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**Struggle  
Against  
Dependence**

**Nontraditional Export Growth in  
Central America and the Caribbean**

edited by  
*Eva Paus*

*Westview Press*

Series in Political Economy  
and Economic Development in Latin America

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# *Struggle Against Dependence*

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***Westview Press***

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*Eva Paus*

*Economic Development in  
Central America and the Caribbean:  
The Role of Nontraditional Exports*

*Eva Paus*

Today, most of the countries in Central America and the Caribbean share a common set of problems and structural characteristics that are the result of a similar history of economic development. The specific articulation of these characteristics and the severity of the economic problems in any particular country, of course, vary. In general, the economies of the region are small, agricultural export economies. Sugar, bananas, coffee, and meat have been the main export items for most countries, but natural resource exports—bauxite and oil—have played a key role for a few Caribbean countries.

The formation of the Central American and Caribbean common markets in the 1960s and 1970s provided a major impetus for import substituting industrialization on a national and regional scale. Nonetheless, overall economic growth has continued to be dependent largely on the foreign exchange earnings of the traditional export sector. The persistent dominance of export agriculture has had very definite implications for the development process and possibilities in the region. The entrenched power of the landed oligarchy has not been challenged successfully. Consequently, the industrial sectors have been put at a disadvantage in the competition for scarce resources, and the governments increasingly have been unable to cover their growing expenditures by higher tax revenues. The highly unequal distribution of land, the expansion of export agriculture at the expense of domestic food production, and the lack of linkages between the export sector and the rest of the economy have effectively excluded a large number of people from economic growth. In addition to maintaining and fostering widespread poverty, the exclusionary nature of the development process has had a restrictive

impact on industrial growth by reducing the already small national markets even further.<sup>1</sup>

Since the late 1970s the countries of the region have faced a growing economic crisis for external as well as internal reasons. The heavy dependence on traditional exports has meant that declining commodity prices, global stagnation, and growing trade protectionism have severely limited the growth of export earnings. At the same time, the collapse of regional markets, the low level of industrialization, the incipient nature of nontraditional exports, and various micro- and macroeconomic barriers to nontraditional export growth have meant that no immediate alternatives have been available to counteract the decline in growth. Furthermore, the contraction in export earnings occurred at the very time when rising trade deficits and debt repayment obligations made earning more foreign exchange increasingly necessary. The need for economic adjustment due to the balance of payments constraints has imposed stringent limitations on the space for economic action. Concomitantly the growing demands for voice and participation by the majority, excluded from the fruits of growth in the past and seriously affected by the economic crisis in the present, require increased space for political and economic action.

What makes the present crisis so severe and persistent in these countries is the coincidence of a cyclical downturn and the culmination of growing internal structural problems. The necessity to undertake restructuring policies in a recessionary economic environment exacerbates the difficulty of embarking on a renewed growth path. There is clearly no quick fix or single solution for the economic problems of these countries, since their resolution demands the enormously difficult task of devising a development and policy program that incorporates and skillfully combines adjustment, restructuring, and redistribution. The magnitude of the crisis and the multiplicity of underlying causes mandate that any proposed way out addresses the full complexity of this problem. Any such proposal has to be formulated on a country level reflecting specific national characteristics. Generally, however, all solutions must address the issues of poverty, the agrarian structure, the stagnation in regional integration, and the dependence on a few traditional export products.

The contributors to this book focus on traditional export dependence and the need to develop a viable alternative by fostering nontraditional export growth. A broad reading of the economic crisis in the Caribbean Basin region precludes the conclusion that successful nontraditional export growth is the panacea for all the economic problems. However, the region's economic prospects will depend to a significant extent on the development and growth of the nontraditional export sector. Nontra-

ditional export growth will be an important element of any economic solution.

The small size of the countries in Central America and the Caribbean, their low level of economic development, and the foreign debt burden mean that foreign trade will have to continue to play an important role in the future growth and development of these economies. In the wake of the international debt crisis, borrowing abroad to alleviate the government budget and/or balance of payments constraint is no longer an option. On the contrary, present payment obligations on previously accumulated foreign debt are precisely one reason why foreign exchange earnings have to be increased. In addition, and in the long run more importantly, economic growth requires rising export revenues to enhance import capacity and thus to allow for the needed supply of imported inputs.

Under these circumstances the promotion of nontraditional exports gains particular importance, since the long-term prospects for the demand and prices for many traditional export commodities are limited. In contrast to traditional exports, nontraditional exports tend to be less susceptible to drastic swings in world demand and price. Thus, they provide a more stable source for the generation of foreign exchange, as well as of income and employment. Furthermore, depending on the nature of the products involved, nontraditional export growth can make an important contribution to sectoral integration and structural economic change. When nontraditional export activities are concentrated in new agricultural and fishery products, they will generate positive income and employment effects, but they will have only a limited impact on structural transformation. When, on the other hand, nontraditional exports take the form of processed agricultural commodities and labor-intensive manufactured goods, they will stimulate economic change, directly and indirectly, through the creation of backward and forward linkages. Furthermore, increased manufactured exports help to bring about productivity-induced growth, not only through larger economies of scale but also through a challenge-response mechanism, where the competitive pressures on the world market force producers to become more efficient and adopt new technologies.

A more detailed discussion of some of the theoretical and policy questions regarding nontraditional exports must take place within the wider context of a comprehensive development strategy. Since the promotion of nontraditional exports is but one element, albeit a crucial one, in an overall development project, successful nontraditional export growth is not independent of progress in overcoming other structural barriers. A solution to the problems of poverty, agrarian structure, and regional integration will further the prospects for nontraditional exports. By the

same token, the persistence of these structural barriers will limit the potential contribution of nontraditional export growth to renewed economic growth and development. In the discussion below, I examine these interdependencies in more detail focusing on the relationship between nontraditional exports and political stability on the one hand and regional integration on the other.

### *Nontraditional Exports and Political Stability*

Continuous growth of nontraditional exports requires an overall economic environment and policy framework conducive to growth. Export-promoting policies have to be located in the larger macroeconomic context, since they can be rendered ineffective if counteracted by other policy measures. Thus, nontraditional exports have to be firmly embedded in a development project that supports them and provides continuity. Consistency in and continuity of an export-linked development strategy are vital, because economic decision makers need reasonable assurance that key parameters will not be changed over the period of their planning horizon. Time and continuity are prerequisites for investment and export marketing decisions and for effective technological learning to translate into productivity increases.

While the requisite policies to promote nontraditional exports will be discussed in detail later in this chapter, the focus here rests on the growth-conducive economic environment and the continuity in policy-making as preconditions for successful nontraditional export growth. Both factors are intimately linked to political stability, the very condition that is missing in several Caribbean Basin countries today. The increasing political instability in recent years in a number of these countries is directly related to the exclusionary nature of past economic growth and development. Table 1.1 shows the extremely uneven distribution of income in Central American countries that prevailed around 1980. The Economic Commission for Latin America and the Caribbean concluded that

although 30 years [late 1940s–late 1970s] of rapid and sustained economic expansion have gone by, over half the inhabitants of Central America—and three-quarters in rural areas—do not have sufficient income to cover the essential needs as regards food, housing, clothing and basic services.<sup>2</sup>

As long as the grave problem of poverty is not addressed, it is difficult to see how in the face of widespread discontent political stability will be attained in those countries where it is absent today and how it will

Table 1.1  
Central America: Structure of Income Distribution and Levels of Per Capita Income, by Countries, Circa 1980 (1970 dollars)

Strata	<u>Costa Rica</u>		<u>El Salvador</u>		<u>Guatemala</u>		<u>Honduras</u>		<u>Nicaragua</u>	
	Per- cent age	Aver- age Income								
Poorest										
20%	4.0	176.7	2.0	46.5	5.3	111.0	4.3	80.7	3.0	61.9
30%										
below the mean	17.0	500.8	10.0	155.1	14.5	202.7	12.7	140.0	13.0	178.2
30%										
above the mean	30.0	883.0	22.0	341.2	26.1	364.3	23.7	254.6	26.0	350.2
Richest										
20%	49.0	1,165.2	66.0	1,535.5	54.1	1,133.6	59.3	796.3	58.0	1,199.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), "Central America: Bases for a Reactivation and Development Policy," *CEPAL Review* No. 28 (April 1986), Table 4, p. 19.

be maintained in those countries where the disenfranchised are starting to articulate their frustrations and claims.

While poverty is determined by a number of factors, the agrarian question is clearly at the root of the problem. Scholars who have done extensive work on this issue point to the conflict between export agriculture and stagnant smallholder food production as the central contradiction of the Caribbean Basin food system.<sup>3</sup> The headline of a recent *New York Times* article, "The Hunger for Land Feeds the Crisis in Central America," highlights one of the main issues in this context, the unequal distribution of land.<sup>4</sup> The problem goes beyond the land tenure system though, as succinctly summarized by Barraclough and Marchetti:

Land tenure arrangements, usurious credit systems, exploitative marketing structures, low levels in infrastructure and technical assistance, and pricing policies all work against the smallholder and, together, ensure that peasant producers cannot accumulate.<sup>5</sup>

The small producers' inability to accumulate has meant that domestic food production has been unable to match the growing internal demand for food. As a result, food imports have increased, imposing an additional strain on the balance of payments. For Central America as a whole, the share of net cereal imports in apparent consumption rose from 14.9

Table 1.2  
 Net Cereal Imports Central American and Caribbean Countries, 1965-1980  
 ('000 metric tons)

	1965		1970		1978		1980	
	Net Cereal Imports	% Share in App. Cons.*	Net Cereal Imports	% Share in App. Cons.*	Net Cereal Imports	% Share in App. Cons.*	Net Cereal Imports	% Share in App. Cons.*
Central America	290	14.6	433	14.9	760	18.8	957	22.9
Caribbean	2,026	69.5	1,724	57.8	2,881	67.6	3,201	68.5
Total Region	2,316	42.1	2,157	36.6	3,641	43.9	4,158	47.0

\*apparent consumption = production + net imports.

Source: Solon Barraclough and Peter Marchetti, "Agrarian Transformation and Food Security in the Caribbean Basin," In: George Irvin and Xabier Gorostiaga (eds.), Towards an Alternative for Central America and the Caribbean (London, Boston, Sidney: George Allen and Unwin, 1985) Table 4, p. 162.

percent in 1970 to 22.9 percent in 1980. The figures for the Caribbean are 57.8 and 68.5 percent, respectively (see Table 1.2). The more disaggregated data on a country level in Table 1.3 confirm the general trend of increasing food import dependence, notwithstanding a few exceptions, most notably Costa Rica and Trinidad and Tobago.

A solution to the agrarian problem in many countries of the region would benefit their development prospects enormously. It would alleviate poverty and thus contribute to political stability, increase the effective size of internal markets, promote stronger linkages between the agricultural and industrial sectors, and, last but not least, reduce food import dependence and save foreign exchange. The extent to which an agrarian transformation can and will be tackled depends, however, on the economic and political reality in any individual country. Under the present circumstances of economic stagnation and adjustment, government resources for more investment, credit, technical advice, and so on, are clearly limited, even if spending priorities are changed. With respect to the political realm, the Nicaraguan economist Xabier Gorostiaga argues that "economic and political transformation cannot be carried out *for* the majority unless it is part of a project implemented *by* the majority."<sup>6</sup> Thus, to a certain extent, political change has to go hand in hand with economic change, and it remains to be seen whether and how governments can emerge that have sufficient political support for implementing a new development project.

Table 1.3  
Cereal Imports as a Share of Apparent Consumption, Selected Central American  
and Caribbean Countries, 1965-1980 ('000 metric tons)

Countries	1965	1970	1978	1980
Guatemala	11.4	12.2	16.1	17.2
El Salvador	17.3	9.9	23.7	12.2
Honduras	----	12.8	17.9	27.9
Nicaragua	6.7	10.5	18.5	24.7
Costa Rica	35.9	44.7	20.2	27.8
Panama	16.3	19.4	15.4	33.5
Subtotal	12.7	14.9	18.8	22.9
Jamaica	96.1	98.3	97.7	98.7
Dominican Republic	34.9	17.2	38.9	43.0
Cuba	81.9	71.7	77.2	76.7
Grenada	100.0	96.6	85.7	83.3
Haiti	11.8	10.3	22.5	32.0
Trinidad & Tobago	92.0	93.1	88.6	78.4
Subtotal	68.5	57.8	67.6	68.5

Source: Solon Barraclough and Peter Marchetti, "Agrarian Transformation and Food Security in the Caribbean Basin," In: George Irvin and Xabier Gorostiaga (eds.), Towards an Alternative for Central America and the Caribbean (London, Boston, Sidney: George Allen and Unwin, 1985) Table 4, p. 162.

### *Nontraditional Exports and Regional Integration*

One of the reasons for the profound present economic crisis in the Caribbean Basin region has been the decline in intraregional trade. That decline clearly increases the importance of nontraditional export growth as a new and more stable source of economic growth. It would be fallacious, though, to advocate the promotion of nontraditional exports as an alternative to and substitute for a revitalization of regional integration. From an individual country's perspective many of the exports to other common market members can certainly be considered nontraditional exports. Yet it might be more appropriate to regard them as a reflection of import substitution on a regional scale due to the common external tariff offering protection from the rest of the world. To the extent that intraregional exports are viewed as extended import substitution, economic policies should foster nontraditional export growth *and* import substitution, and *not* substitute the former for the latter.

The Central American Common Market (CACM) was formed in the early 1960s by Honduras, Costa Rica, El Salvador, Nicaragua, and Guatemala.<sup>7</sup> It established a free trade area with a common external

Table 1.4  
CACM and CARICOM: Intra-Regional Trade (Exports, million dollars)

CACM*		CARICOM	
1966	170.3	1977	269.2
1970	286.3	1978	285.2
1974	532.5	1979	358.5
1978	862.6	1980	500.0
1979	891.7	1981	430.4
1980	1,129.2	1984	405.2
1981	924.9	1985	407.8
1982	764.9		
1983	733.2		
1984	720.7		
1985	547.6		
1986 <sup>e</sup>	421.0		

\* including Honduras

<sup>e</sup> estimated

Source: Inter-American Development Bank (IDB), Economic and Social Progress in Latin America (Washington, D.C.: IDB) various years: 1984 Report, Tables I-2, I-3, p. 57; 1986 Report, Table V-3, p. 65; 1987 Report, Table V-4, p. 75, and Table V-5, p. 79.

tariff. Within five years, 95 percent of the tariff items were traded duty-free within the area. CACM's positive contribution to industrialization and economic growth in the member countries has been widely analyzed in the literature.<sup>8</sup> Honduras withdrew from the CACM in 1971, but it continued to enjoy preferential market access to the other countries through bilateral trade agreements, which it signed with Guatemala, Nicaragua, and Costa Rica during the 1970s and with El Salvador after 1981.<sup>9</sup> The Caribbean Common Market (CARICOM) was established in 1973 in the Treaty of Chaguaramas, which was signed by twelve countries.<sup>10</sup> Due to the small size of the member countries the possibilities for economies of scale were more limited, making integration more difficult. Nevertheless, there is ample documentation of increased regional trade following the formation of CARICOM.<sup>11</sup>

The proximate cause for the decline in regional trade and integration in the early 1980s (see Table 1.4) was the decline in hard currency earnings and the inability to accommodate growing payment arrears among member countries. This crisis in the common markets, however, has many dimensions. With respect to the CACM, Bulmer-Thomas summarizes:

On the technical front, the mechanisms for settling imbalances between member countries have proved inadequate; on the institutional side, national

governments have been unwilling to delegate any part of their sovereignty to supra-national organizations; in the field of economics, CACM has run into problems created by the structure of protection and income inequality, while at the political level the pressure groups to revive and restructure the CACM have not come into existence.<sup>12</sup>

There are two main reasons why a revitalization of regional markets is an important complement to the promotion of nontraditional exports. First, from a long-term and dynamic perspective, more self-sustained development on a national and regional level requires further import substitution. Extended import substitution reduces import dependence and creates dynamic comparative advantages that go beyond products intensive in land and/or unskilled labor. Regional free trade areas help to overcome the limitations of small internal markets. They also provide the necessary space for the growth of infant industries so that they can become competitive on the international market. Second, in view of the present state of the international economy, it is not advisable to rely solely on nontraditional exports as the source of economic growth. Declining growth rates in the industrialized countries<sup>13</sup> have been accompanied in recent years by a surge in protectionism and a proliferation of nontariff barriers to trade.<sup>14</sup> This trend cannot be ignored, and it can obviously jeopardize the success of nontraditional export growth of Caribbean Basin countries in specific product areas, if not overall.

While some scholars point to the increased protectionism in the developed countries to conclude a priori that nontraditional export growth is doomed to failure, others ignore the protectionist climate and continue to hail export diversification as the only alternative to import substitution. Both extremes have to be rejected. Since stable and growing hard currency earnings are needed for future growth, discarding nontraditional export promotion is clearly not an option. Yet a realistic perception of the international trade environment as well as of the functional relationship between import substitution and nontraditional export promotion requires that the right balance is struck between the two.

### *Determinants of Nontraditional Export Growth*

The previous discussion has argued for the importance of pursuing nontraditional export growth in the context of a comprehensive development strategy. Political stability is necessary to establish the potential for macroeconomic stability and continuity in policy-making. It is also true that an enlarged regional market via agrarian transformation and a revitalization of regional integration contributes to economic growth through increased internal demand. Furthermore, a larger market allows

for a learning and development period during which the competitiveness of products steadily approaches world prices and quality standards.

Against this background the analysis focuses now more specifically on nontraditional exports themselves and the determinants of their growth. One of the foremost prerequisites for successful nontraditional export growth is a neutral foreign exchange regime, that is, one that guarantees equal profitability for exporting and selling in the domestic market. The importance of a foreign trade regime that does not discriminate against exports has been widely documented in the literature on nontraditional exports in developing countries.<sup>15</sup> Since an overvalued exchange rate often is the by-product of an extended period of import substitution, the elimination of the implicit antiexport bias requires the adoption of a more realistic exchange rate. A devaluation of the domestic currency in real terms will normally have to be accompanied by export subsidies to compensate, *inter alia*, for the persisting import tariffs and for the initial difficulties of entering new markets.

In many developing countries, exporters of nontraditional commodities are provided with a variety of incentives, which include tax credits, full or partial rebates of different duties, and access to financing at preferential interest rates. In an international trade environment where protectionism is on the rise, it is important to realize, however, that some types of incentives are clearly preferable to others because of their acceptability under the provisions of the General Agreement on Tariffs and Trade (GATT). The GATT rules sanction the use of drawback schemes (duty-free imported inputs used for the production of exportables) and the reimbursement of indirect taxes. While an extensive use of export subsidies not permissible under GATT does not automatically evoke retaliatory action on the part of the importing country, it does provide an easy target for countervailing duties when exporters successfully penetrate an industrialized country's market. On the other hand, Balassa et al. list a range of policies that governments could adopt without running the risk of retaliation:

Export promotion measures such as establishing information services, financing trade fairs, and granting favorable tax treatment for marketing expenditures may be undertaken without risk of retaliation. Furthermore, export credits and guarantees can be provided within the limits acceptable under international rules. Export credits may take the form of prefinancing, the discounting of export bills, medium-term loans for the sale of capital goods and long-term credits for investment in export activities.<sup>16</sup>

While all of these policies are clearly helpful in the promotion of nontraditional exports, they do not add up to the same immediate subsidy

that would be provided, for example, by a tax credit equivalent to 15 percent of the export value. If, however, governments for this reason insist on using direct export subsidies, they become more vulnerable to protectionist backlashes in the form of countervailing duties.

If nontraditional export promotion is taken seriously, the overall policy framework has to be consistent so that the positive impact of appropriate foreign trade policies is not counteracted by stifling policies in other areas. Some scholars in the neoclassical tradition define the optimal overall setting as one where the state plays a minimal role in the economy and where price distortions (i.e., the deviation of prices from their "true" market values) are eliminated.<sup>17</sup> In an attempt to account for differences in output performance among developing countries in the 1970s, Agarwala calculated a composite price distortion index for 31 developing countries and found a statistically significant *negative* correlation between the distortion index and the output growth rate.<sup>18</sup> His analysis and its implications have since been seriously and convincingly challenged by several economists.<sup>19</sup> In addition, two widely acclaimed success stories among developing countries during the 1970s, South Korea and Brazil, do not conform with Agarwala's results in his own analysis.

It would be absurd to argue that price signals are not important for the allocation of resources in a market economy. Nevertheless, it is not the mere existence of price distortions but rather the compatibility or incompatibility of the overall structure of prices that determines whether they foster or hinder economic growth.<sup>20</sup> When the criteria for evaluating growth performance go beyond short-term efficiency to include dynamic gains and distributional aspects, the cumulative effect of a consistent set of price distortions can be more conducive to growth than the complete absence of distortions. The foreign exchange constraint that many developing countries eventually encountered under import substitution was clearly due in significant measure to an overvalued exchange rate, and successful export promotion presupposes the elimination of an antiexport bias. But remedying other price distortions in accordance with development priorities is quite different from demanding the abolition of all distortions. As Fishlow points out: "The correctness of prices must be decided by reference to a comprehensive development strategy, and not independently of it."<sup>21</sup>

By the same token, it is not fruitful to advocate or reject a role for the state in the development process on an abstract level without considering the specific economic situation of a particular country. The nature and extent of a government's presence in the economy have to be contingent upon the demands of the development project. It is important, however, that government operations, like those by private agents, meet certain criteria of efficiency.

In addition to the macroeconomic policy framework, which establishes the general context in which exporters of nontraditional commodities operate, there are a number of important microeconomic determinants of nontraditional export growth. They include factors that affect the cost and quality of exports, like utility costs and availability, transportational infrastructure, quality control standards, and management capabilities. Bureaucratic efficiency that minimizes paperwork, red tape, delays in port, and so on, and intimate knowledge of export markets in terms of regulatory and desired product specifications are additional prerequisites for nontraditional export growth. The fact that most of these determinants do not lend themselves to easy quantification on an aggregate level or to a formal incorporation into more rigorous models does not diminish their importance.<sup>22</sup> In the absence of actual fieldwork, however, it is difficult to gauge their impact in any particular country.

### *Nontraditional Export Growth in the Caribbean Basin Region: Common Experiences and Lessons*

The chapters in this book analyze the experience, determinants, and prospects of the nontraditional export sector in selected Central American and Caribbean countries. Most chapters focus on individual countries: Costa Rica, the Dominican Republic, Guatemala, Panama, Belize, Honduras, Jamaica, and Cuba. Except in the case of Cuba, the country studies are based on fieldwork that the authors conducted as consultants for the U.S. Agency for International Development.<sup>23</sup> Firsthand knowledge of these countries adds an invaluable dimension to these analyses, since it allows the authors to assess the importance of those nontraditional export determinants escaping aggregate quantification.<sup>24</sup> In contrast to export diversification in intraregional trade, nontraditional exports to the rest of the world did not receive serious attention and promotion in most countries until the onset of the economic crisis in the late 1970s. The success of and barriers to nontraditional export growth in the countries under consideration reveal a number of differences as well as shared experiences.

The differences are symptomatic of the specific characteristics of the individual countries. They are also reflected in the regression analyses of the determinants of nontraditional export growth in each country. The econometric results show such a large variation among countries in the statistical significance of the export-determining variables that no general patterns can be discerned.<sup>25</sup> In addition to the country specificity in nontraditional export experience, the chapters also highlight common obstacles confronting these countries in their export diversification efforts,

obstacles that stem from the ramifications of the longtime dominance of traditional exports. The main results with respect to common characteristics and obstacles are summarized below. The Cuban experience is discussed separately afterward.

The consensus is that nontraditional exports have considerable potential in all countries due to the availability of cheap labor, propitious climatic conditions, and favorable geographic location. To date, this potential is far from realization, however. To promote nontraditional exports, all governments—to varying degrees—have adopted policy measures that focus primarily on the foreign trade regime: devaluation or the adoption of a crawling peg and various export incentives schemes. As a result, the overvaluation of the exchange rates has been reduced, and it seems even eliminated in some cases. Between 1980 and 1985, the share of nontraditional exports in total exports increased in all countries except Honduras. In 1985, it ranged from a low of 14 percent in Honduras to a high of 61 percent in Belize. In most countries, though, the growing relative importance of nontraditional exports in the beginning of the 1980s was due to the fact that traditional exports declined even faster than nontraditional exports. In many instances, it was not until 1983–1984 that both export groups recuperated.

With the decline in intraregional trade, the principal new market for nontraditional exporters was the United States. In each country nontraditional exporters have encountered problems in penetrating U.S. markets in particular product categories. The main reasons were lack of familiarity with U.S. policies and procedures as well as trade protectionism in a few instances. In addition, the lack of information about marketing techniques and possibilities turned out to be a handicap for many actual or potential exporters. The importance of infrastructural inadequacies varies, ranging from minor nuisances to considerable obstacles, especially with respect to port and air cargo facilities. In many cases, infrastructural impediments resulted not only in high transportation costs but also in irregular delivery performance. Speedy delivery was a problem not only on the export side, however. Many nontraditional exporters complained about excessively long holdups of imported inputs in customs. Customs delays seem to be symptomatic of more widespread bureaucratic inefficiencies, also reflected, for example, in the processing time and occasional arbitrariness in the provision of export incentives. The unavailability and/or high cost of investment and working capital has been a key problem in nearly all countries. Equally pervasive impediments are the absence of middle-level management and adequate quality control systems.

While some of the problems outlined above are a reflection of “growing pains” that will disappear during the course of the learning process of

those engaged in the production of nontraditional exports, many will not be solved merely by the passing of time. Successful nontraditional export growth in the future is contingent on three main conditions. First, structural economic imbalances need to be removed. The importance of pursuing nontraditional export growth in the context of a comprehensive development project is clearly reflected in the country analyses. Second, policy-induced impediments to exporting have to be dismantled as quickly and as thoroughly as possible. And third, the United States has to improve the region's access to its markets.

The third condition is highlighted in the analysis of the Caribbean Basin Initiative (CBI) in the last chapter of this book. The Reagan administration launched CBI in the early 1980s to provide, among other things, duty-free access to U.S. markets for many exports from the Caribbean Basin region. This signaled recognition of the importance of the nontraditional export sector and offered the hope that CBI policies would contribute substantially to development and growth. However, CBI's contribution to nontraditional export growth has been rather modest to this point, and it will not improve unless its nature and conceptualization are changed.

Finally, the chapter on Cuba warrants some special commentary. Cuba's socialist path, its exclusion from preferential access programs to the U.S. market, and its participation in the Soviet trading bloc set it apart from the other countries of the Central American region studied in this book. Yet Cuba clearly shares with its neighbors the need and desire to diversify its exports. Although the barriers to nontraditional export growth are not highlighted as extensively in the essay on Cuba, it appears that Cuba shares many of the same microeconomic impediments to nontraditional export growth with other countries in the Caribbean Basin. Cuba has two advantages, however, over the other Caribbean Basin countries in this area. First, Cuba does not face the problems of political instability and widespread poverty due to its successful policies in the fields of nutrition, health, and education after the revolution. Second, if the Cuban government makes a serious commitment to nontraditional export promotion, it can be a project that has the full backing of the state in terms of resources and required policy changes. This support, moreover, is likely to endure the complete gestation period of new projects. In contrast, the relatively weak bourgeoisie in most of the other countries will not be able to command the same commitments from their respective governments in the absence of structural political and economic changes.

Taken together, the chapters in this book call for a substantial strengthening of government policies to promote nontraditional exports. Such efforts have to address the immediate and direct obstacles to

nontraditional export growth in each individual country. They cannot be successful, however, in the absence of a solution to the issues of poverty, the agrarian structure, and the stagnation in regional integration. The potential for nontraditional export growth and its contribution to more self-sustained development in the Caribbean Basin countries will not be realized unless nontraditional export production is conceived as an integral part of a new comprehensive development strategy.

### Notes

1. For a much more detailed discussion, see for example John Weeks, "An Interpretation of the Central American Crisis," *Latin American Research Review* 21(1986)3: 31-53; Economic Commission for Latin America and the Caribbean (ECLAC), "Central America: Bases for a Reactivation and Development Policy," *CEPAL Review* (April 1986) No. 28: 11-48; Solon Barraclough and Peter Marchetti, "Agrarian Transformation and Food Security in the Caribbean Basin," in *Towards an Alternative for Central America and the Caribbean*, ed. George Irvin and Xabier Gorostiaga (London, Boston, Sidney: George Allen and Unwin, 1985), 154-193.

2. ECLAC, "Central America," 20.

3. See for example Weeks, "An Interpretation of the Central American Crisis"; Barraclough and Marchetti, "Agrarian Transformation"; and Victor Bulmer-Thomas, "The Crisis in Central America: Economic Roots and Historical Dimensions," *The World Today* 39(September 1983): 328-335.

4. *New York Times*, September 7, 1985, A1 and A5.

5. Barraclough and Marchetti, "Agrarian Transformation," 156.

6. Xabier Gorostiaga, "Towards Alternative Policies for the Region," in *Towards an Alternative*, Irvin and Gorostiaga, 28.

7. Guatemala, El Salvador, Honduras, and Nicaragua signed the General Treaty for Central American Integration in December 1960. Costa Rica joined in 1963.

8. See for example William R. Cline and Enrique Delgado, ed., *Economic Integration in Central America* (Washington, D.C.: Brookings Institution, 1978); and Inter-American Development Bank (IDB), *Economic and Social Progress in Latin America*, Economic Integration, 1984 Report (Washington, D.C.: IDB, 1984).

9. For an excellent analysis of the reasons for Honduras' withdrawal from the CACM, see Robert G. Williams, "The Central American Common Market: A Case Study of the State and Peripheral Capitalism," *SECOLAS Annals* 13(March 1982): 71-82.

10. The signatory countries were Antigua, Barbados, Guyana, Trinidad and Tobago, Dominica, Grenada, Saint Kitts-Nevis-Anguilla, Saint Lucia, Saint Vincent and the Grenadines, Jamaica, Montserrat, and Belize.

11. See for example Karl M. Bennett, "An Evaluation of the CARICOM to Intra-Regional Caribbean Trade," *Social and Economic Studies* 3(March 1982): 74-88; and Marion Williams, "An Analysis of Regional Trade and Payments

Arrangements in CARICOM, 1971–1983," *Social and Economic Studies* 34(December 1985)4: 3–33.

12. Victor Bulmer-Thomas, "Central American Integration, Trade Diversification, and the World Market," in *Towards an Alternative*, Irvin and Gorostiaga, 206.

13. The average annual rate of GDP growth in the industrialized countries declined from 4.9 percent during the 1960–1973 period to 2.8 percent in the period 1973–1979 to 1.9 percent in the 1980–1985 period.

14. See for example the annual *World Development Report* by the World Bank for the last few years.

15. See for example William G. Tyler, "The Anti-Export Bias in Commercial Policies and Export Performance: Some Evidence from the Recent Brazilian Experience," *Weltwirtschaftliches Archiv* 119(1983)1: 97–109; Eva Paus, "La dinámica de acumulación y empleo en la industria textil colombiana: De la promoción de exportaciones al contrabando," *Coyuntura Económica* (Bogotá) 12(December 1982)4: 129–175; Yung Yang, "A Comparative Analysis of the Determinants of Non-Traditional Exports for Brazil, Israel, and South Korea," *Weltwirtschaftliches Archiv* 117(1983)3: 497–511; Juan José Echavarría, "La evolución de las exportaciones colombianas y sus determinantes, un análisis empírico," *Revista del Banco de la República* (Colombia) (August 1980): 1118–1134; Bela Balassa, "Export Incentives and Export Performance in Developing Countries: A Comparative Analysis," *Weltwirtschaftliches Archiv* 114(1978): 35–61; Jürgen Donges and James Riedel, "The Expansion of Manufactured Exports in Developing Countries: An Empirical Assessment of Supply and Demand Issues," *Weltwirtschaftliches Archiv* 113(1977)1: 59–85.

16. Bela Balassa, Gerardo M. Bueno, Pedro-Pablo Kuczynski, and Mario Henrique Simonsen, *Toward Renewed Growth in Latin America* (Washington, D.C.: Institute for International Economics, 1986), 85.

17. This school of thought has come to be labeled by some economists as the New Orthodoxy. Sachs summarizes the policies advocated by the New Orthodoxy of outward orientation as trade liberalization, real exchange rate depreciation, emphasis on the private sector as the source of growth, and a general reduction in all forms of market intervention by the government. Jeffrey D. Sachs, "Trade and Exchange Rate Policies in Growth-Oriented Adjustment Programs," National Bureau of Economic Research, Working Paper No. 226, Cambridge, April 1987.

18. For a definition and measurement of the different components of this distortion index, see Ramgopal Agarwala, "Price Distortions and Growth," *Finance and Development* (March 1984): 33–37.

19. See for example Albert Fishlow, "The State of Latin American Economics," in *Economic and Social Progress in Latin America*, IDB (Washington, D.C.: IDB, 1985), 123–148; and Colin Bradford, "Trade and Structural Change: NICs and Next-Tier NICs as Transitional Economies," *World Development* 15(1987): 299–316.

20. For an excellent discussion of this issue see Howard Pack and Larry E. Westphal, "Industrial Strategy and Technological Change," *Journal of Development Economics* 22(1986): 87–128.

21. Fishlow, "Latin American Economics," 141.

22. One of the first authors to highlight the importance of these microeconomic factors to the success of nontraditional export growth is David Morawetz, "Why the Emperor's Clothes Are not Made in Colombia," World Bank Working Paper No. 368 (Washington, D.C.: 1980).

23. The original mission reports are presented in SRI International, *Nontraditional Export Expansion in the Central American Region* (Washington, D.C.: March 1987).

24. The definition of nontraditional exports varies slightly from one country to the next due to the differing export histories of some products. In the country chapters, the dollar sign (\$) is used to denote U.S. dollars, unless indicated otherwise.

25. The econometric work focused on three key explanatory variables: international demand, domestic capacity, and competitiveness. U.S. imports from the respective country were taken as an indicator of international demand; domestic credit, domestic capital formation, and the value of imports were used to indicate production capacity; and competitiveness was proxied by the real exchange rate and nontraditional exports lagged by one year (as an indicator of market knowledge). Wages, productivity, and effective rates of protection could not be used as proxies because of the unavailability of reliable time series data. The results are presented in SRI International, *Nontraditional Export Expansion*.

# **Problems and Prospects of Export Diversification: Case Studies**

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## *Costa Rica*

*Andrew Zimbalist*

### *Background*

Costa Rica's long-standing democratic tradition, diminutive armed forces, reputed political neutrality, relative domestic tranquility, significant social achievements, high living standard for the region, and exquisite natural beauty all contribute to the frequently heard attribution that Costa Rica is the Switzerland of Central America. These laudable characteristics notwithstanding, Costa Rica shares much more with its neighbors than with any European democracy. To be sure, Costa Rica's per capita gross domestic product in 1986 of \$1,971 exceeds that of Guatemala, the second highest in Central America, by almost \$700, but it is \$542 below that of its neighbor to the south, Panama, and it is \$169 below the average for all of Latin America (excluding Cuba).<sup>1</sup>

As in the neighboring countries, the Costa Rican economy was dominated by agroexports (primarily coffee, joined around 1900 by bananas) until the 1950s. The political system was controlled by production and trading interests connected to coffee that dictated essentially free trade policies. These policies, in turn, meant little industrialization. Manufacturing accounted for less than 10 percent of gross domestic product (GDP) in the early 1950s, with most production by artisans and in small shops. As late as 1958, fewer than 1.5 percent of all industrial plants employed more than fifty workers.<sup>2</sup> On the other hand, in 1948 over 70 percent of the population lived in rural areas and coffee accounted for 45 percent of Costa Rica's exports, bananas for 25 percent, and cocoa for 11 percent.<sup>3</sup>

Costa Rica's externally oriented development pattern was severely jolted by the Great Depression as the U.S. market collapsed and Costa Rican exports fell from \$20 million in 1928 to \$7.5 million in 1940. By World War II rising social unrest and shifting political coalitions began to challenge the development model imposed by the agroexporters. Charges of electoral fraud in the 1948 elections brought the military

Table 2.1  
 Real Annual Rates of Growth, in percentages (constant 1950 prices)

	1948-53	1953-58	1958-63	Share of GDP	
				1948	1963
GDP	7.3	5.6	4.4	--	--
Public Sector	9.4	10.4	3.9	11	18.7
Manufacturing	11.2	7.6	3.8	8	14.4
Construction	21.0	1.4	1.4	2	3.6
Agriculture	5.3	3.5	3.4	43	27.1

Source: Instituto de Investigaciones en Ciencias Economicas (IICE), *El desarrollo economico de Costa Rica: Estudio del sector publico*. San Jose: Universidad de Costa Rica, 1962, p. 7.

into politics and led to a short civil war. The Partido Liberación Nacional (PLN), a middle-class party with social democratic leanings, emerged in the new elections as the dominant party. The PLN, through policies of infant industry protection, support for labor, and heavy investments in basic infrastructure, health, and education, initiated a thirty-year period of successful import substitution industrialization.

Between 1948 and 1963 Costa Rican industrial growth was based upon the expansion of the small internal market, itself a consequence of growing public expenditures, growing urban employment, and modestly increasing wages. Table 2.1 reports real annual growth in GDP of 7.3 percent during the 1948–1953 period, while manufacturing, construction, and the public sector grew at real annual rates of 11.2, 21.0, and 9.4 percent respectively. Strains on public finances and the small domestic market slowed the growth rate of GDP to 5.6 percent during the period 1953–1958 and to 4.4 percent during the 1958–1963 period. By 1963, when the first phase of Costa Rica’s import substitution industrialization came to an end, the manufacturing sector still only contributed 14.4 percent to GDP and construction but 3.6 percent. Within the manufacturing sector, virtually all production was in processed foods and light consumer products; metal products, including basic metals, machinery, and equipment, accounted for a mere 2.6 percent of manufacturing value added.<sup>4</sup> Industrial products made up only 10 percent of all Costa Rican exports in 1963.

In 1963, Costa Rica joined the Central American Common Market (CACM), which allowed for free trade among the five signatory nations and a common external tariff. At the time, this meant expanding the size of Costa Rica’s market from approximately 2 million people to nearly 15 million. The adoption of a common external tariff signified lowering average tariffs for Costa Rica and Guatemala, the higher tariff countries with the largest industrial sectors in the early 1960s, and raising average

tariffs for El Salvador, Honduras, and Nicaragua.<sup>5</sup> In no case, however, was there a major alteration in a country's tariff structure or rates. According to estimates by the Economic Commission for Latin America (ECLA) of the United Nations, the unweighted average tariff in Central America increased from pre-CACM to post-CACM as follows: capital goods, from 12 to 13 percent; raw materials and intermediate goods, from 30 to 34 percent; consumer goods, from 64 to 82 percent. The overall increase was from 42 to 48 percent.<sup>6</sup> These nominal rates of protection are by no means trivial and connote even higher effective rates of protection,<sup>7</sup> but they generally lie below the nominal and effective tariff rates applied in South America. According to ECLA estimates, for instance, the unweighted average tariff on nondurable consumer goods in 1959 was 110 percent in Argentina and 111.6 percent in Venezuela.<sup>8</sup>

The formation of the CACM gave new life to Costa Rica's industrialization project. While the CACM might be viewed as a strategy of export-promoting industrialization for any individual Central American country, it is more often seen from the regional perspective as an extension of the import substitution strategy already under way in Central America, i.e., light industrial goods previously imported came to be produced in the region under protection of a common external tariff. The extent of the CACM's contribution to Central American industrialization is difficult to quantify; estimates attribute from 10 to 25 percent of regional GDP growth to the formation of the CACM.<sup>9</sup>

A common critique of import substitution industrialization is that it leads to inefficiency of domestic industry behind the protection of high effective rates of taxation. According to the more enlightened version of this critique, whereas infant industry protection might be necessary during the early stages of industrial development, political forces evolve in such a way as to make it extremely difficult to remove tariff protection over time; thus, inefficient practices become the entrenched *modus operandi*. This critique certainly has some relevance to the Central American experience, but there is also an interesting qualification that must be made. Because the formation of the CACM involved both market opening (the Central American economies to each other) and market closing (the Central American economies to the rest of the world), it engendered increased competition in some areas and decreased competition in others. The net effect on competition, pricing, and efficiency is not a priori clear. In his study of the CACM, McClelland made a meticulous and comprehensive comparison of 1,200 products and concluded: "While CACM-induced import substitution has resulted in both increases and decreases in individual prices, the decrease may actually be more frequent and, in any case, the overall effect [of the CACM on prices] has been relatively small."<sup>10</sup>

Table 2.2  
Real Annual Rates of Growth, in percentages

	1963-68	1968-73	1973-78	1978-83
GDP	7.2	7.1	5.6	-0.4
Public Sector	6.1	8.3	5.8	2.0
Manufacturing	14.3	10.7	9.7	-1.8

*Source:* L. Garnier, "The Limits of Peripheral Capitalism: Costa Rica, A National Case Study," Ph.D. Dissertation, Department of Economics, New School for Social Research, New York, 1986, Part III, pp. 93, 139, 193.

Another straightforward effect of the CACM was to encourage for the first time foreign investment in Central American manufacturing. Because of its relative political stability, social tranquility, and well-educated labor force, Costa Rica has received more foreign manufacturing capital than the other CACM members. Whereas in 1959 less than 1 percent of foreign investment in Costa Rica went into manufacturing, 21 percent was in manufacturing in 1969. According to one estimate, foreign investment constituted about 58 percent of all industrial investment in medium- and large-scale plant between 1960 and 1970.<sup>11</sup>

Costa Rican exports to the rest of Central America grew from \$1,784 in 1958, to \$3,945 in 1963, to \$36,228 in 1968, \$70,459 in 1973, and \$182,400 in 1978.<sup>12</sup> Thus, the annual growth rate of Costa Rica's CACM exports was 29.1 percent between 1963 and 1978. By 1978, Costa Rica's CACM exports had grown to 21.1 percent of total exports, from only 4.1 percent in 1963. The share of industrial products in total exports grew from 10 percent in 1963 to 25 percent in 1973 and 28 percent in 1978, with over three-quarters of these exports coming from fully or partly foreign-owned companies.<sup>13</sup>

With the stimulus of the CACM, GDP growth rates also picked up again after 1963. As can be appreciated from Table 2.2 the real annual growth rate of GDP was 7.2 percent between 1963 and 1968, 7.1 percent between 1968 and 1973, and 5.6 percent between 1973 and 1978, while average annual growth rates in manufacturing was 14.3, 10.7, and 9.7 percent respectively over these periods. By 1978, however, a number of lingering trouble signs came to the fore, and the Costa Rican economy entered a period of crisis from which it has yet to emerge.

### *Crisis and Stagnation: 1978-1987*

The coming of the world recession, skyrocketing energy prices, high international interest rates, the collapse of the Central American market, and the gradual exhaustion of easy import substitution growth possibilities

brought severe economic difficulties to Costa Rica by 1980. Falling export prices (mainly coffee), a rapidly rising debt, and a sharp rise in debt service payments led to the suspension of such payments in mid-1981. (Partial debt service payments were resumed in July of 1982.) Ensuing fiscal and monetary austerity policy led to a severe recession during 1981 and 1982, with real GDP falling 2.3 percent and 7.3 percent respectively in those years. There has been a slow and somewhat erratic recovery since 1982, but in 1986 per capita GDP was still 9 percent below its 1977 level.

With its external debt approaching \$4.5 billion, Costa Rica has the fourth highest per capita foreign debt in the world.<sup>14</sup> Despite macropolicy restraint in the 1980s and export promotion efforts, Costa Rica's trade balance has been in deficit throughout this decade. However, when debt service payments are excluded, the current account balance was positive in 1982 and projected to be so in 1986. Before rescheduling, Costa Rica's debt service to exports of goods and nonfactor services ratio was 58.7 percent in 1984 and 60.5 percent in 1985; after rescheduling, actual service payments came to 35.2 percent and 38.4 percent respectively.

A closer look at Costa Rica's post-1980 export performance, however, reveals many positive and promising signs. Of its four traditional export products (coffee, bananas, beef, and sugar, in order of importance), only sugar experienced an appreciable decline in value through 1985. This decline is explained by the sharp drop in the U.S. sugar import quota, which fell from 52.4 to 17.6 tons between 1984 and 1987. Prior to 1986, sugar's declining contribution was more than offset by an increase in coffee exports, leading to a modest growth in traditional exports from \$534.7 million in 1982 to \$590.5 million in 1985. With coffee prices falling sharply during 1986 and 1987 (from well over \$2.00 a pound to the fall 1987 level of around \$1.20), however, earnings from coffee exports were off some 40 to 50 percent from their peak.

Nontraditional exports grew from \$106.6 million in 1973 to \$336.4 million in 1978 to a (conservatively) projected \$405.0 million in 1986. This growth is all the more impressive since the principal market for manufacturing exports had been Central America through 1983 and sales to this market first stagnated and then fell precipitously from \$193.0 million in 1984 to \$139.6 million in 1985, and to \$107.3 million in 1986.<sup>15</sup> This collapse is explained largely by the growing indebtedness (over \$300 million in early 1987) of the other CACM countries to Costa Rica and the Central Bank's mid-1985 decision to curtail all noncash purchases through the CACM Clearinghouse. Since Costa Rica's CACM exports have an estimated 50 percent average import component, credit sales to other Central American countries were contributing to Costa Rica's growing foreign debt. But as its nontraditional exports to the

CACM declined, those to the rest of the world increased rapidly, from \$167.1 million in 1982 to a projected \$265.0 million in 1986. Value added from drawback<sup>16</sup> exports is included in this latter figure and amounted to an estimated \$30.0 million. As will be discussed later in this chapter, the prospects for continued growth in the nontraditional sector are rather good, provided international conditions remain supportive and certain domestic improvements are forthcoming.

### *Determinants of Export Performance*

The mild domestic economic recovery since 1983,<sup>17</sup> the expanding U.S. economy, periodic minidevaluations of the colon, ongoing political stability and relative labor peace, government export promotion efforts, and a comparatively good supply of skilled labor, along with other propitious conditions, have all contributed to a healthy expansion of nontraditional exports in recent years (see Table 2.3). Nontraditional exports already constitute a dynamic sector of Costa Rica's economy. The list of successful products in this sector is long, diverse, and growing: fresh fish, shrimp, lobster, plantains, pineapple, cassava, chayote, chocolate paste, macadamia nuts, berries, petunia seeds, electrical switches, clothing, footwear, canned meat, canned sardines, crackers, canned fruit juice and paste, paint, pharmaceutical and medical products, cosmetics, plastics, insecticides, leather, tires, plywood, paper products, synthetic fibers, glass products, cement, galvanized sheets, metal containers and caps, batteries, light bulbs, radio and television sets, electrical cord and cables, records and tapes, refrigeration equipment, and wood furniture, among others. Some of these exports have suffered with the contraction of the CACM, but most continue, or have the potential, to grow. Table 2.4 lists the leading ten nontraditional export groups in 1985.

Nontraditional exports now make up approximately 40 percent of Costa Rica's exports. Given Costa Rica's current economic development strategy, this share must continue to grow if the economy is to achieve both financial stability and steady growth. Nontraditional export growth, in turn, will be a function, *inter alia*, of international conditions, the rate of new domestic investment, and the removal of remaining infrastructural impediments.

### *Domestic Factors: Institutional Constraints*

One domestic impediment lies in Costa Rica's banking structure. There is a small but growing private banking sector, currently providing around 12 percent of all credit to the private sector. Private bank lending, however, still seems to be confined to greater San Jose. Credit allocations

Table 2.3  
Trade Statistics, 1963-85 (millions of U.S. dollars)

	1963	1968	1973	1978	1979	1980	1981	1982	1983	1984	1985
Merchandise Exports (fob)	94.9	170.0	344.8	863.9	942.1	1000.9	1002.6	869.0	852.5	955.9	930.4
Traditional Exports	81.2	118.7	238.2	527.5	587.7	559.0	604.7	534.7	526.3	574.5	579.7
Non-traditional Exports	13.7	51.3	106.6	336.4	354.4	441.9	397.9	334.3	326.2	381.4	350.7
Merchandise Imports (fob)	112.7	193.7	412.1	1049.4	1257.2	1375.2	1090.6	804.9	897.8	995.3	1005.1
Trade Balance	(17.8)	(23.7)	(67.3)	(185.5)	(315.1)	(374.3)	(88.0)	64.1	(45.3)	(39.4)	(74.7)
Current Account Balance	(25.5)	(42.9)	(112.2)	(363.2)	(558.2)	(663.9)	(409.1)	(271.1)	(316.5)	(256.1)	(327.4)
CACM Exports (fob)	3.9	36.2)	70.5	182.4	175.4	275	238.1	167.4	n.a.	n.a.	n.a.
CACM Exports as % of Exports	4.1	21.3	20.4	21.1	18.6	27.5	23.7	19.3	n.a.	n.a.	n.a.

Note: n.a. = not available.

Source: SRI International, Nontraditional Export Expansion in the Central American Region. Arlington, Va.: SRI International for the Agency for International Development, March 1987, pp. CR22-26.

Table 2.4  
 Top Ten Non-Traditional Exports, 1985 (millions of current dollars)

Export Category	1985
Fish and Shellfish	28.1
Medicines	24.9
Flowers and Seeds	21.4
Electrical Equipment	19.5
Chocolate and Cocoa	15.6
Chemical and Plastic Products	15.3
Fabrics	13.5
Tires	9.8
Metal Articles	9.7
Fruits	9.3

Source: Banco Central de Costa Rica, Cuentas Nacionales de Costa Rica, 1985.

and interest rates are closely controlled by the Central Bank, although the system of credit allocation ("topes") has been gradually deregulated since 1984. Central Bank President Eduardo Lizano has stated that "topes" would be ended in 1987. Interest rates, albeit somewhat deregulated, are still largely controlled by the Central Bank.

Tight monetary policy occasioned by Costa Rica's debt, a large public sector deficit, Central Bank financial losses, and the need to retard capital flight combined to produce nominal interest rates in the 26-29 percent range as of late December 1986. This means that real rates ranged from approximately 16 to 19 percent. Given the inherent riskiness of new export investments, these real rates approached prohibitiveness. The complaint of exorbitant real rates from present and prospective exporters has been universal. Interest costs have imposed a very serious obstacle to short-run export financing and long-term capital expansion projects. Moreover, the small savings base with the historical regulation of the banking system also has resulted in loans being unavailable at any price to a large share of nontraditional exporters.

Another impediment lies in Costa Rica's transportation network. Although the situation is improving and the problem is not grave, Costa Rica's available infrastructure for international sea and air shipping still leaves considerable room for improvement. Maritime shipping costs for most products are high, above the rates for larger ports in the region. The problem here, however, is largely one of volume and uneven demand. Competition from non-Conference shippers (shipping companies outside the cartel) and increasing volume are driving rates down, in some cases appreciably; for example, the U.S.-based company GTE reported container

costs to have dropped from \$3,600 to \$2,200 per container to Miami during 1986.

The situation with air freight is more problematic. First, airport installations in San Jose are inadequate. There is no protected area for palletizing or storing cargo. There are no chilling facilities. There have been many reported incidents of perishable products being spoiled due to the absence of such facilities or due to improper, careless handling of the cargo by airport personnel. Improved packaging of perishable products would help to alleviate this problem. Second, air service is inadequate and irregular. Some perishable-product producers claim that they are not allowed to make reservations and that they are sometimes notified a few hours before a flight that space will be available. Prospects for short-term improvements in capacity are poor. It seems that the Costa Rican Aviation Board has restricted cargo-carrying by foreign airlines. According to one informant, LAN Chile was denied permission to make a cargo stopover. Many complained that rates are too high. Part of the problem is unbalanced cargo. The development of new perishable exports and import cutbacks have resulted in air shipments from San Jose to Miami being over 50 percent above return shipments (in weight).

Costa Rican Aviation might consider opening up air cargo transport to additional foreign airlines. Some Costa Rican businessmen have suggested that exporters come together to charter their own cargo planes. Separately, the imbalance of air cargo to and from Miami might be redressed by price incentives to encourage maritime traffic from Miami to switch to air transport.

Costa Rican exporters are required by law to employ an outside customs agent to handle all dealings with Costa Rican Customs. GTE reported that its agent, in league with customs officials, embezzled 3.2 million colones early in 1986. Even after detection of the incident, GTE had to negotiate a settlement that cost the company \$55,000. Reportedly, this "penalty" was levied because GTE is responsible for its agent's behavior even though the agent is not a company employee. Although such incidents are probably rare in Costa Rica, there was a shake-up in Customs in May 1986. Presumably, the reorganization will improve honesty and efficiency, but the customs agent law seems inappropriate. GTE is lobbying for its repeal.

#### *Domestic Factors: Inputs, Prices, and Policies*

Input prices in Costa Rica are generally very competitive. Abundant hydroelectric power supplies practically all of the country's electricity at prices low for the region. There is a modern and reasonably priced

telecommunications network. There is a relatively large number of machine tool shops, providing a substantial and timely supply of parts (both metal and plastic) to local industry.

Probably Costa Rica's greatest asset, however, is its labor force. Literacy is 93.1 percent, the highest in Central America. Longevity and health conditions are number one among the beneficiaries of the Caribbean Basin Initiative (CBI). Higher education has provided an extremely skilled and technically able population. Traditional trade unions represent a small (the figure is unknown) and diminishing share of the work force. There is a growing movement of "solidarity associations," which emphasize a cooperative, as opposed to conflictive, approach to labor-management relations. These associations represent approximately 15 percent of the economically active population. The labor force is hard-working, stable, and, certainly for the region, relatively peaceful.

There is also a sizable group of national and expatriate entrepreneurs who have been educated in first-rate business and engineering schools, often in the United States. Given the opportunities, resources, and proper economic environment, this group is capable of making a significant contribution to developing Costa Rica's export potential.

Wage costs for production workers are approximately the same as elsewhere in Central America. Base wages appear to be slightly below average, but payroll taxes and benefits (roughly 40 to 50 percent of the base wage) are above the norm. According to a 1986 study by the Bobbin Consulting Group, the average hourly wage (without fringes) for textile operators (converted into dollars at the prevailing exchange rate) was \$0.78 in Costa Rica, \$0.83 in Honduras, \$0.89 in Guatemala, \$1.09 in Jamaica, \$1.58 in Panama, and \$4.28 in Puerto Rico. The ample supply of domestic skilled labor for technical and administrative positions in middle management, however, is Costa Rica's strongest drawing card. Companies generally do not have to import their skilled labor at higher foreign salary rates to the same extent as elsewhere in the region. This important advantage of the Costa Rican environment, however, is being threatened by the rapid growth of foreign investment and new exports that raise the demand for such labor. Skilled personnel is in increasingly short supply, and companies are finding their top engineers, technicians, accountants, and others being bid away by other companies in Costa Rica. Salaries for skilled labor, thus, are rising.

Local exporters of new products generally lack marketing information and contacts. This condition can lead either to the failure to identify available marketing outlets or to the sale to new markets at unfavorable terms. The latter include consignment contracts, broken contracts without effective recourse, whimsically rejected shipments, high commissions, low prices, delayed payment, and so on. One exporter, a new strawberry

cooperative (Copefresa), has suffered virtually all of these effects in its dealings with a Miami broker. After losing its first shipment of strawberries in 1984 due to a failure to meet quality specifications, Copefresa rushed into a contract, giving its Miami broker exclusive distribution rights until 1989. The broker charges a 13 percent commission on top of a 36.4 percent price markup. Other brokers have approached Copefresa and offered better deals with broader markets, but Copefresa is locked into its present brokerage arrangement until the 1989 expiration.

A contrary experience at Muebleria Urgelles y Penon S.A., a furniture company, speaks to the same point. The president of this company, thanks to a U.S. college education and personal contacts, spent two years identifying and cultivating possible distribution agents and markets. Once developed, exports were begun. There have been no distribution problems. Such a protracted process, of course, requires financing beyond the means of most new ventures. The furniture company, as a long-standing successful producer for the domestic market, was able to use internal funds.

Liberalization of tariff and exchange rate policies and a series of fiscal incentive programs have provided an important thrust to export growth. CACM tariff reform took effect in 1986, with effective rates dropping from the 50 to 1,600 percent range to the 50 to 150 percent range. Further, the post-1980 policy of exchange rate unification and periodic minidevaluations of the colon (the real effective exchange rate has been devaluing at an average annual rate of 7.4 percent over the 1980-1986 period)<sup>18</sup> has contributed to the instigation of exports. Together with a number of explicit subsidy programs for exports, the period of antiexport bias of economic policy has come to an end. Nonetheless, some maintain that the current incentive package merely puts nontraditional exports at a par with import substitution and further measures should be taken.

Specific export promotion programs undertaken to date include the following: In 1973, Costa Rica introduced export tax credits, or CATs (*Certificados de Abono Tributario*). CATs are negotiable and are granted to exports with a minimum of 35 percent local value added. They are equal to 15 percent of the FOB value of exports. In November 1984 the government put into effect two new pieces of legislation: the export contract and the temporary admission system bylaws (drawback). The former provides a series of tax exemptions (import, export, sales, income) through 1996, 100 percent profit repatriation through 1996 as well as repatriation of accumulated depreciation after four years, special port rates, and other benefits negotiated with each company for exports outside of the CACM. Drawback offers similar tax benefits (without CATs) and streamlined paperwork and regulations for exports to the United States under the provisions of Tariff Schedules of the United

States (TSUS) 806.3/807 and super 807. Another piece of 1984 legislation established export processing or free zones, intended primarily for distribution and light industry assembly operations.<sup>19</sup> Finally, a number of export financing and assistance programs have been created with support from the Agency for International Development (AID). Despite these loan programs, the impressive promotion work of the Costa Rican Coalition of Development Initiatives (CINDE) and the new accelerated depreciation allowances, export financing is still woefully insufficient and too expensive, even through subsidized and loan guarantee programs.

### *International Factors*

International circumstances have been difficult. Increasing protectionism affects all of Costa Rica's markets to one degree or another. Trade within the CACM is curtailed by unpaid debts and lack of foreign exchange. Other Latin American partners, also affected by foreign exchange shortages, are imposing new restrictions, and the United States, with record trade deficits, is sending contradictory and protectionist signals. The Caribbean Basin Initiative is being implemented with a lack of commitment and a lack of consistency. While increased foreign investment offers some prospect for attenuating Costa Rica's short-run foreign exchange constraint, it seems, at the moment anyway, to offer little prospect for promoting long-term development.

*Foreign Investment.* Despite (or perhaps because of) concern with political instability posed by the situations in Nicaragua, El Salvador, and Honduras, foreign investors have grown increasingly attracted to Costa Rica in recent years. Effective government incentives, aggressive promotion efforts, concern over the future of Hong Kong, new and standard General System of Preferences (GSP) restrictions placed on Asian exports to the United States, and the CBI system of preferences have stimulated new investments in garments, electronic assembly, cosmetics, auto parts, and pharmaceuticals by Asian, European and U.S. capital. There have been few joint ventures between foreign and local capital.

Table 2.5 charts the growth of foreign direct investment in Costa Rica since the formation of the CACM and the acceleration of this investment since the mid-1970s when many of the investment promotion measures were introduced. The gradual devaluation of the colon since the early 1980s has also attracted international capital. Even though these sums have grown and are large for the region, they still only amount to 10 to 20 percent of Costa Rica's debt service payments in recent years.

Final foreign investment data are not yet available for 1986, but I was able to obtain a detailed breakdown of new projects registered with

Table 2.5  
Foreign Direct Investment (millions of U.S. dollars)

Period	Yearly Average
1960-64	12.9
1965-69	17.5
1970-74	39.5
1975-79	68.0
1980-82	46.5
1983-85	55.4

Sources: J. Weeks, *The Economics of Central America* (New York: Holmes and Meier, 1985, p. 93); Inter-American Development Bank, *Economic and Social Progress in Latin America, 1987 Report* (Washington, D.C.: IADB, 1987), p. 458.

the Ministry of Foreign Trade through mid-December 1986. The information is illustrative of the sources and motives of the investors and, hence, indicative of the underlying trends and potential. There were 30 new direct foreign investment projects, 22 of U.S. origin, 4 of Korean origin, 3 French, and 1 Taiwanese. Of the 30, there were two joint ventures, one between U.S. and Israeli capital, the other between U.S. and Costa Rican capital. Reportedly, the reluctance to enter joint ventures lies with foreign, not Costa Rican, capital. Of the 30 projects, 19 were in apparel and these accounted for 86.3 percent of the total projected investments. Most of this was in free zones and geared to the special 806/807 U.S. tariff exemptions. Three projects were in electronics, two in food processing, two in metal and mechanics (but totaling only a projected \$300,000 of investment), and one each in wood products, sporting goods, chemicals, and plastics.

Whereas this direct investment will certainly contribute to loosening Costa Rica's short-term foreign exchange constraint, the facts that much of this investment is (a) drawback, (b) has a low local value added component, (c) benefits from tax holidays and unrestricted capital repatriation, and (d) offers few backward or forward linkages raise questions about its contribution to long-term economic development. These questions become more pressing in light of the prohibitive cost of and lack of access to financing for domestic investors. Further, foreign companies are enticing away scarce skilled technical and managerial labor from domestic companies, making the latter's existence yet more fragile. Unless some balance between local and foreign investment is maintained, not only will this have a potentially negative impact upon the country's development potential but it will likely engender eventual political difficulties.

It would seem desirable for the Costa Rican government to evaluate its foreign investment policy at this point. Throughout the 1960s and early 1970s, despite greater regulation and controls on capital, Costa Rica consistently attracted more foreign capital than its neighbors. Costa Rica's many assets will continue to attract capital without proffering exorbitant incentives. Legislation to encourage joint ventures and to allow for the government to capture some tax revenues and be more selective in project approval would seem to be desirable. At the same time, the government should offer increased incentives to local entrepreneurs; among these incentives must be greater access to financing and reasonable real rates of interest.

*CBI and AID.* The drastically reduced U.S. sugar quota, as detailed above, and the sudden imposition of a 46.5 percent flower duty (27 percent for alleged dumping, 19.5 percent for countervailing preferences) by the International Trade Commission (ITC) in November 1986 have been antithetical to the spirit of the CBI. (The flower duty was reduced to 27 percent in December 1986 in exchange for the exporters' agreement to forgo the subsidies provided by the export contract legislation.) This ITC action not only points to the unreliability of CBI preferences but also to the capriciousness of the process. Among other things, the ITC finding reportedly was based on information from only one of ten firms mentioned in the California flower growers' complaint. The finding, which "suspected" the other nine firms to be similar to American Flowers S.A., overlooked the fact, according to the president of Flores del Cerro S.A., that a bunch of flowers in Miami is 10-12 ounces and in Costa Rica it is 16 ounces. The flower duty case is seen as symbolic: This is what happens to successful exporters under the CBI. Since the CBI exhorts countries in the Basin to increase exports to the United States and, implicitly at least, encourages them to offer fiscal incentives for this purpose, this symbolism effectively undermines the constructive atmosphere for exports that the CBI endeavors to promote. Given the manifold impediments to and riskiness in starting new export ventures, this inconsistency in U.S. policy is a powerful deterrent to export expansion in Costa Rica and elsewhere in the Basin.<sup>20</sup>

The CBI has not been accompanied by any major new aid commitments to the region. While it is true that Central America (with 6 percent of Latin America's population) receives some 65 percent of all U.S. assistance to the area,<sup>21</sup> overall U.S. aid disbursements have been falling. In fact, U.S. aid as a share of U.S. gross national product (GNP) has fallen steadily from 0.26 percent in 1965 to below 0.03 percent in 1986.<sup>22</sup>

In addition to insufficient funding for AID programs, the actual implementation of these programs leaves something to be desired. There appears to be a tendency for AID to spread itself too thinly, initiating

too many projects with inadequate financial and technical support. The case of Copefresa, an AID-inspired strawberry producers' cooperative, is illustrative of this problem. Copefresa received AID support in some areas but not in others. By December 1986, after some two years in business, Copefresa had resolved many of its technical production and packaging problems, but ongoing difficulties with transportation and marketing left it in a financial bind. Loans were unavailable to Copefresa from any source. Meetings with the minister of economics, AID officials and others brought sympathy but no financing. The economics of the project are sound. The investment of capital in the project is large. The experience and knowledge gained in production, management, and marketing are enormous. Yet the cooperative is on the threshold of failure. Almost half of the members had already left it as of December 1986. Projects of this nature, no matter how sound they might be in theory, are often fragile. In order to avoid the loss of finance and human capital and the disillusionment associated with failed ventures, such projects should receive an ongoing, comprehensive package of assistance. AID loans to new investments should carry a grace period at least as long as the expected gestation period of the project. Such a commitment from AID and other agencies might imply fewer projects in the short run, but a greater success rate will mean more profitable projects in the long run.

Finally, the market-opening preferences granted by the CBI are insufficient. In 1985, for instance, the United States imported \$6.7 billion worth of goods from CBI beneficiary countries. Of this, \$4.7 billion was subject to the normal U.S. tariff schedule, \$548 million entered duty-free under 806/807 legislation, \$541 million entered duty-free under the GSP and only \$498 million, or 8 percent of total imports from the Basin, entered duty-free under CBI preferences. Since the East Asian Newly Industrialized Countries (NICs) benefit from from 806/807 and GSP preferences, it would seem that some reordering of tariff preferences for the developing world is justifiable. With either trade balances or large surpluses, these countries have no foreign debt. On the contrary, some NICs are accumulating untenably large foreign exchange reserves. Most dramatically, Taiwan has \$71 billion in reserves, second only to Japan.

It is clear from econometric evidence that Costa Rican nontraditional exports are very responsive to increases in U.S. demand. Using data from 1963 through 1985, when Costa Rican nontraditional exports were run on six explanatory variables (including worldwide U.S. imports, nontraditional exports lagged one year, domestic credit, fixed capital formation, merchandise imports in Costa Rica, and time), the equation yields an R-squared of .99 and U.S. imports have the highest t-statistic

(significant at the .03 level) and the second highest elasticity (0.36). That is, for every 1 percent increase in worldwide U.S. imports, Costa Rican nontraditional exports increase by .36 of 1 percent.

### *Assessment of Nontraditional Export Opportunities and Strategy*

Costa Rica's attributes make it one of the most attractive countries in the world for foreign investment. These same attributes, should financing and effective support programs become available, give Costa Rica a significant potential in nontraditional exports. The potential lies not only in labor-intensive activities, but, due to the relatively ample supply of skilled labor and network of parts producers, lies in goods of intermediate capital intensity. Moreover, Costa Rica's abundant hydroelectric resources mean cheap energy that is complementary to capital, implying a natural comparative advantage in more capital-intensive projects. From a long-run perspective, it is important to develop some capital-intensive projects, not only for their potential to spawn indigenous technological development but because they involve greater labor productivity and, other things being equal, the potential for higher standards of living. Many have referred to this approach, one followed by Japan, South Korea, and Taiwan, as being consistent with a dynamic comparative advantage perspective. That is, resource endowments to some degree are given, but they are also made by economic policy choices. Costa Rica is in an unusually good position, for the reasons outlined above, to promote a balance of labor-intensive and capital-intensive projects.

The persistence of current account deficits (albeit shrinking) suggests that the colon might be still overvalued. The post-1980 policy of periodic minidevaluations has helped, but many observers believe a real devaluation of some 5 percent annually would be desirable for the near future. Although such a policy might indeed be appropriate, three caveats should be issued. First, there is a danger in a small, open economy like Costa Rica's that excessive currency depreciation will be passed through in the form of excessive inflation, undermining the intention of devaluation. Second, due to the low domestic value added of most manufacturing exports, devaluation does not have the same straightforward salutary effect on export profitability. The larger the share of imported components, the larger will be the increase in input costs occasioned by any devaluation. The ultimate impact on profitability and sales will then depend on the elasticity of demand for the product. Third, devaluation raises the real value of debt (in domestic currency) to those companies holding foreign loans. In some cases, the magnitude of this effect can be rather large.

Finally, it is appropriate to raise a few larger questions about Costa Rica's strategy. The prevailing strategy appears to be based on the presumption of two incompatibilities: first, between import substitution and export promotion and, second, between markets and active government guidance. This dichotomous, black-and-white view of the world is ideologically driven and not conducive to successful development policy. In a 1986 article on Costa Rica's foreign debt, former Minister of External Financing Ennio Rodriguez commented:<sup>23</sup>

The Costa Rican experience suggests that there has been a certain coordination of conditionality policies. The Agency for International Development has concerned itself with public enterprises, the World Bank with tariff structure and the International Monetary Fund with monetary and fiscal variables. (My translation.)

The Costa Rican government, ideologically surrounded by these financial forces, has assimilated their teachings. Some of the lessons are, of course, important, but others make development canon out of political dogma. Consider, for instance, AID's insistence that the Costa Rican government dismantle its industrial holding company, CODESA (the state development corporation), and return it to the private sector. CODESA was founded in 1972 with the purpose, in the words of former President Daniel Oduber, "to create in Costa Rica an institution capable of developing large new industries, which could then be transferred to the property of Costa Rican stockholders, so as to avoid that only transnational corporations be the ones promoting industrial development in Costa Rica. We are talking about cement, aluminum, fishing, navigation, etc."<sup>24</sup> Given the small size of Costa Rica's internal market, the underdevelopment of its financial institutions, the lack of an experienced, risk-bearing entrepreneurial class, and the facility of foreign capital penetration, it is hard to argue with the objectives of CODESA. Moreover, successful experience with this type of state venture in other countries, such as Japan, suggested its positive potential. Under the pretext that CODESA was contributing to the government budget deficit, however, AID began to make aid packages contingent on a commitment to sell off all of CODESA's companies. In fact, several of CODESA's companies were in the red and being poorly managed. Either selling them off or restructuring management would have been reasonable. Other CODESA companies, however, were either being effectively managed and/or were too young to be turning profits. There was no reason to sell them off, particularly in the absence of viable domestic buyers. The attempt to sell them off resulted, among other things, in managerial neglect and diverted energies. A more pragmatic and less ideological policy on the

part of AID would have approached the reorganization of CODESA more flexibly and productively.

The other thing that AID and the International Monetary Fund (IMF) at times seem to overlook in Central America is that the free market is often not conducive to competition due to the diminutive size of the internal markets. The choice is often between state monopoly, regulated private monopoly, or unregulated private monopoly. It is not a priori obvious that one of these structures is more desirable than the others. This depends on the particulars of each case. The advice from AID nevertheless always seems to be the same: Deregulate and privatize.

Whether or not a government can be efficaciously involved in economic management is a function of the political culture and stock of human capital in each country. Good government attracts good people, and vice versa. Caretaker governments pulling out of economic management are not likely to attract the most skilled, creative minds in a country. Thus, AID might be fulfilling its own prophecy, without building a robust private sector to fill the void.

The period of rapid industrialization in Costa Rica was, in fact, accompanied by a rapidly growing public sector. The Costa Rican government, however, has not been involved in supply management and development planning as have the governments of Japan, South Korea, and Taiwan. Jeffrey Sachs has pointed out the irony of the liberalization thrust in IMF-type conditionality programs, given the active and crucial role played by the government in the most successful development stories of the Third World—the East Asian NICs.<sup>25</sup> The historical record is not on the side of the free market ideologues. Free markets aid penetration by foreign goods and foreign capital. They can also aid development if properly harnessed and guided by a domestically controlled development strategy.

The same logic applies to the unilateral focus on export promotion. It is fine to promote exports, but the opportunity costs must also be assessed. What are the requirements of imported inputs, how intensively do they use a country's scarce resources, what linkages are promoted, what is the income elasticity of demand for the products, do they require wrenching social adjustments (e.g., pushing peasants off their land), and what are the alternatives? There is little evidence that these questions have been systematically analyzed either by the local governments of the Basin or by AID or the IMF. Nor is there any hard evidence for the often-stated allegation that the possibilities for import substitution in the CACM have been exhausted.

As Costa Rica has developed new nontraditional exports, land use patterns have shifted away from staple production toward cash crops.<sup>26</sup> Costa Rica, in turn, has become more dependent on imported foods.

Food imports grew from \$14.6 million in 1960 to \$146.1 million in 1980 (from \$17.9 million to \$68.2 million in constant 1970 dollars.) Net imports of cereal, a dietary staple in the region, grew from 74,000 metric tons in 1965 to 108,000 metric tons in 1980.<sup>27</sup> Particularly when the cash crops fail, peasant producers do not always accept these transformations supinely—not even in pacific Costa Rica, as large peasant demonstrations in San Jose during 1986–1987 have made evident.

All of this is to argue for a more sensible, more humane, and less ideologically bound policy from the United States toward the region. Neither the debt crisis nor political instability nor the human tragedy of mass poverty will go away without long-run, equitable economic development.

### Notes

1. Inter-American Development Bank, *Economic and Social Progress in Latin America, 1987 Report* (Washington, D.C.: Inter-American Development Bank, 1987), p. 2.

2. Leonardo Garnier, "The Limits of Peripheral Capitalism: Costa Rica, A National Case Study," Ph.D. dissertation, Department of Economics, New School for Social Research, New York, 1986, Part III, p. 53.

3. *Ibid.*, p. 21.

4. Oficina de Planificación, *Evolución socioeconómico de Costa Rica, 1950–1980*. (San Jose: EUNED, 1982), p. 97.

5. Donald McClelland, *The Central American Common Market: Economic Policies, Economic Growth, and Choices for the Future* (New York: Praeger Publishers, 1972), p. 76.

6. *Ibid.*, p. 77. McClelland's estimates of average tariffs are lower than ECLA's.

7. See, for instance, the careful and detailed study of Costa Rica's tariff structure in Prodesarrollo, *Estructura de la protección al sector industrial en Costa Rica* (San Jose: DISEGRAF Fernandez Arce, 1984).

8. Santiago Marcario, "Protectionism and Industrialization in Latin America," *Economic Bulletin for Latin America* 9, no. 1, p. 69.

9. The higher estimates are made by SIECA, the Secretariat of the CACM, and are, hence, suspect. See McClelland, *op. cit.*, pp. 33–36, and John Weeks, *The Economies of Central America* (New York: Holmes and Meier, 1985), p. 133.

10. McClelland, *op. cit.*, p. 59.

11. Of this, 38 percent was in 100 percent U.S.-controlled investments and 42 percent was in U.S.-Costa Rican joint ventures. Garnier, *op. cit.*, p. 67.

12. Garnier, *op. cit.*, p. 97. In current dollars, the 1986 level of exports to the CACM was 40 percent below the 1978 level. In constant dollars, the drop would be much larger.

13. *Ibid.*, p. 128.

14. For an excellent discussion of Costa Rica's economic stagnation and debt crisis, see Carlos Manuel Castillo, "La crisis internacional de la deuda: La

experiencia de Costa Rica," en R. French-Davis y R. Feinberg (editores), *Más allá de la crisis de la deuda* (Buenos Aires: Cieplan, 1986).

15. Inter-American Development Bank, *Economic and Social Progress*, p. 75.

16. Drawback exports basically refer to goods that undergo (usually) final processing in Costa Rica with tariff-exempt inputs that are brought into the country for a short period of time. Value added from drawback operations is usually rather low. Drawback is also referred to by the Spanish term *maquila*; hence, the term for the Mexican manufacturers on the U.S. border, *maquiladoras*.

17. An excellent treatment of this recovery and its limited and contradictory nature can be found in Victor Hugo Cespedes et al., *Costa Rica: Recuperación sin reactivación* (San Jose: Academia de Centro America, 1985).

18. Calculated from the IADB, op. cit., 1987, p. 270.

19. For more details on these incentive provisions, information on actual investments, and interviews with foreign executives, see CINDE, *Costa Rica: The Right Business Climate* (San Jose: CINDE, 1986); and CINDE and CENPRO, *Investor's Guide to Costa Rica* (San Jose: Costa Rican-American Chamber of Commerce, 1985).

20. Yet another inconsistency in U.S. export promotion policy affected this author personally. As an SRI consultant, contracted on an AID project, I was informed that when available I was required by State Department regulations to book my plane flights on U.S. carriers. It is a special irony when a consultant on a project to increase foreign exchange earnings for a Basin country is not allowed to travel on that country's national airlines. Branches of the U.S. government should make an effort to coordinate their policy initiatives, at least to the extent that they do not contradict each other.

21. See Marc Lindenberg, "Central America's Elusive Economic Recovery," unpublished manuscript, Kennedy School of Government, Harvard University, 1987.

22. These levels are below those in virtually every other industrialized nation. In 1984, for example, these shares were 0.30, 0.34 and 0.11 in Sweden, Norway, and West Germany respectively.

23. Ennio Rodriguez, "Comentarios," in French-Davis y Feinberg, op. cit.

24. Garnier, op. cit., p. 105.

25. Jeffrey Sachs, "Trade and Exchange Rate Policies in Growth-Oriented Adjustment Programs," National Bureau of Economic Research, Working Paper No. 2226, Cambridge, April 1987.

26. This, in a smaller way, repeats the earlier pattern of developing cotton and meat exports throughout Central America. For an excellent treatment of this, see Robert Williams, *Export Agriculture and the Crisis in Central America* (Chapel Hill: University of North Carolina Press, 1986).

27. Solon Barraclough and Peter Marchetti, "Agrarian Transformation and Food Security in the Caribbean Basin," in G. Irvin and X. Gorostiaga (eds.), *Towards an Alternative for Central America and the Caribbean* (London: George Allen and Unwin, 1985).

## *Dominican Republic*

*John A. Mathieson*

### *Economic Overview*

The agricultural sector and its associated processing industries have historically provided the principal contributions to the Dominican Republic's economy, in the form of income, employment, and export earnings. After having expanded at the relatively high annual average rate of 6 percent in the 1960s and early 1970s, however, the agricultural sector has stagnated over the past decade. Among the factors behind this lack of growth performance are declines in demand (or quotas) for agricultural exports, limits on arable land, and a general absence of economic incentives as compared to those offered in other sectors.

Agriculture's share of the country's domestic output fell from 26 percent in 1965 to 15 percent in 1984. The share of industry (including mining) has risen commensurately, from 20 percent to 31 percent over the period. The share of the service sector, the most important components of which are tourism and commerce, has remained constant at 53 percent of total gross domestic product (GDP).

In the aggregate, the Dominican economy posted very high growth rates (8.5 percent on average) between 1965 and 1973.<sup>1</sup> In the "oil crisis period" of 1973-1984, however, the nation's GDP growth faltered to an average annual rate of only 3.3 percent, or just slightly above the population growth rate of about 2.4 percent. The economy has been subjected to a series of adverse trends and events, such as hurricanes (1979) and other poor weather conditions, high energy import costs, declining sugar prices, and weakened international demand for bauxite and ferronickel.

The combination of externally imposed problems beyond the control of the government with policy-induced budget expenditures and deficits led to a severe foreign exchange crisis in the early 1980s. The government was forced to enter into a three-year, \$390-million Extended Fund Facility agreement with the International Monetary Fund (IMF). This agreement

was suspended in the fall of 1983, however, due primarily to the government's failure to reduce the growth of public expenditures. A new agreement was reached in April 1984, and price rises caused by a creditor-mandated reduction in subsidies led to serious riots.

In early 1985, after a continuing series of negotiations with the Dominican Republic's creditors, the government implemented a harsh stabilization program, involving currency devaluation, tight monetary policies, tax increases, and controls on public sector expenditures. The government subsequently rescheduled a large portion of the country's external debt. The austerity program imposed led to a sharp recession, including the first reduction in real output (officially 1.2 percent) since 1965. Preliminary estimates indicate that a modest recovery of Dominican output took place in 1986, with a growth rate in the range of 1-2 percent.

Since the end of the military rule of Rafael Trujillo in 1966, freely elected governments have succeeded each other in an orderly fashion. The nation elects a president and congress every four years. The basic policy stance of the present Dominican government, headed by President Joaquin Balaguer (elected in mid-1986), is to maintain the austerity strategy of tight monetary and fiscal policies, in hopes that rises in tourism, nontraditional exports, and other economic diversification activities will over time improve the country's economic performance and reduce the currently high rate of unemployment.

### *Trade Policies and Performance*

For most of the 1960s and 1970s, the Dominican development strategy was predicated on substituting locally produced goods for imports. The country's legal framework reflected this goal. The exchange rate was maintained at parity between the U.S. dollar and the Dominican peso, which made imported inputs artificially inexpensive while lowering the competitiveness of Dominican exports in world markets.

In part as a result of these policies, the Dominican Republic's merchandise trade balance, which had fluctuated between surpluses and deficits until 1976, entered a period of chronic structural deficit. The trade deficit grew to an average annual level of about \$500 million in the 1980s (see Appendix 3.1). The deficit was offset to a certain extent in the current account by new inflows in two categories—remittances of funds from Dominicans living abroad and receipts from tourism. Private remittances have grown steadily in recent years, to about \$200 million annually.

The economic effects of protectionism and import substitution have been extensively examined by the World Bank.<sup>2</sup> World Bank economists

posit that import substitution had several profound changes on the Dominican economy. First, the policies stunted growth in agriculture. Currency overvaluation subsidized food imports, making them artificially inexpensive. Second, export growth occurred in spite of, not because of, the import substitution strategy. From 1975 to 1980, the most dynamic economic sectors were those in which factor and product price controls were limited and foreign investment was relatively unregulated. Those sectors were industrial free zones and tourism. Over the period, tourism export receipts grew by 20 percent per year, industrial free zone employment increased by 18 percent per year, and foreign exchange receipts from industrial free zones climbed by 26 percent annually.

Import substitution also reduced the productivity of new capital in the Dominican Republic. According to the World Bank,<sup>3</sup> the return on capital fell from a level of over 40 percent per year to a level of less than 15 percent per year during the period of import substitution. The fall in the productivity of capital can be explained as follows. Under the protectionist regime, private investors responded to biased price incentives by investing in import substituting industries. While their profit levels were maintained artificially high due to government policies, the economic return on capital fell precipitously as funds were channeled to inefficient uses.

Once the problem was recognized, the Dominican government responded rapidly to the trade imbalance. In January 1985 the peso was freed from the government-set rate and allowed to trade freely in the exchange market, settling for most of the late 1980s at approximately 3 Dominican pesos to the U.S. dollar. In 1979, the government passed an export promotion law, Law No. 69, which specifically granted fiscal incentives to exporters of nontraditional products that had a high local content. The Dominican government also offers fiscal incentives to firms that locate in industrial free zones.

Export promotion incentives have spurred exports and provided the foreign exchange needed to finance imports and service the debt. The country's import bill of about \$1.2 billion in recent years amounts to about one-quarter of the nation's total output. The share of fuel costs in total imports has risen from 10 percent in 1965 to 36 percent in 1983, bringing the shares of food, machinery, transportation, and other manufactured imports down.

The Dominican Republic's composition of exports has historically been dominated by a small number of agricultural (sugar, coffee, cocoa, and tobacco) and mineral (bauxite, ferronickel, and gold) products. Dominican authorities deem mineral exports to be nontraditional, but they are considered traditional for purposes of this study because they have been exported for a considerable number of years and they fall into a category

that is generally viewed as traditional. The calculation of even reasonable estimates of the shares of nontraditional manufactured good exports is hindered by the fact that official statistics on the exports of the free zones are not published, and hence export totals do not include these figures. Historically, according to official statistics, the export share of the seven traditional commodities noted above remained at around 90.0 percent of total Dominican exports. This share fell to only about 82.3 percent in 1985 and is expected to continue to decline in the future.

Tourism has become a major growth industry, particularly as a relatively low-cost destination following devaluation of the peso. Four large, new tourist hotels on the north coast "tourist zone" were completed in 1985, as well as several smaller hotels throughout the country. The country's net revenues from travel have expanded from \$371 million in 1984 to \$470 million in 1986, thereby far surpassing sugar as the nation's largest earner of foreign exchange.

The Dominican Republic's current account deficits have been financed by capital inflows. Foreign direct investment has recorded net inflows into the economy in all recent years but 1982. The major burden of balance of payments financing, however, has fallen on official borrowings from foreign governments and banks. These borrowings have over time led to a considerable buildup of external indebtedness and to the consequent debt servicing crisis of 1983 through 1985. As of mid-1987, the nation's external debt totaled \$3.8 billion.

In 1985, the government successfully rescheduled \$290 million of its official bilateral debt with the United States and other Paris Club members. Private commercial banks agreed to a multiyear debt rescheduling of some \$800 million, permitting the country to spread its payments over a 13-year period. These reschedulings have greatly reduced the pent-up pressures on the nation's current payments structure, which had been mired in the need to meet ballooning interest and amortization repayment requirements. Despite the spread-out of payments and the government's austere policy stance, the Dominican Republic is reportedly slipping back into arrearages, estimated at about \$150 million at the end of September 1986.

As noted above, the composition of Dominican exports has been dominated by sales of about seven agricultural and mineral commodities. Among these, the leading role has been played by sugar. Sugar cane is grown principally on the country's southern coastal plain. Except for plantations in the Barahona area, which benefit from major irrigation infrastructure, cane operations are dependent on water from natural rainfall and are therefore vulnerable to adverse climatic conditions.

The Dominican Republic has for decades been one of the world's largest sugar producers. With the United States as its primary market,

the Dominican Republic benefited in the 1960s from the closing of U.S. economic relations with Cuba, a significant export competitor. From 1950 to the mid-1970s, sugar exports constituted about one-half of total Dominican exports, growing from \$44 million in 1950 to a historical peak of \$577 million in 1975, due to unprecedented rises in international sugar prices. Dominican sugar earnings have since that year ebbed and flowed as a direct consequence of swings in world demand and prices. In recent years, however, the country's exports of sugar have declined considerably, to only \$207 million in 1985 and an estimated \$177 million in 1986, as a result of cuts in the U.S. sugar quota and lower sugar prices. The Dominican Republic is the largest foreign supplier of sugar to the United States. From exports of 447,000 tons in 1982, the country's sugar quota was reduced continuously to 278,000 tons in 1986. Quota reductions, increasing supplies of sugar beets from European Community countries, and long-term shifts in consumer tastes away from sugar indicate low profitability and smaller markets for sugar in the foreseeable future. As a result, both the government and the private sector have long sought to diversify the agricultural sector away from sugar production.

A second tier of traditional agricultural exports, in terms of relative foreign exchange earnings, consists of coffee and cacao. Coffee is grown primarily on smallholdings, whose owners rely on migrant workers during harvest seasons. With exports of about \$12.7 million in 1950 and accounting for about 15 percent of the nation's total exports in that year, coffee sales stagnated in real terms until the massive commodity price fluctuations of the mid-1970s. Earnings grew to as high as \$185 million in 1977 and have fluctuated in a descending pattern since that time.

Cacao is cultivated chiefly in the northern province of Duarte. Foreign exchange earnings from sales of cacao and products have historically fallen below those of coffee and have been somewhat less susceptible to cyclical swings. Cacao exports have varied around an average of \$60 million in the 1980s.

The Dominican Republic's last traditional agricultural product, tobacco, has never had a material impact on the country's overall export earnings. International sales expanded gradually to a peak of \$66 million in 1981 (accounting for 5.5 percent of total exports), but fell off to annual averages of approximately \$20 million in subsequent years. However, the domestic tobacco industry has provided the raw material for the large and growing nontraditional export sector producing cigars and processed tobacco.

The Dominican Republic's traditional mineral exports consist of bauxite, ferronickel, and gold. Bauxite was the first ore export, exploited beginning in 1959 from commercial reserves found in the country's southwest

peninsula, very close to the border with Haiti. Bauxite exports expanded at a modest rate, reaching a high point of \$23.1 million in 1978 and declining rapidly thereafter. No bauxite has been exported since 1983.

The production and exportation of ferronickel, used in metal alloys, was initiated in 1972 and grew rapidly to make the ore one of the nation's major foreign exchange earners. Until 1982, ferronickel sales accounted for between 10 and 15 percent of total exports. However, in 1982, the second oil-induced global recession forced exports down drastically to only \$24 million (from a 1979 peak of \$123 million). In recent years, export levels have recovered, to \$120 million in 1985.

Exports of gold or, more precisely, dore (a gold/silver mixture) have been of considerable importance in recent years. One could legitimately question whether gold represents a traditional export, since international sales did not begin until 1975. These exports grew very rapidly until 1980, when sales of nearly \$260 million represented as much as 27.1 percent of total Dominican exports. These exports have declined consistently in recent years because the mine's once rich reserves have dwindled. An estimated \$400-million investment in a new mining/refining process is required to revitalize the industry, and the World Bank has been approached for a loan. The country's 1985 sales of dore amounted to \$114 million and grew slightly in 1986.

Unlike most countries in the Caribbean region, the Dominican Republic's expanding nontraditional export sector is diversified in both agricultural and manufacturing categories. Agribusiness concerns have for several years actively sought to expand their product lines, and light manufacturing companies have been established to take advantage of the country's low wage structure.

Analysis of the Dominican Republic's nontraditional exports is complicated by major data deficiencies. For example, the government does not regularly collect and publish data on the exports generated in the free zones, on the grounds that sales from the zones do not represent true exports because since they only "reexport" imported components that are processed or assembled in the zones. As a result, official figures for exports only include transactions conducted outside the zones. In addition, official figures are probably subject to a serious degree of underreporting, given the allegedly commonplace practice of invoicing at below true value levels in order to retain foreign exchange abroad.

Notwithstanding these and other statistical problems, there is sufficient evidence to indicate that the production and sale of nontraditional exports have indeed "taken off" in the Dominican Republic and represent the only significant prospect for growth in the future. The expansion of these exports require time, however, and hence earnings from nontra-

ditional exports have not yet increased to the point of compensating for reductions in the country's traditional exports.

According to statistics collected by CEDOPEX, the government export promotion agency, nontraditional exports accounted for 17.3 percent of total exports in 1985. These figures do not, however, include exports from the free zones. Including zone exports, the share of nontraditional exports doubles to 35.2 percent.

By any standard, apparel heads the list of the Dominican Republic's nontraditional exports. Almost all of these garments are sold to the United States under trade provisions allowing duties to be applied only to the locally added value of products. Under 807 provisions in U.S. trade law, components made in the United States can be exported for assembly, and only the foreign value added (the labor content) is subject to U.S. tariffs. Precut clothing pieces are brought in from the United States, are assembled in Dominican factories, and are shipped back to the United States. Apparel exports to the United States have grown at a high rate, from \$138 million in 1983 to \$175 million in 1984 and \$217 million in 1985. Sales in 1987 were estimated at over \$380 million. The Dominican Republic is the largest Caribbean Basin apparel exporter to the United States.

The garment industry employs the greatest number of workers in the export free zones and produces the vast majority of zone exports. Nationwide, the apparel industry is estimated to employ somewhere between 100,000 to 150,000 workers, producing clothing for local and export markets.

So long as local wage rates do not rise significantly in U.S. dollar terms, the only practical limit on Dominican apparel exports is the U.S. quota under the multifiber arrangement. In fact, the Dominican Republic has become the site for a number of factories opened by East Asian firms, since their home factories have reached their quota limits. Dominican companies have filled their quotas in several clothing categories, but can diversify into other items.

Other major export goods produced in the free zones include processed tobacco and cigars, paper medical gowns, computer parts, electrical switching gear, shoe parts and other leather products, and gold chains. Total exports in each of these categories exceeded \$10 million in 1985. Values of sales in all of these product areas have fluctuated in recent years, but the overall trend is favorable. According to CEDOPEX statistics, exports from the free zones have risen from \$175 million in 1983 to \$194 million in 1984 and \$205 million in 1985. About 90 percent of the output of the free zones is exported to the United States.

Nontraditional manufactured goods produced outside the Dominican Republic's free zones include a wide variety of products. Processed foods

include beef, cream of coconut, canned peas, and cocoa butter. Among nonfood export items are wearing apparel, leather purses, chemical fertilizer, wood furniture, dry batteries, and cement. Exports of industrial goods are destined primarily for neighboring markets in the Caribbean Common Market (CARICOM) region, whereas most consumer-good items are sold to the United States and other industrial countries.

Exports of nontraditional agricultural products have increased steadily in recent years, at average annual rates of about 13 percent. Declines in incomes derived from traditional cash crops, especially sugar, have forced farmers and agribusiness firms to experiment with alternative crops. Certain products, such as yautia root, sweet potatoes, yucca, and pigeon peas, are exported to countries in the region. Other crops, including frozen mixed vegetables, dried coconuts, sweet peppers, melons, pineapples, and oranges, are shipped primarily to the United States. In each of the product categories listed above, Dominican exports exceeded \$1 million in 1985. CEDOPEX statistics indicate that nontraditional agricultural exports totaled \$40 million in 1985, a figure that is probably understated. The Dominican Republic's nontraditional exports of melons, tropical fruit, avocados, winter vegetables, and other crops filled an estimated 50,000–60,000 forty-foot shipping containers in 1986.

A number of agricultural export ventures have failed and almost all have encountered serious start-up difficulties, such as rejected shipments, transportation problems, or poor marketing or joint venture arrangements. However, agribusiness companies appear to be firmly committed to expand their nontraditional "cash crop" sales, and progress achieved to date suggests that these exports will continue to expand.

### *Determinants of Nontraditional Exports*

Foreign investment has historically played a significant role in the Dominican export sector. Investors from the United States and Europe financed the infrastructure and research and development needed for the nation's agricultural exports, including sugar, cacao, coffee, and tobacco. Over time, an increasing number of investments were joint ventures with locally owned firms.

As in many countries, foreign investment and exports are mutually supportive in the Dominican Republic. Investment inflows have provided capital, technology, and market knowledge and access. Entrepreneurs have been drawn by abundant and technically competent labor resources, political stability, a policy climate conducive to investment, and easy access to U.S. markets. As a result of these and related factors, the Dominican Republic has attracted more new foreign investments than

any other country in the Caribbean/Central American region that is eligible for the Caribbean Basin Initiative (CBI) and other incentives. However, the relatively attractive investment climate rather than CBI incentives has been the principal impetus for investors. Since 1983, over 120 U.S. companies have invested in the Dominican Republic, and ventures by firms from Europe and the Far East have also increased dramatically. Most of these investments have been in the nation's relatively advanced network of industrial free zones.

Abundant and inexpensive labor has been the driving force behind the Dominican Republic's ability to produce and successfully market nontraditional exports. The 1988 national minimum wage of 500 pesos per month translates into an hourly wage rate of about \$.51 at an exchange rate of 5 pesos per U.S. dollar, since the normal work week is 44 hours. The minimum wage rose from a monthly rate of 125 pesos in 1983 to 154 pesos in 1984 and 250 pesos in 1986. Taking domestic inflation into account, wages have recently remained flat in real peso terms, but have fallen significantly in U.S. dollar terms.

The Dominican labor force can be considered the nation's principal economic asset. With high prevailing unemployment levels, the country's pool of available labor is abundant. Workers are characterized as highly trainable, dexterous, and capable of utilizing new technologies. Trade unions are permitted by law, but there have been no unions in the free zones since 1968. Overall, the quantity and quality of productive labor are seen as providing a highly positive contribution to the country's international competitiveness.

At the opposite end of the spectrum from labor, which represents a positive determinant of nontraditional exports, the availability of financial capital is considered the primary constraint to export growth. Prior to currency unification and devaluation, the country's capital pool had diminished due to capital flight. In addition, large portions of available funds were absorbed by the government in efforts to finance budget deficits.

While the problems of capital flight and excessive government spending have been largely overcome, the continuing foreign exchange shortages caused by trade deficits and the high interest rates resulting from tight monetary policies have reduced the availability of investment and working capital to exporters. Exporters interviewed unanimously complained about the cost of borrowing. Commercial bank lending rates in the formal sector have fallen from the 20 to 25 percent range in late 1985 to the 16 to 20 percent range in late 1986. However, access to these funds is highly limited. Interest charges for short-term financing in the informal financial market are typically as high as 30 to 36 percent annually and often require a front-end fee of 6 percent of the principal amount. Thus,

a basic constraint to export growth is not market limitations but rather the dearth of investment funds in the Dominican Republic. The current policy structure provides greater incentives for entrepreneurs to invest capital in tourism ventures than in agricultural or light manufacturing activities.

The problem of shortages of capital and hard currency funds affects many exporters at the daily operational level. Due to their recent performance in producing high-quality, low-cost goods, firms face the "luxury" of rapidly growing orders. However, they are unable to obtain funds for plant expansion or working capital to cover trade financing for larger shipments. As a result, they are often placed in a precarious liquidity position, with uncertain cash-flow capabilities to meet ongoing operating costs. Similarly, many small companies feel they are "forced" into underinvoicing their shipments in order to retain foreign exchange needed to cover foreign currency obligations.

The expansion of Dominican nontraditional exports could not have occurred were it not for the unification/devaluation of the peso in early 1985. As in Jamaica, the adoption of a realistic exchange rate in the Dominican Republic has produced dollar-equivalent wage rates that are competitive not only in the region but worldwide when transportation costs and other factors are taken into consideration. The prevailing exchange rate of about 3:1 is slightly above the calculated "shadow rate" of 3.4:1 and the parallel "black market" rate of 3.1:1. For all practical purposes, the black market has disappeared, since numerous new "storefront" banks can now legally deal in foreign exchange. Should domestic inflation and government unwillingness to allow depreciation in the peso's value cause overvaluation, however, the prospects of nontraditional exporters would be diminished.

The Dominican Republic's industrial free zones have played a critically important catalytic role in the development of nontraditional exports. The first zone, La Romana, was established in 1969. Some 62,000 workers were employed in the country's 9 operational zones in 1987, up from some 44,000 one year earlier. Six additional zones are under construction, and an additional 14 are in start-up phases.

Initial zone activity was heavily concentrated in textiles and apparel, but has gradually become more diversified by adding electronics, footwear, gold chain, cigar, data entry, and other labor-intensive industries. However, garments still constitute between two-thirds and three-fourths of the zones' total output.

Established on the basis of a series of laws and decrees dating back to 1955 and culminating with the Free Zone Law (Law 145) of 1983, the free zones offer producers a number of important fiscal incentives, the most important of which is exoneration from income taxes and

import duties on machinery and components. Companies are required to pay for local expenses (wages, plant leases, and local supplies) in U.S. dollars at prevailing market rates of exchange. These foreign exchange expenses grew from \$44.5 million in 1980 to \$56.8 million in 1984, before falling off to an estimated \$30.0 million in 1985. This latter figure did not represent a reduction in zone activity, but rather was caused by the peso devaluation, which lowered operating costs in the zones. From 1970 to 1985, the free zones contributed approximately \$300 million (net) in foreign exchange to the Dominican economy. In 1987 alone, the zones produced gross exports worth \$309 million. Over the long run, the commercial activities carried out in the free zones have not only been important in their own right by generating employment and foreign exchange, but equally importantly they have created a highly positive "demonstration effect" for the economy as a whole. The free zones have served as a positive catalyst for local export businesses. Having observed the success of firms in the zones, numerous Dominican manufacturers of apparel, furniture, and other goods for local consumption have extended their operations to serve foreign markets.

Notwithstanding the positive contributions of the zones, they have not yet successfully developed "backward linkages" into the domestic economy. With few exceptions, most components are imported rather than obtained locally. However, efforts are now under way to identify and assist domestic suppliers of components, packaging material, and other inputs.

According to most business executives interviewed, the future of nontraditional exports will depend on trends in the availability and cost of electricity. Electricity rates remained relatively flat in the early 1980s, since government-imported oil was sold at subsidized prices. These prices were raised dramatically in early 1985 in concert with the structural adjustment program implemented at that time. Rates are now tied to oil prices. There is some speculation as to whether the full benefits of oil-price reductions have been passed on to industrial consumers. More important than cost, however, is the critical need to reduce the frequency of power outages.

Compared to other countries in the region, the Dominican Republic benefits from sufficient and relatively advanced infrastructure. Most business executives interviewed, however, complained that high transportation costs by both sea and air have strongly reduced their profit margins. This problem is considered particularly acute for producers of relatively low-value bulk commodities such as unprocessed agricultural products. Similar concerns were raised with respect to packaging materials and services, which are generally regarded to be expensive and not of good quality.

Most Dominican exporters of both agricultural and manufactured products expressed a critical need for a strong marketing or joint venture relationship with a U.S. partner. This is particularly important during start-up phases of the business, since Dominican firms with new product lines often have very limited knowledge of U.S. markets and policies. Dominican nontraditional exporters need and are seeking mutually beneficial relationships with U.S. firms, but have had mixed results in this area thus far. In one manufacturing industry example, the U.S. partner did not fulfill its marketing obligations. In a case in agribusiness, the U.S. partner imposed expensive and inappropriate cultivation techniques, resulting in disappointing crop yields.

The export incentive structure governing free zone activities has been developed on the basis of numerous laws and presidential decrees, which in combination provide duty and income tax exoneration and procedures for retaining foreign exchange earnings and remitting profits and investment capital. The overall incentive structure is adequate and in fact has been essential to the viability of firms located in free zones.

Exporting companies operating outside the free zones may qualify for fiscal incentives under Law 299 on "Industrial Incentives and Protection." This 1968 law is highly complex inasmuch as it covers both exporting and import-substituting industries. More important, however, is Law 69, the export incentive law enacted in 1979 to promote non-traditional exports. This legislation allows duty-free entry of imported inputs if they are exported within twelve months after having been assembled or otherwise transformed. These incentives are administered by CEDOPEX, which rules on applications for benefits, and by the Central Bank. Law 69 incentives have been used by a wide range of nontraditional export industries, including apparel, cement, pineapples, cigars, and furniture.

The number of beneficiaries of Law 69 has grown from 659 companies in 1982 to 756 firms in 1984, according to CEDOPEX. In 1984, 275 new products were introduced under this law, and approximately \$421 million in imports entered duty-free under the system. Export tax credits granted under the system totaled 4.8 million pesos in 1985.

The fiscal incentive structure provided by the government is clearly important to nontraditional exporters, who expend considerable energies assuring that their firms obtain benefits. However, the complexities and ambiguities emerging from the numerous incentives laws and provisions (only briefly summarized herein) are the source of ongoing criticism and charges of discretionary treatment.

The provisions of Section 807 of the U.S. Tariff Code, the Generalized System of Preferences (GSP), and the Caribbean Basin Initiative (CBI) are equally if not more important than Dominican incentives to the

viability of nontraditional export activities. Some exporters, particularly in agribusiness, voiced some complaints regarding arbitrary rulings and constantly changing "rules of the game" on the part of U.S. agencies. However, these expressions do not appear as strong as those observed in other countries examined in this study, presumably since the Dominican Republic has a longer history and greater amount of experience in exporting diverse goods to the United States.

Ubiquitous throughout the region, complicated customs practices and delays in clearing imported inputs are considered a principal constraint to Dominican export growth. Most nontraditional exporters operate on tight delivery schedules that require prompt receipt of raw materials and components. Customs clearance delays have resulted in lost contracts. Problems in customs administration are prevalent in most developing countries, particularly those experiencing chronic foreign exchange and government revenue shortages. On a more positive note, however, Dominican exporters indicated that if the government customs system worked well, the entire country could eventually become an "export zone."

Unlike most exporters from Central America, exporters from the Dominican Republic do not speak of political instability as a threat to their businesses. Quite the contrary—several manufacturers located in free zones stated that the nation's record of political stability, with over twenty years of relatively peaceful elections and changes of administrations, was one of its strongest drawing cards.

In addition to political stability, the Dominican Republic has offered policy stability to the business community. The prevailing government stance has followed a relatively stable, probusiness, proexport approach and has not varied between widely diverging development policies as has been the case in Jamaica, for example.

### *Nontraditional Export Opportunities*

The Dominican Republic faces the broadest range of nontraditional export opportunities of all countries in the Caribbean Basin region. The majority of these prospects fall into the categories of agricultural products and light manufactured goods.

The Dominican Republic has already established a strong foothold in a number of agricultural exports, based on the country's agricultural capacity and experience in selling to U.S. and regional markets. Sales of winter vegetables (table tomatoes, sweet peppers, beans, and so on), melons, tropical fruit, avocados, and staples (potatoes, yams, and so on) can be expected to grow over time, particularly after marketing networks

are fully developed and firms gain experience in dealing with U.S. policies and procedures for food imports.

The outlook for processed goods such as canned beans, tomato paste, and other bulk commodities is considered relatively limited compared to that for fresh fruit and vegetables. Overall, the agricultural export sector involving new products is likely to absorb increasing amounts of idle rural labor and to generate rising foreign exchange earnings, but rates of growth will be only moderate. Therefore, agricultural exports should be viewed as a long-term development prospect rather than as a means to meet the country's near-term foreign exchange requirements.

Horticulture has been named by some observers as a strong export opportunity. Local producers claim, however, that they face strong price competition in particular flower categories, particularly from Colombia. In addition, exporters are constrained by infrastructure problems (e.g., lack of refrigeration facilities at airports) and difficulties transporting their products to domestic airports. Overall, therefore, the expansion of horticulture exports will probably be more modest than is generally assumed.

The real opportunities for nontraditional exports in the near future lie in the fields of assembly operations and light manufacturing, where the Dominican Republic has established a clear lead over its Caribbean competitors. Apparel firms will continue to increase their output until they reach their quota limits and are expected to pursue higher value added items and non-quota apparel products, following the strategies successfully employed by firms operating in East Asia.

Exports of labor-intensive manufactures can be expected to burgeon in the years immediately ahead. It is likely that electronics will head the list. Current exporting companies TII Industries and R. E. Phelon, among other smaller firms, have recently been joined by Westinghouse, which estimates that its Dominican work force producing electromechanical devices and printed circuit boards will eventually expand to 1,000 workers. General Electric and GTE Corporation plan similar operations. The Dominican economy, unlike many others in the region, is sufficiently large to support operations of major scale without their becoming "politically visible" due to their size. Other manufacturing possibilities in the near term include footwear (especially shoe parts, which are finished in Puerto Rico), medical supplies, pharmaceuticals, leather products (e.g., gloves, handbags, and other accessories), and jewelry.

In recent years, a considerable amount of attention has been drawn to the so-called twin plant concept. Under this scheme, companies

currently operating in Puerto Rico under Section 936 of the U.S. Internal Revenue Code can set up a complementary plant in the Dominican Republic to take advantage of low wage rates while still maintaining their "936" tax advantages in Puerto Rico. The Dominican Republic has led the field in enticing twin plant operations, of which twenty have been or are in the process of being established. Most of these firms are producing apparel, footwear, and electronics, but other goods include medical supplies, food processing, recycled plastics, and candy. Opportunities in twin plant activities should continue to be pursued but with a degree of caution. First, the long-term outlook for the 936 provision is questionable, given U.S. attempts to eliminate this tax benefit. Second, the Dominican Republic's eligibility for twin plant treatment may be threatened by U.S.-imposed financial reporting requirements, which the government is currently unable to meet.

Dominican exporters of nontraditional manufactures are for the most part currently limited to subcontracting. This was, in fact, the first step taken by many successful exporters such as the newly industrializing countries. Over the long run, one can expect Dominican producers to move into finished products (e.g., consumer electronics) and to begin direct marketing. In fact, as is the case with Jamaica, Dominican exporters should examine new opportunities in product categories currently dominated by East Asian countries and by U.S.-Mexican "maquiladora" operations (U.S. offshore assembly activities set up in Mexico along its border with the United States). Asian exporters are experiencing declines in competitiveness due to rising wage rates and graduation from GSP benefits. Potential product lines would include consumer electronics, Christmas lights and ornaments, toys, sporting goods, bicycles, fabricated metals and plastics, kitchenware and flatware, and many other export items. The manufacturing processes required for these commodities offer, over time, increasing opportunities for "backward linkages" and finding local sources of inputs.

In conclusion, the outlook for nontraditional exports produced in the Dominican Republic will remain bright so long as domestic economic conditions (primarily wages and exchange rates) support price competitiveness and so long as U.S. markets remain open to Dominican goods. The export sector has taken hold and has gradually captured the imagination of both the government and the business community. In particular, the high growth rate in the output and employment levels of Dominican free zones indicates that the competitive wage rates and political stability give the country a definite comparative advantage in labor-intensive and increasingly high value-added assembly operations.

### *Conclusions and Recommendations*

The level of fiscal incentives provided to investors and exporters is sufficient and competitive by regional and world standards. In fact, in some cases (e.g., perpetual tax holidays) the incentives might even be excessive from a national interest perspective. Nonetheless, the policy structure is based on a complex web of laws and decrees and is administered by a host of government and quasi-government agencies. To facilitate business decision making and ongoing management, the government should consider a legal/institutional policy reform that streamlines the structure and administration of investment and export promotion policies. One method for achieving this goal would be the creation of a high-level locus of decision making for reviewing current regulations and designing a comprehensive new system. This investment/export commission, council, or agency would be vested with responsibility to direct the country's shift toward a complete export orientation.

A second recommended measure is the reform of customs procedures and administration. While acknowledging the constraints placed on a country suffering from chronic foreign exchange shortages, the government should over time seek to improve the customs process, which currently deters nontraditional export growth. To a certain extent this will require an educational/training program to sensitize customs officials to the needs of exporters. However, effective reform will depend on the achievement of the more difficult objectives of reducing discretionary treatment and corruption and expanding the government's ability to enforce existing regulations.

The country's financial market faces a basic dilemma in that borrowers complain of high interest charges and collateral requirements, whereas lenders claim that pursuing a loan default claim is extremely difficult. Expanding and deepening capital markets is a long-term proposition that requires good macroeconomic and company-specific performance and increasing trust on the part of all market participants. Long-term capital is needed in the Dominican Republic in order to finance additional factory space and equipment, and short-term funds are required to cover working capital for larger export transactions. Efforts by the government, the private sector, or the international donor community to extend additional capital to legitimate firms with proven performance would generate considerable dividends for the economy as a whole.

As in many countries in the region, Dominican exporting companies can be characterized as having relatively thin management and marketing capabilities. Top-level executives are often responsible for all facets of their firms' operations, including production, administration, and mar-

keting. Programs to train middle-level managers would yield positive long-term results. Local agricultural and manufacturing companies have also benefited significantly from on-the-job training and consulting provided by expatriates on a short-term basis, but these services are often prohibitively expensive. Finally, the U.S. government could assist Dominican exporters by establishing an unchanging set of "rules of the game" for import policies and procedures and by disseminating this information in a clear and comprehensive fashion.

APPENDIX 3.1  
 Quantifiable Determinants of Non-traditional Exports  
 DOMINICAN REPUBLIC, 1963-1986

	1963	1964	1965	1966	1967
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	174.3	179.4	125.5	136.7	156.2
Traditional exports	152.2	162.5	110.2	125.9	142.4
Non-traditional exports	22.1	16.9	15.3	10.8	13.8
Merchandise imports (FOB)	164.6	202.4	120.7	166.9	174.7
Trade balance	9.7	(23.0)	4.8	(30.2)	(18.5)
Current account balance	(19.4)	(61.8)	42.9	(74.9)	(66.2)
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	1,009.1	1,123.3	954.4	1,074.3	1,121.6
GDP growth (Nominal %)		11.3	(15.0)	12.6	4.4
GDP (1980 prices)	2,555.3	2,659.8	2,370.5	2,681.3	2,772.3
GDP growth (Real %)		4.1	(19.9)	13.1	3.4
<b>CAPITAL FORMATION</b>					
Fixed capital formation	139.2	187.9	86.8	156.1	160.7
Increase in stock	17.5	16.6	(2.3)	14.8	7.1
Foreign direct investment**					
Domestic credit	183.8	214.4	216.9	223.6	255.3
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt					
Debt service					
Debt service as % of exports					
<b>OTHER</b>					
M1	130.2	116.6	135.0	116.1	120.2
Budget deficit	(18.1)	(27.1)	(31.6)	(32.5)	(27.9)
GDP deflator (1980=100)	39.5	42.2	40.3	40.1	40.5

All figures in millions of Dominican pesos unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 3.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 DOMINICAN REPUBLIC, 1963-1986

	1968	1969	1970	1971	1972
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	163.5	183.4	214.0	240.7	347.6
Traditional exports	145.3	162.9	188.4	211.9	306.5
Non-traditional exports	18.2	20.5	25.6	28.8	41.1
Merchandise imports (FOB)	196.8	217.2	278.0	309.7	337.7
Trade balance	(33.3)	(33.8)	(64.0)	(69.0)	9.9
Current account balance	(75.2)	(84.7)	(101.9)	(129.4)	(47.1)
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	1,149.4	1,344.5	1,485.5	1,666.5	1,987.4
GDP growth (Nominal %)	2.5	17.0	10.5	12.2	19.3
GDP (1980 prices)	2,785.8	3,125.9	3,392.1	3,760.7	4,151.6
GDP growth (Real %)	0.5	12.2	8.5	10.9	10.4
<b>CAPITAL FORMATION</b>					
Fixed capital formation	165.9	220.1	245.9	293.7	426.7
Increase in stock	(5.1)	31.1	38.4	3.9	(35.1)
Foreign direct investment**					
Domestic credit	314.3	363.7	407.4	479.7	572.2
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt					
Debt service					
Debt service as % of exports					
<b>OTHER</b>					
M1	139.1	149.3	171.7	188.1	222.5
Budget deficit	(13.3)	(16.1)	(10.1)	(19.7)	(3.2)
GDP deflator (1980=100)	41.3	43.0	43.8	44.3	47.9

All figures in millions of Dominican pesos unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 3.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 DOMINICAN REPUBLIC, 1963-1986

	1973	1974	1975	1976	1977
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	442.1	636.8	893.8	716.4	780.5
Traditional exports	396.7	583.8	829.9	635.4	706.8
Non-traditional exports	45.4	53.0	63.9	81.0	73.7
Merchandise imports (FOB)	421.9	673.0	772.7	763.6	849.3
Trade balance	20.2	(36.2)	121.1	(47.2)	(68.8)
Current account balance	(96.6)	(240.9)	(72.8)	(129.2)	(128.6)
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	2,344.7	2,931.2	3,599.1	3,951.5	4,587.1
GDP growth (Nominal %)	18.0	25.0	22.8	9.8	16.1
GDP (1980 prices)	4,687.1	4,968.4	5,226.4	5,578.1	5,855.7
GDP growth (Real %)	12.9	6.0	5.2	6.7	5.0
<b>CAPITAL FORMATION</b>					
Fixed capital formation	497.8	643.6	802.7	780.3	939.2
Increase in stock	20.3	45.1	79.4	101.4	60.3
Foreign direct investment**				52.0	61.2
Domestic credit	702.7	986.1	1,090.2	1,178.1	1,312.2
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt		535.7	637.1	748.4	918.4
Debt service		34.7		58.3	
Debt service as % of exports		5.4		8.1	
<b>OTHER</b>					
M1	260.1	364.2	379.7	390.4	460.0
Budget deficit	(20.6)	(41.8)	56.3	(10.6)	(0.1)
GDP deflator (1980=100)	50.0	59.0	68.9	70.8	78.3

All figures in millions of Dominican pesos unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

## APPENDIX 3.1 (Cont.)

Quantifiable Determinants of Non-traditional Exports  
DOMINICAN REPUBLIC, 1963-1986

	1978	1979	1980	1981	1982
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	675.5	868.6	961.9	1,188.0	767.7
Traditional exports	577.8	764.1	856.6	1,059.6	656.0
Non-traditional exports	97.7	104.5	105.3	128.4	111.7
Merchandise imports (FOB)	862.4	1,137.5	1,519.7	1,451.7	1,257.3
Trade balance	(186.9)	(268.9)	(557.8)	(263.7)	(489.6)
Current account balance	(311.9)	(331.3)	(669.8)	(405.9)	(441.9)
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	4,734.4	5,498.8	6,630.7	7,266.9	7,981.3
GDP growth (Nominal %)	3.2	16.1	20.6	9.6	9.8
GDP (1980 prices)	5,981.3	6,252.1	6,630.7	6,900.1	7,015.7
GDP growth (Real %)	2.1	4.5	6.1	4.1	1.7
<b>CAPITAL FORMATION</b>					
Fixed capital formation	1,031.8	1,334.7	1,566.8	1,640.3	1,540.9
Increase in stock	98.4	59.5	81.8	61.2	104.6
Foreign direct investment**	50.8	13.2	71.2	67.6	(1.3)
Domestic credit	1,413.6	1,639.4	1,963.9	2,318.6	2,773.3
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt	1,073.6	1,198.3	1,478.2	1,636.0	1,913.3
Debt service	90.7	249.3	156.7	233.6	260.3
Debt service as % of exports	13.4	28.7	16.3	19.7	33.9
<b>OTHER</b>					
M1	458.0	598.4	579.6	636.9	715.4
Budget deficit	(70.4)	(315.1)	(172.9)	(181.4)	(246.6)
GDP deflator (1980=100)	79.2	88.0	100.0	105.3	113.8

All figures in millions of Dominican pesos unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 3.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 DOMINICAN REPUBLIC, 1963-1986

	1983	1984	1985	1986
<b>TRADE STATISTICS*</b>				
Merchandise exports (FOB)	785.2	868.1	738.5	717.6
Traditional exports	683.5	735.3	564.4	519.5
Non-traditional exports	101.7	132.8	174.1	198.1
Merchandise imports (FOB)	1,282.2	1,257.1	1,285.9	1,245.8
Trade balance	(497.0)	(389.0)	(547.0)	(528.2)
Current account balance	(421.1)			
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	8,574.8	10,705.6	14,487.9	16,156.6
GDP growth (Nominal %)	7.4	24.8	35.3	11.5
GDP (1980 prices)	7,292.2	7,319.4	7,157.5	7,295.8
GDP growth (Real %)	3.9	0.4	(2.2)	2.0
<b>CAPITAL FORMATION</b>				
Fixed capital formation	1,705.1	2,156.1		
Increase in stock	81.7	99.2		
Foreign direct investment**	45.1	67.5		
Domestic credit	3,233.9	3,502.3	3,844.0	
<b>EXCHANGE RATE</b>				
Exchange rate	1.0	1.0	3.2	2.9
<b>FOREIGN DEBT*</b>				
External debt	2,403.2			
Debt service	230.6			
Debt service as % of exports	29.4			
<b>OTHER</b>				
M1	767.5	1,154.8	1,321.1	1,494.9
Budget deficit	(216.4)	(114.9)	(212.0)	
GDP deflator (1980=100)	117.6	146.3	202.4	221.4

All figures in millions of Dominican pesos unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

***Notes***

1. International Monetary Fund, *International Financial Statistics Yearbook, 1987* (New York: 1987), pp. 310-313.
2. World Bank, "Dominican Republic: Economic Prospects and Policies to Renew Growth," A World Bank Country Study (Washington, D.C.: 1985).
3. *Ibid.* p. 2.

## *Guatemala*

*Philip E. Karp*

Guatemala has been struggling in recent years to achieve export diversification both in terms of markets and the product mix of its exports. Hit hard by declining regional demand, Guatemalan exporters have been attempting to enter new markets and to broaden the range of products shipped abroad. These efforts are hampered by an inefficient industrial structure, developed under the protectionist umbrella of the Central American Common Market (CACM), and growing regional instability that discourages new investment.

### *The Economic and Political Context*

Agriculture remains the mainstay of the Guatemalan economy, accounting for about one-quarter of gross domestic product (GDP), two-thirds of export value, and 60 percent of employment. Commerce and manufacturing contribute, respectively, 25 and 16 percent of GDP. The importance of the mining sector has grown considerably since the discovery of petroleum. However, mining still accounts for less than 3 percent of GDP. While the GDP shares of agriculture, manufacturing, and commerce have remained relatively stable, the diversification and deepening of each of these sectors have increased the range of products suitable for export. Until the mid-1980s, the manufacturing sector in particular enjoyed significant export growth, largely within the framework of the CACM.

Following relatively stable economic growth on the order of 6–7 percent per year throughout the 1960s and 1970s, Guatemala's economy has been buffeted by a series of external shocks since 1979. After recording near-zero growth in 1980 and 1981, the economy was plunged into a recession during the 1982–1983 period, as regional political instability, deteriorating terms of trade, and weakened international

**Table 4.1**  
**Key Output and Price Indicators, Guatemala, 1981-1986**  
 (percentage change)

	1981	1982	1983	1984	1985	1986
Real GDP	0.6	-3.5	-2.6	0.6	-1.1	0.0
Consumer prices	11.4	5.0	6.4	3.6	18.7	23.0

Source: Central Bank of Guatemala, various unpublished reports, 1983-1985; and International Monetary Fund, International Financial Statistics, 1986 (New York: IMF, 1986).

demand combined forces to reduce production and trade. The economy recovered moderately in 1984, but again recorded negative growth in 1985 and zero growth in 1986 due to declining consumption and investment in the face of rising inflation and growing unemployment (see Table 4.1).

Since gaining independence from Spain in 1821, Guatemala has had a turbulent political history. Through most of the nineteenth and early twentieth century, Guatemala was under the rule of a succession of military dictatorships, broken only by a few short periods of democratic government. Since World War II, the country has gone through several periods of political violence that led to the imposition of severe restrictions on civil liberties and widespread allegations of human rights violations. A new government, headed by democratically elected President Marco Vinicio Cerezo, came into office in early 1986. It has initiated an adjustment effort aimed at setting the economy on a path toward stabilization and recovery. The program is centered around exchange rate reform coupled with measures of fiscal and monetary restraint.

#### *Trade and Payments Profile*

Guatemala's balance of payments structure is typical of that of many developing countries, with chronic trade and current account deficits financed by inflows of private and official capital. Guatemala has posted a surplus in its trade balance only once since 1970.

Five major commodities—coffee, cotton, sugar, bananas, and cardamom—account for nearly 65 percent of Guatemala's export receipts. The United States buys about one-third of Guatemala's exports, followed by the rest of Central America with a share of about one-fourth. Central America's share in total exports has declined sharply in recent years, from around 35 percent in 1980 to just over 20 percent in 1985.

**Table 4.2**  
**Balance of Payments Summary, Guatemala, 1981-1985**  
 (millions of U.S. dollars)

	1981	1982	1983	1984	1985
<b>Current Account</b>					
Exports (f.o.b.)	1,291	1,170	1,092	1,132	1,112
Imports (c.i.f.)	1,674	1,388	1,135	1,279	1,175
Trade balance	-383	-218	-43	-146	-63
Net factor payments	-85	-115	-138	-210	-221
Services and transfers (net)	<u>-105</u>	<u>-72</u>	<u>-95</u>	<u>-30</u>	<u>45</u>
	-573	-405	-276	-386	-239
<b>Capital Account*</b>					
Public sector (net)	109	108	124	21	24
Private sector (net)	-9	-219	23	48	108
Financial sector (net)	<u>124</u>	<u>200</u>	<u>161</u>	<u>130</u>	<u>-1</u>
	224	89	308	199	131
<b>Overall Balance</b>	-349	-316	32	-187	-108

\*Includes net errors and omissions

Source: International Monetary Fund, International Financial Statistics, 1986 (New York: IMF, 1986).

Industrial inputs and consumer goods are the largest category of imports, followed by capital equipment and construction materials. The United States has historically been the largest supplier of imports to Guatemala, accounting for about one-third of 1985 imports. As in the case of exports, imports from the rest of Central America have declined steadily since 1981, currently accounting for about 8 percent of the total. Mexico and Venezuela have increased their share in Guatemala's imports in recent years, mainly due to an increase in oil imports under a special financing agreement.

While Guatemala's trade deficit has narrowed since 1980 (Table 4.2), the improvement has stemmed primarily from austerity-induced import compression, as declining commodity prices have kept export revenues relatively stagnant. The improvement in the trade balance has been offset, however, by declining private foreign investment and increased capital flight, both in response to political and economic uncertainties in the region.

Despite a rapid buildup in foreign debt since 1980, Guatemala's debt burden remains well below that of most of its regional neighbors. Guatemala's total outstanding external public debt of approximately US\$1.8 billion (year-end 1986) represents about US\$225 per capita, as

Table 4.3  
Trends in Export Performance, Guatemala, 1980-1985  
(millions of U.S. dollars)

	1980	1981	1982	1983	1984	1985
Total Exports	<u>1,499</u>	<u>1,291</u>	<u>1,170</u>	<u>1,092</u>	<u>1,132</u>	<u>1,112</u>
Traditional	819	727	698	660	706	726
Nontraditional	<u>680</u>	<u>564</u>	<u>472</u>	<u>432</u>	<u>426</u>	<u>386</u>
Agricultural products	101	86	86	67	76	76
Industrial products	488	408	344	324	311	280
Other	91	70	42	41	39	30

Figures may not match figures in Appendix 4.1 due to differences in source and methodology.

Source: Central Bank of Guatemala, various unpublished reports, 1983-1985.

compared to a per capita debt of US\$1,400 for Costa Rica. The ratio of debt service to exports of goods and services, which averaged under 8 percent from 1980 to 1983, has risen to about 25 percent.

### *Export Performance*

As noted previously, Guatemala's export sector is dominated by coffee, cotton, sugar, bananas, and cardamom, with coffee far outpacing any of the others. Other exports denominated as "traditional" by the government are meat and petroleum.<sup>1</sup>

Following strong growth during the late 1970s, the value of traditional exports has remained relatively stagnant since 1980 (see Table 4.3). The value of nontraditional exports has declined steadily, after peaking at US\$680 million in 1980. To a large extent, this decline is the result of a 50 percent drop in exports to other Central American countries. However, nontraditional exports to countries outside the CACM have also fallen, due in part to a loss in competitiveness arising from the overvaluation of the quetzal.

Coffee is Guatemala's most important export crop, typically accounting for from 35 to 40 percent of total export earnings. Coffee exports boomed during 1985 and 1986 because of favorable prices. Adverse weather conditions in several major supplier countries led to a worldwide supply shortage and increasing prices.<sup>2</sup>

Cotton remains Guatemala's second largest export, but cotton's share in total exports has fallen steadily in recent years. This decline reflects lower production, largely due to security problems in cotton-growing areas, coupled with depressed international prices and the rising dollar-cost of pesticides. Total acreage under cotton cultivation has declined from about 129,000 hectares in 1980 to less than 40,000 hectares in 1986.

Banana exports recovered strongly in 1985 to US\$71 million following two years of depressed production resulting from hurricane damage. Exports also benefited from a strengthening of international prices. About 70 percent of banana exports are destined for the United States, where Guatemala faces growing competition from other regional producers.

Like other sugar producers in the region, Guatemala has been seriously affected by reductions in U.S. import quotas. Once the country's third most important export, sugar currently accounts for only about 4 percent of total export value. Despite a 42 percent increase in volume since 1981, export receipts have been cut nearly in half as larger shipments are sold in the free market at prices about one-third of those commanded in the United States.

Guatemala is the world's second largest exporter of cardamom, a food additive widely used in the Middle East and Scandinavia. Cardamom exports have experienced strong growth since 1980 and currently constitute Guatemala's fourth largest export. In 1984, cardamom exports nearly doubled, to US\$100 million, due to an 80 percent price increase resulting from a fall in production in India, the world's largest producer. Although exports fell back in 1985 and 1986, as production recovered in India, they remained at a level nearly double that of 1981. Cardamom production is undertaken primarily by small farmers, who harvest the product from plants that are widely dispersed. Investment in more modern, intensive production methods could easily raise output substantially.

Meat exports have declined steadily in the 1980s, from US\$29 million in 1981 to less than US\$10 million in 1985. The decline reflects both a deterioration in Guatemala's competitive position, due to the poor quality of meat, as well as a loss in potential export earnings because of unregistered shipments of live animals to neighboring countries where sales are more profitable. Exports are likely to be reduced even further by a ban on exports of live animals, which was imposed in April 1986. The largest impact will be on sales to Mexico, which buys over 65 percent of Guatemala's meat exports.

Oil was discovered in Guatemala in the mid-1970s, and exports were initiated in 1980. Proven reserves are estimated at 14 million barrels. After peaking at US\$60 million in 1983, production and exports have declined sharply, due in part to legal disputes over pricing formulas between the government and the two major foreign oil companies. Production capacity was increased by over 1,000 barrels per day in late 1985 as the result of new drilling in the Peten region. However, the outlook for future oil exports is clouded by the sharp drop in international petroleum prices since 1986.

Table 4.4  
 Distribution and Destination of Nontraditional Exports, Guatemala,  
 1981-1985 (millions of U.S. dollars)

	1981	1982	1983	1984	1985
Total	<u>564.6</u>	<u>472.5</u>	<u>431.7</u>	<u>426.1</u>	<u>386.8</u>
CACM	378.9	337.3	322.7	291.5	256.9
Rest of world	185.7	135.2	109.0	134.6	129.9
Agricultural products	<u>86.2</u>	<u>86.4</u>	<u>67.5</u>	<u>76.1</u>	<u>76.9</u>
CACM	26.8	35.0	19.8	14.6	22.8
Rest of world	59.4	51.4	47.7	61.5	54.1
Industrial products	<u>408.2</u>	<u>344.3</u>	<u>323.6</u>	<u>310.9</u>	<u>280.2</u>
CACM	325.8	285.3	272.4	246.9	216.7
Rest of world	82.4	59.0	51.2	64.0	63.5
Other products	<u>70.2</u>	<u>41.8</u>	<u>40.6</u>	<u>39.1</u>	<u>29.7</u>
CACM	26.3	17.0	30.5	30.0	17.4
Rest of world	43.9	24.8	10.1	9.1	12.3

Source: Central Bank of Guatemala, various unpublished reports, 1983-1985; and International Monetary Fund, International Financial Statistics, 1986 (New York: IMF, 1986).

Nontraditional exports include a wide range of agricultural and manufactured products, a large percentage of which are destined for the CACM.<sup>3</sup> Chemical and processed food products account for about one-third of nontraditional exports to CACM buyers, while fresh and frozen fruits and vegetables along with light manufactures assembled under drawback schemes represent the largest categories of nontraditional exports to buyers outside of the region.

Table 4.4 illustrates the distribution and destination of nontraditional exports since 1981. Over two-thirds of nontraditional exports continue to be destined for CACM buyers despite the sharp drop-off in overall sales within the region. CACM buyers are the main markets for industrial products and consumer durables, whereas the largest share of nontraditional agricultural exports is destined for buyers outside of CACM.

Guatemala exports several hundred products that fall into the nontraditional category. Although chemical products make up the largest export group, their sales plummeted in the early 1980s, from 114 million quetzals in 1980 to 76 million quetzals in 1985. This decline was primarily due to a 45 percent drop in sales within the region. As is the case with a number of other industrial products, most exporters of chemical products drew their initial success during the 1970s from the protected access to a relatively large regional market. And like most import substituting industries, they have found it difficult if not impossible to break out of this captive market and compete with other international producers.

There have, however, been some exceptions. One Guatemalan agro-chemical company, originally established by a foreign investor to produce for the CACM market but now Guatemalan-owned, has enjoyed some success during the mid-1980s exporting to the United States. By exploiting an opportunity created by unusual supply conditions in the United States, the company has been able to export US\$2 million a year of a particular herbicide used in cotton production. Nevertheless, overall industrial exports are likely to keep declining as a result of continued weak demand, both inside and outside the region, and an increase in the local currency cost of imported inputs due to the devaluation of the quetzal.

While exports of fresh and frozen fruits and vegetables still represent a relatively small share of nontraditional exports, they have been among the more dynamic sectors in terms of extraregional exports. Fresh and frozen produce exports, destined primarily for the United States, totaled in excess of 10 million quetzals in 1985, nearly double the value in 1980. Guatemala has been among the most successful countries in taking advantage of the opportunities under the Caribbean Basin Initiative (CBI) for exporting fresh winter vegetables to the United States. It has also become a major supplier of frozen vegetables.

Another relatively successful nontraditional export sector is fisheries, where exports—primarily shrimp—averaged in excess of 10 million quetzals from 1981 to 1986, after a major decline in 1980. Other products that have performed quite well in the face of the overall decline in nontraditional exports are flowers and ornamental plants, sesame seeds, and furniture. It is difficult to track the export performance of labor-intensive assembly operations, since most of these goods are produced and exported under drawback schemes and hence are classified as reexports in Guatemalan customs statistics. However, judging from import data collected by the U.S. Department of Commerce, exports of garments and other "807" products have grown rapidly, exceeding US\$10 million in 1985.

### *Determinants of Export Performance*

The export performance of any country is the result of a range of macroeconomic, microeconomic, and policy-related variables. The relative importance of particular determinants varies from country to country and over time within a particular country. The following discussion highlights those factors that are considered to exert the strongest impact on Guatemala's nontraditional export performance.

Probably the single most important element determining the export performance of any country is the level of effective demand for its

products. Clearly the primary reason for the recent decline in Guatemala's nontraditional exports has been the sharp fall-off in demand within the CACM due to deteriorating economic and political conditions. A related factor of considerable importance is access to international markets. The cuts in the U.S. sugar import quotas have cost Guatemala nearly US\$40 million from 1982 to 1985. On the other hand, expanded duty-free access to the U.S. market under the CBI program has created opportunities for a number of nontraditional exports.

Overvaluation of the quetzal contributed significantly to Guatemala's declining export performance during the early 1980s. With the value of the quetzal fixed at parity with the U.S. dollar, Guatemala's competitiveness was eroded by the sharp appreciation of the dollar during 1983 and 1984. The magnitude of the local currency's overvaluation became obvious after dollar parity was abandoned in November 1984. During the subsequent 12 months, the currency depreciated by 62 percent nominally and by 35 percent in real terms. Unfortunately, the potential benefits in terms of improved competitiveness were mitigated by the complexity and disorderly operation of the three-tier exchange market that replaced fixed-dollar parity. The system has since been simplified, with export transactions now handled through either the banking market or the regulated market. Rates in the former floated within a range of 2.70-3.00 quetzals to the U.S. dollar at the end of 1986, while rates in the latter market were fixed at 2.50 quetzals to the U.S. dollar.

Working capital and long-term financing are essential elements of successful export growth, as are investments in increased production capacity. Central Bank statistics show that the rate of credit expansion to the private sector decelerated sharply during the mid-1980s.<sup>4</sup> In some sectors, most notably agriculture, the volume of credit outstanding has actually decreased in recent years. These figures confirm macroeconomic statistics, which show declining rates of both public and private investment.

With a work force of about 2.2 million, 40 percent of whom are unemployed, Guatemala has no shortage of labor. Furthermore, labor is relatively cheap; minimum wages averaged around 160 quetzals per month in December 1986. On the other hand, investors frequently complain of low labor productivity and report that labor shortages exist in many skill categories.<sup>5</sup>

Several major microeconomic factors constrain Guatemala's export performance. Among these are inadequate transportation and manufacturing infrastructure, insufficient information regarding business opportunities and requirements in international markets, and limited managerial and entrepreneurial resources.

Guatemala has an extensive road transport network, centered around the Inter-American highway. However, much of the road network fell into disrepair in the 1980s, particularly the 300-kilometer road from the capital to the Atlantic coast. There are four major ports—Puerto Barrios and Santo Tomas de Castilla on the Gulf of Mexico and Puerto Queztal and Champerico on the Pacific. The ports are connected with Guatemala City by rail. Aerolineas de Guatemala has a monopoly on scheduled domestic air transport, while the country is served by half a dozen international passenger carriers. While transport costs are high, they are not out of line with those in other parts of the region. A more serious problem is capacity, particularly in the case of air freight. Exporters are reluctant to export highly perishable products due to the unreliability of air freight capacity. This problem is exacerbated by a shortage of cold-storage facilities.

An essential requirement for successful export-oriented manufacturing is ready access to suitable factory and storage space as well as utilities. The Guatemalan government has established a free zone at Santo Tomas de Castilla, which is to provide facilities for labor-intensive assembly operations. However, the zone is poorly managed, and its physical infrastructure is inadequate. The local labor supply is also inadequate to meet the needs of a large number of manufacturing operations.<sup>6</sup> The government has announced plans to upgrade the Santo Tomas facility, and it is also considering legislation that would allow for the development of private industrial free zones in other parts of the country.

Success in exporting nontraditional products is highly dependent on up-to-date knowledge and understanding of conditions and requirements in key export markets. Understanding of market requirements is particularly critical in the case of exports of fresh fruits and vegetables to the U.S. market. Exporters throughout the region have frequently had shipments turned away because they did not meet size or quality standards or failed to comply with U.S. government agency regulations.

Perhaps more than in most other businesses, the production and sales functions of nontraditional export require strong business management skills. For managers and entrepreneurs accustomed to producing for a protected local or regional market, exposure to international competition can be extremely sobering, given the real risks involved. In Guatemala, as in other countries in the region, nontraditional exporters tend to be young, well educated, and willing to invest their own capital. On the other hand, many have little if any previous management experience. As a result, the rate of failure of many new export-oriented start-up operations is quite high.

In addition to macro- and microeconomic variables, several policy/promotional variables are of considerable importance as determinants

of Guatemala's export performance. Government policies regarding access to and disposition of foreign exchange have been one of the most important variables affecting export performance. For example, in 1985, when the government temporarily allowed coffee exporters to exchange 50 percent of the proceeds of sales to nonquota markets at the banking rate rather than at the official rate, exports to nonquota markets jumped fivefold, despite a 5 percent decrease in coffee production that year. The government has gradually been increasing the share of export receipts that can be exchanged at market rates. Since the middle of 1986, exporters of nontraditional products can exchange 100 percent of their foreign exchange proceeds in the regulated market at Q2.50 per U.S. dollar. Previously, 50 percent of export proceeds had to be exchanged at the official rate of Q1.00 per U.S. dollar. Exporters view this new measure as a major incentive for nontraditional exports.

The regulatory environment faced by Guatemalan exporters is one that is still geared toward an import-substitution economy. There are hosts of price controls, tariff barriers, and licensing requirements that make exporting difficult and reduce the competitiveness of local producers. A flowchart prepared by the Guatemalan Nontraditional Exporters Guild lists over 25 steps and approvals that may be required to consummate an export transaction.<sup>7</sup>

Exporters are presently up in arms over the government's decision to contract with a Swiss firm, Societe General de Surveillance (SGS), to manage import/export inspection. The justification for bringing in SGS is the need to bring the widespread practice of under- or overinvoicing under control. Such distorted invoicing is clearly a problem in Guatemala. A comparison of Guatemalan export statistics based on customs declarations with those based on foreign exchange receipts processed by the Central Bank shows major discrepancies. The Central Bank estimates that since 1980 over US\$2 billion has been taken out of the country through faulty invoicing.<sup>8</sup> Clearly, it is in the government's interest to control this practice. On the other hand, overzealous inspection by SGS serves to discourage exports, and the country could suffer a net loss. A number of exporters of perishable goods have already suffered losses due to SGS-imposed delays. In other instances, SGS has refused to accept the validity of exporters' long-term f.o.b. contracts.<sup>9</sup>

Although one may legitimately question whether export incentives provide implicit subsidies that may distort the long-run development of a competitive export product mix in a given country, international experience shows that such incentives can play a positive role in the short run by supporting the development of new export products. The only real incentive currently available to nontraditional exporters in

Guatemala is the drawback scheme, which places import duties on inputs used for the production of export goods. A tax credit scheme that was to be made available to nontraditional exporters in 1984 was never implemented.

Political stability is an important determinant of export performance in any country. Overseas buyers are reluctant to enter into long-term purchase contracts in an environment where changing political conditions might interrupt supply. Similarly, both local and foreign investors are generally unwilling to invest in new ventures in a politically unstable environment. Regional political instability has had a strong negative impact on Guatemala's nontraditional export performance. Much of the decline in exports to Honduras, El Salvador, and Nicaragua stems from deteriorating political conditions in those countries. Political instability has also been a key factor behind declining private investment. A major challenge of the current Guatemalan government will be to convince local and foreign investors that the country can provide the economic, political, and policy stability required to justify investment in new production activities.

One of the brighter aspects of Guatemala's nontraditional export sector is the promotional efforts of the Nontraditional Exporters Guild. The guild is generally recognized as one of the most effective private sector promotion agencies in the Caribbean Basin region. A trade committee legally assigned to the Chamber of Industry of Guatemala, the guild was founded in 1982 by Guatemalan businessmen for the purpose of representing the interests of exporters of nontraditional products to the government and overseas buyers. The guild currently has over 150 members, exporting a wide variety of products. It acts both as an interest/lobbying group before the government and as a technical and marketing support service for its members. The guild is receiving financial and technical support from the United States Agency for International Development (AID).

### *Conclusions and Recommendations*

Guatemala lags behind many of its regional neighbors in gaining market shares in the United States and other industrialized countries for nontraditional exports. The proposed recommendations are oriented toward improving Guatemala's performance in this area.

The government's approach of "micro-managing" business activities may have been necessary and even appropriate during the era of import substitution, but it severely constrains the growth of nontraditional

exports. A basic overhaul of government regulations should be a long-term objective. In the near term, however, a program for exemptions or exoneration from specific regulations, provided exclusively for exporters, should be considered as an initial step. This strategy of creating "exceptions to the rules" has been successfully adopted in many East Asian countries as well as in nations in the region.

The need to enforce tariff policies more effectively is present throughout the region, due to the government's requirements to raise government revenues and manage scarce foreign exchange. Once again, however, the ultimate solution lies in expanding export revenues, which in Guatemala are hindered by delays in clearing needed inputs through customs. The adoption of some form of "fast track" clearance service for nontraditional exporters would greatly reduce the impact of this constraint.

As elsewhere in the region, middle-level managers are a scarce commodity in Guatemala. The country's long-term export potential would be enhanced significantly if programs were developed to provide management training and skills upgrading to young Guatemalan entrepreneurs.

Given the country's historical orientation toward exporting to the CACM region, nontraditional exporters lack information and practical experience on ways to penetrate the U.S. market. This in turn has led to examples of unequal marketing arrangements with U.S. "partners," unaccepted shipments, and other distribution "horror stories." While much of this knowledge must come from experience, programs to provide information on U.S. market preferences, possible joint venture partners, and U.S. government rules and regulations would well serve the nontraditional exporters of Guatemala, particularly those in the agricultural sector.

The greatest short-term opportunities for the expansion of Guatemala's nontraditional exports lie in the agribusiness sector. The volume of exports of winter vegetables to the United States is likely to continue to expand, although profit margins may be reduced as producers face growing regional competition. Furthermore, many exporters have found that the notion of a "winter" vegetable market is something of a misnomer. Firms selling to the United States have learned that in order to be successful, it is necessary to export year-round, even if prices are favorable only during a few months of the year. Guatemalan producers feel that the competition for U.S. market share is sufficiently tight that if they were to stop supplying during part of the year, their buyers would turn to other producers.

A number of policy and infrastructural improvements will be required before Guatemala will be competitive in the area of labor-intensive manufacturing. However, over the medium- to long-term, this sector

clearly is one where Guatemala should enjoy some comparative advantage, given the size and low cost of the labor force. There may also be some potential for restructuring some regionally oriented industrial activities toward extraregional markets, although this will require considerable improvements in quality and efficiency.

APPENDIX 4.1  
 Quantifiable Determinants of Nontraditional Exports  
 GUATEMALA, 1963 - 1986

	1963	1964	1965	1966	1967
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	153.4	174.3	192.1	231.9	203.9
Traditional exports	124.8	126.0	138.4	163.2	122.5
Nontraditional exports	28.6	48.3	53.7	68.7	81.4
Merchandise imports (FOB)	150.4	180.5	206.1	201.8	226.5
Trade balance	3.0	(6.2)	(14.0)	30.1	(22.6)
Current account balance	(17.3)	(37.9)	(34.6)	(12.2)	(62.0)
CACM exports					57.9
CACM exports as % of exports					28.4
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	1,263.0	1,294.0	1,331.0	1,391.0	1,454.0
GDP growth (Nominal %)		2.5	2.9	4.5	4.5
GDP (1980 prices)	3,148.0	3,293.0	3,437.0	3,626.0	3,775.0
GDP growth (Real %)		4.6	4.4	5.5	4.1
<b>CAPITAL FORMATION</b>					
Nominal lending rate	8.0	8.0	8.0	8.0	8.0
Discount rate	4.0	4.0	4.0	4.0	4.0
Fixed capital formation	125.0	159.0	175.0	167.0	192.0
Increase in stock	8.0	7.0	2.0	(18.0)	(4.0)
Bank credit by sector	94.9	104.8	103.8	104.6	118.0
Agriculture	39.4	41.5	39.8	36.6	38.4
Fishing	1.6	1.0	1.3	0.9	2.2
Industry	16.4	17.7	17.9	19.4	28.2
Textiles	2.1	2.2	3.0	2.6	3.5
Garments	0.7	0.7	0.7	0.8	1.5
Commerce		3.2	2.4	4.4	4.7
Foreign direct investment**					
Domestic credit	149.0	170.8	187.3	220.1	241.4
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt					
Debt service					
Debt service ratio (% of exports)					
<b>OTHER</b>					
M1					
Budget deficit	(11.7)	(9.8)	(5.9)	(16.3)	(23.4)
GDP deflator (1980=100)	40.1	39.3	38.7	38.3	38.5
Wholesale price index	33.9	35.0	34.3	34.2	34.3

All figures in millions of Quetzales unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 4.1 (Cont.)  
Quantifiable Determinants of Nontraditional Exports  
GUATEMALA, 1963 - 1986

	1968	1969	1970	1971	1972
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	233.5	262.5	297.1	286.9	335.9
Traditional exports	143.5	156.8	172.8	172.6	209.9
Nontraditional exports	90.0	105.7	124.3	114.3	126.0
Merchandise imports (FOB)	237.6	240.9	266.6	290.0	294.8
Trade balance	(4.1)	21.6	30.5	(3.1)	41.1
Current account balance	(50.7)	(19.0)	(7.9)	(49.2)	(11.5)
CACM exports	70.8	83.7	102.3	92.1	98.7
CACM exports as % of exports	30.3	31.9	34.4	32.1	29.4
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	1,611.0	1,715.0	1,904.0	1,985.0	2,102.0
GDP growth (Nominal %)	10.8	6.5	11.0	4.3	5.9
GDP (1980 prices)	4,106.0	4,301.0	4,546.0	4,800.0	5,152.0
GDP growth (Real %)	8.8	4.7	5.7	5.6	7.3
<b>CAPITAL FORMATION</b>					
Nominal lending rate	8.0	8.0	8.0	8.0	8.0
Discount rate	4.0	4.0	4.0	4.0	4.0
Fixed capital formation	221.0	231.0	239.0	264.0	273.0
Increase in stock	23.0	(35.0)	6.0	22.0	(18.0)
Bank credit by sector	138.1	164.8	168.4	193.1	192.1
Agriculture	40.6	44.5	44.5	36.4	42.1
Fishing	1.6	0.7	0.6	0.5	0.2
Industry	40.0	44.6	44.6	52.3	52.0
Textiles	5.0	4.3	7.3	7.6	8.7
Garments	1.6	2.8	3.0	3.9	3.4
Commerce	8.6	11.4	14.5	18.6	15.2
Foreign direct investment**					
Domestic credit	251.4	271.3	275.9	316.6	371.7
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt					
Debt service					
Debt service ratio (% of exports)					
<b>OTHER</b>					
M1					
Budget deficit	(8.0)	15.3	(13.1)	(30.1)	(45.2)
GDP deflator (1980=100)	39.2	39.9	41.9	41.3	40.8
Wholesale price index	35.7	36.9	37.8	38.6	38.3

All figures in millions of Quetzales unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 4.1 (Cont.)  
 Quantifiable Determinants of Nontraditional Exports  
 GUATEMALA, 1963 - 1986

	1973	1974	1975	1976	1977
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	442.0	582.3	640.9	760.4	1,160.2
Traditional exports	268.7	348.8	408.8	496.6	837.1
Nontraditional exports	173.3	233.5	232.1	263.8	323.1
Merchandise imports (FOB)	391.4	631.5	672.4	950.7	1,087.0
Trade balance	50.6	(49.2)	(31.5)	(190.3)	73.2
Current account balance	7.7	(103.1)	(65.7)	(77.5)	(35.3)
CACM exports	130.0	163.2	169.0	189.0	222.5
CACM exports as % of exports	29.4	28.0	26.4	24.9	19.2
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	2,569.0	3,162.0	3,646.0	4,365.0	5,481.0
GDP growth (Nominal %)	22.2	23.1	15.3	19.7	25.6
GDP (1980 prices)	5,502.0	5,853.0	5,967.0	6,407.0	6,908.0
GDP growth (Real %)	6.8	6.4	1.9	7.4	7.8
<b>CAPITAL FORMATION</b>					
Nominal lending rate	8.0	11.0	11.0	11.0	11.0
Discount rate	4.0	5.0	5.0	5.0	7.0
Fixed capital formation	357.0	468.0	571.0	900.0	1,039.0
Increase in stock	(5.0)	120.0	16.0	34.0	60.0
Bank credit by sector	218.9	349.9	380.4	434.4	507.0
Agriculture	51.2	92.4	90.5	85.5	84.6
Fishing	0.2	0.5	0.4	0.8	0.4
Industry	64.1	122.6	122.9	129.3	145.0
Textiles	9.3	19.5	19.8	24.1	29.9
Garments	4.5	5.3	5.3	5.9	8.0
Commerce	15.0	17.8	9.0	10.1	12.1
Foreign direct investment**					83.4
Domestic credit	408.1	526.7	597.1	668.8	755.7
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt	206.2		267.7		635.2
Debt service	19.8		14.1		17.1
Debt service ratio (% of exports)	4.5		2.2		1.5
<b>OTHER</b>					
M1			374.1	527.2	667.8
Budget deficit	(38.0)	(45.6)	(30.6)	(111.2)	(51.2)
GDP deflator (1980=100)	46.7	54.0	61.1	68.1	79.3
Wholesale price index	43.8	53.8	60.4	66.8	75.5

All figures in millions of Quetzales unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 4.1 (Cont.)  
 Quantifiable Determinants of Nontraditional Exports  
 GUATEMALA, 1963 - 1986

	1978	1979	1980	1981	1982
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	1,092.4	1,221.4	1,519.8	1,291.3	1,170.4
Traditional exports	740.6	768.3	812.1	620.3	575.7
Nontraditional exports	351.8	453.1	707.7	671.0	594.7
Merchandise imports (FOB)	1,283.8	1,401.7	1,472.6	1,540.0	1,284.3
Trade balance	(191.4)	(180.3)	47.2	(248.7)	(113.9)
Current account balance	(270.5)	(205.6)	(163.3)	(572.7)	(399.1)
CACM exports	255.0	311.0	404.6	356.8	
CACM exports as % of exports	23.3	25.5	26.6	27.6	
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	6,071.0	6,903.0	7,879.0	8,608.0	8,728.0
GDP growth (Nominal %)	10.8	13.7	14.1	9.3	1.4
GDP (1980 prices)	7,253.0	7,595.0	7,879.0	7,932.0	7,652.0
GDP growth (Real %)	5.0	4.7	3.7	0.7	(3.5)
<b>CAPITAL FORMATION</b>					
Nominal lending rate	11.0	11.0	11.0	15.0	12.0
Discount rate	5.0	9.0	8.0	12.0	9.0
Fixed capital formation	1,218.0	1,286.0	1,295.0	1,443.0	1,314.0
Increase in stock	95.0	8.0	(44.0)	23.0	(67.0)
Bank credit by sector	579.5	663.5	777.2	810.7	828.7
Agriculture	92.6	88.4	150.5	161.5	153.4
Fishing	2.7	1.7	2.4	2.5	4.1
Industry	149.5	195.0	247.8	242.2	251.9
Textiles	16.8	22.0	23.1	30.0	24.0
Garments	7.7	8.1	8.0	7.1	7.6
Commerce	20.7	26.2	24.9	225.0	33.0
Foreign direct investment**	101.8	90.6	85.1	108.2	69.1
Domestic credit	919.5	1,130.4	1,608.8	2,259.8	2,636.2
<b>EXCHANGE RATE</b>					
Exchange rate	1.0	1.0	1.0	1.0	1.0
<b>FOREIGN DEBT*</b>					
External debt	744.6	820.4	1,050.4	1,383.6	1,510.4
Debt service	26.1	37.3	44.8	60.3	87.9
Debt service ratio (% of exports)	2.4	3.1	2.9	4.7	7.5
<b>OTHER</b>					
M1	739.3	843.3	855.2	858.8	786.6
Budget deficit	(71.2)	(149.1)	(307.3)	(535.4)	(416.9)
GDP deflator (1980=100)	83.7	90.9	100.0	108.5	114.1
Wholesale price index	78.2	86.2	100.0	111.7	105.3

All figures in millions of Quetzales unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 4.1 (Cont.)  
 Quantifiable Determinants of Nontraditional Exports  
 GUATEMALA, 1963 - 1986

	1983	1984	1985	1986
<b>TRADE STATISTICS*</b>				
Merchandise exports (FOB)	1,091.7	1,132.2	1,059.7	1,043.8
Traditional exports	600.0	580.8		
Nontraditional exports	491.7	551.4		
Merchandise imports (FOB)	1,056.0	1,182.2	1,076.7	875.7
Trade balance	35.7	(50.0)	(17.0)	168.1
Current account balance	(223.9)	(377.4)	(246.3)	(17.6)
CACM exports				
CACM exports as % of exports				
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	9,035.0	9,397.0	11,180.0	15,785.0
GDP growth (Nominal %)	3.5	4.0	19.0	41.2
GDP (1980 prices)	7,446.0	7,490.0	7,446.0	7,448.0
GDP growth (Real %)	(2.7)	0.6	(0.6)	0.0
<b>CAPITAL FORMATION</b>				
Nominal lending rate	12.0	12.0	14.0	14.0
Discount rate	9.0	9.0	9.0	
Fixed capital formation	954.0	920.0	1,225.0	1,543.0
Increase in stock	33.0	32.0	61.0	57.0
Bank credit by sector	977.4	1,197.7		
Agriculture	179.6	187.6		
Fishing	2.9	5.9		
Industry	276.4	342.7		
Textiles	31.3	31.2		
Garments	9.0	12.7		
Commerce	46.8	68.0		
Foreign direct investment**	42.0	37.1	60.3	
Domestic credit	3,010.3	3,519.5	3,829.3	
<b>EXCHANGE RATE</b>				
Exchange rate	1.0	1.0	1.0	1.9
<b>FOREIGN DEBT*</b>				
External debt				
Debt service				
Debt service ratio (% of exports)				
<b>OTHER</b>				
M1	833.8	869.4	1,346.5	1,608.4
Budget deficit	(318.0)			
GDP deflator (1980=100)	121.3			
Wholesale price index	106.2	112.2	138.3	197.7

All figures in millions of Quetzales unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

### Notes

1. The official distinction between "traditional" and "nontraditional" exports is meaningful in Guatemala, as the latter are eligible for special incentive treatment, most notably with respect to the foreign exchange treatment of export receipts.

2. 1985 coffee exports were also boosted by a drawdown of stocks prompted by a change in regulations with respect to the exchange rate treatment of coffee export receipts. Whereas all coffee receipts previously had to be exchanged at the official exchange rate of Q\$1.0 per U.S.\$1, new regulations were put into effect in 1985 allowing exporters to exchange 50 percent of the proceeds of sales to nonquota markets at the banking rate, which averaged about Q\$2.8 per U.S.\$1 during 1985.

3. All exports to members of the Central American Common Market are classified as "nontraditional" and are eligible for the benefits noted earlier.

4. From 1980 to 1984, the volume of new credit to private borrowers declined by over 60 percent. Hardest hit was the agricultural sector. Central Bank of Guatemala, *Statistical Bulletin*, various issues.

5. One foreign garment manufacturer with broad regional experience reported that labor productivity in Guatemala is the lowest in the region. He reported frequent work stoppages, high rates of labor turnover and absenteeism, and even cases of sabotage. While his particular case may be extreme, the general impression of low labor productivity was confirmed by other firms engaged in labor-intensive manufacturing operations.

6. As of November 1986, only three manufacturing companies had established operations in the Santo Tomas free zone.

7. "National Export Promotion Plan," Nontraditional Exporters Guild, Guatemala City, 1986.

8. Author's interview with Central Bank officials, November 1986.

9. One exporter of fresh vegetables provided the author with a signed f.o.b. contract from a produce broker in Miami for 10-pound boxes of snow peas, along with a copy of a letter from SGS indicating that the exporter was in violation of foreign exchange regulations because his export receipts for a shipment of snow peas (at the price stipulated in the FOB contract) were undervalued by 50 percent.

## *Panama*

*Andrew Zimbalist*

### *Background*

Panama's statehood was born with the canal and its economy has lived by the canal. Belonging neither to the Central American nor South American family of nations, Panama has a higher gross domestic product (GDP) per capita than any of its Central American neighbors and has a higher foreign debt per capita (\$4.93 billion or \$2,200 per capita at the end of 1986) than any other country in Latin America. Over 70 percent of Panama's GDP originates in services.<sup>1</sup>

After having failed to persuade the governments in Nicaragua and Colombia to yield sovereignty over two different proposed canal routes, U.S. President Theodore Roosevelt with the aid of U.S. troops and battleships successfully orchestrated the secession of the province of Panama from Colombia in 1903. Washington immediately recognized the new government, and within two weeks a new canal treaty ceding sovereignty over a ten-mile strip running the width of Panama was signed. The canal was put into operation in 1914, and the 1903 treaty fixed an annual rent of \$250,000 to be paid to the government of Panama. The treaty also provided that Panamanian workers working in the Canal Zone would be exempt from Panamanian income taxes. A 1904 treaty fixed the Panamanian currency, the balboa, at parity with the dollar. The parity has been preserved to this day, with the dollar circulating as the paper and coin medium of exchange and the balboa circulating only in coin.

According to the area handbook study of Panama published by the U.S. government: "At formation of the republic in 1903, a few white merchant families comprised the political and economic elite that dominated most governments until 1968."<sup>2</sup> In his history of Panama's economy, Robert Looney adds: "Also because of the political influence wielded by commercial interests, Panama has developed a mercantilist mentality. . . . Before 1968, the country had developed under a series of governments

with a largely *laissez-faire* approach to government's role in the economy."<sup>3</sup> Whereas these evaluations seem to apply as generalizations, they are a bit misleading in some of their specifics.

It is certainly true that prior to the coming to power of Omar Torrijos in 1969, the Panamanian government did little to create new industries, to redistribute income, or to build an effective infrastructure for economic growth. It is also true that the Panamanian economy has had a merchant orientation throughout its history, with only a diminutive industrial sector. In 1945, for instance, the manufacturing sector contributed only 8.2 percent to GDP.<sup>4</sup> However, weak economic performance during the Depression and World War II years along with sharp dualism and acute inequality created an imperative after the war to increase employment opportunities and commence an industrialization drive. Whether or not the Panamanian government represented principally merchant interests, the stability of its rule depended on improved social conditions. The 1950s, then, witnessed a series of protectionist and other policies that marked the beginning of an import substitution strategy.

The first measure was Law No. 12 of 1950, which stated that it was the proper duty of the government to provide protection and to give incentives to particular economic sectors in order to promote the development of the country. Law No. 19 of 1952 gave the *Oficina de Regulación de Precios* the power to fix import quotas. Law No. 25 of 1957 provided a comprehensive schedule of import tariffs and duties and marked the first significant application of industrial protectionism in Panama. The basic structure from this law remained in effect until the new Law of Industrial Incentives of March 1986. Finally, and importantly, there was the Remon-Eisenhower Treaty of 1955. This treaty provided for restricting Panamanian employees in the Canal Zone from using the Zone's commissaries and import privileges; curbing many of the Zone's light manufacturing, agricultural and service activities; and creating a single wage scale for Panamanian and U.S. workers in the Zone. Each of these provisions stimulated the development of Panama's internal market and, along with foreign investment, contributed to roughly two decades (through 1973) of healthy import substitution industrial growth (see Table 5.1).

Despite the creditable growth rates in industry, the manufacturing sector remained small, and with the exception of the refining of Venezuelan crude oil, it was overwhelmingly concentrated in traditional and light industrial activities. In 1975, for instance, fewer than 10 percent of industrial establishments employed more than 100 people, nearly 50 percent of manufacturing value added was generated in the food and beverages branches, and manufacturing output accounted for only 6 percent of Panama's merchandise exports. (Merchandise exports them-

Table 5.1  
Annual Rates of Real Growth, GDP and Industry, in percentages  
(constant 1960 prices)

	1950-60	1960-73	1973-81
GDP	4.8	7.8	3.7
Industry	8.8	9.8	0.3
Industry Share (end of period)	13.1	16.7	12.9

Source: Calculated by the author from data provided by the government statistical office, The Contraloria General de la Republica, Panama City.

selves only accounted for between 12 and 20 percent of Panama's foreign exchange earnings during the 1970s.)<sup>5</sup> The frailty of Panama's industrial sector is suggested by its sudden stagnation in the mid-1970s following the collapse of Panama City's building boom.

Some have attributed Panama's weak industrial base to its low rates of tariff protection. In his authoritative work on the economic development in Central America, for instance, John Weeks argued: "The characteristics of the manufacturing sector of Panama seem to be the consequence of the government's liberal trade policies of the last two decades. Compared to other Central American countries, Panama has pursued a low tariff policy. . . ."<sup>6</sup> While it is certainly true that Panama's average rates of protection have been below those of members of the Central American Common Market (CACM), it is misleading to characterize this as constituting liberal trade policy. This is because Panama has relied heavily upon import quotas since the early 1950s. In the early 1980s there were quotas on some 470 different imported products.<sup>7</sup> In many cases, quotas and tariffs were applied to the same product. Quotas were often imposed at the discretion of the relevant government body, usually the Oficina de Regulación de Precios, pursuant to the request of a politically important, local manufacturer.<sup>8</sup> Further, nominal tariffs were supplemented by general import levies and hefty servicing fees. In short, there is no hard evidence that Panama's lack of industrial growth is attributable simply to inadequate protectionism.

Among other factors, it seems that Panama's small domestic market and lack of preferential access to the CACM played a key role in limiting industrial expansion. During the 1970s, for instance, only 1 percent of the CACM's total import bill consisted of Panamanian exports; of this, 35 percent was refined petroleum. More generally, it must be stated that the dynamic sector of Panama's economy and, hence, the sector that

received the attention of public policy and investment capital was always connected to the needs of the Canal Zone: primarily food for the residents and workers in the Zone and gasoline for bunkering ships. Largely because of the canal and the use of the dollar as domestic currency, another important economic activity developed after 1970. The government banking law of that year permitted virtually unregulated and untaxed offshore banking, allowing international banks to locate their financial operations in Panama on paper and escape taxation in the countries involved in the commerce. Panama quickly became the offshore banking center of the Western Hemisphere, with over 150 international banks maintaining offices in Panama City. Aside from the initial construction activities and some employment generation, these banks have little to do with the Panamanian economy.

When the building boom of the early 1970s slowed, the industrial sector entered a period of slow growth from which it has yet to emerge. This slowdown has been attributed to a number of factors: the gradual exhaustion of easy import substitution possibilities, the sharp rise in oil prices and the consequent international recession, the uncertainty surrounding the renegotiation of the canal treaty as well as certain domestic programs (e.g., agrarian reform, the 1972 labor code, public enterprise expansion), and the declining growth of canal traffic with the advent of larger, modern container ships.<sup>9</sup>

In response to the growth slowdown, the Panamanian government followed an expansionary fiscal policy, with growing budget deficits financed largely by foreign borrowing. The new canal accord, in effect as of October 1, 1979, began a gradual transfer of administration over the Zone to Panama. Despite increased rental income provided by the treaty, administrative and maintenance costs grew more rapidly than revenues and exacerbated public finances. Eventually, the growing financial imbalances and bloated foreign debt brought pressure from international institutions to follow domestic austerity and export promotion programs. Slow growth has continued in the 1980s and has led to official open unemployment rates in the neighborhood of 11–12 percent. Widespread corruption in government and serious political instability along with the perception of inconsistent and ineffective government policy have undermined efforts to stimulate private investment.

The present political crisis, sparked by the June 1987 accusations by Colonel Diaz Herrera of top-level political corruption and malfeasance, has made the prospects for improved economic performance bleak indeed. Among other things, U.S. economic and military aid and the U.S. sugar quota have been suspended, Panamanian assets of some \$50 million in the United States have been frozen, and U.S. companies operating in

Panama have been instructed not to pay local taxes or canal revenues. As a direct consequence of these measures, by June 1988 economic activity in Panama was at 55 percent of normal, unemployment had doubled to at least 20 percent, retail sales were off 70 percent, and industrial production was off 60 percent.<sup>10</sup>

As the U.S. has called for the replacement of General Manuel Noriega, Panama has expelled the U.S. AID team from the country and the Panamanian National Assembly has passed (on November 24, 1987) a resolution calling for the suspension of visas for U.S. military personnel and the initiation of discussions to remove the U.S. Southern Command from Panama. It is obvious that there must be some resolution to this political crisis before a consistent and credible economic program can be put in place.

### *Determinants of Export Performance*

Panama has traditionally run a sizable merchandise trade deficit. Over the past five years this deficit has averaged \$920 million yearly (FOB) or 19.3 percent of Panama's GDP in 1985 (see Table 5.2). This merchandise deficit had been substantially offset by large surpluses in current account services (excluding factor payments). However, with slow growth in Panama Canal transit and growing debt service payments, Panama's overall current account has been in serious deficit in recent years, averaging \$244 million over the 1982-1986 quinquennium. Panama's external debt exceeded \$4.9 billion at the end of 1986, the largest per capita foreign debt in Latin America.<sup>11</sup>

Panama's traditional merchandise exports (bananas, shrimp, sugar, coffee, and refined petroleum) fell from a value of \$263.1 million in 1980 to \$200.2 million in 1985. Of these five products, only shrimp offers the potential for good growth in the near future. Panama's coffee exports have not reached the quota assigned by the International Coffee Agreement since the mid-1970s. Panama's sugar exports, notoriously inefficient, have been decimated by drastic cuts in the U.S. sugar quota as well as very low world prices. The drop in world sugar prices is also attributable to the European Economic Community's subsidy program, which converted the EEC from a net sugar importer of 1.1 million tons in 1974 to a net exporter of 3.4 million tons in 1983. Banana exports, subject to fluctuating world market prices, have stabilized while petroleum exports have fallen to practically zero in the context of the world oil glut. Given these conditions, the development of new, non-traditional export products seems to be an urgent necessity if Panama is to service its external debt and restore the economy to a trajectory of steady growth.

Table 5.2  
Trade Statistics 1963-85  
(millions of U.S. dollars)

	1963	1968	1973	1978	1979	1980	1981	1982	1983	1984	1985
Merchandise Exports (FOB)	47.8	93.8	135.3	246.8	294.7	353.4	319.4	310.2	303.5	258.2	301.2
Traditional Exports	45.4	86.4	115.8	191.5	218.7	263.1	236.5	224.8	220.7	179.1	200.2
Nontraditional Exports	2.4	7.4	19.5	55.3	76.0	90.3	82.9	85.4	82.8	79.1	101.0
Merchandise Imports (FOB)	162.8	266.3	454.0	844.8	1,062.9	1,288.9	1,372.5	1,407.4	1,231.7	1,167.9	1,205.1
Trade Balance	(115.0)	(172.5)	(318.7)	(598.0)	(768.2)	(935.5)	(1,053.1)	(1,097.2)	(928.2)	(909.7)	(903.9)
Current Account Balance	(25.0)	(15.0)	(111.0)	(208.0)	(311.0)	(311.0)	56.0	(51.0)	247	(70.0)	21.0
CACM Exports (FOB)	n.a.	2.8	9.1	26.6	29.6	46.5	32.9	27.6	24.9	n.a.	n.a.
CACM Exports as % of Exports	n.a.	3.0	6.7	10.8	10.0	13.2	10.3	8.9	8.2	n.a.	n.a.

Note: n.a. = not available.

Source: SRI International, Nontraditional Export Expansion in the Central American Region. Arlington, Va.: SRI International for the Agency for International Development, March 1987, pp. P20-24.

Table 5.3  
Non-Traditional Exports, 1978-83 (millions of dollars)

Export	1978	1979	1980	1981	1982	1983
Beverages and Tobacco	2.7	4.0	5.3	5.4	5.0	5.3
Hides, Skins and Furs	-	-	.4	.4	.9	.9
Metal Ores and Scrap	.3	1.0	.9	1.6	.9	1.5
Animal Oils and Fats	1.5	1.4	4.7	1.3	.3	.9
Chemicals	2.1	3.6	4.6	6.7	4.2	6.0
Leather Products	2.2	5.4	2.4	2.6	5.2	4.5
Rubber Products	-	-	.3	.9	1.2	1.7
Paper Products	2.4	3.4	5.7	3.4	4.0	3.4
Non-metal Mineral Manufactures	.7	3.0	.1	1.6	.9	1.1
Non-ferrous Metal Manufactures	1.5	2.1	1.8	1.3	.9	2.0
Metal Manufactures	1.4	1.0	1.9	1.0	.8	.8
Clothing	8.6	8.6	10.4	14.0	17.3	7.6
Footwear	.3	1.4	1.2	.8	1.7	1.3
Miscellaneous Manu- factures	1.7	2.2	2.8	1.7	2.1	1.0

Source: SRI International, Nontraditional Export Expansion in the Central American Region. Arlington, Va.: SRI International for the Agency for International Development, March 1987, pp. P18-19.

In fact, nontraditional exports, starting from a miniscule base, have experienced a steady expansion since the early 1970s, growing from \$7.3 million in 1971 to \$76.0 million in 1979 to \$101.0 million in 1985 and \$66.4 million during the first six months of 1986. Panama's leading nontraditional exports in agriculture have been melons, watermelons, okra, and scallops and, in industry, textiles, food processing, paper products, chemicals (particularly pharmaceuticals), and nonferrous metals (see Table 5.3). There is potential for further expansion in these categories if a variety of serious obstacles can be overcome.

### *Macroeconomic Determinants*

After growing at an average annual rate of 8.0 percent during the 1960s and 4.5 percent during the 1970s, real GDP has slowed to a growth rate of approximately 3 percent in this decade. Given the absence of a Central Bank and independent monetary policy, all public debt must be financed by dollar-denominated borrowing. As the economy slowed, the government deficit grew as did foreign borrowing. The government deficit reached 10.8 percent of GDP in 1982. To rectify this imbalance, the authorities implemented in 1983 and 1984 a severe austerity program, supported by an International Monetary Fund (IMF) standby agreement. Together with the gradual closing of the Central American market and

the inauspicious international economic conditions, real GDP in 1983 stagnated for the first time in over twenty years. Growth has been modest since then, but it has occurred primarily in services (for example, the transoceanic pipeline and the Colon Free Zone) and not goods production. Accordingly, open unemployment has grown to record levels (the official rate, regarded widely as an underestimate, is around 12 percent) as the labor force participation has declined.

Apart from drawback-type operations and primary product exports, the typical life cycle for new exports involves an initial period of production for the domestic market. With the domestic market stagnating, conditions are not propitious for new product development. Furthermore, rising unemployment and cutbacks in public expenditures, most recently in social security, have aggravated an already unstable political environment. Together with widespread cynicism and distrust for the government, the macro situation is not encouraging for new investments.

The government has introduced a number of export promotion laws since the mid-1970s. These efforts have been helpful, but they are generally perceived by the private sector to lack coherence and consistency. Given the historical lassitude engendered by protectionism and import substitution, piecemeal government policies are unlikely to provide the requisite "big push" needed to launch a major program of nontraditional exports. Before considering what aspects of the economic environment must be addressed by government policy before Panama can enter a period of export-led growth, it is important to review the individual legislative attempts at export promotion.

In December of 1974, effective 1975, the government created a tax credit certificate (CAT) for all nontraditional exports. The amount of the CAT is equal to 20 percent of local value added and is granted to products with a minimum of 20 percent local content. Since 1977 the CATs have been transferable. Despite their success, the impact of CATs has been weakened by unpredictable and often lengthy administrative delays, as well as by their concentration in certain product groups and enterprises. Nearly half the value of all CATs has been received by six enterprises.

The second attempt to encourage new exports was a decree of January 1979. Companies operating under this program are required to export the entire output of finished products; in return, they are granted duty-free import of machinery, raw materials, and intermediate products and exemption from sales, export, and corporate income tax. They are also granted a three-month exemption from the restrictive provisions of Panama's labor code (to be discussed below). As of January 1984 only 7 firms employing a total of 700 workers were functioning under this

program. Among other problems, the program was inadequately advertised, especially to foreign investors.

In 1982, the Investment Promotion Council (CNI) was established. Its function was to advertise investment possibilities in Panama and to facilitate foreign investors' application procedures by unifying a maze of bureaucratic steps. It appears that the CNI has fulfilled this second function more successfully than the first.

It should be noted that the government has taken a number of measures in recent years at the urging of the IMF, the World Bank, and AID to dismantle policies allegedly supporting the development strategies of import substitution and food self-sufficiency. In 1986, by eliminating quantitative import quotas, reducing tariff barriers, and removing food price supports, the intention was to generate a reallocation of resources more in line with Panama's international comparative advantage. Non-competitive items would cease to be produced, freeing resources for new export production. Although some success from these new policies appears to be forthcoming, it must be stressed that removing price controls in a small economy like Panama's does not always lead to competitive prices. New price distortions often emerge because of the market power of producers, distributors, or other interested parties.

In March of 1986, the government passed several new pieces of legislation with a bearing on exports. The new Industrial Law establishes a five-year process for the further reduction of import tariffs. This law also reduces tax exonerations for companies producing for the domestic market, and it extends the 1979 decree to cover that share of company output that is exported. Amendments to the labor code were also passed that, while introducing some new flexibility, are unlikely to significantly affect employment practices or labor costs. Finally, the government has appreciably simplified the red tape necessary for exporting most products.

Panama's infrastructure corresponds to that of a service-exporting, not a goods-exporting, economy. Bureaucratic practices and managerial mentality, although changing, still reflect the vestiges of a noncompetitive, protected, import substituting and services-oriented economy. As international exigencies and domestic economic policy choices lead to a new orientation, Panama's infrastructure lags behind its production for export potential. In a sense, as a country Panama is at the beginning of an export life cycle. Major infrastructural investments are certainly called for, as are interim subsidies to exporters in order to bring costs to competitive levels and permit rational export development.

Transportation—land, air and sea—stands out as the overriding infrastructural impediment. Costs are high, service is irregular, practices are inefficient, and installations are inadequate. The problem is sufficiently important to merit a detailed discussion.

International maritime shipping primarily occurs through two ports: Balboa, at the Pacific end of the canal, and Cristobal, at the Atlantic end. Both ports are poorly equipped with inefficient layouts, suffer from serious rigidities in their labor organization and are encumbered by Panama's central government control. The result is excessively high port charges and unreasonable and very costly delays.

In the early 1970s, many other regional ports invested in container equipment and handling space. Balboa and Cristobal, then run by the U.S. Canal Zone Administration, did not invest in modernization. Only at the end of the decade did two private shipping lines set up their own container gantries in Balboa. The Cristobal port has invested with World Bank support in a container area and is scheduled to purchase two gantries. Until now, it has relied on the service of smaller container carriers, either of the roll-on/roll-off variety, or vessels equipped with their own gear.

The crane of U.S. Lines at Balboa has a picking capacity of 24 containers per hour, but Balboa's poor layout and facilities reduce maximum picking to 15. One major problem is the absence of adequate container storage facilities at the port. Unloaded containers must be driven by vehicles, called "hustlers," several kilometers through often heavy traffic and stoplights to a storage area. At the storage area the hustler relies upon a forklift to empty the container. The hustler must then travel an additional several kilometers on roads frequently in disrepair to pick up a new container to return to port, again depending upon the operation of a forklift for loading. A second problem is inadequate equipment maintenance machinery at the port. The hustlers, toplifters, forklifts, and other machinery all require maintenance. These services, however, are woefully deficient. The head of U.S. Lines, Ron Holloman, reported that his toplifters experienced a 60 percent downtime.

A third problem is that vehicle operators often report to work inebriated or are absent without warning. The Panamanian labor code, to be discussed below, makes it impossible or impractical to dismiss such workers. Among other obstacles, Holloman reported that workers routinely purchase for a small fee doctors' excuses at Avenida Central. Not only is there insufficient equipment, then, but what is available is often idle due to absenteeism or shirking. The labor system is rigid in other ways. For instance, stevedores must be hired in groups of 16 for periods of 8 hours, whether this number of labor hours is needed for a particular vessel or not.

A fourth problem pointed out by Holloman is that ships are often damaged in port. Although ships pay a separate \$3,000 docking fee at Balboa, the standard dock buffers to protect the ship's side have worn down and they have not been replaced. These and other problems raise

port charges and unduly extend the ship's stay in port. Extra fuel costs alone from an extra day in port are estimated to total \$15,000.

When Panama concentrated on import substitution and was under little competitive pressure, higher transportation costs were simply passed along in the form of higher prices with minimal complaint. As an aspiring, fledgling goods-exporting country, these inefficiencies can no longer go ignored.

A universal complaint of Panamanian exporters was exorbitant shipping costs. Exporter after exporter showed me receipts comparing shipping costs per container with similar contents from Panama to Miami with shipping costs from Venezuela (or another neighboring country) to Miami, the latter being invariably cheaper and by a good margin. The president of Arcitek, an exporter of tiles and building materials, for example, claimed that he paid \$1,560 per container, while his Venezuelan competitors paid only \$600 per container to Miami. This shipping cost differential amounted to 10 percent of the output price. The president of APEX (Panamanian Association of Exporters) told me that his friend imported a car from Miami through the Costa Rican port of Puntarenas on the Atlantic and then drove the car overland to Panama City. This circuitous route saved him several hundred dollars.

Part of the explanation here certainly lies in excessive port-related costs. Part, however, lies in the low and asymmetric volume of Panamanian shipping trade as well as in the low value per container of the products shipped. These characteristics make it less profitable for shipping lines to stop in Panama's ports, and when they do stop, they charge higher prices. U.S. Lines and Sea Line, the two largest conference (organization of shipping companies) shippers, have recently discontinued northbound service from Balboa. One seafood exporter who had experienced an impressive growth in scallop exports expressed concern that he would be unable to contract with any timely shipper in the near future. Such interruptions in service not only denote the loss of a particular shipment and likely cash-flow problems, but often entail as well loss of land transportation, distribution, and marketing arrangements.

Given these circumstances it is perhaps not surprising that the shipping conference and exporters' organizations have been at loggerheads. Twice in the last six months of 1986 the conference attempted to raise its rates but was forced to rescind the increase. Now service is being curtailed.

Conferences do function as a cartel. When reliable nonconference shippers are unavailable, the conferences are able to set monopoly prices. Panamanian exporters claim exploitation. It is beyond the scope of this analysis to evaluate the contrasting allegations, but the pricing problem can be seen neutrally to be a function of the early phase of the export cycle. While export volume is low and asymmetrical, unit shipping costs

are high. As volume grows over time, particularly with improved port efficiency, these costs decrease. From this perspective, an interim shipping and support subsidy would seem to be appropriate.

Air shipping for perishables has similar problems. Some exporters claimed rates were twice as high from Panama as from neighboring countries. Others reported that perishable output was lost by air shipping foul-ups.

Land transportation is also very costly. Trucking companies operate in cartel-like fashion to enforce restrictive practices. Foreign truckers are prohibited from hauling cargo of Panamanian origin in Panama, meaning that foreign trucks must return home empty. Between provinces within Panama similar regulations obtain. Some interviewees alleged a link between the truck companies and the military. Others said trucking was controlled by the mafia. One said the truck companies maintained their control over land transportation by violence, citing a recent incident when the roads to Colon were blocked for days by truckers and the government took no action to clear them.

Other infrastructural deficiencies are related to financing, utilities, and telecommunications. They will be treated in the next section on micro-economic determinants.

### *Microeconomic Determinants*

Just as it is a sad irony that Panama with its world-famous canal should have shipping difficulties, it is ironic that with over 150 international banks located in Panama City there should be financing problems for domestic nontraditional exporters. Financing problems come in all shapes and sizes, both for industrial as well as agricultural producers. In the case of the latter, however, the difficulties appear universal. Unavailability of short-term export financing as well as medium- and long-term loans were frequently heard complaints. AID's small business loan program is well conceived and appears to be making at least a small dent in the problem for industrial producers. Agricultural loans, though, seem to have dried up several years ago, when Chase Manhattan and Bank of America pulled out of rural areas. New loan guarantee programs have been established, and it is possible this problem will be alleviated in the future.

Price distortions have also retarded export development. There is some dispute as to whether government control over agricultural prices through the IMA (Institute of Agricultural Marketing) until October 1985 actually encouraged food self-sufficiency at the expense of export production. Food self-sufficiency itself was certainly not achieved. In constant 1970 dollars, Panamanian food imports grew from \$16.8 million in 1960

to \$19.8 million in 1970 and to \$34.7 million in 1980.<sup>12</sup> Government price controls were almost entirely removed in October 1985, however, and no longer constitute an impediment, if they ever were. A more likely impediment is the existence of market-determined monopoly prices for several goods. The experience of Galletas (Cookies) Pascual S.A. is illustrative in this regard. Galletas pays 30 cents a pound for unrefined sugar (the current world price is approximately 6 cents). The company argues that this price is set in collusion between the government-owned mills and the Santa Rosa mill, which is owned by Eric Delvalle (the "former" president of Panama). Further, Galletas pays \$18 a bag for flour and the world price, according to it, is \$11. It attributes this to the fact that flour distribution in Panama is controlled by two companies. A similar problem exists for lard. These high input prices, Galletas claims, makes it uncompetitive internationally. With competitive input prices, Galletas estimates that it would export 40 percent, in contrast to the present 1 percent, of its output.

Another microeconomic problem is the rigidities imposed by the labor code issued under Torrijos in 1972. The largest single complaint from exporters was that the code makes it very difficult and expensive to dismiss a worker for almost any reason. If a worker is laid off due to demand problems, severance pay requirements are high. Since most exporters seem to feel that their export contracts can be broken at any time (and many have experienced this), it is rather risky to hire workers for an export expansion drive. Exporters need more flexibility, either through amendments to the labor code or through the institution of unemployment insurance to replace burdensome severance pay requirements, or both. The impracticality of dismissal, of course, also weakens worker incentive to perform at capacity and this hurts productivity.

There appear to be no experimental programs under way at present to increase worker productivity. Given problems of worker morale, occasional restiveness, and union militance (e.g., the general strike of May 1986), it is striking to find an absence of quality control circles, human resource development, or other management programs. A productivity commission was recently formed, and it has expressed some interest in such efforts.

Panama is reputed to have both a relatively skilled and expensive labor force for the region. While this is true on the average, it obscures the reality of many enterprises. White collar skills and wages are high due to the influence of the former Canal Zone and Panama's foreign banking sector. Yet many production enterprises pay workers close to the minimum wage of \$.69 an hour. All labor payments are subject to an approximately 40 percent social benefits tax. The Panamanian government does not record wage and salary data systematically, making

it difficult to decipher the true labor costs in this dual labor market. According to data presented by the International Labor Office (ILO), average monthly earnings in 1982 in Panamanian manufacturing were more than double those in Costa Rica, 16 percent greater than those in Honduras, and 28 percent greater than in Guatemala. It appears that these data apply to all employees, not just production workers.

Electricity costs in Panama in 1980 were more than double those in Jamaica, El Salvador, and Honduras, 50 percent above those in Costa Rica, but 50 percent below those in Guatemala. According to World Bank estimates, international telephone rates in Panama were 20 percent above those in Costa Rica, slightly above the rates in Guatemala and El Salvador, but below the rates in several other Caribbean Basin Initiative (CBI) countries.<sup>13</sup>

Knowledge of marketing channels and opportunities is being developed and does not appear to be a major operative bottleneck to export expansion in most cases. Marketing knowledge is being gathered and disseminated very effectively by the export promotion institute, IPCE. IPCE has also made great strides in simplifying and expediting administrative procedures for exporting. IPCE's head, Paul Leignadier, is a dynamic, impressive figure who, despite the manifold obstacles, seems to have generated some momentum and esprit de corps among Panamanian exporters.

### *Other Considerations*

As discussed previously, the Panamanian government has not implemented a consistent package of measures to promote export development. Further, with changing and fragile political regimes, policy direction has often shifted. Contraband is still prevalent and most believe the military is actively involved. Whatever might have been his deficiencies, Torrijos was able to impart a clear policy orientation and relatively stable institutional framework. Today, it appears that political parties work at cross-purposes to each other from their ministerial posts and that the military continues to pull many economic strings. Businessmen complain it is unclear who is making policy and who is responsible for its implementation. New export product promotion is inherently risky, even in a stable institutional context. Appreciable success in nontraditional exporting will require changes in Panamanian politics.

It is equally imperative that U. S. policy toward CBI exports be made consistent. While the United States says it is promoting Caribbean Basin exports and CBI treatment eliminated the .625 cents per pound tariff on imported sugar, the United States reduced sugar imports from Latin America by over 70 percent between 1981 and 1985, with further

substantial reductions in 1986 and 1987. Part of the explanation for this import reduction lies in the growing substitution of high-fructose corn syrup for sugar by U.S. soft drink producers (itself a function of government price supports), but another part lies in the fact that U.S. cane producers have been allowed to expand their output in recent years as domestic demand has fallen. It is difficult for Latin American exporters to understand the rationale of this policy in the context of CBI exhortations for improved export performance. Similarly, many Panamanians question the continuation of U.S. protection of textiles, apparel, and tuna, products for which a considerable export potential out of the Basin exists.

The largest problem in this regard has been created by the November 1986 decision of the U.S. International Trade Commission decision to impose a 46.5 percent duty on Costa Rican flowers. Not only were the ITC's methods dubious in determining domestic costs, but the finding that export-related tax credits were countervailable has thrown a monkey wrench into the whole concept of policy measures for export promotion. Further, although the duty is on Costa Rican flowers, Panamanian exporters see it as a direct threat to themselves. Since any damaged U.S. producer can bring a suit before the ITC without regard to U.S. government intentions or the CBI preferences, Panamanian exporters treat the case of Costa Rican flowers as symbolic of what happens whenever the CBI effort bears fruit and export success is achieved. Given the natural hurdles to effective export promotion and the inherent riskiness of new ventures, this ambiguity in U.S. policy has a devastating effect on the whole export development project.

### *Assessment of Nontraditional Export Opportunities*

The aforementioned constraints notwithstanding, there are many bright prospects on Panama's export horizon. Maquila or drawback-type assembly in the Colon Free Zone, with low value added and linkage contributions, has been expanding rapidly. Scallop fishing and exporting have skyrocketed to over \$20 million annually and have significant potential for continued growth.

There exists considerable promise for the development of small-scale, labor-intensive selected vegetable and fruit crops for export, particularly near the rivers of the central provinces. An asparagus marketing cooperative, supported by AID's Agriculture Cooperative Marketing Project, is about to export its first crop. Agroexport development will depend upon the availability and conditions of long-term financing. Gestation periods for new projects in this area are typically two to four years; loans with grace periods of this length are necessary. Finally, the further expansion of melon and beef exports is also feasible.

An enormous potential exists in the development of Panamanian forestry products, especially for tropical hardwoods from the forests of Darien. There is, however, a danger of unregulated exploitation of forestry resources unless the government's National Renewable Resources Institute is strengthened.

Given its human resources and geographical location, Panama has considerable potential in the area of industrial exports as well. This applies both to the expansion of existing export products (e.g., designer clothes, building materials, cosmetics, radiators, food processing, assembly of electronic, medical, and pharmaceutical products) and to the development of new high technology projects. As always, most export products offer the opportunities for either forward or backward linkages. These should be pursued on a case-by-case basis, with greatest priority given to those products with higher domestic value added components and potential spread effects. Many export projects would benefit from the expansion of the domestic parts industry (e.g., through the development of a network of small machine shops).

Direct foreign investment in Panama has been appreciable, but it has not been a dynamic factor in promoting either industrialization or new exports. According to John Weeks, in the late 1970s the total asset value of direct foreign investment in Central America came to \$1.8 billion, while in Panama it came to nearly double that amount, \$3.5 billion.<sup>14</sup> The lion's share of this sum, of course, has gone into services primarily related to the canal and to offshore banking. Another source reports that 70 percent of new capital formation in Panamanian manufacturing in 1971 was due to foreign capital.<sup>15</sup> Nevertheless, apart from oil refining and some utilities, almost all foreign manufacturing capital has gone into food processing and textiles. A large share of this has been in the Colon Free Zone or on drawback contract provisions, entailing low value added and revenue contributions to the domestic economy.<sup>16</sup> Furthermore, despite the CBI and the easy access to the U.S. market that Panama offers to Asian capital, the tendency in direct foreign investment during the 1980s has been downward. From 1980 through 1985, direct foreign investment averaged a meager \$30.2 million a year.<sup>17</sup> Given the current political environment, prospects for increased foreign investments are dismal.

It must also be observed that foreign investment in manufacturing overwhelmingly has been concentrated in labor-intensive projects. Domestic capital developing nontraditional exports has also emphasized labor-intensive projects. There is a danger, however, that emphasizing labor-intensive projects, based upon a presumed comparative advantage in cheap labor, will lock Panama into low-productivity branches. This circumstance, coupled with strong competition from other CBI countries

and the rapidly expanding maquiladoras of northern Mexico, will impede income growth and standard-of-living improvements for the majority of Panamanians. This prospective dilemma can be confronted by emphasis on integrative projects and specialization through regional CBI planning and by the search for projects of intermediate capital intensity with a significant technological component. The formation of a CBI scientific research and development institute might facilitate the identification and promotion of such projects.

### *Conclusion*

Panama is in transition between a foreign-dominated entrepot and a sovereign hybrid entrepot/productive economy. The country's peculiar history leaves a legacy of an inadequate domestic social base to govern during this transition. This problem must be resolved before the development project can be successfully resumed.

Once the political problem is resolved, it is clear that Panama has a series of characteristics conducive to economic growth: the canal and its propitious location, a relatively skilled bilingual labor force, and abundant hydroelectric resources, among others. Given the diminutive size of the domestic market, however, economic integration with either Central or South America is desirable. With a larger market, Panama's export promotion strategy can be appropriately balanced with renewed efforts at import substitution. Nontraditional exports at this time are too small to serve as a leading sector in the development process. Once the political and macroeconomic environment is sanitized and the growth process resumes, the needed infrastructural elements (such as efficient domestic capital markets) can be put in place to support further expansion of nontraditional export products. A development strategy predicated on the prior expansion of this sector, however, will fall by its own weight, even with political stability.

### *Notes*

1. This figure, of course, varies from year to year and also depends on the base year chosen to construct the price deflator. In 1983, for instance, using constant 1970 prices, services accounted for 80.5 percent of value added, agriculture for 10.1 percent, and industry for 9.4 percent. World Bank, *Panama: Structural Change and Growth Prospects*, Report No. 5236-PAN, Vol. 1, February 1985.

2. Richard Nyrop (ed.), *Panama: A Country Study* (Washington, D.C.: U.S.G.P.O., 1981), p. 96.

3. Robert Looney, *The Economic Development of Panama* (New York: Praeger, 1976), p. 4–5.
4. *Ibid.*, p. 10.
5. Nyrop, *Panama*, p. 119; and John Panzer, *La evolución del sector industrial panameno y su relación con la protección* (Panama: Ministerio de Planificación y Política Económica, 1985), p. 39.
6. John Weeks, *The Economies of Central America* (New York: Holmes & Meier, 1985), p. 146.
7. Panzer, *La evolución del sector industrial*, p. 24.
8. For some specific examples, see *ibid.*, p. 4.
9. In fact, the number of ocean ships transiting the canal peaked at 14,829 in 1970, and the amount of cargo carried peaked at 137.8 million tons in 1974. Nyrop, *Panama*, p. 95.
10. Steven Erlanger, "U.S. Economic Warfare Brings Disaster to Panama," *New York Times*, June 9, 1988, p. 1.
11. Inter-American Development Bank, *Economic and Social Progress in Latin America, 1987 Report* (Washington, D.C.: Inter-American Development Bank, 1987), p. 360.
12. S. Barraclough and P. Marchetti, "Agrarian Transformation and Food Security in the Caribbean Basin," in B. Irvin and X. Gorostiaga (eds.), *Towards an Alternative for Central America and the Caribbean* (London: George Allen and Unwin, 1985), p. 175.
13. This comparative cost data is from World Bank, *Panama: Structural Change and Growth Prospects*.
14. Weeks, *The Economies of Central America*, p. 55.
15. Looney, *The Economic Development of Panama*, p. 93.
16. For an interesting discussion of economic activities in the Colon Free Zone and its potential, see World Bank, *Panama: Structural Change and Growth Prospects*, pp. 109–117.
17. Inter-American Development Bank, *Economic and Social Progress*, p. 458.

## *Belize*

*Philip E. Karp*

Belize presents a classic case of a small, open economy, heavily dependent upon a limited number of export products and struggling to achieve economic diversification in the face of limited resources, inadequate physical infrastructure, and the vagaries of international economic and political conditions. Historically dependent upon sugar for about one-half of its export earnings, Belize has been forced to seek other sources of export revenue as international demand for sugar has declined and access to key international markets has been reduced.

Opportunities for economic diversification are limited by the small size of the labor force, the relatively underdeveloped state of physical infrastructure, and a severe shortage of investment capital. In addition, the openness of Belize's economy makes the country particularly vulnerable to external economic shocks, further complicating efforts to achieve stable economic growth.

Belize's economy is based primarily on agriculture, which in the mid-1980s accounted for about 25 percent of gross domestic product (GDP) and about 75 percent of exports. Approximately one-third of Belize's 165,000 inhabitants are employed in agriculture. Manufacturing and construction account for about 15 percent of GDP. About half of the manufacturing output involves processing of agricultural products, primarily sugar and citrus. The service sector, which includes trade, public administration, tourism, and transportation, accounts for about 55 percent of GDP and about 45 percent of employment. Merchandising remains the principal nonagricultural business activity of Belize. Most commercial establishments are family-owned and operate with limited capital. Most nonagricultural manufacturing operations are scaled to serve the small domestic market.

An important factor in Belize's national income is private remittances. Since 1970, some 30,000 Belizeans have found work outside the country, mostly in the United States. Remittances from these workers, which

have averaged approximately US\$14 million per year between 1981 and 1986, have in some years accounted for as much as 15 percent of total foreign exchange receipts.

Belize's economy is highly dependent on foreign trade (see Appendix 6.1). In the mid-1980s, imports have represented about three-quarters of GDP, while exports have represented about half of GDP. Despite abundant agricultural land, foodstuffs represent the largest category of imports. Other major import categories include manufactured goods, capital equipment, and oil. The United States is Belize's largest trading partner, supplying most of the country's food imports and representing the biggest market for Belize's exports. Other principal trading partners are the United Kingdom, Canada, and Mexico. While Belize exports some orange juice concentrate and meat to other members of the Caribbean Common Market (CARICOM), in general the free trade union has never represented a large market and is unlikely to in the near and medium future. Although Belize would welcome the chance to diversify its export market base, real opportunities are scarce. In general, Belizean dependence on the U.S. markets is not regarded as a serious problem, since the markets are fairly stable, and Belize is such a small participant.

Belize's economy expanded steadily during the 1960s and 1970s, with real growth averaging about 4.8 percent per year over the period. Expanded economic output during the 1960s was spurred in large part by growing sugar exports that benefited from an injection of foreign investment in increased refinery capacity.<sup>1</sup> Growth during the 1970s resulted from continued expansion in sugar exports along with the reestablishment of the banana industry and the development of a number of import substituting manufacturing industries.<sup>2</sup>

The vulnerability to external shocks of Belize's small, open economy became painfully evident during the 1981–1982 global economic recession. Following nearly two decades of steady growth, real GDP fell by nearly 5 percent due to a decline in world demand for Belize's exports, worsening terms of trade, and a drop-off in reexports to Mexico. A bumper sugar crop helped spur a modest 1.5 percent increase in real output during 1983, and in 1984, real growth accelerated to just under 4 percent as construction and manufacturing picked up markedly while the country's terms of trade improved. In 1985, real GDP growth weakened to 1.8 percent due in large part to a decline in agricultural production and exports—a trend that continued in 1986 as Belize faced further cuts in its sugar export quota to the United States.

Politics in Belize has been dominated by two major political parties. The left-of-center People's United Party (PUP) held leadership for nearly twenty years under the charismatic George Price. However, in December 1984, in the first election following full independence from the United

Kingdom, the PUP suffered a major defeat at the hands of the United Democratic Party (UDP), which capitalized on growing public dissatisfaction with worsening economic conditions. Nominally more conservative than his predecessor, UDP Prime Minister Manuel Esquivel has made economic diversification a major goal and has sought to attract increased foreign investment to the country. He has also sought to ease long-standing tensions with neighboring Guatemala.<sup>3</sup>

### *Export Structure and Performance*

Belize's export sector is dominated by sugar and sugar-related products, primarily molasses. The country's other major traditional export is timber, although production and exports have been declining steadily for a number of years. In a country with such a small export base as Belize, it is difficult to make meaningful distinctions between "traditional" and "nontraditional" exports. Those exports labeled "nontraditional" here are products that have been singled out for emphasis in the country's drive for export diversification. Major nontraditional exports include citrus, garments, and fish. Bananas, formerly an important export crop, have once again begun to make a significant contribution to export earnings. A number of other nontraditional products, including fresh fruits and vegetables, cacao, and meat, are exported in small quantities, with several offering considerable potential for expansion.

Another important—although unrecorded—nontraditional export is marijuana. U.S. drug enforcement officials report that Belize is the fourth largest supplier of marijuana to the United States, following Colombia, Mexico, and Jamaica, with exports valued at as high as US\$75 million per year.<sup>4</sup> Marijuana exports are estimated to have increased by more than 500 percent since 1982 as a result of income and employment losses in the sugar sector.

As Table 6.1 shows, the total value of Belize's exports has fluctuated considerably in recent years, driven by erratic shifts in both the volume and value of sugar exports. Overall, the value of domestic exports (total exports minus reexports) dropped by nearly 22 percent from 1980 to 1985. Sales to the United States and the United Kingdom account for almost 90 percent of domestic exports. Re-exports, destined primarily for Mexico and Guatemala, have also fluctuated. Re-export trade amounted to US\$12 million, or 20 percent of total recorded exports in 1975. By 1981, reexports had increased to over US\$44 million. AA

The sugar industry has been the mainstay of the Belizean economy since the 1960s. Sugarcane production is carried out by some 5,500 farmers under a licensing system specifying the volume that each farmer

Table 6.1  
Foreign Trade, Belize, 1980-1986 (millions of U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986
Domestic exports	82.1	74.8	60.7	65.2	72.9	64.4	60.0
Re-exports	<u>28.8</u>	<u>44.3</u>	<u>31.2</u>	<u>12.6</u>	<u>32.1</u>	<u>25.7</u>	<u>30.0</u>
Total exports	110.9	119.1	91.9	77.8	105.0	90.1	90.9
Total imports	<u>149.8</u>	<u>162.0</u>	<u>128.0</u>	<u>111.8</u>	<u>130.2</u>	<u>128.2</u>	<u>122.5</u>
Balance	-38.9	-42.9	-36.1	-34.0	-25.2	-38.1	-31.6

Source: International Monetary Fund, *International Financial Statistics* December 1986 (New York: IMF, 1986), pp.118-119; and author's estimates based on interviews with Central Bank officials.

can deliver for processing. These quotas are established each year by the Belize Sugar Board based on expected developments in Belize's export markets. While quotas themselves are not transferable, farmers whose production exceeds their allowed tonnage may sell their excess cane to growers who are unable to fulfill their quotas.

Processing is undertaken by Belize Sugar Industries, Ltd. Total processing capacity has been reduced by about 25 percent following the closure of one of the country's two processing plants in 1985. Sugar is sold to the United States and the United Kingdom at preferential prices under special quota agreements. The remainder is sold on the free market at much lower prices.

While sugar and molasses continue to be Belize's most important exports, their share of total domestic exports has fallen from a peak of 61 percent in 1980 to 39 percent in 1985. The value of sugar exports has fallen by more than 50 percent since 1980 as a result of reductions in average prices and limitations in Belize's access to the U.S. market. Since 1983, Belize's quota in the United States has been cut by more than 65 percent. As a result, Belize has been forced to sell an increased share of its production in the free market at a price in the mid-1980s of about one-third of that commanded in the U.S. market.

Forestry was the main economic activity of Belize during the nineteenth century. Indeed, the exploitation of timber resources was one of the primary reasons for the establishment of a British colony in the region. While large tracts of unexploited timber resources remain, the timber industry has declined substantially. Over the period 1980-1985, timber production contributed only 2.0 percent of GDP and 1.7 percent of domestic exports. Timber exports in 1985 totaled less than US\$1 million.

With the decline in exports of Belize's two major traditional commodities, sales of nontraditional products have taken on increasing importance. Garments have now become Belize's second most important

export, accounting for nearly 25 percent of 1985 domestic exports, up from less than 12 percent in 1982. The vast majority (over 90 percent) of garment exports is destined for the United States, with the remainder sold in Europe. Most garment production for export to the U.S. market involves assembly operations whereby garments are cut in the United States and finished in Belize. Under Section 807 of the U.S. Tariff Code, such garments are subject to U.S. import duties only on the value added in Belize.

Because such a large share of Belize's garment exports is destined for the U.S. market, performance of this sector has tended to reflect demand conditions in the United States. Garment exports fell by over 40 percent in 1981 and 1982, but recovered strongly in 1983 and 1984 based on renewed demand in the U.S. market. In 1985, production topped the 2-million-piece mark for the first time, as exports totaled just under US\$16 million.

The outlook for garment exports remains largely dependent upon U.S. demand. If demand in the U.S. market continues to be strong, exports are likely to remain at least at current levels. However, significant increases in garment exports will require either new investment—current producers are operating at or near maximum capacity—or a shift away from assembly operations toward higher value-added production.

Citrus represents another increasingly important export. The citrus industry in Belize is based primarily on the production of orange and grapefruit concentrate. About half of the 9,000 acres under citrus cultivation are owned by the two existing citrus processing companies. Citrus exports of US\$12.1 million in 1985 accounted for about 19 percent of domestic exports, well over double the 1980 share. The main market for citrus exports is the United States, with smaller markets in Trinidad and Tobago and Jamaica. The dramatic increase in the value of citrus exports since 1980 has been largely due to the opening of the U.S. market to citrus concentrates under the Caribbean Basin Initiative (CBI). Export volume has increased by an average of 14 percent per year since 1980.

Another growing nontraditional export is fish and shellfish, which accounted for 11.5 percent of 1985 domestic exports. Shrimp is joining lobster and conch as an important export as the introduction of new trawl-fishing activity has expanded catches dramatically. Both shrimp and lobster enjoy virtually guaranteed access to the U.S. markets.<sup>5</sup> Demand and prices for Belizean conch have increased due to sharp drop-offs in production in the Bahamas and Turks and Caicos islands, currently the two largest suppliers to the U.S. market. Despite growing demand in the U.S. market, exports of fresh fin fish remain minimal due to the unreliability of air transport.

Increased exports of marine products will require diversification to additional species. Local fishermen report that the lobster catch is currently at or near maximum sustainable yield, while conch production has been falling steadily due to overfishing. On the other hand, largely untapped potential is said to exist for offshore shrimp and fin fish production. However, exploitation of these resources will require investment in more modern fishing techniques. One of the major fishing cooperatives has already entered into a joint venture for trawl-fishing for shrimp, while another cooperative is looking to follow suit. Investors remain optimistic about the potential of shrimp-farming operations, although the technical and financial viability of shrimp farming in Belize remains unproven.<sup>6</sup>

Following several years of stagnant production, bananas have once again become an important export from Belize. Exports are destined exclusively to the U.K. market, where Belize enjoys preferential access under the Lome Convention. From 1981 to 1985, the Banana Control Board, a government statutory body, was virtually the sole producer of bananas in Belize. Bananas are exported through Fyffes, a U.K. subsidiary of United Fruit, which is the sole buyer of Belize bananas. Increases in export value in the first half of the 1980s resulted mainly from a renegotiation of the pricing formula used by Fyffes, as export volume remained virtually unchanged. However, since the sale of the banana industry to private-sector Honduran owners in late 1985, production and exports have increased dramatically, due in large part to substantial new investment and a consequent increase in land under cultivation.

Nevertheless, production levels in the mid-1980s were still insufficient to justify direct shipments to the United Kingdom, thus entailing extremely high transportation costs. Export shipments currently are routed via Puerto Cortes, Honduras. It is estimated that production would have to more than double to make direct shipments economically viable.<sup>7</sup> Investors hope that the recent privatization of production will lead to a rehabilitation of the industry and to production increases sufficient to justify direct export shipments. However, Belizean producers are likely to face strong competition in the market from other Central American producers, particularly Nicaragua, which has been seeking new sources of hard currency due to the U.S. trade embargo.

While cacao currently accounts for less than 1 percent of recorded domestic exports, production has been expanding rapidly, from less than 12,000 pounds in 1980 to over 200,000 pounds in 1986. The bulk of current production emanates from a 600-acre estate owned by a local subsidiary of Hershey Foods Corporation. Hershey provides seeds, technical assistance, and a guaranteed market to a growing network of private growers. Many of these producers work at the Hershey estate and tend their own plots during their free time. The value of cacao

exports, which topped US\$160,000 in 1985, is expected to increase markedly in the future as production increases.

The livestock sector has long been identified as a source of considerable export potential in Belize. However, exports of live cows and horses to Guadeloupe and Martinique, which accounted for about US\$500,000 per year in the mid-1980s, have fallen to virtually zero due to a ban on exports of live animals. Exports of frozen and processed meat amounted to less than US\$250,000 in 1985 (approximately the same as the 1980 level), despite a major effort by a U.S. investor to rehabilitate the government-owned meat processing facility. Ninety percent of exported meat is destined for the United States, with the remainder sold to CARICOM buyers. The company has sought approval to export to the European Economic Community (EEC) market in an effort to increase exports.

### *Export Outlook*

The outlook for several of Belize's key exports is heavily dependent upon policy-induced factors beyond local control. Sugar exports will continue to be conditioned by the vagaries of international demand and prices and by the degree to which Belize can maintain its already diminished access to preferential markets. Despite intense lobbying by Caribbean and Central American sugar producers, it is unlikely that these countries' export quotas to the U.S. market will be increased in the foreseeable future. On the contrary, it is quite possible that these producers will face further cuts in their U.S. market access.

The outlook for Belize's citrus exports is also heavily dependent upon U.S. trade policy. A number of major new investments have been announced that could increase acreage under production more than fivefold by 1990.<sup>8</sup> However, the economic viability of these investments is based on an assumed duty differential between exports from Belize and those of alternative suppliers. An import tariff of US\$0.35 per gallon is placed on orange juice concentrate from Brazil, while concentrate from Belize enters the U.S. market duty-free. Most of the interest in investment in citrus production in Belize comes from U.S. companies that are now obtaining a great deal of citrus concentrate from Brazil.

Growing pressure from U.S. producers to exclude citrus from the list of products eligible for duty-free entry into the United States under the Caribbean Basin Initiative could seriously hinder Belize's future export prospects. The success of U.S. citrus growers in pressuring Congress to exclude citrus projects from eligibility for the Overseas Private Investment Corporation (OPIC) insurance coverage has already threatened to derail the investment plans of one large U.S. company.

The prospects for increasing banana exports are also threatened by a potential change in the policy stance of one of Belize's major trading partners, in this case the United Kingdom. The U.K. government is facing strong pressure from African and Asian producers to gain preferential access to the U.K. market. If they succeed in gaining access, U.K. demand for Belizean bananas might well diminish.

The Belizean authorities are looking to new products, such as winter fruits and vegetables, to make up for some of the losses in traditional export receipts. Substantial new investment has been undertaken in winter vegetable production, with producers forecasting that exports will reach US\$10 million per year by 1990. However, Belize is likely to face strong competition from other regional producers, many of whom enjoy lower labor costs and superior transportation links with the U.S. market. In addition, U.S. demand for imported winter vegetables is subject to the vagaries of weather conditions in the southern and southwestern portions of the United States.

### *Determinants of Export Performance*

A wide range of variables influences a particular country's export performance. This section will examine those macroeconomic, microeconomic, and policy/promotional variables that exert the strongest influence on Belize's export performance.

#### *Macroeconomic Determinants*

Perhaps the single most important element affecting the export performance of any country is the level of effective demand for its products. In the case of Belize, given the heavy concentration of exports destined for the United States and the United Kingdom, export performance tends to reflect economic performance in those countries.

Belize currently enjoys preferential treatment in both the U.S. and U.K. markets, under CBI and the Lome Convention, respectively. While this treatment opens these markets up to many Belizean products on favorable terms, policy-induced market access carries the risk of being extremely vulnerable to protectionist shifts in buyer countries.

The effective exchange rate of the Belize dollar (BZ\$) is another key macroeconomic determinant of the country's export performance. The Belize dollar has been pegged to the U.S. dollar at a rate of 2:1 since 1976. The International Monetary Fund (IMF) estimated that the real effective exchange rate of the Belizean dollar (the trade-weighted exchange rate adjusted for relative consumer price indices) rose by 23 percent from 1980 to 1985, reflecting the general increase in the external value

of the U.S. dollar.<sup>9</sup> There is little doubt that the deterioration of Belize's trade position over this period can be attributed, in large part, to the strong dollar. In particular, Belize's trade deficit with the United Kingdom has been strongly affected by the value of the U.S. dollar relative to the pound sterling. All of Belize's sugar and banana export contracts with the United Kingdom are denominated in sterling. While the relative value of the BZ\$ has little to do with the *volume* of sugar and banana exports to the United Kingdom, since both products are sold under guaranteed quantity purchase arrangements, the appreciation of the BZ\$ strongly affects the export *value*. The Central Bank of Belize estimated that the cumulative loss in sugar export revenue due to BZ\$ appreciation exceeded BZ\$60 million between 1980 and 1985.<sup>10</sup>

The appreciation of the U.S. dollar has also had a detrimental effect on Belize's exports of nontraditional products. Two garment manufacturers, interviewed in late 1986, reported that they had lost their share of the EEC market in 1983 and 1984. Thus far they have been unable to resume exports to Europe despite a substantial decline in the real effective exchange rate of the BZ\$ since 1985.

Working capital and long-term financing are essential elements of successful export growth. The lack of availability of local long-term financing, due in part to a relatively undeveloped capital market, is widely recognized as a major constraint to investment in export-oriented ventures in Belize. The four commercial banks currently operating in Belize (three are branches of foreign banks) are oriented primarily toward low-risk, short-term credit operations. Investors and exporters report that it is virtually impossible to obtain financing for terms longer than six to twelve months. In addition, banks require collateral, in the form of real estate or deposits, of up to 300 percent of the value of the loan. These requirements are a particularly strong deterrent to investments in manufacturing operations, since banks will not accept inventory or machinery as collateral. Exporters are also constrained by the poorly developed state of financial services. They frequently have difficulty in obtaining such routine financial services as advances against a letter of credit from a recognized U.S. buyer.

Central Bank statistics on domestic credit operations of the local banking sector confirm this picture. In 1985, commercial loans and advances to the private sector contracted by BZ\$9.4 million, or 7.2 percent from their 1984 level. Lending to the agricultural and transport sectors was hardest hit, with respective declines of 11.2 percent and 30.8 percent in credit outstanding.<sup>11</sup>

Belize's population, and hence the size of its labor force, is quite small relative to the size of the country. The 1985 population density of 6 persons per square kilometer is one of the lowest in the world.

Despite a major influx of refugees in recent years, the labor force currently stands at less than 50,000. Wage rates, while low by U.S. standards, are higher than those found in competitor countries in Central America and the Caribbean. Skilled labor is in particularly short supply. Furthermore, despite significant unemployment (17 percent in 1985), there is a seasonal shortage of agricultural labor, with 1,500 imported workers from neighboring countries required each year to harvest the citrus and sugar crops. In order to ease this shortage, the government has encouraged the immigration of experienced agricultural workers from neighboring countries.

In addition to a shortage of workers in a number of skill categories, managers complain of low worker productivity and high turnover. For example, one major employer in the manufacturing sector reported that turnover among trainees is currently about 65 percent. On the positive side, Belizean workers are English-speaking and the vast majority are literate. Many are bilingual in English and Spanish.

#### *Microeconomic Determinants*

Among the microeconomic determinants of nontraditional export growth is Belize's limited transportation and manufacturing infrastructure. That situation and a shortage of managerial skill constitute the major constraints to export expansion.

Most of Belize's exports are transported by road or by ship, with limited quantities sent by air. The high cost and limited capacity of existing transportation facilities reduce the competitiveness of Belize's exports and make export of certain types of products all but impossible. Road shipment is the most reliable form of transport. The driving time from Belize City to the southwestern United States is approximately 18 hours. A number of export companies own and operate their own trucks. A potential problem facing foreign companies that wish to follow this example is a provision of the Belize investment code that limits ownership of internal transport operations to Belizean companies.

While the port at Belize City is able to handle roll-on/roll-off container traffic, it is not deep enough to accommodate bulk transport vessels or large oceangoing ships. As a result, the majority of agricultural exports must be transshipped, thereby increasing transportation time and costs. Sugar is barged from Commerce Bight to Belize City, where it is off-loaded onto ships moored in deep water off Belize Harbor. Bananas are barged to Puerto Cortes, Honduras, for shipment to the United Kingdom, while citrus is barged from Dangriga to Belize Harbor for transshipment.

The international airport 10 miles south of Belize City is served by TAN-SAHSA (Honduras) and TACA (El Salvador).<sup>12</sup> While both of these airlines operate regularly scheduled service, no flights originate in Belize

or have Belize as their final destination. As a result, the capacity for shipment of exports by air freight is limited and unreliable. This constraint makes it virtually impossible for producers to consider exporting highly perishable products, such as fresh fish or cut flowers. Exporters are hoping that the recent introduction of freight and passenger service by Toucan Air, a newly established Belize-based airline, will help to improve air freight capacity. Transport limitations also create difficulties in obtaining spare parts and other imported production inputs. Producers must be virtually self-sufficient, since it can take as long as six months to get spare parts or new equipment.

An important requirement for successful export-oriented manufacturing is access to readily available and low-cost factory, storage, and office space, as well as reliable sources of power and other utilities. There is very little factory or storage space available to accommodate manufacturing or processing operations in Belize. Potential exporters must count on building their own facilities, a process complicated by the high cost and slow pace of local construction. A related constraint is the high cost of electrical power. Consumers of electricity pay US\$0.21 per kilowatt-hour, a rate that is three to four times higher than that paid by industrial consumers in competitor countries.

The government hopes to partially address these constraints through the establishment of a free zone in the northern part of the country, near the Mexican border. Manufacturers would be given access to factory shells and lower-cost electricity (to be purchased from Mexico). Workers would include migrants from Mexico as well as Belizeans unemployed by the closing of the Libertad sugar factory.

Like any other business, the success of nontraditional export operations requires sound management. As with a number of other skill categories, the number of experienced managers available in Belize is limited. Foreign investors interested in establishing export-oriented ventures have generally found that absentee management does not work, since it is difficult to locate local managers or entrepreneurs to whom day-to-day operations can be entrusted. To a certain extent, this shortage is a function of the lack of export-oriented experience rather than a shortage of general management skills. Most local managers have traditionally been involved in domestic commerce and not in export-oriented production activities. As a result, many are not accustomed to doing business in a market where efficiency, timeliness, and quality control are of primary importance.

#### *Policy/Promotional Determinants*

Political stability is a major determinant of export growth. Buyers of export products are generally unwilling to enter into long-term purchase

contracts if they are afraid that changing political conditions could interrupt supply. By the same token, investors, both local and foreign, are unlikely to invest in new ventures in a politically unstable environment.

For the most part, investors and exporters rate political stability as one of the strong points of Belize's business climate, particularly relative to other countries in the region. However, a number of foreign investors have expressed concern over the failure of the current government to honor fully the provisions of development concessions granted by the previous government. Consistency and stability of government policies are as important to investors as the content of these policies. In order to feel secure in investing in long-term ventures, investors must feel confident that the "rules of the game" will remain the same over the life of their investments.

With respect to policy/regulatory conditions, Belizean exporters report few of the "nuisance" constraints generally identified by exporters in other countries. Customs procedures are relatively efficient, although some exporters reported occasional delays in clearing imports of production inputs.

Licenses are required for the export of most products, although export licensing is essentially a registration procedure, with licenses granted promptly and routinely in most cases. Export taxes of 2 to 5 percent are currently levied on several agricultural exports. Given the preferential market access and price that Belize enjoys for most affected products, these taxes probably have little impact on export volume. However, they do lower the return to producers.

Local and foreign investors in both export- and non-export-oriented ventures are eligible for a number of investment incentives. These incentives, which are granted for periods of up to fifteen years, include tax holidays, relief from import duties on machinery, equipment, and raw materials, and guaranteed repatriation of capital (including profits and capital gains). In addition, investors may be granted permission to carry forward net losses incurred during the tax holiday period for set-off against profits for up to five years following expiration of the tax holiday.

To be eligible for these incentives, investors must be granted a development concession by the Office of Economic Development, the Belize government's investment approval agency. The Office of Economic Development reports that its review of applications for development concessions generally takes about six months. However, a number of investors reported that the process often takes much longer.

One disturbing aspect of the current investment incentive/approval system is the discretionary nature of available incentives. The term and provisions of the concessions granted to specific investments are deter-

mined on a case-by-case basis. In some cases, certain investors have reportedly been granted special concessions not provided to other investments in the same sector. A related problem, noted earlier, has been the failure of the current government to honor certain provisions of development concessions granted by the previous government.

Promotion of Belizean exports is undertaken mainly by the Belize Export and Investment Promotion Unit (BEIPU), a division of the Belize Chamber of Commerce and Industry. BEIPU is a relatively new organization and has not as yet undertaken any active promotion efforts. With financial and technical support from the U.S. Agency for International Development (AID), BEIPU is currently providing information and assistance to current and potential exporters and is seeking to identify new export opportunities.

The impact of policy-related factors on Belize's future export performance has already been addressed in some detail. Like other countries that depend on a relatively narrow export base, Belize's export performance is highly dependent upon continued access to key markets, particularly the United States. Indeed, it can be strongly argued that policy developments in the United States that affect Belize's market access are the single most important set of factors governing the country's export performance.

Therefore, a potential cloud on the horizon for Belize is the increased pressure being put on the U.S. government by domestic producers to limit the market access of Belize and other CBI countries. The success of Florida citrus growers in pressuring Congress to exclude citrus ventures from eligibility for OPIC insurance has already been noted. A recent AID administrative directive, adopted in response to congressional pressure, instructs AID field missions to refrain from supporting activities that may compete with U.S. producers or exporters. The result in Belize has been a "hands-off" attitude on the part of AID toward the citrus sector, despite the strong potential of citrus to replace sugar as the country's most important export.

### *Nontraditional Export Opportunities*

Belize's greatest comparative advantage for increased nontraditional exports is in the agribusiness sector, where producers can take advantage of the country's favorable climate and abundant arable land. Within this sector, citrus clearly offers the greatest opportunities for increased exports, subject to the caveat already discussed—namely, continued duty-free access to the U.S. market.

The export of winter vegetables destined for the U.S. market clearly offers potential for expansion. However, expectations for this sector

should not be overblown. Exporters of winter vegetables from other countries in the region have learned—in many cases from painful experience—that the produce business can be very risky. Yields have often been below expectations, and a crop that ripens two weeks early or two weeks late can mean that an exporter misses a window of opportunity in the U.S. market. Furthermore, exporters have found that the cost of marketing winter vegetables can be as much as one and one-half times the cost of production, thereby reducing profit margins substantially. Profit margins are also being reduced, as a growing number of Central American and Caribbean producers compete with each other in exporting to the United States, thereby driving down prices. As a result, projects that are highly touted one year—such as an Israeli-Jamaican joint venture that was expected to generate as much as US\$50 million per year in exports—may go bankrupt the next.

Exports of cacao seem to offer legitimate potential for stable growth, at least in volume terms. There also appears to be considerable opportunity for increased exports from the fisheries sector through expansion into new species and use of more modern fishing techniques. Improvements in the capacity and reliability of air freight transport would also open up opportunities for export of fresh fin fish, albeit on a limited volume basis.

Opportunities for expansion of garment production or introduction of other labor-intensive assembly operations are limited by the small size of the labor force. A careful analysis of Belize's long-term comparative advantage in this sector should be undertaken before resources are committed to the establishment of the proposed free zone discussed earlier. In the short term, however, it would take only the addition of one or two medium- to large-sized firms to generate a substantial percentage increase in production and exports, given the high concentration of current production.

### *Conclusions and Recommendations*

By far the biggest operating constraint facing existing and potential exporters is the lack of working capital and long-term financing at reasonable terms. This problem could be addressed by making special lines of credit available to exporters, either directly or through a new or existing financial institution, as well as through support of the development of new capital market institutions and instruments.

Under Belize's current investment code, the term and specific benefits granted to recipients of development concessions are not automatic. Rather, concessions are granted on a case-by-case basis, with the length

and scope of individual concessions based on the extent of local value added, as well as expected profitability, foreign exchange earnings, and employment creation. The discretionary nature of the process creates perceptions, whether justified or not, of favoritism or discriminatory treatment. Experience has shown that automaticity and equal treatment are key elements of successful investment codes. If differential incentives are provided, they should be utilized to target investments toward priority industries or sectors, and the criteria for eligibility should be clearly set out in the investment code. Within a particular sector, all investments should be treated equally. The preference of investors for this type of system has been confirmed by a number of major surveys of international companies.<sup>13</sup>

Finally, mechanisms should be sought to establish an adequate pool of trained local managerial personnel. In particular, training should be directed at imparting an understanding and appreciation of the requirements of managing export operations. Thus, training programs should focus on such topics as export marketing techniques and requirements, customs procedures, foreign exchange procedures, and quality control.

APPENDIX 6.1  
Quantifiable Determinants of Non-traditional Exports  
BELIZE, 1970-1986

	1970	1971	1972	1973
<b>TRADE STATISTICS</b>				
Domestic exports	23.2	24.7	31.8	42.2
Traditional				
Nontraditional				
Re-exports	8.1	7.0	9.1	10.5
Total exports	31.3	31.7	40.9	52.7
Imports	55.6	58.6	69.3	72.3
Trade balance	(24.3)	(26.9)	(28.4)	(19.6)
CACM exports	0.1	0.2	0.0	0.0
CACM exports, % of dom. exp.	0.4	0.8	0.0	0.0
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	74.3	79.3	90.0	110.3
GDP (1980 prices)	217.9	225.5	239.7	248.9
<b>CAPITAL FORMATION</b>				
Commercial lending rate				
Fixed capital formation				27.0
Increase in stock				5.7
Foreign direct investment*				
Dom. credit				
Commercial lending				
to Private sector				
Agriculture				
Manufacturing				
Commerce				
<b>EXCHANGE RATE</b>				
Official Rate	1.7	1.6	1.6	1.6
REER index (1980=1.00)**				
<b>FOREIGN DEBT</b>				
External debt outstanding				0.7
Debt service				0.1
Debt service ratio				
(% of exports)				
<b>OTHER</b>				
M1				
Minimum wage				
Budget deficit				
GDP deflator (1980=100)	34.1	35.2	37.5	44.3

All figures in millions of Belize dollars unless otherwise specified.  
Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Real Effective Exchange Rate Index

APPENDIX 6.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 BELIZE, 1970-1986

	1974	1975	1976	1977
<b>TRADE STATISTICS</b>				
Domestic exports	65.6	95.9	68.2	89.0
Traditional				
Nontraditional				
Re-exports	14.3	24.5	25.9	35.2
Total exports	79.9	120.4	94.1	124.2
Imports	109.2	159.2	161.5	180.2
Trade balance	(29.3)	(38.8)	(67.4)	(56.0)
CACM exports	0.0	0.0	0.5	0.5
CACM exports, % of dom. exp.	0.0	0.0	0.7	0.6
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	154.2	188.8	183.2	211.6
GDP (1980 prices)	272.1	273.9	272.1	283.4
<b>CAPITAL FORMATION</b>				
Commercial lending rate			11.5	11.3
Fixed capital formation	38.6	53.0	58.0	62.9
Increase in stock	4.2	8.0	11.2	5.8
Foreign direct investment*				
Dom. credit			64.4	64.5
Commercial lending to Private sector				
Agriculture				
Manufacturing				
Commerce				
<b>EXCHANGE RATE</b>				
Official Rate	1.7	1.8	2.2	2.0
REER index (1980=1.00)**				
<b>FOREIGN DEBT</b>				
External debt outstanding	2.0	3.9	6.8	15.9
Debt service	0.0	0.1	0.1	0.1
Debt service ratio (% of exports)	0.1	0.1	0.2	0.2
<b>OTHER</b>				
M1			21.3	24.7
Minimum wage				
Budget deficit				
GDP deflator (1980=100)	56.7	68.9	67.3	74.7

All figures in millions of Belize dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Real Effective Exchange Rate Index

APPENDIX 6.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 BELIZE, 1970-1986

	1978	1979	1980	1981
<b>TRADE STATISTICS</b>				
Domestic exports	109.8	113.1	164.1	149.5
Traditional			97.5	87.7
Nontraditional			66.6	61.8
Re-exports	49.8	60.3	57.6	88.5
Total exports	159.6	173.4	221.7	238.0
Imports	213.0	263.7	299.5	323.9
Trade balance	(53.4)	(90.3)	(77.8)	(85.9)
CACM exports	0.7	1.0	1.4	
CACM exports, % of dom. exp.	0.6	0.9	0.9	
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	241.7	282.4	342.4	361.7
GDP (1980 prices)	305.8	323.7	340.2	345.5
<b>CAPITAL FORMATION</b>				
Commercial lending rate	11.3	11.6	16.5	19.3
Fixed capital formation	69.1	81.0	88.1	98.1
Increase in stock	3.3	10.2		14.4
Foreign direct investment*				
Dom. credit	71.7	90.8	103.9	126.6
Commercial lending to Private sector			91.9	108.7
Agriculture			24.1	24.1
Manufacturing			12.5	11.9
Commerce			25.2	36.3
<b>EXCHANGE RATE</b>				
Official Rate	2.0	2.0	2.0	2.0
REER index (1980=1.00)**	0.96	0.89	1.00	0.87
<b>FOREIGN DEBT</b>				
External debt outstanding	26.7	33.5	41.5	48.2
Debt service	0.8	0.9	1.2	2.3
Debt service ratio (% of exports)	1.0	1.0	1.1	1.9
<b>OTHER</b>				
M1	36.0	36.9	41.7	39.6
Minimum wage				
Budget deficit	12.1	2.6	5.0	5.9
GDP deflator (1980=100)	79.0	87.2	100.0	104.7

All figures in millions of Belize dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Real Effective Exchange Rate Index

APPENDIX 6.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 BELIZE, 1970-1986

	1982	1983	1984	1985
<b>TRADE STATISTICS</b>				
Domestic exports	121.4	130.3	145.7	128.8
Traditional	69.3	71.0	67.3	50.2
Nontraditional	52.1	59.3	78.4	78.6
Re-exports	62.4	25.2	46.2	51.4
Total exports	183.8	155.5	191.9	180.2
Imports	256.0	223.6	260.4	256.3
Trade balance	(72.2)	(68.1)	(68.5)	(76.1)
CACM exports				
CACM exports, % of dom. exp.				
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	330.9	347.8	364.7	385.1
GDP (1980 prices)	325.8	332.4	334.8	350.1
<b>CAPITAL FORMATION</b>				
Commercial lending rate	18.8	16.4	14.8	16.1
Fixed capital formation	72.7	65.6	69.1	68.7
Increase in stock	15.4	6.5	(5.2)	
Foreign direct investment*			(3.7)	3.7
Dom. credit	161.2	187.5	205.2	207.1
Commercial lending to Private sector	132.3	141.4	151.9	141.5
Agriculture	22.7	17.2	16.7	14.3
Manufacturing	18.1	18.6	11.9	21.1
Commerce	41.3	42.7	44.0	45.9
<b>EXCHANGE RATE</b>				
Official Rate	2.0	2.0	2.0	2.0
REER index (1980=1.00)**	0.79	0.77	0.69	0.75
<b>FOREIGN DEBT</b>				
External debt outstanding	51.5	55.7	67.3	88.0
Debt service	5.8	8.0	10.1	13.5
Debt service ratio (% of exports)	6.3	10.3	10.5	15.0
<b>OTHER</b>				
M1	39.4	42.4	50.0	58.6
Minimum wage				
Budget deficit				
GDP deflator (1980=100)	101.6	104.6	108.9	

All figures in millions of Belize dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Real Effective Exchange Rate Index

### Notes

1. Tate & Lyle, a United Kingdom-based multinational corporation, purchased Belize's two sugar refineries in 1964. Tate & Lyle established a wholly owned subsidiary, Belize Sugar Industries, to operate the refineries and invested several million dollars in expansion and modernization of the facilities.

2. Banana production has a long history in Belize. The industry was established in the late nineteenth century, with production destined to serve the U.S. market. The industry prospered until an outbreak of Panama disease in the 1930s that virtually wiped out production. The industry was rehabilitated with the help of British aid in the early 1960s, but suffered major setbacks resulting from severe hurricane damage in 1975 and 1978.

3. Tensions between Guatemala and Belize stem from a long-standing border dispute. Fear of possible moves by Guatemala to enforce its claim by military means has led the United Kingdom to maintain a military garrison in Belize.

4. Estimates reported by a U.S. embassy official in Belize.

5. Belize's production is sufficiently small that the total catch of a given species may be taken up by one major buyer. For example, one of Belize's two major fishing cooperatives currently sells nearly 100 percent of its lobster catch to the Red Lobster restaurant chain in the United States.

6. One U.S.-financed shrimp-farming venture has recently begun to export on a small scale and expects production to increase tenfold by 1990. The World Bank has earmarked US\$5 million to encourage the development of small shrimp-farming operations.

7. World Bank, *Belize Economic Report* (Washington, D.C.: World Bank, 1984), pp. 30-31.

8. In 1985, Coca-Cola Foods purchased nearly 700,000 acres of land in the northwestern part of Belize. The company's plans call for planting of 50,000 acres by 1995 and development of a processing plant for production of citrus concentrate. Total projected investment is US\$150 million.

9. International Monetary Fund, "Country Economic Memorandum," November 1986, p. 43.

10. Central Bank of Belize, *Fourth Annual Report and Accounts, 1985* (Belmopan: Central Bank, April 1986).

11. *Ibid.*

12. Challenge International, the only U.S. air carrier serving Belize, declared bankruptcy in late 1987.

13. One of the best-known surveys of foreign investor attitudes toward host country investment policies was conducted by the U.S. Committee for Economic Development. CED conducted in-depth interviews with ninety multinational corporations headquartered in the United States, Japan, Australia, and eight countries in Western Europe. The major findings are reported by Isaiah Frank in *Foreign Enterprise in Developing Countries* (Baltimore, Maryland: The Johns Hopkins University Press, 1980).

## *Honduras*

*Kathleen D. Heffernan*

The Honduran economy is driven by agriculture. The agricultural sector generated 31.4 percent of gross domestic product (GDP) in 1985, while manufacturing generated 14.1 percent, commerce 12.4 percent, and services 10.7 percent. An estimated 51.0 percent of the Honduran labor force of 1.1 million people is employed in agriculture, forestry, hunting, and fishing. The recent real GDP increases have kept pace with the 2.9 percent annual population growth, resulting in a GDP per capita of \$832 per year that has remained fairly steady over the past several years.

Honduras is a democratic republic and elects a president and a national congress every four years. The present constitution was adopted in 1982. In 1986, incoming President Jose Azcona outlined an economic program to stimulate the private sector, export-led economic growth and development by setting fiscal and monetary targets and by implementing several structural reforms.

Azcona proposed to increase exports by providing incentives, such as export processing zones, and to restore internal and external confidence in the Honduran economy by refinancing the external debt. His plan also was intended to rationalize public sector operations by improving tax administration to increase revenues without raising tax rates and by selling certain state-owned companies to reduce the budget deficit without cutting out essential services. It remains to be seen whether Azcona can successfully implement his policies and maintain them long enough to convince the local and world business community that Honduras is a profitable place to do business.

Policy stability is a key positive attribute that the business community seeks when selecting an investment location. Continual change in the rules of the game is anathema to business, because variability—in regulations, tax rates, or any other important policy—increases risk. Even variability in less significant policies causes headaches for the private

sector. For these reasons, entrepreneurs do not react immediately to policy initiatives, but rather wait two to three years to assess the longevity of the policy reform. Usually only after this lag, once entrepreneurs are convinced that the changes are lasting, will they make investments. For example, a 1981 World Bank study presented both qualitative and quantitative evidence that entrepreneurs in the Colombia textile industry responded to incentives only after a waiting period of several years, during which they evaluated the strength of the government's commitment to policy reform.<sup>1</sup>

The largest issue confronting both the private and public sectors in Honduras is the regional political conflict. Even more than variability in domestic policy, uncertainty surrounding Central American political stability is severely constraining new investment and expansion in existing investments in Honduras.

### *Trade and Payments Profile*

The Honduran government's attitude toward the role of exports in promoting economic growth has evolved over time. Initially, as in most Central and Latin American countries, the export sector was not seen as strategically important. The government concentrated instead on producing for local markets. This strategy is evident in the Central American Agreement on Fiscal Incentives that was signed by the Central American countries in 1973.<sup>2</sup> The treaty gave fiscal incentives, such as exemptions from taxes and import duties, to firms that used a high percentage of local materials in their products. In some cases, protection was provided from competing imported goods. One negative result of the protection was the expansion of firms that were uncompetitive internationally and survived in the domestic markets only as a result of favorable treatment. Despite little governmental encouragement, Honduran exports rose fairly steadily during the 1960s and 1970s. Exports as a percentage of total output increased from 10 percent in the early 1960s to 16 percent in the late 1970s (see Appendix 7.1).

It was not until the 1980s that a greater role for exports was recognized and incorporated into legislation. The Export Promotion Law of 1983 and the Temporary Import Law of 1984 both seek to promote exports by offering tax incentives and duty exemptions to firms that export. The Export Promotion Law was directed specifically at nontraditional exports and offered tax rebates to exporters of nontraditional products.

In part as a result of the governmental policies just mentioned, Honduras ran a trade surplus in only three of the last 25 years. More alarming than the existence of a trade deficit is its growing size. From

1983 to 1985, imports rose by an average of 17.6 percent annually, while exports only increased by 7.7 percent per year. Honduran exports actually fell from 1980 to 1982, and then rose by 1985 to 95.0 percent of their 1980 value. Resurgence has been confined to traditional exports, however; in 1985, nontraditional exports had reached only three-quarters of their 1980 value.

Foreign exchange reserves reached a low of \$98 million in mid-1983, enough for 6 weeks of imports, increased to \$132 million in May 1986, and fell to \$107 million in September 1986.<sup>3</sup> In addition to covering the mounting trade deficit, these hard currency reserves are needed to repay the foreign debt. The sum of annual amortization and interest charges on the foreign debt increased by 17.1 percent over the 5 years from 1980 to 1985, from 23.5 percent to 29.0 percent of annual export revenue.

The destination of Honduran exports has shifted slightly toward Japan and the European Economic Community since 1980, and away from Central America and the Caribbean. One reason for the change is government encouragement to ship to countries that pay in hard currency, in order to ease the foreign exchange shortage. Exports to the United States declined from \$460 million in 1984 (64 percent of total Honduran exports) to \$438 million in 1985 (56 percent of total exports). Nonetheless, the United States continues to be Honduras' most important trading partner.

The 1983 Export Promotion Law classifies exports as traditional or nontraditional as a function of their value and/or the number of years they have been exported. Based on this definition, the Honduran government considers 16 products to be traditional exports. In descending order of export value in 1985, they are bananas, coffee, zinc, lobster, wood, unrefined sugar, refrigerated meat, silver, shrimp, tobacco, lead, cotton, petroleum derivatives, furs and skins, metal products, and standing cattle. These traditional exports represent 84.4 percent of total export earnings, a percentage that increased slowly but steadily between 1980 and 1986, up from 82.0 percent in 1980.

The 16 products mentioned can be classified into three tiers based on export earnings. The top tier, consisting of bananas and coffee, represents two-thirds of all traditional exports and three-fifths of all exports. A 1 percent increase in banana exports alone brings in \$5 million in additional foreign exchange. A second tier of traditional exports includes zinc, lobster, and wood. Each of the other 11 categories can be considered in the third tier.

Exports classified as nontraditional by the Honduran government totaled \$122 million in 1985, or 16 percent of total exports. Of the hundreds of products considered to be nontraditional, pineapples, palm

oil, fruit jellies, and wood products head the list, each generating \$5-10 million in export earnings in 1985.<sup>4</sup>

The value of Honduran traditional exports fell slightly, by 0.2 percent, from 1980 to 1985. Over that five-year period the value of banana, zinc, and lobster exports increased, while the value of coffee and wood exports diminished. Honduran banana exports rose by an average of 4.2 percent per year from 1980 to 1985. This increase was due in part to an upswing in the price paid for the fruit, which increased from \$4.81 per 40-pound box to \$5.87 over the five-year period.

Rising prices and increasing export volume resulted in a 34.4 percent annual growth in the value of zinc exports from 1980 to 1985, but a downturn is expected in the late 1980s due to world price decreases. The rapid rise in the value of zinc exports from 1980 to 1985 was nearly equaled by the 33.1 percent yearly growth rate in lobster exports. Export volume doubled from 1980 to 1984 and then doubled again during 1985.

The value of Honduran coffee exports fell by 25 percent from 1980 to 1983, then recovered slightly in 1985, stimulated by increases in prices received and export volume. Given coffee's position as the nation's second most important export, the higher coffee price could significantly boost the value of total Honduran exports for the late 1980s.

According to the Honduran Forestry Development Corporation, COH-DEFOR, five million hectares, 45 percent of the total area of Honduras, is covered by forests. This vast natural resource has provided Honduras with its fifth most important export, wood. The value of wood exports rose steadily from 1980 to 1982, from \$36.2 million to \$44.6 million, then fell to \$34.1 million in 1985.

Honduras' most important nontraditional exports are, in order, pineapple, palm oil, fruit conserves, and manufactured wood products. Together these four goods total 26.7 percent of nontraditional exports and 4.2 percent of total exports. The performance of nontraditional exports has been mixed. Of the four most important nontraditional exports, palm oil has exhibited stunning growth, pineapple and conserves have increased more slowly, and manufactured wooden goods have experienced a dramatic decrease.

The value of palm oil exports has soared over the past 4 years. As late as 1982, Honduras did not export any palm oil, but in 1985 it exported \$10 million. Because of congressional concern about potential injury to U.S. producers, the U.S. Agency for International Development (AID) is prohibited from directly or indirectly assisting palm oil exporters, as well as exporters of sugar and citrus, as stated in AID Policy Determination 71. Given that the value of palm oil exports exceeded the value of every nontraditional export product except pineapples and brought in more foreign exchange in 1985 than did 7 of the 16 traditional

export products, the restriction on aid to palm oil producers can be considered a serious restriction on AID's ability to promote exports. A second obstacle to increased palm oil exports is low price: The price in world markets was reported to have collapsed in 1986.

Price increases spurred pineapple production and pushed the value of pineapple exports to \$14 million in 1984, nearly double its 1980 value. The value of fruit conserve exports also rose from 1980 to 1985, although not as much as the value of pineapple exports. Jam and jelly exports rose from their 1980 level of \$4.5 million to \$5.8 million in 1985. The value of 1986 exports was expected to top the 1985 value by 35 percent.

In contrast to the other three important nontraditional exports, the value of manufactured wooden products exports declined steadily from 1980 to 1985, to \$5.7 million, one-third of their 1980 value. The volume of wooden goods exported slumped by nearly half over the five-year period. A knowledgeable observer attributed part of the decrease to poor domestic economic conditions and a high level of government regulation of the wood products industry, but went on to suggest that part of the fall may be illusory, due solely to underinvoicing. It is interesting to note that the Honduran government is the only licensed exporter of unprocessed wood, but the private sector is free to export processed wooden products. This situation has reportedly led to the export of low-value items such as broom handles made from high-value types of wood.

In addition to the four important nontraditional exports, Honduras exports hundreds of other items in small quantities. Nine of these nontraditional exports are discussed below, in order of value of 1985 exports. They are cigars, cacao, citrus, melons, plantains, gum rosin, textiles, ornamentals, and cardamom. These nine were chosen because they represent both successes and failures among nontraditional exports and therefore are able to indicate some important determinants of nontraditional export growth. In several cases, such as grapefruit, melon, and plantain, weather and market conditions were key factors leading to increased (or decreased) exports. Trade legislation in the United States was an extremely important determinant for manufactured and assembled goods, such as garments. Technical assistance was a primary reason underlying rapid expansion in cacao exports over the period from 1980 to 1985.

Honduras exported cigars worth \$4.5 million in 1985, above their 1980 value but below their 1984 high of \$6.5 million. The rise and fall in part resulted from upturns and downturns in the market price for the product.

The value of cacao exports more than tripled from 1980 to 1985, to \$3.2 million. Part of this spectacular growth was due to an AID-sponsored cacao research and extension project that is educating farmers in how to ferment their cacao, and the importance of doing so, since the resulting product commands a higher price that boosts both Honduran foreign exchange earnings and farm income.

Honduran grapefruit exports fluctuated from 1980 to 1985, reaching a high of \$3.6 million in 1983, then contracting to \$2.6 million in 1985 due to weather and market conditions. Melon exports expanded from \$0.8 million in 1980 to \$1.8 million in 1985. Export volume continued to increase in 1986. Similarly, plantain exports to countries outside Central America jumped from \$0.2 million to \$1.5 million from 1984 to 1985 and was expected to double in 1986. The upswing resulted from increasing export volume, which grew eightfold during 1985.

In contrast to most of the other nontraditional exports, gum rosin exports have dropped. From \$6.7 million in 1981, the value of gum rosin exports slumped steadily to \$1.5 million in 1985. One reason cited by a Honduran gum rosin exporter for the reduction is increased production from other countries, primarily the People's Republic of China, that has flooded the world market and brought the price down from \$650 to \$300 per metric ton.

Garment assembly is experiencing a boom in Honduras as local and joint venture manufacturers take advantage of the Tariff Schedule of the United States (TSUS) 807 legislation, under which goods assembled abroad pay duty only on value added when they reenter the United States. Although the Honduran Central Bank does not collect export statistics on this particular category, one shirt assembly firm reported 40 percent annual growth in export value over the last several years. In contrast, corset and brassiere assembly has shown a marked fall, from \$2.6 million in 1980 to \$0.7 million in 1985, and no turnaround is expected. The volume of corset and brassiere exports from January until April 1986 was half the volume of the same four-month period in 1985. The downturn appears to be the result of internal management difficulties within several of the large garment assembly firms operating in the country. In an economy as small as that of Honduras, changes in production levels of individual firms are sometimes plainly reflected in aggregate data.

Ornamental plants is another category that the Central Bank does not yet disaggregate from its export statistics, but if growth continues, it might have to in the future. One exporter of 45 varieties, including dracaenia and palms, estimated a 50 percent increase in export value during 1986, to \$900,000, and a 12 percent increase during 1987. In late 1986, the nursery employed approximately 100 people.

Cardamom, the last nontraditional export to be discussed, is not widely used in the United States, but is an ingredient in ice creams and breads in Scandinavia and is used as a spice and in rituals in India and throughout the Middle Eastern and Arabian countries. Using working capital and storage space provided by the Honduran Federation of Agricultural and Agro-Industrial Producers and Exporters, FEPRO-EXAAH, 35 cardamom producers formed the Cardamom Exporting Association in Honduras and released their first shipment of 10,000 kilos destined for Jordan in late 1986. Although the value of the first shipment is negligible, cardamom exports could reach \$10 million in 1990, according to AID. Since cardamom producers also tend to be small coffee farmers, a cardamom export take-off could have very positive income generation and equity effects.

### *Determinants of Export Performance*

This section examines in more detail the macroeconomic and microeconomic determinants of nontraditional exports growth in Honduras. Turning first to the macroeconomic determinants of export performance, one notes that low Honduran wages are attractive to labor-intensive industries, but two difficulties—an overvalued currency and high-cost credit—constrain Honduran exports.

Low Honduran wage rates are very attractive for labor-intensive industries. In 1986, the Honduran minimum wage varied from \$2.30 to \$3.55 per day, depending on activity and location within the country. The base wage for employees in light manufacturing in the larger Honduran cities was \$3.30 per day.

The Honduran government maintains the local currency, the lempira, at an overvalued rate. The official rate, 2.00 lempiras to US\$1.00, was set by decree in 1918 and was never modified. An illegal but tolerated parallel market has sprung up. The premium in the parallel market was as high as 30 percent in 1984 and 1985, but fell to approximately 10 percent in 1986.

Both working capital and long-term credit at affordable rates are necessary to allow exporters to function and expand. Although inflation is low in Honduras (4.4 percent in late 1986), interest rates have remained high as a result of tight monetary policy. The lending rate in December 1986 was 17 percent.

In addition to macroeconomic determinants, several firm-specific, or microeconomic, factors also affect export performance. In general, Honduran firms have good foreign market contacts and information and a high level of quality control. However, poor internal management and risk-avoiding behavior both constrain export growth.

Quality control does not appear to be a problem for Honduran exporters. High quality is achieved through thorough knowledge of market standards and careful checks of the products. The Foundation for Entrepreneurial Research and Development (FIDE) offers quality assurance technical assistance to exporters.

As in any business activity, the success of nontraditional exporting depends on the quality of its management. The generally low educational level in Honduras, combined with the lack of an in-country postgraduate business management program, means that many managers will be unprepared for their tasks.

Several nontraditional export firms interviewed had experienced serious setbacks as a result of poor management. For example, to fill an order for Spain, a tobacco firm redirected all its output there, thus alienating its other customers. It began an expensive expansion, only to have Spain buy nothing the following year. The annoyed "traditional" customers were unwilling to accept the following year's production, and the tobacco company has not yet recovered. A second example of an export company suffering from poor management is an apparel firm that has found itself with a large and growing inventory, but seems unable to locate new customers.

To prepare managers in the technical aspects of business, as well as to make strategic business decisions, training programs could be targeted directly at nontraditional export firms. Some training is now offered: FIDE provided scholarships to three Honduran businessmen to attend a two-week course on marketing strategies at the World Trade Center in New York.

Nontraditional exporters are taking on an inherently risky operation—one that is untried. Several observers of the Honduran economy commented that Honduras has a notable lack of risk takers. There are several reasons for the Honduran business community's risk-avoidance behavior. From an economic perspective, lower-income units are less likely to take risks because a negative outcome would place them in a bad, even untenable, position. From a sociological perspective, the Honduran culture discourages risk taking. Especially in rural areas, the Honduran society is still essentially a peasant society that ostracizes deviants. Foreigners, such as the Palestinian immigrants who arrived at the turn of the twentieth century, have become very successful entrepreneurs, but Hondurans typically have not.

AID is trying to overcome this cultural barrier by supporting the entrepreneurs who come to its attention with invitational travel and in-country seminars. This seems to be an effective method for slowly wearing down the cultural constraints on risk taking.

A first step in exporting is contact between a Honduran businessman and a potential investor or buyer. This is fairly easy for an exporter of a traditional good, for the product is a proven one, and the Honduran producer and foreign buyer are probably reasonably familiar with its production and transport. Because of a lack of information on both sides, initial contact with new markets is more difficult for nontraditional exporters. In Honduras, FEPROEXAAH, which is AID-financed and nonprofit, and FIDE assist Hondurans to make contacts by coordinating visits by potential investors.

The AID mission to Honduras estimated that through the initiative of FEPROEXAAH, U.S. affiliates, and the private agribusiness sector, 12 ventures were undertaken or expanded from 1984 to 1986, resulting in \$8 million in investment, \$3 million in export earnings from nontraditional commodities, and 1,400 jobs in agriculture and agribusiness. One of these ventures is a multimillion-dollar orange juice concentration plant that created 133 jobs and exported concentrate worth an estimated \$1.3 million in 1986.

Both FIDE and FEPROEXAAH promote Honduran exports. One of the organizations' main purposes is to create a network of business contacts for Honduran producers and exporters. Both organizations send and receive information on investment and export opportunities through four specialized networks in the United States. These networks are the International Resource Center (IRC), which deals with agroindustries in the western United States; the International Planning and Analysis Center (IPAC), which specializes in wood; the Chicago Association of Commerce and Industry (CACI), for apparel and textile inquiries; and the Inter-America's Group (IAG) which also handles agroindustrial suppliers, buyers, and investors. Each issue of FIDE's monthly newsletter, published in both English and Spanish, describes export opportunities that FIDE learned of through the networks and other informal contacts and provides interested businessmen with the name, address, and phone number of the person to contact.

Using specialized marketing intermediaries seems to have brought a certain degree of success. At least two contracts were signed in 1986 between parties initially brought together by the specialized networks, one for \$1 million of wooden table legs, and one for 12,100 dozen T-shirts and turtleneck shirts. In addition, by using the networks to locate additional marketing channels for Honduran plantains, FEPROEXAAH was able to break the monopoly the intermediary had maintained and greatly enhance the producers' profitability. The new marketing strategy is one reason that plantain exports have increased from \$0.2 million in 1980 to \$2 million in 1985.

FIDE also represents Honduran industries in trade shows. During the summer of 1986, FIDE and AID assisted Honduran businesses to exhibit at trade shows for sporting goods, cigars, and furniture. Each event served to increase visibility of Honduran products in world markets and introduce Honduran businessmen to potential buyers. In addition to coordinating trade visits, FEPROEXAAH also sends out trial containers to assess market response. The federation has successfully used this strategy with potatoes and pineapples.

Contacts made through FIDE and FEPROEXAAH also assist the Honduran business community in another key area: knowledge of the regulations concerning market entry. Not knowing can be costly. The value of Honduran exports denied entry into the U.S. markets due to poor condition, a high pesticide level, or improper labeling totaled \$1,189,504 in 1983, \$563,322 in 1984, and \$561,650 in 1985, according to FIDE. Contacts are one of the best sources of this information, but FIDE has also successfully used indirect methods to inform Honduran exporters. In 1986, FIDE participated in conferences on textile and food imports to the United States with the goal of familiarizing its staff with import regulations in order to inform the Honduran exporters.

In addition, foreign buyers and investors usually introduce new, efficient production techniques. Thus, contacts with foreign markets and investors are doubly important, for they not only increase sales, they can also increase profitability per unit produced.

FIDE encourages technology transfer both indirectly, by increasing Honduran contacts with foreign markets, and directly, by contracting for technical assistance for Honduran enterprises. As an example of the latter, FIDE contracted with a U.S. textile industry consulting firm to train Honduran employees to sew and to operate a computerized financial control system. FIDE lent the Honduran-U.S. joint venture training funds at a slightly subsidized rate.

Three decrees offer incentives to Honduran exporters. The Puerto Cortes Industrial Free Zone, created by Decree No. 356 in 1976, offers exporters duty-free importation of machines and raw materials, no federal, state, or local income or corporate taxes, unrestricted repatriation of profits and capital, and exemption from export controls and duties. Decree No. 220-83, the 1983 Export Promotion Law, creates fiscal incentives for nontraditional exports by rebating (using export certificates, CEFEX) the indirect taxes such as customs duties or sales taxes that exporters incur. Decree No. 87 of 1984, the Temporary Import Regime, suspends import taxes on raw materials and equipment and eliminates the income tax for ten years for producers who export outside Central America. Exporters gain some measure of benefit from several laws Honduras has on the books to promote exports, specifically nontraditional

exports. However, the effectiveness of incentives is diminished by the manner in which the government bureaucracy implements the regulations.

An impediment to exporting in Honduras is the government workers who process export and import licenses and forms. Exporters uniformly complained about their attitude, their slowness, and the painstaking detail they demand. Undoubtedly, some of the delays in processing are due to the foreign exchange shortage discussed earlier. But even given structural problems that cause delays, the attitude of the civil servants remains a problem that perhaps a training program or incentives could correct.

Several other factors affect Honduran exporters, some positively, some negatively. On the positive side, exporters have fairly good access to decision makers on political and economic matters that affect them. They can benefit from research on new agricultural products and techniques and from an excellent transportation infrastructure, and they can receive assistance in locating and adapting modern production techniques. However, the overriding issue of regional political instability constrains Honduran exports.

Exporters need to lobby effectively in their home country and to a lesser extent in the countries to which they export in order to promote their interests. Investment laws, tax laws, and quotas directly affect them, and they must be organized to protect themselves.

Effective coalitions of exporters have been established in Honduras, in large part by AID, and have benefited their members. FIDE was invited to participate in the TSUS 807 negotiations regarding textile imports into the United States. FEPROEXAAH organized cacao producers into a coalition that applied for and received more than \$1 million from AID for cacao research and extension. Establishing and initially maintaining the organizations that can give voice to exporters' needs and acquire resources from host country private and public sectors is perhaps one of the most beneficial uses of AID's scarce resources. In creating such organizations, AID leverages its resources to bring about short-term improvements in conditions for exporters, and at the same time it creates lasting channels through which exporters can continue to have an impact on public policy over the long term.

Just as industry needs technical assistance to improve upon its products and production techniques, so does agriculture. The technical assistance need not come from the government, since private seed and machinery companies often impart new product ideas or technologies. But those groups not well served by the private sector, mainly smaller farmers and producers of crops grown in smaller quantities, tend to depend on the government for assistance.

Honduras responded to the challenge of keeping its farmers up-to-date in 1984, when the government of Honduras and AID opened the Honduran Agricultural Research Foundation (FHIA) in facilities donated by United Brands Company in La Lima, Honduras. FHIA's mandate is to conduct laboratory and on-farm research on priority problems and opportunities in four nontraditional areas: cacao, citrus, plantains, and vegetables. The institute is currently screening over 200 nontraditional crops to identify the most promising alternatives. It is too early to assess FHIA's impact on Honduran agricultural exports, although there have been several instances, one involving cucumbers, where FHIA studies revealed and solved the problems causing low-quality, nonexportable fruits and vegetables.

Honduras boasts an excellent transportation infrastructure, but air cargo service is unpredictable, and maritime container service is expensive. There are three international airports in Honduras: Tegucigalpa, San Pedro Sula, and La Ceiba. They are serviced by TAN-SAHSA (Honduras), TACA (El Salvador), LACSA (Costa Rica), Iberia, Pan-Am, Japan Airlines, KLM, Lufthansa, Eastern, British Airways, Varig, Air France, Alitalia, and Challenge, but only TAN-SAHSA can carry cargo into and out of Honduras. Cargo service is unpredictable, with delays sometimes resulting when certain cargo is given preference over others.

Several international shipping companies service Honduras and dock in the main ports of Puerto Cortes, La Ceiba, Tela, and Puerto Castilla on the Caribbean Sea, and Henecan on the Pacific Ocean. Shipping rates from Honduras are high; the per pound, per mile rate is reportedly one of the highest in the world and is due in large part to low volume.

Overland transportation is not a constraint to exporting. Throughout the country, there are 16,351 kilometers of highways and roads linking the major cities and production centers. In addition, there is a railroad system serving the north coast, mainly for the transportation of export-bound bananas.

A fundamental constraint on Honduran exports is the political instability Central America is experiencing. Presently, few investors are interested in the area; private investment fell by 69 percent over the 1981-1984 period and increased by only 2 percent in 1985. Capital flight is estimated at \$100 million a year.

Shrimp provides an example of the dampening effect regional instability has on Honduran exports. The shrimp export potential is estimated at \$100 million annually, but the most appropriate shrimp-farming sites are located on Honduras' short southern coast between El Salvador and Nicaragua, an unstable, vulnerable region. Although a Honduran-U.S. consortium did make a \$4-million investment in shrimp production in 1986, the consortium has reportedly postponed two investments worth

a total of \$12.5 million pending resolution of the region's political difficulties. Thus, significant export growth is stymied by the uncertain political situation in the region.

Competitiveness is a combination of all of the macroeconomic, microeconomic, policy, and promotional issues just discussed. A country's ability to compete in international markets for investment and export market share depends on the sum total of all of these factors. Just as a chain is only as strong as its weakest link, a country's ability to export successfully depends on receiving a mark of "adequate or better" on each of the important criteria. Unfortunately, the current political unrest in the Central American region is acting as the "weakest link" and is undermining Honduras' efforts to increase investment and exports.

The various determinants just discussed are the principal factors that encourage or, conversely, stunt growth in nontraditional exports. It is fitting to mention that there are three sources of growth in nontraditional exports: One source is increases in the export levels of goods currently being traded. These increases are stimulated by additional investment in industries that have begun to "take off." The preceding discussion illustrated that a number of products fall into this category, among them fruit conserves, palm oil, cacao, citrus fruits, melons, and plantains. A second source of opportunities is new products or spin-offs from present exporters. These new products can be classified as horizontal spin-offs, which are new but related products; vertical spin-offs, which are inputs into the present production processes; and unrelated spin-offs.

Horizontal spin-offs often result when entrepreneurs make contacts, export successfully, and receive orders for additional products or when they spot opportunities on their own initiative. For example, a nursery owner interviewed in conjunction with this study showed a great deal of enthusiasm and interest in beginning to export new products in addition to the plants he already sold. He identified viable markets for leather leaf (a fern often used in flower arrangements), tropical flowers such as bird of paradise, dried flowers, and herbs. The banana industry's move into exporting banana paste is a second example of a horizontal spin-off. Possible horizontal spin-offs are numerous and include banana chips and additional winter vegetables and spices.

An example of a vertical spin-off comes from the textile industry. Several years ago, when the Honduran government was considering taxing elastic imports in order to appease the local elastic industry, a joint venture lingerie firm began to produce its own elastic. In addition to meeting its own elastic needs, the firm now exports elastic. Another vertical spin-off is packaging materials, such as cartons, used in exporting. The volume of Honduran box exports more than quadrupled in the first four months of 1986, compared with the first four months of 1985. One

factor that may slow carton exports is the protection the carton industry has received from the Honduran government, which has resulted in low-quality, high-priced, locally produced cartons. Presently, Honduran manufacturers need the permission of the local box manufacturer before they can import cartons. A representative of the local carton firm said that the firm routinely approves such requests if the firm is unable to produce the product specified. Additional potential vertical spin-offs include plastic pots for plants, chemicals, and garment pieces cut in-country rather than imported.

An example of an unrelated spin-off is provided by a Honduran family that has very successfully exported shirts and recently began manufacturing and exporting plastic items such as pens and drinking straws. The family's new venture illustrates that nontraditional export growth is facilitated by the presence of individuals already knowledgeable about risk taking, manufacturing, and exporting, who already have contacts in foreign markets and start-up and working capital.

A third source of nontraditional export opportunities is the export promotion institutions that elicit and disseminate market information. As of December 1986, Honduran export promotion institutions had received inquiries from potential buyers and joint venture partners in the following areas: baked goods, ceramic toilets, wooden products, chemicals, electronic circuit assembly, brushes, wire products, shellfish, fruits and vegetables, hand-crafted items, textiles, and sesame oil.

### *Conclusions and Recommendations*

Based on interviews held in-country in late 1986, there are a series of actions that, if implemented, could improve the prospects for nontraditional export growth. In general, Honduran firms and organizations have been successful in making contacts with foreign markets, disseminating information on foreign markets, assuring quality control, instructing in efficient, modern production techniques, creating the channels that give the Honduran exporters an effective voice in domestic politics and international decision making on issues that directly affect them, and developing improved agricultural practices and varieties and making them available to farmers.

Less has been accomplished toward fulfilling other requirements. The following conditions are constraining Honduran nontraditional exports: an overvalued exchange rate, lack of access to credit and foreign exchange, regional political instability, the dearth of risk-takers, export red-tape, poor internal firm management, and uncompetitive transport costs. On this list of areas for action, three policy areas stand out clearly as the

most important: achieving regional peace, devaluing the lempira, and improving the functioning of the Honduran capital markets to offer new financing mechanisms to those sectors of the business community that are unable to provide real estate as collateral.

Regional political conflict is the fundamental constraint on growth in nontraditional exports from Honduras. Until stability and peace come to the region, domestic and foreign investors will be very wary about committing resources in Honduras.

In addition, the lempira should be devalued. The overvalued lempira harms exporters in two ways. Overvaluation creates artificially high unit costs for exports and thus reduces price competitiveness. In addition, the overvalued rate creates a shortage of foreign exchange at the Central Bank. The bank responds by slowing down issuance of import permits to delay foreign exchange disbursements. In the words of one exporter, "Exporting is easy. I can get an export permit in one day. But I have waited up to three months for an import permit. They (the Central Bank) just don't understand that a delay like that is crippling." President Jose Azcona declared 1987 the "Year of the Export." However, until the lempira is devalued by approximately 10 percent, it is unlikely that Honduras will experience any sizable increase in exports.

A third constraint is the unavailability and high cost of credit. A review of Honduran capital markets would indicate a dearth of financial instruments and financing mechanisms that would facilitate business borrowing. For larger, more-established firms, issuance of commercial paper might lower their borrowing costs. For smaller, newer firms and agricultural associations, perhaps the solidarity group concept of pooling micro-enterprises to reduce risks could be expanded upon to include groups that are larger than the micro-enterprises but too risky to fulfill bank lending requirements. Risk or venture capital could be made more available. Equity markets could be strengthened by increasing minority stockholder rights.

In addition to or perhaps as an alternative to the creation of new financial instruments and institutions, one possibility would be to establish a training and strategic planning program with the banks operating in Honduras, which might lead them to begin to identify the benefits and risks associated with accepting additional assets, such as inventory or letters of credit, in place of real assets as collateral. However, as important as access to credit and a correctly valued exchange rate are to export growth, it is regional political instability that is the primary constraint on growth in Honduran exports.

APPENDIX 7.1  
 Quantifiable Determinants of Non-traditional Exports  
 HONDURAS, 1963 - 1986

	1963	1964	1965	1966	1967
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	83.3	93.8	126.6	142.9	158.1
Traditional exports	58.3	63.3	88.5	104.0	112.7
Nontraditional exports	25.0	30.5	38.1	38.8	45.4
Merchandise imports	95.1	101.7	122.0	148.1	164.8
Trade balance	(11.8)	(7.9)	4.6	(5.2)	(6.7)
Current account balance	(13.8)	(11.2)	(7.0)	(19.2)	(28.6)
CACM exports	14.6	19.1	23.5	22.2	23.4
<b>GROSS DOMESTIC PRODUCT</b>					
GDP (Nominal)	820.0	914.0	1,017.0	1,100.0	1,196.0
GDP growth (Nominal %)	11.5	11.3	8.2	8.7	8.6
GDP (1980 prices)	2,142.0	2,270.0	2,504.0	2,651.0	2,774.0
GDP growth (Real %)	6.0	10.3	5.9	4.6	7.3
<b>CAPITAL FORMATION</b>					
Borrowing rate	9.0	9.0	9.0	9.0	9.0
Fixed capital formation	122.0	123.0	132.0	159.0	213.0
Private	90.0	98.0	108.0	132.0	173.0
Public	32.0	24.0	24.0	27.0	40.0
Increase in stock	9.0	11.0	16.0	17.0	22.0
Foreign direct investment*					
Domestic credit	127.1	140.6	161.5	173.6	152.6
Investment by sector					
Agriculture	19.0	26.1	36.2	38.1	35.6
Cattle	6.3	6.3	7.7	10.2	14.2
Industry	11.4	16.4	24.8	31.1	47.3
Commerce	30.5	37.8	45.1	54.4	73.8
Services	5.8	8.0	13.0	15.7	17.3
Housing	8.0	10.2	13.9	17.1	26.4
<b>EXCHANGE RATE</b>					
Exchange rate, official	2.0	2.0	2.0	2.0	2.0
Exchange rate, parallel					
Real effec. exch. rate index			1.408	1.367	1.337
<b>FOREIGN DEBT</b>					
Public external debt*					
Amortization	2.0	3.0	3.0	3.0	4.0
Debt service					
Debt service ratio					
<b>OTHER</b>					
M1	79.1	89.8	104.6	106.9	114.3
Minimum wage (L/day)**					
Budget deficit	(5.7)	(6.7)	0.6	(5.0)	(4.1)
Consumer price index	53.3	54.0	55.5	56.8	57.9

All figures in millions of Lempiras unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Honduras instituted a minimum wage in 1980

APPENDIX 7.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 HONDURAS, 1963 - 1986

	1968	1969	1970	1971	1972
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	179.0	171.2	181.4	194.2	209.5
Traditional exports	119.5	116.9	127.1	150.5	160.6
Nontraditional exports	59.5	54.3	54.3	43.7	48.9
Merchandise imports	184.7	184.3	220.7	193.4	193.3
Trade balance	(5.8)	(13.1)	(39.3)	0.8	16.2
Current account balance	(24.7)	(30.6)	(63.8)	(22.7)	(12.7)
CACM exports	30.3	22.1	18.0	5.4	5.8
<b>GROSS DOMESTIC PRODUCT</b>					
GDP (Nominal)	1,299.0	1,348.0	1,446.0	1,551.0	1,683.0
GDP growth (Nominal %)	3.8	7.3	7.3	8.5	12.6
GDP (1980 prices)	2,976.0	2,986.0	3,125.0	3,294.0	3,427.0
GDP growth (Real %)	0.3	4.7	5.4	4.0	5.6
<b>CAPITAL FORMATION</b>					
Borrowing rate	9.0	9.0	9.0	9.0	9.0
Fixed capital formation	226.0	244.0	268.0	253.0	245.0
Private	178.0	159.0	174.0	182.0	188.0
Public	48.0	85.0	94.0	71.0	57.0
Increase in stock	13.0	14.0	34.0	(3.0)	11.0
Foreign direct investment*					
Domestic credit	177.0	237.2	304.6	369.3	406.5
Investment by sector					
Agriculture	35.9	50.1	64.0	61.9	61.0
Cattle	18.3	24.8	40.0	47.3	68.6
Industry	51.9	75.3	104.0	103.9	102.4
Commerce	61.9	72.2	85.0	71.0	109.0
Services	20.9	28.0	28.9	34.9	27.8
Housing	31.8	41.0	56.9	60.3	65.2
<b>EXCHANGE RATE</b>					
Exchange rate, official	2.0	2.0	2.0	2.0	2.0
Exchange rate, parallel			2.0	2.2	2.4
Real effec. exch. rate index	1.306	1.167	1.124	1.114	1.102
<b>FOREIGN DEBT</b>					
Public external debt*					
Amortization	4.0	4.0	7.0	7.0	10.0
Debt service			21.7	26.8	33.8
Debt service ratio			12.0	13.8	16.1
<b>OTHER</b>					
M1	127.4	148.1	158.9	169.4	192.9
Minimum wage (L/day)**					
Budget deficit	(5.4)	(27.8)	(39.4)	(44.6)	(45.4)
Consumer price index	58.9	59.6	61.9	63.2	65.2

All figures in millions of Lempiras unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Honduras instituted a minimum wage in 1980

APPENDIX 7.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 HONDURAS, 1963 - 1986

	1973	1974	1975	1976	1977
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	261.4	294.3	303.2	397.2	518.6
Traditional exports	199.7	179.7	182.0	275.6	371.0
Nontraditional exports	61.7	114.6	121.2	121.7	147.7
Merchandise imports	262.3	380.1	404.3	453.1	579.4
Trade balance	(0.9)	(85.9)	(101.1)	(55.9)	(60.8)
Current account balance	(34.6)	(104.0)	(112.1)	(104.8)	(128.7)
CACM exports	10.0	23.7	26.6	35.7	43.4
<b>GROSS DOMESTIC PRODUCT</b>					
GDP (Nominal)	1,895.0	2,114.0	2,241.0	2,626.0	3,321.0
GDP growth (Nominal %)	11.6	6.0	17.2	26.5	14.8
GDP (1980 prices)	3,619.0	3,615.0	3,506.0	3,788.0	4,222.0
GDP growth (Real %)	(0.1)	(3.0)	8.0	11.5	7.4
<b>CAPITAL FORMATION</b>					
Borrowing rate	9.0	11.0	11.0	11.0	11.0
Fixed capital formation	325.0	433.0	476.0	550.0	711.0
Private	237.0	311.0	314.0	360.0	445.0
Public	88.0	122.0	162.0	100.0	266.0
Increase in stock	23.0	109.0	(75.0)	(101.0)	109.0
Foreign direct investment*			7.0	5.3	8.9
Domestic credit	499.0	554.1	670.7	815.8	951.9
Investment by sector					
Agriculture	71.5	74.1	105.0	137.6	308.0
Cattle		0.7	34.9	24.2	33.8
Industry	137.3	128.7	147.0	172.9	258.0
Commerce	147.0	170.0	203.9	271.3	323.6
Services	31.5	65.3	86.6	81.2	121.7
Housing	70.7	71.0	84.7	70.0	112.2
<b>EXCHANGE RATE</b>					
Exchange rate, official	2.0	2.0	2.0	2.0	2.0
Exchange rate, parallel	2.4	2.4	2.3	2.3	2.5
Real effec. exch. rate index	1.096	1.088	1.091	1.022	0.996
<b>FOREIGN DEBT</b>					
Public external debt*		171.2		344.0	
Amortization	18.0	19.0	30.0	45.0	63.0
Debt service	54.7	63.8	96.8	151.0	209.5
Debt service ratio	20.9	21.7	31.9	38.0	40.4
<b>OTHER</b>					
M1	238.4	242.4	262.7	361.0	411.3
Minimum wage (L/day)**					
Budget deficit	116.0	(5.6)	(48.0)	(31.2)	2.7
Consumer price index	68.2	76.9	83.1	87.3	94.6

All figures in millions of Lempiras unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Honduras instituted a minimum wage in 1980

APPENDIX 7.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 HONDURAS, 1963 - 1986

	1978	1979	1980	1981	1982
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	612.8	733.6	850.3	782.8	676.5
Traditional exports	439.8	508.4	558.4	522.3	471.6
Nontraditional exports	173.0	225.3	291.9	260.5	204.9
Merchandise imports	699.2	825.8	1,019.3	960.0	700.5
Trade balance	(86.5)	(92.2)	(169.0)	(177.2)	(24.0)
Current account balance	(157.2)	(192.1)	(316.8)	(302.7)	(228.3)
CACM exports	49.2	60.0	83.9	65.9	51.9
<b>GROSS DOMESTIC PRODUCT</b>					
GDP (Nominal)	3,814.0	4,378.0	4,976.0	5,293.0	5,582.0
GDP growth (Nominal %)	14.8	13.7	6.4	5.5	5.5
GDP (1980 prices)	4,535.0	4,843.0	4,976.0	5,034.0	4,945.0
GDP growth (Real %)	6.8	2.7	1.2	(1.8)	(0.5)
<b>CAPITAL FORMATION</b>					
Borrowing rate	14.0	16.0	16.0	16.0	16.5
Fixed capital formation	941.0	1,004.0	1,235.0	1,051.0	968.0
Private	586.0	634.0	758.0	597.0	437.0
Public	355.0	370.0	477.0	405.0	531.0
Increase in stock	46.0	89.0	68.0	74.0	(141.0)
Foreign direct investment*	13.2	9.9	5.8	(3.6)	13.8
Domestic credit	1,103.5	1,243.1	1,421.9	1,650.2	1,943.0
Investment by sector					
Agriculture	265.0	283.6	209.8	191.0	229.4
Cattle	38.7	61.4	51.8	80.3	93.5
Industry	271.2	294.0	262.8	287.6	411.4
Commerce	473.0	439.8	376.4	401.0	400.2
Services	131.2	203.5	224.7	157.5	162.9
Housing	112.6	137.8	123.0	142.5	137.3
<b>EXCHANGE RATE</b>					
Exchange rate, official	2.0	2.0	2.0	2.0	2.0
Exchange rate, parallel	2.6	2.6	2.4	2.2	2.1
Real effec. exch. rate index	1	1.045	1.106	1.073	0.969
<b>FOREIGN DEBT</b>					
Public external debt*	594.6	759.8	985.3	1,227.7	1,379.9
Amortization	80.0	137.0	113.0	133.0	105.0
Debt service	272.5	394.8	386.7	454.8	461.1
Debt service ratio	44.5	53.8	45.5	58.1	68.2
<b>OTHER</b>					
M1	480.4	545.6	610.3	637.4	716.9
Minimum wage (L/day)**			5.7	5.7	6.6
Budget deficit	(29.7)	(79.2)	(140.2)	(144.5)	(379.6)
Consumer price index	100.0	112.1	132.4	144.8	157.8

All figures in millions of Lempiras unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Honduras instituted a minimum wage in 1980

APPENDIX 7.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 HONDURAS, 1963 - 1986

	1983	1984	1985	1986
<b>TRADE STATISTICS*</b>				
Merchandise exports (FOB)	698.7	745.7	780.1	
Traditional exports	453.9	483.1		
Nontraditional exports	244.8	262.6		
Merchandise imports	822.7	953.7	1,144.5	
Trade balance	(124.0)	(208.0)	(364.4)	
Current account balance	(219.2)	(301.9)	(262.8)	
CACM exports	85.0	70.0	45.0	
<b>GROSS DOMESTIC PRODUCT</b>				
GDP (Nominal)	5,891.0	6,297.0	6,719.0	
GDP growth (Nominal %)	6.9	6.7		
GDP (1980 prices)	4,921.0	5,058.0	5,210.0	
GDP growth (Real %)	2.8	3.0		
<b>CAPITAL FORMATION</b>				
Borrowing rate	17.0	17.0	17.0	17.0
Fixed capital formation	1,060.0	1,193.0	1,177.0	
Private	450.0	463.0	502.0	
Public	610.0	730.0	662.0	
Increase in stock	(130.0)	75.0	134.0	
Foreign direct investment*	21.0	20.5	27.5	
Domestic credit	2,346.5	2,653.3	2,883.7	
Investment by sector				
Agriculture	286.9	9.6	357.9	216.4*
Cattle	117.0	135.5	159.1	102.6*
Industry	466.8	465.7	579.1	348.4*
Commerce	413.6	604.4	748.9	628.6*
Services	225.0	195.9	206.8	119.8*
Housing	158.1	150.8	148.8	83.6*
<b>EXCHANGE RATE</b>				
Exchange rate, official	2.0	2.0	2.0	2.0
Exchange rate, parallel	2.1	2.0		2.3
Real effec. exch. rate index	0.854	0.836		
<b>FOREIGN DEBT</b>				
Public external debt*	1,570.3			
Amortization	112.0	174.0		
Debt service	454.2	410.8	452.8	
Debt service ratio	65.0	55.1	58.0	
<b>OTHER</b>				
M1	814.9	846.0	855.6	
Minimum wage (L/day)**	6.6	6.6	6.6	6.6
Budget deficit	(370.4)	(279.8)	(386.6)	
Consumer price index	170.9	178.9	184.9	

All figures in millions of Lempiras unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$, \*\*Honduras instituted a minimum wage in 1980  
 \* January-July

**Notes**

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2. Investment Promotion Office, Ministry of Economy, *Honduras Investment Guide* (Tegucigalpa, Honduras: 1986), p. 17.
3. International Monetary Fund, *International Financial Statistics*, Volume 39, no. 12, December 1986 (Washington, D.C.: 1986), p. 247.
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## *Jamaica*

*John A. Mathieson*

Over the past two decades, Jamaica has undergone fundamental changes in economic structure, performance, and strategy. These shifts have been accompanied by and to a large degree resulted from a basic swing in the political philosophy of government leaderships in the nation's democratic but fragile political system. Jamaica's economic and political fortunes have been integrally associated with the nation's export and balance of payments performance, with the causal relationships working in both directions. The success of the current government headed by Edward Seaga will ultimately hinge on its ability to stimulate foreign exchange earning activities primarily in tourism and in the production and sale of nontraditional exports.

### *Recent Economic and Political Developments*

In the 1950s and 1960s, Jamaica's economic strategy centered around the goals of developing the nation's large bauxite reserves discovered in the 1950s, expanding the tourist industry, and encouraging domestic industry through an import substitution based industrialization policy. Successful efforts in these areas, combined with a rich agricultural base, enabled Jamaica to obtain annual gross national product (GNP) growth rates averaging 4.4 percent in the 1960s.

The oil price rise of 1973, however, was the first in a series of unfavorable internal and external developments that led Jamaica to experience negative growth rates in every year but one from 1973 to 1980 (see Appendix 8.1). Deterioration of the investment climate, unfavorable publicity for the tourist industry, and inappropriate fiscal and monetary policies caused GNP to decline between 1973 and 1980 by 18.3 percent overall and by as much as 25 percent per capita. By 1980, unemployment had grown to over 30 percent of the labor force, and consumer price inflation reached nearly 30 percent per year.

Several domestic factors help explain Jamaica's poor economic performance in the 1970s. The administration of Michael Manley was elected in 1972 on a platform of "democratic socialism" aimed at diversifying the economy, reducing urban unemployment, and redistributing income. The People's National Party (PNP) leaders in power increased government spending in the absence of corresponding rises in revenue, which eventually contributed to a 25 percent average annual inflation rate over the 1976 to 1980 period. The PNP government increased foreign borrowing and drew down its foreign exchange reserves to the point where, by the mid-1970s, shortages of foreign exchange caused cutbacks and closings of dozens of factories for lack of imported raw materials, equipment, and spare parts. The PNP government's nationalistic policy toward the bauxite mining companies also contributed to the economic decline.

In 1980, the government that had presided over the decline, the PNP led by Manley, was voted out of office in favor of the Jamaica Labour party. The new prime minister, Edward Seaga, has sought to increase investment and exports in order to revitalize the Jamaican economy.<sup>1</sup> Jamaica's investment and export incentive laws have been reformed, and investment promotion offices have been established locally and overseas. The government also strengthened Jamaica's political and economic ties with the United States, Jamaica's main trading partner.

These efforts to shift from import substitution to an export expansion strategy resulted in initial successes that represent a significant achievement given the depressed condition of the world economy over the period. Since 1983, however, this forward momentum was halted due to a number of factors, primarily shortages of foreign exchange. In addition, many of the reforms promised by the Seaga government were not implemented, which dampened investor confidence. Driven largely by reduced production from the mining sector, Jamaica's real output stagnated in 1984 and fell in 1985.

### *Trade and Payments Performance*

The composition of Jamaica's external trade falls into a pattern prevalent in many small developing countries—heavy dependence on a wide range of imported goods to meet production and consumption needs and an equally heavy dependence on a select number of commodity exports to earn needed foreign exchange. Most raw materials, machinery, and parts used by Jamaica's industry are imported, and a large portion of consumption goods are also of foreign origin. In 1985, Jamaica's imports of goods and services amounted to as much as two-thirds of the nation's gross domestic product (GDP), a share that has risen from about one-

third in the late 1960s and about one-half in the early 1980s. The implication of this import dependence is that if foreign purchases of food, raw materials, capital goods, and consumer goods cannot be maintained at appropriate levels, then the entire economy will experience commensurate, almost immediate consequences.

To finance the imports required to sustain the nation's economy, Jamaica has relied on export earnings generated from a highly concentrated set of minerals and agricultural commodities. More specifically, sales of bauxite and alumina (the raw material and intermediate material, respectively, used in producing aluminum) and sugar have traditionally made up the lion's share of Jamaica's total exports. These three commodities accounted for 78 percent of total Jamaican merchandise exports in 1970 and as much as 84 percent in 1980, before declining to 63 percent in 1985.

The diverse commodity requirements on the import side of the equation and concentrated commodity dependence on the export side necessarily create an extremely high degree of vulnerability. That is, the performance and prospects of the Jamaican economy as a whole are strongly sensitive to shifts in supply/demand conditions and policies in the aluminum and sugar markets.

Jamaica's balance of payments structure is also typical of that of many developing countries.<sup>2</sup> Recurrent trade and current account deficits are offset by inflows of official and private capital. Jamaica's merchandise trade balance has recorded deficits in every year since 1961. Trade in services has also resulted in net deficits, despite significant earnings in tourism. Tourist expenditures have risen steadily from an average \$70 million per year in the late 1960s to a level of \$400 million in 1984 and 1985. While tourism is clearly an important generator of employment, the foreign exchange contributions of the tourism sector are negated to a certain extent by the large import bills incurred to support the industry. The financing of current account shortfalls has been accomplished through capital inflows, largely in the form of official government borrowings.

Cyclical trends in Jamaica's merchandise trade balance reflect changes in international prices of oil, bauxite, and sugar. Import levels peaked in 1975 and again in 1981 due to the escalation of oil prices and declined thereafter. Export performance followed a similar pattern, with peaks occurring in the mid-1970s and early 1980s.

Long-term trends in Jamaica's trade balance are more ominous. Exports kept pace with imports in the 1960s, with the former growing at an average annual rate of 9.4 percent and the latter by 10.6 percent. In the decade of the 1970s, export expansion of 12.1 percent annually actually exceeded the 9.1 percent rate recorded for Jamaican imports. In the first half of the 1980s, however, the situation was reversed. While

imports in 1985 were at the same level as that recorded in 1980, exports dropped precipitously, by an average annual rate of 11.0 percent, from \$936 million in 1980 to only \$535 million in 1985. When this latter figure is netted against Jamaica's 1985 import bill of \$1,144 million, the result is a merchandise trade deficit of \$609 million.

To finance Jamaica's external financial shortfall, the government has not drawn down the nation's foreign exchange reserves, which in mid-1986 were sufficient to cover only about two months of imports. Instead, deficits have been funded by a combination of foreign assistance (unrequited transfers) and foreign borrowing, most of which consists of official borrowing from bilateral and multilateral lending institutions. As a consequence, Jamaica's external debt has grown steadily over the past decade, from \$529 million in 1974 to nearly \$2.0 billion at the end of 1983. Over three-quarters of the latter figure represents indebtedness to foreign official creditors.

Jamaica faces a major challenge to develop existing and new sources of foreign exchange earnings. Tourism may expand in the years ahead, but only marginally. Therefore, the principal responsibility for generating the additional foreign exchange will fall to exporters of traditional and nontraditional goods.

Jamaica's initial traditional export was sugar, with the British operating the island as a plantation colony. The discovery of large bauxite reserves in the mid-1950s led to the development of a major bauxite/alumina complex, which by the following decade became the dominant factor in Jamaica's exports and overall economic development.

Aluminum is the most recently discovered of the common metals used industrially in large quantities. In less than a century, commercial use of aluminum has by any measure surpassed all other metals except iron and steel. Aluminum's properties of light weight, high electrical and thermal conductivity, corrosion resistance, and casting capabilities have led to the use of the metal in a wide range of industrial, construction, and consumer good areas.

The production of aluminum from bauxite is a two-step process: Bauxite is first refined to obtain its oxidized form, alumina, which in turn is smelted into aluminum. With reserves in excess of 500 million tons, Jamaica has since the late 1960s ranked as one of the largest bauxite/alumina producers in the world. Over time, Jamaican bauxite was mined by most of the largest aluminum companies, including the following ventures: Alcan Jamaica, Alumina Partners of Jamaica, the Kaiser Bauxite Company, Reynolds Jamaica Mines, and Alcoa Minerals of Jamaica. Jamaica's exports of bauxite and alumina expanded throughout the 1960s and early 1970s. In the late 1970s, Jamaica's production accounted for approximately 20 percent of world output.

However, the long-term growth potential of the industry was dampened by increases in energy prices, which lifted production costs, and by the imposition in Jamaica of a production levy in 1974. Foreign exchange earnings from bauxite peaked in 1978 at \$234 million and declined continuously thereafter to \$77 million in 1985. Alumina sales grew rapidly throughout the latter 1970s, reaching a peak of \$589 million in 1981. The severe recession sparked by the second round of oil price rises reversed that trend, resulting in an ultimate 65 percent fall in alumina earnings, to \$212 million in 1985.

Jamaica's performance in bauxite and alumina was adversely affected in recent years by the closures of several companies (Reynolds, Alpart, and Alcoa) and by the completion of shipments to supply the U.S. strategic stockpile. According to most forecasts, the outlook for Jamaican bauxite sales is for very modest growth to perhaps \$90 million per year through the early 1990s. Exports of alumina are generally expected to rise more rapidly, by perhaps 7-8 percent annually, over this period. Even under the most optimistic of scenarios, however, the bauxite/alumina industry cannot be expected to fill more than a small portion of the current and anticipated gap in Jamaica's foreign exchange requirements.

Jamaica's second major traditional export is sugar. Over the past fifteen years, sugar has exhibited lackluster export performance, with annual earnings averaging about \$50 million. The only exceptions occurred in 1974 and 1975, when quantum rises in world sugar prices resulted in Jamaican sugar exports of \$82 million and \$154 million, respectively. Until the mid-1990s, the annual volume of sugar sales is expected to remain relatively constant, leading to annual earnings of approximately \$50 million.

A number of other agricultural, mining, and manufactured products are classified as traditional exports by the government. The combined earnings of these exports totaled \$42 million in 1985, or about 11 percent of total traditional exports.

Traditional agricultural exports consist of bananas, citrus fruit, coffee, cacao, and pimentos. Sales of bananas have fluctuated over the past fifteen years from highs of \$18 million to a low of under \$2 million and have leveled off to an annual average of about \$5 million in recent years. Citrus exports have remained stagnant at about \$1 million annually. Foreign sales of coffee, cacao, and pimentos have also fluctuated and when combined contribute about \$10-20 million per year. While some gains in traditional agriculture exports are possible over time, they are not expected to be significant. Other than bauxite and alumina, Jamaica's only traditional mining export is gypsum, which is used in making

plaster and plasterboard. Annual exports have remained relatively constant at around \$1 million.

Jamaica's traditional exports of manufactures are essentially processed agricultural products. These include rum and processed forms of citrus fruits, coffee, and cacao. Sales of rum have stabilized in the range of \$8–10 million per year. The remaining three traditional "manufacturing" categories of citrus, coffee, and cocoa products contribute a combined total of approximately \$7 million annually.

Ignoring cyclical fluctuations, Jamaica's traditional export sales grew by an average rate of 10 percent per year from 1970 to 1981, from \$289 million to \$842 million. This healthy growth was largely responsible for sustaining the domestic economy and financing imports. Since 1981, however, total traditional exports have steadily declined, at an average annual rate of 19 percent through 1986. Total traditional exports of \$352 million in 1985 are less than one-half of the sales recorded in the peak year of 1981.

The future prospects of Jamaica's traditional export sector are limited. Sales of bauxite and alumina could recover to a certain extent, but will depend on the combination of world economic recovery and a continuation of relatively low energy prices. Any expansions of other traditional exports are likely to be modest. Therefore, the Jamaican economy will have to rely on growth in nontraditional exports to meet its foreign exchange requirements.

Jamaican exports of nontraditional goods have grown steadily over the past fifteen years, at an average annual rate of 8.3 percent, but this expansion has been insufficient to take up the slack of declining traditional exports. The nontraditional product share of total exports has more than doubled, from 14 percent in 1970 to 38 percent in 1986.

Jamaican nontraditional exports can be classified as foodstuffs, beverages and tobacco, crude materials, apparel, or other. Each of these product groups faces a different set of circumstances, constraints, and opportunities.

Jamaican sales of foodstuffs consist of winter vegetables (sweet peppers, tomatoes, onions, okra, pumpkins, and other vegetables), staples (cassava, sweet potatoes, and yams), avocados, and various food preparations. Taken together, these exports rose from \$8 million in 1970 to \$29 million in 1985.

Winter vegetables destined for U.S. markets have for a number of years been considered to hold great promise, but these high expectations have not been fulfilled. Several private winter vegetable projects have failed. The crop yields were not as high as had been anticipated. The domestic infrastructure and transportation system are not sufficient to handle this highly time-sensitive industry, which requires that vegetables

reach their ultimate markets in approximately one day. In addition, external freight costs are high and follow irregular schedules. Finally, the costs of marketing winter vegetables, estimated at around 1.6 times the cost of actual production, pare back the margins of the farming operation.

Exports of food staples, particularly yams, have grown steadily in recent years, but their market potential is limited. The production of avocados has also expanded, but from a very low base. The final category of "other food exports" includes a wide range of prepared food items, such as jams and jellies, sauces, bulk processed food, and ethnic food preparations. A number of new products have been developed in recent years and are currently being actively marketed. The prospects for processed foods are viewed as reasonably good but limited. Successful marketing of processed foods is critically dependent on attractive packaging and sophisticated product presentation. Jamaican producers have historically paid little attention to packaging since they enjoyed a captive local market. As a result, canning and packaging capabilities are considered poor by international standards and would have to be improved to capture foreign market shares. Additional problems include high unit prices due to small-scale operations, outdated machinery, and high-cost inputs other than the food itself. If these constraints are effectively addressed, the long-term outlook for such products as juices, concentrates, snack foods, preserves, sauces, and ethnic foods is for gradual increases in sales, but not in volumes that will have any material impact on total exports.

Jamaican tobacco, cigars, and beverages (primarily nonrum alcoholic beverages) have been sold internationally for decades, but are considered to be "nontraditional" by the government. These exports have been relatively stagnant in the \$20-million range for the past decade. Efforts are currently under way to expand sales of cigars, liqueurs, and beer, but these products face stiff competition and restrictive trade barriers.

Jamaican exports of crude materials consist of horticulture products (cut flowers), foliage, and an assortment of other animal and vegetable materials. Sales of cut flowers have never exceeded \$1 million in value, but are considered by local entrepreneurs to have some potential for growth. The export receipts obtained by sales of other crude materials have declined in recent years.

The most vibrant sector of nontraditional export sectors by far is that of textiles and other forms of light manufacturing. Jamaica's exports of wearing apparel have an extensive history, reaching back decades, but until recently the majority of clothing sold was of relatively low cost and quality and intended to serve the Caribbean Common Market (CARICOM). As a result, exports of apparel stagnated at annual levels

of \$4-8 million from 1970 to 1981. Since that time, new investments have been made, especially in the Kingston Free Zone, to assemble garments for U.S. markets under 807 provisions.<sup>3</sup> Under these provisions in U.S. trade law, companies ship American-made components such as cut cloth to be assembled overseas, and only the foreign labor costs of the products' value added are subject to U.S. tariffs. Exports of apparel have grown from \$7 million in 1981 to as much as \$36 million in 1985, at a compound annual rise of 50 percent. In fact, this latter figure may even be understated, since U.S. statistics show wearing apparel and accessories imports from Jamaica at over \$54 million.

The apparel industry accounts for three-quarters of the factory space and 85 percent of the Kingston Free Zone's labor force of 7,000. Nine of the Free Zone's current list of tenants are apparel companies, including one Asian-owned company that employs 4,000 people. Jamaica's clothing producers have in a period of several years developed sufficient experience and marketing contacts to obtain larger, longer-term contracts and increasingly stable relationships with their North American buyers. In addition, the demonstration effect has worked to attract new investments in apparel production, primarily from entrepreneurs from the Far East who face quota limits in their home countries. From a purely economic standpoint, the prospects of the apparel industry in Jamaica are excellent. The only major factors that could contain the growth of clothing exports in the long run are a significant rise in U.S. dollar-equivalent wage rates (resulting from either rising local currency wage rates or overvaluation of the Jamaican dollar) or trade restrictions (through quotas or elimination of 807 provisions) in the United States.

The final category of Jamaica's nontraditional exports is known as "other" and consists of a wide range of miscellaneous manufactured products such as furniture, metal fabrication, machinery, and electronic switchgear. Jamaica's miscellaneous manufactures, which have exhibited strong growth and are expected to continue to rise, are increasingly targeted at the U.S. market. Prior to the 1980s, these various products were oriented toward serving the CARICOM market, which is limited in size and volatile in nature. There was little market-driven inducement to increase the quality of products, and economies of scale were not possible to achieve. Over the past few years, sales of these manufactures to members of CARICOM (primarily Trinidad and Tobago) have rapidly declined. Consequently, Jamaican producers have shifted their emphasis and product mix toward the United States, employing labor-intensive production techniques and achieving high-volume output. Initial indications show that a rapid takeoff of these nontraditional exports is clearly possible.

To summarize, Jamaica's historical trade strategy was aimed at selling traditional commodities (bauxite, alumina, sugar, and bananas) to industrial countries and exporting the majority of nontraditional products to other developing countries, primarily its neighbors in the Caribbean region. By one measure, in as late as 1980, 40 percent of Jamaica's nontraditional exports was shipped to CARICOM countries. This share fell to only 29 percent in 1985. In the same years, the U.S. share of Jamaica's total nontraditional exports grew from less than 18 percent to 34 percent. This shift reflects not only economic realities prevalent in the region, but also new opportunities opened by various incentives offered under the rubric of the Caribbean Basin Initiative (CBI) and through other preference provisions.

The ownership and pattern of investment in export-related activities in Jamaica have changed in concert with the nation's structure of exports. Initially, Jamaica's sugar and bauxite industries were dominated by expatriate owners and multinational corporations. Control in both sectors shifted to local hands in the 1970s as lands and mines were nationalized. Jamaica experienced almost no foreign investment in the early 1980s, due both to domestic political uncertainty and to depressed global demand and consequent consolidation by international investors. The vacuum of foreign investment was not filled by increases in Jamaican-owned ventures, although some local firms continued to produce for markets in the Caribbean region.

The initial phase of nontraditional export growth was launched by the re-entry of foreign entrepreneurs in assembly operations located primarily in the Kingston Free Zone. These included both U.S. and Asian firms seeking to take advantage of low wage structures and U.S. preferential trade provisions. A number of these ventures have proven profitable and have grown over time. This demonstration effect has in turn led to a rising number of joint ventures and to new, Jamaican-owned export activities located outside the free zone. The latter often consist of local manufacturers who previously served Caribbean markets and are now shifting their strategies toward U.S. markets.

While the actual number of new local and foreign investments associated with nontraditional exports and various provisions of the Caribbean Basin Initiative has not been significant and has yet to have a demonstrable effect on the economy, the ventures now in operation have planted the seeds for growth potential over time under appropriate conditions. However, the success of most of these investments remains critically dependent upon trade preference provisions extended by the United States.

### *Determinants of Export Performance*

The export performance of any country is the result of a host of macroeconomic, microeconomic, and policy variables. A number of basic determinants—resource endowments, comparative costs, product quality, marketing expertise, and so on—hold true across the board for all competitors in international markets. Other variables relate to the specific experience of an individual nation. The following discussion reviews those factors that are considered to exert the strongest impact on Jamaica's export performance.

The timely development of a diversified economy and export base in Jamaica was precluded by a lack of foresight of basic economic trends and by unstable and counterproductive policy strategies.<sup>4</sup> Throughout the 1960s and 1970s the government retained an excessive reliance on employment, income, and revenue generated by traditional exports, primarily sugar and bauxite. Then, the Manley government sought to extract more "rents" from the mining sector through nationalistic policies at the very time when the industry entered into a period of serious worldwide decline. Simultaneously, government intervention reached new heights throughout the economy in the 1970s, resulting in the creation of literally hundreds of state enterprises, most of which were managed like government agencies and recorded continuous losses.

As the government attempted to improve public welfare and reduce the "exploitation" of workers by foreign and local private enterprises, the government budget swung into a rising deficit position. This in turn required financing through the assumption of foreign debt, which ultimately led to high debt servicing requirements. The government also refused to devalue the Jamaican dollar, lest a currency realignment raise import costs to consumers.

The change in government in 1980 created a shift in economic philosophy, but the Seaga administration has been politically constrained from reversing many of the policies enacted under the Manley government, particularly those that would result in higher costs for publicly provided goods and services and reductions in government employment. As a consequence, private entrepreneurs have been reluctant to invest in new ventures because they are wary of a possible change in government and another basic shift in the policy framework.

As with all other exporting countries, the most critical determinant of export performance is levels of effective demand for Jamaican products. International demand for aluminum clearly swamps all other variables affecting Jamaica's sales of alumina and bauxite, and the same holds true for sugar and other traditional exports. For nontraditional exports,

declining incomes and demand in CARICOM have in the recent past adversely affected Jamaica's regional sales.

On the positive side, the large U.S. market and the opportunities opened by the CBI program and other provisions have opened a vast market for Jamaican producers of the "new" variety of nontraditional exports (e.g., apparel, leather goods, electronics, and so on). However, this demand is in large part policy-determined and is highly vulnerable to shifts in U.S. policies.

Jamaica's nontraditional exports would without question not be internationally competitive if the government had not abandoned the fixed exchange rate regime that in the late 1970s and early 1980s led to significant overvaluation. In 1983, the government adopted a managed floating rate system based on weekly auctions conducted by the Bank of Jamaica. The exchange rate declined from J\$1.78 per U.S. dollar in 1982 to rates in the range of J\$6.3–6.6 per U.S. dollar at the end of 1986. Current rates are generally considered to be reflective of the true value of the Jamaican dollar—the official exchange rate is now roughly the same as the black market rate—although some slippage toward overvaluation (due to domestic inflation of about 25 percent) has occurred. Overall, however, the current exchange rate has attracted foreign and local investors interested in producing labor-intensive products, since Jamaica's U.S. dollar-equivalent wage rate is considered competitive.

Jamaica's labor force is abundant, relatively well educated and skilled, and inexpensive. Executives in a wide range of nontraditional export industries, including apparel, leather goods, electronics, foodstuffs, furniture, and others, unanimously give high marks to the Jamaican work force for trainability, low turnover, and productivity. Workers respond well to production incentives (quality and quantity) offered by a number of exporters.

Wages are relatively low, starting at about J\$75 (US\$11.50) per week for unskilled workers and moving up to about J\$300 (US\$46.15) per week for laborers with higher skills and more experience. Jamaica's reputation for labor union militancy is not borne out by the recent experience of export industries, according to executives in those firms. While the labor movement remains strong and continuously attacks employers (especially those in the Kingston Free Zone) for "exploitative" wage rates, executives ascribe these protests to the unions' attempts to retain their membership rolls, which have been declining due to Jamaica's economic stagnation. Overall, from the perspective of nontraditional exporters, Jamaica's labor force constitutes a highly positive factor contributing to their ability to expand sales.

From 1971 to 1985, the aggregate output of Jamaica's productive sectors (agriculture, mining, manufacturing, and construction) declined

by a total of 42 percent as expressed in constant prices. This trend has had detrimental effects on Jamaica's population, which has suffered from falling standards of living. To a limited extent, this slack has been taken up by increases in the size of the services sector, especially government, but the latter growth has resulted in higher government budget deficits and external indebtedness.

From the standpoint of nontraditional export prospects, Jamaica's economic decline has ironically laid the groundwork for what might prove to be long-term export growth. The weakening or stagnation of Jamaica's traditional basic industries (mining, sugar production, and tourism) has forced both the government and the business community to pursue an alternative source of income—nontraditional exports. Shifts from an import substitution strategy to export promotion policies have begun, although they are far from complete. Entrepreneurs are considering and developing products based on Jamaica's true comparative advantages favoring labor-intensive production. Finally, the labor force has adjusted its attitudes and demands downward to reflect current economic realities. In short, the falling rents generated by Jamaica's natural resource abundance (bauxite) have created a situation similar to that initially faced by the East Asian Newly Industrializing Countries (NICs), which were forced to rely on their labor forces to create exports and income.

High fiscal deficits and external indebtedness, as well as governmental intervention in financial markets, have led to a general shortage of capital at appropriate rates and maturities for productive enterprises. Historically, Jamaica's bauxite/alumina operations contributed not only income and foreign exchange, but also inflows of foreign capital. A large portion of these funds has flowed out of Jamaica over the past decade as foreign producers closed their operations.

In recent years, economic decline has dampened profits and savings. In addition, growing government budget deficits have placed increasing pressure on available financial resources. Finally, while the government's monetary policy is appropriate for seeking price stability and international financial objectives, the resulting interest rates (currently about 25 percent for commercial borrowing) are onerous for entrepreneurs attempting to secure either long-term investment capital or short-term working capital. The general dearth of financial capital is a fact of life in most developing countries; it has in Jamaica acted as a deterrent to nontraditional export ventures.

Jamaican-owned exporting firms have great difficulty in raising funds to finance either expansions or ongoing operations. Owners must pay what they feel to be exorbitant interest rates for borrowings and typically must offer even their personal property as collateral on loans. Lending institutions not only do not assume risks, but in addition often obtain

an equity position in firms they finance. As a result, exporters often limit the scale of their operations rather than expand to meet market demand.

Inaugurated in 1976, the Kingston Free Zone has been in operation for slightly over one decade. Levels of activity in the zone were initially low, but have expanded rapidly in recent years, to the point where the zone's 20 resident companies now employ 7,000 people. The zone generates about J\$19 million (US\$3.0 million) per month in exports and approximately one-half of Jamaica's total exports of apparel. The zone offers a 100-percent tax holiday and duty-free entry of raw materials and machinery. The importance of the zone has been its demonstration effect, indicating to other Jamaican companies that a nontraditional export orientation can indeed prove profitable.

The lack of adequate factory space represents a major constraint to Jamaican exporters. The Kingston Free Zone is fully subscribed, and a long list of applicants for 807-type operations awaits factory space. A second free zone has been established in Montego Bay.

In addition to the dearth of suitable factory shells, local exporters complain of general infrastructure problems. The poor quality of the domestic transportation system and the lack of adequate utilities services are considered to place Jamaican producers at a competitive disadvantage.

Exporters uniformly complain of high costs for shipping and air transportation. Executives claim that the shipping costs from Jamaica to New York are in the area of US\$1,600 for a 40-foot container, compared to only US\$800-1,100 per container from Taiwan. Shipping companies confirm the \$1,600 figure for Jamaica, but note that the cost of shipping a container from Taiwan is \$4,470. Although there appears to be a misperception of comparative costs, the issue of high freight charges and uncertain schedules has been raised as a basic constraint throughout the Caribbean region.

Electricity charges are considered onerous to nontraditional exporters, who claim that the pricing structure subsidizes consumers at the expense of manufacturers. In addition, current rates are based on an oil price of \$30 per barrel, with the government absorbing the benefits created by lower oil prices.

The majority of Jamaica's nontraditional exporters import virtually all of their raw materials, components, and machinery. As a result, the only added value associated with their operations is the labor input, thereby limiting the economic benefits to Jamaica. All executives interviewed, however, express an interest in local input sources, but have encountered two sets of problems. First, because their 100-percent export operations benefit from a preferred status, the documentation required for obtaining inputs locally is as complex as that for importing them. Firms operating

in the free zone indicate that the paperwork associated with commercial transactions with companies outside the zone precludes use of local sources. The second problem facing exporters relates to prices and quality. Exporters would prefer to purchase inputs (e.g., buttons, elastic, packaging materials, and so on) from local producers, but find either that these goods are prohibitively expensive or are not of sufficient quality for U.S. consumers.

All exporters interviewed report that they have no problem recruiting and training production line workers. However, most encounter considerable problems filling middle-management positions, particularly those requiring business skills such as accounting, inventory management, quality control, and process flow management. In fact, the majority of successful nontraditional export firms consist of a very small group of senior managers and production line workers, with no middle-management layer whatsoever. As a result, if senior executives are traveling or are otherwise occupied, business decision making is brought to a halt.

Most nontraditional exporters are fully familiar with the CARICOM market, but have a very limited knowledge of the U.S. market and trade policy structure. Many exporters can therefore relate personal "horror stories" connected with rejected shipments, unwarranted delays in U.S. customs clearance, and problems with the U.S. Department of Agriculture or Food and Drug Administration. Most of these problems can be ascribed to limited experience and the fact that nontraditional exporters are still on the "learning curve" with respect to dealing with the U.S. market. In order to succeed, most exporters tend to enter into formal or informal marketing relationships with their U.S. customers.

Over the past five years, the Jamaican government has inaugurated a basic shift from an import substitution strategy to an export promotion approach. While the change in attitudes and policies is not yet complete, the fundamental policy structure favoring nontraditional exporters is now in place. Free zone firms benefit from permanent income tax holidays and duty-free entry of raw materials and machinery. Exporters to the CARICOM region obtain tax holidays (up to nine years) and duty-free entry as designated by the Industrial Incentives Act. The Export Industry Encouragement Act, for manufacturers producing goods for export outside the local and CARICOM regions, provides ten-year tax holidays and exemption from import duties. The Export Credit Fund and the Export Development Fund provide subsidized financing to bona fide exporters. In combination, these policy structures have established the necessary foundation for long-term growth in nontraditional exports.

By far the largest number of complaints expressed by exporters relates to Jamaica's customs policies and procedures. The government has con-

tracted with a Swiss company, Société Général de Surveillance (SGS), to administer import regulations, and most exporters accuse the company of causing unwarranted delays and imposing a high degree of discretionary treatment. Exporters note that it takes up to three weeks to clear a container and that they are subject to a container stripping station fee, for which their containers are emptied to search for contraband. Firms producing goods for both local markets and export are theoretically allowed a tariff rebate for the export portion of their output, but many companies have never even applied for the rebate, since they must deal with as many as seven different agencies and have never heard of examples where companies actually received the rebate. Executives in these firms claim that they must pay 100 percent or higher tariffs on new equipment imports. In short, the export industry is in essence an "enclave" sector. Firms that export all of their production are basically protected from onerous import duties, but companies serving both local and foreign markets are placed at a clear disadvantage.

Most exporters express a general complaint about government bureaucracy and red tape.<sup>5</sup> For example, despite the efforts of Jamaica's investment promotion agency, Jamaica National Investment Promotion Limited (JNIP), new investors must deal with a large number of government ministries. Delays and documentation requirements are viewed as a large constraint. However, most successful exporters note that they have through concerted efforts been able to break through bureaucratic impasses.

Most of Jamaica's recent growth of nontraditional exports can be attributed to Section 807 of the U.S. Tariff Code, under which only domestic value added is subject to U.S. tariffs. Additional incentives are provided by the U.S. Generalized System of Preferences (GSP) and various provisions of the Caribbean Basin Economic Recovery Act. Jamaica's nascent nontraditional export industry would be eliminated if U.S. incentives were withdrawn. In addition, several exporters question the overall economic value of 807 provisions, which provide little room for middle management, local entrepreneurs, and backward linkages because exporting firms only represent assembly operations. However, the experience of such countries as South Korea, the Republic of China, and Hong Kong, which began exporting in a similar fashion, suggests that assembly exports can lead toward long-term increases in added value.

### *Nontraditional Export Opportunities*

The greatest potential for increases in Jamaica's nontraditional exports lies in the area of manufactures requiring labor-intensive production

techniques. Labor costs and availability are Jamaica's only significant comparative advantage and will remain so as long as the Jamaican dollar's value reflects the true cost of labor.

Exports of garments will continue to increase until Jamaica reaches quota levels in specific clothing categories. Jamaica's first quota was negotiated in mid-1986. Sales of electronics components, which have only recently begun, also hold relatively high potential. While the Jamaican furniture industry has been beset by a wide range of problems, the long-term prospects for sales of furniture and other processed wood products (such as parquet flooring) would also appear to be good, particularly as manufacturers gain experience.

If Jamaica's wage rate and foreign exchange rate remain competitive, one could over time expect additional products to be added to the country's currently concentrated line of exports. Possible candidates include consumer electronics, footwear and other leather goods, toys, sporting equipment, Christmas lights and ornaments, and other labor-intensive goods. In fact, entrepreneurs could find market niches in the entire array of exports that initially drove the performance of the East Asian NICs, where rises in wages are now reducing these nations' competitiveness.

A number of product categories that are viewed as generally promising will probably not live up to their expectations. These include data entry, winter vegetables, horticulture, and processed foods. Data entry is in reality a service rather than a good. Eight data entry companies are now in operation. The average firm size is 15 to 30 work stations, which if run in three shifts would employ 45-90 workers. Most firms operate on a batch basis, in which data are flown in from the United States, processed, and flown back to the United States. Problems facing the Jamaican industry include short-response delivery dates, client demands for 98 percent accuracy at low costs, and a dearth of marketing skills. Plans for the construction of a teleport are considered by the industry an exciting idea in theory, but the necessary government involvement in the project gives rise to private sector skepticism. Data entry activities can be expected to expand in the future, but not to the point where they have a material impact on Jamaica's foreign exchange earnings.

The outlook for winter vegetables and horticulture products is constrained by both economic and political factors. These sectors require strong infrastructure and transportation facilities, are highly competitive, involve major risks, and are susceptible to covert and overt forms of protectionism. Finally, expansions of processed foods will only take place after major investments are made to upgrade machinery and packaging facilities. In addition, the markets for the types of products envisioned are relatively limited in size.

As it has in the past, Jamaica's future economic performance—and political prospects—will be closely tied to the nation's ability to generate foreign exchange earnings. The previous pillars of the economy, sugar and bauxite, cannot provide the export revenues necessary to sustain Jamaica's economy and finance needed imports, and earnings from tourism will under the best of circumstances grow only gradually over time.

By process of elimination, one can logically conclude that the only possible significant source of foreign exchange earnings lies in sales of nontraditional exports, primarily manufactures requiring labor-intensive production techniques. The production and sale of manufactures on an internationally competitive basis is much more complex than that for agricultural and mining products, inasmuch as manufacturing typically involves a larger number of inputs and interactions with other economic entities. If Jamaica is to move beyond enclave assembly activities and increase local value added, then the overall operating and policy environment will have to be significantly improved.

### *Conclusions and Recommendations*

Jamaica's nontraditional export sector has only recently been established and is based on a combination of favorable wage/foreign exchange rates and the adoption of export incentives. The most important overall recommendation is for the government to maintain policy stability and give the export industry time to expand. Until the last few years, the private sector has been loath to invest in new ventures out of fear that the government and/or its policy stance would change radically. Jamaica's nontraditional exporters have to deal with sufficient commercial risks that they should not have to worry about domestic political risks.

Customs problems represent the greatest policy constraint expressed by exporters. Tight enforcement of tariff policies can be anticipated to continue so long as Jamaica experiences foreign exchange problems. However, the administration of customs procedures can and should be improved, especially for foreign exchange earning sectors such as non-traditional export industries. These firms should be provided preferential and streamlined treatment.

The largest economic constraint facing exporters is the dearth of venture and working capital at reasonable terms. Larger national efforts are required to expand the country's stock of financial capital. Capital is needed to overcome the critical shortage of suitable factory space, to purchase equipment, and to expand export operations to achieve appropriate economies of scale.

For the most part, Jamaica's nontraditional exporters consider themselves to be novices at marketing products in the United States. Programs

should be developed to provide seminars and consulting on not only sales techniques and strategies, but also methods for dealing with U.S. government agencies and requirements.

The size of many of Jamaica's export firms is constrained to a certain extent by the absence of effective middle management. The entrepreneurs themselves are generally well educated, but often the capabilities of their immediate subordinates to conduct ongoing business transactions are minimal. Formal or informal training programs on specific business skills would provide considerable benefits to existing and new firms.

## APPENDIX 8.1

Quantifiable Determinants of Non-traditional Exports  
JAMAICA, 1963 - 1986

	1963	1964	1965	1966	1967
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	201.9	216.3	214.3	228.1	222.8
Traditional exports	146.7	95.5	142.3	202.6	204.6
Non-traditional exports	55.2	120.8	72.0	25.5	18.2
Imports (CIF)	225.5	289.4	289.1	327.2	348.9
Trade balance	(23.6)	(73.1)	(74.8)	(99.1)	(126.1)
Current account balance	9.8	(43.7)	(30.5)	(42.1)	(81.4)
CACM exports					0.6
CACM exports as % of exports					0.0
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	558.5	588.6	635.7	690.8	744.9
GDP growth (Nominal %)		5.4	8.0	8.7	7.8
GDP (1980 prices)	3,347.9	3,759.5	3,969.7	4,059.8	4,249.0
GDP growth (Real %)		12.3	5.6	2.3	4.7
<b>CAPITAL FORMATION</b>					
Commercial lending rate					
Discount rate	4.0	5.0	5.0	5.5	6.0
Fixed capital formation	91.6	111.8	124.2	146.0	170.0
Increase in stock	8.1	9.1	4.8	5.6	7.4
Foreign direct investment**					
Domestic credit	97.7	130.7	143.4	146.2	165.4
Commercial lending					
to Private sector					
Agriculture					
Mining					
Manufacturing					
Tourism					
<b>EXCHANGE RATE</b>					
Exchange rate (J\$/US\$)	0.7	0.7	0.7	0.7	0.7
<b>FOREIGN DEBT*</b>					
Public external debt					
Debt service					
Debt service ratio					
(% of exports)					
<b>OTHER</b>					
M1	58.7	63.8	63.7	71.3	75.7
Budget deficit	(11.7)	(15.1)	(15.5)	(18.6)	(23.3)
GDP deflator (1980=100)	16.7	15.7	16.0	17.0	17.5

All figures in millions of Jamaican dollars unless otherwise specified.

Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 8.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 JAMAICA, 1963 - 1986

	1968	1969	1970	1971	1972
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	215.4	246.2	335.2	330.2	380.0
Traditional exports	177.5	210.1	288.5	280.1	322.1
Non-traditional exports	37.9	36.1	46.7	40.2	57.9
Imports (CIF)	387.3	442.3	525.4	553.0	636.0
Trade balance	(171.9)	(196.1)	(190.2)	(222.8)	(256.0)
Current account balance	(91.9)	(123.6)	(152.9)	(172.2)	(196.7)
CACM exports	1.1	1.0	1.0	0.4	0.9
CACM exports as % of exports	0.5	0.4	0.3	0.1	0.2
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	820.0	992.6	1,170.6	1,282.4	1,439.1
GDP growth (Nominal %)	10.1	21.0	17.9	9.6	12.2
GDP (1980 prices)	4,453.2	4,596.6	5,143.5	5,304.8	5,795.3
GDP growth (Real %)	4.8	3.2	11.9	3.1	9.2
<b>CAPITAL FORMATION</b>					
Commercial lending rate					
Discount rate	5.0	6.0	6.0	5.0	6.0
Fixed capital formation	221.4	315.3	367.1	356.1	366.8
Increase in stock	9.1	33.6	2.1	55.5	26.6
Foreign direct investment**					
Domestic credit	202.6	264.8	318.2	384.9	527.9
Commercial lending to Private sector					
Agriculture					
Mining					
Manufacturing					
Tourism					
<b>EXCHANGE RATE</b>					
Exchange rate (J\$/US\$)	0.8	0.8	0.8	0.8	0.8
<b>FOREIGN DEBT*</b>					
Public external debt					
Debt service					
Debt service ratio (% of exports)					
<b>OTHER</b>					
M1	94.9	111.1	126.7	160.0	172.6
Budget deficit	(30.1)	(20.5)	(31.7)	(47.8)	(59.4)
GDP deflator (1980=100)	18.4	21.6	22.8	24.2	24.8

All figures in millions of Jamaican dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 8.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 JAMAICA, 1963 - 1986

	1973	1974	1975	1976	1977
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	382.8	718.4	837.0	617.0	711.2
Traditional exports	323.8	635.7	693.0	527.0	629.9
Non-traditional exports	59.0	82.7	114.0	89.9	81.3
Imports (CIF)	676.6	935.5	1,123.6	912.8	746.8
Trade balance	(293.8)	(217.1)	(286.6)	(295.8)	(35.6)
Current account balance	(247.6)	(91.9)	(282.8)	(302.6)	(42.1)
CACM exports	2.7	2.3	2.9	2.7	4.6
CACM exports as % of exports	0.7	0.3	0.3	0.4	0.6
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	1,719.9	2,159.2	2,600.6	2,696.4	2,954.3
GDP growth (Nominal %)	19.5	25.5	20.4	3.7	9.6
GDP (1980 prices)	5,878.6	5,606.7	5,589.6	5,228.7	5,104.3
GDP growth (Real %)	1.4	(4.6)	(0.3)	(6.5)	(2.4)
<b>CAPITAL FORMATION</b>					
Commercial lending rate					
Discount rate	7.0	9.0	8.0	9.0	9.0
Fixed capital formation	448.2	478.2	609.6	450.8	349.5
Increase in stock	93.6	47.0	60.5	40.3	11.7
Foreign direct investment**					(8.3)
Domestic credit	613.3	666.9	949.6	1,204.0	1,347.9
Commercial lending					
to Private sector			696.4	702.2	658.7
Agriculture			71.1	82.4	90.5
Mining			5.8	6.5	6.2
Manufacturing			117.7	123.1	118.9
Tourism			12.1	13.0	10.7
<b>EXCHANGE RATE</b>					
Exchange rate (J\$/US\$)	0.9	0.9	0.9	0.9	0.9
<b>FOREIGN DEBT*</b>					
Public external debt		528.6	688.4	885.9	920.3
Debt service		64.8		111.9	
Debt service ratio (% of exports)		9.0		18.1	
<b>OTHER</b>					
M1	218.3	258.1	312.8	343.0	510.2
Budget deficit	(90.5)	(167.9)	(206.0)	(418.3)	(428.2)
GDP deflator (1980=100)	29.3	38.5	46.5	51.6	57.9

All figures in millions of Jamaican dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 8.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 JAMAICA, 1963 - 1986

	1978	1979	1980	1981	1982
<b>TRADE STATISTICS*</b>					
Merchandise exports (FOB)	772.2	806.3	935.5	966.3	746.6
Traditional exports	682.2	675.3	829.0	842.4	603.3
Non-traditional exports	90.0	131.1	106.5	123.8	143.3
Imports (CIF)	864.7	1,002.8	1,173.8	1,467.1	1,375.9
Trade balance	(92.5)	(196.5)	(238.3)	(500.8)	(629.3)
Current account balance	(50.1)	(138.9)	(166.1)	(336.8)	(403.4)
CACM exports	4.0	1.4	0.3	0.2	1.4
CACM exports as % of exports	0.5	0.2	0.0	0.0	0.2
<b>GROSS DOMESTIC PRODUCT</b>					
GDP	3,737.4	4,274.6	4,750.1	5,267.2	5,841.9
GDP growth (Nominal %)	26.5	14.4	11.1	10.9	10.9
GDP (1980 prices)	5,132.1	5,043.0	4,750.1	4,868.5	4,915.8
GDP growth (Real %)	0.5	(1.7)	(5.8)	2.5	1.0
<b>CAPITAL FORMATION</b>					
Commercial lending rate			15.5	15.5	15.7
Discount rate	9.0	9.0	11.0	11.0	11.0
Fixed capital formation	498.9	748.1	690.1	953.8	1,167.8
Increase in stock	64.0	71.3	64.0	123.4	45.9
Foreign direct investment**	(21.2)	(20.4)	21.3	(9.8)	14.3
Domestic credit	1,735.2	2,526.7	2,649.4	3,797.0	4,605.3
Commercial lending					
to Private sector	767.6	900.9	1,088.1	1,494.8	193.0
Agriculture	81.9	93.1	117.8	230.8	265.3
Mining	5.7	5.8	6.3	7.8	12.0
Manufacturing	132.8	164.1	213.9	317.3	396.7
Tourism	25.8	35.6	60.3	76.2	98.8
<b>EXCHANGE RATE</b>					
Exchange rate (J\$/US\$)	1.4	1.8	1.8	1.8	1.8
<b>FOREIGN DEBT*</b>					
Public external debt	1,050.3	1,176.8	1,396.4	1,537.1	1,846.5
Debt service	197.7	199.7	200.9	397.2	258.9
Debt service ratio (% of exports)	25.6	24.8	21.5	41.1	34.7
<b>OTHER</b>					
M1	494.7	541.1	647.4	687.1	729.2
Budget deficit	(625.0)	(655.8)	(986.0)	(874.9)	(896.2)
GDP deflator (1980=100)	72.8	84.8	100.0	108.2	118.8

All figures in millions of Jamaican dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

APPENDIX 8.1 (Cont.)  
 Quantifiable Determinants of Non-traditional Exports  
 JAMAICA, 1963 - 1986

	1983	1984	1985	1986
<b>TRADE STATISTICS*</b>				
Merchandise exports (FOB)	673.1	687.9	535.1	595.9
Traditional exports	521.0	547.8	381.0	351.8
Non-traditional exports	152.1	140.0	154.1	244.1
Imports (CIF)	1,280.9	1,183.2	1,143.6	963.6
Trade balance	(607.8)	(495.3)	(608.5)	(367.7)
Current account balance	(354.9)	(308.9)	(21.5)	
CACM exports				
CACM exports as % of exports				
<b>GROSS DOMESTIC PRODUCT</b>				
GDP	6,897.0	9,367.8	11,263.1	
GDP growth (Nominal %)	18.1	35.8	20.2	
GDP (1980 prices)	5,015.2	4,995.5	4,764.1	
GDP growth (Real %)	2.0	(0.4)	(4.6)	
<b>CAPITAL FORMATION</b>				
Commercial lending rate	16.4	18.2	24.5	
Discount rate	11.0	16.0	21.0	
Fixed capital formation	1,417.4	1,962.5		
Increase in stock	69.7	143.7		
Foreign direct investment**	(17.5)			
Domestic credit	6,011.6	6,735.6	6,481.9	
Commercial lending				
to Private sector	2,447.4	2,745.8	3,048.2	
Agriculture	265.3	401.0	296.9	
Mining	11.6	10.0	6.4	
Manufacturing	520.4	681.0	726.1	
Tourism	107.7	125.4	184.9	
<b>EXCHANGE RATE</b>				
Exchange rate (J\$/US\$)	1.9	3.9	5.6	6.5
<b>FOREIGN DEBT*</b>				
Public external debt	1,949.9			
Debt service	205.0	357.2	336.8	330.6
Debt service ratio	30.5	51.9	62.9	
(% of exports)				
<b>OTHER</b>				
M1	884.3	1,012.4	1,410.4	
Budget deficit	(941.2)	(1,287.1)	(379.4)	
GDP deflator (1980=100)	137.5	187.5	236.4	

All figures in millions of Jamaican dollars unless otherwise specified.  
 Empty cells indicate that data are unavailable.

\*Millions of US\$

\*\*Millions of SDRs

### Notes

1. An excellent analysis of political transition in Jamaica can be found in Michael Massing, "The Jamaica Experiment," *Atlantic Monthly*, September 1983. Another useful review is "Blueprint Island: A Survey of Jamaica," *The Economist*, February 12, 1983.

2. The most thorough statistics on the Jamaican economy are produced by the Statistical Institute of Jamaica. The following publications are particularly useful: "The Jamaica Economy: A Statistical Assessment" (an annual publication); "Statistical Review" (monthly); and "Production Statistics" (annual).

3. See Port Authority of Jamaica, "Kingston Export Free Zone: Its Development Over the Last Ten Years," *Port News*, July 1986.

4. A comprehensive assessment of government policies (industrial incentives, nominal and effective protection, taxation, and so on) through the 1970s was prepared by Mahmood Ali Ayub in *Made in Jamaica: The Development of the Manufacturing Sector*, World Bank Staff Occasional Papers, No. 31, 1981.

5. See, for example, "Study on the Institutional Framework of the Industrial Sector in Jamaica," report prepared by Development Associates for the Office of Project Execution, United Nations Development Programme, New York, April 1983.

## *Cuba*

*Andrew Zimbalist*

In January 1959, Fidel Castro's revolutionary government came to power. In April 1961, on the eve of the Bay of Pigs invasion, Castro declared the Cuban revolution to be socialist. With socialism came not only a different system of economic management and, eventually, central planning, but also a different strategy regarding the foreign sector in the development process. At first, there was an all-out effort to diversify away from sugar. This idealistic policy left the economy spread too thinly and without any substitute exports to earn foreign exchange. In 1963, a new strategy was adopted to increase sugar production and, at the same time, to engage in a gradual process of export diversification and import substitution. This basic policy has been pursued ever since, although greater emphasis was placed on import substitution until roughly 1980. In December 1984, in the wake of a burgeoning foreign exchange crisis, it was decided to place top priority on developing new export products and accelerating the pace of import substitution.

As a member of the Soviet trading bloc, the Council of Mutual Economic Assistance (CMEA), and excluded from the International Monetary Fund (IMF), the World Bank, and the Organization of American States (OAS), Cuba has not come under pressure to follow traditional austerity, free market-type policies. Thus, it is instructive to follow the Cuban experience to see how a different set of development strategies, institutional arrangements, and trading partners can affect the development process.

It is commonplace to assert that foreign trade plays a central role in the economic development of small, underdeveloped countries. In fact, revolutions in communications and information technology, as well as vast improvements in transportation technology, have created conditions of strong interdependence for all the world's economies. Even the United States, the world's largest and most developed economy with a rich

endowment of natural resources, is intimately involved in and dependent upon the international trading and financial networks.

There is certainly no country in Latin America whose economic fortunes are not intricately bound up with developments in the world economy. Generally, this observation applies with greater force to the smaller economies of the region.

Cuba is no exception. In 1985, average Cuban exports and imports as a share of net material product (NMP) came to 50.1 percent and as a share of gross social product (GSP) to 26.0 percent.<sup>1</sup> Cuban growth has slowed dramatically in recent years as the prices of its exports have fallen more rapidly than the prices of its imports, foreign markets have closed, export production has been hampered by unfavorable climatic conditions, and the debt burden has become more imposing.

Nevertheless, so far in the 1980s the Cuban economy has proven to be more resilient to world market shocks than other Latin American economies. It is generally held that the magnitude and character of Cuba's economic relations with the Soviet Union and other CMEA countries have made Cuba's differential performance possible. At the same time, most analysts have concluded that Cuba is at least as dependent on sugar exports today as it was in 1958, the last year of the Fulgencio Batista government, and that Cuba has generally failed in its project of export diversification.<sup>2</sup>

Each of these arguments about the Cuban economy is misleading. First, claims of Cuba's sugar dependence and lack of export diversification have been greatly exaggerated. Second, while it is uncontested that Cuba has benefited enormously from Soviet economic aid and favorable terms of trade within CMEA, the size of this aid has been overstated by improper methodology. In this chapter, each of these propositions is reexamined, and then the current situation of Cuba's external economy is analyzed briefly.

### *Sugar Dependence*

Sugar has been dubbed the albatross of the pre-1959 Cuban economy. During the 1948-1958 period, sugar exports averaged 84.1 percent of total Cuban exports. Despite the beginnings of bagasse processing after 1956, forward and backward linkages to sugar production went largely undeveloped. Employment was seasonal, land use was wasteful, large profits were repatriated, and prices were volatile. Under these circumstances, sugar's ability to stimulate a broader economic development was nonexistent. Lack of diversification and dependency went hand-in-hand with underdevelopment and stagnation.

In a quantitative sense Cuba is certainly as dependent on the Soviet Union in the 1980s as it was on the United States in the 1950s. Dependency theory, however, whatever its limitations, is an effort at analytical explanation, not just empirical description of the development process. It is impossible to conclude that the qualitative relationship of dependence on the Soviet Union is commensurate with that of the earlier dependence on the United States. Just as in a parent-child relationship, dependency is to some degree unavoidable during early development, but according to its nature, it can either nurture eventual strength and growing independence or it can lead to weakness and ongoing dependence.

Cuban dependence on the Soviet Union is not altogether benign, but its effects on Cuban development have been on the whole salutary. Terms of trade have been stable and favorable, technological transfer and labor training have been readily forthcoming, machine tool/heavy industry production has been encouraged, the nature of the sugar industry and its market have been transformed, spin-off industries have been promoted, profit repatriation has ceased, and so on. These issues are too complex for an extended treatment here. The main point is that a simple number like the share of sugar in total exports does not have the same implications for Cuban development today as it did thirty years ago. Depending on world market conditions, Cuba still sells between 10 and 40 percent of its sugar on the volatile world market, but the CMEA market provides a soft and reliable cushion. Sugar has also been the basis for significant forward and backward linkages since 1959, and harvest mechanization, production integration, and labor force reorganization have eliminated the noxious social and economic effects of seasonal *zafra* (sugar harvest) labor. Despite this and despite the positive prospects for the further development of sugarcane by-products,<sup>3</sup> the argument could be persuasively made that, given conditions of world sugar demand, Cuba is putting too many eggs in the cane basket.

Although Cuba continues to invest in expanding sugar production and milling capacity, investments in nontraditional export products have allowed for a significant diversification of Cuba's exports in recent years. Table 9.1 shows the share of sugar in total Cuban exports since 1979. There is a clear downward trend. As Jorge Perez-Lopez points out,<sup>4</sup> several percentage points of this decreasing share are attributable to Cuban reexports of Soviet oil. These reexports are made possible due to an agreement with the Soviet Union to the effect that any petroleum shipments specified in the five-year trade protocol agreement that Cuba does not consume due to energy conservation measures may be exported by Cuba. Cuba reduced its energy consumption per peso of GSP by 25 percent between 1980 and 1985.<sup>5</sup> A large share of this saving is attributable to replacement of oil by bagasse as the sole source of energy

**Table 9.1**  
**Share of Sugar and Its Byproducts in Total Exports, 1979-1985, in percentages**

1979	1980	1981	1982	1983	1984	1985
85.9	83.7	79.1	77.2	74.0	75.5	74.5

**Source:** Calculated from data presented in the *Comite Estatal de Precios, Anuario Estadístico de Cuba, 1985* (Havana, Cuba: 1986), pp. 396-397.

in Cuba's sugar mills. Further supporting these exports has been a very rapid expansion in Cuban domestic petroleum output, which more than tripled between 1981 and 1985, from 258.9 thousand tons of crude oil extraction to 867.6 thousand tons. In 1987, crude oil extraction surpassed 1 million tons and by 1990 production is projected at 2 million tons.<sup>6</sup> Perez-Lopez, however, overstates the importance of oil reexports by almost 2 percentage points (and, hence, understates the decrease in the sugar share) by assuming that certain petroleum by-products exported by Cuba are from the Soviet Union, when in fact they are produced in Cuba (e.g., naphtha).

More importantly, if one is going to make qualifications to the above sugar shares in order to gauge the true extent of production diversification, it is necessary to express the value of sugar and other exports in constant prices. That is, one would have to adjust for the manifold increase in sugar prices paid by the Soviet Union after the mid-1970s. If this were done, the diversification of the productive base for exports would be much more extensive than suggested in the nominal sugar share, as can be seen in Table 9.3.

Constant price raw sugar exports are straightforward to compute. Volume for each year is multiplied by the average 1965 raw sugar price received by Cuba. Constant price total exports are considerably more complicated to compute. The latter entails developing an export price index without complete price information. Although some shortcuts are necessary, the Cuban Statistical Yearbook does have sufficient price data for Cuba's principal exports to allow for a reasonable estimation. The 1985 yearbook divides Cuban exports into six categories: sugar and its derivatives, mining, tobacco and beverages, fish, agricultural products, and other. Within each category several principal export products are included with volume and sales data for 1965, 1970, 1975, 1980, and 1985; hence, average export prices are calculable for each year and price indices can be computed for each category. The issue then becomes how to aggregate the category indexes into one overall export price

Table 9.2  
Price Index of Cuban Exports

	1965	1970	1975	1980	1985
Using 1965 Export Shares	100	120	385	510	519
Using 1985 Export Shares	100	116	357	428	447

Source: Comité Estatal de Precios, Anuario Estadístico de Cuba, 1985 (Havana, Cuba: 1986), pp. 371-470.

index, which was done by using both 1965 and 1985 value shares (in current prices) of each category in total exports. Since sugar prices rise more rapidly over the 1965-1985 period than the prices of other exports and since raw sugar's (current price) share in exports was greater in 1965 (85.8 percent) than in 1985 (74.4 percent), using 1965 value shares (weights) causes the export price deflator to rise more rapidly. Thus, using the 1985 weights causes constant price total exports to increase more than by using 1965 weights and produces a lower estimate for sugar's share in total exports in 1985.

Table 9.2 shows the two estimated price indexes of Cuban exports, with 1965 and 1985 weights respectively. The estimated index with 1965 weights is similar to an earlier export price index for the period 1962-1979 developed by Olga Torres of the Economic Commission for Latin America of the United Nations.<sup>7</sup>

Table 9.3 presents estimates of constant 1965 price raw sugar exports and total exports and the constant price sugar export share. In the last column, the constant price sugar export share is recalculated assuming no petroleum reexports.<sup>8</sup> Further, for each year an alternative weighting method is used to estimate the export price deflator, constant price exports, and raw sugar export shares. These results are reported below each year and are marked with an asterisk.

The constant price sugar share in exports falls dramatically after 1980 when the 1965 weighted price deflator is used, and it falls steadily over the entire 1965-1985 period when the 1985 weighted price deflator is used. Unfortunately, neither deflator is theoretically more correct than the other. One frequently used technique in similar cases is to average the results from the two methods. If this is done, the constant price sugar share in total exports goes from 84.5 percent in 1965, to 85.3 percent in 1970, to 79.2 percent in 1975, to 80.1 percent in 1980, and to 63.9 percent in 1985. That is, there is a mild and gradual decrease in the sugar share from 1965 to 1980 and, once again, a dramatic decrease after 1980. Even when one removes the influence of petroleum

Table 9.3  
Constant Price Sugar Export Shares

	Total Exports (1965 prices, mill. pesos)	Raw Sugar Exports (1965 prices, mill. pesos)	Sugar Share, in % (1965 prices)	
			(a)	(b)
1965	690.9	583.3	84.5	84.5
1970	874.6	757.9	86.7	86.7
1970*	904.7	757.9	83.8	83.8
1975	766.9	630.3	82.2	82.2
1975*	827.0	630.3	76.2	76.2
1980	777.8	677.1	87.1	89.1
1980*	926.8	677.1	73.1	74.8
1985	1152.8	790.8	68.6	74.6
1985*	1338.5	790.8	59.1	64.3

(a) includes all exports

(b) includes all exports except petroleum reexports

\* This calculation uses 1985 export value shares (weights) to estimate the export price deflator. See explanation in text.

Source: *Comite Estatal de Precios, Anuario Estadístico de Cuba, 1985* (Havana, Cuba: 1986), pp. 371-470.

reexports (see the last column of Table 9.3), the same basic pattern obtains. Whether the change was more gradual over the entire period or more sudden after 1980, the basic conclusion is that there has been an appreciable decline in the (constant price) sugar share in exports; stated differently, there has been an appreciable diversification in the productive base of exports. Further, it seems that the pace of this diversification accelerated in the early 1980s.

This is not to say that Cuba could not or should not have done better. It is only to recognize that more has been done than is generally claimed. One very revealing indication of Cuba's success at diversification can be seen by comparing Cuba's efforts at increasing nontraditional exports (all exports excluding sugar, nickel, tobacco, rum, coffee, and petroleum) with those of other nations in the Caribbean Basin—nations that have benefited from specialized tariff treatment and preferences by the United States under the General System of Preferences (GSP) and Caribbean Basin Initiative (CBI).

The Cuban growth of nontraditional exports from 258.4 million pesos in 1980 to 611.6 million pesos in 1985 constituted an average annual growth rate of 18.8 percent (Table 9.4), 8.2 percentage points above the growth rate of the Dominican Republic, the next best performer in the group.<sup>9</sup> Cuba started in 1980 from a lower base of nontraditional exports than either Costa Rica or Guatemala, but from roughly double the base of Panama, the Dominican Republic, or Jamaica.

Table 9.4  
Annual Growth Rate of Non-Traditional Exports, 1980-1985,  
in percentages

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Cuba	18.8
Costa Rica	- 4.7
Guatemala	- 5.1*
Honduras	- 2.7*
Panama	2.3
Dominican Republic	10.6
Jamaica	7.4

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\* 1980-1984

Sources: Calculated from Comité Estatal de Precios, Anuario Estadístico de Cuba, 1986 (Havana, Cuba: 1986), pp. 426-435; and SRI International, Nontraditional Export Expansion in the Central American Region (Arlington, Va.: SRI International for the Agency for International Development, March 1987), pp. CR22-26, G23-27, H31-35, P20-24, DR26-30, J26-30.

Between 1980 and 1985 Cuba introduced 111 new export products and experienced significant growth in exports of citrus fruits, fish products, steel products, recycled raw materials, scrap metals, gas stoves, paper products, books, soldering irons and electrodes, nonelectrical machinery, transportation materials and machinery, cement, fiberboard, radios, sulphuric acid, batteries, and teletransmission and processing equipment, among others.<sup>10</sup> Cuba is also exporting several manufactured items that hold interesting potential for the future, including agriculture machinery and implements, boats, computer keyboards and terminals, pharmaceutical products, and refrigerators (see Table 9.5). In 1985, Cuba's nonsugar exports, excluding petroleum reexports, were 1,023.1 million pesos; of this, 448.9 million pesos, or 43.9 percent, were for convertible currency. Thus, more than half of Cuba's nonsugar exports benefit from the CMEA's protected market, but over two-fifths were exported to competitive world market countries.<sup>11</sup> Further, considering only industrial nontraditional exports, out of a total 147.7 million pesos in 1986, 90.8 million (61.5 percent) went to market economies.<sup>12</sup>

Cuba, moreover, has succeeded in breaking into these markets without the benefit of direct foreign investment. The 1982 foreign investment code, allowing 49 percent foreign ownership, did not attract any foreign investment in manufacturing through 1986.<sup>13</sup> Although Cuba initiated negotiations with a number of West European and Canadian firms, strong negative pressure from the Reagan administration, among other factors, put prospective projects on indefinite hold. Cuba's hard currency trading possibilities have, however, been facilitated by capitalist trading

Table 9.5  
 Selected Non-Traditional Exports, 1980-1985 (million pesos)

Product	1980	1983	1985
Fish & Shellfish	86.1	102.7	115.1
Ethyl Alcohol	1.3	6.3	6.7
Citrus Fruits	41.3	119.5	143.9
Other Fruits & Vegetables	14.4	15.6	40.2
Coffee, Tea & Cocoa	23.3	47.2	39.0
Copper Concentrate	5.3	5.1	6.2
Refractory Chrome	1.6	1.3	3.2
Medicines	1.2	6.4	9.9
Chemical Elements	2.1	7.2	7.3
Manufactured Articles	29.0	55.6	59.9
Cement	11.5	5.8	2.2
Marble	1.3	1.9	2.2
Iron & Steel Products	2.6	19.2	21.9
Non-Electrical Machinery	2.8	29.3	18.6

Source: Comité Estatal de Precios, Anuario Estadístico de Cuba, 1985 (Havana, Cuba: 1986), pp. 394-405.

companies. The Italian trading company, SOCOMET, for instance, represents several Italian exporters to Cuba and is committed to marketing a return flow of Cuban products to Italy. In 1986, SOCOMET marketed Cuban nickel, canned fruit juices, textiles, marble, tractor tires, electronic components, and customized software in Italy.

The development of Cuban-manufactured nontraditional exports benefits from a well-developed infrastructure, state support, and a stable, skilled labor force. It is hindered, *inter alia*, by supply shortages, insufficient quality control, inadequate packaging and port facilities, lack of marketing ties, and foreign exchange difficulties.

The data in Table 9.4 include only merchandise exports and, hence, do not reflect the rapid growth in tourism and tourist services in recent years. Tourism revenues in 1985, for instance, grew by 33 percent. The total number of tourists visiting Cuba grew from 96.6 thousand in 1978 to 240.5 thousand in 1985; of the latter number only 48.3 thousand were from socialist countries. Put differently, out of 100.4 million pesos of total tourism revenues in 1985, only 19.4 million (or 19.3 percent) came from visitors from socialist countries. If air and ground transportation, communications, and other tourist services were included, tourist revenue in 1985 would rise to 118 million pesos.<sup>14</sup> Tourism revenues grew by a further 7.2 percent in 1986, placing tourism ahead of tobacco as fourth on the list of hard currency earners, behind sugar, oil reexports, and fish products.<sup>15</sup> Table 9.4 also does not register the

sizable service exports in the form of construction, educational, and medical personnel to other Third World countries.<sup>16</sup>

Finally, along with Cuba's modest success in export diversification, it should be mentioned that Cuba has made considerable strides in its import substitution program. Rapid growth in capital goods (12.8 percent average annual growth from 1961 to 1985), in construction materials (7.8 percent average annual growth from 1965 to 1985), metal products (14.4 percent annual growth rate), electrical energy (7.9 percent annual growth rate), chemicals (7.5 percent), among other branches, have denoted a profound transformation in Cuba's industrial base.<sup>17</sup> As a consequence of this transformation, the share of manufactured goods in Cuban imports fell from 58.9 percent in 1970 to 44.7 percent in 1983.<sup>18</sup>

Additionally, Cuba is making important strides in import substituting for its energy supplies. Domestic crude oil extraction has increased from 258 thousand tons in 1981 to over 1 million tons in 1987. With the opening of new onshore and offshore fields, production is scheduled to reach 2 million tons by 1990. The main difficulty with Cuban crude is its high sulfur content, but new refineries are being built to adjust for this "density" and some existing industrial plants are being retrofitted to be able to consume the heavier crude. Four nuclear reactors in Cienfuegos will come on stream in 1990, and additional reactors are planned to provide Cuba eventually with 75 percent of its electricity requirements. It has been estimated that every kilowatt-hour of energy saved or produced in Cuba saves 4.73 cents in foreign exchange. Since Cuba still imports nearly 70 percent of its energy, these savings can amount to significant sums.<sup>19</sup>

Cuba has also diversified its agricultural base and become less dependent on food imports. Substantial improvements in Cuban nutrition have been accompanied by a steady decline in the share of food products in total imports, from 20.5 percent in 1958 to 9.3 percent in 1986.<sup>20</sup>

It should also be mentioned that one significant impediment to further diversification since 1980 has been the tightening of the U.S. blockade under Reagan, to be discussed below. The Third World debt crisis and growing protectionism have also limited Cuban markets. To be sure, Cuba has continued to run overall trade deficits, and in 1986 Cuba experienced a hard currency trade deficit for the first time in this decade.<sup>21</sup>

### *Soviet Aid*

Cuba's membership in the CMEA has, among other things, provided a stable market (with subsidized prices and guaranteed sales) for its primary exports. This stability has not only facilitated economic planning, but

it has made the quest for developing new export products less pressing than it would otherwise have been.

Cuban social or economic accomplishments, when acknowledged, are often attributed to massive doses of Soviet aid.<sup>22</sup> Implicit in this attribution is that Cuba's economic dependence on the Soviet Union is different and more benign in its economic impact than Cuba's previous dependence on the United States, although this is never made explicit. In fact, Soviet economic aid is enormous and the Cuban economy would scarcely be what it is without it. Yet several caveats must be made. First, as discussed below, the magnitude of this aid has been greatly overstated by faulty methodology. Second, even if the exaggerated aid figures were accepted, on a per capita basis Cuba would still be receiving less CMEA aid than many other Latin American economies receive in Western aid. Third, if one is attempting to disentangle the sources of Cuban growth and isolate its domestic and foreign components, it is hardly sufficient to consider only the beneficial effects of Soviet aid. One must also consider the monumental and ongoing costs to Cuba of the U.S. blockade. In 1982, the Cubans estimated these cumulative costs to be approaching \$10 billion.<sup>23</sup>

Most scholars of Cuba have relied upon the Soviet aid estimates provided by the U.S. Central Intelligence Agency. The CIA estimates include not only direct balance of payments and project aid but also price subsidies for sugar, nickel, petroleum, and other products. The sugar price subsidy is by far the largest component of Soviet aid in the CIA reckoning (e.g., 68.3 percent of total aid in 1983).<sup>24</sup> To estimate this subsidy the CIA (a) uses the official peso/dollar exchange rate, (b) ignores the tied nature of the aid, that is, payments are overwhelmingly in ruble credits usable only for inferior Soviet goods, and (c) assumes the aid to be the difference between the converted dollar price paid by the Soviets and the free market price. Steps (a) and (b) have no economic justification and engender a significant upward bias. Step (c) is arbitrary and betrays either a political bias or a miscomprehension of world sugar trade.

Roughly only 14 percent of world sugar is sold at free market prices; the rest is sold under preferential agreements, at above world market prices.<sup>25</sup> The "free" market price is thus not a true scarcity price, because the subsidized prices of preferential trade cause the quantity of sugar supply to be higher and the quantity of sugar demand to be lower than would prevail under true free market conditions. The world market price is, therefore, lower than the true scarcity price of sugar and cannot be employed properly as the opportunity cost (the price at which Cuba would have to sell its sugar if it did not have a preferential agreement with the Soviet Union) to calculate Soviet subsidies.

Some have suggested that an appropriate alternative price might be the preferential U.S. market price, where Cuba used to sell the vast bulk of its sugar exports prior to the U.S. embargo.<sup>26</sup> In mid-March 1988 the world market price was approximately 8 cents per pound, in contrast to the U.S. preferential price of around 22 cents, the EEC preferential price of near 20 cents and the Soviet price of approximately 36 centavos a pound for raw sugar.<sup>27</sup>

If the Soviet price is converted at the official commercial exchange rate of 1 peso equals \$1.00, then it equals 36 cents and when compared to the world price it constitutes a subsidy per pound, as computed by the CIA, of 28 cents. If the opportunity cost were taken to be the U.S. market, the subsidy would fall by half to 14 cents per pound using the official exchange rate. However, given Cuba's chronic current account deficit it seems that the Cuban peso is significantly overvalued at the official fixed rate, so even 14 cents a pound would be too high an estimate.<sup>28</sup>

To be sure, in all but three years between 1960 and 1974 the U.S. preferential price was above the Soviet price, implying a reverse subsidy until the mid-1970s. One author has estimated that Cuban sugar revenue would have been \$800 million higher over this period had Cuba been trading with the United States instead of with the Soviet Union.<sup>29</sup>

Also part of the CIA estimate are price subsidies of oil and other products. The oil price subsidy was substantial in 1983, the last year for which the CIA estimated Soviet aid to Cuba. Since 1986, however, Cuba has paid above the world market price for Soviet crude, denoting a reverse subsidy. The 1976 trade agreement between Cuba and the USSR stipulated that Cuba buy crude oil from the USSR at the average price of the previous five years on the world market. When oil prices were rising, this meant that Cuba was purchasing Soviet oil at subsidized prices. However, as oil prices first leveled off in the early 1980s and then began a precipitous drop in 1986, this pricing formula meant that Cuba was paying above world market prices for its crude. One Cuban official stated that Cuba was paying the USSR \$26 a barrel in early 1987, implying a reverse subsidy of some \$8.<sup>30</sup> Of course, since Cuba pays for the oil in convertible rubles and then sells much of it for hard currency, the market value of this reverse subsidy would be less than \$8.

Between 1980 and 1985 the Soviet purchase price for Cuban raw sugar rose by 32.7 percent, while the price Cuba paid for Soviet crude oil rose by 155.6 percent. Overall, between 1980 and 1985 the (weighted) average price of Cuban imports from the Soviet Union rose by 82.49 percent, while the average price of Cuba's exports to the Soviet Union rose by only 32.15 percent.<sup>31</sup> The direction of the price subsidies during

Table 9.6  
1985 Cuban Import Prices of Selected Products (pesos)

Product	USSR	World Market*
Wheat Grain (per ton)	189.4	126.1
Tires (per unit)	115.1	43.3
Buses (per unit)	23,125	12,000
Trucks (per unit)	13,715	12,785
Automobiles (per unit)	3207	2259
Cut Lumber (per cu. meter)	151.3	108.8
Tin Plates (per ton)	641.2	559.6
Butter (per ton)	1667	1157
Powdered Milk (per ton)	975.1	721.6

\* The "world market" price represents the lowest price Cuba paid for the product from any of its trading partners; when this price was not available, it represents the average price paid to all its capitalist trading partners. Per ton prices refer to metric, as opposed to short, tons.

the 1980s, then, is moving against the Cubans. From the partial information available, it appears that this tendency has continued since 1985.

It is also essential to note that Soviet payments for Cuban exports are in ruble credits. Cuba is thus tied to buying lower-quality and often overpriced Soviet goods, lessening the real value of the subsidy further. The very fact that the Soviet Union cannot compete on world markets with its manufactured goods is ample evidence of either lower quality or higher prices or both. There are also many specific examples. Examples from earlier periods have been discussed elsewhere.<sup>32</sup> Some evidence for the mid-1980s is provided in Table 9.6.

The prices in Table 9.6 show that for several products Cuba pays the Soviet Union above the world market price. Many of the products listed are not homogeneous, and the quoted price is not adjusted for quality. The price comparison, then, is not precise and may either understate or overstate the actual differential between Soviet and world market prices.

There is also new evidence of deficient quality of Soviet goods and services. For instance, there have been repeated structural problems with the new Soviet-designed and -built Celia Sanchez textile factory in Santiago, Cuba, that have forced drastic production cutbacks. The factory cost Cuba several million rubles. The two new Soviet-designed nickel plants have encountered a series of technological problems, first delaying initial production and then reducing capacity. Cuban authorities have also complained recently about delays in the arrival of Soviet oil and other inputs.<sup>33</sup>

In the end, it cannot be denied that Soviet aid and special terms of trade offered to Cuba have played a large role in supporting Cuba's economic progress. Yet the existing analyses significantly exaggerate the magnitude of Soviet aid and do not support the claim that Cuba's economic and social successes are entirely attributable to its special relationship with the Soviet Union. Further, before any arguments can be soundly made regarding the Cuban economy's ability to generate self-sustained development, it is imperative that the direct and indirect costs of the U.S. economic blockade and political aggression be taken into account.

Nor can one overlook Cuba's extensive program of international aid. For instance, in January 1985, Cuba had 1 civilian international aid worker for every 625 Cuban inhabitants, whereas during 1982 the U.S. ratio was 1 aid worker for every 36,298 U.S. inhabitants.<sup>34</sup> Cuba had more health workers abroad in 1985 (1,500 in 25 countries) than did the World Health Organization. In 1981, Cuba accounted for 19.4 percent of all Soviet, East European, and Cuban technicians working abroad. During the 1984-1985 academic year, Cuba granted scholarships to 22,000 foreign students from 82 developing countries to study in Cuba, 1,800 of these in medicine; whereas, during the academic year 1982-1983, the United States funded but 9,000 scholarships for foreigners to study there. Although Cuba began to charge for some international assistance programs in 1977, these charges are on an ability-to-pay basis. Thus, poor countries receive the assistance without charge, and middle-income countries pay subsidized prices. Cuba also regularly offers humanitarian aid to Third World countries.<sup>35</sup>

Finally, despite the magnitude of Soviet aid to Cuba, there are other economies in Latin America that receive more international aid per capita than Cuba does. For instance, Puerto Rico received \$1.82 billion in aid from the United States in 1975, \$3.71 billion in 1980, and \$4.57 billion in 1983, while Cuba received from the Soviet Union, even according to the inflated CIA estimates, \$ .91 billion, \$2.63 billion, and \$3.1 billion respectively in these years. Thus, in 1983, with a population one-third that of Cuba's, Puerto Rico received 1.47 times more aid than Cuba, or 4.42 times more aid on a per capita basis. Yet the Puerto Rican economy can hardly boast of the social or economic achievements of post-1958 Cuba.<sup>36</sup>

### *Trade Prospects and Debt*

At the end of September 1986, Cuba's hard currency debt equaled \$4.68 billion and its debt to the USSR roughly equaled 7.5 billion rubles.<sup>37</sup>

At official exchange rates converted to dollars, the debt to the USSR was approximately \$10 billion. Again, the official rates are widely recognized to overvalue both the ruble and the peso, so this figure must be interpreted as an upper bound of the market value of Cuba's debt. Nevertheless, it lies considerably below the \$23 billion estimated by some Western experts.<sup>38</sup>

For purposes of comparison, it is helpful to total Cuba's 1986 Western and Soviet debt, which comes to \$14.68 billion, or \$1,439 per capita. This is below the 1986 per capita debt in several Latin American economies: \$2,030 in Venezuela, \$1,822 in Chile, \$1,800 in Costa Rica, and \$1,714 in Argentina. It is above the levels in most other Latin American countries: for example, \$1,306 in Mexico, \$1,000 Ecuador, \$890 in Peru, and \$832 in Brazil. If debt were considered instead as a share of national income, Cuba would still fall somewhere in the middle of Latin American economies.

The more important point about Cuban debt, however, is that roughly two-thirds of it is with the Soviet Union and is held on very different terms from its Western debt. Cuba's debt payments (principal and interest) to the USSR were suspended in 1972 and were to resume in 1986 with a payment equivalent to \$125 million. Given Cuba's foreign exchange problems in 1986, however, the USSR agreed to delay all payments to 1990 at least. Many observers believe these payments will be delayed indefinitely as long as Cuba's political alliance with the Soviet Union is maintained.

Despite the extraordinary terms of Cuba's Soviet debt, Cuba's Western debt is sufficiently large and payments on it sufficiently burdensome to create a significant and growing problem in its own right. Until the summer of 1986, Cuba had been a model debtor, making all due service payments punctually. Since that time, most payments on its private debt have not been made, and no mutually satisfactory rescheduling has been arranged between Cuba and its private creditors.

Much of Cuba's story is told by the debt experience of the rest of Third World. Mounting accumulations of petrodollars in the 1970s, commercial banks' presumption that governments were creditworthy, demands for more rapid growth in the Third World, the need for additional foreign exchange to pay for more expensive oil, and so on all led to growing indebtedness among developing nations. When the unprecedentedly high interest rates arrived in late 1979, world market demand for Third World exports diminished at the same time as the interest burden on debt began to soar. Shrinking markets, growing protectionism and deteriorating terms of trade had by 1982 made the problems of debt intractable for many less-developed countries, as well as for international financial markets.

Cuba's particular situation has been further aggravated by a number of factors. First, the economic blockade by the United States has been tightened during the Reagan administration. An early effective measure was to pressure many foreign companies doing business with the United States not to trade with Cuba. In 1981, the French conglomerate Le Creusot Loire was using Cuban nickel in steel it was shipping to the United States. The steel was banned from entering the United States and Le Creusot Loire canceled its contract to build two factories, already under construction, for converting bagasse to paper. In early 1982, two Canadian firms negotiating contracts to build a citrus processing factory and a power plant backed down under pressure from the U.S. Department of Commerce. The next measure came in May of 1982, when U.S. tourism to Cuba, which had been opened during the Carter administration, was prohibited, depriving Cuba of potentially substantial foreign exchange earnings. More recently, the Reagan administration has (a) proscribed dollar remittances from Cuban exiles in the United States to relatives in Cuba, (b) forbidden U.S. companies to trade with joint Cuban-Panamanian companies operating out of Panama, and (c) refused to pay dollar charges for Cuban exit visas. Reagan has also pressured multinational banks and foreign governments not to reschedule Cuba's debt or to impose harsh terms and, generally, to restrict their trade with Cuba; it is difficult to assess what, if any, effect this pressure has had. However, in its March 1986 report to Cuba's creditors, the National Bank claimed that because of "the lack of access to creditor countries' markets, 50 million pesos worth of nonsugar exports could not be sold in the convertible currency area."<sup>39</sup>

Second, and this also affects many Caribbean Basin countries, developments in the world sugar market have been extremely unfavorable. World market prices fell steadily from an average of 29 cents per pound in 1980 to 4 cents in 1985. Since that time there has been only a slight recovery, with prices currently (mid-September 1987) around 6 cents. A major influence behind these plummeting prices has been the marked reduction in U.S. sugar imports, which in 1988 will be approximately 85 percent below their level in 1981. Part of this reduction is attributable to the substitution of high-fructose corn syrup for sugar by U.S. soft drink producers, but part is because the U.S. government has allowed U.S. cane producers to increase output (at heavily subsidized prices) even in the face of falling demand.<sup>40</sup> The shrinking U.S. market for sugar imports impacts Cuba in two ways: First, it means more sugar production is sold on the world market by other sugar exporters, further depressing prices; second, it means that many of Cuba's natural trading partners in Latin America (e.g., Costa Rica, Panama, the Dominican Republic, Brazil) do not earn sufficient foreign exchange to expand or

even maintain their imports from Cuba. Of course, in terms of real purchasing power the nominally low sugar prices of the world market are even lower.

Third, all agricultural exporters are vulnerable to natural cycles, but Cuba has experienced unusually bad times since 1980. At the beginning of the decade, Cuba's sugar crop was decimated by cane rust, and the tobacco crop was acutely affected by blue mold. In October of 1985 the Cuban countryside was devastated by Hurricane Kate, which among other things was estimated to have reduced the 1985-1986 harvest by 1 million tons. Since the hurricane there has been an intensifying drought, with rainfall in 1986 at 35 percent below the annual average. The drought is held responsible for reducing the 1986-1987 sugar harvest by another 1 million tons and for seriously damaging output of several other crops. Finally, the torrential rains that struck Cuba in December 1986 are reported to have destroyed 9,400 acres of tobacco land and severely damaged an additional 20,000 acres.

Fourth, as already explained, Cuba has been reexporting Soviet petroleum since 1980. From 1983 to 1985, such exports averaged 41.7 percent of all hard currency earnings. The rapid drop in world oil prices, beginning in late 1985, lowered 1986 earnings from reexports by an estimated \$300 million. In 1986, oil reexports accounted for only 26 percent of Cuba's hard currency earnings.<sup>41</sup> The situation has improved somewhat in 1987, as oil prices have recovered approximately half of the previous drop.

Fifth, Cuba has been seriously affected by the steady devaluation of the dollar against the currencies of other industrialized market economies since mid-1985. Many of Cuba's exports are denominated in dollars, corresponding to the dollar's preeminent role on world commodity markets. Yet, since Cuba does not trade with the United States, most of its imports from the developed market economies are denominated in those currencies that have appreciated against the dollar. Further, most of Cuba's hard currency debt is denominated in nondollar currencies, such as the yen, mark, and krona. Since most of these currencies have appreciated in value against the dollar by over 40 percent since mid-1985, the dollar value of Cuba's debt has risen accordingly. The Cuban National Bank has estimated that the dollar devaluation cost the Cubans over \$150 million in 1986.<sup>42</sup>

All told, hard currency availability for imports had diminished dramatically by 1986. According to the figures of the Cuban National Bank, hard currency export earnings plus net credits in 1986 came to \$650 million available for hard currency imports. This sum stands in sharp contrast to the \$1.5 billion that was available in 1984. The 1986 predicament is even bleaker in comparative terms when the figures are

put in constant 1984 dollars: 1986 available hard currency was worth only \$500 million in 1984 purchasing power.

Although Cuba's hard currency problem is experienced to varying degrees by all Latin American countries and Cuba's condition has been exacerbated by the special factors enumerated above, it should not be overlooked that Cuba's long-term foreign trade performance has left much to be desired. With overall balance of trade deficits in all but two years since 1959, Cuba's external economy had been able to avoid crisis until mid-1986, in large measure due to the cushion provided by the CMEA.

Cuba was first forced to ask for debt rescheduling in August 1982, in the wake of rising interest rates and falling sugar prices. At the time, the Cubans requested a rescheduling of all their medium-term obligations falling due between September 1982 and December 1985, including stretching out payments over ten years with a three-year grace period. Eventually, Cuba accepted less favorable terms (rescheduling of obligations maturing between September 1982 and December 1983 only, amortization periods of seven to eight years, and higher rates of interest than requested).<sup>43</sup> These terms forced Cuba back to the bargaining table to renegotiate its debt in 1984, again in 1985 and again in 1986. Agreements were reached with Cuba's private and public creditors in both 1984 and 1985. In 1986, however, although agreement with Cuba's public creditors at the Paris Club was reached after several months delay in July, no agreement was forthcoming between Cuba and its private creditor institutions (which held 57 percent of Cuba's \$4.68 billion foreign debt in September 1986).<sup>44</sup>

Cuba's acute hard currency shortage compelled it to reject the private banks' offer in 1986.<sup>45</sup> Medium-term debt service payments have been halted and short-term service payments have become irregular. By September 1987 no new accord had been reported. Although Cuba has neither taken a principled stand against paying its debt nor declared a suspension of payments nor set limits on its servicing obligations as have Peru and Brazil, Cuba does seem to have entered the ambiguous terrain of debt muddling along with many of its Latin American neighbors.

For its part, Cuba, without recourse to the World Bank or the IMF, has drastically curtailed hard currency imports, imposed a domestic austerity program,<sup>46</sup> and reduced planned growth from the 5 percent range to 1 to 1.5 percent. The partial recovery of petroleum prices in 1987 has helped Cuba, but unfavorable weather patterns have brought considerable harm to Cuba's crops and lowered hard currency export projections for 1987. The generalized shortages engendered by these circumstances have lent a sense of greater urgency to Cuba's current reevaluation of the role of material incentives in a socialist economy.

The lack of bank financing and export credit underwriting forced Cuba to resort increasingly during 1986 and 1987 to suppliers' credits that carry higher interest charges. This prevented Cuba from benefiting from the falling international interest rates of 1986. Interest payments on the debt in 1986 came to 261.6 million pesos, just 6.2 million pesos below the 1985 level.

With hard currency trade surpluses from 1980 to 1985, it has been the large deficit in services that has produced Cuba's current account (hard currency) deficits during the 1980s. These deficits, in turn, are responsible for Cuba's growing foreign debt.

Hard currency trade surpluses were 367 million pesos in 1980, 285 million in 1981, and 624 million in 1982. These surpluses permitted the reduction of Cuba's foreign debt from 3.3 billion pesos in 1979 to 2.7 billion in 1982. Between 1982 and 1985, however, shrinking trade surpluses and growing interest payments led to the debt buildup. The first hard currency trade deficit of the decade came in 1986, and this was compounded by the rapid dollar devaluation. By the end of September 1986, the hard currency debt in pesos stood at 3.87 billion, up 44 percent from 1982.

Despite increases in tourism revenue, earnings from construction and medical services overseas, and the growth of the national merchant fleet, Cuba's large debt service payments and the effects of exchange rate variation kept the 1986 service balance negative. Excluding the interest payments on the debt, however, Cuba's 1986 service balance in hard currency turned to a positive 26.4 million pesos, from a negative 308.9 million pesos in 1985.<sup>47</sup>

There are also some reasons for optimism regarding Cuba's merchandise trade balance. Barring major natural or political disruptions, it appears that Cuba's exports are poised for a period of strong growth. Installations have been made to allow for significant jumps in nickel, copper, sugar, and refined petroleum exports. Healthy growth can be expected in many of the new manufactured exports mentioned above. Further, Cuba has begun to revise its pricing methods for international trade with the goal of bringing foreign and domestic prices in line with each other. If Cuban authorities hold to this policy, it should help to stimulate greater efficiency in export production as well as to curtail imports. It should also help in selecting new export products and in remedying the anomalous situation that exists for several export products that use up more foreign exchange in their production than they generate in their sale.<sup>48</sup>

### *Conclusion*

Cuba's difficult foreign exchange situation, along with domestic economic problems, has brought a temporary halt to a protracted period of rapid

growth. Economic output stagnated in 1986 and fell by approximately 3 percent in 1987. But there are new signs of improvement in Cuba's foreign trade and internal economic organization. Although Cuba's trade balance has been precarious since the early 1960s, Cuba's growing foreign debt, unlike elsewhere in Latin America, has been used in the service of promoting a significant industrial transformation.

Cuba has pursued a "walking on two legs" policy of simultaneous import substitution and export promotion, with the former receiving greater priority through 1980. Central planning has allowed the state to act as a surrogate entrepreneurial class (often weak or absent in developing countries) and to mobilize resources for the industrialization process. The CMEA has provided a cushion from the vicissitudes of the world economy, allowing the bulk of Cuba's investment projects to come to fruition.

The Cuban case suggests that single-minded concentration on the market mechanism and export promotion may not provide the most effective resolution to the debt crisis and the development dilemma of the Third World. To be sure, the governments of the East Asian NICs have played active indicative planning roles in their economies. Given the absence of a mature financial infrastructure, an organized entrepreneurial class, and a growth dynamic, the governments of today's underdeveloped nations have an important part to play in the development process. A further lesson of the NICs and of the Cuban experience is that the government must make investment choices from the perspective of dynamic comparative advantage, concentrating resources on human capital development and on new areas with competitive potential. Static comparative advantage choices, commended by short-run market forces, generally consign a country to labor-intensive, low-productivity activities. Together the Cuban and East Asian cases make clear that the industrialization process can occur in a variety of institutional and political frameworks.

### Notes

1. Shares are calculated from data in the 1985 Statistical Yearbook of Cuba. Net material product is basically equal to gross domestic product minus depreciation and the value of all non-productive services in the economy. Gross social product, on the other hand, is generally greater than gross domestic product for Cuba even though it too excludes non-productive services. This is because it is based on the gross value, rather than value added, of output.

2. For a review of some of this literature, see Claes Brundenius and A. Zimbalist, "Cubanology and Cuban Economic Performance," in A. Zimbalist (ed.), *Cuban Political Economy: Controversies in Cubanology* (Boulder, Colo.: Westview Press, 1988) and Richard Turits, "Trade, Debt and the Cuban Economy,"

in A. Zimbalist (ed.), *Cuba's Socialist Economy Toward the 1990s* (Boulder, Colo.: L. Rienner, 1987).

3. Sugarcane can produce several times more energy and fiber per hectare than any other crop. See, James G. Brown, *The International Sugar Industry: Developments and Prospects*, World Bank Staff Commodity Working Paper No. 18 (Washington, D.C.: The World Bank, 1987). Also see, James Fry, *Sugar: Aspects of a Complex Commodity Market*, Division Working Paper No. 1985-1 (Washington, D.C.: The World Bank, 1985). Each of these papers provides an excellent discussion of the world sugar market, its dilemmas, and its potentials.

4. Jorge Perez-Lopez, "Cuban Economy in the 1980s," *Problems of Communism* (September-October 1986), p. 22. Also see Perez-Lopez, *Sugar and the Cuban Economy: An Assessment* (Coral Gables: Research Institute for Cuban Studies, University of Miami, 1987).

5. Banco Nacional de Cuba, *Informe Económico*, March 1986, p. 5.

6. *Anuario Estadístico de Cuba, 1985*, p. 237.

7. Olga Ester Torres, "El desarrollo de la economía cubana a partir de 1959," *Comercio Exterior*, vol. 31, no. 3, marzo de 1981, p. 291.

8. This is accomplished by taking the share of petroleum reexports in total exports in 1980 and 1985 and diminishing constant price exports by this percentage. The constant price value of raw sugar exports was then divided by this diminished constant price total export value. Since there were no petroleum reexports in 1965, 1970, or 1975, the reported shares in the last two columns are identical for these years.

9. The Cuban data are from the Banco Nacional de Cuba, *Informe Económico* of March 1986, p. 10. They do not include re-exports. The data from the other countries come from their trade statistics, as reported in SRI International, *Nontraditional Export Expansion in the Central American Region* (Washington, D.C., March 1987).

10. According to one Cuban source, Cuba had also introduced 115 new export products between 1976 and 1980 (Humberto Perez, "La plataforma programática y el desarrollo económico de Cuba," *Cuba Socialista*, vol. 3 [June 1982], p. 39). Yet another Cuban source reports that between 1977 and 1985, 150 new export products were introduced (Ciei, *Aspectos Sobresalientes de la Economía Cubana (VI)* [Habana: Centro de Estudios Demográficos, 1986], p. 42).

11. These data are calculated from Comité Estatal de Estadística, *Anuario Estadístico de Cuba, 1985* (Habana, 1986), and Banco Nacional de Cuba, *Informe Económico 1986* (Habana, 1987).

12. *Cuba Business*, vol. 1, no. 2 (December 1987), p. 6.

13. According to the *Wall Street Journal*, Cuba's foreign investment code will be changed in 1988 to allow 100 percent foreign ownership in the tourist industry. Reportedly, this change is part of an effort to upgrade the quality of tourist services. Peggy Berkowitz, "Cuba Is Seeking Another Rescheduling of Its Loans from Governments, Banks," *Wall Street Journal*, January 13, 1988, p. 18.

14. Revenue from tourist services alone (e.g., air and ground transportation and communications) more than doubled from 1984 to 1985, increasing from 8.5 million pesos to 17.6 million.

15. *Informe Económico, 1987*, p. 19. In 1986, 90.8 percent of all tourism revenues came from visitors from market countries.

16. These service exports are discussed in considerable detail in Susan Eckstein, "Why Cuban Internationalism?" in Zimbalist, *Cuban Political Economy*, and Julie Feinsilver, "Cuba as a 'World Medical Power': The Politics of Symbolism," Ph.D. dissertation, Yale University, December 1987.

17. These data on the composition of industrial growth are from A. Zimbalist, "Cuban Industrial Growth, 1965-84," *World Development*, vol. 15, no. 1 (January 1987), p. 90. There are several excellent sources on the development of Cuba's heavy industrial branches. Among them: Miguel Figueras, *Producción de maquinarias y equipos en Cuba* (Habana: Editorial Científico-Técnica, 1985); Claes Brundenius, "Development and Prospects of Capital Goods Production in Cuba," in Zimbalist, *Cuba's Socialist Economy Toward the 1990s*; Hugo Garcia, "La industria siderúrgica en Cuba," *Economía y Desarrollo* 97 (March-April 1987); Omar Perez, "La industria de materiales de construcción," *Economía y Desarrollo* 98 (May-June 1987).

18. *Cuba*, Industrial Development Review Series, UNIDO, Vienna/IS.615, 1986.

19. *Cuba Business*, vol. 1, no. 2 (December 1987), p. 4.

20. *Anuario Estadístico de Cuba, 1986*, p. 425.

21. In its overall trade (convertible and non-convertible currencies) Cuba has run a balance of trade deficit every year since the revolution, except in 1960 and 1974. AEC, 1985, p. 376.

22. For instance, see Lawrence Theriot, *Cuba Faces the Economic Realities of the 1980s*, prepared for the Bureau of East-West Trade (Washington, D.C.: Department of Commerce, 1982).

23. Banco Nacional, *Informe Económico* of 1982. Since no methodology is provided, this figure is cited only as illustrative of the magnitudes involved.

24. Central Intelligence Agency, *The Cuban Economy: A Statistical Review* (Washington, D.C.: Government Printing Office, 1984), p. 40.

25. See Fry, *Sugar: Aspects of*, p. 20.

26. A. Zimbalist, "Soviet Aid, U.S. Blockade and the Cuban Economy," *Comparative Economic Studies* 24 (Winter 1982); Willard Radell, "Cuban-Soviet Sugar Trade, 1960-1976," *Journal of Developing Areas* 17 (April 1983).

27. The Soviet price has varied between roughly 22 and 39 centavos per pound over the last ten years. There have been several reports that the 1986-1990 trade protocol agreement with the Soviet Union calls for a 7 percent reduction in the average sugar price. See Economist's Intelligence Unit, *Country Report: Cuba, D.R., Haiti and Puerto Rico*, nos. 1-4, 1986, and Staff of Radio José Martí, *Cuba: Quarterly Situation Report* (Washington, D.C.: United States Information Service, 1986). Castro, speaking at the Third Party Congress on November 30, 1986, also alluded to the Soviet price as falling below 30 centavos per pound. See *Granma Weekly Review*, December 14, 1987, part 2, p. 4. The *Quarterly Economic Report* of March 1987 of the Cuban National Bank lists the quantity and value of Cuban sugar exports to the USSR for the first quarter of both 1986 and 1987; this comparison suggests that the Soviet purchase price for Cuban raw sugar fell 7.3 percent in 1987.

28. Cuba's exchange rate deviation index is probably over one; that is, for purposes of estimating Cuban GDP per capita, a straight exchange rate conversion would likely understate the dollar value of Cuban GDP per capita. This observation, however, does not contradict the observation that for purposes of obtaining international equilibrium (and measuring the free market of Cuban transactions), the Cuban peso is overvalued. The discrepancy arises because of the behavior of the relative prices of tradables and nontradables (particularly basic, often subsidized and labor-intensive, goods).

In his new book, *To Make the World Safe for Revolution* (Cambridge: Harvard University Press, 1988), Jorge Domínguez recognizes the problems with the CIA estimates and makes his own estimates using the price Cuba receives for its sugar from Spain, Canada, and Japan as the opportunity cost. Domínguez's method improves little on that of the CIA's, however, because Canada and Japan, and Spain since 1979, have bought Cuban sugar at the residual world market, not preferential, prices. Hence, it is not surprising that Domínguez produces estimates similar to the CIA's.

29. John T. Smith, "Sugar Dependency in Cuba: Capitalism Versus Socialism," in M. Seligson (ed.), *The Gap Between Rich and Poor* (Boulder, Colo.: Westview Press, 1984), pp. 373-374.

30. Conversation with the author, May 1987.

31. These figures are based on those products reported in the 1985 Statistical Yearbook and include 88.5 percent of the value of Cuba's exports to the USSR and 72.5 percent of the value of the imports. If the different coverage were adjusted for, the percent increase in import prices would be 3.1 times greater than the percent increase in export prices, as opposed to the unadjusted figure of 2.6, based on the percentages given in the text.

32. See A. Zimbalist, "Soviet Aid, the U.S. Blockade and the Cuban Economy," *Comparative Economic Studies*, vol. 24, no. 4 (Winter 1982).

33. These examples are cited in Staff of Radio José Martí, *Cuba: Quarterly Situation Report*, Second Quarter, 1987, II-5. This report also claims: "In addition, former Cuban officials have stated that the Soviet Union hardly ever provides its less developed trading partner with up-to-date technology or adequate supplies of goods, parts and services." The reference for this statement, however, refers only to one former official, Luis Negrete. Interestingly, this report further suggests that although actual debt repayment to the USSR has been put on hold, the Cubans might be expected to perform other services for the Soviets, such as exporting manpower for Soviet-conceived projects. No evidence is adduced, however, to back up this speculation.

34. This and other figures in this paragraph come from Feinsilver, "Cuba as a 'World Medical Power'" unless otherwise noted. Also see Eckstein, "Why Cuban Internationalism?" and Michael Erisman, *Cuba's International Relations* (Boulder, Colo.: Westview Press, 1985).

35. To mention three recent examples: \$2.5 million to Mexico for earthquake relief; construction and educational materials for two schools in Uruguay; and construction and equipping of an intensive-care unit for a hospital in Santa Cruz, Bolivia. The last two examples were cited in the *Quarterly Situation Report*

(Second Quarter, 1987, II-16) on Radio José Martí, Cuba. The first is cited in *Granma Weekly Review*, December 14, 1986, part 2, p. 4.

36. Soviet aid figures are from the CIA, *The Cuban Economy: A Statistical Review* (Washington, D.C.: U.S.G.P.O., 1984). Puerto Rico aid figures are from various publications of the U.S. Department of Commerce, cited in Feinsilver, "Cuba as a 'World Medical Power.'" The subject of aid to, and underdevelopment in, Puerto Rico is analyzed in interesting detail by Richard Weisskopf, *Factories and Food Stamps: The Puerto Rican Model of Development* (Baltimore: The Johns Hopkins University Press, 1986).

37. Cuba's hard currency debt figure is from the Banco Nacional's *Informe Económico* (annual report to its creditors) of May 1987, p. 27. The reported peso value was converted into dollars at the average 1986 official exchange rate. The ruble debt figure is from A. Bekarevitch, a Cuba specialist at the Latin American Institute of the Soviet Academy of Sciences, in a communication to Brundenius. Of the 7.5 billion rubles, 6 billion originated as trade aid and 1.5 billion as project aid. The Economist's Intelligence Unit's *Country Profile: Cuba, 1986-87* reports Cuba's debt to the USSR to be \$7.5 billion in 1985. This figure appears to come from the same source as Bekarevitch's, but it is not stated what conversion factor was used to put the estimate in dollars.

38. See *Cuba Business*, April 1987, p. 1.

39. Banco Nacional de Cuba, *Economic Report* (Habana, March 1986), p. 4. Legislation has been introduced in both houses of the U.S. Congress that would extend the blockade further, essentially by punishing countries that continued to lend aid or trade with Cuba.

40. Another strong influence on the world sugar market has been the rapid expansion of subsidized beet sugar production in the European Economic Community, which turned from being a significant net importer of sugar in the late 1970s to being a net exporter of around 4.5 million tons annually (roughly one-quarter of free market trade).

41. *Informe Económico*, May 1987.

42. Banco Nacional de Cuba, *Highlights of the Balance of Payments, 1986-87*, p. 9.

43. Banco Nacional de Cuba, *Cuba: Foreign Debt and Its Rescheduling Process* (Havana, December 1986).

44. Of this privately held debt, 61.4 percent was medium-term; the rest was short-term. Banco Nacional de Cuba, *Informe Económico*, May 1987, p. 28.

45. The Economist's Intelligence Unit described Cuba's 1986 negotiations with its private creditor banks as follows: "Negotiations with private banks have continued without yet reaching a final agreement. In response to Cuba's original request for \$300 million, the group of creditor institutions headed by Credit Lyonnais made an offer at the end of last year which involved rescheduling the debt and "recycling" the interest payments with an \$85 million loan (in Deutschmarks) to cover obligations on short and medium term debts due between June 1986 and June 1987. The banks are also said to have drafted an offer to reschedule payments of principal falling due in 1987 over a ten year period. It seems probable that talks will continue to drag on for a while longer,

and may well overlap with the 1987 round of talks with the Paris Club on Cuba's government to government debt" (EIU, *Country Report* [No. 1, 1987, p. 12]).

46. This is a Cuban-styled, not IMF-vintage, austerity program. It involves some consumption cutbacks, higher prices on some services, and restrictions on perquisites, but it has not increased unemployment or lowered wages. In fact, lower wages have been increased to minimize the burden of austerity on low-income groups.

47. This and other data on debt come from the Banco Nacional's annual reports to Cuba's creditors.

48. The distortions and waste in foreign trade connected to Cuba's price system are discussed in R. Gonzalez and C. Menendez, "La evaluación de la efectividad de las exportaciones y su vinculación con el sistema de precios," *Teoría y Práctica de los Precios* (journal of the Cuban State Price Committee), no. 2 (abril-junio 1986).

*A Critical Look at  
Nontraditional Export Demand:  
The Caribbean Basin Initiative*

*Eva Paus*

Successful growth of nontraditional exports depends on a number of factors influencing their supply and the demand in the international market. In contrast to the other case studies in this book, which mainly concentrate on an analysis of the supply-determining factors, this chapter focuses on an important aspect of the demand side—the Caribbean Basin Initiative. It investigates the contribution to nontraditional export growth by the Caribbean Basin Initiative (CBI), which grants preferential access to the U.S. market for most Caribbean and Central American countries. The United States and Canada constitute the largest export markets for all the countries studied in this book, except for Cuba and Guatemala, as well as for many of the other Caribbean Basin economies.

In the last thirty years, major U.S. policy initiatives with respect to Latin America seem to have arisen primarily in response to political changes in the region that were perceived as threats to the economic interests and national security of the United States. In the wake of the Cuban revolution, President John F. Kennedy launched the Alliance for Progress in 1961.<sup>1</sup> Twenty-one years later, in the face of revolutions of left-leaning regimes in Nicaragua and Grenada in 1979, the ongoing civil war in El Salvador, and a growing stream of immigrants from Central American and Caribbean countries to the United States, President Ronald Reagan announced an economic policy initiative specifically geared toward the Caribbean Basin countries: "The program . . . is an integrated program that helps our neighbors help themselves, a program that will create conditions under which creativity and private entrepreneurship and self-help can flourish."<sup>2</sup>

The initiative, which was signed into law on August 5, 1983, as the Caribbean Basin Economic Recovery Act (CBERA)—generally known as

CBI—was to promote economic development in the region by emphasizing export-oriented development based on nontraditional export growth. To achieve this goal CBI provided duty-free access to the U.S. market for 12 years and promised increased U.S. aid to the Caribbean Basin countries.<sup>3</sup> It was expected that the potential of CBI would be realized by the private sector, not only in the respective countries but also in the United States, since the provisions for one-way free trade would attract increased U.S. investment in the region.

Given the importance of nontraditional export growth to the future development of the Caribbean Basin economies, far-ranging access to the U.S. market would certainly provide a valuable contribution by eliminating a potential demand constraint on nontraditional export growth. It is therefore not surprising that CBI has been acclaimed as a major stimulus to future development in the area. Elliot Abrams, the assistant secretary of state for inter-American affairs, testified that "the CBI embodies the U.S. effort to contribute to the region's political stability, social tranquility, and economic growth and development."<sup>4</sup> And according to Kenn George, the director general of the U.S. and Foreign Commercial Service, "The CBI is possibly one of the greatest testimonies of the Reagan Administration's commitment to improving our standard of living and that of our neighbors."<sup>5</sup>

It is widely accepted today that the Alliance for Progress did not meet with the hoped-for success. Although CBI has been in place for only a few years, the analysis in this chapter will show that, in its present form, CBI cannot and will not live up to the high expectations expressed in the rhetoric of Reagan administration officials. CBI's contribution to nontraditional export growth in the Caribbean Basin area has been rather modest to this point. I will argue that because of its very nature CBI has been and will continue to be insufficient to provide for successful export-oriented development in the designated beneficiary countries.

### *The Impact of CBI on Nontraditional Export Growth*

Of the twenty-eight countries declared eligible for CBI provisions, all but six had been designated actual beneficiaries by the end of 1987.<sup>6</sup> The beneficiary countries are Antigua and Barbuda, Aruba, Bahamas, Barbados, Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Haiti, Honduras, Jamaica, Panama, Saint Lucia, Saint Vincent and the Grenadines, Trinidad and Tobago, Montserrat, Netherland Antilles, Saint Christopher-Nevis, and the British Virgin Islands. All countries were designated beneficiaries by the time CBI

became effective (January 1, 1984), with the exception of the Bahamas and Aruba, which were designated in March 1985 and April 1986, respectively. The six countries that by late 1987 had not been designated are Anguilla, Guyana, Nicaragua, Suriname, Cayman Islands, and Turks and Caicos Islands. At the end of 1987, Guyana applied for CBI status with the U.S. government. Cuba, Mexico, Colombia, and Venezuela are the only countries in the Caribbean Basin area that are not eligible for CBI preferences.

In principle, CBI grants duty-free access to nearly all products the United States imports from designated beneficiary countries if they meet the specified local content requirements. CBI stipulates that 35 percent of the product value must be produced in one or more of the beneficiary countries. In meeting the local content requirement, Puerto Rico and the U.S. Virgin Islands can be counted as beneficiaries, and up to 15 percent of the local content may be accounted for by U.S. materials. Only a few products are specifically excluded from duty-free treatment: textile and apparel articles that are subject to textile agreements, footwear, handbags, luggage, flat goods, work gloves, certain leather apparel, canned tuna, petroleum and petroleum derivatives, and watches and watch parts if any of the material originates from a Communist country.<sup>7</sup> These products are also ineligible under the Generalized System of Preferences (GSP), a preferential market access provision that applies to all CBI-eligible countries.<sup>8</sup> In addition, exports of beef and veal products and sugar can only enter under CBI if the exporting country has submitted a stable food production plan, which shows that such exports are not at the expense of food production for the local market.<sup>9</sup> U.S. imports of sugar have been regulated by quotas since 1982. Although CBI contains quotas for sugar as well, they have not been binding since they are larger than the quotas that the United States set under its sugar import policy in 1982. Finally, duty-free treatment granted for any product to a particular country under CBI can be suspended, since the CBI legislation contains safeguard clauses for the protection of U.S. industries.

Though the list of product exceptions is short, it is important since it includes precisely some of the products (e.g., apparel) in which the Caribbean Basin exporting countries might greatly benefit from preferential market access. CBI will only bestow a competitive advantage on the beneficiary countries in the export of those commodities that do not already benefit from duty-free access. After the full implementation of the Tokyo Round tariff cuts (1987), about one-third of the nearly 9,000 products in the Tariff Schedules of the United States (TSUS) can enter the United States duty-free.<sup>10</sup> Thus, due to the unconditional most-favored-nation rule (MFN) under the General Agreement on Tariffs and Trade (GATT), CBI countries can export these products duty-free to the

Table 10.1  
U.S. Trade with Countries Designated under CBI, 1982-1986

Year	U.S. Exports (million dollars)	Share of U.S. Exports to the World (percent)	U.S. Imports (million dollars)	Share of U.S. Imports from the World (percent)	U.S. Trade Balance (million dollars)
1982	5,958.9	2.9	7,771.5	3.2	(1,812.6)
1983	5,532.0	2.8	8,763.9	3.4	(3,231.9)
1984	5,952.9	2.8	8,649.2	2.7	(2,696.4)
1985	5,743.0	2.8	6,687.2	1.9	( 944.2)
1986	6,064.6	2.9	6,064.8	1.6	( 0.2)

Source: U.S. International Trade Commission (ITC), Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers, Second Report 1986, USITC Publication 2024, September 1987, Table 2, p. 2.

U.S. market. Furthermore, under items 806.30 and 807.00 of the U.S. tariff schedule, which refer to the reimport of U.S. materials processed or assembled abroad, only the value added outside the United States and the value of inputs of non-U.S. origin are subject to duty.<sup>11</sup> Finally, the Generalized System of Preferences allows for duty-free import of about 3,000 of the TSUS products. GSP has, however, some distinct disadvantages vis-à-vis CBI, in that its 35 percent local content requirement is more stringent and duty-free access is only guaranteed up to the competitive-need limit.<sup>12</sup>

The preceding background information will serve as a basis for an analysis of the actual trade flows between the United States and the CBI countries. On an aggregate level, the U.S. trade balance with the designated beneficiary CBI countries has steadily improved since CBI became effective in 1984 (see Table 10.1). Ironically this is due almost exclusively to a decline in U.S. imports from the area, whereas U.S. exports to the CBI countries have not changed much. In 1986, U.S. exports reached \$6.065 billion, which was equivalent to 2.9 percent of all U.S. exports to the world. In contrast, U.S. imports from CBI countries have declined steadily in absolute as well as relative terms. They decreased from a high of \$8.764 billion in 1983 (3.4 percent of total U.S. imports) to a low of \$6.065 billion in 1986 (1.6 percent of total U.S. imports). Dividing the CBI countries into different subgroups, however, shows that most of the decline was due to reduced imports of petroleum (see Table 10.2). When the oil-refining countries are excluded, U.S. imports from CBI countries have increased by 25.4 percent since the implementation of the CBI. Nevertheless, this increase was far below the rise in U.S. world imports, which grew by 41.9 percent between 1983 and 1986.

Table 10.2  
U.S. Imports from Designated CBI Countries

	1982	1983	1984	1985	1986	1983-1986 (percentage change)
	(million dollars)					
US world imports	243,951.9	258,047.8	325,725.7	345,275.5	366,063.4	41.9
US imports from CBI countries	7,771.5	8,763.9	8,649.2	6,687.2	6,064.8	-30.8
-Oil-refining countries	4,780.4	5,268.4	4,538.8	2,674.7	1,682.5	-68.1
-Central America	1,647.0	1,848.3	2,044.5	2,095.3	2,466.3	33.4
-Eastern Caribbean	133.6	240.8	297.2	297.6	190.6	-20.8
-Central Caribbean	1,210.5	1,406.4	1,768.8	1,619.6	1,725.2	22.7
US imports from CBI countries excl. oil-refining countries	2,991.1	3,495.5	4,110.4	4,012.5	4,382.3	25.4

Source: U.S. world imports from Department of Commerce, Survey of Current Business, various issues. All other data modified from ITC, Annual Report (Second), p. 4.

The top 10 U.S. imports from CBI beneficiary countries are listed in Table 10.3. Between 1983 and 1986, they accounted for more than 90 percent of total imports. The data show the drastic decline in imports of crude and refined petroleum during this period and the steady increase in imports of agricultural products, apparel, and fishery products.

Table 10.4 shows the decomposition of U.S. imports from designated CBI beneficiary countries according to the different types of duty treatment. The share of imports that entered MFN duty-free increased from 21.7 percent in 1983 to 38.6 percent in 1986. With an absolute decline in imports subject to duty (largely due to the decrease in petroleum imports) and an increase in imports that entered duty-free under the various special access provisions, the share of dutiable imports declined from 64.8 percent in 1983 to 31.2 percent in 1986.

The aggregate figures conceal the diversity among the four subregions of the Caribbean Basin area in the utilization of the different duty-free provisions. That information is provided on a country and subregional level in Table 10.5 for U.S. imports in 1985. On average, the share of MFN duty-free imports in the total imports from Central America was 63 percent, whereas it was 32 percent for the Central Caribbean countries

Table 10.3  
Top 10 U.S. Imports from Designated CBI Beneficiary Countries by Major 2-Digit SIC-Based Group (Customs value, million dollars)

SIC-Based Product Group	1983	1984	1985	1986
01 Agricultural products	1,026.5	1,197.0	1,269.8	1,616.3
13+29 Crude and refined petrol.	5,062.0	4,247.5	2,425.6	1,392.9
23 Apparel	390.2	492.9	643.4	813.7
20 Food products	629.8	712.6	529.4	500.0
28 Chemicals	261.8	360.1	319.8	301.6
09 Fishery products	183.6	212.9	236.0	300.0
36 Electrical machinery	345.0	454.0	351.8	233.2
33 Primary metals	172.1	254.0	210.9	186.7
39 Misc. manufacturers	84.5	104.8	186.1	162.0
Total	8,155.5	8,035.8	6,172.8	5,506.4
Share in total imports (%)	93.1	92.9	92.3	90.8

Source: U.S. Department of Labor, Trade and Employment Effects of the Caribbean Basin Economic Recovery Act, Third Annual Report to the Congress (Prepared by Gregory K. Schoepfle and Clinton R. Shiells), August 1987, from Table 4, p. 75.

Table 10.4  
U.S. Imports from Designated CBI Beneficiary Countries (Customs value, million dollars)

Item	1983	1984	1985	1986
Total	8,763.9	8,649.2	6,687.2	6,064.8
MFN duty-free	1,906.1	2,170.7	2,070.7	2,340.5
Subject to duty	6,857.8	6,478.5	4,616.5	3,724.3
GSP	565.8	592.2	533.5	476.2
CBI	-----	576.0	492.9	670.7
TSUS 806.30/807.00*	519.0	587.5	545.6	611.4
Special Rate Provision	97.8	155.4	82.2	76.2
Dutiable	5,675.3	4,567.5	2,962.3	1,889.8
TSUS 807.00*	746.7	820.3	782.6	872.8
Share in total imports (%)				
MFN duty-free	21.7	25.1	31.0	38.6
GSP	6.5	6.8	8.0	7.9
CBI	---	6.7	7.4	11.1
TSUS 806.30/807.00*	5.9	6.8	8.2	10.1
Dutiable	64.8	52.8	44.3	31.2
TSUS 807.00*	8.5	9.5	11.7	11.4

\*Data for TSUS 806.00/807.00 are adjusted to account for the value of U.S. content. The data for TSUS 807.00 separately include both the dutiable and non-dutiable portion.

Source: Department of Labor, Trade and Employment Effects (Third Annual Report). Data for TSUS 807.00 from Table 9, p. 80. All other data from Table 8, p. 79.

Table 10.5  
U.S. Imports from Designated CBI Beneficiary Countries, 1985

Country	Total Imports (1,000 dollars)	CBI	GSP	True CBI	806.30/ 807.00	MFN duty-free
(as percentage of total imports)						
Central America	2,095,344	9.3	9.5	6.9	8.6	63.1
Belize	46,951	17.9	23.2	17.4	30.6	21.9
Costa Rica	489,294	14.9	10.8	13.9	20.4	48.6
El Salvador	395,658	4.9	8.7	2.5	5.7	68.8
Guatemala	399,617	10.8	12.6	7.5	2.3	64.5
Honduras	370,219	12.2	6.7	7.2	7.9	69.9
Panama	393,605	1.8	6.5	0.4	1.0	72.7
Eastern Caribbean	297,578	6.6	6.1	2.7	31.8	10.2
Antigua	24,695	1.4	4.9		23.3	57.1
Barbados	202,194	5.6	6.8	2.4	34.2	2.6
British Virgin Is.	11,902	0.2	negl	0.2	negl	8.1
Dominica	14,161	2.3	5.5	0.1	1.8	9.1
Grenada	1,309	7.3		0.3	15.6	38.1
Montserrat	3,620	2.7	5.8		39.3	38.1
St. Kitts-Nevis	16,258	33.8	14.0	9.5	39.4	3.6
St. Lucia	13,796	11.6	0.5	11.3	57.1	20.8
St. Vincent	9,643	2.1		1.0	37.0	22.4
Central Caribbean	1,619,560	16.1	12.5	3.9	31.6	31.7
Dominican Rep.	965,847	18.0	13.5	3.6	25.7	35.8
Haiti	386,697	12.0	13.7	1.8	57.2	8.5
Jamaica	267,016	15.1	7.0	8.0	15.5	50.2
Oil-Ref. Count.	2,634,744	0.8	4.3	0.4	negl	7.7
Bahamas	626,084	0.5	13.6	0.3	negl	7.5
Netherlands Ant.	793,162	0.4	0.6	negl	negl	8.7
Trinidad and Tobago	1,255,498	1.3	1.9	0.7		7.1

negl negligible

Blank cells indicate no U.S. imports in that category.

Figures for St. Christopher-Nevis (St. Kitts-Nevis) include data for Anguilla which is not a designated CBI beneficiary country but for which no separate data are available. The data for TSUS items 806.30/807.00 include both the dutiable and non-dutiable portion. True CBI refers to all imports of commodities that entered the U.S. duty-free under CBI and that were not eligible for GSP duty-free treatment.

Source: Data for MFN duty-free from Joseph Pelzman and Gregory K. Schoepfle, "The Impact of the Caribbean Basin Economic Recovery Act on Caribbean Nations Exports and Development" Economic Development and Cultural Change (forthcoming), Table 5. All other data from U.S. Department of Labor, Trade and Employment Effects of the Caribbean Basin Economic Recovery Act, Second Annual Report (prepared by Gregory K. Schoepfle and Clinton R. Shiells), September 1986. Total imports: p. 65; CBI: p. 85; GSP: p. 87; 806.30/807.00: p. 97; True CBI: calculated from Appendix 3.

and 10 and 8 percent for the Eastern Caribbean and oil-refining countries, respectively. In contrast, the share of imports entering under 806.30/807.00 was substantially more important for the Eastern and Central Caribbean than for Central America and the oil-refining countries. Imports entering duty-free under CBI and GSP each accounted for more than 10 percent of total imports only for the Central Caribbean, and they were relatively insignificant for the oil-refining countries.

The total value of imports under CBI in 1985 as shown in Table 10.4 exaggerates CBI's importance to the export earnings of the Caribbean Basin countries, since some of the products imported under CBI also qualify for GSP duty-free treatment. In order to discern the marginal contribution of CBI over GSP, one has to look at those products that were imported under CBI and that were not eligible for GSP. I will call this subset "true CBI imports" in this discussion. In 1985, true CBI imports accounted for 3.4 percent of all U.S. imports from the beneficiary countries. The more disaggregated picture in Table 10.5 shows that the marginal benefit of CBI was largest for the Central American countries, where true CBI imports made up 6.9 percent of total imports. The share for the Central Caribbean, Eastern Caribbean, and oil-refining countries was 3.9, 2.7, and 0.4 percent, respectively. In view of the fact that many imports enter the United States duty-free under the most-favored-nation rule, a better reflection of the importance of true CBI imports is their share in total imports subject to duty (total imports minus MFN duty-free imports). When examining this share, the differential impact of CBI on the various subregions becomes even more pronounced. The share for Central America is 18.7 percent, for the Central Caribbean 5.7 percent, for the Eastern Caribbean 3.0 percent, and for the oil-refining countries 0.4 percent.

These figures reveal the extent to which the different subregions took advantage of the CBI duty-free provisions given the structure of their exports and their ability to reallocate resources toward true CBI products in the short run. The figures do not show, however, the potential impact of CBI on the export *earnings* of the affected countries, since that depends on the previous tariff rates of true CBI imports, the amount of trade involved, the supply elasticities in the exporting countries, and the demand elasticities in the United States. On the basis of the export profile of the designated CBI beneficiary countries in 1983, Pelzman and Schoepfle estimated that due to the tariff elimination for true CBI products, export earnings would increase by \$24.7 million if exports in the CBI countries were restricted at their 1983 level, that is, if export supply elasticities were equal to zero. That is equivalent to 0.3 percent of total export earnings in 1983 and 0.4 percent of all exports subject to duty. If, on the other hand, export supply elasticities are assumed to

be infinite, export revenues would increase between \$164 million (trade diversion) and \$267 million (trade creation). That corresponds to 2.4 and 3.9 percent of exports subject to duty in 1983.<sup>13</sup>

The reasons for this relatively small impact of CBI duty-free provisions are twofold.<sup>14</sup> On the one hand, it is a reflection of the relatively small degree of export diversification in the designated CBI beneficiary countries. And on the other hand, it is the result of the statutory CBI exclusions of some products, especially textiles and apparel, whose tariff rates are high and which are important export items for some of the CBI countries. U.S. imports of apparel not eligible under CBI amounted to \$794.6 million in 1986, an increase of 107 percent over 1983.<sup>15</sup> In contrast, the import value of the most important true CBI products in 1986 were \$121.2 million for meat and meat packing products (SIC 201), \$23.7 million for steel mill products (SIC 331), \$18.5 million for fresh fruit (SIC 017), and \$4 million for vegetables and melons (SIC 016).<sup>16</sup>

On February 20, 1986, President Reagan introduced a new program that would liberalize import quotas on a bilateral basis for CBI countries for imports of apparel and some textiles, if those products are assembled only from U.S.-made and U.S.-cut fabric. By late 1987, the Dominican Republic, Haiti, Jamaica, and Trinidad and Tobago had signed a bilateral textile agreement with the United States under this program. Imports under this provision, known as "super 807," were \$1.3 million in 1986.<sup>17</sup>

Although this chapter focuses on CBI's contribution to the exports and export earnings of the beneficiary countries, it is pertinent to highlight another U.S. policy measure, the allocation of sugar import quotas, which has had a very negative impact on the export revenues of the CBI beneficiary countries. In order to support U.S. domestic sugar production in the face of declining demand, the United States imposed sugar import quotas in 1982, with quota allocations based on U.S. sugar imports between 1975 and 1981. Table 10.6 shows the reduction in allotted quotas for the sugar-exporting CBI countries, which has been particularly severe since 1985. As a result, the value of U.S. imports of sugar, syrups, and molasses (TSUS number 155.20) declined from \$426.8 million in 1984 to \$205.6 million in 1986.<sup>18</sup>

It is ironic that on an aggregate level the small, but nevertheless positive, contribution of CBI to the export earnings of the beneficiary countries has been largely negated by the negative impact of the sugar quotas. The promotion of nontraditional exports clearly aims at reducing the countries' dependence on such traditional export commodities as sugar. However, given the precarious economic situation in many CBI countries and the infrastructural barriers to a rapid increase in the production of nontraditional exports, a forced reduction of their sugar export earnings is hardly desirable in the short run. If the goal of the

Table 10.6  
U.S. Quota Allocations for Sugar Imports (Short tons, raw value)

Country	October 1, 1982- September 25, 1983	September 26, 1983- September 28, 1984	October 1, 1984- November 30, 1985	December 1, 1985- December 31, 1986	January 1, 1987- December 31, 1987
Barbados	19,600	21,294	17,780	12,500	7,500
Belize	30,800	33,462	27,940	18,876	10,010
Costa Rica	42,000	62,415	52,302	34,713	17,583
Dominican Republic	492,800	535,392	447,040	302,016	160,160
El Salvador	72,800	89,163	74,561	50,000	26,020
Guatemala	134,400	146,016	121,190	82,368	43,680
Haiti	16,500	16,776	12,500	12,500	7,500
Honduras	28,000	59,514	50,017	32,713	15,917
Jamaica	30,800	33,462	27,940	18,876	10,010
Panama	81,200	88,218	73,600	49,764	26,390
St. Kitts- Nevis	16,500	16,776	12,500	12,500	7,500
Trinidad- Tobago	19,600	21,294	17,780	12,500	7,500
Total	985,000	1,123,782	935,150	639,326	349,770

Source: Data were provided by the U.S. Department of Agriculture.

U.S. administration is to help Caribbean Basin countries increase their export earnings, then U.S. policies are clearly working at cross-purposes. While CBI aims at promoting nontraditional exports, the sugar import quotas counteract the positive impact on export revenues by drastically reducing the foreign exchange earnings of a key traditional export commodity.

### *CBI and U.S. Capital Flows to Beneficiary Countries*

The previous section demonstrated the short-term impact of CBI due to the one-time elimination of tariffs on products not covered by other preferential market access agreements. The medium- and long-term benefits of CBI will be larger, however, if resources are reallocated and thus exports restructured to take advantage of the additional duty-free provisions. Proponents of the CBI put particular emphasis on these dynamic aspects, since they envisioned that the CBI trade benefits would attract substantial amounts of U.S. private investment to the beneficiary countries, which would speed up the restructuring process.

Apart from the duty-free access to the U.S. market, there are few new incentives to entice U.S. investment into the Caribbean Basin area. The final version of the Caribbean Basin Economic Recovery Act did not include any of the original proposals regarding investment tax credits

and accelerated depreciation allowances. Instead, it provides tax deductions for conventions held by U.S. companies in designated CBI countries. In addition, CBI countries are eligible sites for the establishment of Foreign Sales Corporations, which qualify for special tax treatment. Finally, the Tax Reform Act of 1986 modified Section 936 of the Internal Revenue Code, which grants tax preferences to U.S. corporations operating in Puerto Rico. The modifications provide that "936" funds (the earnings of U.S. corporations qualifying for Section 936 that are held in deposits in Puerto Rican banks) can be lent for investment in a designated CBI country.<sup>19</sup> In the hope of preventing U.S. companies in Puerto Rico from totally relocating their production facilities to CBI countries, the Puerto Rican government has vigorously promoted 936 financing at preferential interest rates and the establishment of twin plants (production sharing between Puerto Rico and a CBI country, where the more labor-intensive parts of a production process would be relocated from Puerto Rico to a CBI country). However, for any of the incentives outlined above to hold, a CBI country has to sign a Tax Information Exchange Agreement (TIEA) with the United States. And by late 1987, only Jamaica, Barbados, Grenada, and St. Lucia had done so.<sup>20</sup> There are a variety of reasons for the reluctance of many countries to sign a TIEA with the United States. They range from nationalistic concerns about loss of sovereignty to the fear of possible harassment over tax evasion of a signatory country's citizens living in the United States.

It is unclear how much U.S. direct foreign investment has actually been undertaken in response to CBI, but preliminary information indicates that it has been rather modest. In mid-1985, the Department of Commerce finished its first survey of U.S. investment projects in designated CBI countries. It identified 285 projects, most of which were attributed to the CBI.<sup>21</sup> These data have since been seriously challenged in a study by the U.S. General Accounting Office, which found that about half of the 285 businesses were not related to CBI trade provisions.<sup>22</sup> Some of them had never opened, some were not exporting to the United States, some were exporting under preferential trade agreements other than CBI, and again others were exporting commodities that were excluded from CBI trade preferences.<sup>23</sup> Some of the country studies in this book provide a more detailed discussion of the nature and implications of specific investment projects.

Despite the lack of quantitative aggregate data, it is possible to draw some preliminary conclusions on the basis of existing qualitative information.<sup>24</sup> A lot of U.S. investment in the area was in the manufacturing of commodities that are only eligible for the duty-free provisions under 806.30 and 807.00 TSUS, especially textiles and apparel. Much of the remaining investment was in areas eligible for GSP as well as CBI. There

were, however, some investments in the production of goods eligible only under CBI, mainly in fresh pineapple (predominantly in the Dominican Republic and Costa Rica), in citrus (Belize), in cut flowers (Costa Rica), and in ethanol (mainly in El Salvador, Costa Rica, and Jamaica). Although only a few investment projects can be attributed directly to the CBI, it is of course possible that in a wider sense CBI was an important stimulus in that all the publicity surrounding it raised U.S. investors' awareness of the Caribbean Basin area as an investment possibility. With respect to production sharing projects between Puerto Rico and a CBI country, it seems that lower wages rather than 936 financing were the main attraction, since most twin plants were established in countries that had not signed a TIEA with the United States.<sup>25</sup>

There are a number of reasons why U.S. investors have not responded more favorably after the implementation of CBI. First, as discussed above, the marginal benefits of the CBI duty-free provisions are rather limited. Second, the attraction of low wages and duty-free access to the U.S. market is often outweighed by the disincentive of weak infrastructure in all its different facets. Third, the political instability—especially in some of the Central American countries—is a definite deterrent to foreign investment. And finally, there is the uncertainty as to whether successful exporting under CBI will evoke unfavorable policy reactions on the part of the U.S. government. Exports that have encountered barriers so far are citrus, ethanol, and cut flowers. The services of the U.S. government-owned Overseas Private Investment Corporation (OPIC) were suspended for investment in citrus projects. With respect to ethanol, legislation was passed in 1986 requiring the key input to come from the Caribbean Basin rather than from the United States, as was the case before. In both cases, the actions were apparently undertaken in response to powerful lobbying by U.S. producers who tried to block increased competition from imports.<sup>26</sup> The most publicized case revolved around charges of unfair trade practices and dumping that were brought against Costa Rica's cut flower exports in 1986 (discussed in detail in Chapter 2).<sup>27</sup> While trading under CBI does not exempt any country from countervailing duties and antidumping charges according to the stipulations of U.S. trade legislation, it seems that the Costa Rican incident has led to increased uncertainty for existing as well as potential exporters. The following statement by A.N.R. Robinson, the prime minister of Trinidad and Tobago, expresses a widely shared sentiment among exporters in the region: "Although the present CBI legislation excludes all of those products in the CBI countries that may be capable of competing with U.S. domestic producers, the few products that the CBI countries do export under the programme face the constant threat of antidumping and counter-vailing duty petitions by U.S. producers."<sup>28</sup>

Most of the factors discussed above that thwart a rapid increase in foreign investment in the CBI countries are of course also inhibiting a forceful commitment to investment for the production of nontraditional exports on the part of the local private sectors in the CBI countries. Domestic capitalists are actually facing a number of additional barriers. On the one hand, the difficult economic situation in many CBI countries does not provide a propitious climate for investment in general, regardless of whether it is primarily directed toward the internal or the international market. On the other hand, the lack of familiarity with U.S. product specifications—especially regarding agricultural products—and with marketing techniques and channels outside the domestic economy provides sizable obstacles for first-time exporters, in particular for the smaller firms that are more strapped for resources.

Irrespective of how much investment has actually taken place, it is important to assess the potential contribution of increased foreign and domestic investment to less dependent development in the countries under consideration. Investment in the production of nontraditional agricultural commodities will be especially beneficial for a reduction of dependence, if land resources are diverted from the cultivation of traditional export products, such as sugar, to more profitable alternatives. The social benefits are more ambiguous, though, if the cultivation of nontraditional agricultural export crops substitutes for domestic food production.

When investment takes place in basic assembly-type production, one has to be careful not to exaggerate the positive effects. While such investments do create employment and generate foreign exchange, they normally create very few linkages with the rest of the economy. The absence of linkages has been noted critically in several case studies in this book (see, for example, the discussion on Costa Rica and Jamaica in Chapters 2 and 8). One indication of the low level of domestic value added in assembly production in CBI countries is the fact that the U.S. content share in imports under TSUS item 807.00 from CBI beneficiary countries was 70 percent in 1986, whereas it was only 17 percent for U.S. 807.00 imports from the rest of the world.<sup>29</sup> The Puerto Rican experience provides its neighbors with a telling lesson regarding the long-term benefits of offshore production. Pantojas-García points out that the development model followed by Puerto Rico since 1947 has been based on practically the same principles that have induced offshore production throughout the Caribbean Basin area. "These principles are (a) abundant cheap labor, (b) tax incentives or tax holidays for foreign investments, (c) duty-free access to the US market, and (d) geographical proximity to the United States."<sup>30</sup> While the Puerto Rican model has been criticized by many scholars for its inability to provide for self-

sustaining economic development, it is noteworthy to see some sections of the U.S. Department of Commerce share this criticism:

Under the present economic structure, Puerto Rico's U.S. subsidiary firms appear to be reduced to only "production units" with a main function of producing most efficiently in terms of minimizing companywide production cost and wastages. The local industries (U.S. subsidiaries) do not emphasize in their operation local purchases of inputs and local distribution and marketing of outputs. They remain dependent on the parent companies who have very little knowledge of the local markets. . . . As a result, most of these firms import their raw materials and export nearly all their production. This limits the potential for both backward and forward linkages, and the industrial process in Puerto Rico is not vertically integrated despite the tremendous increase in industrial output over the past 30 years.<sup>31</sup>

Thus, with respect to the longer-term impact of foreign investment on the development capacity of the economy, host-country governments in the Caribbean Basin areas have to be much more concerned with those types of investment that make more extensive use of domestic inputs beyond cheap and unskilled labor.

In addition to direct U.S. foreign investment in designated CBI countries, capital inflow has also come from U.S. economic assistance. Table 10.7 shows the amounts of U.S. economic assistance to the Caribbean and Central America between 1980 and 1988. It comprises development assistance and economic support funds, which are basically project financing and balance of payments assistance, respectively. Since the inception of CBI in 1984, the level of assistance has differed widely by subregion and country. For the Caribbean as a whole it has evolved around a stagnant trend, whereas for Central America it has fluctuated around a rising trend.

Apart from the heterogeneity of the growth of economic assistance across countries, there are a number of factors that modify the impact of this assistance on furthering the development of the region. First, a lot of the aid has been concentrated on four Central American countries: El Salvador, Honduras, Guatemala, and Costa Rica, with El Salvador clearly heading the list. The special position of El Salvador is highlighted again when the relative importance of economic assistance is measured from the individual country's perspective. In 1986, U.S. economic assistance as a percentage of U.S. imports was 70.2 percent for El Salvador, whereas it was substantially lower for every other country (see Table 10.8). Second, a large percentage of economic assistance has gone for balance of payments support, 59 percent for the Caribbean and 64.2 percent for Central America in 1986. Nevertheless, balance of payments

Table 10.7  
U.S. Economic Assistance to the Caribbean and Central America (1,000 dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988*
Dominican Rep.	34,640	17,393	60,047	35,763	64,346	125,078	66,501	37,500	55,000
Grenada	-----	-----	-----	-----	-----	11,128	-----	-----	-----
Haiti	11,127	9,160	12,015	24,800	25,738	30,721	46,059	66,165	62,000
Jamaica	2,684	53,924	119,409	90,000	87,639	114,560	83,550	39,500	63,600
Carib. Regional	45,183	27,044	50,055	57,000	104,598	46,507	49,275	42,100	46,000
Caribbean	93,634	107,521	241,526	207,563	282,321	327,994	245,385	185,265	226,600
Belize	-----	-----	-----	11,650	3,875	21,650	8,764	9,550	9,300
Costa Rica	13,561	11,475	31,540	144,133	145,470	180,547	131,531	140,490	102,900
El Salvador	52,255	78,245	154,573	170,140	161,370	372,755	260,925	463,646	275,620
Guatemala	7,764	9,135	8,182	38,850	4,491	70,533	84,746	132,088	113,300
Honduras	45,824	25,660	67,967	50,100	70,995	199,333	105,556	177,260	140,362
Panama	1,043	8,639	11,686	10,000	10,720	68,822	24,540	19,334	29,343
ROCAP	4,156	10,598	13,130	28,850	15,458	105,809	25,039	30,021	29,361
Central American Regional	-----	-----	-----	-----	-----	54,648	71,678	25,115	31,914
Central America	124,603	143,752	287,078	453,723	412,379	1,074,097	712,779	997,504	732,100

ROCAP: Regional Office for Central America and Panama

\* Request levels only

Source: Agency for International Development (AID), Congressional Presentation, Annex III, various years.

Table 10.8  
U.S. Economic Assistance to the Caribbean and Central America, 1986

Country	Econ. Ass./ U.S. Imports	Econ. Supp. Funds/ Econ. Assistance	Grant Element (percent)
Dominican Republic	6.3	60.1	83.1
Haiti	12.5	46.3	99.6
Jamaica	28.0	69.4	90.4
Caribbean Regional	N.A.	51.9	96.3
-----			
Caribbean	N.A.	59.0	91.3
Belize	17.5	21.8	82.9
Costa Rica	20.3	91.7	95.2
El Salvador	70.2	67.9	96.9
Guatemala	13.8	56.5	64.8
Honduras	24.5	58.0	85.2
Panama	7.0	23.4	69.5
ROCAP	N.A.	47.9	61.7
Central American Regional	N.A.	58.9	100.0
-----			
Central America	N.A.	64.2	85.5

N.A. not applicable

Source: U.S. imports from U.S. Department of Labor, Trade and Employment Effects (Third Annual Report), Table 2, p. 73. All other data calculated from AID, Congressional Presentation, Fiscal Year 1988, Annex III, Latin America and the Caribbean.

support has obviously made a positive contribution by alleviating the foreign exchange constraint in the short run. Along the same lines, it is noteworthy that the grant element (grants/total economic assistance) in the aid flows has been fairly high for most countries, ranging from a high of 99.6 percent for Haiti to a low of 64.8 percent for Guatemala in 1986. Finally, in view of the wide consensus about the need to reduce the U.S. federal budget deficit, it seems rather likely that economic assistance to the CBI countries, with the possible exception of some of the Central American countries, will decline in the coming years.

### *Conclusions*

An overall evaluation of the contribution of the Caribbean Basin Initiative to nontraditional export growth in the beneficiary countries depends to some extent on one's point of reference. On the one hand, the analysis in this chapter about the benefits from CBI in three areas, primarily nontraditional exports and secondarily foreign investment and economic assistance, leads to the conclusion that the overall impact has been positive but very modest. On the other hand, if the results are measured

against the expectations and standards set by the proponents of CBI in the Reagan administration, the initiative has clearly been a failure.

At the beginning of this chapter it was noted that the Caribbean Basin Economic Recovery Act was motivated primarily by political factors. In the end, the particular motivation for a policy initiative is largely irrelevant, as long as the economic problems of the countries toward which the policies are geared are identified correctly and addressed in a way that makes a valuable contribution to their solution. However, political factors in the wider sense of the word are precisely the key factors that explain the sharp discrepancy between lofty rhetoric about the impact of the CBI and the actual reality. Since CBI is aimed at stimulating nontraditional export growth in the beneficiary countries, it clearly addresses one of their key economic problems—excessive dependence on one or a few traditional export products for the generation of foreign exchange. The impact of such a potentially effective program has been substantially reduced, though, due to U.S. domestic economic-political concerns and in part because of political-ideological factors.

The statutory exclusion of certain products from duty-free access to the U.S. market has limited the potential marginal benefit of CBI. The remaining trade advantages have been attenuated and in some countries possibly even outweighed by the continuous reduction in U.S. sugar import quotas. Both policies, the exclusion of “sensitive” products and the reduction of sugar imports, are a clear reflection of the U.S. administration’s concern with protecting certain domestic industries and constituencies.

Partially in response to these shortcomings, the Caribbean Basin Economic Recovery Expansion Act, H.R. 3101, was introduced in the U.S. Congress in August 1987.<sup>32</sup> The most important elements of the so-called CBI II are an extension of CBI’s duration until the year 2007, less stringent local content requirements for the Eastern Caribbean countries in that up to 25 percent of the local content may be accounted for by U.S. materials, an increase of the sugar quotas to the levels of 1983–1984, and less stringent cumulation procedures in case of injury tests.<sup>33</sup> Furthermore, textiles that are manufactured wholly of U.S.-made inputs would enjoy duty- and quota-free access to the U.S. market under a new tariff item, TSUS 807.50. CBI II would be beneficial for the countries concerned primarily because of the changes regarding injury tests and local content requirements for the Eastern Caribbean. In contrast, the benefits from TSUS 805.50 are severely limited, since local sourcing is excluded by definition. Moreover, it is highly unlikely that sugar import quotas will be restored at a higher level.

In any case, the Expansion Act does not change the overall conceptualization of the original CBI, which is very much a reflection of the

Reagan administration's ideology with an emphasis on free markets and private initiative. The cornerstone of CBI is one-way duty-free trade. While free market access is in general undoubtedly an important factor for nontraditional export growth, it ceases to be a key factor if the situation in the beneficiary countries is such that they cannot take advantage of it. The case studies in this book show that the lack of infrastructure in all its various manifestations is a serious and key impediment to a restructuring of exports in favor of nontraditional commodities. But infrastructural barriers will have to be dealt with by governments and not by the private sector. It is arguable whether and to what extent U.S. policies should address these problems. It is clear, however, that if the United States wants to provide a policy initiative that truly aims at fostering nontraditional export growth in the Caribbean Basin area, it must address them, for they will remain key obstacles to success in this vital area.

### *Notes*

1. In a message to Congress Kennedy proclaimed: "Hemispheric development will require substantial outside resources for economic development, a major self-help effort by the Latin American nations themselves, inter-American cooperation to deal with the problems of economic integration and commodity markets and other measures designed to speed economic growth and improve understanding among the American nations." J.F. Kennedy in a message to Congress March 14, 1961, *Department of State Bulletin* 44 (April 3, 1961): 475.

2. Address before the Organization of American States on February 24, 1982, *Department of State Bulletin* 82 (April 1982): 3.

3. CBI provisions will expire on September 30, 1995.

4. Subcommittee on Oversight of the Committee on Ways and Means, House of Representatives, *Review of the Impact and Effectiveness of the Caribbean Basin Initiative*, 99th Congress, 2nd session, February 25 and 27, 1986, 131.

5. *Business America*, January 7, 1985, p. 5.

6. Public Law 98-67. Section 212 does not list Aruba, which gained independence of the Netherland Antilles in 1986.

7. *Ibid.*, Section 213(b).

8. The U.S. Generalized System of Preferences has been in effect since 1976. Under GSP, the United States grants duty-free entry to the exports of a number of manufactured and semimanufactured commodities by developing countries. The duty-free access extends only up to a certain value for each of the exporting country's products—the competitive needs limit—which is revised periodically.

9. Only five designated beneficiaries had not filed a food production plan as of September 1987: Antigua, Montserrat, Netherland Antilles, Saint Lucia, and Saint Vincent and the Grenadines. U.S. Department of Labor, *Trade and Employment Effects of the Caribbean Basin Economic Recovery Act*, Third Annual

Report to the Congress, prepared by Gregory K. Schoepfle and Clinton R. Shiells, September 1987, 4.

10. Bela Balassa and Carol Balassa, "Industrial Protection in the Developed Countries," *The World Economy* 7 (June 1984): 182.

11. Item 806.30 covers most metallic articles produced in the United States that are exported for processing and then reimported for further processing. Item 807.00 applies to those U.S.-manufactured goods that are assembled abroad and then reimported.

12. Under GSP, 35 percent of the product value has to be produced in the beneficiary country or in several countries, if they are members of a recognized association.

13. Joseph Pelzman and Gregory K. Schoepfle, "The Impact of the Caribbean Basin Economic Recovery Act on Caribbean Nations' Exports and Development," *Economic Development and Cultural Change* 36 (July 1988): 753-796. In the case where export supply elasticities are assumed to be zero, the export earnings of the CBI countries would simply increase by the amount of the forgone U.S. tariff revenue. Under the assumption of perfectly elastic export supply elasticities, the change in export revenues was estimated at the 3-digit SIC level on the basis of the following reduced form equation:  $\Delta M_k = M_k^0 t' n_k$ , where  $M_k^0$  is the 1983 value of dutiable imports by the United States from all CBI countries,  $t' [= \Delta T / (1 + T)]$ , where  $T$  is the tariff rate] is the change in the U.S. import price due to the elimination of the tariff, and  $n_k$  is the elasticity of demand of U.S. imports. With respect to the latter variable, the analysis assumes that the U.S. demand elasticity for a commodity imported from CBI countries is the same as the overall U.S. import demand elasticity for that product.

14. The relatively small impact of CBI on the export earnings of the beneficiary countries certainly supports the argument of the United States to the other Contracting Parties of GATT of asking for a waiver of the nondiscrimination principle for CBI. Part of the reasoning was that "CBERA would not create undue difficulties for the trade of other Contracting Parties." Wolfgang Benedek, "The Caribbean Basin Economic Recovery Act: A New Type of Preference in GATT?" *Journal of World Trade Law* 20 (Jan.-Feb. 1986): 31.

15. U.S. International Trade Commission (ITC), *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers*, Second Report 1986, USITC Publication 2024, September 1987, 11.

16. U.S. Department of Labor, *Trade and Employment Effects* (Third Annual Report), from Table 14, pp. 85-87. Table 14 lists U.S. imports from CBI beneficiary countries by 3-digit SIC-based groups in which imports of CBI-eligible or possibly eligible products grew by at least 25 percent and \$1 million in absolute value since 1983, or where they increased by less than 25 percent but by more than \$5 million.

17. See ITC, *Annual Report* (Second), 9.

18. U.S. Department of Commerce, *Trade and Employment Effects* (Third Annual Report), from Table 6, p. 77.

19. For further details see the U.S. Internal Revenue Code and Jorge R. Gonzalez, "Principal Issues in 936-CBI Financing," Miami Conference on the Caribbean, November 17, 1986, mimeo.

20. For a Foreign Sales Corporation to qualify for special tax treatment, a CBI country can also sign an income tax treaty with the United States, which is less stringent than a TIEA. With respect to the eligibility for 936 funds at preferential interest rates, there are two additional requirements that have to be met: Investments must be in "active business assets" or "development projects," and they must have been approved by the Government Development Bank of Puerto Rico.

21. For a listing of these projects see for example *Business America*, July 22, 1985, 4.

22. U.S. General Accounting Office (GAO), *Caribbean Basin Initiative, Need for More Reliable Data on Business Activity Resulting from the Initiative*, August 1986, GAO/NSIAD-86-201BR.

23. The results of a new survey by the Department of Commerce have not yet been made public at the time of the writing of this chapter.

24. These preliminary conclusions are based primarily on the GAO, *Caribbean Basin Initiative; ITC, Annual Report (Second)*; and Commonwealth of Puerto Rico, Economic Development Administration, "General Information on Puerto Rico's Caribbean Economic Development Program," February 19, 1987, mimeo.

25. Even before 936 financing became available, Gonzalez had pointed out that "it is clear that the great majority of production sharing ventures can be undertaken by 936 corporations and others in Puerto Rico without financing." "Principle Issues in 936-CBI Financing," 3.

The lower wages in some Caribbean Basin countries clearly crystallize as a decisive factor in production sharing projects in the discussion of Commonwealth of Puerto Rico, "General Information." The study describes at length one production sharing example where Westinghouse relocated the production of quicklag breakers from Puerto Rico to the Dominican Republic. It concludes that "by performing the more labor-intensive assembly work at the Dominican plant and the more skilled processes in Aguas Buenas [plant in Puerto Rico], Westinghouse was able to reduce the cost of its end-product by five to seven percent."

26. According to the ITC, *Annual Report (Second)*, p. 22: "The U.S. citrus industry (i.e., Florida and California growers) has mounted political opposition to the tariff concession and effectively blocked U.S. assistance programs such as insurance and other services of OPIC." For a discussion about the change in legislation for ethanol inputs see ITC, *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers*, First Report 1984-85, USITC Publication 1897, September 1986, pp. 4-5 and 4-6.

27. For a detailed description see *Caribbean Action*, Winter 1987. In the end, the United States suspended all proceedings regarding countervailing duties, as Costa Rica voluntarily eliminated a variety of export subsidies for cut flower exporters. The reduction in anti-dumping charges from 27 percent to 0.78 percent in February of 1987 has been contested by U.S. producers of cut flowers.

28. *The Times of the Americas*, 31(Dec. 16, 1987)25, p. 8.

29. U.S. Department of Labor, *Trade and Employment Effects (Third Annual Report)*, 26.

30. Emilio Pantojas-García, "The U.S. Caribbean Basin Initiative and the Puerto Rican Experience: Some Parallels and Lessons," *Latin American Perspectives* 12(Fall 1985): 116.

31. U.S. Department of Commerce (Interagency Task Force), *Economic Study of Puerto Rico*, Vol II (Washington, D.C.: Government Printing Office, 1979), 90, as quoted in Pantojas-García, "The U.S. Caribbean Basin Initiative and the Puerto Rican Experience," pp. 117-118.

32. As of summer 1988, the House Committee on Ways and Means had not completed hearings on H.R. 3101.

33. CBI countries' exports would be exempted from cumulative injury determinations in cases where the ITC was asked to decide on suspension of duty-free treatment of imports due to injury to domestic industries.

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