also have an escape for special situations when prior consultation would not be required.[17/]

Consultations of the type described in the preceeding sections are essential to progress toward monetary union. They could be readily inaugurated in accordance with the procedures and machinery established by the Monetary Agreement signed in San Salvador in February 1964. An agreement providing for prior consultation need not be a complicated document; such consultation could in fact be initiated informally without a written agreement.

C. Stage Two: Pooling Reserves

1. Liquidity and Exchange Rate Stabilidity

In order to maintain stable exchange rates during an interim or preliminary period, it is necessary that there be not only coordination of monetary and fiscal policies, but that each country have adequate foreign exchange reserves, or access to such reserves, in order to finance temporary and reversible balance of payments deficits. They must individually be able to ride through periods of economic or political difficulty without imposing exchange restrictions or altering exchange rates.

17/ The Council of the European Economic Community in April 1964 provided for prior consultation regarding monetary measures contemplated by Member States. See Annex II.

The Monetary Agreement signed in San Salvador on February 25, 1964 sets forth in Article 2 one of the goals as:

> "4) specific mechanisms designed to provide financial assistance adequate to prevent unfavorable trends in the exchange systems, lessen the effects of temporary disturbances in the balance of payments, and further the free movement of capital in Central America;"

While the Central American countries can assist each other as contemplated in the Monetary Agreement, there are limitations upon their ability to render such mutual assistance. One of the limitations is the fact that the Central American countries have to a large extent similar economies and exports. They therefore tend to experience economic difficulties at the same time; a weakness in coffee affects all countries, although Honduras less than the others. For this reason the countries, singly or as a group, will continue to need to look to outside sources for major assistance in periods of severe balance of payments difficulty. As diversification of production and of exports continues, the economies of the countries in the region may tend less and less to rise and fall together.

The foreign exchange reserves of the Central American countries have increased substantially during the past few years. The period 1958-1961 was one of depressed export earnings and weakening reserves as noted in Section III. Since that time the prices of coffee, cotton and other export commodities have risen along with increases in volume exported, so that the liquidity position of these countries has strengthened materially. This improvement has taken place along with an increase in imports. Moreover, receipts of foreign capital have also increased and contributed to the growth in reserves. The present strong liquidity position of the member countries, allowing for seasonal factors the highest in history, is especially helpful to the establishment of a monetary union. The liquidity position of the countries and of the region as a whole is shown in the following table:

LIQUIDITY POSITION OF THE CENTRAL AMERICAN COMMON MARKET COUNTRIES

(millions of dollars; central bank, end of period)

	Foreign Exchange			Gold			IMF Gold Tranche Position			Liquidity		
	1962	1963	1964 Aug.	1962	1963	1964 Aug.	1962	1963	1964 Aug.	1962	1963	1964 Aug.
Costa Rica	10.1	13.5	14.3	2.1	2.1	2.1	.4	-	-	12.6	15.6	16.4
El Salvador	5.4	21.3	32.5	17.8	17.8	17.8	2.8	5.0	5.0	26.0	44.1	55.4
Guatemala	22.7	35.4	40.6	23.5	23.1	23.0	-	-	3.8	46.2	58.5	67.4
Honduras	13.2	12.3	20.6	.1	.1	.1	-	-	-	13.3	12.5	20.7
Nicaragua	16.6	31.6	36.3	.6	.2	.3	-	-	-	17.2	31.8	36.7
Total	68.0	114.1	144.3	44.1	43.3	43.3	3.2	5.0	8.8	115.3	162.5	196.6

Source: IMF, International Financial Statistics.

In view of pressing needs for development, the countries will doubtless wish to avoid maintenance of external reserves at levels higher than necessary for exchange stability. Access to International Monetary Fund resources, a primary source of assistance in meeting unusual balance of payments fluctuations, will enable the countries to utilize a larger portion of their increased foreign exchange earnings for urgently needed imports.

To the extent that the foreign reserves of the Central American countries can be pooled or utilized in some manner to support each other's currencies, these resources would be economized and used more effectively than if the reserves remain independent and decentralized. Where each country, for example, seeks to maintain reserves large enough to meet possible needs, the total reserves of all the countries must be larger than if the combined reserves are available, at least in part, to a country in difficulty.

Furthermore, when an external deficit of a member country is attributable to imports from within the region, and the country loses reserves to another member country, that is, when difficulties arise from internal shifts in trade involving the loss of exchange by one country and a corresponding gain by another, regional assistance may be feasible. The limitations on the Central American countries' ability to help each other due to the similarity of their economies and exports would not apply to this situation of balance of payments pressures resulting from intra-regional trade movements. This type of assistance would not represent a loss of foreign exchange for the region as a whole. The situation would differ from that, for example, due to a poor coffee crop, where the countries might simultaneously be in need of assistance; in the latter case outside assistance, such as that extended by the International Monetary Fund, might be required.

If one member country, however, were in a strong reserve position, regardless of the reasons, it might be able to assist a member in difficulty, even though the difficulty did not arise from integration. Ability to extend mutual assistance, therefore, and the need for assistance, are not necessarily related to integration factors. Such assistance should not be thought of merely in terms of meeting integration pressures.

Despite certain limitations due to the similarity of exports, whatever arrangements can be developed whereby the countries can render balance of payments assistance to each other would be in the direction of more efficient utilization of regional reserves, would release reserves for development and be a constructive step toward monetary union.

Mutual balance of payments assistance can, as at present, be extended bilaterally at the discretion of the individual central banks, or it can be based on some form of commitment, such as a pooling of reserves or stabilization fund, with appropriate qualifications as to the amount and circumstances under which such assistance will be provided.

2. A Regional Fund

Under either approach to a common currency there could be a partial pooling of reserves. A regional fund could be established, (1) to provide balance of payments assistance and help countries avoid exchange restrictions or exchange rate adjustments, subject to appropriate limitations, as discussed in the preceding section and elsewhere, or (2) it could serve as backing for the gradual introduction of regional pesos, namely, the second approach to monetary union. It would be possible to have two funds, one for each of these purposes. A fund to back regional pesos, however, should be entirely separate and not be available, and thus subject to possible depletion, to provide balance of payments assistance to national currencies.

Various types of arrangements are possible regarding a partial pooling of reserves. The amount subscribed to a central fund could be the same for all countries, but preferably should vary with the reserve positions of the countries, and perhaps other criteria. Each country could, for example, provide a certain percentage of its average reserves over a previous period, e.g., the previous three years. A figure of ten percent of average reserves over the past three years would provide a fund in the neighborhood of $15 million, which could subsequently be increased; a fifteen percent subscription would provide a fund of about $23 million.[18/]

Alternatively, quotas could be assigned the countries based upon a combination of economic indices. Subscriptions to the fund would presumably be in terms of the Central American peso used by the Clearing House, equivalent to the United States dollar, or whatever unit is selected for the monetary union. Subscriptions would be payable in convertible foreign currencies or gold. In order to increase the fund's available resources, the International Monetary Fund might be asked to provide a special type of standby arrangement whereby International

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18/ A longer period of years would provide a somewhat more representative base, in light of changes in individual reserve positions. Ten percent of reserves on a five year base would amount to $13 million. The relative country subscriptions, however, would not be greatly altered by a five year base.

Monetary Fund resources would be available to the fund under specified conditions. Such a standby to a multilateral institution would be a departure from International Monetary Fund practice and would be based upon individual IMF country quotas. At such time as a common currency were fully established the individual IMF quotas would doubtless be combined into a single quota. Such an ultimate combining of quotas should raise no difficult problems for the International Monetary Fund. An increase in quotas might also be requested in view of the growing importance of the combined Central American economy.

As Central American integration progresses and the countries move toward a common currency, subscriptions to a stabilization fund could be progressively increased according to a schedule of stages. The requirements for moving from one stage to the next, when additional resources would be called up, would need to be carefully defined and provide flexibility, not unlike the provisions in the Treaty of Rome, which established the European Economic Community and which provides for successive stages of increasing economic integration. Eventually a stabilization fund in its entirity would become a reserve for a regional peso, or whatever the currency were called.

If the pooled resources, on the other hand, were backing for regional currency, their gradual expansion could be according to procedures outlined in Section V.D.3.

The administration of a stabilization fund, including access to it, would presumably be under the general supervision of the Monetary Council, and according to established principles and procedures. Each country, however, would have automatic access to the fund up to the amount of its subscription. It could continue to show this sum in its own reserves since access to these funds would be assured. A country might also be given reasonable assurance of access to a certain additional sum.

A regional stabilization fund of the type described would be patterned somewhat after the International Monetary Fund, and incorporate arrangements and principles which have proved workable and effective over a period of years. The main underlying principles would be: variable subscriptions by the different countries, automatic access up to the amount of a country's subscription, discretionary control by management over further access, policy recommendations to the borrower and accompanying conditions as considered appropriate, and progressive expansion and development of the fund accompanying integration and moves to a common currency. Weighted voting, utilized in the International Monetary Fund, would appear undesirable and unnecessary in view of the more nearly equal economic positions of the Central American countries as compared to the wide differences in economic positions among the members of the International Monetary Fund.

A stabilization fund could eventually evolve into an institution to issue regional pesos. A possible institution of this nature, the Central American Monetary Board, is discussed in Section V.E.2. The individual countries would then no longer need access to the fund since they would not have the responsibility for maintaining separate currencies. The fund, finally consisting of the countries' combined reserves, would be utilized to maintain exchange rate stability and convertibility of the Central American peso.

The pooling of reserves in a stabilization fund would be especially helpful in the case of the first approach to a common currency, namely, the issuance of identical currencies by the individual central banks, and the continuance during an interim period of separate currency systems.

If the second approach to a common currency is pursued, that is the issuance of regional currency by a central institution, the pooled reserves could be the beginning of a central fund against which regional currency is issued, as discussed in Section V.D.3. The fund in this case would be available to redeem the regional currency. A fund of this type would permit introduction of the Central American peso at an early date in whatever amounts, large or small, the countries wished. Traders and investors within the region would then be able to do business in terms of a regional peso, presumably a strong currency and relatively immune to political and other difficulties in any one country.

3. Stabilization Fund and the Central American Clearing House

The functions of the Central American Clearing House, established in 1961 (discussed in Section IV.C), and which has operated so successfully to facilitate trade, are different from those of a possible stabilization fund; but they are nevertheless related. The principal function of the Clearing House is to offset and settle balances arising out of current trade among the Central American countries and Mexico. In connection with this function, the Clearing House provides for limited automatic credits. Amounts owed in excess of these credits are settled weekly and represent the principal amounts cleared. Liquidating settlements of the automatic credits take place every six months. The main purpose of the Clearing House is thus to facilitate payments by offsetting debits and credits, rather than to provide balance of payments assistance. At the same time, utilization of the Clearing House credits does provide a small amount of temporary balance of payments assistance.

The main purpose of a stabilization fund, on the other hand, would be to provide balance of payments assistance in cases where this is needed, so as to facilitate maintenance of exchange rate stability and currency convertibility. The two functions are, however, not unrelated, both having to do with balance of payments credits.

The Clearing House is administered by the Executive Secretary of the Monetary Council, with the advice of the Committee on Exchange and Clearing Policies. A stabilization fund might be administered by a general manager who would also be under the Monetary Council, which would make the major decisions.

4. Exchange Rate Guarantees

A firm and unqualified guarantee by the Central American countries of each other's exchange rates would involve formidable difficulties, which probably rule it out as a feasible measure. The countries which would be guaranteeing another country's exchange rate would, in effect, be writing a blank check and accepting an unknown and potentially large liability, even with coordinated monetary and fiscal policies. Although no devaluation of a Central American currency now appears on the horizon, it is impossible to forecast the future of any currency in any country. If a guarantee were subject to withdrawal and could be cancelled it would have little value.

It might be possible to estimate the maximum liability reasonably conceivable under a guarantee, to provide for limited and selective application of the guarantee in order to reduce the liability and eliminate speculators, to establish ceilings on indemnities and a limit to a country's liability, arrange for a funding of possible losses, and to work out other protective arrangements which would nevertheless permit guarantees to provide a certain amount of assurance regarding the continuance of particular exchange rates. As a practical device, however, guarantees of exchange rates of separate national currencies subject to separate control would offer considerable difficulties for a Central American monetary union.

Guaranteed exchange rates would also raise problems of the adjustment of balance of payments disequilibrium among the countries.

If a country, for example, renounces intra-regional exchange rate changes and experiences inflation, other means of adjusting major and irreversible balance of payments disequilibrium must be relied upon. Such other measures might be deflationary and inconsistent with high levels of employment and economic growth.

A firm guarantee of exchange rates accompanied by definitive regional control over national monetary and fiscal policies, and supported by a pooling of reserves, would be a different matter, and in essence merely a guarantee of different divisions of a common currency. The individual currencies would in effect be merely subdivisions of a common monetary unit, but carrying their original names. Thus a guarantee, for example, of the rate between the quetzal and lempira, under the conditions of central control noted, would mean that the lempira was actually 50 centavos of a new peso, but was still called a lempira.

5. Exchange Stabilization Agreement

The possibility has already been discussed of creating a central reserve fund, either to support the existing national currencies or possible new separate but uniform currencies. Either of these plans clearly would be of an interim nature. While a guarantee of the exchange rates of national currencies, without definitive central supervision of monetary and fiscal policies, offers serious difficulties, certain measures can be taken, in addition to consultation and coordination of policies, which would provide the public further assurance that an exchange rate is firm, and that a country's money can be accepted with confidence. An exchange stabilization agreement among the Central American countries could be entered into, either as an alternative to a stabilization fund, or supplementary thereto.

Such an agreement could provide: 1) a declaration of intention to assist each other to maintain stable exchange rates and avoid the imposition of exchange restrictions and devaluation; 2) that upon the recommendation of the Monetary Council the countries would confer promptly on possible financial assistance, which might be extended singly or jointly by them to a country needing balance of payments assistance; and 3) that the countries would consider other measures of aiding each other, such as cooperation in obtaining financial assistance in foreign countries.

If the agreement were an alternative to a stabilization fund, it could go further than the above provisions and involve a commitment to provide funds, under specified conditions, to a member needing assistance. It could be not unlike the agreement to lend, entered into in 1962 by the "Group of Ten," whereby the United States and the principal European countries and Japan (with Switzerland now eleven countries) agreed to provide $6 billion to the International Monetary Fund to meet special needs. An agreement along these lines, involving a specific commitment, could be entered into during Stage One. Once a common currency has been achieved, the stabilization agreement, like the stabilization fund, would no longer be necessary. If the countries move rapidly in the issuance of regional currency by a central fund, that is the second approach, neither a stabilization agreement nor stabilization fund might be necessary.

D. Stage Three: Introduction of the Central American Peso

1. The Central American Peso

Regardless of the road which is taken to monetary union and the time schedule, early agreement is desirable on the nature of the monetary unit to be adopted. The agreement would not only define the gold value of the unit, but specify the subdivision of coins, their size and general appearance, thereby enabling countries that choose to do so to begin to adapt their currency systems to the common unit.[19/]

The Central American countries in August 1961 adopted as the monetary unit for the Clearing House, which was then being established, the Central American peso with a gold value equivalent to that of the United States dollar. This unit is currently utilized by the Clearing House for all its transactions. It is identical in value to that of the quetzal of Guatemala and the balboa of Panama.

Much can be said for the adoption of this unit for the projected Central American monetary union. Being the same as the United States dollar, the quetzal and balboa, it is a well-known denomination throughout the area. It is also well-known and widely used throughout the world generally. Moreover, it is the same as the unit adopted by the International Monetary Fund and used in all IMF transactions and accounts. It was used by the European Payments Union and is currently widely used in Europe.

19/ For example, if the peso were worth one dollar, El Salvador could issue a five colon note called also a two peso note. Honduras could issue a two lempira note called also a one peso note, and Guatemala could call the quetzal also one peso.

One handicap to such a unit for Central America is that the smallest subdivision, namely one centavo, is not sufficiently small in value for certian areas where some purchases are made for less than this amount. In order to meet this situation, a one-half centavo piece could be issued, if warranted. As economic development proceeds in Central America and as living standards are raised, transactions for less than one centavo will tend to disappear. It is sometimes said that a high value for the monetary unit leads to a higher cost of living. The evidence for this, however, is not convincing.

While there is much to be said for a peso, or whatever the unit might be called, equivalent in value to that of the dollar, quetzal, and balboa, a case might also be made for a unit worth half this amount, or even one-fourth of this amount. It has been suggested that psychologically it is desirable to have a small unit adapted to the purchases of the people, and sufficiently small that workers can receive a large number of units in wages. A worker thus who receives for a job one peso worth a dollar, might prefer to receive four pesos worth 25 cents each. In any event it would be desirable to have the unit an even relationship to the dollar.

If the unit for the Central American monetary union were to be the peso now used by the Clearing House, no problem would arise with respect to the conversion of the quetzal and balboa into Central American pesos, since their values are identical. As to the lempira, worth fifty cents United States money, the public in Honduras would readily understand that two lempiras were the equivalent of one peso, and adjust prices accordingly. Similarly in Salvador, the relationship of the colon, worth forty cents United States money, to the new peso would not involve complicated calculations; the public would be quick to realize that the peso was worth two and one half colones, and that a 10 centavo peso coin was worth one quarter of a colon. In order to simplify conversions for Salvador, however, a coin worth 20 centavos of a peso could be issued. One 20 centavo piece would thus be worth half a colon, and two 20 centavo coins would be worth exactly one colon.

In regard to the Nicaraguan córdoba, worth 14.285 cents United States money, and thus 7 to the peso, and the Costa Rican colon worth 15.094 U.S. cents and thus 6.625 to the peso, the conversion computations would be more complicated. A slight adjustment in the values of the existing currencies for conversion purposes might be made. Thus the Costa Rican colon could be converted into pesos at seven colones to the peso instead of 6.625, thereby simplifying the exchange. This minor alteration in value would be in the direction of strengthening Costa Rica's external competitiveness and improving the foreign exchange position of the colon; it would make the colon identical in value with the córdoba. If Costa Rica and Nicaragua desired to convert at a rate of eight to the peso, the conversion and adjustment of prices would be simpler. This rate would involve a small devaluation, which raises other questions not discussed here. Such a conversion rate is therefore not being put forward as a proposal.

2. Pesos Issued as National Currency

It was noted in Section V.A. that there are two main approaches to a meaningful monetary union and a common currency for Central America. The first is the issuance by each country of money of identical value and similar appearance, so that it could circulate interchangeably throughout the region in accordance with agreed procedures. The money would be an obligation of the individual governments, or their central banks, until such time as the separate currency systems were merged into a single system for the region.

The other road to monetary union and a common currency is through issuance of Central American pesos by a central regional institution. The money would be an obligation of the regional institution, and would be designed to replace existing national money, either gradually during a period of joint circulation, or through immediate conversion of existing money to the new. These are the two feasible roads to meaningful monetary union.

If it is desired to pursue the first course and proceed via the continued use of national currencies, it is necessary that the existing currencies be replaced by new money of uniform value and design. The present currencies can not well circulate interchangeably in the several countries in view of their diverse values and the need for complicated conversion calculations. According to this approach, each central bank would issue Central American pesos which would be identical in gold value and in general appearance. Coins would be of the same denominations, metallic content, size and appearance. All money would carry an identification of the issuing country, so that responsibility for the money could be ascertained. Such indentifying inscription should be relatively inconspicuous so as not to interfere with the general similarity of appearance and acceptability of the money. The money should be thought of as Central American money.

As a check against over-issue of money by any one country, all money received by a central bank other than its own, would be returned to the country of issue for credit. It would not be returned to circulation, except by the country of issue. The compensation of debits and credits could be carried out through the Clearing House according to existing procedures; at the present time money from the different countries is returned for credit through the Clearing House. This is the procedure followed for many years in the United States where each of the twelve Federal Reserve Banks returned to the issuing Federal Reserve Bank all notes of such bank which it received. Notes of the Federal Reserve Bank of New York received by the Federal Reserve Bank of San Francisco were thus returned to New York. They were cleared through the System's settlement fund. Since the notes of the different Federal Reserve Banks are inherent parts of a single monetary system and are obligations of the United States Government, this procedure was discontinued in 1954.

The practice of returning pesos to the issuer would prevent any one country from acquiring the goods or services of other countries by issuing unduly large amounts of money, which could be spent in the other countries. An unduly large issue of pesos by any central bank would soon be presented to it for payment through the Clearing House. This procedure would keep the circulation of pesos of the different countries in reasonable balance, and prevent domination of the field by the pesos of any one country.

In order to inaugurate the system, an agreement or treaty would need to be drawn up providing for the necessary operating details. Legislative authority would probably also be required in the individual countries to put the plan into operation. Once these requirements were met the central banks of the region could begin issuing Central American pesos, which would make their way into circulation gradually alongside of existing money. The pesos would be in demand for payments among the different countries, since there would be no conversion costs, and by travelers. Bank accounts could be kept in pesos and payments among the countries made by check. Little by little the pesos would become generally known and their circulation expanded. The parallel circulation of pesos and local money would give the public an opportunity to become familiar with the value of the peso, and to adjust local prices and costs to a peso basis.

The countries of Central America and Panama not only have different monetary units, with the exception of Guatemala and Panama, but different monetary systems, laws and regulations. The type of monetary union under discussion, wherein the countries would move toward identical systems, would require that the countries adapt certain features of their monetary systems to a common agreed pattern. For example, if the countries were to issue identical Central American pesos to circulate throughout the Isthmus, uniformity is especially needed in the field of exchange restrictions, namely, possible limitations upon the purchase of foreign currencies, and thus upon the transferability of funds to foreign countries.

Free convertibility of Central American currencies into currencies outside the region, although highly desirable, is not essential to a monetary union based upon the circulation of national currencies. Uniformity throughout the region of whatever exchange regulations may be imposed is, however, well-nigh essential. For example, if under a monetary union wherein the currencies were interchangeable, one country imposed restrictions upon the purchase of foreign exchange, and thus did not permit the free transferability of its currency outside the area, whereas others did permit such convertibility, persons in the country whose currency was inconvertible could evade the regulations by exchanging their currency for that of the other countries; through these other currencies they could acquire the desired foreign currency. This problem was discussed in Section II.D.

The other countries, whose currencies were convertible, would as a result tend to have an increased demand for foreign exchange. The currency of the country imposing exchange restrictions, however, would be presented to the central banks of the other countries, and be returned through the Clearing House to the country imposing restrictions; such country would be required to redeem the debit balances in convertible currency. Importation of the restricted goods and a flight of capital from the country imposing restrictions could thus take place via the other countries, and draw down the reserves of these other countries until reimbursed through the Clearing House. If this process continued very far and the issuing central bank of the country imposing restrictions had difficulty in redeeming its money, the money might depreciate; interchangeability of such money might have to be withdrawn.

If all the countries, on the other hand, had uniform systems of exchange restrictions, the above situation could not arise and a monetary union would be able to function, although the benefits would, of course, not be as great as under a system of complete convertibility. A single currency for the region would thus require uniformity of exchange restrictions. It would also require uniformity in the effectiveness of enforcement. If, for example, there were a thriving black market in one country, but not in the others, restrictions of the latter countries would be undermined.

The currencies of all the Central American countries and Panama are essentially convertible, with the exception of those of Guatemala and El Salvador which are subject to capital controls. Inasmuch as all the currencies are essentially convertible for current transactions, and only Guatemala and El Salvador impose capital controls, and since these latter two countries are in strong reserve positions and plan eventually to eliminate such controls, the question of exchange restrictions should pose no difficult problem. Either El Salvador and Guatemala would have to abolish capital controls, which would be the preferable solution, or the others would have to impose such controls. Continuation of the long and excellent record of most of the countries regarding convertibility should be a major objective of a monetary union.

While there is much to be said for the approach to monetary union outlined above, it is not free from possible difficulties. One of the main difficulties is, as discussed in Sections II.B. and V.B.1., the possible disruption of the system through a particular currency becoming out of line with the others as a result of divergent price and cost movements, balance of payments difficulties, or other developments which would bring it into disfavor and pressure.

The currency of a country experiencing inflation, balance of payments deficits, or economic difficulties, might come under suspicion and be rejected by the public or accepted only at a discount in terms of the other currencies. It might be presented to the banks in large amounts in exchange for the other currencies. The central banks which received it would return it to the issuing bank for credit at the Clearing House. The issuing central bank would thus tend to accumulate large liabilities at the Clearing House.

Financial support adequate to maintain the parity of such currency might not be available, or in fact warranted if the currency were materially overvalued at current exchange rates. It would then depreciate in terms of the other currencies. If one of the currencies depreciated it would tend to bring the entire monetary union into disrepute, since the public would acquire the habit of examining each piece of money, and be susceptible to rumors, rather than accepting money at its face value without question, which is an essential attribute of a successful monetary system.

A political crisis in one country could immediately cause the money of that country to come under suspicion in the other countries, and, rightly or wrongly, lead to its acceptance only at a discount. Such discount could also appear in the country experiencing the political difficulty. The period of suspicion might not last long, and the currency eventually return to good standing, but would at least temporarily be disturbing to the monetary union. The success of a union based upon national currencies would require that all of the currencies remain above question, real or imagined.

The countries participating in a union based upon national currencies would find it difficult to give an unqualified guarantee of the parity of the various currencies, since this would be tantamount to a pledge of unlimited financial support. The difficulties with exchange rate guarantees were discussed in Section V.C.4.

In order to minimize the possible dangers noted, the countries might establish a special fund of resources which would be pledged to maintain the parity of national pesos. It would be available under certain conditions to support a currency under pressure. This special fund could be in the form of contingent liabilities of the different banks, up to specified amounts, and its availability be under the supervision of the Monetary Council. A stabilization agreement establishing a fund of this nature was discussed in Section V.C. If the stabilization fund, also described in Section V.C., were functioning, there would be no need for a special fund; an assured "second tranche" might take its place.

The absence of a central institution with formal authority to determine the monetary and fiscal policies of the participating countries, and thereby prevent or reduce the likelihood of a particular currency getting out of line with the others, is less of a handicap if there is close cooperation and a strong and active Monetary Council. The Council's control over access to stabilization fund resources would strengthen its position vis-a-vis individual countries. For example, if a particular country experienced inflation, and its monetary authorities were lax and failed to follow accepted policies, such country might find the door closed not only to the Central American stabilization fund and perhaps other Central American privileges, but to external resources as well. Foreign lenders would give weight to the views of the Monetary Council and be inclined to refuse assistance without the tacit endorsement of the Council. The Council would thus possess leverage against a recalcitrant country in order to maintain the integrity of the monetary union. The Council might develop other means, such as the withdrawal of certain privileges, of influencing a member country to avoid reckless policies. For this and other reasons it is desirable that Central America develop a strong and active Monetary Council.

It would be desirable that the Central American peso be legal tender in all the countries in order to facilitate its acceptability. Such legal tender quality, however, could be the source of difficulties in the event that a particular currency came under suspicion and pressure as discussed above. People would hasten to pay their obligations in the money in disfavor; if it should go to a discount the recipients who were required to accept it would lose. Under such conditions the legal tender quality, if provided, could automatically cease.

The above difficulties, while they are real and potentially the source of trouble and a breakdown of the monetary union, might not materialize for an extended period. Over a relatively short period of time, such as a few years, the probabilities are that no serious trouble would arise, especially if there were close cooperation among central banks, and coordination of monetary and fiscal policies; and particularly if the union started off on the basis of reasonably strong currencies and realistic exchange rates. Under at least average conditions and normal fluctuations, such a union might function successfully for a fairly long period of time; it could weather small crises. Eventually, however, it would be likely to run into trouble. Obviously it would not in itself create a permanent currency system for a unified Central America, although it could serve as a stepping stone to a subsequent common currency centrally controlled and supported.

3. Pesos Issued by Regional Institution

The other main apporach to a common currency, in contrast to the one involving the circulation of identical national currencies, is through the issuance of Central American pesos by a central institution representing the region as a whole. The pesos would be obligations of the regional institution and be supported by resources under its control. They could be introduced gradually against funds derived from a partial pooling of reserves as noted in Section V.C. They would circulate alongside of existing national currencies, and be designed sooner or later to replace the national money.

This approach to monetary union avoids the difficulties inherent in a union of separate currency systems. In view of its advantages and the fact that it can be started in a modest fashion, this plan is preferable and merits careful consideration. The following is an outline of a possible arrangement whereby a regional institution would issue Central American pesos.

The Central American Monetary Board, or whatever the regional institution were called, would be given resources subscribed by each central bank or government, payable partly in convertible foreign exchange or gold and partly in local currency. The central bank, or government, would receive in return for its subscription an equivalent amount in Central American pesos, either in cash or as credit to its account at the Monetary Board. The central bank would then be in a position to meet the demands for pesos on the part of the commercial banks, the business world or the general public. The subscription of each central bank or government would be according to assigned quotas, which could be based upon a composite of such things as the size of the country's monetary supply, holdings of foreign exchange and gold, foreign trade, gross national product, population, etc.

In addition to receiving pesos equal to its subscription, a central bank could acquire more pesos, or peso credits, as needed by purchasing them from the Monetary Board with its own currency and foreign exchange or gold, in a specified ratio. This ratio, for example, might initially be at least 50 percent in foreign exchange or gold, and 50 percent in low interest bearing short term renewable notes payable in its own currency, with a gold value guarantee. The original subscription could, if thought desirable, involve a higher percentage in convertible foreign exchange or gold, so that the new peso would have unquestioned backing, command public confidence and get off to a good start. The ratio for the subsequent purchase of pesos by central banks could be changed in the light of experience, but during the initial period the peso should have such strength that it would enjoy the highest standing and be especially well regarded.

It would be possible to provide that the regional peso be backed one hundred percent by gold or foreign exchange. Such a requirement, however, would provide little flexibility from the standpoint of adjusting the supply of pesos to the liquidity needs of the Central American economy. An increase in the monetary supply would thus be dependent upon the availability of foreign exchange and a satisfactory balance of payments position. Balance of payments deficits would tend to cause monetary contraction, deflation and depression as pesos were presented to buy foreign exchange. Moreover, such a high ratio would tie up foreign exchange needed for imports and economic development. For these and other reasons such a rigid requirement is undesirable. It is also unnecessary since all outstanding pesos are not likely to be presented simultaneously for conversion into foreign exchange, especially when the peso became the major or sole currency. The purpose of the reserve is to provide for balance of payments fluctuations and meet freely demands for foreign exchange, including those which at times may be heavy. The ratio of foreign exchange and gold holdings to moneysupply is thus less significant than the relationship of such holdings to prospective balance of payments fluctuations and possible demands for foreign currencies. It is, nevertheless, a ratio of consequence.

The present ratio of central bank international liquidity (holdings of foreign exchange and gold and the IMF gold tranche position) to the money supply, including demand deposits, varies from about 20 percent in Costa Rica to about 62 percent in El Salvador. The average for the five countries is approximately 50 percent, as can be seen in the Table below; this ratio is somewhat higher than it has customarily been. If Costa Rica, which presently has low foreign exchange reserves, is excluded the ratio is approximately 57 percent.

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES AND MONEY SUPPLY

(End of August 1964; millions of dollars)

	Central Bank 1/ International Liquidity	Money Supply (dollar equivalent)	Ratio of External Reserves To Money (Percent)
Costa Rica	16.4	80.7	20.3
El Salvador	55.4	89.8	61.7
Guatemala	67.4	120.0	56.2
Honduras	20.7	44.4	46.7
Nicaragua	36.6	61.0	60.0
Region	196.5	395.9	49.6

1/ Includes foreign exchange, gold and IMF gold tranche position.

Source: IMF, International Financial Statistics.

The amount of pesos each central bank would be allowed to buy, paying, for example, 50 percent in its own interest bearing notes, would be limited by ceilings established by the Monetary Board. These ceilings could be raised by the Board for all countries, or individually according to circumstances.[20] The ceilings would be flexible and changed as the Board considered desirable in light of demands for pesos, financial stability, and the economic growth and development of the countries of the region.[21] In place of ceilings or in addition to ceilings it would be possible to establish certain criteria as to the kinds of notes, or their collateral, which would be acceptable by the Board, and the interest rate to be borne by the notes offered in the purchase of pesos. The interest rates could be changed by the Board from time to time, either to encourage or discourage central bank acquisition of pesos, and might vary from country to country depending upon local conditions.

The central banks of the different countries during this transitional stage would continue to operate to a large extent as at present. Their lending, foreign exchange and other activities would be relatively unaffected. They and the commercial banks could maintain accounts for their depositors in terms of pesos; it is common practice for banks to maintain deposit accounts in more than one currency. Through peso bank accounts payments could be made by check anywhere within the region. Business among the different countries could thus be carried out in terms of a single currency. The hypothetical peso, now used by the Central American Clearing House for accounting purposes, could be used by private business for the conduct of transactions. In order to encourage the use of pesos, the government could make payment of a portion of salaries and other expenses in pesos.

20/ The two currency unions in Africa, discussed in Annex III, utilize credit ceilings to obtain reasonable uniformity of credit policies and prevent undue monetary expansion. The central Board sets credit ceilings for each member state. In the case of the West African Currency Union the amount of credit permitted to the public sector is also related to the volume of ordinary government revenues. In the case of the Equatorial African Union credits to the government are limited only by the general ceilings established by the central Board.

21/ The addition of pesos to the money supply would not be inflationary, since national currency would be presented to central banks in the purchase of pesos equivalent in value to the pesos issued. The expansion of the peso circulation would be under control of the Monetary Board through ceilings and other measures.

The central banks' own bank notes presumably would gradually be replaced by the new pesos. When the final stage for a common currency were reached, the present local currencies would be required to be exchanged for the new pesos and would thus disappear. The central banks would then relinquish to the Monetary Board their currency issuing authority. This final stage is discussed in the next section, V.E.

During the period of joint circulation of regional pesos and local money, the central banks would maintain close consultation regarding policies. If, however, a particular country followed a lax credit policy, expanded its currency unduly and experienced inflation, it might have balance of payments deficits and pressure on its exchange rate, as noted above. Doubts as to the country's ability to maintain the exchange rate might cause the public to turn to Central American pesos in preference to the country's own currency. The central bank of such country might have difficulty in obtaining an adequate supply of pesos from the Monetary Board, since this would require giving up foreign exchange or gold. The bank might reach its ceiling or be required to pay a higher interest rate on its notes. The inflating country would be under pressure to follow a more moderate monetary and fiscal policy. If it did not do so but continued to inflate, it might eventually find its currency at a discount in terms of pesos. The Monetary Board and other countries would, of course, endeavor to prevent such a situation from arising, and help a country avoid depreciation of its currency.

If a particular country experienced balance of payments difficulties during the period of joint circulation, whether due to inflation, lax policies or to conditions beyond its control, and imposed exchange restrictions in view of pressure on its exchange rate, convertible pesos, to which the local restrictions could not apply, would tend to disappear from circulation in such country or go to a premium in terms of local money. They could be utilized for the purchase of foreign exchange from the Monetary Board and would thus tend to be sought out.

Such a situation would not be likely to arise unless the monetary authorities of a country persisted in lax policies -- which is not according to recent Central American history; for a number of years, in several cases many years, these countries have especially good records of monetary stability. For reasons discussed in section V.B.1., however, balance of payments difficulties could arise regardless of monetary and fiscal policies. Structural and other changes in a country's exports and balance of payments items, not due to monetary causes, can take place and be the source of trouble. During a relatively short period of years, however, as a stage toward a single currency, serious difficulty in the system outlined here, namely the joint circulation of regional pesos and local money, would not appear likely.

If such a situation nevertheless did arise it would differ from that in the case of pesos issued as national currency, in that in the present case it would not be the regional peso which was in trouble, but the local currency of a particular country. The regional peso would presumably continue strong and be unaffected.

A situation could, of course, develop wherein several or all of the countries experienced balance of payments problems. The Monetary Board might then find itself confronted with special demands for foreign exchange in redemption of pesos. The resources of the Board, actual and potential, should therefore be ample to meet extraordinary demands, so that convertibility of the peso would not be threatened. In addition to the resources provided by the central banks, the Monetary Board would doubtless look to the International Monetary Fund for assistance. The Monetary Board would work closely with the International Monetary Fund and, through the drawing rights of the individual Central American countries, have access to International Monetary Fund resources. The mechanics of utilizing these International Monetary Fund drawing rights to support the peso would need to be developed.

Since the peso would presumably be freely convertible into foreign exchange, a problem arises from the fact that El Salvador and Guatemala maintain restrictions on the transfer of capital abroad. So long as these restrictions continue, capital could escape from these countries through purchase by the public of pesos, which could then be converted into foreign exchange. Until El Salvador and Guatemala are able to remove these restrictions, similar restrictions would need to apply to the purchase of pesos.

A stabilization fund (see Section V.C.), if established, could be available to assist not only national currencies, so long as they continued, but to help support the regional peso if necessary. If the Monetary Board were the administering authority of the stabilization fund during this stage of joint circulation, it would give special attention to rendering whatever assistance the peso might require. The Board would have a dual responsibility, namely, rendering assistance to national currencies as appropriate, and also to the peso. It would have a direct interest in the avoidance of difficulty in any national currency as well as in the peso. Eventually the stabilization fund would be merged with the resources behind the peso as discussed in Section V.E.2.

It would be desirable that the Central American peso be made legal tender in all the countries. The problems which would arise in the case of nationally issued pesos, if they were made legal tender, would not be likely to arise in this case. For example, if an individual country were in financial difficulty its national pesos would be in disfavor and perhaps at a discount; compulsory acceptance might impose a hardship upon the recipient. Pesos issued by the Monetary Board, on the other hand, would presumably be strong and not likely to go to a discount in terms of local money, so that no hardship would be imposed upon recipients. As a protection, however, against such a contingency, the legal tender quality could automatically cease if the peso depreciated in terms of national currencies.

The system outlined here could be commenced by two or three countries with the door left open for other countries to participate at such time as they wished. A modest fund could be established by such countries as are interested, and regional pesos issued against these resources. Such a fund could be established at an early date and allowed to expand as conditions indicated. The Central American peso could make its way into the channels of trade as circumstances determine.

E. Stage Four: Unification of Monetary and Banking Systems

1. Conversion of National Currencies to Central American Pesos

The final stage in monetary unification would involve the conversion of all national currencies, whether present currencies or identical pesos issued by the individual central banks, into Central American pesos issued by a regional institution. Two problems arise in this connection. The first has to do with the procedures for shifting to the regional peso basis. The second and major problem has to do with the organization and functioning of the regional monetary and banking system under the unified arrangement.

In regard to conversion procedures, it would be possible, although probably more difficult politically, to move directly in a single operation from the present national currency systems to a regional common currency system. Such a move would be essentially the second approach discussed above, wherein a regional institution issued pesos, but compressed into a single action rather than undertaken gradually. The period of joint circualtion of pesos and local currencies would in this case be eliminated or materially reduced, and instead a short period would be announced during which time all local currencies were to be exchanged for pesos of the regional institution.

In the case of the first approach to monetary union, namely a temporary period of parallel circulation of the present local currencies and pesos issued by the individual central banks as national currency, a first step in the procedure of shifting to a system of regional pesos as the sole currency could be the conversion by each country of all its present currency to the national peso basis. A date would be announced and widely publicized with simple explanations, prior to which time all local money would need to be presented in exchange for pesos, which would still be national currency. Commercial banks and other facilities would be utilized as agents to conduct the mechanics of the conversion. The rate of conversion would involve no loss to the public.

After the expiration of the conversion period, the old currency would lose its legal tender quality. It could still be exchanged for pesos, but at a small penalty discount. The conversion period might at the last minute be extended if it appeared that real hardship were involved, due perhaps to inadequate information in outlying areas, or insufficient facilities to conduct the conversion effectively, and without undue inconvenience to the public. It would be desirable to avoid public ill-will.

The next step would be the taking over by the regional institution, namely the Central American Monetary Board discussed below, of the national pesos issued by the centrul banks. These national pesos would have become the sole currency in the different countries as a result of the conversion operations. As national currency, however, the pesos would be subject to the vicissitudes, favorable and unfavorable, which affect national currencies and therefore should give way to regional pesos. When taken over by the Monetary Board the national pesos would become obligations of the Board and the responsibility of the region. They would cease to be liabilities of the central banks.

The Monetary Board in accepting liability for the pesos would need to acquire as well the assets behind the previously national pesos. Pending such time as Central America were ready for a complete unification of the central banks, and consolidation of their assets and liabilities into a single regional institution, it would be possible for the Monetary Board to acquire only an amount of assets equivalent to the note liability accepted by the Board. Holdings of gold and foreign exchange would doubtless be included in the assets acquired. The details of acquisition of assets by the Board would obviously require considerable study. It would be desirable, however, if feasible politically, that the final merger of the central banks into a single institution, as discussed in the next section, take place at the time the Monetary Board became the sole issuer of currency in Central America.

In the case of the second approach to monetary union, namely, the parallel circulation of existing local currencies and regional pesos issued by a regional institution, the conversion of the present local currencies to regional pesos would involve the taking over of the local currencies by the regional institution, that is, the Monetary Board. The conversion operation, wherein the local currencies would be exchanged for regional pesos, would be similar to the procedure described in the previous paragraphs. The local currencies still held by the public would be required to be converted into regional pesos by a specified date and according to well publicized procedures. The regional pesos, which would then constitute the entire circulation of each country, would be obligations of the Monetary Board. The acquisition of assets of the central banks to offset the monetary liabilities accepted would be the same as in the previous case.

The organization and functioning of the regional monetary and banking system under the unified arrangement are discussed in the next section.

2. The Central American Monetary Board

A fully operative regional currency system for Central America would require management of the system by a strong central institution, which might be called the Central American Monetary Board, or perhaps the Reserve Bank of Central America. As noted in the previous section, such an institution would have the exclusive right of issuing money in Central America.

At such time during the fourth stage as Central America were ready for the final step, the Board would become a regional central bank, providing Central America with a unified monetary and banking system. The present central banks would then become inherent parts of the regional institution. Their assets and liabilities would be consolidated. Pending such complete integration, the Monetary Board and central banks could continue to operate as outlined above.

The stabilization fund discussed in section V.C. would be absorbed into the unified system. It could in fact become the nucleus and evolve into the regional institution. The member countries' subscriptions to the fund could become deposit balances at the Monetary Board. The fund's resources in their entirety would be merged into the Board's assets.

The Monetary Board as a regional central bank would control the money supply, hold the reserves behind the currency, foreign exchange and gold, and seek to administer the monetary and banking system in the interests of financial stability, the expansion of trade and the economic and social development of all the Central American countries. The expansion and contraction of the money supply, whether money in circulation or in the form of demand deposits, and its adaptation to the economic needs of the country, would be under the Board's supervision, in order to prevent economic and financial difficulties, and to achieve the above objectives. If the demand for pesos on the part of the business world increased, and the commercial banks needed more pesos to meet these demands, they could acquire the money from the Board by borrowing or selling to it some of their commercial paper or other securities, according to standards and regulations determined by the Board. They would deal with the present central banks which would have become branches of the regional central institution. The commercial banks would maintain deposits at these branches as at present.

In order to regulate the volume of money and credit effectively, as indicated by economic and financial conditions, the Board would need to have authority over such things as the interest rate charged commercial banks when they borrowed from it to obtain additional cash. Raising the rate would make credit more costly, and thus tend to discourage borrowing, whereas lowering the rate would have the opposite effect and tend to ease credit conditions. The Board would also be able to buy and sell securities in the different countries, thereby putting funds in the market in the case of securities bought by the Board, or withdrawing funds from circulation in the case of securities sold. It would have authority to raise or lower reserve requirements of the commercial banks. In this manner it would be able to ease or tighten credit conditions and carry out desired monetary policies for the region.

A common currency system would require that the central institution have adequate monetary tools of this nature, commonly possessed by central banks, in order to prevent destructive inflation or deflation, and through monetary policy see that the currency system made its full contribution to the economic and social development of the region.

The central banks would continue to carry out their present functions, but as branches of the regional institution and in accordance with its policies. They would hold cash reserves of the commercial banks, extend loans and engage in foreign exchange and other activities as they now do. They would also continue to serve as fiscal agents of the governments. The central banks would be linked together through the Monetary Board into a unified central banking system for the region.

When monetary unification is achieved the individual country quotas at the International Monetary Fund would need to be consolidated; they might also be increased in view of the economic growth of the region. The International Monetary Fund has divided a country's membership, as when India separated into two countries, India and Pakistan, but has never consolidated memberships. This, however, should not be difficult. The new relationship between the Central American countries and the International Monetary Fund, including acceptance of the par value of the peso, would need to be worked out, but should pose no major problems.

Fiscal coordination among the different countries, important to monetary union, to financial stability and economic development, would be achieved during the transitional stages through regular consultation among the Ministers of Finance or Economy, depending upon their responsibilities for national fiscal affairs, (or a Budget Policy Committee) and the Monetary Board. Budgetary surpluses and deficits and the way deficits are financed affect the internal liquidity of a country and its monetary condition. Unless fiscal policies are coordinated and properly controlled, inflation and other difficulties could arise and the monetary union break down. It is important, therefore, that progress toward fiscal integration proceed parallel with that toward monetary integration.

It might not be politically possible, however, to arrange that complete fiscal integration -- not discussed in detail here -- coincide with monetary and banking unification. In the meantime close and effective fiscal coordination would be essential. At such time as political union were achieved and the different fiscal administrations consolidated, or sooner if feasible, authoritative control over the countries' fiscal policies, and their definitive coordination with monetary policies, could be undertaken.

VI.

Preliminary Measures for Monetary Union

THE previous sections outlined possible stages directed toward a monetary union involving a common currency and unified banking system for Central America. In order to facilitate progress toward such a union, it is desirable that agreement be reached, at least tentatively, on the general nature and broad outlines of the monetary and banking system to be sought, and also on certain details of the projected system. In this connection procedures have been established by the central banks, and plans are underway to study all aspects of the problem of monetary union. The Monetary Council, its Secretariat and Committees established in April 1964, have undertaken a comprehensive program of analysis.

Some of the measures which require early study or agreement, and on which specific proposals are needed for consideration by the Monetary Council or action by governments are as follows:

1. Selection of Monetary Unit

A proposal on the nature of the monetary unit, its gold value and subdivisions. (See Section V.D.1.)

2. Coordination of Monetary and Fiscal Policies

A proposal for prior consultation among central banks on specific monetary actions, with appropriate escapes; and also for periodic reviews of each country's economic and financial positions and policies by the Monetary Council in conjunction with the Ministers of Finance or Economy. (See Section V.B.)

3. Fiscal Consultation

A proposal for regular consultation on fiscal policies among the Ministers of Finance or Economy, depending upon their responsibility for fiscal affairs. (See Section V.B.1.)

4. Uniformity of Fiscal Procedures

A proposal for greater uniformity among the Central American Governments of fiscal procedures and budgetary practices, including consolidation of accounts into a comprehensive budget. (See Section V.B.1.)

5. Statistical Information

A proposal for greater uniformity, completeness and clarity of content of economic and financial data. Reliable statistical information to facilitate analysis of current developments is indispensable to the formulation of appropriate monetary and fiscal policies for the region. Work on this problem is well underway. (See Section V.B.1.)

6. Pooling Reserves

A proposal for a partial pooling of reserves, as backing for the gradual introduction of the Central American peso, and/or as a stabilization fund to assist countries in balance of payments difficulties as envisaged in the Monetary Agreement of February 25, 1964. (See Section V.C. and V.D.3.)

7. Harmonization of Monetary Laws and Regulations

A proposal for the standardization of certain monetary and banking laws and regulations, namely, those which involve few problems, to be followed by subsequent proposals. (See Section V.D.2.)

8. Banking Practices

A proposal for greater uniformity and standardization of banking practices including charges. (See Section IV.C.)

9. Monetary Union

A proposal regarding the basic principles and general nature of a Central American Monetary Union, details and a time schedule to be worked out later. Discussion and agreement, at least tentative, on this fundamental problem are important to progress in all areas. (See Section II.B.C.D. and V.D.2 and 3.)

ANNEXES

ANNEX I.

Panama and the Central American Monetary Union

PANAMA is not at present a member of the Central American Common Market, although Panama is interested in establishing some form of relationship and may eventually become a full member. Panama has for several years sent observers to meetings of various Common Market institutions and also participates in several of the regional programs.

The understanding between representatives of Panama and the Central American Governments that some type of association would be arranged was confirmed by the Presidents of these countries in the Declaration of Central America in March 1963. The Presidents of Central America at that time reaffirmed their hope that Panama would participate more closely with the economic integration movement. The President of Panama, for his part, declared that his Government was prepared to initiate immediate negotiations, with a view to concluding a special agreement to facilitate the association of Panama with the economic integration movement.

Numerous discussions were held in 1963 regarding some form of Panamanian association with the Common Market. These discussions were interrupted by the disturbances in Panama early in 1964. Moreover, Central American business interests, particularly in El Salvador and Guatemala, have opposed Panama's entry into the Common Market upon any basis other than full membership. Opposition also exists among business interests in Panama. As a result of these and other difficulties, such as differences in tariff structure and trade policies, no formal ties exist.

Panama has no central bank and utilizes the United States dollar as its currency, the dollar being identical in value with the Panamanian balboa, which is the official monetary unit of Panama. The paper circulation of Panama consists entirely of United States Federal Reserve notes and a few silver certificates, whereas the subsidiary coins are largely Panamanian. [1] The balboa coins are similar in size and appearance to United States coins and both circulate interchangeably. The dollar is legal tender in Panama, as provided in Panama's basic monetary law of 1904, and in accordance with the 1904 Monetary Agreement between Panama and the United States. This situation is considered in some quarters to be a barrier to Panama's entry into the Common Market.

The use of the United States dollar in Panama, and the absence of a central bank have been debated pro and con in Panama. The dollar, a stable, strong and convertible currency, has been of substantial benefit to Panama, as widely recognized by Panamanians. [2] In view of confidence in the dollar, investment capital has been attracted to Panama and local capital has remained within the country. This situation is in contrast to that in other countries where the practice prevails of keeping a large amount of funds abroad as protection against exchange rate instability and inconvertibility. Although the use of a foreign currency is regarded by some Panamanians as a reflection on the country's sovereignty, few are ready to alter the present arrangement.

The question of establishment of a central bank in Panama is closely related to that of utilization of the United States dollar; this is because one of the main functions of a central bank is to issue money, whether in the form of deposit credits or circulating currency. The lack of a central bank means that Panama is limited with respect to carrying out certain monetary and credit policies, namely in its ability to influence interest rates and to expand or contract the supply of money and credit as indicated by economic conditions within Panama. In order that credit and the dollar circulation in Panama expand, the commercial banks must, except within limits, draw on their dollar reserves held abroad. The expansion of credit in Panama has thus commonly been accompanied by a decline in external dollar assets; the relationship, however, is not a rigid one. There is, moreover, no centralized management of credit expansion or contraction. The minting of additional Panamanian coins requires an act of the Panamanian Congress.

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[1] For a brief period in 1941 Panama issued paper currency. No institution in Panama is presently authorized to issue balboa notes.

[2] In our discussions in Panama with bankers, businessmen, government officials, etc., we found no one who wanted to give up the United States dollar, at least not at present.

While the present system in Panama has exhibited considerable flexibility, due to substantial holdings of foreign assets and responsible actions of the commercial banks, it has limitations and could be the source of difficulties. Balance of payments deficits could draw down external assets and lead to a contraction of credit, deflationary pressures and depression. Propossals have therefore been made for modifications in the system. Some of these involve retention of the dollar currency and others provide for discontinuance of the dollar. It has, for example, been proposed that there be established an institution to serve as a superintendency of the banks and to hold their cash reserves, now held by the banks themselves. It might also have funds of its own and grant rediscounts, and thus permit Panama to have a more effective credit policy without, however, replacement of the United States dollar by Panamanian paper currency.[3] Proposals for a central bank, on the other hand, generally envisage issuance of Panamanian paper currency, which is one of the main functions of a central bank in connection with its responsibility for regulating credit creation and the money supply. Eventually Panama may wish to make some changes in the present system, although there is little support for discontinuance of the dollar.

The fact that Panama uses dollars as its currency and has no central bank raises special problems, but is no basic barrier to participation in a Central American monetary union. Panama, for example, could permit Central American pesos to circulate alongside of United States dollars. Assuming that the peso were equivalent to the dollar or a simple subdivision of the dollar, such as 50 cents, no complicated conversion problem would exist. Pesos could be receivable by the government in payment of taxes, etc. If the peso were made legal tender generally, this quality should probably automatically cease in the event that the peso depreciated in terms of dollars. The peso, however, would doubtless be a stable currency in view of the history of currency and exchange stability in the Central American countries and the conservative management of the central banks. Since use of the dollar could continue along with the peso, the benefits from the dollar currency would remain.

The absence of a central bank would be no more of an omission or handicap to Panama than at present. Panama could establish whatever national administrative arrangements were necessary for representation in the management of the Central American monetary system and for the

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[3] See report by Robert Triffin, May 24, 1962, entitled Credit Policy and Banking Structure in the Economic Development of Panama, prepared for the Panamanian Government.

circulation of pesos in Panama. The Banco Nacional, a government bank, could handle matters. [4] Eventually Panama would probably wish to regularize participation in the monetary union. However, as an interim arrangement, which could continue for a long period, the use of United States dollars and the absence of a central bank need not be a barrier to participation in the prospective Central American monetary union, nor membership in the Common Market.

From the standpoint of the Central Americans, the continued use of dollars in Panama would offer no serious disadvantages to them in the operations of the monetary union. The fact that the dollar is an attraction to investors and may result in their favoring Panama over the other countries would not be a new development; it would not be a result of membership in the monetary union. Panama's use of the dollar might, however, be objectionable to the Central Americans for this and other reasons. The dollar currency might be questioned as a symbol of the special relation of Panama to the United States. The Central Americans might desire that the peso be the sole legal tender currency, if this were the situation in the other countries.

If Panama at some future date chose to give up the dollar currency and become a member of the monetary union on the same basis as the other countries, the dollar currency of Panama would be an advantage and valuable asset. Since practically the entire monetary circulation of Panama consists of dollars, and thus has little Panamanian fiduciary element, the conversion of these dollars into Central American pesos would yield Panama a net supply of dollar foreign exchange over and above that needed to support the peso.

For example, if the peso were worth one dollar, Panama in converting to pesos would receive from the public 100 dollars for every 100 pesos which it gave in exchange. If the peso were backed by a reserve of 50 per cent in gold or foreign exchange, these 100 pesos would have been acquired by Panama from the Central American monetary authority at a cost of only 50 dollars in United States currency and 50 dollars equivalent in Panamanian government obligations. Panama would thus have

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[4] The Banco Nacional de Panamá, established in 1904, is owned and operated by the Panama Government. It is fiscal agent for the government and also operates as a commercial bank, specializing in urban mortgage loans, which the other banks are not legally permitted to make. It holds over one third of total domestic deposits.

left over, after conversion of the 100 dollars into pesos, 50 dollars to utilize as Panama might elect. [5]

If Panama were prepared to acquire Central American pesos from the monetary union on the basis of one dollar for one peso, the monetary authority would thus receive 100 rather than 50 percent in dollars for the pesos issued; this favorable exchange, whereby the union would receive a substantial addition to its dollar reserve, would be an attraction to the Central Americans to have Panama enter the monetary union.

Panamanian participation in the Central American monetary union, either on the basis of continuing the present dollar currency or as a member on the same basis as the others, offers no insoluble problem to Panama or to the Central Americans. The dollar currency and absence of a central bank are not valid reasons why Panama should not be a member of the Central American Common Market. Such membership is, of course, a separate question outside the scope of this report.

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[5] The dollar circulation in Panama has been estimated to amount to around $35 million, of which about $15 million is in the banks. The dollars in Panama represent an export of capital from Panama. In order to have acquired the dollars in the first instance Panama needed to export goods and services or to receive investments. The dollars acquired by Panama were not used to buy imports but were retained in Panama. The loss of earnings on this capital is roughly the price being paid by Panama for the advantages, which are very real, of having the dollar currency.

ANNEX II.

European Economic Community Plans for Monetary Union

A. Monetary Provisions of Treaty of Rome

WHEN the European Economic Community (EEC) was established by the Treaty of Rome, signed in March 1957 by representatives of Belgium, West Germany, France, Italy, Luxembourg and the Netherlands, the member countries were not prepared to accept provisions which limited their sovereign powers over monetary and financial matters. The few Treaty articles dealing with these subjects, therefore, do not envisage a thorough-going monetary union, but rather cooperation among independent states and coordination of policies.

Despite its reliance largely on cooperation and voluntary actions of members, the Rome Treaty, nevertheless, sets forth certain important principles and commits the members to a number of monetary and financial policy objectives. Article 104 thus says:

> "Each Member State shall pursue the economic policy necessary to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while ensuring a high level of employment and the stability of the level of prices."[1]

To facilitate attainment of these objectives, Article 105 provides that "Member States shall coordinate their economic policies." This

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[1] Balance of payments equilibrium is given a certain priority over employment and price stability. The Article assumes, however, there is not likely to be any serious inconsistency among these objectives. Recent discussions within the EEC have given considerable attention to the adjustment process, namely, means of removing balance of payments disequilibrium and at the same time maintaining high levels of employment.

article also provides for establishment of a Monetary Committee to promote such coordination.

If a member country experiences balance of payments difficulties, the Commission, according to the Treaty, may recommend to the country certain measures designed to relieve the difficulties. Article 108 provides for mutual assistance, financial and other, to a country in balance of payments difficulty, although no country is compelled by the Treaty to grant such assistance.

In regard to restrictions on payments among the countries, each country undertakes to permit transfers of funds within the EEC insofar as the movement of goods, services, capital and persons is free. Thus according to Article 106:

> "1. Each Member State undertakes to authorize, in the currency of the Member State in which the creditor or the beneficiary resides, any payments connected with the exchange of goods, services or capital, and also any transfers of capital and wages, to the extent that the movement of goods, services, capital and persons is freed as between Member States in application of this Treaty. ...
>
> "4. Member States shall, where necessary, seek agreement concerning the measures to be taken in order to enable the payments and transfers mentioned in this Article to be effected. ..."

With respect to capital movements, Member States shall, according to Article 67, "progressively abolish as between themselves restrictions on the movement of capital ..." Furthermore , the Commission, under Article 70, shall "propose to the Council measures in regard to the progressive coordination of the exchange policies of Member States in respect of the movement of capital between those States and third countries."

Adjustments of exchange rates are dealt with in Article 107 which provides:

> "1. Each Member State shall treat its policy with regard to exchange rates as a matter of common interest.
>
> "2. If a Member State alters its exchange rate in a manner which is incompatible with the objectives laid down in Article 104 and which seriously distorts the conditions of competition the Commission may, after consulting the Monetary Committee, authorize other Member States to take for a strictly limited period the necessary measures, of which it shall determine the conditions and particulars, in order to deal with the consequences of such alteration."

These and other monetary provisions recognize that the free flow of funds within the Community, namely, absence of exchange and other restrictions, and stable exchange rates are essential to the free flow of trade and investment and thus to the basic objectives of the Common Market. Curtailment of imports by a member country, for example, because of balance of payments or exchange rate difficulties, would defeat the main purposes of the Common Market. The Treaty, therefore, requires countries to pursue policies aimed at avoiding such difficulties.

Since balance of payments and exchange rate difficulties among the countries, however, may occur so long as there are independent currency systems, the Treaty provides various escapes and exceptions to the free movement of trade in order to meet such eventualities. The freedom of trade is thus not absolute. Articles 108, 109 and 226 provide for special measures which may be taken by a country in order to safeguard its balance of payments. The Commission may examine the situation in such cases and make recommendations.

The monetary provisions of the Treaty are, as can be seen, based upon the concept of independent sovereign states, rather than a centralization of authority or merging of financial systems. The cooperation among member states and coordination of policies provided for, went as far as was considered feasible at the time the Treaty was drafted. The provisions were designed to facilitate, although they could not assure, the free movement of trade, unrestricted payments at stable exchange rates, and the proper functioning of the Common Market.

Efforts through the Treaty to achieve these objectives, however, emphasize the fact that freedom of trade and payments cannot be permanently assured without a common currency or the equivalent, and centralized control over monetary and fiscal policies.

While the monetary and financial provisions of the Treaty were limited by political realities, they left open the question of subsequent and definitive integration in this field. Such eventual integration, however, was in the minds of drafters of the Treaty. It was and is expected to accompany political union, visualized by leaders in the integration movement as the ultimate goal. The Treaty was intended to, and did, open the door to increasingly close monetary and financial relations among the EEC members, a necessary prelude to monetary union. The Commission, in fact, has recommended a monetary union to be achieved during the third stage of the EEC. It will soon submit to the Council proposals for the progressive introduction of a monetary union.

B. Monetary and Financial Responsibilities of EEC Institutions

MONETARY and financial relations among the EEC countries, and of the Community with the rest of the world, are the concern of a number of EEC institutions. These institutions and their responsibilities in this field are as follows:

1. The Assembly - The Assembly or European Parliament as it is called consists of 142 delegates appointed by the Parliaments of the six countries from among their members; it represents the people of the EEC countries. While it is not an executive body with decision making authority it is nonetheless influential. It may censure the Commission by a two-thirds vote in which case the Commission must resign as a body.

The Parliament has concerned itself, among other things, with monetary matters. In October 1962, after debating in detail the question of coordination of monetary and financial policies, it adopted a resolution that in the long run the coordinated monetary policy required by the Treaty of Rome would need to be replaced by a common monetary policy, and also that the gradual development of a common monetary policy would logically result from the further development of the Community.

2. The Council - The senior executive body of the Community is the Council, or Council of Ministers as it is commonly called, con-

sisting of one representative from each member government. The members of the Council are not full time officials and have responsibilities in their home governments. The Council is the body which makes major policy decisions as authorized by the Treaty. It acts upon recommendations from the Commission. Weighted voting is provided for and certain actions require a unanimous vote.

In April 1964, the Council made a number of significant decisions in the monetary and financial field, as discussed below. It also recommended to the member countries certain anti-inflationary measures, such as limiting the increase in government spending to five percent annually and financing anything above this amount by additional taxation. These actions by the Council were taken upon the recommendation of the Commission.

3. The Commission - The active operating organ of the European Economic Community is the Commission, which consists of nine full time members chosen for their general competence rather than as representatives of individual countries; not more than two, however, may be from the same country. They are appointed by the member countries, "acting in common agreement." The members of the Commission are specifically forbidden to seek or accept instructions from any government. They may not engage in any other paid activity but must devote their time to the work of the Commission.

The Treaty assigns to the Commission broad responsibilities having to do with the functioning and development of the Common Market. In addition to rendering decisions of its own, it formulates recommendations for the consideration of the Council. The Commission's functions include important monetary and financial responsibilities. It has thus given considerable attention to these matters, as discussed below.

4. Monetary Committee - In order to promote the coordination of monetary and financial policies as envisaged by the Treaty, Article 105 established a Monetary Committee with consultative status. The Committee is instructed "to keep under review the monetary and financial situation of Member States and of the Community and also the general payments system of Member States and to report regularly thereon to the Council and the Commission; and to formulate opinions ..." The Committee consists of fourteen members, two appointed by each of the six member countries and two by the Commission. When the Commission submits important monetary or financial proposals to the Council, it must first consult the Monetary Committee.

The functions of the Monetary Committee, as described in the Committee's Sixth Annual Report, are "to observe the monetary and Financial policies and general payments systems of the Member States and, more generally, to promote the coordination of the Member States' monetary policies to the extent necessary for the efficient functioning of the Common Market."

The Committee during its early years was engaged primarily in reviewing semi-annually the monetary and financial position of the member countries. In addition to the regular reviews other functions have been undertaken. The Committee keeps the countries' financial positions under more or less constant surveillance. At times it reviews the position of a country upon short notice when the country's economic situation calls for such action, as was recently the case with Italy.

The Committee has undertaken comparative studies of the instruments of monetary and financial policy available to the member countries. It has also studied the problems and possibilities of closer monetary association among the member countries. Although an advisory body, it has developed into an important coordinating agency for monetary and financial policy in the European Common Market. Discussions in the Monetary Committee, and also in the Economic Policy Committee, exert considerable influence on policies of the member countries.

In recent years the activities of the Monetary Committee have expanded. It has given special attention to international financial problems affecting the European Common Market, such as questions of international liquidity and possible changes in the international monetary mechanism. It has also been actively concerned with the trend of foreign payments of the member countries and problems arising out of balance of payments developments. In April 1964 it was given additional responsibilities by the Council having to do with prior consultation in the field of international monetary relations.

5. <u>Committee of Governors of the Central Banks</u> - The Council in April 1964 established a Committee consisting of the Governors of the central banks of the member states. Such a Committee was recommended in the action program proposed by the Commission in October 1962; a proposal for its establishment was submitted as a formal recommendation to the Council in June 1963.

Since the central banks are the principal agencies which determine and carry out monetary policies in the individual countries, it was considered desirable that they meet regularly as a formal body to promote effective coordination of policies and to assist each other as may be needed and feasible. The Committee of Governors is instructed by the Council to consult on policies, especially with respect to credit, the money market and the foreign exchange market. It was envisaged by the Commission that the Committee of Governors would eventually become the central organ of a federal type banking system for the European Economic Community. Powers would be gradually transferred to this central body.

The Governors of the central banks have long met each month in Basle, Switzerland as directors of the Bank for International Settlements (BIS). At these regular meetings the Governors from the Common Market countries also meet separately to discuss Common Market matters. In addition to the meetings of the Governors, the Ministers of Finance of the EEC countries hold unofficial meetings from time to time; they have on occasion met jointly with the Governors. Financial consultation, formal and informal, is thus frequent and close.

6. Budgetary Policy Committee - The Council also established in April 1964 a Budgetary Policy Committee. A Committee of this nature was recommended in the action program proposed by the Commission, and was included in the Commission's recommendation to the Council for a Committee of Governors of the Central Banks.

It was recognized that central bank collaboration is in itself not enough since budgetary policies and decisions may have as great an effect upon a country's monetary situation as central bank actions, and at times may have substantially greater monetary consequences. Budget surplusses and deficits and the means by which deficits are financed thus have important effects upon a country's internal liquidity and its general monetary condition. Excessive government borrowing from banks, for example, may lead to inflation, rising prices and balance of payments deficits, with deleterious effects upon the Common Market.

The Budgetary Policy Committee is instructed to study and compare the budgetary policies of the member countries. In addition it is to formulate opinions on its own initiative whenever it deems this necessary for the proper fulfillment of its function. The Committee is composed of one representative of each Member State and of the Commission.

7. European Investment Bank - The Treaty established the European Investment Bank as the long term lending and investing agency of the

European Common Market. The bank makes loans to Member Governments or to private enterprises for projects within the Community. Subject to unanimous approval by its six governors, the Finance Ministers, it also may lend outside the Community, as under the Greek, Turkish and African Association agreements. Of its capital of $1 billion, seventy-five percent is callable only if needed to meet obligations toward those who have lent it funds. The bank raises money by borrowing in the capital markets of the Community and of other countries. It has thus far loaned approximately $400 million to borrowers, especially Italy, for infrastructure development purposes.

In the field of monetary relations, the Bank is authorized to transfer its holdings of the currency of one member country into the currency of any other member country as necessary to carry out its functions. It may not, however, convert the holdings of currency of a member into the currency of a third country without agreement of the member countries concerned.

Other financial institutions and activities, similarly not strictly monetary, have been established. They include the European Development Fund, the Social Fund, the European Agricultural Guidance and Guarantee Fund, and The European Coal and Steel Community High Authority's borrowing and lending operations.

C. Prior Consultation on Monetary and Financial Matters

SINCE the actions of a member country in the field of monetary and financial affairs can have important effects upon the other members of the EEC and upon the development of the Community itself, it was felt that consultations among appropriate officials should take place before any major decision in this field is made by any member country. Accordingly, the action program proposed by the Commission in October 1962 included a recommendation, formally made to the Council in June 1963, that there be consultation on all major monetary and financial matters prior to decisions taken by a member.

The Council in April 1964, acting upon the recommendations of the Commission, provided that there be prior consultation among the members on major measures in this field, unless special circumstances preclude such consultation. The Committee of Governors of the Central Banks is thus instructed by the Council to study principal measures contemplated by a central bank before these measures are adopted, provided circumstances and particularly timing permit. The measures wherein prior consultation is required include especially those relating to credit, the money market, the foreign exchange market, and the main measures within the competence of the central banks. The Committee has wide latitude and independence and determines its own policies and activities.

In the field of international monetary relations the Council assigned to the Monetary Committee the responsibility of conducting such prior consultations. These consultations are required with respect to "any important decision or adoption of attitude by the Member States in the field of international monetary relations," unless precluded by circumstances and especially by timing. The field where prior consultation is required includes such things as drawings on the International Monetary Fund, assistance under other international agreements, participation in major measures of financial support to non-EEC members and decisions or attitudes regarding the general working of the international monetary system.

In regard to prior consultation on exchange rate adjustments undertaken by Governments, the Council issued in April 1964 a Declaration, in contrast to Decisions in the other matters acted upon at that time, that "the Governments of the Member States shall consult together before any change is made in the exchange parity of the currency of one or more Member States, by appropriate procedures which shall be specified after obtaining the opinion of the Monetary Committee;" Since an alteration in a country's exchange rate can have far reaching consequences for the Common Market -- for example, in the case of agricultural policy -- prior consultation regarding exchange adjustments is considered especially necessary.

The conditional nature of the requirement for prior study and consultation reflects the underlying concept of sovereign independence of the Member States. While the decision as to consultation in each case is left to the individual country, an obligation is nevertheless created to consult in advance unless such consultation is not feasible; failure to consult must have a justification. The action of the Council is thus a significant step.

The need for prior consultation has been increased not only by the development of the Community, but by the changing economic and financial position of the Member Countries, especially since the end of 1962. The Community no longer has an external surplus on account of goods and services, a reversal of the favorable situation which prevailed during its earlier years. As a result of inflationary pressures and rising costs, the competitive position of the Community vis-a-vis other industrialized countries has weakened. Divergent trends in the balance of payments positions of the different countries, and in their internal monetary conditions, have created strains within the Community. Sharp balance of payments deterioration, for example, took place in 1963 in Italy and France in contrast to the strong position of Germany.

The large increase in reserves which has taken place due to inflows of funds from countries outside the EEC rather than from exports of goods and services, is not considered desirable as a permanent feature for industrialized countries; such countries might more appropriately be exporters rather than importers of capital, especially in the interests of the developing countries. The changed economic and financial positions of the countries, individually and as a group, have been the source of special problems and emphasize the need for prior consultation, as directed by the Council. They also point up some of the fundamental difficulties of achieving a monetary union among separate monetary systems.

D. Progress Toward Monetary Union

SINCE the signing of the Rome Treaty the six EEC countries have made substantial progress in freeing trade among themselves, developing a common external tariff and uniting their economies in a number of areas. 2/ In the monetary field they are confronted with the problem of how to achieve a meaningful and secure monetary union under conditions of independent sovereign states. Such a union requires a high degree of centralization of control over monetary and fiscal policies. None of the member countries is yet prepared to yield to a central body final decisions in this vital field.

A monetary union among separate currency systems, each subject to policy decisions by a separate national authority, inevitably has an element of insecurity. Close collaboration and efforts to coordinate monetary and fiscal policies can reduce the likelihood of divergent trends and serious disturbances, but even with the best of cooperation such collaboration cannot assure that there will be no balance of payments or exchange rate difficulties which would have disruptive effects upon monetary relations. EEC monetary authorities, well aware of this

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2/ Intra-Community trade in 1963 increased approximately 132 percent over that in 1958, whereas extra-Community trade increased approximately 36 percent over that in 1958.

basic problem, are undertaking such measures as are possible within the present political context. They are also laying plans for future steps as these become feasible. A monetary union involving a single centrally controlled currency for the Community, however, is generally regarded as some distance away. Other types of monetary association or union short of a common currency are, therefore, being explored.

Despite the underlying difficulties a number of significant and constructive measures have been taken. The frequent association and increasingly close collaboration which has developed among the principal EEC monetary and financial officials is a positive accomplishment. Close working relations of this type are essential to the development of a monetary union of substance and to the Community generally. It is in this area of cooperation and effective coordination of policies that current efforts are being directed.

The April 1964 recommendations of the Council to the members regarding anti-inflationary and other economic and financial policies, and the specific nature of the measures recommended to individual countries, represent a significant development in joint efforts to deal with divergent trends in the different countries and to coordinate policies. While the recommendations were directed primarily to Italy, they included separate recommendations to each of the members of the Community based on their individual requirements. The Council set forth ten basic general guidelines directed toward "reestablishment of the Community's internal and external economic equilibrium."

The Commission in its action program in October 1962 proposed that a monetary union be an objective for the third stage, which begins in January 1966 and runs until the first of January 1970. Although plans for monetary union were affected by the slow-down of the integration movement after January 1963, when France opposed British membership in the EEC, renewed interest in such a union exists. In October 1964 the Commission in a communication to the Council and to the Member Governments, said that progress in the field of monetary policy is increasingly urgent. It stated that it would soon submit to the Council proposals for the progressive introduction of a monetary union.

There are differences of opinion in Europe as to the timing and feasibility of a monetary union. One view is that a formal union must await a genuine united Europe wherein there is a Parliament with authority to enact legislation binding upon all members. It is felt that a federal central banking system under centralized direction, designed to operate such a monetary union, is feasible only if there is a centrally formulated and controlled budget policy, various other centralized policies, and a common legislature. It is said that a common central bank presupposes a common state.

An opposing view is that a monetary union need not await political union, that it can give strong impetus to economic integration, also to political union, and that plans for monetary union should proceed. It is held that while a high degree of monetary and fiscal policy coordination is necessary to the success of a monetary union, central policy formulation in the monetary and fiscal field is not dependent upon the centralization of governmental functions in general; moreover, that during a transition period, workable central control over monetary and fiscal policy can be achieved by informal arrangements. It is believed that monetary integration, therefore, should proceed parallel with the entire integration process, and that it can promote this process.

As to the type of monetary union envisaged, although the ultimate goal is a common currency, current discussions regarding an EEC monetary union for the period ahead are in terms of firmly fixed exchange rates and assured currency convertibility within the Community. Immutable exchange rates and free payments among the countries are considered essential to the functioning of the Common Market. The common agricultural policy, involving agreed prices for agricultural commodities, would, for example, be disrupted by a change in the pattern of member country exchange rates. [3] Three of the six countries, France, Germany and the Netherlands, have made exchange rate changes since establishment of the European Common Market. If these changes were made today they would create serious problems which did not arise when the earlier exchange adjustments were made -- a fact which indicates the extent to which economic integration has progressed.

The means of assuring firmly fixed exchange rates among the countries, and internal convertibility, i.e. free transferability of currencies within the EEC, is the crux of the problem; it remains unsolved. If a member country renounces intra-EEC exchange rate changes, other means of adjusting major balance of payments imbalances to an equilibrium position must be relied upon. Whether such other means can be adequate and consistent with high levels of domestic employment and economic growth, is questioned in some quarters. The adjustment process and the dilemma of internal versus external stability are, therefore, being actively studied.

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[3] Consideration is being given to a possible common monetary unit in which to denominate the agreed agricultural prices.

Attention is also being directed to the liberalization of capital movements and the development of an integrated capital market. Due to different systems of taxation, among other things, the present capital markets are compartmentalized, so that savings do not flow freely in response to investment opportunities within the Community. An adequate capital market thus does not exist and large borrowers look to New York and London. Improvement in the functioning of the member countries' capital markets is also needed in order to make them more accessible to borrowers outside the Community. Plans to harmonize taxes on capital transactions and improve the functioning of the capital markets are underway.

Considerable discussion has taken place over a possible pooling of external monetary reserves. The Treaty of Rome, which contemplates mutual aid to assist a country in balance of payments difficulty, does not provide for a joint fund, or for an arrangement to raise funds to assist such a country. Proposals have been made that provisions for mutual aid be made concrete, such as through a partial pooling of reserves or an agreement to lend to a member country in difficulty under specified conditions.

The European Parliament in its report on the coordination of monetary policy, and the Commission in its proposed action program, both suggested that an agreement be entered into among the member countries specifying their obligations to provide funds in the case of need by a member country. Opponents to such a measure argue that present arrangements for financial assistance are adequate, that the International Monetary Fund and existing agreements are available to provide necessary aid, and that the central banks stand ready to help each other without a contractual commitment. It is also charged that the availability of assistance would encourage lax financial policies. Plans for some type of measure in this field are, however, being studied.

While a monetary union controlled by a central authoritative body is not imminent, considerable progress toward monetary integration not only has been made, but attitudes toward monetary relations have changed significantly. At the time the Treaty of Rome was signed an effective monetary union would have been regarded by many as utopian. Today there is widespread willingness to contemplate the development of such a union. The debates in the European Parliament and discussions in the Commission reveal that monetary union is widely regarded as a feasible goal. The nature of such a monetary union and the steps by which it is to be achieved, however, are still undetermined. The problems ahead are considerable.

ANNEX III.

African Monetary Unions

MONETARY unions have been established and are successfully functioning among a number of newly independent African States. Two of these unions are the West African Currency Union and the Currency Union of Equatorial Africa. 1/ The countries which are members of these unions, seven in the first case and five in the other, were formerly governed by France and constituted the territories of French West Africa, and French Equatorial Africa and Cameroon. They used a currency unit known as the CFA franc, the letters being derived from the words Colonies Francaise d'Afrique. These currency unions have been developed from the currency system which prevailed in the pre-independence period. A single currency, and freedom of trade which has continued among the countries of Equatorial Africa, contributes to their economic development.

The formation of these monetary unions was made less difficult politically by the fact that the member countries previously had a common currency and central monetary control. The problem of yielding sovereign rights over monetary matters to a supra-national body was, therefore, less of a departure than would be the case for countries which have long exercised these rights. Two West African countries, however, Guinea and Mali, which formerly were part of the common currency area under France, are not members of the monetary union for political reasons rather than because of dissatisfaction over economic or financial aspects of the union.

A. West African Currency Union

THE West African Currency Union embraces the seven countries of Dahomey, Ivory Coast, Mauritania, Niger, Senegal, Togo and Upper Volta. An agreement establishing the currency union was signed by

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1/ A monetary union also exists in East Africa among Kenya, Tanzania and Uganda.

the member countries in May 1961, and the union became effective in November 1962. 2/

The monetary union is administered by a common central bank, the Banque Centrale des Etats de l'Afrique Occidentale (BCEAO). This bank was formed in 1959 out of the Institute of Emission which in 1955 took over the right of note issue from a private bank. In each member country of the currency union there is a Monetary Committee which carries out at the national level the policy decisions of the central bank. The BCEAO is managed by a Board of Directors of eighteen members, two from each of the six member countries and six from France. Each national Monetary Committee consists of five members, three appointed by the member government and two from among the members of the central Board of Directors.

The BCEAO is the sole currency issuing authority in the participating countries. It has powers customarily possessed by central banks enabling it to determine monetary policy for the entire area. The currency unit is the CFA Franc, although the letters now stand for Communauté Financiere Africaine. The notes are legal tender in all of the member countries but not in other parts of the franc area. 3/ Fifty CFA francs are the equivalent of one French franc, so that 246.853 CFA francs equal one United States dollar. The notes have marks identifying the member states in which the notes were issued. Notes issued by one branch of the BCEAO when received by a branch in another state or by the government are returned to the branch which originally issued them. This provision maintains a rough balance among the amounts of notes issued by the different states.

The BCEAO, as authorized in its statutes, establishes credit ceilings for each member country. It also may vary the rediscount rate and prescribe liquidity ratios for the commercial banks. The amount of credit

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2/ Mali signed the Agreement but later withdrew and established a central bank of its own. Togo did not sign but arranged, pending establishment of its own central bank, to participate in the union.

3/ There are six different CFA francs issued throughout the franc area in Africa. Each CFA franc is legal tender only in the territory of issue. Seventeen African countries continue to be members of the franc area. The characteristics of the franc area are: free transferability of funds within the area but restrictions on payments to outside countries, free trade within the area but restrictions on imports from outside countries, exchange rates pegged to the French franc, foreign exchange reserves held in French francs in France, and settlement of foreign exchange transactions through the Paris exchange market. The CFA francs are all mutually at par.

which the BCEAO may extend to the governments and the duration of such credits, are also limited by relating the permissible volume of credits to ordinary government revenues. In this manner the BCEAO is able to limit credit expansion and maintain a degree of uniformity in credit policies in the different countries. Each national Monetary Committee has the responsibility of allocating its global rediscount ceiling among the local banks. The centralization of monetary policy in the BCEAO, and through this central control the maintenance of reasonable uniformity of monetary conditions within the member countries, is basic to the success of the monetary union.

The BCEAO also holds in common the external reserves for all the member countries. No restrictions exist upon the transfer of funds among the countries within the union. Under a convention between France and the BCEAO, France guarantees unlimited conversion of CFA francs into French francs. This is carried out by the French Treasury granting automatic credits to the BCEAO if the bank's French franc balances with the French Treasury should be insufficient for conversion purposes. Inasmuch as the French franc is convertible into dollars or other currencies, the CFA franc is thus also convertible, via the French franc. The head office of the bank is provisionally located in Paris, but the head office can be moved to one of the participating countries by a unanimous decision.

B. The Currency Union of Equatorial Africa

THE Currency Union of Equatorial Africa embraces the five countries of the Central African Republic, Chad, Congo (Brazzaville), Gabon and Cameroon. The features of this currency union are similar to, but not identical with those of the West African Currency Union.

The currency union of these countries is administered by a common central bank, the Banque Centrale des Etats de l'Afrique Equatoriale et du Cameroun (BCEAEC). This bank was formed out of the former Institut d'Emission de l'Afrique Equatoriale Francaise et du Cameroun, which until 1959 exercised the sole right of note issue in these territories.

The BCEAEC is managed by a Board of Directors of sixteen members, eight representing the five participating countries and eight representing France. Cameroon has four directors and each of the other four countries has one director. There are three Monetary Committees, one for Cameroon, one for Gabon and one for the other three countries combined. France is represented on each of the Monetary Committees.

Since most of the members of the national Monetary Committees are also members of the Board of Directors of the BCEAEC, the Committees have wider powers to determine credit policies than their counterparts in the Monetary Committees of the West African Currency Union. The central Board has thus delegated to the Monetary Committees the power to fix rediscount ceilings. The Board, however, fixes the discount rate since it believes this should be uniform for all the member countries.

The BCEAEC has the exclusive right of issuing currency, which is the CFA franc, in the member countries. The notes issued in the different countries have identifying marks, and those issued in Cameroon have the picture of the President of Cameroon. All the notes are legal tender in each of the participating countries.

The central bank determines the monetary policy for the five member countries and thus maintains a degree of uniformity in policies which is essential to the success of the monetary union. It also holds the foreign exchange reserves of the countries. These reserves are in French francs. France guarantees the unlimited convertibility of the CFA franc into French francs, as in the case of the CFA francs of the BCEAO. Since the notes issued by the BCEAEC are freely convertible into French francs, through the French franc they are convertible into dollars and other currencies.

The bank grants short term and medium term credit to the private sector, as does the BCEAO. The BCEAEC, in contrast to the BCEAO, does not grant direct credits to the member governments. It does, however, discount Treasury bills for the commercial banks and in this manner indirectly loans to the governments. The amount of such loans to the governments is limited only by the global credit ceilings.

ANNEX IV.

Monetary History of Central America

A. Spanish Period

WHEN Central America was a dependency of Spain it had the Spanish system of currency, although outside the more important towns trade was carried on by barter and native forms of money, particularly corn and cacao beans. The Spanish system of currency was based upon the real as the unit, which dated from 1369 and was a mixture of silver and copper. [1] Under the Spanish laws of 1497 silver pieces of eight reales were coined, and came to be known variously as pesos, duros, duros fuertes, or pieces of eight. They originally contained 394.829 grains of fine silver, but the amount of silver was little by little reduced, and by 1800 they contained on the average only about 371 grains of fine silver, namely 25 grams .900 fine. This amount of silver is approximately the same as that in the present United States silver dollar; in fact the silver dollar, established by the Act of 1792, was based upon the Spanish piece of eight, which then circulated widely in the United States as it had in the colonies.

Spanish gold coins also circulated in Central America. The principal gold coin was the onza, sometimes called a doblón or doubloon, and was supposed to contain an ounce of gold. Actually, it contained less. It circulated as the equivalent of about sixteen silver pesos. In addition to Spanish coins there were coins from various Latin American and European countries. Many of the coins were of inferior weight and mutilated; they were accepted at a discount.

Since the mints in Mexico, Peru and Guatemala [2] were not equipped to turn out at all times enough round money, they issued irregular

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[1] The real was originally 1/70 of a mixture of one marc of silver (3550. 16 grains troy) and three marcs of copper.

[2] The Royal Mint in Guatemala was founded in 1733, the dies and machinery having been brought down from Mexico. The founding of the mint and subsequent minting of the first coins were occasions for ceremony and celebration.

pieces of silver stamped with the official insignia. These were known as "macacos", "moneda cortada," or "moneda macuquina." They were allowed to take whatever shape resulted when the die was pressed down. They contained good silver and were issued in almost all the customary denominations. Macacos circulated widely throughout Central America and had a long history of about three hundred years. They were finally demonetized by Guatemala in 1873, the last country to declare against them; they continued to circulate in Guatemala and elsewhere for a time thereafter.

During the Spanish period the currency thus consisted of a confused mixture of coins from various countries, often debased, circulating at varying values. The Spanish piece of eight and the Mexican silver dollar, which were more or less identical and closely resembled the present United States silver dollar, were the principal coins and units of account; each was called a peso. Paper currency had not yet made its way into general circulation in Central America.

B. Early National Period

WHEN Central America declared its independence from Spain in 1821, and soon thereafter formed the Republic of Central America with headquarters in Guatemala, the currency continued to be the same as before independence. The coins were a miscellaneous and confused lot from various nations. The mints in Central America struck some coins with the insignia of the new Republic of Central America, but the foreign coins constituted the principal currency. Even after the union was dissolved in 1838, these coinings continued for a number of years.

With the dissolution of the union the currency in each of the now independent countries continued essentially unchanged. It remained, in fact, much the same throughout a good deal of Central America until well into the twentieth century. National currency systems were not effectively developed until late in the nineteenth century, or later, so that the countries all had similar currencies -- not a monetary union, however, to be copied. Numerous laws were enacted and decrees issued by the individual governments in the endeavor to deal with the confused currency situation. Money of inferior quality was a problem. Coins were counterfeited, clipped and plugged. Public employees would receive the better grade coins and quietly substitute for them money of inferior quality which could be bought cheaply. Tables of official ratings of the value of the different coins were common. Certain badly debased coins were declared unacceptable by the governments.

Both gold and silver coins were in circulation, the currency system being bimetalism. The changing market ratio of the value of gold and silver was the source of difficulty, since the market ratio frequently differed from the ratio of the metallic content of the coins; gold coins or silver coins thus tended to be melted down for their metal depending upon the market price of the metals.

In 1851 Guatemala declared the United States dollar legal tender for public and private transactions at the rate of one dollar for one peso. The silver peso of 25 grams .900 fine was made the official monetary unit of Guatemala in 1870. Guatemala during this period coined a large amount of Guatemalan silver pesos which circulated throughout Central America, also some gold coins at the mint ratio of 15.51 parts of silver to one of gold. When the price of silver fell beginning about 1873, the gold coins, as a result of the fall in silver prices, came to be undervalued in metallic content and disappeared from circulation.

The first bank notes in Guatemala were those of the Banco Nacional de Guatemala founded in 1874, although government paper notes had been issued as early as 1834. The government notes were acceptable by the government for payments due it, and often circulated as money; they were usually bought at a large discount. The Banco Nacional lasted only two years, but other banks were soon established and issued bank notes. These notes were redeemable in coin, except for a short period, until 1897 when the period of inconvertible and depreciated paper money began in Guatemala.

Increased issues of bank notes in Guatemala, beginning in the 1880's, drove much of the silver from circulation. This exodus of silver was accelerated after 1894 by further large issues of paper currency by the banks, due primarily to government borrowing from the banks; later, government paper currency was also issued. In 1897 the banks were relieved of their obligation to redeem their notes in coin. Depreciation of the peso followed; its value steadily declined under the rule of Estrada Cabrera, which began in 1898, until by the 1920's the peso was worth only one or two cents in United States money. A major currency reform introducing the quetzal as the monetary unit, equivalent to one United States dollar, was undertaken in 1925.

The situation in Costa Rica during most of the 19th century was not very different from that in Guatemala. The mixed and unsatisfactory condition of the currency continued until near the end of the century. The Government, as in the other countries, frequently found it necessary to post a table rating the values of the various coins, and to prohibit the circulation of certain debased coins such as some Honduran "silver" money, which was actually over fifty percent copper, and similarly some Peruvian silver soles.

Costa Rica decided to rid itself of the polyglot and unsatisfactory currency, much of which went back to the Spanish period, and according to the monetary law of 1896 adopted the gold standard. A comprehensive currency reform was successfully carried through and the gold colon, worth 46.5 cents in United States money of that period, was introduced. All the Costa Rican currency was redeemable in gold. Costa Rica was the first country to make an effective break with the old system and install its own money as the principal currency of the country.

The new currency system functioned well until after the outbreak of the first World War in 1914. As a result of the war and the strong demand for sterling and other foreign currencies, gold flowed out of Costa Rica in large amounts. In September 1914 the banks were relieved of their obligation to redeem their notes in gold. Thus began the regime of inconvertibility of the colon in Costa Rica.

In November 1914 the Government of Costa Rica organized the Banco Internacional, a government bank. After Tinoco assumed power in 1917 the bank issued a large amount of bank notes, which depreciated progressively accompanying the increased issues. In 1919, when Tinoco was overthrown, the notes were worth less than half their original value in United States money. In 1921 the Government, as part of its plan to rehabilitate the currency, decreed that the banks, with the exception of the Banco Internacional, should redeem their notes in gold. The banks had retained large stocks of gold and were able to do this. These notes were thus retired and in the same year the Banco Internacional was made the sole bank of issue. A currency reform took place in 1923 and 1924.

The currency history of El Salvador during the 19th century is similar to that of Costa Rica and the other Central American countries; the currency consisted of a mixed lot of foreign coins. According to the Monetary Law of 1883 the silver peso of 25 grams .900 fine, the customary weight of the good quality pesos, was adopted as the monetary unit. The law also provided for gold coins at the mint ratio of 15.5 to 1, but apparently few if any gold coins were minted. El Salvador undertook to introduce the gold standard by a law of 1892, which declared the monetary unit to be the gold peso provided for in the law of 1883. A mint was established in 1892 and both gold and silver coins were struck. Efforts to establish the gold standard, however, were not successful since the gold coins were undervalued in terms of the silver coins and promptly disappeared. Silver continued to be the chief money of the country.

The earliest bank notes in El Salvador were those of the Banco Internacional, founded in 1880, the first bank in the country. Other banks were soon established and also issued notes. These bank notes were effectively redeemable in silver until after the outbreak of the first World War. They became inconvertible at that time following heavy demands upon the banks for silver; the notes then depreciated.

In 1919 a law was adopted by El Salvador embodying the gold standard, the colon to be worth 50 cents in United States money. The banks sold their silver reserves -- the price of silver was then high -- and replaced the silver with gold. In 1920 the banks accordingly began redeeming their notes in gold at the rate of two colones to the dollar, and El Salvador was on the gold standard.

The currency of Honduras during the nineteenth century consisted of coins which had circulated during the Spanish period, together with newer coins from various countries, as in the case of the other Central American countries. Honduras coined some of its own money, beginning in 1822, when a die for coining money was brought to Tegucigalpa from Mexico. The early coins struck were macacos. Coinings of Honduran money continued until 1858. The coins were to a large extent debased, containing a large amount of copper. These debased coins drove the better silver coins from circulation.

After the price of silver fell beginning about 1873, silver money from various nations, which had been driven out of Honduras by the debased coins, reappeared in circulation. The coins, principally those of Chile, Peru, Mexico, Guatemala, Spain and other countries, were not identical in weight, but were in general similar to the customary silver peso of 25 g [illegible] .900 fine. The monetary law of 1879 declared the monetary unit of Honduras to be the peso of this weight. A considerable amount of full weight Honduran silver coins were minted in accordance with this law. The silver in the coins, however, contained a certain amount of gold so that many of the coins were exported and the gold extracted. The currency thus continued to consist largely of coins from other countries, especially from Guatemala and Chile.

After the beginning of the first World War, the price of silver rose considerably and large amounts of the silver coins of Honduras were exported and hoarded. The notes of the two banks were presented for redemption in silver so that their circulation contracted. The silver peso which had been worth in the neighborhood of 40 cents in United States money -- its value fluctuated -- rose in value to around 50 cents or more.

In order to relieve the scarcity of money in Honduras, the Banco Atlántida with headquarters on the North Coast where United States money circulated, arranged with the Government in 1918 to introduce United States money into other parts of the country. It was authorized to redeem its notes in United States money at the rate of two pesos to the dollar. A decree was issued in 1918 making United States money legal tender at this rate. Honduras thus indirectly adopted the gold standard, by making the peso worth 50 cents in United States gold money. During 1919 and 1920 United States money constituted the principal circulating medium.

When the price of silver declined beginning in the latter part of 1920, the old silver coins reappeared in circulation in Honduras. They tended to circulate at a discount in terms of United States money, which continued in circulation. Honduras thus remained effectively upon the gold standard.

The early monetary experience of Nicaragua was not very different from that of the other Central American countries. Independence from Spain brought little change in the currency situation. In 1826 a decree provided that the public offices would accept all the money of good quality that circulated before the revolution. The currency thus continued to be a confused mixture of foreign coins, the Spanish piece of eight or peso being the principal coin and unit of account.

No fundamental change in the currency of Nicaragua took place until the latter part of the seventies and early eighties. The government then issued "Billetes del Tesoro", paper currency which was redeemable in coin and circulated alongside of the metallic money. The notes were issued in moderation and the principal difficulty was that of counterfeiting. A government decree of 1882 arranged for the issuance of bank notes, and in 1887 the Bank of Nicaragua was granted the exclusive right to issue notes. The government then discontinued issuing notes. The bank notes circulated at par with the silver.

A new government, however, under Zelaya came into power in 1893 and proceeeded to issue large amounts of paper currency alongside of the bank notes. The government notes from the beginning went to a discount in terms of silver and the bank notes. The government finally forced the bank to retire its notes, leaving the field clear for the government notes.

Emissions of government notes were moderate until 1901 and 1902 when large amounts were issued. Depreciation was rapid and by 1903 little silver remained in circulation, being driven out by the government notes which continued to depreciate. The silver went to a large extent to Honduras and El Salvador. Costa Rica had several years earlier replaced the old silver by national money redeemable in gold. in Guatemala similar events were taking place as in Nicaragua; silver in Guatemala was being driven out by excessive issues of paper currency.

After the overthrow of Zelaya in 1909 and United States intervention in Nicaragua, a comprehensive currency reform was undertaken. According to the law of 1912 a new unit, the córdoba, was introduced equivalent to one United States dollar. The old paper pesos were converted into córdobas at the rate of 12.50 pesos to one córdoba. The Banco Nacional de Nicaragua was organized in 1912 and given the exclusive right to issue córdoba notes. The currency system adopted was the gold exchange standard. According to this standard, the currency was redeemable, not in gold but in drafts upon a gold standard country, in this case the United States, whose money was redeemable in gold. The córdoba was thus freely redeemable in drafts upon the United States at the rate of one dollar for one córdoba. An Exchange Fund was established in New York to provide for free redemption in dollars.

The outbreak of the First World War brought a strong demand in Nicaragua for dollars and other foreign currencies. In October 1914 the Banco Nacional de Nicaragua found it necessary to suspend redemption of córdobas. The córdoba promptly depreciated. Nicaragua's early and successful experience with the gold exchange standard thus lasted only about two years.

In summary, at the time of the first World War the Central American countries were well on the way toward independent currency systems. The currency of Costa Rica was the colon, which since 1896 had been convertible into gold; convertibility ceased after the outbreak of war. El Salvador still retained the silver peso, although during the war the bank notes were no longer redeemable in silver. In Guatemala the currency consisted principally of depreciated bank notes, which had not been redeemable in silver pesos since 1897. Honduras retained the old silver peso as its currency; during the war these tended to disappear and United States money was introduced. Nicaragua had completed a currency reform in 1912, and had introduced the córdoba, equal to one United States dollar and redeemable in dollars. Redemption of the córdobas ceased upon the outbreak of war.

C. Modern Period

THE decade after the first World War saw the final disappearance from circulation in all the Central American countries of the miscellaneous foreign silver coins, coins from Mexico, Chile, Peru, Guatemala, Spain, etc.; they had enjoyed a long history in Central America. Some of the coins were of debased metallic content, and many dated back to the Spanish period. When the price of silver was high during the war the silver coins were exported or hoarded and disappeared from circulation in Honduras and El Salvador, the only countries where they still circulated. In Guatemala they had largely been driven out by depreciated paper. Costa Rica and Nicaragua had earlier instituted thoroughgoing monetary reforms. After the price of silver declined beginning in late 1920 the old coins reappeared in Honduras and El Salvador.

The war had disrupted the currency systems of all the Central American countries, and in each case basic reform was needed. These countries were also aware that the absence of central banks was a handicap to their financial stability and economic growth. Accordingly a series of major monetary reforms took place during the 1920's.

Costa Rica

IN Costa Rica the notes of the Banco Internacional were depreciated and in the early 1920's fluctuated in value between about 20 and 25 cents United States money. The depreciation resulted from large note issues by the Tinoco regime, which ended in 1919. Before the war Costa Rican colones were freely convertible into gold at 46.5 cents.

In order to stábilize the colon, Costa Rica, according to a decree of October 10, 1922, established the "Caja de Conversion," which issued notes against gold or foreign exchange at the fixed rate of 25 cents United States money per colon. The Caja did not get underway until late 1923, but gradually replaced notes of the Banco Internacional, which had become the sole bank of issue in 1921, with its own notes. The new notes were freely redeemable and stable at 25 cents United States money. The notes of the Banco Internacional, no longer issued, were received by the Caja at a declining discount and destroyed.

The colon remained convertible into gold from its initial issue by the Caja until the world-wide depression, which began in 1929. As a result of a shortage of foreign exchange, convertibility was suspended in 1931. The official rate for the sale of foreign exchange was changed from four colones to the dollar to 4.25 to the dollar, then 4.50 and 4.75. In 1935 when a free market for the purchase and sale of dollars determined the rate, the colon depreciated to nearly seven to the dollar, or about 14 cents United States money. By 1937 the rate had improved and become relatively stable at around 18 cents, 5.60 to the dollar.

The rate of 5.615 to the dollar was adopted as the par value of the colon in December 1946. Costa Rica, however, maintained a system of multiple exchange rates whereby importers paid a more depreciated rate than 5.615. There was also a free rate for the sale of exchange derived from a few sources; this free rate fluctuated and was more depreciated than the import rate. Exporters, however, were required to deliver proceeds from their exports at the 5.61 rate.

In 1961 the par value of the colon was changed to its present level of 6.625 to the dollar, or 15.094 cents, and the system of multiple exchange rates abolished. A major feature of this reform was the unification of the exchange system around the previous free rate of 6.63 colones to the dollar, and the removal of exchange restrictions. Costa Rica today has no restrictions on foreign payments and exchange may be purchased freely by the public at a stable exchange rate. Costa Rica accepted the obligations of Article VIII of the International Monetary Fund in 1965.

The Banco Central de Costa Rica was established by the law of January 1950 and is the sole bank of issue. The commercial banks in Costa Rica were nationalized by the Government and placed under the supervision of the Central Bank. They operate with considerable independence.

El Salvador

EL Salvador introduced the gold standard in 1920 when, according to the law of September 1919, the three banks of issue began redeeming their notes freely at the rate of 50 cents United States money to the colon, the pre-war value. The banks had converted their silver reserves into gold at favorable prices and were able to maintain the colon at this rate. Alongside of the bank notes a considerable amount of the old silver money was in circulation in El Salvador, having reappeared when the high price of silver collapsed in late 1920. The old silver coins were subsequently withdrawn from circulation. A certain amount of United States currency also circulated in El Salvador at the rate of two colones to the dollar.

The colon continued to be freely convertible into gold at the rate of fifty cents United States money until the depression of the 1930's brought a shortage of foreign exchange. The banks in October 1931 were relieved of their obligation to redeem their notes and deposits in gold, and the colon accordingly depreciated.

El Salvador was concerned over the depreciation and instability of the colon, and also over the lack of a central bank. Accordingly, a number of special commissions were created to study the problem and recommend appropriate measures. As a result the Banco Agrícola was converted into the Banco Central de Reserva de El Salvador, which began operations as such in July 1934. The colon was stabilized by the bank at 2.5 to the United States dollar, namely forty cents, and was freely redeemable in foreign exchange at this rate. The newly created central bank took over the notes of the other banks and became the sole bank of issue. The bank was reorganized and nationalized in 1961; it had previously been privately owned.

El Salvador has maintained the colon at the above rate of forty cents continuously since 1934. Due to a decline in reserves, largely because of lower receipts from coffee exports, exchange controls were introduced in April 1961 to regulate capital movements; they are still in force. As a result of good export earnings since 1961 the bank is currently in a strong reserve position. El Salvador accepted the obligations of Article VIII of the International Monetary Fund in 1946.

Guatemala

GUATEMALA'S long period of depreciated paper money came to an end in 1925. The peso had been inconvertible since 1897, prior to which time the bank notes were at a par with the silver peso of 25 grams .900 fine. The paper currency was not only depreciated but in a dilapidated physical condition. The monetary situation was thoroughly unsatisfactory and Guatemala realized that basic monetary reform was needed. Guatemala also observed the success of the monetary reforms in El Salvador and Costa Rica.

A thorough study of the problem led to a decree, approved by the National Assembly May 2, 1925, which provided for a new currency unit, the quetzal, equivalent in gold value to the United States dollar.

The old and worn paper pesos were accepted in exchange for quetzales at the rate of 60 pesos to the quetzal. The pesos continued to be legal tender at this rate, but were gradually retired. A considerable amount of United States paper currency also circulated in Guatemala. The reform of 1925 also included establishment of a central bank, the Banco Central de Guatemala.

The basic laws regarding the present monetary and banking system of Guatemala were promulgated during the years 1945 to 1947. Monetary policy in Guatemala, according to these laws, is the special responsibility of the "Junta Monetaria," which includes the President and Vice President of the Banco de Guatemala. The Banco Central de Guatemala was reorganized in 1945 as the Banco de Guatemala. It is the sole bank of issue, and has maintained the quetzal continuously at a parity with the United States dollar. The bank currently has strong foreign exchange reserves.

In October 1962 Guatemala introduced a system of exchange controls, provided for in the Monetary Law of December 1945 but never invoked. A two percent surcharge on non-essential imports was applied in November 1962. The controls were liberalized in May 1963 and the multiple rates abolished; the controls were further liberalized in October 1963. The controls are administered by the Banco de Guatemala under the direction of the Monetary Board, and apply primarily to capital movements. Guatemala accepted the obligations of Article VIII of the International Monetary Fund in January 1947.

Honduras

THE monetary circulation of Honduras after the first World War consisted of United States money and the old miscellaneous foreign silver coins; these reappeared after the price of silver declined sharply in late 1920. They circulated at varying discounts in terms of United States money. In order to maintain the value of the silver peso at fifty cents United States money, the Government decreed that pesos were acceptable in payment of customs dues at the rate of two pesos to the dollar. Since the government received an excessive amount of pesos this decree was subsequently modified so that only half of customs dues could be paid in silver.

Proposals were made to remedy the unsatisfactory monetary situation, and finally in April 1926 a law was adopted which established the lempira, worth fifty cents in United States money, as the official monetary unit of Honduras. However, the law was not put into operation until 1931, when lempira coins were minted and placed in circulation. The circulation during the 1920's thus consisted largely of United States dollars. As a result of the depression beginning in 1929, dollars were exported to meet the demands for foreign exchange. In view of the resulting contraction in the supply of money, lempiras were minted in accordance with a decree of March 1931.

Although Honduras did not suffer a serious shortage of foreign exchange during the depression of the 1930's, a system of exchange control was introduced in 1934 following the example of other Latin American countries. The system was administered by an Exchange Control Commission until taken over by the central bank in 1950. Since Honduras had no serious shortage of foreign exchange the system was administered liberally and most of the time there was little limitation on the purchase of foreign currencies. Only between 1937 and 1943 can it be said that there were restrictions on the purchase of foreign exchange.

After the outbreak of the second World War and as a result of substantial dollar expenditures by the United States Government for the Pan American Highway, and also by United States fruit companies operating in Honduras, dollars were more plentiful and large amounts were brought into Honduras. United States coins were imported to meet a shortage of silver lempira currency. 3/ From 1943 until 1949 United States money thus constituted the major part of the circulation of Honduras. In 1949 due to a scarcity of small change the government authorized the minting of additional lempira coins, which circulated alongside of the United States money.

Early in 1950 Honduras revised its monetary, banking and exchange system. The currency had been devalued in 1934 when the United States devalued the dollar, but the new gold content of the lempira had not been defined. This was done in the 1950 law which made the lempira equal to fifty cents U.S. money.

Honduras had no central bank, and in connection with the monetary reform the Banco Central de Honduras was established and began operations July 1, 1950. The bank took over the right of note issue from the two private banks, and became the sole bank of issue.

3/ The banks had generous amounts of silver lempiras but these were unavailable since they were required for legal reserves. The government rejected a proposal to permit the banks to substitute foreign exchange for lempiras.

The lempira has remained stable continuously at the rate of two lempiras to the dollar, and Honduras has at present no restrictions on foreign payments. Foreign exchange may thus be purchased freely by the public without restriction. Honduras accepted the obligations of Article VIII of the International Monetary Fund in 1950.

Nicaragua

DURING the latter part of the 1920's Nicaragua experienced an adverse balance of trade and a loss of reserves. As a result of the depression, which began in 1929, the córdoba came under increased pressure from a shortage of foreign exchange, and accordingly depreciated from its former value of one United States dollar. During the early years of the depression the depreciation of the córdoba was not great; in the free exchange market, established in January 1934, the premiums were around 15 to 20 percent. The official rate was raised that year from 102 córdobas for 100 dollars to 110 córdobas.

Depreciation of the córdoba continued, and during the second World War the free exchange rate fluctuated from around 500 to well over 600 córdobas for 100 dollars. According to the law of March 2, 1945 the buying rate of exchange from exports was fixed at 498.75 córdobas for 100 dollars.

The basic monetary law of Nicaragua is that of November 1940, replacing the law of 1912. It provides among other things that the gold value of the córdoba may be varied from time to time by the central bank according to economic conditions.

In November 1950 the system of multiple exchange rates was altered; the official rate was maintained at five córdobas to the dollar, but thereafter applied only to government imports. Exchange receipts were to be surrendered at 6.60 córdobas to the dollar, and through a system of sur-charges, importers and others paid seven, eight and ten córdobas to the dollar, depending upon the nature of the transaction.

Nicaragua in March 1963 simplified the rate structure and consolidated the rates at seven córdobas to the dollar, namely 14.285 cents, the present rate. At the same time Nicaragua eliminated exchange restrictions and made the córdoba freely convertible at this single rate. Nicaragua accepted the obligations of Article VIII of the International Monetary Fund in 1964.

The Banco Nacional de Nicaragua was established by a law of October 26, 1940. The bank was divided into two departments, the Banking Department and the Issue Department. Since it lacked some of the main attributes of a central bank, a new institution, the Banco Central de Nicaragua, was established according to the law of August 1960 and began operations in 1961. It took over functions previously performed by the Issue Department of the Banco Nacional de Nicaragua, which is now a government owned commercial bank. The córdoba has remained stable at seven to the United States dollar and is supported by strong reserves.

In summary, the monetary systems of all the Central American countries have developed to a point where they are now in a generally satisfactory condition. The currencies enjoy the confidence of the public and are among the strongest in Latin America. Little or no inflation exists and prices have long been maintained at relatively constant levels. The central banks are strong and well managed. Foreign exchange reserves are in most cases larger that at any time in history and exchange rates are stable. All the currencies are essentially convertible for current transactions, although capital controls exist in the cases of El Salvador and Guatemala. The present healthy monetary situation provides a solid background for inauguration of a Central American monetary union.

APPENDICES

APPENDIX A.

Monetary Provisions of Central American Treaties and Agreements

I. Multilateral Treaty on Central American Free Trade and Economic Integration

Signed in Tegucigalpa on June 10, 1958

Article VIII

The Central Banks of the Contracting States shall cooperate closely with a view to preventing any currency speculation that might affect the rates of exchange and maintaining the convertibility of the currencies of the respective countries on a basis which, in normal conditions, shall guarantee the freedom, uniformity and stability of exchange.

Any of the Contracting States which establishes quota restrictions on international currency transfers shall adopt the measures necessary to ensure that such restrictions do not discriminate against the other States.

In case of serious balance of payments difficulties which affect or are apt to affect the monetary and payments relations between the Contracting States, the Central American Trade Commission, acting of its own motion or the request of one of the Governments, shall immediately study the problem for the purpose of recommending to the Contracting Governments a satisfactory solution compatible with the multilateral free trade regime.

II. Central American Convention on the Equalization of Import Duties and Charges

Signed in Tegucigalpa on September 1, 1959

Article VI

The Contracting States agree to the establishment of fixed equivalences, solely for equalization purposes, between the currency units in which each country's tariff duties are expressed and a common currency unit equivalent to the United States dollar. These equivalences, which are those existing at the date of signature of the present Agreement, are established as follows: Guatemala, 1 quetzal; El Salvador, a currency unit equivalent to the United States dollar; Honduras, 2 lempiras; Nicaragua, a currency unit equivalent to the United States dollar; and Costa Rica, 5.67 or 6.65 colones, according to the exchange provisions applicable to the item in question. If a country makes any change in the equivalence of its currency unit vis-a-vis the United States dollar in respect of goods included in Schedules A and B, it shall be under the obligation to alter its tariffs immediately in the proportion necessary to maintain equalization.

III. Treaty of Economic Association Among the Republics of Honduras, Guatemala and El Salvador

Signed in Guatemala City on February 6, 1960

Article I

The Contracting Parties hereby establish an Economic Association, which will guarantee the free movement of persons, goods and capital between their territories.

Article IV

The Contracting Parties shall endeavor to maintain free convertibility of their currencies, and in no case may exchange restrictions be established that discriminate against any Contracting Party.

Article VI

The Contracting Parties shall see that no legislative or administrative provision unduly impedes the free movement of persons, goods, and capital between them.

IV. General Treaty on Central American Economic Integration

Signed in Managua on December 13, 1960

Article X

The Central Banks of the Signatory States shall cooperate closely in order to prevent any currency speculation that might affect the rates of exchange and to maintain the convertibility of the currencies of the respective countries on a basis which, in normal conditions, shall guarantee the freedom, uniformity and stability of exchange.

Any Signatory State which establishes quantitative restrictions on international monetary transfers shall adopt whatever measures are necessary to ensure that such restrictions do not discriminate against the other States.

Should serious balance-of-payments difficulties arise which affect, or are apt to affect, monetary relations in respect of payments between the Signatory States, the Executive Council, acting of its own accord or at the request of one of the Parties, shall immediately study the problem in cooperation with the Central Banks for the purpose of recommending to the Signatory States a satisfactory solution compatible with the maintenance of the multilateral free trade regime.

V. Declaration of Central America

Approved by the Presidents of Central America, Panama, and the United States in San José, on March 19, 1963

The Presidents of the Republics of Central America and Panama are determined to improve the well-being of their peoples, and are aware that such a task demands a dynamic economic and social development program based on the carefully planned use of human, natural and financial resources. It also depends on important changes of the economic, social and administrative structure, within the framework of the principles that govern our democratic institutions. They have met with the President of the United States of America in San José, Costa Rica, to review the difficulties which impede the achievement of these objectives as well as the progress thus far made in the Isthmus since the integration programs began and since the Alliance for Progress was jointly established by the Republics of the Hemisphere in August 1961.

Following an analysis of the situation, the Presidents of the Republics of Central America, convinced that the best hope for the development of the region is through economic integration, and bearing in mind the extraordinary efforts made toward this end in the last decade and of the importance of accelerating over-all economic growth, pledge to their peoples:

- To accelerate establishment of a customs union to perfect the functioning of the Central American Common Market;

- To formulate and implement national economic and social development plans, coordinating them at the Central American level, and progressively to carry out regional planning for the various sectors of the economy;

- To establish a monetary union and common fiscal, monetary and social policies within the program of economic integration;

...

VI. Agreement for Establishment of the Central American Monetary Union

Signed in San Salvador on February 25, 1964

The Central Bank of Costa Rica, the Central Reserve Bank of El Salvador, the Bank of Guatemala, the Central Bank of Honduras and the Central Bank of Nicaragua:

WHEREAS:

FIRST:

The General Agreement of Central American Economic Integration, in its Article X, entrusts to the Central Banks of the Member States, "the necessary cooperation to avoid monetary speculation which may affect the rate of exchange, and to maintain the convertibility of the Central American currencies on a basis which guarantees, within a normal regime, the freedom, uniformity and stability of exchange."

SECOND:

The Central American Economic Council, in its Second Special Meeting of August 16, 1962, agreed "To declare that it is in the best interests of the Central American Economic Integration Program, to create the means and mechanisms necessary to assure a continuous and permanent coordination of monetary and exchange policies of the Member States, including the expansion and improvement of the present system of multilateral clearing of payments;" and "To request from the Central Banks of the Member States, the prompt study of the above mechanisms, as well as the submission to the Executive Council of the General Treaty, of concrete proposals for an agreement necessary for the full achievement of the above mentioned objectives."

THIRD:

At a meeting held in San José, Costa Rica, on March 19, 1963, the Presidents of the Central American States committed themselves before their people, "to establish a monetary union and a common policy concerning fiscal, economic, and social matters, within the Economic Integration Program; and

FOURTH:

The above mentioned agreements and pronouncements of the Central American Governments; and the progress achieved within the Program of Central American Economic Integration, and within the mechanisms of cooperation established by the Central Banks; as well as the monetary conditions prevailing in the countries of the area, indicate the need and opportunity to adopt measures tending to achieve by stages the monetary integration of Central America.

Agree to enter into the following

AGREEMENT FOR ESTABLISHMENT OF THE CENTRAL AMERICAN MONETARY UNION

ARTICLE I

The objective of this Agreement is to promote the coordination of monetary, exchange, and credit policies of the Central American countries, and to create progressively the basis for the Central American Monetary Union.

To this end, the Central Banks of Central America agree on the following goals:

1) To promote uniformity of the Central American exchange systems, as well as the stability and convertibility of the currencies of the area;

2) To expand the multilateral clearings system of Central America, and to stimulate the use of national currencies in all transactions among the Central American countries;

3) To promote financial assistance designed to correct temporary disturbances in the balance of payments, and to prevent unfavorable trends in the Central American exchange systems;

4) To obtain a high degree of uniformity in legislation, as well as in the monetary, exchange, and credit structures and conditions of the Central American countries;

5) To create appropriate conditions to foster the coordination of monetary and fiscal policies; and

6) To establish a permanent system of information and consultation, in order to bring about common means of action and instruments of monetary, exchange, and credit policies.

ARTICLE II

The goals of monetary integration set forth in this Agreement will be achieved gradually and progressively through the following means:

1) Exchange of information, specific research and regular consultation in the monetary, exchange, and credit fields;

2) Technical investigation relating to the legislation, institutional structure, conditions of development, and nature of the instruments of monetary, exchange, and credit policies of the Central American countries;

3) Consultation at a high executive and technical level, on a voluntary and strictly confidential basis, with respect to the domestic and foreign policies of the Central Banks;

4) Specific mechanisms designed to provide financial assistance adequate to prevent unfavorable trendsin the exchange systems, lessen the effects of temporary disturbances in the balance of payments, and to further the free flow of capital in Central America; and

5) Consultation and studies designed to achieve favorable conditions to coordinate the monetary and fiscal policies.

On the basis of such progress as may be accomplished, will be determined the appropriate time to formulate and propose agreements that may be necessary to create the Central American Monetary Union.

ARTICLE III

The execution of this Agreement will be in charge of the Central Banks System of Central America, through the following bodies:

1) The Central American Monetary Council;

2) The Committees for consultation or action; and

3) The Executive Secretariat.

ARTICLE IV

The Central American Monetary Council will consist of the Presidents of the Central Banks of El Salvador, Guatemala, Honduras and Nicaragua, and the Manager of the Central Bank of Costa Rica, as members.

Each Central Bank will appoint a permanent alternate member of the Council, selected from their high executive officials.

ARTICLE V

The Central American Monetary Council will have the following functions:

1) To hold periodic consultations on the general aspects of the monetary, exchange and credit policies of the Central American countries, and to agree or recommend adequate measures to arrive at common policies;

2) To maintain the necessary relations and hold consultations with the governmental authorities of Central America in order to coordinate the monetary and fiscal policies;

3) To determine the scope and procedures for achievement of the program set forth in this Agreement;

4) To agree on the measures needed to enlarge and improve the Central American system of multilateral clearings;

5) To establish consultative or executive Committees that the Council considers necessary in order to fulfill all functions related to the achievement of the program set forth in this Agreement. The Council will determine the functions and obligations of these Committees;

6) To appoint the Executive Secretary;

7) To approve the rules and regulations that will govern the Committees and Executive Secretariat;

8) To approve the budget of all bodies comprising the System of Central Banks of Central America;

9) To submit drafts of agreements whose approval at a governmental level may be necessary to achieve the Central American Monetary Union;

10) To interpret the terms and conditions of this Agreement; and

11) All other functions that may be necessary to meet the objectives of this Agreement.

ARTICLE VI

Annually the Council will elect a President from among its members in rotation.

The Council will hold meetings as follows:

1) One regular annual meeting, and special meetings whenever called by the Council or the President, or requested by any one of its members.

2) Its resolutions will be by a majority of votes of all members; they will be binding only on such Central Banks whose representative subscribed to them, or adhered to such resolutions at a later date.

3) The Executive Secretary will participate in the discussions of the Council, without vote. The alternate members of the Council may participate in the same manner.

ARTICLE VII

There will be, at least, the following Committees:

1) Committee on Monetary Policy;

2) Committee on Exchange and Clearing Policies;

3) Committee on Financial Operations; and

4) Committee on Legal Studies.

The Council will establish these Committees or any others that circumstances may require.

ARTICLE VIII

Each Central Bank will participate in all Committees through a representative and an alternate member.

ARTICLE IX

The Executive Secretariat will be in charge of a Secretary, who is a Central American officer, elected by the Monetary Council for a term of two years, eligible for reelection, and must be a person of well-known professional competence in central banking matters and international finance.

The Executive Secretary will be responsible exclusively to the Central American Monetary Council.

ARTICLE X

The Executive Secretariat will be responsible for the preparation of all necessary technical studies and will coordinate the activities of the Committees. At the same time, it will provide clerical services for conferences and meetings of the Central Banks System. It will be governed by this Agreement and the regulations and decisions adopted by the Central American Monetary Council.

Headquarters of the Executive Secretariat will be rotated every two years among the Central Banks, as determined by the Monetary Council.

ARTICLE XI

The officers and employees of the Executive Secretariat must be nationals of the Central American countries.

ARTICLE XII

The Central American Monetary Council will determine the provision of funds for operating expenses of the organs of the System.

ARTICLE XIII

Through the Executive Secretary, the different organs of the System will operate in close collaboration and coordination of activities with other organizations and entities of the Central American Economic Integration Program.

ARTICLE XIV

This Agreement will have indefinite life, and may be amended by unanimous decision of the Central Banks.

ARTICLE XV

This Agreement will be subject to ratification by the Central Banks. Such ratification will be notified by each Central Bank to the Permanent Secretariat of the General Treaty of Central American Economic Integration, and simultaneously to the other Central Banks of Central America.

ARTICLE XVI

This Agreement will become effective eight days after the date of notification of the ratification. It will be binding only on those Central Banks which have ratified it.

ARTICLE XVII

The Committee on Exchange and Clearing Policies mentioned in Article VII, will act as a consultative body for exchange policy, and when this Agreement has been ratified by the five Central Banks, will also be responsible for the execution of the Central American Clearing House Agreement, as well as for any other clearing or credit arrangements that may be signed with countries outside the area.

ARTICLE XVIII

The Central American Monetary Council will hold its first meeting within sixty days from the date when this Agreement becomes effective. It will be convened by the Central Reserve Bank of El Salvador, in consultation with the other Central Banks.

Measures will be taken at such meeting with regard to the organization and establishment of the different organs of the System.

In witness whereof, the representatives of the Central Banks of Central America, have signed this instrument in five copies, in the city of San Salvador, Republic of El Salvador, on February 25, 1964.

For COSTA RICA: Carlos M. Escalante,
President, Board of Directors, Central Bank of Costa Rica

Alvaro Castro Jenkins,
Manager, Central Bank of Costa Rica

For EL SALVADOR: Francisco Aquino h.,
President, Central Reserve Bank of El Salvador

For GUATEMALA: Gustavo Herrera Orellana,
President a. i., Bank of Guatemala

Francisco Fernández Rivas
Manager, Bank of Guatemala

For HONDURAS: Roberto Ramírez,
President, Central Bank of Honduras

For NICARAGUA: Francisco J. Laínez,
President, Central Bank of Nicaragua

VII. General Regulations of the Committees and of the Executive Secretariat of the Agreement for Establishment of the Central American Monetary Union

Approved by the Monetary Council in San José on May 19, 1964

TITLE ONE

THE COMMITTEES

Chapter I — GENERAL PROVISIONS

Article 1.— The Committees created by the Agreement for Establishment of the Central American Monetary Union, are consultative and executive bodies of the Central American Central Banks System. As such, these Committees will act on request of the Monetary Council or the Executive Secretary, in accordance with these Regulations.

Article 2.— The duties of the Committees consist of preparing proposals for the Monetary Council regarding the adoption of measures designed to realize progressively the objectives of the Agreement for Establishment of the Central American Monetary Union.

Article 3.— Each Committee will consist of one member and one alternate member appointed by each Central Bank, for indefinite periods. Appointments will be notified through letter addressed to the Executive Secretary, with copies to the other Central Banks. The alternate member will act only in the absence of the member.

Article 4.— The Central Banks will endeavor to nominate officers for the different Committees whose activities are related to their duties in the respective Committee.

Article 5.— Every two years, the Committees will elect a Chairman from among their respective members, who will discharge the following duties:

a) to call and preside at meetings of the Committee;

b) to direct, supervise, and coordinate the activities of the Committee; and

c) to represent the Committee in its external relations.

In case of absence of the Chairman, the respective alternate member will act as substitute.

The chairmanship of each Committee will be discharged in rotation by the members of every Central Bank, and the respective elections will endeavor to achieve geographical distribution, in order that all Central Banks may share in the responsibilities assigned to the Committees.

A project undertaken by a Central Bank must be completed by this bank, even when the chairmanship has passed to another bank.

Article 6.— The Committees will hold all meetings necessary to complete their work programs, meeting at least once a year. Meetings will be called by the Chairman of the Committee whenever he deems convenient, or at the request of the Executive Secretary or of any of its Members.

Article 7.— The attendance of three members of a Committee (members or alternate members) will constitute a quorum. However, the Chairman will endeavor to obtain the participation of all members, in order to expedite proceedings related to resolutions adopted by the Committee.

Article 8.— All Committee decisions will be taken through a majority of at least three votes.

All dissenting votes and the opinions of the minority shall be recorded in the minutes.

Article 9.— The Executive Secretary or his representative will participate in the meetings of the Committees, without vote. Advisers appointed by the Central Banks, will participate in the same manner.

Article 10.— The Executive Secretary and the Chairman of the respective Committee will be in charge of the organization of the meetings, and will coordinate the preparation of work presented to the Committees.

Article 11. — At the end of each meeting, a minute will be prepared summing up the discussions and recommendations. The original of this minute will be signed by all attendant members, remaining in the custody of the Executive Secretary, who will send a copy to the President of the Central American Monetary Council, and to all other Members.

Article 12. — Copies of all documents received or dispatched by every Committee will be sent to the Executive Secretary.

Chapter II — SPECIAL PROVISIONS

COMMITTEE ON MONETARY POLICY

Article 13. — The Committee on Monetary Policy will study and recommend measures considered appropriate to coordinate and harmonize the monetary and financial policies of the Central Banks.

Article 14. — In fulfillment of its objectives, this Committee will discharge the following functions and duties:

a) development of a permanent system of exchange of information and of periodic consultation on the decisions, activities, and instruments of monetary and financial policies;

b) elaboration of standard statistics to permit greater comparability and facility of analysis in the fields of national income, money and banking, balance of payments, public finances, foreign trade and prices;

c) study of the institutional structure, stage of development, and nature of the instruments of monetary, exchange, and credit policies;

d) preparation of studies designed to harmonize the monetary policies of the Central Banks with the fiscal policies of the Central American countries; and

e) all other functions and duties recommended by the Central American Monetary Council.

COMMITTEE ON FINANCIAL OPERATIONS

Article 15. — The Committee on Financial Operations will study and recommend measures considered appropriate to facilitate financial operations among the Central Banks of Central America, and among these and other institutions.

Article 16. — To fulfill its objectives this Committee will have as functions and duties the study and recommendation of:

a) measures tending to accelerate the expansion and development of the market for securities in the Central American countries;

b) mechanisms to facilitate financing of trade in the area, including the development of a market for bank acceptances;

c) common policies to finance Central American exports to the rest of the world;

d) concrete measures to develop mechanisms designed to facilitate mutual financial assistance among the Central Banks;

e) measures to improve and standardize the practices of financial operations of the Central Banks;

f) measures to standardize the practices and uses of credit instruments, in order to facilitate their negotiation in the Central American countries;

g) joint action of the Central Banks to gain better terms in negotiations undertaken with foreign financial institutions.

The Committee on Financial Operations will fulfill all other functions and duties assigned by the Central American Monetary Council.

COMMITTEE ON LEGAL STUDIES

Article 17. — The Committee on Legal Studies will consider the legal aspects and institutions related to the execution of the Agreement for Establishment of the Central American Monetary Union.

Article 18.— In fulfillment of its objectives, this Committee will discharge the following functions and duties:

a) to prepare studies and suggest measures to bring up to date and co-ordinate the monetary, banking, and financial legislation of the Central American countries;

b) to keep under permanent analysis the legal instruments of the Central American Monetary Union, and to propose the necessary agreements or arrangements to achieve their improvement;

c) to give an opinion on matters of a legal character having to do with the Central American Monetary Council, the Executive Secretary and the other Committees; and

d) all other functions and duties assigned by the Central American Monetary Council.

COMMITTEE ON EXCHANGE AND CLEARING POLICIES

Article 19.— The Committee on Exchange and Clearing Policies will study and recommend measures designed to coordinate the exchange practices and to improve the system of Central American multilateral clearings.

Article 20.— This Committee will have the following functions and duties:

a) to propose to the Central American Monetary Council regulations to govern the operations of the Central American Clearing House;

b) to give an opinion on matters relative to the interpretation of the Agreement, of the Clearing House and its regulations;

c) to appoint annually an Auditing Commission in rotation among the Member Banks, designed to review the operations of the Clearing House, and to consider the reports of such Commission;

d) to submit to the Central American Monetary Council, together with its opinion, the annual report and financial statements of the Clearing House presented by the Executive Secretary;

e) to determine the means of fixing the uniform rate of interest mentioned in the Clearing House Agreement;

f) to propose to the Monetary Council the method of settlement of Clearing House operations in case of its dissolution;

g) to propose to the Executive Secretariat measures tending to prevent exchange speculation;

h) to propose to the Executive Secretariat measures tending to stimulate and extend the use of the Central American currencies in payments within the area, including the execution of information programs;

i) to direct and supervise, within the specific regulations approved by the Monetary Council, the activities concerning the multilateral clearing agreements signed among the Central American Central Banks and other foreign financial institutions; and

j) all other functions and duties assigned by the Monetary Council.

TITLE TWO

EXECUTIVE SECRETARIAT

Article 21. — The Executive Secretariat will be in charge of a Secretary, a Central American officer elected by the Monetary Council for a term of two years, who may be reelected. The Secretary must be a person of well-known professional competence in matters of central banking and international finance.

The Executive Secretary will be responsible exclusively to the Central American Monetary Council. He will act as a full time officer and may not accept another post, except when expressly authorized by the Monetary Council.

Article 22. — The Executive Secretary will be responsible for the execution of resolutions of the Central American Monetary Council; for the coordination of activities of the different Committees of the Central American Central Banks System; and of all studies necessary to achieve the objectives mentioned in the Agreement for Establishment of the Central American Monetary Union.

Article 23.— The Executive Secretary will have the following functions and duties:

a) to prepare all technical studies necessary in order to carry out the work programs approved by the Central American Monetary Council;

b) to organize the meetings of the Central American Monetary Council, to participate in these, and to maintain records and minutes;

c) to manage the Central American Clearing House;

d) to coordinate the activities of the different Committees; to submit to the Central American Monetary Council drafts of work programs; and to recommend respective priorities;

e) to collaborate with the different Committee Chairmen regarding the organization of their meetings; to participate or be represented in such meetings; and to communicate to the Central American Monetary Council all recommendations adopted;

f) to give technical and material assistance in the preparation of work agreed by the Committees;

g) to maintain a record and file of the technical studies, as well as of the statistical data published by the Central American Central Banks;

h) to prepare and publish regularly a statistical bulletin containing information of the Central American countries, of a monetary, exchange, credit, and fiscal character;

i) to submit to the Regular Meeting of the Central American Monetary Council an annual report, which will be distributed among the Members of the Council at least 15 days before the meeting; and

j) to perform all other functions specially recommended by the Central American Monetary Council.

Article 24.— The Executive Secretary will be directly responsible for the operation of the Executive Secretariat; he will appoint and remove the personnel, and submit a budget annually to the Central American Monetary Council.

Article 25.— The officers and employees of the Executive Secretariat must be nationals of Central American countries.

TITLE THREE

MISCELLANEOUS PROVISIONS

Article 26.— All technical assistance programs concerning the achievement of objectives of the Agreement for Establishment of the Central American Monetary Union, require the approval of the Central American Monetary Council, which will act on these after considering opinions submitted by the respective Committee.

Article 27.— The Central American Monetary Council will decide on matters not considered in these Regulations.

Article 28.— These Regulations become effective on May 21, 1964.

San José, May 19, 1964.

APPENDIX B.

Central American Common Market Statistical Tables

Central American Common Market Statistical Tables

Statistical data from different sources do not always coincide. The following tables, therefore, show some variation in data quoted from different sources. The Central American countries are endeavoring to introduce greater uniformity and consistency in their statistics.

GENERAL

1. Area and Population.
2. Health and Education.
3. Gross National Product.
4. Economic Growth Rates.

TRADE

5. External Trade.
6. External Trade: Costa Rica.
7. External Trade: El Salvador.
8. External Trade: Guatemala.
9. External Trade: Honduras.
10. External Trade: Nicaragua.
11. Intra-Regional Trade.

MONEY AND BALANCE OF PAYMENTS

FISCAL

Table I

CENTRAL AMERICAN COMMON MARKET

AREA AND POPULATION

	Area (Sq. Mi.)	Persons Per Sq. Mi. 1964	Population (Thousands) 1960	1961	1962	1963	1964	Annual Growth (Percent)
Costa Rica	19,695	71.1	1,165	1,216	1,270	1,325	1,400	4.7
El Salvador	8,260	336.9	2,436	2,517	2,600	2,697	2,783	3.4
Guatemala	42,000	101.9	3,765	3,886	3,980	4,099	4,278	3.1
Honduras	43,277	48.5	1,837	1,896	1,959	2,024	2,100	3.4
Nicaragua	49,000	32.4	1,408	1,450	1,494	1,540	1,586	2.9
Central America	162,232	74.9	10,611	10,965	11,303	11,685	12,147	3.4

Source: Area figures for El Salvador and Nicaragua are based on revised estimates of the national cartographic agencies. Population figures are largely estimates of national planning agencies or national census offices.

Table 2

CENTRAL AMERICAN COMMON MARKET

HEALTH AND EDUCATION

	Unit	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
Literacy	Percent	88	48	30	47	40
Life Expectancy	Years	60	51	44	45	50
Doctors	Persons Per Doctor	2580	5010	4130	4600	2830
Infant Mortality	1000 Live Births	66	71	86	44	54

Source: U. S. Agency for International Development, Division of Statistics and Reports.

Table 3

CENTRAL AMERICAN COMMON MARKET

GROSS NATIONAL PRODUCT

(millions of U.S. dollars; Per Capita in dollars)

	1960		1961		1962		1963		1964	
	Total	Per Capita	Total	Per Capita	Total	Per Capita	Total	Per Capita	Total	Per Capita
Costa Rica	418.0	358	424.8	349	469.3	369	494.7	373	n.a.	n.a.
El Salvador	561.3	230	605.0	240	659.0	253	718.0	266	764.7	275
Guatemala	1,047.9	278	1,088.1	280	1,115.6	280	1,205.3	294	1,240.0	290
Honduras	377.8	206	394.6	210	421.5	215	434.8	217	n.a.	n.a.
Nicaragua	327.7	233	357.0	246	397.0	266	429.1	279	463.4	292
Central America	2,732.7	258	2,869.5	262	3,062.4	271	3,281.9	281	n.a.	n.a.

Source: Figures are from Central Banks, National Planning Offices and USAID Program Offices.

Table 4 GENERAL

CENTRAL AMERICAN COMMON MARKET

ECONOMIC GROWTH RATES 1/

(percent)

	Gross National Product			Consumption						Investment					
				Private		Public		Total		Private		Public		Gross	
	1950-64	1960-64	1963 over 1962	1950-64	1960-64	1950-64	1960-64	1950-64	1960-64	1950-64	1960-64	1950-64	1960-64	1950-64	1960-64
Costa Rica	6.2	3.9	5.5	5.1	3.0	9.2	8.8	5.6	3.2	5.8	2.2	15.0	14.5	7.6	5.1
El Salvador	5.3	8.0	8.9	5.1	6.7	5.3	5.6	5.1	6.6	6.1	4.4	9.5	14.4	7.0	7.1
Guatemala	4.0	4.4	8.0	3.7	4.1	3.9	0.6	3.8	3.8	4.8	7.1	5.1	10.5	4.9	7.[illegible]
Honduras	3.7	4.0	3.1	4.4	4.6	5.5	3.9	4.5	4.6	4.5	3.4	9.3	17.0	4.4	6.9
Nicaragua	5.9	7.6	8.1	6.3	8.3	4.4	5.0	6.1	7.9	7.1	4.4	12.4	17.3	8.4	7.7
Central America	4.8	5.4	7.1	4.6	5.1	5.5	3.3	4.7	4.9	5.1	4.6	8.9	14.0	6.0	7.0

1/ Figures for 1960-64 partly estimated.

Source: Joint Planning Mission for Central America.
Central banks.
US/AID Program Offices.

Table 5

CENTRAL AMERICAN COMMON MARKET

EXTERNAL TRADE

(millions of U.S. dollars)

	Total Trade			Intra-Regional Trade 1/ (cif)	Trade With Rest of World		Trade Balance	
	Exports (fob)	Imports (fob)	Imports (cif)		Exports (fob)	Imports (cif)	Exports and Imports (both fob) 2/	Exports fob Imports cif
1958	449.0	463.6	501.0	20.5	428.4	480.5	-14.6	-52.0
1959	431.4	435.6	464.8	28.0	403.4	436.8	-4.2	-33.4
1960	438.3	479.7	513.7	32.7	405.6	481.0	-41.4	-75.4
1961	449.6	447.8	495.8	36.8	412.8	458.9	1.8	-46.2
1962	510.6	501.9	548.4	50.4	460.2	498.0	8.7	-37.8
1963	584.6	594.1	647.1	66.2	518.5	580.8	-9.5	-62.5

1/ Exports of one country are imports of another; therefore only a single figure for trade within the region is shown. The figure could be considered either intra-regional exports or imports.

2/ Both exports and imports of El Salvador are cif.

Source: IMF, International Financial Statistics.
SIECA.

Table 6

CENTRAL AMERICAN COMMON MARKET

EXTERNAL TRADE: COSTA RICA

(millions of U.S. dollars)

	Total Trade		Intra-Regional Trade		Trade With Rest of World		Trade Balance	
	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports and Imports (both fob)	Exports fob Imports cif
1958	91.9	99.3	1.4	1.0	90.5	98.3	4.2	-7.4
1959	76.7	102.7	1.6	3.9	75.1	98.8	-17.5	-26.0
1960	85.8	109.9	1.9	3.5	83.9	106.4	-11.9	-24.1
1961	84.2	107.1	2.0	4.0	82.2	103.1	-12.7	-22.9
1962	93.0	113.4	1.9	3.5	91.1	109.9	-9.9	-20.4
1963	95.0	123.9	4.3	4.0	90.7	119.9	-15.9	-28.9

Principal Exports 1960-62 as percent of total: Coffee 53; Bananas 24.

Source: IMF, International Financial Statistics.
SIECA.

Table 7

CENTRAL AMERICAN COMMON MARKET

EXTERNAL TRADE: EL SALVADOR

(millions of U.S. dollars)

	Total Trade		Intra-Regional Trade		Trade With Rest of World		Trade Balance	
	Exports (fob)	Imports (cif)	Exports (fob)	Imporrs (cif)	Exports (fob)	Imports (cif)	Exports and Imports (both cif)	Exports fob Imports cif
1958	116.0	108.0	7.1	10.5	108.9	97.5	9.7	8.0
1959	113.4	99.5	8.6	12.5	104.8	87.0	12.1	13.9
1960	116.8	122.4	12.7	13.5	104.1	108.9	-20.0	-5.6
1961	119.1	108.7	14.4	14.7	104.7	94.0	9.8	10.4
1962	136.3	124.8	18.3	22.1	118.0	102.7	14.0	11.5
1963	153.8	151.8	23.9	27.9	129.9	123.9	-2.0	2.0

Principal Exparts 1960-62 as percent of total: Coffee 57; Cotton 19.

Source: IMF, International Financial Statistics.
SIECA.

Table 8

CENTRAL AMERICAN COMMON MARKET

EXTERNAL TRADE: GUATEMALA

(millions of U.S. dollars)

	Total Trade		Intra-Regional Trade		Trade With Rest of World		Trade Balance	
	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports and Imports (both fob)	Exports fob Imports cif
1958	107.5	149.7	3.7	2.3	103.8	147.4	-30.2	-42.2
1959	107.6	134.0	5.1	3.1	102.5	130.9	-20.6	-26.4
1960	116.6	137.9	7.3	7.6	109.3	130.3	-8.9	-21.3
1961	112.7	133.6	10.3	8.9	102.4	124.7	-6.6	-20.9
1962	117.4	133.0	13.0	11.2	104.4	121.8	-3.9	-15.6
1963	154.0	165.5	20.7	14.2	133.5	151.3	3.7	-11.5

Principal Exports 1960-62 as percent of total: Coffee 62; Bananas 13.

Source: IMF, International Financial Statistics.
SIECA.

Table 9

CENTRAL AMERICAN COMMON MARKET

EXTERNAL TRADE: HONDURAS

(millions of U.S. dollars)

	Total Trade		Intra-Regional Trade		Trade With Rest of World		Trade Balance	
	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports and Imports (both fob)	Exports fob Imports cif
1958	69.8	66.1	7.4	4.0	62.4	62.1	3.8	3.7
1959	68.7	61.8	8.8	4.5	59.9	57.3	6.9	6.9
1960	63.1	71.8	7.4	5.3	55.7	66.5	-1.1	-8.7
1961	73.0	72.0	8.3	6.4	64.7	65.6	7.8	1.0
1962	81.5	79.8	13.8	8.9	67.7	70.9	4.1	1.7
1963	82.2	95.1	13.2	13.3	69.0	81.8	-4.5	-12.9

Principal Exports 1960-62 as percent of total: Bananas 45; Coffee 15; Wood 10.

Source: IMF, International Financial Statistics.
SIECA.

Table 10

CENTRAL AMERICAN COMMON MARKET

EXTERNAL TRADE: NICARAGUA

(millions of U.S. dollars)

	Total Trade		Intra-Regional Trade		Trade With Rest of World		Trade Balance	
	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports (fob)	Imports (cif)	Exports and Imports (both fob)	Exports fob Imports cif
1958	63.8	77.9	1.0	2.7	62.8	75.2	-2.1	-14.1
1959	65.0	66.8	3.9	4.0	61.1	62.8	14.9	-1.8
1960	56.0	71.7	3.4	2.8	52.6	68.9	.5	-15.7
1961	60.6	74.4	1.8	2.9	58.8	71.5	3.5	-13.8
1962	82.4	97.4	3.4	4.7	79.0	92.7	4.4	-15.0
1963	99.6	110.8	4.0	6.9	95.6	103.9	9.2	-11.2

Principal Exports 1960-62 as percent of total: Cotton 33; Coffee 26.

Source: IMF, International Financial Statistics.
SIECA.

Table II

CENTRAL AMERICAN COMMON MARKET

INTRA-REGIONAL TRADE

(millions of U.S. dollars)

Importing Country	Exporting Country											
	Costa Rica		El Salvador		Guatemala		Honduras		Nicaragua		Central America	
	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963
Costa Rica	-	-	1.2	2.1	0.1	0.4	0.1	0.3	0.5	1.5	1.9	4.3
El Salvador	2.0	2.3	-	-	6.1	11.5	5.7	7.9	3.1	2.2	16.9	23.9
Guatemala	0.3	0.6	8.5	12.7	-	-	3.0	4.6	1.6	2.9	13.4	20.8
Honduras	0.2	0.2	10.4	10.8	1.5	2.0	-	-	0.2	0.2	12.3	13.2
Nicaragua	0.8	0.9	2.0	2.4	0.2	0.2	0.1	0.5	-	-	3.1	4.0
Central America	3.3	4.0	22.1	28.0	7.9	14.1	8.9	13.3	5.4	6.8	47.6 1/	66.2

1/ Figures compiled by SIECA show total intra-regional trade for 1962 as amounting to $50.4 million.

Source: Joint Planning Mission for Central America.

Table 12

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES

(millions of dollars; central banks, end of period)

	Gold	Foreign Exchange	IMF Gold Tranche Position	Total Reserves 1/
1958	62.2	58.6	6.4	127.2
1959	56.6	56.3	7.9	120.8
1960	56.2	61.5	8.0	125.8
1961	44.1	63.5	3.8	111.4
1962	44.1	68.0	3.2	115.3
1963	43.3	114.2	5.0	162.4
1964 (Aug.)	43.2	138.0	8.8	190.0

1/ These figures in some cases differ slightly from IMF figures; Total Reserves are the sum of the other items.

Source: IMF, International Financial Statistics.

Table 13

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES: COSTA RICA

(millions of dollars; central bank, end of period)

	Gold	Foreign Exchange	IMF Gold Tranche Position	Total Reserves
1958	2.11	17.41	1.25	20.77
1959	2.11	11.22	1.25	14.58
1960	2.11	9.96	1.38	13.45
1961	2.11	4.17	-	6.28
1962	2.11	10.11	.40	12.62
1963	2.11	13.53	-	15.64
1964 (Aug.)	2.11	14.30	-	16.41

Source: IMF, International Financial Statistics.

Table 14

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES: EL SALVADOR

(millions of dollars; central bank, end of period)

	Gold	Foreign Exchange	IMF Gold Tranche Position	Total Reserves
1958	31.4	6.4	1.9	39.7
1959	30.4	7.3	-	37.7
1960	30.0	3.1	-	33.1
1961	17.9	6.6	-	24.5
1962	17.8	5.4	2.8	26.0
1963	17.8	21.3	5.0	44.1
1964 (Sept.)	17.8	27.2	5.0	50.0

Source: IMF, International Financial Statistics.

Table 15

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES: GUATEMALA

(millions of dollars; central bank, end of period)

	Gold	Foreign Exchange	IMF Gold Tranche Position	Total Reserves
1958	27.3	20.6	1.3	49.2
1959	23.6	16.7	3.8	44.1
1960	23.6	26.7	3.8	54.1
1961	23.6	27.4	3.8	54.8
1962	23.5	22.7	-	46.2
1963	23.1	35.4	-	58.5
1964 (Aug.)	23.0	40.6	3.8	67.4

Source: IMF, International Financial Statistics.

Table 16

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES: HONDURAS

(millions of dollars; central bank, end of period)

	Gold	Foreign Exchange	IMF Gold Tranche Position	Total Reserves
1958	.11	7.90	1.88	9.89
1959	.11	12.31	-	12.42
1960	.11	13.20	-	13.31
1961	.11	12.22	-	12.33
1962	.11	13.19	-	13.30
1963	.11	12.33	-	12.44
1964 (Sept.)	.11	19.61	-	19.72

Source: IMF, International Financial Statistics.

Table 17

CENTRAL AMERICAN COMMON MARKET

EXTERNAL RESERVES: NICARAGUA

(millions of dollars; central bank, end of period)

	Gold	Convertible Currencies	IMF Gold Tranche Position	Total Reserves
1958	1.30	6.26	-	7.56
1959	.36	8.75	2.81	11.92
1960	.35	8.57	2.81	11.73
1961	.40	13.14	-	13.54
1962	.62	16.61	-	17.23
1963	.23	31.59	-	31.82
1964 (Oct.)	.16	36.34	-	36.50

Source: IMF, International Financial Statistics.

Table 18

CENTRAL AMERICAN COMMON MARKET

MONEY SUPPLY

(millions of currency units; end of December)

	Currency	1958		1959		1960		1961		1962		1963		1964	
		Money	Index	Money	Index	Money	Index	Money	Index	Money	Index	Money	Index	Money	Index
Costa Rica	Colon	398.5	100	426.8	107	433.0	109	421.9	106	480.0	120	535.3	134	534.5	134 (Aug.)
El Salvador	Colon	212.6	100	216.4	102	203.3	96	194.8	92	195.0	92	234.3	110	213.1	101 (Sept.)
Guatemala	Quetzal	104.5	100	107.5	103	102.1	98	103.1	99	107.2	103	119.0	114	120.0	115 (Sept.)
Honduras	Lempira	62.5	100	64.4	103	63.4	101	63.9	102	72.6	116	80.5	129	88.9	142 (Sept.)
Nicaragua	Córdoba	251.6	100	253.2	101	263.9	105	272.7	108	352.9	140	397.4	158	410.8	163 (Oct.)

Source; IMF, International Financial Statistics.

Table 19

CENTRAL AMERICAN COMMON MARKET

COST OF LIVING

(1958 = 100)

	1958	1959	1960	1961	1962	1963	1964
Costa Rica	100	100	101	104	107	111	113(Sept.)
El Salvador	100	99	99	97	97	98	100(Oct.)
Guatemala	100	100	98	98	100	100	99(Oct.)
Honduras	100	101	99	101	102	105	110(Nov.)
Nicaragua	100	97	95	95	96	96	100(Oct.)

Source: International Monetary Fund.

Table 20

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS

NOTE: This Table appears on page 18 of the text, and is not repeated here.

Table 21

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS: COSTA RICA

(millions of dollars; minus sign indicates debit)

	1960	1961	1962	1963
Goods and Services				
Trade Balance (f.o.b.)	-11.9	-12.7	-9.9	-15.9
Freight and Merchandise Insurance	-9.8	-9.7	-8.6	-10.0
Investment Income	-3.7	-2.7	-8.2	-9.4
Other Services	5.3	5.4	4.6	5.9
Total	-20.1	-19.7	-22.1	-29.4
Transfers				
Private	.8	1.9	2.0	5.4
Government	3.3	5.2	2.6	
Capital n.i.e.				
Private	4.7	4.5	19.3	25.1
Government	.7	-.7	6.1	
Commercial Banks				
Assets	-1.6	-.5	1.1	-.4
Liabilities	1.3	-.4	3.8	.8
Monetary Authorities				
Net IMF Position	-.1	5.1	-4.1	9.6
Monetary Gold	-	-	-	-
Foreign Exchange	1.3	5.8	-5.9	-3.4
Other Liabilities	10.8	.6	3.3	-4.5
Total	12.0	11.5	-6.7	-1.7
Net Errors and Omissions	-1.1	-1.8	-6.1	-3.2

Source: IMF, International Financial Statistics.

Table 22

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS: EL SALVADOR

(millions of dollars; minus sign indicates debit)

	1960	1961	1962	1963
Goods and Services				
Trade Balance (c.i.f.)	-20.0	9.8	14.0	-2.0
Travel	-4.0	-4.9	-6.0	-6.5
Other Services	-4.7	-7.3	-9.8	-8.8
Total	-28.7	-2.4	-1.7	-17.3
Transfers				
Private	.2	.6	1.7	3.7
Government	.8	1.6	2.5	3.5
Capital n.i.e.				
Private	9.6	13.0	12.0	19.7
Government	-1.5	-1.6	-2.4	1.2
Commercial Banks				
Assets	5.3	1.2	-.1	-.5
Liabilities	3.1	.3	3.0	2.4
Monetary Authorities				
Net IMF Position	5.8	-3.2	-8.0	-
Monetary Gold	.4	12.1	.1	-
Foreign Exchange	4.2	-3.9	1.2	-15.9
Liab. to Other International Inst.	.3	1.0	.5	-.4
Other Liabilities	2.8	-.7	-1.5	4.6
Total	13.5	5.3	-7.7	-11.7
Net Errors and Omissions	-2.5	-18.0	-7.4	-.9

Source: IMF, International Financial Statistics.

Table 23

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS: GUATEMALA

(millions of dollars; minus sign indicates debit)

	1960	1961	1962	1963
Goods and Services				
Trade Balance (f.o.b.)	-8.9	-6.6	-3.9	3.7
Freight and Merchandise Insurance	-11.8	-12.1	-12.3	-14.2
Investment Income	-5.0	-6.7	-8.6	-4.7
Other Services	.1	1.2	1.8	-5.3
Total	-25.6	-24.2	-23.0	-20.5
Transfers				
Private	.1	1.7	-.6	-.1
Government	14.5	14.6	7.9	2.4
Capital n.i.e.				
Private	19.4	13.2	16.4	19.0
Government	3.4	-3.5	-4.9	13.3
Commercial Banks				
Assets	-	-1.2	.4	.4
Liabilities	1.8	1.9	.6	3.3
Monetary Authorities				
Net IMF Position	-	-	5.0	-1.1
Monetary Gold	-	-	.1	.4
Foreign Exchange	-10.0	-.7	4.7	-12.7
Other Liabilities	2.6	3.6	4.4	2.5
Total	-7.4	2.9	14.2	-10.9
Net Errors and Omissions	-6.2	-5.4	-11.0	-6.9

Source: IMF, International Financial Statistics.

Table 24

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS: HONDURAS

(millions of dollars; minus sign indicates debit)

	1960	1961	1962	1963
Goods and Services				
Trade Balance (f.o.b.)	-1.1	7.8	4.1	-4.5
Freight and Merchandise Insurance	-7.6	-7.0	-8.1	-8.5
Investment Income	8.5	-1.0	-4.3	-1.6
Other Services	3.3	.8	1.8	-.3
Total	3.1	.6	-6.5	-14.3
Transfers				
Private	-.6	-.5	-.5	-.7
Government	3.2	5.0	2.9	3.4
Capital n.i.e.				
Private	-7.9	-6.4	.1	11.7
Government	2.3	-.9	1.5	1.9
Deposit Money Banks				
Assets	-.2	.1	-.2	.2
Liabilities	.9	-.5	.6	2.3
Monetary Authorities				
Net IMF Position	.5	1.3	1.3	-1.0
Monetary Gold	-	-	-	-
Foreign Exchange	-.9	.7	1.0	.9
Other Liabilities	.3	1.8	-.3	-.1
Total	-.1	3.8	2.0	-.2
Net Errors and Omissions	-.7	-1.1	-.1	-4.2

Source: IMF, International Financial Statistics.

Table 25

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS: NICARAGUA

(millions of dollars; minus sign indicates debit)

	1960	1961	1962	1963
Goods and Services				
Exports-Imports (f.o.b.)	.5	3.5	4.4	9.2
Nonmonetary Gold	7.0	7.7	7.3	6.4
Services	-17.9	-18.5	-25.0	-24.6
Total	-10.4	-7.3	-13.3	-9.0
Transfers				
Private	.2	.3	.5	1.6
Government	2.7	3.5	3.0	2.5
Capital n.i.e.				
Private	5.6	1.8	16.7	14.2
Government	-1.6	-3.9	1.9	1.1
Commercial Banks				
Assets	-.2	.1	-.6	-.3
Liabilities	-.1	-1.5	.1	4.0
Monetary Authorities				
Net IMF Position	-	4.5	-	6.0
Monetary Gold	-.1	.2	-.2	.4
Other Claims	.2	-4.6	-3.7	-14.9
Other Liabilities	4.4	6.7	-.1	-2.5
Total	4.5	6.8	-4.0	-11.0
Net Errors and Omissions	-.7	.2	-4.3	-3.1

Source: IMF, International Financial Statistics.

Table 26

CENTRAL AMERICAN COMMON MARKET

BALANCE OF PAYMENTS PROJECTIONS, EXCLUDING INTRA-REGIONAL TRADE 1/

(Millions of 1962 Central American Pesos)

	1965	1966	1967	1968	1969	1974
CURRENT ACCOUNT						
Exports of Goods & Services	665.7	688.4	733.0	791.9	846.4	1192.6
Imports of Goods & Services	784.4	791.0	792.7	820.4	848.7	972.5
Commercial Balance	-118.7	-102.6	-59.7	-28.5	-2.3	220.1
Adjustment for Terms of Trade	10.0	-5.5	-14.7	-25.3	-29.8	-109.7
Adjusted Commercial Balance	-108.7	-103.1	-74.4	-53.8	-32.1	110.4
Net Factor Payments	-34.4	-45.3	-57.7	-68.5	-82.5	-149.2
Net Transfers	13.5	14.7	14.3	14.6	14.4	16.9
Balance of Current Acc't	-129.6	-138.7	-117.8	-107.7	-100.2	-21.9
CAPITAL ACCOUNT						
Capital Receipts	249.8	262.3	255.6	263.9	270.5	255.8
Credits						
Public	117.3	129.2	117.6	123.2	142.0	122.4
Private	75.8	79.9	84.3	88.9	93.7	115.1
Foreign Investments	55.7	49.4	49.7	48.9	34.8	18.3
Transfers	1.0	4.0	4.0	2.9	-	-
Capital Payments	120.2	123.6	137.8	156.2	170.3	233.9
Amortization of Loans						
Public	33.1	29.6	25.4	28.7	29.3	57.6
Private	60.1	63.4	75.1	86.0	90.2	110.8
Amortization Investments	16.6	23.7	30.3	33.5	40.3	56.9
Other Payments	1.0	1.2	1.2	1.4	1.4	1.5
Increase in Reserves	9.4	5.7	5.8	6.6	9.1	7.1
Balance on Capital Account	129.6	138.7	117.8	107.7	100.2	21.9

1/ These projections of the Joint Planning Mission are targets and not forecasts.

Source: Joint Planning Mission for Central America.

Table 27

CENTRAL AMERICAN COMMON MARKET

CENTRAL GOVERNMENT REVENUES AND EXPENDITURES 1/

(thousands of U.S. dollars)

	1960			1961			1962			1963			1964		
	Revenues	Expenditures	Surplus or Deficit	Revenues	Expenditures	Surplus or Deficit	Revenues	Expenditures	Surplus or Deficit	Revenues	Expenditures	Surplus or Deficit	Revenues	Expenditures	Surplus or Deficit
Costa Rica	52,780	56,556	-3,776	47,800	61,248	-13,448	58,060	66,255	-8,195	58,000	71,789	-13,789	-	-	-
El Salvador	68,394	69,704	-1,310	64,450	72,993	-8,543	68,671	72,008	-3,337	72,479	74,501	-2,022	84,082	88,915	-4,833
Guatemala	87,881	123,426	-35,545	87,243	111,067	-23,824	85,362	118,424	-33,062	82,620	109,856	-27,236	98,134	110,107	-11,973
Honduras	34,900	38,050	-3,150	35,330	38,300	-2,970	36,765	39,600	-2,835	38,812	41,600	-2,788	-	-	-
Nicaragua	34,129	37,500	-3,371	35,474	36,200	-726	37,124	39,300	-2,176	43,927	43,900	27	52,573	45,492	7,081
Central America	278,084	325,236	-47,152	270,297	319,808	-49,511	285,982	335,587	-49,605	295,838	341,646	-45,808	-	-	-

1/ Figures do not include receipts and expenditures, frequently large, of the autonomous government agencies nor of the social security agencies. In the case of Guatemala and Nicaragua the fiscal years ending June 30 are shown under that year. Beginning in January 1965 all countries' accounts are being kept on a calendar year basis.

Source: Annual reports of Ministries of Finance and of Controllers General.

Table 28

FISCAL

CENTRAL AMERICAN COMMON MARKET

CENTRAL GOVERNMENT TAX REVENUES 1/

(thousands of U.S. dollars; per capita in dollars)

	1960			1961			1962			1963			1964		
	Tax Revenue	Percent of GNP	Tax Burden Per Capita	Tax Revenue	Percent of GNP	Tax Burden Per Capita	Tax Revenue	Percent of GNP	Tax Burden Per Capita	Tax Revenue	Percent of GNP	Tax Burden Per Capita	Tax Revenue	Percent of GNP	Tax Burden Per Capita
Costa Rica	39,950	9.7	[illegible]4.29	37,350	8.8	30.71	45,600	9.7	35.90	50,190	10.1	37.87	-	-	-
El Salvador	61,855	11.0	25.39	56,580	9.4	22.48	60,790	9.2	23.38	65,614	9.1	24.49	79,822	10.4	28.68
Guatemala	79,096	7.5	21.00	78,410	7.2	20.18	76,890	6.9	19.32	78,030	6.5	19.04	88,173	7.1	20.61
Honduras	33,734	8.9	18.36	33,311	8.4	17.57	34,456	8.2	17.59	36,351	8.3	17.96	-	-	-
Nicaragua	30,732	9.4	21.57	32,375	9.1	22.32	34,280	8.6	22.94	39,187	9.1	25.44	47,608	10.3	30.01

1/ Figures include customs receipts but not social security taxes. In the case of Guatemala and Nicaragua the fiscal years ending June 30 are shown under that year. Beginning in January 1965 all countries' accounts are being kept on a calendar year basis.

Source: Annual Reports of Ministries of Finance and of Controllers General.

Table 29

CENTRAL AMERICAN COMMON MARKET

IMPORT DUTIES

	1960		1961		1962		1963		1964	
	Percentage of Import Value	Percentage of Government Revenues	Percentage of Import Value	Percentage of Government Revenues	Percentage of Import Value	Percentage of Government Revenues	Percentage of Import Value	Percentage of Government Revenues	Percentage of Import Value	Percentage of Government Revenues
Costa Rica	26.1	54.5	24.5	54.8	26.0	50.6	25.4	54.4	-	-
El Salvador	22.8	40.8	21.3	35.9	19.2	34.9	15.9	33.2	14.3	30.7
Guatemala	20.3	31.8	21.1	32.2	19.8	30.8	15.3	30.7	17.1	27.6
Honduras	24.5	48.3	23.8	48.5	22.0	47.3	18.8	46.3	-	-
Nicaragua	21.7	45.5	21.9	45.8	17.4	45.8	17.8	44.9	17.6	36.4

Source: Annual Reports of Ministries of Finance and Controllers General.

Table 30

CENTRAL AMERICAN COMMON MARKET

INCOME TAXES

	Percent of Total Revenue	Burden Per Capita (dollar equivalent)	Maximum Rate Percent 1/	Basic Personal Exemption (family of four)	Percent of Population Paying
		1960			
Costa Rica	10.7	4.85	30 (30)	1,500	1.6
El Salvador	8.0	2.26	44 (15)	2,800	0.4
Guatemala 2/	7.3	1.70	43 (43)	-	-
Honduras	14.9	2.83	30 (30)	1,500	0.8
Nicaragua	9.8	2.38	30 (30)	3,142	0.2
		1961			
Costa Rica	12.4	4.89	30 (30)	1,500	1.4
El Salvador	9.7	2.49	76.5 (20)	2,800	0.4
Guatemala 2/	7.2	1.61	43 (43)	-	-
Honduras	13.4	2.51	30 (30)	1,500	0.8
Nicaragua	8.0	1.96	30 (30)	3,142	0.2
		1962			
Costa Rica	17.8	8.23	30 (30)	1,500	1.8
El Salvador	13.7	3.62	76.5 (20)	2,800	0.4
Guatemala 2/	7.6	1.62	43 (43)	-	-
Honduras	12.5	2.35	30 (30)	1,500	0.8
Nicaragua	7.6	1.90	30 (30)	3,142	0.2

Continued on next page.

Table 30 (cont'd)

CENTRAL AMERICAN COMMON MARKET

INCOME TAXES

	Percent of Total Revenue	Burden Per Capita (dollar equivalent)	Maximum Rate Percent 1/	Basic Personal Exemption (family of four)	Percent of Population Paying
			1963		
Costa Rica	12.7	5.58	30 (30)	1,500	1.8
El Salvador	13.7	3.67	76.5 (20)	2,800	0.4
Guatemala 2/	9.1	1.83	43 (43)	-	-
Honduras	14.6	2.79	30 (30)	1,500	0.7
Nicaragua	8.1	2.31	30 (30)	3,142	0.2
			1964		
Costa Rica	-	-	30 (30)	1,500	-
El Salvador	16.9	5.10	60 (28)	2,800	-
Guatemala 2/	8.0	1.84	48 (48)	3,200	0.3
Honduras	-	-	30 (30)	1,500	-
Nicaragua	7.0	2.58	30 (30)	3,142	-

1/ Rate in parenthesis applies to business.
2/ Guatemala had no personal income tax until July 1, 1963. As of that date a single income tax was made applicable to persons and businesses; the previous business profits tax was repealed effective July 1, 1964.

Source: Annual Reports of Ministries of Finance and of Controllers General.

Table 31

CENTRAL AMERICAN COMMON MARKET

NATIONAL DEBT

(millions of U.S. dollars; end of year)

	1961				1962				1963			
	Internal	External	Total	Percent of GNP	Internal	External	Total	Percent of GNP	Internal	External	Total	Percent of GNP
Costa Rica	47.4	27.5	74.9	17.5	60.8	33.8	94.6	20.1	61.6	38.1	99.2	22.6
El Salvador	26.5	31.2	57.7	2.4	33.0	35.0	68.0	2.2	31.8	42.5	74.3	2.7
Guatemala 1/	49.2	25.5	74.7	6.9	62.4	22.3	84.7	7.3	62.6	29.1	91.7	7.6
Honduras	19.6	16.0	35.6	8.4	22.0	23.1	45.1	8.9	24.0	33.4	57.4	9.3
Nicaragua 1/	7.7	3.9	11.6	3.6	16.5	6.0	22.5	5.6	17.1	7.1	24.2	5.6
Central America	150.4	104.1	254.5	8.9	194.7	120.2	314.9	10.3	197.1	150.2	346.8	10.6

1/ June 30 data; totals are therefore approximate.

Source: Official reports of respective governments.