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CENTRAL AMERICAN COMMON MARKET

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DISSERTATION COMMITTEE

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THE INTEGRATION INDUSTRIES SCHEME OF THE CENTRAL AMERICAN COMMON MARKET

CHAPTER I

INTRODUCTION

During the past decade the concept of economic integration has found an important place in economic theory. The first significant attempt to put this theory into practice was the development of the European Economic Community. This outstanding movement put into play a genuine concern on the part of all countries for the nature and the significance of this new economic phenomenon.

Significant theoretical models have been constructed which demonstrate the possible benefits and defects of integration. Although most analyses have been static in nature, the long-run dynamic effects have also been given consideration. It is evident, however, that almost all contributions have been made against the background of the European movement. Economic integration theory has been approached generally from the point of view of a developed society.

The European movement was looked upon by underdeveloped countries only in terms of the effect which it had upon their own economies. The most unappealing aspect

of the EEC was the common external tariff barrier to outside countries. Given the importance of the European market, it was believed that this could cause exports from Latin America to Europe to decrease considerably.

Consequently, some developing countries responded quickly to the possibility of economic integration among their own economies. The groundwork had been laid for them by economic theoreticians, and a sample of the practical application of the theory was provided by the European movement. However, the potential effects of integration among underdeveloped countries were unclear. There is still a considerable vacuum in economic theory concerning the relevance of economic integration to the developing areas. Little is known about the impact of integration on improving the agricultural output or expanding the industrial base of underdeveloped countries.

In spite of this situation, many of the developing areas have proceeded to experiment with economic integration under the assumption that there are benefits to be gained. One of these movements is taking place in Central America and is called the Central American Common Market (CACM). Consisting of Guatemala, Honduras, El Salvador, Nicaragua, and Costa Rica, this movement is in many respects the most dynamic integration program in today's world. It officially went into operation in 1958 and is currently approaching the fulfillment of all the requirements of a customs union.

This integration program is, in reality, a mechanism to help bring about the development of the Central American region. As one might expect, there is considerable emphasis upon the role that the Common Market can play in building the industrial base. This interest is exemplified by the fact that an industrial agreement was developed simultaneously with the first treaty of economic integration. It is referred to as the Agreement on the Regime of Integration Industries.

Central America maintains a small or practically nonexistent industrial complex. One of the reasons for a lack of growth in this sector is the limited market which any one country possesses. Each of the countries of Central America has a per capita income of less than $400 and a GNP of less than 800 million dollars. Individually, they cannot support an industrial base of any significance.

It is the purpose of the Integration Industries Program to take advantage of the enlarged market resulting from integration. It is believed that new industries will evolve if they can solicit the demand of the entire regional market. This scheme is particularly aimed at developing industries which can incur decreases in per unit costs as output increases. The chances of a large output for individual firms are limited when sales possibilities are dictated by the level of income in each of the respective national territories. Although still small relative to the developed areas, the regional market can magnify

demand considerably. The probability of developing an industrial base is therefore enhanced.

The Integration Industries Scheme is an example of industrial development through the use of economic planning. This development scheme uses regional comparative advantage to determine which countries can most efficiently produce commodities dependent upon a large market. The firms are allocated to different countries on the basis of local resource availability and overall area demand. The number of integration firms existing at any given time is determined by the condition of demand. Because of demand limitations, this number will typically be small.

A firm desiring to become an integration industry must follow specific procedures established by the treaty. Integration firms are accorded special benefits and protections not given to other producers. Also, each firm is subjected to various regulations.

Purpose and Scope

The Integration Industries Program is a unique experiment in industrial development. It has been staunchly supported by the Economic Commission for Latin America in spite of the fact that the United States government has taken a dim view of this particular system (See Chapter V). The Common Market has generally progressed well; yet, integration industries have been slow in coming. In terms of being a stimulus to industrial development, this program has thus far been of negligible importance.

This topic is approached from the point of view of regional integration and its subsequent effect upon economic development. The Integration Industries Scheme provides an opportunity to study a unique experiment in industrial development. Moreover, it constitutes a valid case study of the problems which characterize the use of integration as a tool for industrial development. A coordinated system of economic integration is not easily conceived, especially when development considerations are of extreme importance. Even though a process of regional integration seems to be a reasonable approach to improve development possibilities, it is marked with uncertainty and proves to be an arduous and painful transition. The Integration Industries Scheme reveals the nature and the significance of the problems of regional industrial growth.

A detailed analysis of the Integration Industries Scheme is the major task of this project. Basic to the analysis is the determination of the objectives of the program, including the theoretical considerations which underlie these objectives. One of the important defects of the scheme is its monopolistic character. In this connection, information on the regulatory aspects, as well as the incentive measures, of the program are presented. This is followed by a description of the designation procedures involved in allocating integration industries and a brief history of the scheme during its first years of operation.

Also of particular importance is an analysis of the reasons for the lack of success which has characterized the early years of the program. Through an evaluation of its major problems and a comparison of the Integration Industries Scheme with other regional mechanisms now in use, an attempt is made to ascertain the value of this program in the regional development framework of Central America. Lastly, suggestions are made to improve the implementation and operation of integration industries.

The theory upon which the Integration Industries Scheme is based has not been challenged within an empirical framework. The assumption is made that economic integration increases sales opportunities and that this allows the occurrence of economies of large-scale production. Although this project does not propose to empirically verify this basic theory of integration, some limited information concerning the effect of the Central American Common Market upon the sales and costs of production of one of the integration firms now in operation is presented in Appendix A.

The theme which permeates this paper is necessarily one of industrialization. An assumption is implicitly made that this sector is an important variable in the development process of Central America. Arguments are available which deny that Central America or any other developing area needs to follow policies promoting industrialization. Even though these are of some importance, they are not

considered as relevant to this endeavor. It is assumed, therefore, that Central America needs to expand its industrial base. The Integration Industries Scheme is examined within the context of its importance in fulfilling this goal.

It is further assumed that the most logical approach for a developing country to use in building an industrial complex is that of import substitution. Since the very essence of a common market is dependent upon a common external tariff, it seems reasonable that this policy should be carried over into the industrial sector. Moreover, measurement of the volume of imports is typically the best method available to developing countries for determining the amount of consumer demand for a given product. There are various authors who explain by logical and persuasive reasoning that this approach is not sound development policy. These arguments are not considered in this paper. The only theoretical and practical considerations concerning import substitution which are incorporated within this project are those which deal with the magnitude of the external tariff barrier. That is, a policy of tariff protection in support of infant industries is looked upon as being desirable as long as it is not abused. This abuse begins when the prices of external products are raised out of proportion to the domestic price level.

Procedure

The data and information relevant to this project were collected during a recent field trip to Central America. Numerous interviews were conducted with various officials associated with the Common Market. Also, research was conducted at SIECA, the legal organism of the Common Market; ICAITI, the Institute for Industrial Research and Technology of the Common Market; and ROCAP, the U.S. AID Mission to Central America and Panama.

This project is divided into seven chapters. Like Chapter I, Chapters II and III are introductory in nature. Chapter II consists of a general summary of the theory of economic integration. Important contributions are summarized, and special consideration is given to the determination of the relevance of integration to the developing areas. Chapter III presents an introductory survey of the Central American Common Market. Emphasis is placed on the increase in regional trade, economic growth, and the institutions which have been developed to implement the idea of regionalism.

A history and analysis of the Agreement on the Regime of Integration Industries is the subject of Chapter IV. This includes an examination of the treaty and the subsequent protocols. Information is presented on the goals of the program, the tools of implementation, as well as a brief history of the Integration Industries Program.

Chapter V outlines the major problems which characterize the Integration Industries Program. The particular weaknesses of the scheme are presented with emphasis on the legal bottlenecks and the aspects of control. Other mechanisms to promote industrialization are compared and contrasted with integration industries in Chapter VI. An attempt is made to determine the value of the Integration Industries Scheme as a mechanism to promote industrial growth. Suggestions are made to improve the methods of designating integration industries and the system of regulation. A summary of the study and its major findings are reserved for Chapter VII.

CHAPTER II

THE THEORY OF ECONOMIC INTEGRATION: THE DEVELOPING AREAS

Introduction

Few economists would disagree that free trade would contribute to efficiency in the utilization of resources. It is recognized, however, that maximum efficiency can become a reality only under conditions of pure competition. Market imperfections exist in world markets and within national territories. On a national level, attempts are made to correct imperfections in economic systems through varying degrees of state intervention. Such intervention on a world-wide basis is not likely.

The case for multilateral free trade rests upon the efficiency of the price system, and this mechanism is not perfect. For example, the quantities of a commodity demanded and supplied may not respond to price changes because of rigidities. Also, where competition is imperfect, restrictions in production and distorted prices may result.

Contrariwise, nationalistic policies of protectionism lead to a misallocation of resources. Tariffs

tend to cause higher internal prices than would exist under free trade. These high prices may attract entrepreneurs and bring about a distortion in resource allocation. Although protection is acceptable to most governments, this method of promoting economic growth typically does not lead to efficient production or consumption.

As an alternative to free trade and national protectionism, recent years have witnessed a new development in international trade called economic integration. This is the removal of tariff barriers among countries participating in a regional trading group.

Economic integration is sometimes referred to in the General Theory of the Second Best. "The General Theory of the Second Best states that if one of the Paretian optimum conditions cannot be fulfilled a second best optimum situation is achieved only by departing from all other optimum conditions."[1] That is, if there is introduced into a general equilibrium system a specific constraint which prevents the attainment of the Paretian optimum, the other Paretian conditions are not desirable.

In the case of one form of economic integration called a customs union, tariffs among member countries are removed, but there remains an outside tariff against

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[1]R. G. Lipsey and Calvin Lancaster, "The General Theory of the Second Best," The Review of Economic Studies, XXIV, No. 63 (1956-1957), p. 12.

nonmember countries. Although this does not satisfy all of the Paretian optimum conditions--that is, making all relative prices equal to all rates of transformation in production--it brings about the satisfaction of some of the optimum conditions--that is, making some relative prices equal to some rates of transformation in production. This may have the effect of either increasing or decreasing world trade.[1] A customs union is an application of the negative corollary of the General Theory of the Second Best, which states that nothing can be said *a priori* about the welfare and efficiency aspects of a change which permits the satisfaction of some, but not all, of the Paretian conditions.[2]

The first goal of this chapter is to summarize some of the important theoretical aspects of economic integration. Both the benefits and the drawbacks of the system are considered briefly. In spite of the fact that the applicability of integration to the developing areas is largely unknown, an effort is made to establish the role of integration among such economies. This is accomplished in the background of the most important theoretical contributions in the field of economic integration.

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[1]See Pages 14 and 18.

[2]Lipsey and Lancaster, *op. cit.*, p. 14.

Basic Theory of Economic Integration

Stages of Integration

Countries desiring economic integration actually have several choices open to them. Professor Balassa, one of the leading authorities in this field, has broken integration into five general classifications.[1] The first stage is called the free trade area. This connotates the removal of tariffs and quantitative restrictions between participating countries. Each member maintains its own tariff policy against nonmembers. The second stage is the customs union. In this case, the tariffs against nonmembers are equalized, i.e., a common external tariff wall is established.

The third stage, called a common market, implies that impediments to factor movements, as well as trade restrictions, are removed; that is, labor and capital are allowed to move freely throughout an integration area. The fourth stage of integration, the economic union, includes all of the before-mentioned steps plus a harmonization of national economic policies. The area should, in this case, begin to operate largely as if it were merged into one. Economic policies are not antithetical but, rather, are

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[1]Bela Balassa, The Theory of the Economic Integration (Homewood, Illinois: Richard D. Irwin, Inc., 1961), p. 2.

complementary to the common effort of regional growth. The last and most ideal phase is total economic integration. This not only implies unification of monetary, fiscal, social, and countercyclical policies, but also connotates a supranational authority whose decisions are binding upon member states.

The process of integration is a cumulative one. As countries proceed and are successful at making economic, social, and political harmony between nations more of a reality, the closer do these same nations approach full economic integration. If they are successful at bringing about the elimination of tariffs, they are participating in the most moderate type of integration called a free trade area.

The Benefits of Integration

The impact of economic integration is primarily measured on the basis of production and consumption and must be considered on both static and dynamic levels. Static analysis is concerned with the short-run impact resulting because of the removal of tariffs. The removal of these duties could result in a saving in cost due to a shift in purchases from a higher cost to a lower cost source of supply. For this to occur, the purchase of products must be shifted from national sources to other countries within the integration area.

This effect is best explained through the use of an example. Assume the money costs of producing a particular commodity are 25 dollars for country A, 20 dollars for country B, and 15 dollars for country C. If country A maintains a tariff of 15 dollars per unit, its domestic product will be cheaper than the products of country B or C. However, if countries A and B form a customs union with a common external tariff of 15 dollars per unit, country A should now buy the product from country B for 20 dollars. This price is lower than either A's internal price of 25 dollars or C's price of 30 dollars. (Country C's price is now the sum of the 15-dollar domestic cost and the 15-dollar tariff.) Thus, country A imports from country B a product which was formerly produced domestically. Costs are, therefore, reduced because of purchases from a lower cost source of supply.[1]

Integration can have a similar effect upon consumption. J. E. Meade evaluates the effects of changes in consumption by comparing the ratios of the marginal utilities of products within individual countries in relation to domestic price ratios.[2] In his example, Meade suggests that tariff reductions alter the ratios of marginal utility

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[1]M. O. Clement, Richard Pfister, and Kenneth Rothwell, "The Theory of Customs Unions," Theoretical Issues in International Economics (Boston: Houghton Mifflin, 1967), p. 178.

[2]J. E. Meade, The Theory of Customs Unions (Amsterdam: North Holland Publishing Company, 1955), pp. 44-52.

and prices and, hence, increase living standards. For example, assume that country A produces good X, country B--good Y, and country C--good Z, and that country A maintains a tariff of 10 per cent, country B--20 per cent, and country C--30 per cent. Assume now that countries A and B form a customs union. Before tariffs are removed, the ratio of the price of good Y to good X is greater in country A than in country B; that is, the price of good Y is raised in country A by the 10 per cent duty, and the price of good X is raised in country B by the 20 per cent tariff. When country A removes the duty on good Y, consumption (imports) of Y will probably increase. Therefore, the ratio of the marginal utility of Y to the marginal utility of X is reduced for country A. The favorable consumption effect occurs because consumers are enabled to adjust their consumption to a lower price ratio. The degree to which this ratio is reduced would give some indication of the potential gain in living standards for country A.

Country B will undergo a similar effect for product X; however, the probable contraction of trade between country C and the union members will tend to dampen the consumption gains between countries A and B. The overall significance of the consumption effect will be largely dependent upon the elasticities of demand of union members for each other's goods and by the union members for outside goods. Franz Gehrels suggests that the consumption effect of

economic integration is always positive and leads to an improvement in welfare.[1]

Benefits from integration may also occur because of dynamic considerations. These may accrue due to the shift in demand precipitated by tariff reductions. Firms can increase production efficiency because of large-scale economies. The advantages of a large market were recognized by Adam Smith and have been elaborated on considerably by such contemporary authors as Rodan, Nurkse, and Scitovsky.[2]

If there are, in reality, benefits of large-scale production, increased sales by firms in an integrated area will allow reductions in unit costs over a period of time. This cannot be expected to take place in the very short run; yet, there is every reason to believe that a sufficient time period will bring about more efficient operating conditions.[3] Unfortunately, economic theory is not of much help in assessing the importance of large-scale economies. Empirical studies are incomplete and are subject to

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[1]See Franz Gehrels, "Customs Unions from a Single Country Viewpoint," The Review of Economic Studies, XXIV, No. 1 (1956-1957), pp. 61-64.

[2]For examples, see: Ragnar Nurkse, Problems of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell, 1953), Chapter 1; Tibor Scitovsky, "Two Concepts of External Economies," Journal of Political Economy, LXII (April, 1954), pp. 143-151; and Rosenstein Rodan, "The Problems of Industrialization in Eastern and South Eastern Europe," Economic Journal, LIII (1943), pp. 202-211.

[3]Balassa, op. cit., Chapter 6.

differing interpretations.[1] Additional benefits may result from more intensive competition. The release of tariffs among the countries of an integration area will force firms to compete on a regional level as opposed to a national level. Increased competition will tend to bring about a more efficient utilization of resources.

It is also of importance to note that the overall growth potential of an integration area is enhanced through more investment opportunities. An enlarged market lessens uncertainty and presents a greater attraction to entrepreneurial talent than does the market of a single country.

Integration schemes which have reached the stage of a common market have an additional advantage. The free flow of the factors of production can equalize factor prices. That is, the total output of an integration area is increased with the same volume of inputs when labor and capital move from areas of low marginal productivity to areas of higher marginal productivity. The potentiality for further gains from factor movement is exhausted only after marginal productivities have become equalized in different areas.

Imperfections of Economic Integration

Economic integration may bring about some advantages not possible within national entities. Yet, it must

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[1] Clement, Pfister, and Rothwell, _op. cit._, p. 199.

be conceded that there are defects in integration which lessen the attractiveness of the system. There is little doubt that the biggest question mark in integration theory revolves around the subject of trade diversion versus trade creation.

It has been shown earlier in this chapter that the removal of tariffs may initially result in a positive production effect. Should this occur, it connotates a movement toward a free trade position or a creation of trade--that is, a movement of purchases from a high-cost (national) to a low-cost (regional) source of supply. Jacob Viner has pointed out that economic integration may either bring about trade creation or it may cause trade diversion.[1]

Trade diversion is a shift in purchases from a low-cost to a high-cost source of supply or a shift in consumption from countries external to an integration area to those inside an integration area. To demonstrate this, assume that countries A, B, and C produce a given product and that the respective unit costs are 25 dollars, 20 dollars, and 15 dollars. Assume further that country A has a tariff of 7 dollars. Hence, country A imports the good from country C prior to union formation. Assume now that countries A and B form an integration area with a common external tariff of 7 dollars. Country A will subsequently

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[1]Jacob Viner, The Customs Union Issue (New York: Carnegie Endowment for International Peace, 1950), pp. 46-51.

buy the product from country B at a cost of 20 dollars. Hence, trade is not created but, rather, diverted from country C to country B. Viner maintains that economic integration is desirable only in the case where trade creation is greater than trade diversion.[1]

Although his analysis is completely static in nature, Viner has correctly indicated that economic integration might not lead to an increase in world trade and welfare in spite of the removal of tariffs among member countries. He also elaborates on the complementarity or the competitiveness that exists among the members of an integration area. The greater the competition that exists among the member countries, the more trade will increase as a result of integration. That is, if there is a great deal of overlapping in the range of commodities manufactured and also significant differences in the cost of producing them, the removal of barriers will cause a considerable increase in trade.[2] On the other hand, countries which are complementary in nature will experience a relatively small increase in trade. J. E. Meade states that the trade benefits of integration will be greatest if initially there is competition, but potentially there is complementarity.[3]

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[1] Ibid., p. 46.

[2] Ibid., p. 51.

[3] Meade, op. cit., pp. 25-26.

The issues of trade diversion versus trade creation and competitiveness versus complementarity are basic to the theory of economic integration. In the case of the European Economic Community, there would appear to be net trade creation because there is a good deal of competition among the member countries. Much less clear, however, is the change in world trade to be expected from integration projects among developing economies. That is, the possibilities of a shift in consumption from a national high-cost producer to a regional low-cost source of supply would seem to be much less. For example, individual underdeveloped countries import many industrial goods, most of which are not produced nationally. However, the formation of a customs union, which includes countries engaging in the production of manufactured goods, may cause imports to be diverted from outside sources to countries within the integration area. Such a shift in consumption from outside countries to countries within the region would be trade diversion.[1]

There seems to be little doubt that underdeveloped economies do not have as much to gain from integration as do the developed areas.[2] However, it seems unreasonable

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[1]At least one author has argued for trade creation in developing countries. See Raymond Mikesell, "The Theory of Common Markets as Applied to Regional Trading Arrangements among Developing Economies," International Trade Theory in a Developing World, ed. Roy Harrod and D. C. Hague (London: Macmillan and Co., 1963), pp. 205-229.

[2]See: R. L. Allen, "Integration in Less Developed Areas," Kyklos, XIV, Fasc. 3 (1961), pp. 315-336; and

to generalize that integration movements among developing areas are categorically undesirable because they do not meet the tests of current integration theory. Rather, each program of integration should be closely evaluated not only in terms of static integration theory, but also in terms of overall growth potential on a regional level as opposed to a national level.

A Rationale for Integration among Developing Economies

Although the free trade doctrine is generally adhered to by most economists, the relevance of this theory to the developing areas has been challenged. The principles of free trade have been given rebuttal by such writers as Prebisch and Myrdal.

It is the opinion of these authors that the comparative cost concept is less relevant for developing countries than it is for developed economies. It is argued that the terms of trade have moved against the underdeveloped areas because of Engel's law and an increase in efficiency in the consumption of raw materials. The low price elasticity of demand for primary products coupled with a high income elasticity for industrial goods have caused a deterioration in the export sector of developing economies.[1] Furthermore,

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Gerald Meier, "Effects of a Customs Union on Economic Development," Social and Economic Studies, IX, No. 1 (1960), pp. 29-36.

[1]Raul Prebisch, "The Role of Commercial Policies in Underdeveloped Countries," American Economic Association Proceedings, XLIX, No. 2 (1959), pp. 251-273.

there is a backwash effect resulting from attempts to expand trade. Steadily deteriorating terms of trade tend to attract capital and resources away from nonindustrial areas.[1]

These authors hold that there are no natural laws which tend to pull developing countries out of the so-called vicious circle of poverty. However, each of the countries can pursue individual policies to initiate the development process. One suggested method is import substitution through the vehicle of a protective tariff.[2]

However, national development efforts have also proved unsatisfactory in many cases. Limited markets and resources combine to force a condition of protected inefficiency with little or no real growth taking place. One way to deal with this problem is to correct the restrictive aspects. Economic integration is one alternative approach since this would provide a larger market and make available additional resources. Thus, the development process could be initiated on a regional basis with the protection of a common external tariff.

Deriving Some Criteria for Integration among Less Developed Economies

Integration brings about a more rational pattern of trade and production than could exist on a national level,

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[1]Gunnar Myrdal, Economic Theory and Underdeveloped Regions (London: Duckworth and Co., 1957), Chapter 3.

[2]Prebisch, op. cit., pp. 254-260.

mainly because specialization is extended to a region rather than being oriented toward small narrow markets. Trade diversion may occur, but as R. G. Lipsey indicates, it is not correct to say that trade diversion is bad in all cases.[1] Professor Staffan Linder has given one example in which trade diversion is preferable to trade creation.

> To the extent that it /trade diversion/ consists of diverting the importation of noninput goods away from advanced industrial countries, trade diversion is almost the very essence of the customs union postulated. It enables the concentration of scarce foreign exchange on input imports, thereby enhancing capacity use and growth. The point of issue is not whether the new producer is more or less efficient than the former one. The question is, rather, whether it is not more advantageous to buy a commodity from a new producer than to waste foreign exchange on importation from an advanced country.[2]

If integration allows the concentration of foreign exchange on capital equipment imports, the resulting trade diversionary effect may actually be a desirable phenomenon. Linder refers to this as efficient trade diversion.[3] A customs union among developing economies has, therefore, a strategic attraction. It enables an underdeveloped country to maintain restrictions on noninput imports from industrial

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[1] R. G. Lipsey, "The Theory of Customs Unions: Trade Diversion and Welfare," Economica, XXIV (February, 1957), p. 41.

[2] Staffan B. Linder, "Customs Unions and Economic Development," Latin American Economic Integration, ed. Miguel Wionczek (New York: Frederick Praeger, 1966), pp. 39-40.

[3] Ibid., p. 40.

countries while enjoying the advantages of free trade with other less developed economies.[1]

The current body of integration theory is less applicable to developing countries than it is to developed areas. Although it is important to evaluate all integration movements in terms of integration theory, it also seems reasonable that integration movements in developing areas should be accorded an additional set of criteria. The most pertinent and critical criterion relates to the development of some sort of framework which is conducive to the acceleration of economic growth of less developed countries. If a particular economic integration program can significantly help to bring about the growth and development of its member countries, then there should be a prima facie case for such a movement.

> As regards underdeveloped countries . . . the conventional theory simply misses the basic point. Being designed to explore the problem of optimal allocation of resources, under given conditions of production, within a competitive framework, it cannot illuminate situations, such as those which arise in underdeveloped countries, in which neither resources nor conditions of production can be taken as given, and in which the mobility of factors of production obstructs the operation of market forces . . . . The primary question for any potential grouping of underdeveloped countries is whether discriminatory encouragement of trade with one another would tend to accelerate the rate of growth or not.[2]

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[1] *Ibid.*, p. 38.

[2] Sidney Dell, *A Latin American Common Market?* (London: Oxford University Press, 1966), pp. 16-17.

However, there is much information to be collected and evaluated, as well as many theoretical contributions to be made, before one can concisely formulate the place of integration in the development framework. For example, does integration improve the climate for investment? What is the effect upon the regional balance of payments? What is the magnitude of the enlarged market, and can it be drawn away from the import sector? Will integration bring about economies of scale? Is the absolute volume of foreign exchange available for real capital imports significantly higher or lower?

These are a few criteria which can be used to evaluate integration projects in less developed areas. Because integration is viewed as a tool for development, each of the variables is directed toward the union members and not to the rest of the world. If these, as well as other factors important to the development process, are or may be affected positively, then a movement toward integration in a developing area should be seriously considered.

The efficiency and welfare of world resources should be considered mainly in a dynamic perspective. Even though comparative advantage is a static concept, it is subject to change over a period of time. Comparative costs change with man's ability to use and manipulate resources in a more efficient manner. Thus far, the only economies which have been able to accomplish this to any significant

degree are the United States, West Europe or, more recently, Japan. Economic integration among developing economies offers an opportunity to extend comparative advantage to a regional level. Given a sufficient period of time along with the impetus of the increase in demand, regional specialization hopefully can be extended to an international plateau.

Summary

Economic integration is concerned with geographically discriminatory changes in tariff barriers. It does not bring about a condition of free trade but causes the relaxation of tariffs between the members of an economic union. Integration can consist of several different stages. These stages attempt to delineate the different possible degrees of economic unity. The attainment of each of the successive steps is largely determined by the willingness of member countries to give up national sovereignty.

Economic integration purports to bring about various benefits but also has significant disadvantages. The production and consumption of union members can be positively affected, both on a static and a dynamic level. Moreover, the enlarged market provides a better atmosphere for investment, and the free flow of the factors of production can increase production efficiency of member countries. The main disadvantage of economic union centers around the

initial impact of integration on world trade. Those movements which are characterized by trade diversion as opposed to trade creation are typically considered as undesirable.

Contemporary integration theory appears to have limited applicability to the developing areas. These movements should be considered less in terms of the static effect on world welfare and more in terms of the impetus which they can have on the growth and development of the participating economies. Relevant criteria for integration in developing areas should include such economic factors as the magnitude of the change in demand, the existence of economies of large-scale production, the effect of the union on the regional balance of payments, the attraction of new investment, and the availability of foreign exchange for real capital imports. Very little is known about the impact of integration on economic development, and there is ample room for many theoretical and empirical contributions.

Underdeveloped countries have limitations, both on the demand and supply sides of their economies. Integration constitutes an attempt to stimulate demand and, subsequently, to induce capital formation on a regional level. The impact of integration on world efficiency and welfare should be considered over the long run in a dynamic perspective.

CHAPTER III

THE CENTRAL AMERICAN COMMON MARKET

Introduction

There is perhaps no better example of a need for economic integration among developing countries than in the small Isthmus of Central America. One of the most striking features of these countries is that they are small in virtually all respects. Considered individually, the territorial dimensions of the Central American countries range from 8,000 to 50,000 square miles. The size of the populations varies between 1.5 and 4.5 million people, and the magnitude of purchasing power ranges from 500 million to slightly over one billion dollars.[1] One author states that the achievement of significant economies of scale requires a market of between 10 to 15 million people.[2] No individual country in Central America approaches this figure; yet, when viewed as a unit, the magnitude of the population and total

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[1]Carlos M. Castillo, Growth and Integration in Central America (New York: Frederick Praeger, 1966), p. 71.

[2]E. A. Robinson, (ed.), Economic Consequences of the Size of Nations, Proceedings of Conference held by International Economic Association (London: Macmillan and Co., 1960), pp. xvii-xviii.

purchasing power constitute a more desirable climate for economic development.

The Isthmus of Central America existed as a federal republic after it obtained its independence from Spain in 1821. However, the area was not at that time, nor did it become, economically and politically unified. Due to poor transportation connections and geographic separatism, the federation disintegrated by 1840, dividing into five separate countries including Guatemala, El Salvador, Nicaragua, Honduras, and Costa Rica[1] (See Map 1).

During the period from 1840-1950, each of the countries followed policies supposedly conducive to the development of the individual states. Development proceeded erratically and was marked by considerable instability. Early in the 1950's under the leadership of the Economic Commission for Latin America (ECLA), negotiations began for the reconstruction of Central American unity. These negotiations sought the consolidation of national markets and their gradual formation into a single economic unit.

The goal of the Central American integration plan is the attainment of a common market. It is an example of an attempt to utilize integration as a mechanism for economic development. The goals of the coalition not only center around the release of tariff barriers, but also are

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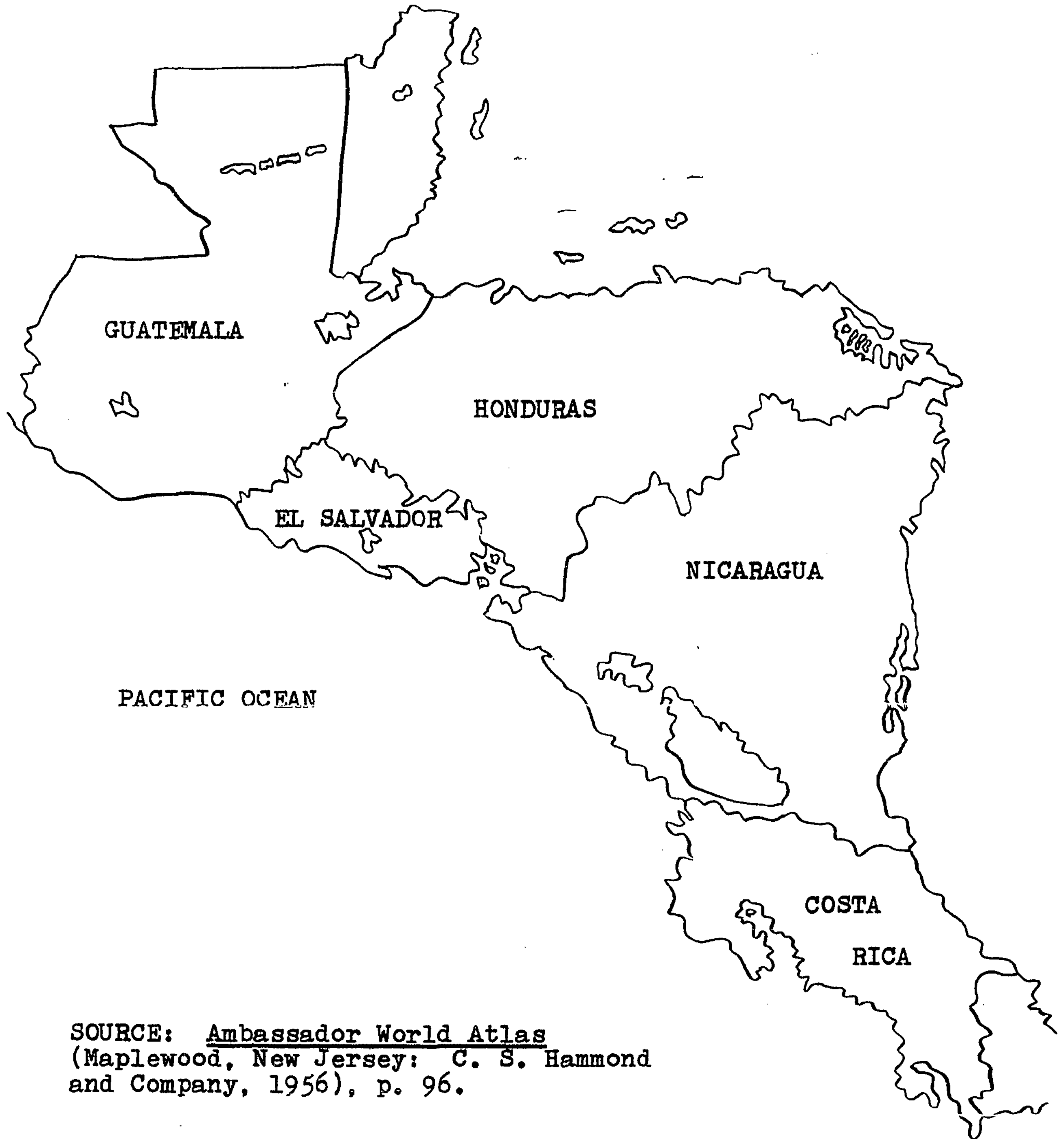
[1]Castillo, op. cit., pp. 1-8.

MAP 1

CENTRAL AMERICA



SOURCE: <u>Ambassador World Atlas</u> (Maplewood, New Jersey: C. S. Hammond and Company, 1956), p. 96.

characterized by various policies and programs specifically aimed at regional growth and development.

This chapter consists of a description and evaluation of this integration scheme. Following a short synopsis of the economy of Central America, information is presented on the institutional framework of the Common Market. The increases in regional trade since the inception of integration are also considered. Emphasis is placed upon the effect of the Common Market on the level of economic activity in each of the member countries and the region as a whole.

The Central American Economy

The majority of the people of the isthmus reside in the southeastern Guatemala highlands, the north coast and interior valleys of Honduras, the Pacific littoral of Nicaragua, the central plateau of Costa Rica, and throughout El Salvador. The Pacific side contains the largest amount of inhabitants and the greatest degree of economic activity. The rate of population growth for the years 1950-1960 of approximately 3.4 per cent is among the highest in the world. Racially, Central Americans are highly varied. One-half of Guatemala's population is Indian. Costa Ricans are unique for their high percentage of Caucasian blood. More generally, the population is mixed Indian-white with traces of Negro blood.[1]

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[1]Guatemala, Permanent Secretariat of the General Treaty of Central American Integration, The Central American Common Market, II (Guatemala, December, 1964), p. 11.

The economy of the area depends upon agriculture much as it did during the Colonial Era. More than two-thirds of the 13 million people gain their livelihood by farming. Agriculture contributes 37 per cent of the gross product and brings in 90 per cent of the export revenue. Three products (bananas, coffee, and cotton) earn over 80 per cent of foreign exchange.[1] These crops are grown on the best land in each of the countries but provide little food for the population. Consequently, the import sector is heavily concentrated with basic consumer staples. In an average year, consumer goods make up more than 50 per cent of total imports. Many parts of the economy exist only on a subsistence level and depend upon the very basic commodities of beans, squash, and maize.

Although there is considerable attention given to its development, the manufacturing sector of Central America is minute. Most industrial goods are imported. In Guatemala, for example, the main industrial activity is food processing although there are a number of small cottage-type manufacturing units. El Salvador is the most industrialized of the group. Its chief industry is cotton textiles. Honduras, the least industrialized country, only employs 6 per cent of the population in this sector. Nicaragua, which is almost as weak, concentrates on food and lumber processing.

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[1]Robert West and John Augelli, Middle America: Its Lands and Peoples (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1966), p. 383.

Although some success has been encountered in Costa Rica, manufacturing accounts for only 13 per cent of GNP. In the central highlands of Costa Rica, there are food-processing plants, textile mills, and shoe and clothing manufacturers.[1]

As a general rule, apart from the relatively widespread handicrafts firms, Central American industry is characterized by small firms producing consumer goods. The limits and subdivisions of the market have hampered growth and economic operations for even small industries with low capital requirements.[2] The incipient stage of industrial development and the low productivity of most agricultural endeavors have combined to bring about a heavy reliance on the foreign sector. The availability of foreign exchange is almost exclusively dependent upon the sales of coffee, bananas, and cotton. Both the inelasticities of demand and supply for these products contribute to the economic instability of the Central American area.

Tables 1 and 2 indicate the absolute and the relative economic positions of each of the member countries. In terms of gross national product, Guatemala is significantly better off than the remaining members. On a per capita

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[1]Ibid., Chapter 13.

[2]Naciones Unidas, Comisión Económica Para America Latina, Comité de Cooperación Económica del Istmo Centroamericano, La Integración Económica de Centroamerica (E/CN.12/422, November, 1956) (New York, 1956), p. 4.

TABLE 1

GROSS NATIONAL PRODUCT FOR FIVE CENTRAL AMERICAN COUNTRIES, ANNUALLY, 1957-1966
(In millions of dollars converted at fixed exchange rates)

Year	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
1957	933.0	530.7	343.5	345.1	352.1
1958	962.0	552.0	358.0	347.4	380.9
1959	983.0	532.8	374.5	351.1	396.5
1960	1010.0	564.4	389.5	355.4	419.9
1961	1031.0	575.2	396.5	378.5	434.1
1962	1080.0	641.6	418.5	412.7	474.6
1963	1200.0	678.0	434.0	466.5	516.8
1964	1311.0	747.6	466.5	513.7	551.5
1965	1316.0	794.4	504.0	570.8	595.1
1966[a]	1379.0	854.0	536.0	---	633.5

[a]Figures for the year 1966 were not available for Nicaragua.

SOURCE: International Monetary Fund, <u>International Financial Statistics</u>, XX, No. 3 (March, 1967); International Monetary Fund, <u>International Financial Statistics</u>, XXI, No. 2 (February, 1968).

TABLE 2

GROSS NATIONAL PRODUCT PER CAPITA FOR FIVE CENTRAL AMERICAN COUNTRIES, ANNUALLY, 1957-1966
(In hundreds of dollars converted at fixed exchange rates)

Year	Guatemala	El Salvador	Honduras	Nicaragua	Costa Rica
1957	270	234	203	263	342
1958	271	237	208	261	352
1959	269	223	208	254	350
1960	265	230	205	251	359
1961	265	228	200	261	356
1962	266	244	202	275	374
1963	287	250	202	303	385
1964	304	265	211	321	397
1965	296	271	221	346	415
1966[a]	301	280	227	---	425

[a]Figures for the year 1966 were not available for Nicaragua.

SOURCE: Adapted from International Monetary Fund, _International Financial Statistics_, XX, No. 3 (March, 1967); International Monetary Fund, _International Financial Statistics_, XXI, No. 2 (February, 1968).

basis, however, Costa Rica is the most advanced economy. Usually, the countries show a small increase each year in GNP. However, none has been able to incur a sustained growth in per capita GNP, except during the last four- to six-year period. In an absolute sense, the level of economic activity in each of the countries is small. In fact, the combined output of the entire region only approximates that of the small country of Israel. The chances for creating a viable economic unit within such small national territories are severely limited.

The Common Market: Background and Organization

The movement toward integration in Central America began in 1951 when various bilateral trade agreements were developed for the purpose of increasing regional trade. In 1952, the Central American Economic Cooperation Committee was created. Its purpose was to undertake a program of gradual and progressive integration of the Central American economy.[1] A significant advancement was made in 1955 when the Central American Research Institute for Industry (ICAITI) was established. ICAITI was conceived in order to promote and foster industrial growth and productivity throughout Central America.[2]

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[1] The Central American Common Market, p. 22.

[2] Central American Research Institute for Industry (Guatemala City: ICAITI, /n.d./).

In 1958, a trade document called the Multilateral Treaty on Free Trade and Central American Integration was signed by Guatemala, El Salvador, Honduras, and Nicaragua. Through this treaty, the member states granted each other free trade of many products originating in the respective national territories. The ultimate objective--a free trade association--was to evolve in ten years.[1]

Also in 1958, the Agreement on the Regime of Integration Industries was devised for the purpose of building large- and medium-sized industries in Central America (See Chapter IV). The idea of industrial growth in the integration area was considered to be equally as important as the free flow of trade. Hence, an industrial agreement arose simultaneously with the removal of tariff duties.

The Multilateral Treaty was superseded by the General Treaty of Economic Integration in 1960. Initially signed by Guatemala, El Salvador, Nicaragua, and Honduras, this agreement was more encompassing than the first treaty. It granted the right of free trade to all Central American products, except those specifically enumerated in the treaty. This meant that 74 per cent of all items listed on the Central American tariff schedule were immediately entitled to free trade.[2] Costa Rica accepted the new treaty in 1963.

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[1]The Central American Common Market, p. 22.

[2]Roger D. Hansen, Central America: Regional Integration and Economic Development, Studies in Development Progress, No. 1 (New York: National Planning Association, October, 1967), p. 27.

The General Treaty also created the main legal institutions of the Common Market. The Economic Council, composed of the ministers of economy, is the final authority for the negotiation of agreements. The Executive Council, consisting of the vice ministers of economy, acts as the working body for all legal considerations. Under the direction of both the Economic and the Executive Councils is the Permanent Secretariat (SIECA). Created in 1961, the Permanent Secretariat acts as the statistical and implementational organ of the General Treaty and handles the technical workload of the higher councils.[1]

The Central American Convention on the Equalization of Import Tariffs was developed in conjunction with the General Treaty. The common external tariff is being negotiated under the auspices of this agreement. Also, the Central American Bank for Economic Integration (CABEI) was formally inaugurated in 1961. This organization was conceived specifically to promote the process of integration. Its leading activities are to be concentrated in five general areas--infrastructure, long-term investment projects, agriculture, structural readjustment, and other activities of regional importance. A capital subscription of 4 million dollars by each of the five member countries provided the bank with its initial assets. In 1964, the U.S. Agency for

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[1] Ibid., p. 26.

International Development announced a loan of 10 million, raising the capitalization of the bank to 26 million dollars.[1]

Also in 1961, in order to encourage intra-Central American trade, a regional clearing house was created. This institution is aimed at facilitating the settlement of inter-country monetary balances arising from trade. Under this arrangement, each central bank is obliged to grant up to $500,000 in automatic credits to other banks in the Common Market.[2]

Thus, the basic foundation for the market was laid during the period from 1958 to 1961. The General Treaty was the prime mover since it provided the framework for integration and paved the way for the addition of other important agreements. Accordingly, Central America witnessed the development of various institutions concerned with regional integration. In this respect, as well as others, the Central American Program has been successful; in fact, it is now the most comprehensive integration movement in the underdeveloped world.

Achievements of the Central American Common Market

Stage of Integration

The Central American movement is referred to as a "common market." Even though one observes the union in this

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[1]Dell, *op. cit.*, p. 26.

[2]Hansen, *op. cit.*, p. 26.

perspective, there is substantial progress yet to be made before the theoretical conditions of a true common market are fulfilled. However, the first stage of integration--the free trade association--has virtually been attained. The moment the General Treaty went into effect, over 74 per cent of all the items listed on the tariff schedule were entitled to free trade. During the next five years (1961-1966), another 20 per cent was released so that approximately 94 per cent of the items of regional trade is exempted from tariff duties.[1]

The level of free intraregional trade is unlikely to reach 100 per cent in the near future. There are certain products which each of the countries will not set loose, either because these products bring in considerable tariff revenue or because the individual countries are determined to protect them from external competition. For example, each of the members is committed to the development of oil refining. Consequently, none of them wants to open these products to free trade since a low-cost producer would drive the less efficient producers out of business.

Central America is equally as close to the level of a customs union. By the end of 1966, uniform external tariffs had been negotiated for nearly 98 per cent of the items on the tariff schedule. This high percentage is somewhat misleading because the remaining items represent about 30

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[1]*Ibid.*, p. 25.

per cent of total imports and between 25 and 45 per cent of total customs revenue.[1] Since the member countries depend heavily on tariffs for government revenue, the remaining 2 per cent of customs duties are likely to be eliminated rather slowly.

Relative to other integration movements, Central America is close to all of the requisites of a customs union. The stage of a common market, however, is not within the immediate realm of possibility. There are, as yet, no regional programs oriented toward encouraging the free flow of the factors of production. The existence of a heavy Indian population and Negro elements in certain parts of Central America will deter factor mobility. As a consequence, Central America is technically not a "common market." It is, in reality, a customs union. Advancements beyond this level are practically inconceivable for at least an additional decade.

Changes in Intraregional Trade

Trade among Central American countries has increased with great rapidity during the first years of the Common Market. Table 3 presents data on regional and total imports for member countries during the period from 1960 to 1965. Column 1 indicates that intraregional trade has increased substantially--in fact, by 316 per cent over the period

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[1]Dell, op. cit., p. 58.

TABLE 3

REGIONAL AND TOTAL IMPORTS OF FIVE CENTRAL AMERICAN COUNTRIES, ANNUALLY, 1960-1965
(In millions of dollars)

Year	(1) Intra-Central American Imports	(2) Total Imports	(3) Per Cent of Intra-Central American Imports to Total Imports
1960	$32.7	$514.2	6.4%
1961	36.8	495.9	7.4
1962	50.8	552.1	9.3
1963	72.1	651.6	10.2
1964	106.4	769.0	13.7
1965	136.0	867.8	15.6

SOURCE: Adapted from Guatemala, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Anuario Estadístico Centroamericano de Comercio Exterior (Guatemala, October 12, 1966), p. 22.

under consideration. The percentage of regional imports to total imports shown in Column 3 also has improved although it is still low.

The most spectacular growth in area trade has been in industrial goods. Industrial trade increased 530 per cent from approximately 15 million to 98 million dollars in five years' time. Agricultural goods increased by 108 per cent or from 16 million to 35 million dollars.[1] The magnitude of the trade increase in Central America has been particularly impressive, especially in industrial goods. Since this change in trade occurred over such a short period of time, it appears that previously idle capacity was placed into operation. The time period was not long enough to significantly augment productive capacity.

Economic Growth in Central America

Since the inception of the Common Market, there has been a noticeable change in the rate of growth of all countries, both on the basis of GNP and GNP per capita. The growth rates brought out in Table 4 verify this phenomenon. This table indicates the growth of GNP and GNP per capita for two separate time periods--1957-1961 and 1962-1966. Since the Common Market was not well underway until 1961, Table 4 should provide some information about the impact of economic integration on the rate of growth.

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[1]Hansen, _op. cit._, p. 34.

TABLE 4

GROWTH RATES OF GNP AND GNP PER CAPITA
FOR FIVE CENTRAL AMERICAN COUNTRIES,
FOUR-YEAR PERIODS, 1957-1966

	Total GNP		GNP Per Capita	
	1957-1961	1962-1966	1957-1961	1962-1966
Guatemala	2.5%	6.2%	-.7%	3.1%
El Salvador	2.0	7.4	-.6	3.5
Honduras	3.6	5.4	-.4	2.8
Nicaragua	2.3	11.0[a]	-.2	8.0[a]
Costa Rica	5.3	7.5	1.0	3.2

[a]Data for 1966 were not available for Nicaragua.

SOURCE: Computed from International Monetary Fund, International Financial Statistics, XXI, No. 2 (February, 1968).

During the period 1957-1961, increases in GNP were registered for each of the countries. However, a translation of these figures into a per capita framework indicates that no positive change occurred, except in the case of Costa Rica. Generally speaking, the growth in output did not quite keep pace with the population.

On the other hand, the figures for the period from 1962-1966 reveal a significant growth rate not only in GNP but also in GNP per capita. All countries, with the exception of Honduras, registered unusually large growth rates. The rate of growth was particularly pronounced for Nicaragua. The integration area easily achieved the Alliance for Progress goal of a 2.5 per cent increase in per capita income. Moreover, this was accomplished in spite of a population growth rate of 3.4 per cent, which, incidently, surpasses by a considerable margin the Latin American average of 2.8 per cent.

Foreign private investment has noticeably increased since the development of the Common Market. Table 5 attempts to show the impact of the Common Market on foreign private investment by presenting investment figures for selected years before and after the incidence of economic integration.

According to International Monetary Fund statistics, the investment inflow into the Common Market changed substantially after 1960, more than doubling between 1962 and 1965. The percentage of foreign private investment to total

TABLE 5

FOREIGN PRIVATE INVESTMENT IN CENTRAL AMERICA,
SELECTED YEARS, 1956-1966
(In millions of dollars)

	1956	1958	1960	1962	1964	1965	1966
Guatemala	10.9	17.2	19.4	16.7	39.6	42.8	5.8
El Salvador	-1.3	5.7	9.6	12.1	27.8	17.3	14.8
Honduras	-.6	-.7	-7.9	2.9	7.6	11.1	6.6
Nicaragua	.2	.7	.8	2.4	2.3	3.7	2.8
Costa Rica	.6	.6	.7	3.2	2.0	5.0	4.3
Total	9.8	22.3	22.6	37.3	79.3	79.9	34.3
Per Cent of Total Private Investment[a]	---	7.5%	7.3%	11.9%	18.1%	16.4%	---

[a]Insufficient data for the years 1956 and 1966.

SOURCE: Adapted from International Monetary Fund, International Financial Statistics, XX, No. 12 (December, 1967); International Monetary Fund, International Financial Statistics, XXI, No. 4 (April, 1968).

private investment also improved, increasing from 7.5 per cent in 1958 to 16.4 per cent in 1965. It reached a peak of 18.1 per cent in 1964.

Individual country figures reveal that Guatemala and El Salvador have been the most successful in attracting foreign capital. These countries have the largest industrial complexes and the largest markets of Central America. Significant increases were also experienced by each of the remaining countries. However, foreign investment for the year 1966 perceptibly decreased. This is almost entirely due to the reduction in the case of Guatemala. Increased political uncertainty in this country may have been a factor in the decline.

The Central American Bank for Economic Integration has also helped to increase economic activity. During 1961-1967, the bank approved a total loan volume of 92.0 million dollars. Of this amount, 42.8 million was used for industrial investment and 33.4 million for infrastructure projects.[1]

During the years in which the Common Market has been in effect, the level of economic activity has noticeably increased in Central America. It is not possible to attribute all of this growth directly to the integration program. Yet, it seems reasonable to conclude that during 1960-1966,

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[1]Secretaría Permanente del Tratado General de Integración Económica Centroamericana, Carta Informativa, A Monthly Report Prepared by SIECA, No. 66 (Guatemala City: SIECA, April 12, 1967), pp. 25-26.

the Common Market has acted as a stimulus to economic advancement.[1] In spite of this success, it is too early to offer definitive judgments on the effect of integration on economic growth and development. The next five- to seven-year period should permit a more tangible statement about a possible cause-and-effect relationship between integration and growth in Central America.

Summary

Central America has historically based its economic livelihood upon the exports of coffee, cotton, and bananas. The Central American economy is characterized by a small industrial complex and a large dependence upon subsistence agriculture. In certain areas of the isthmus, there is considerable population pressure although, in terms of total available land, the absolute number of people is not excessive.

Since World War II, most of the countries have attempted to develop internally through import substitution. However, early in the 1950's, economic separatism began to give way to economic integration. Integration first became a reality in 1958, but only on a limited basis. The General Treaty for Economic Integration, signed in 1960,

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[1]Early reports indicate that Central America has encountered problems during 1966-1967. Growth rates have slowed, and there is a regional balance-of-payments deficit. See "Central American Common Market," World Business (January, 1968), pp. 14-16.

actually constitutes the implementational tool for a far reaching program of integration among the five member countries.

The development of the institutional framework closely pursued the integration movement. This includes such organizations as the Permanent Secretariat (SIECA), the research organ (ICAITI), the Central American Bank for Economic Integration (CABEI), and a regional clearing house to finance trade among Common Market countries.

The integration scheme has reached the stage of a customs union. A high percentage of trade is not subject to restrictions, and the common external tariff is near completion. The first years of integration were marked by an impressive increase in regional trade. From 1960-1965 trade increased 316 per cent, the largest change taking place in industrial goods. During the same period, the growth of the region progressed well, both on the basis of GNP and GNP per capita. Nicaragua led all other countries with a growth in GNP of 11.0 per cent and GNP per capita of 8.0 per cent. There was also a noticeable increase in the inflow of capital from abroad.

Overall, it appears that the integration movement has been instrumental in bringing about a more conducive atmosphere for economic development. However, the full impact of integration upon the Central American economy will not be known for a number of years.

CHAPTER IV

AN ANALYSIS AND HISTORY OF THE INTEGRATION INDUSTRIES SCHEME

Introduction

The success of the Common Market during its early years of operation has brought about a tendency to neglect the less effective portions of the integration movement. It is misleading to give the impression that the idea of regional growth is firmly imbedded in the Central American economy. It is, in fact, true that the Common Market is permeated with conflicts of interest. Individual countries do not tend to stress the growth of the region but rather the progress which takes place within the respective national territories. Numerous documents have given considerable publicity to the accomplishments of the Common Market. Much less investigation has probed those areas which have met with difficulty.

One of the main problems which characterizes integration in less developed areas is reciprocity and balanced development. In Central America, this is particularly apparent in "regional" efforts to promote industrialization. Although national development programs have attracted

significant small-scale industrial activity, especially in the cases of Guatemala and El Salvador, regional endeavors have met with little tangible success. One of the weakest elements in the regional framework is the Integration Industries Scheme.

A basic description and analysis of the theoretical and practical aspects of this scheme is the major objective of this chapter. Information on the goals of the program, the designation process, and the regulatory process is presented. Also presented is a historical survey of the scheme during the period from 1958-1967.

Agreement on the Regime of Integration Industries[1]

In order to develop a program of industrialization in Central America to supplement the trade movement, the five member countries began early negotiations to derive an agreement or treaty to begin to expand the industrial base. All of the members were concerned about the low level of industrial activity in the Central American area. The internal structure of industry registered few significant changes over the preceding decades and continued to rest

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[1]The concept of integration "industries" is somewhat misleading. Technically, these are integration plants or, at best, integration firms. It is true that these plants or firms will often constitute the industry. For that reason, the terms "industry," "firm," and "plant" will be used interchangeably in this study.

mainly upon a few traditional activities--food, beverages, tobacco, clothing, textiles, wood, and furniture.[1]

A successful program of industrialization is partially dependent upon large internal markets. Industry flourishes the most wherever consumption of industrial goods is maintained at a high level. The countries of Central America have definite demand limitations within each of their internal markets. This factor has been stressed considerably by ECLA. The Commission believes, however, that the entire Central American area could conceivably be large enough to merit a movement toward industrialization. It was with this factor in mind that ECLA proposed what it refers to as "industrias integradas" or integrated industries.[2]

On June 10, 1958, the governments of Central America drew up the Integration Industries Treaty. This treaty turned out to be a simplified draft which set forth the principles which were to guide Central American industrial

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[1]Economic Commission for Latin America, "Central America: Industrial Policy Problems," Economic Bulletin for Latin America, IX, No. 1 (1964), p. 119.

[2]Although used often in literature, the phrase "integrated" industries is technically not correct. The industries in question are not integrated in the usual sense of the word, either vertically or horizontally. They are instead merely "integration" industries which simply connotates industries which operate under the privileges of the treaty. The fact that they are referred to in the treaty as "industrias de integración" rather than "industrias integradas" confirms this interpretation. Henceforth, the author shall use the more correct usage.

integration. The development of specific industries to be incorporated under the scheme was to be determined on an individual basis and would be the subject of additional protocols.

Theoretical Considerations of the Treaty

The basic motif of this treaty centers around Article II, which states:

> Central American integration industries shall be considered to be those industries which, in the criteria of the Central American Commission for Industrial Integration, are comprised of one or more plants, the minimum capacity of which requires access to the Central American Market in order to operate under reasonably economic and competitive conditions.[1]

This article contains the basic theory which permeates the entire treaty. This is not a new and unexpected development of integration theory but rather is a direct attempt to apply one of the most important benefits to be gained from any economic integration movement--namely, the advantages of the increased size of a market. Many industries, even of a medium-sized nature, cannot attract sufficient demand to become efficient within the confines of any one of the Central American countries. On the other hand, the combined demand of all five countries provides a better possibility for increasing sales and bringing about

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[1]Guatemala, Agency for International Development, ROCAP, Regional Office for Central America and Panama, Economic Integration Treaties of Central America (Guatemala, 1966), Article II, p. 21, "The Agreement on the Regime of Central American Integrated Industries."

economies of large-scale production. The lowering of per unit costs, in theory, would allow a reasonable profit margin and, subsequently, lower prices for consumers.

Some aspects of the preceding quotation are not sufficiently clear. Although the incidence of lower prices is implicit in such a theory and is of much concern to economists, one is really not sure that the officials were considering this possibility, especially in view of a permanent common tariff to the outside[1] and the typical reluctance of firms to lower product prices.

The addition of the word "competitive" in the last line of the quotation is also confusing. Apparently, this refers to outside competition because the agreement calls for, at least initially, one plant to operate within the confines of the entire market. If so, it assumes that the external tariff will not be too high to completely discourage foreign competition.

Also fundamental to the theory supporting integration industries is an efficient utilization of the limited resources available in Central America. According to ECLA, the creation of integration industries will avoid duplication of investments and unutilized capacity.[2] This connotates a

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[1]Ibid., Art. III, p. 22.

[2]Joseph Pincus, El Mercado Común Centroamericano (Guatemala: Agencia Para Desarrollo Internacional, Oficina Regional Para Asuntos de Centroamerica y Panama [ROCAP], June, 1963), p. 39.

complementary growth of the industrial base and an efficient use of existing resources as opposed to an excessive number of firms producing similar products with none of them being able to operate at full capacity. It is argued that one plant is often all that is needed and, indeed, all that the Common Market can support.

This is a detailed and purposeful attempt at planned industrial development. It proposes to promote industry on a firm-by-firm basis in accordance with production possibilities and regional demand. In addition, it is characterized by balanced industrial development; that is, integration plants are to be evenly allocated among all countries. In fact, a temporary article is written into the treaty which states that a second plant cannot be designated to any one country until all of the other members have received at least one integration plant.[1] This restrictive clause was no doubt founded on the fear of Nicaragua and Honduras that most of the integration plants would be located in the more industrialized areas of Guatemala and El Salvador.

The treaty does not list the products which fall into the realm of integration industries. Studies of ECLA, however, state that there are mainly eleven areas of interest. These are petroleum refining, fertilizers, insecticides, pharmaceutical products, tires and tubes, paints,

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[1] Economic Integration Treaties of Central America, p. 25.

ceramics and glass products, plastics, fish products, cotton products, and wood products.[1]

Integration industries are established regional monopolies protected from external competition. The Integration Industries Scheme is, therefore, subject to all the abuses which can result from market power. These potential abuses have influenced the attitude of the United States government toward the Integration Industries Scheme. The U.S. has made it clear that it does not support a program which has such direct monopolistic inclinations.[2]

The Economic Commission for Latin America, as well as the member countries, realize the monopolistic character of this program. It is for this reason that the benefits and regulations associated with the scheme are spelled out in each of the protocols designating integration industries.

Benefits of Integration Industries

In order to make this program attractive to prospective investors, the Integration Industries Agreement stipulated various advantages which would be available to those firms operating under the auspices of this system.

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[1]Pincus, op. cit., p. 40.

[2]Representative Martha W. Griffiths, Economic Policies and Programs in Middle America, A Report to the Subcommittee on Inter-American Economic Relationships of the Joint Economic Committee (Washington, D.C.: U.S. Government Printing Office, 1963), p. 26.

Tariff protection against imports. In Central America, as in most developing areas, the most popular route of industrialization is through import substitution. Each individual country of Central America has been very careful to protect its infant industries. Integration industries also operate along the lines of import substitution; that is, protection from outside competition is provided not only in the country of origin but throughout the entire Central American market.[1] The products of the integration plant are allowed to flow to the other Central American countries without an intraregional tariff barrier, and they also receive the protection of a common tariff to the outside. This is in agreement with the so-called theory of customs unions.

Protection from competition within the Common Market. There exists the possibility that certain of the individual countries may have sufficient markets to attract the development of industries which are competitive with an integration industry. The Common Market cannot dictate the actions taken on a national level to promote economic development.

The entry of competitive firms would be unlikely after an integration firm absorbed regional demand and enhanced production efficiency. However, such an occurrence

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[1]Guatemala, Agency for International Development, ROCAP, Regional Office for Central America and Panama, _Economic Integration Treaties of Central America_ (Guatemala, 1966), Article XXVI, p. 33, "Protocol to the Agreement on the Regime of Central American Integration Industries."

is possible before a firm becomes well established in the Common Market.[1] In the event that this does occur, the Integration Industries Agreement provides for a special system which benefits the integration firm. That is, integration industries are granted tariff protection from competitive firms producing within the Common Market. However, the tariff on such products is to be reduced by 10 per cent each year. Hence, competitive products would be subject to free trade after a period of ten years.[2]

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[1]This possibility has become a reality in the case of tires and tubes (See Page 80).

[2]"Protocol to the Agreement on the Regime of Central American Integration Industries," op. cit., Art. III, p. 27. Close analysis of the preceding benefit will reveal a conflict between the existence of integration industries and regional free trade. The granting of free trade privileges to the products of integration plants is an extension of the trade movement. Yet, it is also true that products of a competitive nature would be delayed in increments for a period of ten years. It is, therefore, possible that the Integration Industries Agreement could be a restrictive influence on free trade. In view of this, Article I of the first protocol states that:

> The benefits of the Convention on the System of Central American Integration Industries will not restrict or limit the commercial interchange taking place under the protection of the General Treaty of Central American Economic Integration.

This has the effect of preventing those firms producing products already subject to free trade from becoming integration industries. As a consequence, integration industries will mostly constitute new products which have not been accepted for free trade or which have been accepted but have never been traded. This does not present an extreme difficulty because there are certainly many industries which are not yet established in Central America. See Andrew Wardlaw, "The Operations of the Central American Common Market," (unpublished report, Agency for International Development, Washington, D.C., August, 1966), pp. 59-60. (Mimeographed.)

Protection against dumping. In the event that unfair practices develop among foreign exporters of competitive products, such as selling at prices lower than normal or lower than regular prices on the international market, the integration firms are protected by the suspension of all imports which are engaged in these practices.[1]

Imports of raw materials. Another important advantage of the integration industries is found in Article VI of the first protocol. Integration plants are to enjoy, for a period of ten years, total exemption of duties on the importation of raw materials and intermediate products utilized in the production of the commodities which have integration status.[2] Since many production inputs are imported by developing economies, this factor is not of insignificant importance in lowering production costs. It is understood, however, that the integration plants are to use Central American materials if and when these are available. Although this clause is not to be found in writing anywhere in the treaty or its protocols, it is apparently implicitly assumed that firms will use Central American products whenever possible.

Article VI further provides that integration plants are to be exempt from taxes on production or consumption of

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[1]"Protocol to the Agreement on the Regime of Central American Integration Industries," op. cit., Art. VIII, p. 27.

[2]Ibid., Art. VI, p. 27.

imported raw materials or intermediate products.[1] If national governments have separate laws with respect to these taxes, the integration industries are to be reimbursed for any amount paid. The Central American Agreement on Fiscal Incentives, which has not as yet gone into effect, has similar privileges for new plants, but even this liberal document allows similar exemptions for a period of only five years.

The benefits received by a firm operating under the Integration Industries Scheme are seemingly more than enough to attract many entrepreneurs. If one adds to this the fact that each integration industry is, at least temporarily, an ordained monopoly, this scheme should prove attractive to prospective investors. However, the proponents of this program realize the significant market power which could be exerted by an integration industry. As a result, the protocols, in addition to listing the advantages of the integration industries, also postulate a number of special requirements and restrictions--many of which make the program less attractive.

Obligations of Integration Industries

Initial plant capacity. One of the main benefits of the Integration Industries Scheme centers around the availability of the entire market for integration firms.

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[1] *Ibid.*

Equally as important is the fact that these firms should have the minimum capacity to satisfy the demand of all Central American countries. With this in mind, each of the protocols stipulates a minimum capacity for the integration plants. The determination of this capacity is to be based upon the total demand for a given product as determined by the historical volume of imports by Common Market countries. For example, the minimum annual capacity of the caustic soda and chlorated insecticides industry in Nicaragua is 4,700 metric tons of caustic soda and 2,700 metric tons of chlorated camphene insecticides.[1] The tire and tube industry of Guatemala is to have a yearly capacity of 225,000 tires and 180,000 tubes.[2] If the firms cannot satisfy the regional demand, the Executive Council--the main legislative body of the Common Market--can authorize enough imports to supply the needs of the area.

Initial capitalization. Since the contracting states prefer that integration firms do not become dominated by foreign companies, restrictions are placed upon the ownership of the capital of integration firms. The caustic soda and chlorated insecticides industry, for example, was forced to offer at least 40 per cent of its

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[1]Ibid., Art. XIV, p. 29.

[2]Ibid., Art. XXII, p. 32.

stock to Central American investors.[1] In like manner, each of the protocols dictates the amount of capitalization and the minimum Central American participation.

Price controls. Price controls are perhaps the most crucial form of regulation written into the treaty. Logically, these controls must be implemented plant by plant and product by product. Periodic studies must be undertaken to determine the level of prices. In the case of tires and tubes, Article XXV states that the final selling price to the consumer shall in no case exceed the lowest list price in effect as of December 1, 1962.[2] Of course, it is not enough to set up requirements. Studies must follow to check adherence to the regulations. This requires time and considerable resources.

Also, should economies of scale be experienced by an integration firm, one cannot expect that it will kindly respond by lowering its prices. Therefore, studies of costs of production need to be undertaken to determine the feasibility of price decreases. The treaty leaves this point open when it states that:

> The Executive Council, through its Secretariat, shall be responsible for insuring the correct application of the foregoing provisions and for authorizing, as appropriate, such modifications in prices as considered advisable, due to fluctuations in production costs.[3]

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[1] *Ibid.*, Art. XIII, p. 28. [2] *Ibid.*, Art. XXV, p. 32.

[3] *Ibid.*, Art. XVII, p. 29.

It is unclear whether or not this article is specifically concerned with economies of scale. The fact that the word "fluctuation" is used suggests that costs, on a per unit basis, may either go up or down and that prices should be adjusted accordingly.

Quality controls. The products of integration plants are to fulfill quality norms to be formulated by the Research Institute (ICAITI) and approved by the Executive Council. If it is decided that the quality of the products of integration plants does not meet the standards of similar imported products, the Executive Council shall determine the measures which should be taken.[1] The likely action of the Executive Council would be the authorization of imports at low tariff rates.

Distribution and supply of products. In order to prevent a monopoly over product distribution, the treaty states that the proprietors of integration plants shall not be permitted to act as retail distributors of the products specifically covered by the scheme. Integration plants are obligated to fill all orders formulated by distributors.[2] For example, as a guarantee for an adequate and constant supply of tires and tubes, this plant is required to maintain on the market of the five member countries stocks which are the equivalent of two-months demand.

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[1] *Ibid.*, Art. IV, p. 27.

[2] *Ibid.*, Art. VII, p. 27.

Additional factors restricting monopoly power. A potentially limiting factor with respect to monopoly may result because the Executive Council can, by a majority vote, designate a second plant as an integration industry provided that this plant offers 60 per cent of its capital to Central American investors.[1] Of course, one additional plant does not, by any means, guarantee effective competition.

Another limitation on monopoly may evolve because the scheme does not preclude the establishment of a competitive plant at the national level. Such a firm could not operate tariff free in the Common Market for a period of ten years, but it could gain national protection from outside competition and compete with the products of the integration plant on a national basis. In addition, this firm would not be subject to the various regulations concerning integration industries.

In most instances, however, this would seem to be an unlikely occurrence. That is, if the original regional monopoly expands its scale of operations and absorbs the market, an additional firm should not be able to economically exist. Moreover, if this should occur in a short period of time, it would be in direct opposition to a basic premise of the Integration Industries Scheme. That is, if

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[1] Ibid., Art. XXVII, p. 33.

a firm can compete on a national scale with a plant of integration, there is really no need to have an integration industry since, by definition, such firms need the entire regional market in order to incur sufficient sales and, thereby, create reasonably efficient operating conditions.

In summary, it cannot be denied that the benefits to be received by integration industries are substantial. Yet, regulations and controls are also extensive in number and degree. These conceivably could lessen the number of applications. In this program an additional factor is of importance. It is the procedure which must be followed by industries seeking integration status. Unfortunately, this designation process is long, cumbersome, and filled with uncertainties.

Designation Procedures[1]

Initial application. To obtain integration status, firms must first apply to the Permanent Secretariat (SIECA), either individually or in conjunction with their national governments. Typically, this preliminary report is enacted through the national government because of the added prestige and also because support by the national government may have some bearing upon the final result of the

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[1]This information was gained through an interview by the author with Dr. Guillermo Noriega Morales, Head of the Industrial Department of the Permanent Secretariat and also by studying various unpublished proposals printed by the Permanent Secretariat.

application. The preliminary report is often very detailed, spelling out the conditions of demand, probable costs involved, and the amount and source of the initial capitalization of the firm. The Permanent Secretariat makes a preliminary study of the application, making certain that the proposal is economically feasible and desirable.

Executive Council. If the Permanent Secretariat deems the project as acceptable, it is passed on to the Executive Council. This council, which meets approximately once each month, makes a preliminary decision concerning the desirability of the proposed project. However, since this council concerns itself with virtually all important matters of the Common Market, this decision may take two to three months, if not longer.

Research by ICAITI. When the Executive Council approves the application, it asks the Research Institute (ICAITI) to conduct a study of the project. ICAITI examines the economic feasibility of the project on a technical basis. It estimates the total import demand for the product at the time of the application and also makes projections of future demand. Many studies for various products have already been accomplished by ICAITI. It is possible that any given study might have been carried out before ICAITI receives the request. However, in the event that research must begin from scratch, the study could take as long as one year. The applications for integration status sometimes contain their own estimates of internal demand.

Drafting the protocol. A report is submitted by the Research Institute to the Permanent Secretariat (SIECA). SIECA, in turn, examines this report and prepares a statement which typically recommends the project, stipulating any reservations which it might have. Both reports are then resubmitted to the Executive Council. The council discusses these statements in detail. If it can agree on the location of the plant, a protocol is drawn up.

Ratification of the protocol. When and if the Executive Council drafts the protocol, it generally recommends that the document be signed by the Economic Council. The Economic Council--the highest official Market organism composed of the Ministers of Economic Affairs of the member countries--usually signs the agreement without a great deal of consideration. Thus far at least, the Economic Council has not been a significant bottleneck in the legal apparatus.

Unfortunately, this is not the final step of the ratification procedure. Copies of the protocol must be sent to each of the member countries of the Common Market. It is here that regional politics begins to play a significant role. The protocol cannot go into effect until at least three of the contracting members have officially deposited their ratification at the Office of the Permanent Secretariat. As soon as three of the countries ratify the agreement, the firm can begin operations, but only in those countries which ratified the agreement.

There is a dispute now in process concerning whether or not a declared integration industry can operate tariff free in the nonsigning countries. Although it has been legally decided that declared integration industries have the right of free trade in all countries,[1] this action has not, as yet, been enforced and most likely will not be since there is no means to make such a decision compulsory.

Historical Survey of the Integration Industries Scheme

The Integration Industries Scheme was developed with the expectation that it would provide a driving force for medium- and large-scale industrialization in Central America. Its achievements to date do not confirm these expectations. The tangible results provided by the system, as measured from the years 1958 to 1967, have been limited.

One could perhaps predict a major source of the bottlenecks involved in this program while reading the first portion of this chapter. The legal and institutional restrictions which were incorporated within the scheme are important influences on its implementation. An examination of the history of this mechanism bears out their importance.

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[1]Honduras, Consejo Ejecutivo, Vigesimonovena Reunión, septiembre 17-23, 1967, Secretaria Permanente de Tratado General de Integración Económica Centroamericana, _Memorandum de la Sección Jurídica sobre la Opinión sobre si las Llantas y Neumáticos Fabricados por Ginsa Tienen Derecho al Libre Comercio en Honduras_ (SIECA/CE-XXIX/D.T.21, September 2, 1967) (Guatemala, 1967), pp. 1-3.

During the embryonic years of the integration movement, a program of industrialization was uppermost in the plans of the member countries. In spite of this zeal, the final draft of the Integration Industries Treaty was something less than had been envisioned by the Economic Commission for Latin America. Rather than being an inclusive document which was applicable to all industries, it only consisted of a small number of basic principles which were to guide Central American industrial integration.[1]

It became apparent that the original Integration Industries Treaty would have little or no real meaning in the implementation of the program when it was agreed that each designation of an integration industry would require a signed protocol which had to be ratified by at least three of the member countries.

Although signed in Tegucigalpa on June 10, 1958, the original treaty was not ratified by Guatemala, El Salvador, Honduras, and Nicaragua until June 4, 1961. Costa Rica did not ratify the agreement until September 23, 1963.[2] Thus, the ratification of the original agreement took a period of three years, disregarding Costa Rica's

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[1]United Nations, Economic Commission for Latin America, Economic and Social Council, Report to the Central American Co-operation Committee, February 25, 1957-June 10, 1958 (E/CN.12/CCE/151, 1959) (New York, 1959), p. 10.

[2]Wardlaw, op. cit., p. 61. It should be recalled that Costa Rica did not become part of the Common Market until this same year; the ratification of the agreement by Costa Rica, therefore, was delayed until that time.

late entry. A question arises as to whether or not this was a valid sample of the manner in which the subsequent protocols were to evolve. Unfortunately, the answer is "yes."

History of the First Protocol

In the meeting of the Economic Co-operation Committee of Central America in November, 1961, each of the member countries demonstrated an interest in at least one project. The following products were considered by the corresponding countries:

1. Tires and Tubes -- Guatemala
2. Caustic Soda and Insecticides -- Nicaragua
3. Glass Containers -- Honduras
4. Electric Light Bulbs -- Honduras
5. Wire and Copper Tubing -- El Salvador[1]

Since Costa Rica was not yet part of the Common Market, no project was presented. Honduras was forced to withdraw one of its proposed projects because of the agreement on balanced allocation of integration industries. As a result, Honduras decided to submit the project on glass containers and withdrew its request for an electric light bulbs plant.

Tire and tube plant. One of the proposed plants of integration was already in operation on a national scale.

[1]Naciones Unidas, Comisión Económica Para America Latina, Comité de Cooperación Económica del Istmo Centroamericano, Grupo de Trabajo ad hoc Sobre Desarrollo Industrial, Informe del Relator (E/CN.12/CCE/G.T. IND/12, December 8, 1961) (New York, 1961), p. 11.

This was the tire and tube plant of Guatemala which operates under the title of Gran Industria de Neumáticos Centroamericanos (GINSA). None of the remaining plants were, as yet, constructed. This firm had been considering the idea of becoming an integration industry since it first began operations in 1957. Unlike the other proposed plants, GINSA had the experience of approximately five years of production within the Guatemalan market. As a result, this firm was able to present a detailed proposal which presented a convincing case for becoming an industry of integration.

First of all, the capital distribution of the Guatemalan firm was very much in line with the requirements of the treaty. Only 5.8 per cent of the capital was foreign.[1] In addition, GINSA had financed its own study of the demand for tires in Guatemala and Central America. Although the market of Guatemala was not large enough to allow reasonable efficiency in production, this firm maintained that the Central American market was adequate to support at least one plant. Since there were no other producers of tires and tubes in Central America, GINSA's case for becoming an integration industry was solid.

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[1]Naciones Unidas, Comisión Económica Para America Latina, Comité de Cooperación Económica del Istmo Centroamericano, Grupo de Trabajo ad hoc Sobre Desarrollo Industrial, Estudio Tecnológico-Económico de la Industria de Llantas en Centroamerica (E/CN.12/CCE/G.T. IND/4, November 23, 1961) (New York, 1961), p. 7.

GINSA acted rapidly. The projections of demand for tires and tubes merited, in the opinion of GINSA, a second plant by the year 1966. The firm proposed in December, 1962, that the second plant be located in Costa Rica and that it be built and operated by GINSA.[1] These quick actions on the part of GINSA were accomplished in anticipation of possible competition and also because of the fact that a second plant in the same industry can be decreed by the Executive Council without the usual ratification procedure.[2] GINSA was virtually assured of receiving integration status for its Guatemalan plant. If a second plant were to be constructed by the firm in 1966, this would in effect guarantee a monopoly throughout Central America.

Early in 1963, however, the proposal of GINSA was countered by an application by Costa Rica for the second plant of tires and tubes. The Firestone Tire and Rubber Company had consented to build a plant in Costa Rica. The proposal which GINSA had made to move into Costa Rica was apparently not appealing to the Costa Rican government. This was the formal beginning of the well-known dispute between GINSA and the Firestone Tire and Rubber Company.

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[1]Guatemala, Consejo Ejecutivo, Segunda Reunión, diciembre 10-15, 1962, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, <u>Estudio de Evaluación Técnica-Económica de la Fábrica de Llantas y Cámaras para Automóvil</u> (SIECA/CE-II/D.T.2, November 28, 1962) (Guatemala, 1962), p. 29.

[2]<u>Economic Integration Treaties of Central America</u>, Art. XXVII, p. 33.

Even though Costa Rica had not, as yet, officially ratified the Integration Industries Agreement, the Minister of the Economy of Costa Rica, acting for Firestone, deposited an application for the second plant of tires and tubes in April, 1963.[1] With a detailed estimation of costs of production and projected sales, the proposal suggested a capacity of 100,000 tires. The most convincing aspect of the project was that a second plant of separate ownership would prevent a pure monopoly from existing in tire and tube production.[2] Equally unattractive, however, was the fact that 75 per cent of the capital of the firm was to come from Firestone.[3]

The Permanent Secretariat (SIECA) prepared a reply to the Costa Rican government. Both the original proposal and the reply of SIECA were presented at the fourth reunion of the Executive Council in April, 1963. The Secretariat expressed its opinion that the internal demand in Central America for tires and tubes was not, as yet, sufficient to merit the existence of a second plant. The report indicated

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[1]Guatemala, Consejo Ejecutivo, Cuarta Reunión, abril 17-27, 1963, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Solicitud del Gobierno de Costa Rica para una Segunda Planta de Llantas y Tubos (SIECA/CE-IV/16, March 31, 1963) (Guatemala, 1963), Annex A, pp. 1-4.

[2]*Ibid.*, p. 3.

[3]*Ibid.*, p. 1.

that an additional plant with a capacity of 100,000 would be sustainable by 1969 or 1970.[1]

The Secretariat based its decision on the data presented in Table 6. The data in this table indicate the estimated demand for tires in Central America (Column 1), the production of GINSA (Column 2), and the corresponding residual unfulfilled by GINSA (Column 3). GINSA's production is based upon its capacity as required by the first protocol.[2] Column 3 indicates that the regional demand of Central America will be sufficient to support additional capacity of 100,000 tires by 1969. On the basis of this reasoning, the request for a second plant for the production of tires and tubes was denied, at least temporarily.

Caustic soda and insecticides plants. In August, 1962, Nicaragua presented to the Permanent Secretariat its formal proposal for caustic soda and insecticides plants.[3] It should be noted that this application contained a request for two plants. Legally, the establishment of both of these plants in the same country would be in violation of the agreement on balanced allocation of industries. It was

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[1]Guatemala, Consejo Ejecutivo, Cuarta Reunión, abril 17-27, 1963, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Apreciación Sobre la Solicitud del Gobierno de Costa Rica Para Establecimiento de una Segunda Planta de Llantas y Neumáticos (SIECA/CE-IV/16, April 6, 1963) (Guatemala, 1963), p. 21.

[2]Economic Integration Treaties of Central America, Art. XXII, p. 32.

[3]Wardlaw, op. cit., p. 69.

TABLE 6

ESTIMATED DEMAND AND PRODUCTION OF TIRES IN CENTRAL AMERICA, ANNUALLY, 1965-1970
(In thousands of units)

Year	(1) Estimated Demand[a]	(2) Production Capacity of GINSA	(3) Margin of Demand Not Fulfilled by GINSA
1965	246	225	21
1966	268	225	43
1967	287	225	62
1968	311	225	86
1969	334	225	109
1970	364	225	139

[a]Based on 80 per cent of total demand, leaving 20 per cent for imports.

SOURCE: Guatemala, Consejo Ejecutivo, Cuarta Reunión, abril 17-27, 1963, Secretaría Permanente del Tratado General de Integración Económica Centroamericana, <u>Apreciación Sobre la Solicitud del Gobierno de Costa Rica Para Establecimiento de una Segunda Planta de Llantas y Neumáticos</u> (SIECA/CE-IV/16, April 6, 1963) (Guatemala, 1963), p. 14.

decided, however, that the two plants were so closely interconnected that they would be considered as one.

At the second meeting of the Executive Council in December, 1962, the first protocol to the Integration Industries Agreement was prepared and signed. It included a declaration of integration status for the tire and tube plant of Guatemala and caustic soda and insecticides plants for Nicaragua.[1]

The movement of the first protocol through the first steps of the legal apparatus was reasonably rapid. Unfortunately, the protocol could not go into effect until it was signed by the Economic Council and ratified by at least three of the member countries. Although the Economic Council constituted no significant barrier in the progress of the protocol, the ratifications of the respective members were instrumental in delaying the protocol for a relatively long period of time. It was not until February 26, 1965, that any of the ratifications were deposited and then only by Guatemala, El Salvador, and Costa Rica. Nicaragua ratified the protocol in August, 1965, and Honduras has yet to accept it.[2]

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[1]Guatemala, Secretaría Permanente del Tratado General de Integración Económica Centroamericana, Resoluciones del Consejo Ejecutivo (Guatemala, June, 1967), Act 2, Resolution 7, p. 13.

[2]Wardlaw, op. cit., p. 69.

As would be expected, the tire and tube plant immediately began operations in the countries which ratified the protocol. Hence, GINSA has functioned under the privileges of the scheme for approximately two years. The caustic soda and insecticides plants were not constructed until integration status was virtually assured. According to the treaty, the two Nicaraguan plants were not required to begin production until twelve months after the protocol went into effect.[1] Consequently, Nicaragua announced in December, 1965, that the construction of the plants would proceed and that they would begin production in the latter part of 1967. The plants were to be listed under the titles of Electro-química Pensalt (ELPELSA) and Hercules de Centroamerica (HERCASA).[2] As of October, 1967, the plants had just begun operations.

History of the Second Protocol

The third plant to be considered for integration status was a glass factory to be located in Honduras. Although Honduras indicated as early as 1961 that it was interested in a glass factory, a formal application was

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[1]Economic Integration Treaties of Central America, Art. II, p. 28.

[2]Chile, Consejo Económico Interamericano, junio 15-26, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Informe Sobre los Avances del Programa de Integración Económica Centroamericana (febrero, 1966-mayo, 1967) (Guatemala, June, 1967), p. 8.

apparently not presented to the Executive Council until January, 1965.[1]

Originally, in 1961, Honduras requested a factory to produce glass containers. However, the owners of the proposed glass containers factory, which originally sought integration status in Honduras, decided in 1963 to construct a plant in Guatemala City to serve the national market. Instead of receiving the privileges of the Integration Industries Scheme, this firm is now operating under the auspices of the so-called Sistema Especial de Promoción de Actividades Productivas (Special System for Promoting Industrial Activities).[2] Consequently, the second protocol designating an integration industry was altered to include a plate glass factory to be located in Honduras.

The movement of the second protocol through the preliminary steps of the legal framework was reasonably fast. As early as July, 1965, the Executive Council approved the application.[3] It was accepted by the Economic

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[1]Honduras, Consejo Ejecutivo, Undécima Reunión, enero 12-18, 1965, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Proyecto de Fabricación de Envases de Vidrio y Vidrio Plano (SIECA/CE-XI/53, Add. 1, December, 1964) (Guatemala, January 4, 1965), pp. 1-4.

[2]Informe Sobre los Avances del Programa de Integración Económica Centroamericana, p. 8 (See Chapter VI).

[3]Resoluciones del Consejo Ejecutivo, Act 16, Resolution 37, p. 73.

Council in November of the same year.[1] However, the second protocol has been able to advance only slightly beyond this stage. So far, only Nicaragua has ratified the Honduran glass factory. In all probability, the second protocol will eventually be ratified; yet, it is virtually certain that the ratification process will take at least as much time as it did in the case of the first protocol.

Status of the Second Plant of Tires and Tubes

Costa Rica did not give up in her quest for the second tire and tube plant. In February, 1965, a report which again explained the bases for a second tire and tube plant was reviewed by the Economic Council.[2] Because the Executive Council was unable to make a decision concerning the second plant, the application had to be referred to the Economic Council. The Economic Council ruled that the plant could have a maximum of 30 per cent foreign participation in the capital of the firm and not the 75 per cent suggested by Firestone.[3] The Economic Council was also

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[1]Guatemala, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Resoluciones del Consejo Económico (Guatemala, June, 1967), Act 16, Resolution 18, p. 37.

[2]San Salvador, Consejo Económico, Cuarta Reunión Ordinaria, febrero 5-9, 1965, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Bases Para la Incorporación de una Segunda Planta de Llantas al Amparo del Convenio Sobre el Régimen de Industrias Centroamericanas de Integración (Guatemala, September, 1966), Act 13, pp. 1-4.

[3]Ibid., p. 1.

careful to point out that the product produced should carry Central American brand names and not the more familiar insignia of the foreign producer.[1]

The protocol for a second plant to produce tires and tubes has been prepared but has not, as yet, been approved by the Executive Council. The approval of the Executive Council is all that is required to accord integration status to a second plant; however, this council still has the matter under consideration. Perhaps one of the main reasons for the lack of acceptance has been the persistent complaints of the Guatemalan tire and tube plant that it has not been able to operate at full capacity.[2]

Firestone decided not to wait for a decision by the Executive Council. Instead, a plant has been constructed in Costa Rica to serve the national market and also, through an agreement, the market of Panama.[3] These actions by Costa Rica directly oppose the theory supporting integration industries. Theoretically, the Guatemalan firm needs the entire market for efficient production and a reasonable return. The Permanent Secretariat suggested that a second

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[1] *Ibid*., p. 3.

[2] Guatemala, Consejo Ejecutivo, Trigésima Reunión, octubre 30-noviembre 5, 1967, Secretaría Permanente del Tratado General de Integración Económica Centroamericana, *Exposición del Gobierno de Guatemala, Problemas que afectan a la Industria de Integración--de llantas y neumáticos establecida en dicha República* (SIECA/CE-XXX/D.T.2, October 13, 1967) (Guatemala, 1967), p. 3 (See Chapter V).

[3] Interview with Guillermo Noriega Morales, *op. cit*.

plant would not be merited until 1969, at which time the Firestone plant was virtually assured of receiving integration status. However, the Common Market has no authority over the efforts of national governments to promote industry. Each of the member countries still maintains its own incentive devices to attract industrial activity.

According to conditions enumerated in the original treaty, the Firestone plant will receive a 10 per cent annual reduction in the tariffs on tires and tubes in each of the countries of Central America.[1] In the event that the Costa Rican plant becomes an industry of integration (which is a reasonable possibility in the near future), the tariff will be removed.[2]

New Applications

During the years 1966 and 1967, seven new applications were made for integration industries. All five of the participating countries have deposited at least one proposal. Both the quantity of the applications and their competitive nature are unprecedented in the history of the program.

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[1] Economic Integration Treaties of Central America, Art. IV, p. 22.

[2] The development of the tire and tube industry in Central America poses an interesting study of industrial growth in developing areas. This industry will be briefly discussed in Chapter VI.

The first project to be presented was a pulp and paper mill to be located on the northern coast of Guatemala.[1] There is little doubt that the resources of Guatemala merit the existence of a pulp and paper industry. However, Guatemala is not the only country in Central America with abundant forests. Two other countries--Honduras[2] and Nicaragua[3]--are also seeking the same industry.

Three applications for a pulp and paper industry will have to be considered simultaneously by the Executive Council. Logically, the location of the first plant will have to be determined on the basis of recommendations by the Research Institute and the Permanent Secretariat. However, the influence of politics will be difficult to avoid.

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[1]Nicaragua, Consejo Ejecutivo, Vigésima Reunión, septiembre 16-19, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Resumen del Proyecto de Pulpa y Papel de Guatemala (SIECA/CE-XXII/D.T.9-A, September 13, 1966) (Guatemala, 1966), pp. 1-7.

[2]Nicaragua, Consejo Ejecutivo, Vigésima Segunda Reunión, septiembre 16-19, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Resumen del Proyecto de Pulpa y Papel de Honduras (SIECA/CE-XXII, D.T.9, September 9, 1966) (Guatemala, 1966), pp. 1-10.

[3]Honduras, Consejo Ejecutivo, Vigesimonovena Reunión, septiembre 17-23, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Resumen del Proyecto de Pulpa y Papel de Nicaragua (SIECA/CE-XXIX/D.T.29, September 7, 1967) (Guatemala, 1967), pp. 1-9.

A similar problem is arising with respect to a nylon filaments industry. Guatemala[1] and El Salvador[2] presented applications for a nylon filaments plant in November, 1966. The development of a nylon filaments plant is logical since there are two tire and tube plants in Central America which would use this product as an input. Again, however, it is unlikely that two plants will be needed. Hence, the Executive Council will be forced to make a decision regarding the most practical location of the plant.

The two remaining applications are also competitive in nature. Both Honduras[3] and Costa Rica[4] have proposed a steel industry. It seem improbable that a steel industry can be comparatively efficient in Central America, but since developing countries take a great deal of pride in

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[1]Nicaragua, Consejo Ejecutivo, Vigésima Segunda Reunión, noviembre 15-19, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Solicitud de Guatemala Para Incorporar una Planta Productora de Filamentos de Nilón al Régimen de Industrias de Integración (SIECA/CE-XXII/D.T.4, June 15, 1966) (Guatemala, 1966), pp. 1-6.

[2]Guatemala, Consejo Ejecutivo, Vigésima Cuarta Reunión, noviembre 15-19, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Resumen del Proyecto de Nilón de El Salvador (SIECA/CE-XXIV/D.T.13, November 3, 1966) (Guatemala, 1966), pp. 1-5.

[3]Guatemala, Consejo Ejecutivo, Vigésima Cuarta Reunión, noviembre 15-19, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Resumen de Proyecto Siderurgico de Honduras (SIECA/CE-XXII/D.T.11, November 8, 1966) (Guatemala, 1966), pp. 1-9.

[4]Informe Sobre los Avances del Programa de Integración Económica Centroamericana, p. 9.

having their own steel complex, one should not be surprised by these proposals. It is possible that the Research Institute and the Permanent Secretariat will conclude that conditions are not, as yet, desirable for the development of a steel industry.

The number of applications presented in 1966-67 is somewhat puzzling. In no other single period of time has there been such an interest in utilizing the Integration Industries Program. It is likely that the renewed interest in the scheme originated because of a reinterpretation by the Economic Council of the so-called balanced growth article in the Integration Industries Treaty. It should be recalled that this article prevented countries from receiving additional integration industries until all countries acquired at least one.

The original clause found in the Integration Industries Treaty reads as follows:

> The contracting states shall not designate a second plant in the same country until each of the five Central American countries has been assigned a plant in accordance with the protocols contemplated in Article III.[1]

Although this statement is not ambiguous, the Economic Council has chosen to reinterpret this clause to allow the designation of more than one industry at any given time. That is, the Economic Council in April, 1964, reinterpreted

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[1] Economic Integration Treaties of Central America, p. 25.

this clause to mean that a second integration plant cannot be assigned within the "same industry" to any country until a plant in the "same industry" has been assigned to each of the remaining countries.[1]

This new interpretation has apparently left the door open for the designation of more than one industry to a country without consideration of the requirement that each of the other countries possess an equal amount of integration industries. For example, Guatemala and Nicaragua, which possess integration plants, no longer need to wait until the other members have received an integration industry before applying for additional plants. Contrariwise, Nicaragua and Guatemala will not be able to establish a second plant in their respective integration industries on their own soil until each of the contracting states also has one integration plant in that same industry. Even though it is still somewhat restrictive, the new interpretation by the Economic Council has apparently released one of the most binding provisions of the Integration Industries Scheme and, hence, has been influential in bringing about the recent wave of applications. This new interpretation has not, as yet, been challenged by the member countries.

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[1]Wardlaw, op. cit., p. 92.

Summary

The theory supporting the Integration Industries Scheme is an extension of one of the most well-known principles of economic integration; that is, the benefits which can accrue due to the increased size of a market. Regional demand will theoretically support many industries that could not exist on a national level. Through the offer of an enlarged market and other attractive incentives, the Integration Industries Scheme attempts to promote the development of medium- and large-scale industries in Central America.

The original treaty and the subsequent protocols demonstrate that the problem of monopoly was recognized. Integration firms are monopolies, but like many monopolies in the United States, they are regulated. Admittedly, the provision of regulations does not guarantee that they will be enforced. It is not an easy task to carry out regulations regarding such things as quality and pricing.

The legal steps which must be followed to become an integration industry are many and involve a considerable amount of time. It is possible that a proposal could be held up in the Executive Council, for example, for an indefinite period of time. If and when it does pass, it could be filled with suggested changes which prove unacceptable to the firm. If one also assumes that the firm will not begin construction of the plant until it has been ratified, the time factor is expanded even more.

In terms of being a stimulus to industrial development, the Integration Industries Scheme has thus far been rather unsuccessful. Although the treaty was signed in 1958, it was not fully ratified until 1963. The first protocol which designated a tire and tube plant for Guatemala and caustic soda and insecticides plants for Nicaragua was signed in January, 1963, but was not ratified until February, 1965. The second protocol which designated a plate glass factory for Honduras was signed in November, 1965, but since then has only been ratified by one country. Honduras has not ratified either of the protocols. Companies seeking integration status must possess a great deal of patience and perseverance. If in line with past experience and if successful, an applying firm may become an integration industry in three to five years.

A new interpretation of the restrictive Temporary Article of the treaty by the Economic Council has been a factor in spurring a number of new proposals for integration industries. Guatemala, Honduras, and Nicaragua have recently indicated a desire for a pulp and paper industry; Guatemala and El Salvador, a nylon filaments industry; and Costa Rica and Honduras, a steel industry. Since many countries are applying for the same industries, decisions will have to be made concerning the optimum allocation of the plants. Given the lack of success of the program up

to this point, it is conceivable that the future of the Integration Industries Scheme may depend upon the dexterity and finesse with which the new proposals are handled.

CHAPTER V

AN ANALYSIS OF THE PROBLEMS ASSOCIATED WITH THE INTEGRATION INDUSTRIES SCHEME

Introduction

A planned program of industrial development typically is characterized by numerous perplexing problems. These problems become more complex when such a program is pursued within the framework of economic integration. The Integration Industries Scheme is characterized by problems inherent in economic planning as well as economic integration.

The major problems of this program center basically around two separate categories. The first of these is concerned with the mechanisms, policies, and attitudes which determine the character and the significance of the Integration Industries Scheme. The long and cumbersome procedure which must be followed by firms seeking integration status is the most apparent problem in the first category. After industries have been designated, a second major problem area evolves. This is the apparatus of control over the integration industries. Since these firms are legal monopolies, the aspects of control become crucial.

The types and amounts of regulation require a great deal of flexibility and adaptation on the part of regulatory authorities. Decisions must be made on the basis of efficiency and welfare criteria; yet, they cannot be too lax nor can they be too stringent.

This chapter contains a description and analysis of the major problems of the scheme. Particular reference is made to GINSA, the tire and tube plant, since this provides the only opportunity for a case study of an integration industry in operation. Particular emphasis is placed upon those factors which explain why the program has met with rather limited success. In this connection, the Honduran problem and also the negative attitude of the United States toward the program are given special attention.

Problems of Implementation

Industrial Politics

The development of a program of economic integration is usually a slow process. Even though integration may be in its earliest infancy, the concept which permeates its entire realm is industrialization, especially in the developing areas. In fact, if integration were not considered to be a convenient means to industrialization, it is likely that some schemes would not be conceived. Industrial programs are often hastily developed and are expected to bring

immediate results. However, the foresight and the planning necessary for industrial growth are not recognized until a system has failed to work.

The Integration Industries Agreement did not provide a good framework for a far reaching program of industrialization. The Economic Commission for Latin America had definite ideas about the desirable characteristics of such an agreement. However, la política industrial[1] would not permit the needed flexibility. Each country acted as if it believed the development of one country would be at the expense of others. Consequently, the Integration Industries Agreement was filled with legal and institutional bottlenecks.

Each of the members wanted to have a voice in the declaration of integration industries in order to protect its national interests. Even though this was to be a regional program, development was viewed principally on a national level. Both the Executive Council and the Economic Council contain members from each of the respective countries. Yet, this was not sufficient protection of national sovereignty. It was also agreed that each protocol had to be ratified by the legislatures of at least three members before it could go into effect. Furthermore, as a last protective device, an article was

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[1]The English language does not typically use this specific term. Generally, it refers to politics as it relates to the industrial sector.

included which prevented any one country from receiving two integration industries until each had been designated at least one. Thus, the Integration Industries Agreement reflected the fact that a regional atmosphere of industrial development was not present in 1958.

Important Factors Acting to Restrain the Designation Procedure

Perhaps no single clause has affected the time and the uncertainty of the designation procedure more than the ratification requirement. Each of the protocols adopted has been delayed for approximately two years pending ratification. ECLA has recommended that this clause be removed from the treaty and that the Economic Council become the ultimate authority.[1] The Permanent Secretariat and the Research Institute also recognize the limitations posed by this clause. There has been discussion about the possibility of taking action to make this change; however, this matter has not, as yet, been formally considered.[2]

The temporary article concerned with balanced growth has also been instrumental in delaying implementation. During the period from 1958-1964, this article was interpreted to mean that no country could receive a second

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[1]Naciones Unidas, Comisión Económica Para America Latina, Evaluación de la Integración Económica en Centroamerica (E/CN.12/CCE/327/Rev. 2, January, 1966) (New York, 1966), p. 161.

[2]Interview with Guillermo Noreiga Morales, op. cit.

integration industry until each was designated one. Consequently, each country was permitted only one application at a time, and this application had to be accepted before additional firms could be considered. There is little doubt that this clause was important in accounting for the apparent lack of interest in the scheme from 1962-1965. Since all countries had not received one designation, it was pointless for any country to apply for a second firm.

As was indicated in Chapter IV, in 1964 the Economic Council reinterpreted the balanced growth clause to mean that a second integration plant "in the same industry" cannot be allocated to a given country until all countries receive at least one plant "in that same industry." Under this interpretation, a country apparently may receive any number of designations in different industries without restriction. This seemingly adds flexibility to the mechanism. However, as long as each country plays an important role in determining the existence of integration plants through ratification, the new interpretation may not be extremely meaningful. Moreover, this view of balanced growth distorts the concept of comparative advantage in the integration area. For example, if Guatemala can produce tires and tubes relatively efficiently, then it seems ridiculous to allow all countries to have their own tire and tube operation before Guatemala can build additional plants.

The case of Honduras. Honduras is the least developed nation of Central America. It entered the Common Market with less manufacturing than the other member countries. Before the Common Market became a reality, most of the countries were following policies on a national level to promote industrial growth. The most popular policy was import substitution. The countries following this policy maintained external tariff barriers to protect internal infant industries.

At the time of acceptance of the General Treaty for Economic Integration, Honduras had not begun a purposeful program of import substitution. Therefore, the tariff structure was not as high in Honduras as it was in the remaining countries. When Honduras subscribed to the common external tariff, trade was diverted from outside sources to internal countries. Consequently, Honduras has been obliged to pay higher prices for many Central American goods that she originally imported from outside sources. In addition, Honduras has complained that this sacrifice has not resulted in any increase in the sales of Honduran products to other areas of the Common Market.[1]

This particular example reveals the problem of reciprocity and balanced development in Central America. Honduras has developed a rather negative attitude toward

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[1]Wardlaw, op. cit., p. 85.

the integration movement because this country has not experienced the growth patterns which have characterized the other economies during the first years of integration.[1] One of the actions taken by Honduras to impress upon the remaining countries its dissatisfaction with present conditions has been a refusal to ratify the existing protocols of the Integration Industries Program. Thus, the actions of one sovereign nation serve to restrain the entire regional effort.

The members of an integration area should not expect to experience equal growth rates. With this factor in mind, it does not seem rational, especially in the short run, to allow one country to stymie the entire integration movement. Yet, when documents such as the Integration Industries Agreement contain protective clauses, each of which reflects a deep-seated concern over national sovereignty, it becomes rather easy for one country to influence the success of the integration movement. By refusing to ratify the protocols designating integration industries, Honduras partially accounts for the relative lack of success which has characterized the Integration Industries Scheme.

U.S. Attitudes

The United States has taken a very favorable attitude toward the general movement of integration in Central

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[1]See Table 4, Chapter III.

America. This was witnessed in 1961 when President Kennedy stated:

> We must support all economic integration which is a genuine step toward larger markets and greater competitive opportunity. The fragmentation of Latin America's economies is a serious barrier to industrial growth. Projects such as the Central American Common Market and free trade areas in South America can help to remove these obstacles.[1]

The position of the United States regarding integration industries, however, is the direct opposite.

> The United States opposes integration industries and considers that they will tend to limit competition and ultimately benefit neither the economy of the region or the consumer. It is hoped that the Regime of Central American Integration Industries is not to become a lasting feature of the regional economic integration program.[2]

The United States may be taking a genuine, but naive, view toward monopoly or it could be seeking to protect its investors. The important consideration, however, is that its attitude is negative, and this conceivably has affected the success of the scheme. The U.S. extended approximately 10 million dollars in loans to the Central American Bank for Economic Integration (CABEI), none of which can be used to finance integration industries.[3]

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[1]"Address of the President of the U.S. to Latin American Diplomats and Members of U.S. Congress," Department of State Bulletin, XLIV (April 3, 1961), p. 473.

[2]Letter from Robert E. Simpson, Director, Office of International Regional Economics, Department of Commerce, in James Cochrane, "U.S. Attitudes Toward Central American Economic Integration," Inter-American Economic Affairs, XVIII (Autumn, 1964), p. 83.

[3]Interview with Licenciado Antonio Palacios, Coordinator, Banco de Guatemala, November 4, 1967.

Such a measure would seem to influence the success of the program considerably since there is a serious capital shortage in Central America. Yet, it appears that this has not been the case because most potential investors, at least so far, have been sufficiently liquid to avoid borrowing from the Bank of Integration. According to one representative from the bank, CABEI has performed a negligible role in the Integration Industries Program simply because it has not, as yet, been called upon for financial support.[1]

The only other pressure which the U.S. may have exerted on the scheme would be in the form of policy statements. Exactly what significance these statements have had in discouraging firms from using the program is difficult to determine. A representative of the U.S. AID Mission to Central America and Panama (ROCAP) indicated that the attitude of the United States has not hindered the program.[2] At any rate, it is evident that there are various bottlenecks which have hindered the scheme more than U.S. policy statements.

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[1]Interview with Licenciado Collart, Representative of the Industrial Promotion Division of CABEI, Guatemala City, Guatemala, November 4, 1967.

[2]Interview with Mr. William Sowash, Assistant Director, Development Planning, ROCAP, Agency for International Development, Guatemala City, Guatemala, October 27, 1967.

The Regulatory Mechanism

The Integration Industries Scheme is characterized by a problem of monopoly control. Integration industries are legal monopolies and, consequently, the restrictive aspects of monopoly power must be alleviated through regulatory devices. Thus far, the Permanent Secretariat and the Executive Council have been presented with the task of regulating integration industries.

Even though there is only one firm which has operated under the scheme for a significant period of time, the Permanent Secretariat has been beset with numerous problems. Because it is the first integration industry, the tire and tube plant has been, to some extent, an experimental device. It has been subject to various regulations and restrictions, some of which were unexpected. For example, the integration firm had not anticipated that her products would not be accorded the market of Honduras. Legally, Honduras is obligated to remove tariffs; as yet, this country has refused to accept the protocol.

Distribution Policy

One of the important regulations established by the first protocol is concerned with control over the distribution of tires and tubes. The Executive Council has established a fixed rate of discount (from the final selling prices) at which GINSA can sell its tires to distributors. Since the final selling prices are established by decree,

many distributors are unhappy about a low rate of profit. Distributors prefer to handle foreign tires because of a higher rate of return.[1]

GINSA is also required to maintain stocks in each country equal to two-months supply and, therefore, must maintain warehouses at extra cost. The firm argues that this is both unnecessary and inefficient. The whole problem of distribution could be completely solved, according to GINSA, if the firm were able to dictate its own sales policy.[2]

The control over distribution policy was written into the first protocol and is unlikely to be dropped completely. However, to the extent that distributors are getting a low return from GINSA's products, the integration firm has a legitimate complaint.

Tariff Policy

Probably the main problem which concerns GINSA is that the firm has not been able to fully utilize its installed capacity. GINSA was required by the first protocol to increase its capacity to 225,000 tires. Rather than merely fulfill this requirement, the firm proceeded to increase its capacity to 300,000 tires. During the

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[1] Exposición del Gobierno de Guatemala, Problemas que afectan a la Industria de Integración--de llantas y neumáticos establecida en dicha República, pp. 1-3.

[2] Ibid., p. 3.

year 1966, GINSA sold 171,601 tires--a substantial increase over recent years but which was, according to the firm, only 57.2 per cent of its installed capacity.[1]

In spite of its early success, GINSA is anxious to operate closer to the actual capacity of the firm. The total imports of tires and tubes of Central America from outside countries were still high in 1966, amounting to $6,228,820.[2] In the same year, the imports of other member countries from Guatemala reached $4,781,106.[3] During 1964-1966, sales in Common Market countries by the integration firm increased substantially.[4] Yet, imports from outside countries continued to be high (in an absolute sense) in 1966. This was true in spite of the common external tariff established by the treaty. Foreign firms were able to capture a substantial portion of the market even though the prices of their tires and tubes were noticeably higher.[5]

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[1]Exposición del Gobierno de Guatemala, Problemas que afectan a la Industria de Integración--de llantas y neumáticos establecida en dicha República, p. 3.

[2]See Table 11, Appendix A. Figures on the exact number of tires and tubes imported from outside countries were not available. A rough estimate would be 140,000 tires and 135,000 tubes.

[3]See Table 10, Appendix A. Figures on the exact number of tires and tubes imported from Guatemala were not available. A rough estimate would be 100,000 tires and 90,000 tubes.

[4]See Table 10, Appendix A.

[5]A survey of tire prices in Guatemala City by the author showed that foreign tires sold for approximately three to five dollars more than those of GINSA for comparable sizes.

This is not an unusual problem for firms in developing areas. Foreign brand names are strong in the minds of the consumer. Many are willing to pay a higher price for foreign tires because they believe that these tires are of a higher quality. In many circumstances, foreign products are superior to products produced within the Common Market. Apparently, however, tires produced by GINSA are equal in quality to the foreign brands.[1]

The integration firm is impatient with the reluctance of consumers to increase their response to its lower prices. Part of this impatience is inspired by the existence of an additional firm in Costa Rica. GINSA is likely to lose a good share of the Costa Rican market. To compensate for this loss, the integration firm would like to increase sales in other Common Market countries. The suggested method is to further insulate the Central American market from the outside through higher tariffs.

GINSA argues that the present system is inadequate for proper protection. In one particular circumstance, it appears that GINSA's complaint is justified. Because of the amazing competitiveness of Japanese products, the existing duties of 90 cents specific (75 cents for large

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[1]The quality of GINSA's tires has been verified by tests through the Research Institute (ICAITI). Also, questions asked by the author to a small sample of consumers and retailers in Guatemala City revealed no discontent with the quality of GINSA's tires.

tires) and 10 per cent ad valorem are insufficient to raise Japanese tires to price levels comparable to other brands.

The data in Table 7 help to explain this phenomenon. For the three different sizes of tires considered in this table, the final Japanese price is lower than either GINSA's or those from the United States. Observe also that the prices of U.S. tires are noticeably higher than those of either GINSA or Japan (Column 4).

GINSA proposes to correct this situation by imposing a duty rate of two dollars [illegible] 20 per cent ad valorem.[1] In accordance [illegible]f import substitution, the integration [illegible] sufficient protection from the inex[illegible]roducts. However, it appears that GINSA is a[illegible]se this circumstance to take advantage of an opportunity for complete isolation of the common market for tires. Even though the prices of tires are lower in the case of Japan, the imports of tires and tubes from that country in 1966 only amounted to $1,303,200 or 27 per cent of total imports. The imports from the United States, in spite of the apparent higher prices of U.S. products, amounted to $3,319,900 or 49 per cent of total imports.[2]

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[1]Guatemala, Consejo Ejecutivo, Trigésima Reunión, octubre 30-noviembre 5, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, _Comentarios de la Secretaria a la Exposición del Gobierno de Guatemala_ (SIECA/CE-XXX/D.T.26, October 16, 1967) (Guatemala, 1967), p. 11.

[2]_Ibid._, p. 6.

TABLE 7

COMPARISON OF PRICES OF THREE SIZES OF TIRES MADE BY JAPAN, THE UNITED STATES, AND GINSA AT CURRENT TARIFF RATES
(In U.S. dollars)

Country of Origin	(1) Value (cif)	(2) Weight	(3) Duties	(4) Value (cif) and Duties
670-15:				
Japan	$ 8.53	10.20K	$.90s + 10% ad. val.	$ 18.51
U.S.A.	17.99	10.20K	.90s + 10% ad. val.	28.97
GINSA	---	---	---	23.60
750-17/10:				
Japan	25.57	25.32K	.75s + 10% ad. val.	47.11
U.S.A.	60.86	25.32K	.75s + 10% ad. val.	85.93
GINSA	---	---	---	75.83
825-20/12:				
Japan	44.16	37.00K	.75s + 10% ad. val.	76.33
U.S.A.	79.92	37.00K	.75s + 10% ad. val.	115.66
GINSA	---	---	---	112.00

tires) and 10 per cent ad valorem are insufficient to raise Japanese tires to price levels comparable to other brands.

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GINSA proposes to correct this situation by imposing a duty rate of two dollars specific and 20 per cent ad valorem.[1] In accordance with the theory of import substitution, the integration firm is entitled to sufficient protection from the inexpensive Japanese products. However, it appears that GINSA is attempting to use this circumstance to take advantage of an opportunity for complete isolation of the common market for tires. Even though the prices of tires are lower in the case of Japan, the imports of tires and tubes from that country in 1966 only amounted to $1,303,200 or 27 per cent of total imports. The imports from the United States, in spite of the apparent higher prices of U.S. products, amounted to $3,319,900 or 49 per cent of total imports.[2]

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[1]Guatemala, Consejo Ejecutivo, Trigésima Reunión, octubre 30-noviembre 5, 1967, Secretaría Permanente del Tratado General de Integración Económica Centroamericana, _Comentarios de la Secretaría a la Exposición del Gobierno de Guatemala_ (SIECA/CE-XXX/D.T.26, October 16, 1967) (Guatemala, 1967), p. 11.

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U.S.A.	17.99	10.20K	.90s + 10% ad. val.	28.97
GINSA	---	---	---	23.60
750-17/10:				
Japan	25.57	25.32K	.75s + 10% ad. val.	47.11
U.S.A.	60.86	25.32K	.75s + 10% ad. val.	85.93
GINSA	---	---	---	75.83
825-20/12:				
Japan	44.16	37.00K	.75s + 10% ad. val.	76.33
U.S.A.	79.92	37.00K	.75s + 10% ad. val.	115.66
GINSA	---	---	---	112.00

SOURCE: Adapted from Guatemala, Consejo Ejecutivo, Trigésima Reunión, octubre 30-noviembre 5, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Comentarios de la Secretaria a la Exposición del Gobierno de Guatemala (SIECA/CE-XXX/D.T.26, October 16, 1967) (Guatemala, 1967), p. 10.

The effect of the proposed tariff change on the same three tires is indicated in Table 8. As the figures in Column 4 demonstrate, not only would the prices of Japanese tires be substantially increased, but also the prices of U.S. tires would be raised completely out of proportion to those of the integration firm. Consequently, consumers would virtually be forced to purchase tires from the integration firm, and GINSA would benefit because of increased sales and profits.[1]

Since the integration firm is an infant industry in the Common Market, it seems reasonable that the tariff on Japanese tires should be raised to equalize the prices of tires sold by GINSA and Japan.[2] However, the proposed general increase in the tariff on all imported tires should not be needed to expand the sales of the integration firm. Consumers in Central America are responding to the quality and the prices of GINSA's products. Excluding the imports of Guatemala and Honduras from outside countries, GINSA was able to attract nearly one-half of the import market in two years (1964-1966).[3] If GINSA launches an extensive

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[1]It is important to note that the increase in the tariff would most likely decrease tariff revenue because of reduced imports.

[2]The Permanent Secretariat has expressed its opinion in favor of this measure. Comentarios de la Secretaria a la Exposición del Gobierno de Guatemala, p. 12.

[3]See Table 12, Appendix A.

TABLE 8

COMPARISON OF PRICES OF THREE SIZES OF TIRES MADE BY JAPAN, THE UNITED STATES, AND GINSA AT PROPOSED TARIFF RATES
(In U.S. dollars)

Country of Origin	(1) Value (cif)	(2) Weight	(3) Duty Requested	(4) New List Price
670/15:				
Japan	$ 8.53	10.20K	$2s + 10% ad. val.	$ 30.64
U.S.A.	17.99	10.20K	2s + 10% ad. val.	41.99
GINSA	---	---	---	23.60
750-17/10:				
Japan	25.57	25.32K	2s + 10% ad. val.	81.32
U.S.A.	60.86	25.32K	2s + 10% ad. val.	123.67
GINSA	---	---	---	75.83
825-20/12:				
Japan	44.16	37.00K	2s + 10% ad. val.	126.99
U.S.A.	79.92	37.00K	2s + 10% ad. val.	169.90
GINSA	---	---	---	112.00

SOURCE: Adapted from Guatemala, Consejo Ejecutivo, Trigésima Reunión, octubre 30-noviembre 5, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, <u>Comentarios de la Secretaria a la Exposición del Gobierno de Guatemala</u> (SIECA/CE-XXX/D.T.26, October 16, 1967) (Guatemala, 1967), p. 10.

advertising campaign, the firm should be able to further increase its sales in the Common Market without increasing tariffs. However, since a new plant has been constructed in Costa Rica, GINSA should perhaps be cautious about additional plant expansion, at least in the near future.

The very nature of the Integration Industries Program dictates problems of control, such as those described above. The integration firm desires to receive all of the benefits of the system but does not want to be bothered with the aspects of control. The Permanent Secretariat, as well as other Common Market authorities, realize the economic significance of monopoly. Hence, there is a conscientious attempt to install what are believed to be necessary regulatory devices. The firm thus becomes involved in a maze of bureaucratic controls, some of which may be unnecessary. A certain amount of regulation is needed; yet, regulations should not be so stringent as to discourage entrepreneurs from utilizing the Integration Industries System.

The problems associated with the controlling mechanism have not emerged in force because of the relative infancy of the program. If the bottlenecks which have thus far restricted the implementation of the agreement are relaxed, it seems probable that monopoly regulation will become an increasingly important problem area. This does not mean that a more effective system of regulations

cannot be developed.[1] It is certain, however, that the Permanent Secretariat and the Executive Council, with their diverse interests in the Common Market, are in no position to handle regulatory matters.

New Plant in Costa Rica

The development of firms on a national basis which are competitive with integration industries demonstrates a lack of knowledge or respect for the theory supporting this industrial scheme. New firms are not supposed to be constructed until the market can support them. If firms of individual countries intend to compete with integration industries, the system may as well not exist. Given the size of the Central American area, it is difficult enough to utilize the capacity of a single firm. The sporadic addition of new firms tends to compound the problem of excess capacity and may lead to increased protected inefficiency.

In the case of the tire and tube industry, the new plant is perhaps one or two years premature since the estimated demand for regionally produced tires in 1970 is approximately 400,000 tires.[2] This should be sufficient

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[1]See Chapter VI for suggestions to improve the regulatory process.

[2]_Exposición del Gobierno de Guatemala. Problemas que afectan a la Industria de Integración--de llantas y neumáticos establecida en dicha República_, p. 7.

to support the 300,000 capacity of GINSA and the 100,000 capacity of the new firm.

The development of the tire and tube industry in Central America over the next decade will present an interesting case study of industrial growth in a developing area. The most probable occurrence would seem to be a splitting of the market between the two firms. The Firestone plant is likely to fulfill virtually the entire market of Costa Rica and the majority of Nicaragua's. GINSA will concentrate mainly on Guatemala and also the comparatively strong market of El Salvador. Assuming that Honduras eventually signs the first protocol, sales will probably be split in that country with its primary emphasis still on the import sector. Both companies should make good inroads into the import market, and any expansion in internal demand for tires will probably be fulfilled by the Central American firms.

Summary

There are numerous problems which characterize the Integration Industries Scheme. Many of these concern the excessive preoccupation of the member countries with national interests. Each of the members has shown a desire to industrialize; yet, they have been unwilling to permit the existence of an atmosphere conducive to a successful regional development program.

Because of this factor, the Integration Industries Scheme has been enveloped with restraining clauses which permit the actions of one country to significantly affect the entire regional effort. The ratification requirement and the balanced growth clause are good examples of this phenomenon. Each of these factors has been important in accounting for the lack of success which has characterized the scheme. For example, Honduras, which has incurred numerous problems during the first years of integration, has chosen not to ratify any of the existing protocols designating integration industries.

The concept which permeates the Integration Industries Treaty is that of balanced growth and reciprocity. If one or more of the countries is adversely affected by integration in the short run, sufficient conditions are established which permit a country or countries to curtail the regional development movement.

It is the belief of some authors that the negative attitude of the United States toward the scheme has helped to prevent successful implementation. Although U.S. policy statements may have been an intangible factor in discouraging possible entrepreneurial activity, these effects have probably been negligible when compared with the institutional restraints in the system.

The problem of regulation in the Integration Industries Program is in its embryonic stage. However, it is

not too early to perceive that these aspects of the scheme will require a great deal of adaptability on the part of regulatory officials. If too much control is exerted, this will act as a disincentive for the utilization of the agreement. Likewise, integration industries cannot be permitted to abuse their legal monopoly power. As more integration industries are designated, this problem will become more evident.

The addition of firms on a national level which are competitive with integration industries undermines the basis of the Integration Industries Scheme. Movements in this direction may result in excess capacity and enhanced protected inefficiency. In a small market area, it is imperative that national policies be coordinated with regional development plans.

CHAPTER VI

ALTERNATIVE APPROACHES FOR REGIONAL INDUSTRIAL DEVELOPMENT IN CENTRAL AMERICA

Introduction

Because the Integration Industries Scheme has been of limited effectiveness in developing the industrial base of Central America and also because this system is concerned primarily with medium to heavy industries, other programs have been conceived which attempt to speed up the overall industrialization process. In addition to integration industries, there are four mechanisms concerned with industrial growth. These consist of a program of fiscal incentives, a special system for the promotion of production, the so-called assembling industries, and a project for the development of textiles.

This chapter briefly examines each of these agreements in terms of their objectives and their accomplishments. An attempt is made to determine the role of these mechanisms in initiating industrial development. It is important to note whether or not these programs are intended or able to replace the Integration Industries Scheme.

It is also the goal of this chapter to suggest some possible improvements which could be incorporated within the Integration Industries Scheme. Recommendations are made to ease the restrictions of implementation and to smooth the wheels of operation, both with the goal of making this program an effective tool for future use.

Convention on Fiscal Incentives

With the exception of the Integration Industries Program, the Convention on Fiscal Incentives is the oldest industrial agreement existing in the Common Market. This treaty was signed on July 31, 1962, and consists of an attempt to fix the limits on tariff and tax concessions which Central American countries can offer to encourage industrial investments.[1]

Currently, each of the member countries has its own incentive devices--some being strong and others rather weak. A regional system of fiscal incentives would restrict the competition among the countries in attracting new manufacturing by equalizing incentive measures. For example, the possible benefits available under the convention would be total exemption from import levies on machinery and equipment for a period of ten years, total exemption on levies for raw materials and semi-manufactures

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[1] Cinco Años de Labores en la Integración Económica Centroamericana (Guatemala: Secretaria Permanente del Tratado General de Integración Económica Centroamericana, October 12, 1966), p. 53.

for five years, total exemption from income taxes for eight years, and exemption from property and asset taxes for ten years.[1]

The privileges to be gained by each firm operating under the agreement are quite substantial. Unfortunately, however, this program has not as yet been implemented. By February, 1965, the fourth ratification of the agreement was deposited by Nicaragua, but Honduras has not yet accepted the agreement. Honduras argues that she should be granted special concessions because of her relatively underdeveloped condition. This program provides no such concessions. Honduras indicated that this agreement would compound the unfavorable effects which have characterized her country during the first years of the Common Market.[2] Honduras has proposed a new program of incentives which grants special concessions to her own industry. Thus far, only Nicaragua has ratified this special agreement.[3]

Consequently, there does not exist a generalized program of fiscal incentives in Central America. Unless

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[1]Guatemala, Agency for International Development, Regional Office for Central America and Panama (ROCAP), Central American Agreement on the Equalization of Fiscal Incentives for Industrial Development (April, 1964), (Guatemala, 1964), Art. VIII, p. 5.

[2]Wardlaw, op. cit., p. 90.

[3]Nicaragua, Consejo Económico, Decimotercera Reunión Extraordinaria, septiembre 19-23, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Protocolo al Convenio de Incentivos Fiscales al Desarrollo Industrial (August, 1966) (Guatemala, 1966), pp. 1-26.

the member countries are willing to grant special concessions to Honduras, it appears that each of the countries will continue to use national devices, at least in the reasonably near future.

Special System for the Promotion of Production

A second program has been in effect since January, 1963. It is called the Special System for the Promotion of Production. Under this system, the Economic Council may designate industries for what is called Special Systems Status. These firms then receive additional tariff protection. Like integration industries, these concessions must be written up in the form of a protocol and are subject to ratification by the member countries.[1]

A selected industry must be one which produces goods that are not currently manufactured in the area. The increased duty does not become effective until it is established that the production of the article has begun and that there exists sufficient capacity to satisfy 50 per cent of the area's demand. Unlike integration industries, these firms are not legal monopolies. There is apparently no limit on the number of competitive plants which may enjoy these rights. The only aspect of control in the Special System is the right of the Executive Council to raise and lower duties as it deems necessary.[2]

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[1]Cinco Años de Labores en la Integración Económica Centroamericana, p. 52.

[2]Wardlaw, op. cit., p. 77.

In spite of its relative infancy, this program has met with some success. The first plant to receive the privileges of the system is located in El Salvador and produces electric light bulbs. This plant began operations in April, 1965. In February, 1967, a glass factory in Guatemala City was also incorporated under the system. Three additional firms producing machetes were designated in April, 1967, bringing the total to five.[1] In addition, there are many firms which are currently applying for special protection, and there is a good possibility that the near future will see even more.

The Special System is not as complicated as the Integration Industries Scheme. Since the firms are not legal monopolies, there is less need for controls. The safeguard for the consumer is the power of the Executive Council to reduce tariffs if prices are excessively high and to allow foreign competition to force regional prices back into line.[2]

The Special System is really nothing more than an attempt to protect infant industries. Firms agree to supply a certain percentage of area demand, and they are

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[1] Informe Sobre los Avances del Programa de Integración Económica Centroamericana, pp. 9-10.

[2] The tariff established under the Special System is high. In the case of electric light bulbs, the external tariff is approximately $1.00 specific and 10 per cent ad valorem. The usual rate is approximately 20 cents specific and 10 per cent ad valorem. See Wardlaw, op. cit., p. 80.

rewarded by protection from foreign competition. This mechanism is appealing because it tends to attract entrepreneurs and also because governments are rather quickly convinced about its desirability, especially since increased tariff revenue may result.

Assembling Industries and Textile Development

The remaining agreements established to promote industry are still in an embryonic stage. An assembling industries program was intended to be a special section of the Convention on Fiscal Incentives. Since this convention has not been accepted, new proposals are being considered for the development of assembling industries. Currently, ICAITI is examining the possibility of industries specializing in the assembly of various products into a final unit.[1]

A special program for building the textile industry in Central America is also under consideration. Although textiles are currently produced, the industry is apparently not of sufficient size to fulfill the regional demand for these products. In collaboration with the United Nations, Central America is planning to increase its capacity for textile production. Preliminary analyses have been completed which estimate regional demand and the necessary

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[1] Cinco Años de Labores en la Integración Económica Centroamericana, p. 54.

investment to expand production.[1]

The assembling industries and textile development constitute special programs which are aimed at specific aspects of Central America's industrial base. Like the Integration Industries Scheme, these are examples of planned industrial development. Since investment in developing areas is usually not a spontaneous reflex, as many would hope, such projects have a great deal of merit.

The Role of Integration Industries

Even though there are a number of projects associated with industrial development in Central America, none has met with a great deal of success. Still, however, most of the programs are needed. For example, the concept of economic integration implies a unified system of fiscal incentives. As long as each country continues to use its own tools for incentives, development will proceed principally on a national basis. A coordinated fiscal program can help countries become an integrated unit.

The Integration Industries Scheme is not in opposition to the Convention on Fiscal Incentives. The two programs complement each other. That is, there are numerous small industries in Central America whose growth may respond to tariff and/or tax privileges. General fiscal incentives connotate a diverse, unplanned attempt at

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[1] Informe Sobre los Avances del Programa de Integración Económica Centroamericana, p. 10.

attracting innovative activity into small manufacturing endeavors. An integration industry constitutes the construction of medium to heavy industry. As long as integration industries are permitted to fulfill the role for which they were conceived, these two programs can easily exist side by side. These systems are not diametrically opposed but, rather, seek to accomplish separate goals.

This is also true in the case of more specific development plans, such as textiles and assembling industries. In fact, these plans could conceivably be included under the Integration Industries Scheme, depending upon the state of regional demand. However, if it is possible for competition to exist, there is no good reason to avoid it.

Although the Special System for the Promotion of Production has been the most successful (or least unsuccessful) regional industrial mechanism, this is the program which is most in conflict with the Integration Industries Scheme. The theoretical aspects of the Special System are unclear. For example, there are already three firms producing machetes; and since each firm is required to be of sufficient capacity to satisfy 50 per cent of area demand, two firms should be able to meet the demand of the entire market.

There is apparently no limitation on the number of firms in one industry which can operate under the system.

Therefore, the requirement that each firm be able to produce 50 per cent of area demand may cause a situation of over capacity. Contrariwise, if there is only one firm assigned under the system, this, in effect, is a grant of monopoly power. The result is the establishment of a firm in the same market situation as an integration industry but without the aspects of control. The only control maintained by the Executive Council is discretion over tariff policy.

The main benefits of the Special System are that it is relatively easy to implement and easy to operate. The firms prefer it because they are less restricted, and the market authorities are attracted to it because of its simplicity and because it seems to work when other programs have failed.

The Special System may be able to partially substitute for the lack of a generally accepted program of fiscal incentives. Yet, it appears that it cannot effectively replace the Integration Industries Scheme. As long as there are products which can only be produced with relative efficiency by a single plant because of demand limitations, integration industries should continue to exist.

If new plants in the same industry are liberally designated under the Special System (with high tariffs), a large number of them may be able to survive due to excessive pricing. However, this will probably create

excess capacity, and consumers will experience a reduction in real income. On the other hand, the designation of only one plant would not allow the competitive factor, upon which the system largely depends, to be brought into operation. The main question is the determination of the number of firms in any one industry that Central America can support, given its small total market. If at any given time the market can support only one, then the Integration Industries Scheme should be used.

As long as the Special System is applied to small-scale operations, it may be in harmony with integration industries. If it begins to replace the scheme (which seems to be a possibility), the result is likely to be abused tariff protection combined with over capacity.

Each of the programs established to develop the industrial base of Central America is defendable. There is little doubt that the most important consideration in the short run is whether or not a system works. Still, none of the alternative programs replaces or invalidates the concepts supporting the Integration Industries Scheme. The Economic Commission for Latin America continues to be interested in promoting a vigorous and intensive application of the Agreement on Integration Industries.[1] For large as well as many medium-sized industries, there

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[1] _Evaluación de la Integración Económica en Centroamerica_, p. 159.

initially appears to be no logical alternative other than regional monopolies.

Equally as clear, however, is the fact that efficiency and welfare criteria are not sufficient tests of an industrial program. If the scheme cannot be made operative, its theoretical aspects will tend to become meaningless. Some means must be found to improve the designation and regulatory processes of the scheme.

Suggestions for Consideration

Improving the Designation Process

Certainly the most critical improvement needed in the legal framework of the program is the removal of legislative ratification. There appears to be no way to effectively implement the program if each of the countries maintains this last chance to approve or disapprove integration industries. The ratification requirement increases the amount of time needed to designate new industries and enhances uncertainty for entrepreneurs. It is true that this clause was incorporated into the agreement to protect the sovereignty of the individual nations and to insure the incidence of reciprocity in the Central American region. Although the aspects of reciprocity cannot be neglected, they should not be permitted to be restrictive enough to restrain the regional development program.[1]

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[1]Reciprocity constitutes a perplexing problem for integration movements among developing countries. One

As a short-run measure, the repeal of the above-mentioned clause would be of considerable importance. Over a period of time, however, it is the opinion of this author that the system should be entirely revised.

As the mechanism presently operates, the Executive Council is the center of activity. Every protocol and decision emanates from this body. The duties and responsibilities of this organism are far too inclusive. The Integration Industries Program is actually only a small part of the workload of the Executive Council.

This points to the need for a specialized industrial commission. ECLA recommended the development of such an organ at the inception of the scheme.[1] It is now becoming

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cannot expect a country to experience a large trade deficit and a low rate of growth without becoming disenchanted with integration. Therefore, policy measures need to be readily available to aid the less fortunate countries. In severe cases, temporary quantitative controls may be necessary. More generally, however, regional aid programs from such institutions as the Central American Bank for Economic Integration should come into play. It is interesting to note that one form of aid could be directly associated with the Integration Industries Scheme. In this regard, it has been suggested by the Economic Commission for Latin America that Honduras be allowed to develop a special series of integration industries. This is not possible as long as the scheme continues to be unsuccessful. On the other hand, an acceptance of this method of aid would most likely reverse the attitude of Honduras toward this program. Hence, one of the important bottlenecks facing the system would be released. See Evaluación de la Integración Económica en Centroamerica, p. 159.

[1]Naciones Unidas, Comisión Económica Para America Latina, Comité de Cooperación Económica del Istmo Centroamericano, Analisis de las Medidas y Alternativas Para Poner en Vigor el Régimen de Industrias Centroamericanas de Integración (E/CN.12/CEE/166, August 12, 1959) (New York, 1959), p. 1.

of paramount importance. This council could consist of representatives from each country who are familiar with industrial development problems in Central America. But, in particular, it should maintain a staff of competent people who are knowledgeable about technical considerations in industrial development.

This proposed industrial commission would become the working body of the industrial movement in Central America. A close-working relationship with the Permanent Secretariat (SIECA) and the Research Institute (ICAITI) would be instrumental. In fact, it is logical that the industrial commission become a specific branch of SIECA with minor decision-making powers. The handling and processing of applications should be left entirely to the commission. Only after the protocols are drawn up should the Executive Council be needed. The decision of the Executive Council should be considered as final but subject to review by the Economic Council.

The Research Institute should also play a more poignant role in implementing the scheme. Under the current arrangement, ICAITI undertakes research projects at the request of the Executive Council. This occurs after the firm deposits an application at the Permanent Secretariat and the Executive Council puts a preliminary stamp of approval on the project. As a consequence, unless studies are completed by the firm, the magnitude of demand

and resource availability for producing a product are initially unknown. This lack of knowledge may act as a disincentive to potential entrepreneurs.

The industrialization process would seem to be more efficient if the Research Institute would act as a point of departure. That is, this organization should continually be undertaking industrial feasibility studies in order to determine the logical pattern which industry should follow. As projects are completed, the information could be supplied to possible entrepreneurs, and investors could, in this manner, be made aware of the areas in which there is potential innovative activity.

The implementation of the Integration Industries Scheme, then, should center basically around three organs. The proposed industrial commission, operating through the Permanent Secretariat, would be the working body; ICAITI, the research organism; and the Executive Council, the final decision-making entity. The Economic Council need not perform a significant role; rather, it should only act as an organ of final appeal. The designation process could be improved considerably if these three bodies were allowed to implement the Integration Industries Scheme.

Improving the Regulatory Mechanism

If and when new integration industries are designated in significant numbers, the problem of monopoly regulation will become substantial. This is especially true

if each of the industries is forced to adhere to specific rules and regulations written into the protocols. The solution to this problem is the determination of a weapon of control which is sufficient to prevent monopoly abuse but flexible enough to prevent litigation over countless regulations. Certainly the present system, with its many control devices, is too inflexible and cumbersome. There is admittedly no simple solution. Yet, it does appear that there are some logical and relatively efficient avenues available.

The Permanent Secretariat apparently does not regularly receive annual reports of the operations of integration industries.[1] This is unfortunate because periodic analyses of sales and costs of production seem to be one of the most logical methods of regulation. If the Executive Council could agree on what constitutes a reasonable rate of return for a year's operations, such examinations could reveal whether or not firms are earning monopoly profits. If profits were to exceed a reasonable rate of return, the prices of the products sold by the integration plant could be lowered accordingly. Subsequently, the outside tariff could be reduced by the amount of the price decline. In

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[1]The author attempted to procure copies of the Annual Operational Report of the tire and tube plant at the Office of the Permanent Secretariat, but the Secretariat did not have this information and could not procure it.

this manner, the benefits of the enlarged market could be passed on to the consumer and not exist only for the producer.

The other regulatory power needed would be control over the external tariff. If quality standards of integration firms are low or products are not being supplied in adequate quantities, the industrial commission should be able to relax tariffs and allow foreign companies on the market at competitive prices. During infancy, integration firms should be accorded reasonable protection. Yet, the ultimate goal over time ought to be the complete relaxation of the common tariff.

It is the belief of the author that regulatory powers consisting of cost-and-profit evaluation and discretionary tariff policy would be sufficient to do an effective job of preventing most abuses of monopoly. Other specific problems which arise could be handled on an individual basis. The regulatory process would become more flexible and could be implemented with less effort.

Each of the suggestions above is made in a general sense on the basis of efficiency and welfare criteria. Although the scheme should provide incentives for entrepreneurs, the benefits to the producer should not be at the expense of consumers. Producers are entitled to a fair rate of return; yet, should the opportunity arise, they are unlikely to pass up the chance for more profits.

Periodic audits combined with discretionary tariff policy can allow benefits for producers and, at the same time, protect the interests of the consumer.

The Next Decade

Through a study of the Integration Industries Scheme, some of the important problems which characterize integration movements among developing areas have been presented. Perhaps the most significant reason for the problems which have arisen in Central America is the absence of a regional attitude which is conducive to the development of the overall integration area. Each of the countries maintains nationalistic motivations and seemingly believes that one country cannot grow unless another stagnates. Consequently, the concept of regional balance and reciprocity permeates decision making. The Integration Industries Scheme reflects this sort of attitude.

The successful initiation of reform measures to improve the Integration Industries Scheme will largely be determined by the prevailing attitudes of individual countries. If each of the members prefers to retain protective clauses which allow one country to significantly influence the success of the program, then the needed reforms will probably not evolve. On the other hand, if adequate flexibility can be built into the scheme, this would be a step forward in bringing about a regional development ethic.

The future of the Integration Industries Scheme depends upon the addition of new elasticity to the designation and regulatory processes. If necessary measures are not implemented, it seems probable that the mechanism will fall into disuse. In this event, the Central American Integration Program will have experienced, for the first time, an important setback.

Summary

Central America has conceived several programs aimed at building its industrial base. Since the inception of the Integration Industries Scheme in 1958, four additional agreements have evolved. The Agreement on Fiscal Incentives, signed in 1962, has not gone into effect because of the Honduran problem. Special programs aimed at stimulating certain industrial categories--the assembling and textile industries--are currently in their infancy.

The most successful mechanism has been the so-called Special System for the Promotion of Production. This system attempts to initiate regional industrial growth through external tariff protection. Because it is relatively easy to implement and operate, this system has met with reasonable success.

The Special System can probably substitute for the lack of a general agreement on fiscal incentives; yet, it

cannot effectively displace the theory in support of the Integration Industries Scheme. As long as Central America continues to be a small market, the Integration Industries Scheme should be a significant part of the industrial movement.

Suggestions were made to improve the operation of the scheme. Improved efficiency in the designation process depends upon the repeal of the ratification requirement. Other important improvements would be the development of an industrial commission to act as the working body for the designation and regulation of integration industries. It is also suggested that the Research Institute act as a point of departure in the designation process and that the Executive Council be the main decision-making body of the scheme. The regulatory aspects should be carried out by the industrial commission through studies of costs of production and discretionary control over tariffs.

It is difficult to ascertain whether or not the Integration Industries Scheme will be revised in the near future. If the individual countries continue to be concerned only with national development, improvements probably will not evolve. In this event, the Integration Industries Program may fall into complete disuse.

CHAPTER VII

SUMMARY AND CONCLUSIONS

This study has been concerned with the concept of economic integration as it relates to the developing areas. It has assumed that industrialization is a desirable avenue of development policy in Central America and, accordingly, has examined a particular tool for regional industrial growth within the context of economic integration.

A detailed analysis of this tool, called the Integration Industries Scheme, was preceded by a short summary of the theory of economic integration and also a brief evaluation of the Central American integration movement.

The theory of integration was approached from the point of view of the possible benefits and drawbacks which characterize economic integration. It was concluded that the most substantive innovation in this area was made by Jacob Viner. He concludes that customs unions are not desirable unless they result in overall trade creation and do not merely divert trade from external to internal sources. As it relates to developed economies, this criterion is logical and consistent.

It was further concluded, however, that most current integration theory is not as applicable to movements among underdeveloped economies as it is to integration in developed areas. The relevant consideration for developing areas is not the condition of world trade but, rather, the usefulness of integration as a tool to promote a better climate for economic development. Consequently, an additional set of criteria are needed to evaluate integration movements in these areas. The conclusion follows that these criteria ought not revolve around the condition of world trade but, instead, the determination of the impact of integration on growth and development.

One of the most successful attempts at economic integration among developing economies has taken place in Central America. It was discovered that a regional development scheme is logical in this small isthmus, mainly because it is composed of countries too small to maintain viable economic units. Integration has been accepted as one method to alleviate the important bottleneck of size in Central America. As a consequence, the General Treaty of Economic Integration was signed in 1960. This confirmed the organization of the Central American integration scheme, the ultimate goal being the attainment of a common market.

Generally speaking, Central America experienced a successful embryonic period. The institutional framework

conducive to regional integration was well underway by the early sixties. The release of tariff barriers was rapid; and regional trade responded well, increasing by more than 300 per cent between 1960 and 1965. The regional economy showed a high growth rate for the first half of the decade. The initial impact of integration favorably affected Central America; yet, it was concluded that the role of this movement in influencing the level of growth and development in Central America will not be known for at least an additional five years.

Despite early success, Central America is characterized by numerous important bottlenecks which have the effect of restraining the regional movement. The body of this study was specifically oriented toward a case study of perhaps the least successful program of the Common Market--the Integration Industries Scheme. This subject was approached from the point of view of being a new experiment in industrial development and was, therefore, examined both on a theoretical and practical basis--each with the goal of gaining insight into the problems of economic development within the framework of economic integration.

First of all, a description, theoretical analysis, and brief history of the Integration Industries Scheme were undertaken. The Integration Industries Agreement, signed in 1958, was intended to develop those industries

which require a large sales volume in order to operate under conditions of efficiency. This was to be a type of planned industrial development which takes advantage of the enlarged market resulting from integration. Integration industries are to be designated on the basis of the size of regional demand and the availability of adequate resources.

The various incentive devices for attracting entrepreneurs were explained to be: exemptions from duties on production inputs, freedom from taxation, a protective external tariff, and protection from possible internal competition. Regulatory conditions to curb the abuse of monopoly power included such factors as control over prices, quality, and distribution policy. The designation procedure for firms seeking integration status was found to be long and arduous. Each integration firm faces the uncertainty of approval by the Permanent Secretariat (SIECA), the Research Institute (ICAITI), the Executive Council, the Economic Council, and finally, by three of the member countries. To insure balanced industrial development, a clause was included in the treaty which stated that a country could not receive two integration industries until each country received at least one.

Although the initial agreement was hoped to be an important device to promote regional industrial growth, in reality, it was characterized by numerous constraining

factors which have tended to restrict the success of the program. During the first ten years of operation, only two integration industries have been approved, and then only by four of the member countries. These consist of a tire and tube plant located in Guatemala and caustic soda and insecticides plants constructed in Nicaragua. Although a glass factory has been designated for Honduras, only one country has approved this protocol.

During 1966 and 1967, the Integration Industries Scheme experienced a new flourish of applications. The reason for the new interest was speculated to be a new interpretation by the Economic Council of the restrictive article on balanced growth. However, no additional protocols have, as yet, been adopted.

The most perplexing problems facing the scheme were discovered to be not so much of a theoretical nature[1] but,

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[1]A limited empirical study of the theory supporting integration industries is presented in Appendix A. This constitutes a case study of the tire and tube plant located in Guatemala City. Information is presented on the changes in output and sales of GINSA precipitated by the enlarged market. This firm was able to more than double its sales within a period of less than two years. Still, however, the absolute volume of imports of tires and tubes into Central America from outside sources was found to be high.

An analysis of the effect of the increased output of the firm on its production costs was limited because of inadequate data. On the basis of available information, it is projected that the enlarged market did not bring about a substantial reduction in unit costs. This conclusion is reached principally because of the short time period involved. It is further concluded that additional information is needed before any definitive statement could be made about economies of scale in this and other integration firms.

instead, of a practical and political character. Two major problem areas were discussed. The first of these was concerned with the policies and attitudes which affect the implementation of industrial development on a regional basis. It was explained that two clauses, both political in origin, have been instrumental in restraining the program--the first being the country-by-country ratification requirement and the second being the balanced growth doctrine. Although the negative attitude of the United States has been accused of restraining the Integration Industries Scheme, a conclusion was reached that this influence has been of comparatively little significance.

Because Honduras has been adversely affected by integration, this country has developed a hostile attitude toward the scheme. None of the existing protocols has been ratified by Honduras. Until special benefits and aid are accorded, the entire integration program will be restrained by this member. Because of the strong concern over national sovereignty on the part of member countries, sufficient conditions were incorporated in the Integration Industries Agreement to allow a single country to significantly affect the success of regional industrialization. It was concluded that the attitude of Honduras reflects the general preoccupation with balanced development in Central America.

The second general problem area discussed was concerned with the regulatory aspects of the Integration

Industries Scheme. The small number of integration industries now in operation has not brought this problem completely to the surface; yet, an examination of the relations between market authorities and one of the existing firms revealed that the addition of new integration industries would accentuate the ineptness of the current regulatory mechanism. It was explained that the Integration Industries Scheme is characterized by an important dilemma; that is, the aspects of control cannot be stringent enough to discourage the use of the program. On the other hand, they must be of such a degree to prevent the utilization of monopoly power.

In addition to integration industries, other projects have been developed to promote regional industrialization. These include a regional system of fiscal incentives, specialized plans for the development of textiles and assembling industries, and a so-called Special System for the Promotion of Production. The goals and the progress of these mechanisms were discussed for the purpose of ascertaining the role of the Integration Industries Scheme in Central American industrial development.

It was discovered that a regional system of fiscal incentives has not yet been approved. Plans oriented toward textiles and assembling industries are still in their infancy. However, the Special System for the

Promotion of Production has turned out to be the most successful regional program to date. The Special System consists of special tariff protection from outside countries on the basis of the infant industry argument.

A subsequent evaluation of these programs indicated that a regional system of fiscal incentives and specialized plans to promote textiles and assembling industries do not tend to replace but, rather, support the Integration Industries Scheme. On the other hand, it was reasoned that the Special System for the Promotion of Production could result in a general condition of production overcapacity, mainly because it depends upon the existence of competition--a luxury which the limited Central American market cannot support. Since this mechanism contains no regulatory apparatus, it may have the effect of attracting those firms which should be classified as integration industries.

A conclusion was reached that none of the regional industrial mechanisms can effectively replace the Integration Industries Scheme. This conclusion was based upon the fact that the small market of Central America can initially support, in many fields, only one firm.

Suggestions were made to improve the implementational and regulatory aspects of the scheme. As a preliminary step, it was recommended that the ratification requirement be immediately removed. An alternative plan

aimed at improving the overall efficiency of the system was also presented. The creation of an industrial commission was considered to be of extreme importance. This organization should take over the implementational and the regulatory aspects of the program. It was further suggested that the regulation of integration industries be streamlined through periodic evaluations of production costs and profits.

A projection was made that the future prospects for the Integration Industries Scheme will be highly dependent upon the initiation of reform measures and the subsequent relaxation of extreme nationalistic motivations. If the Integration Industries Scheme is not revised within the next decade, it is unlikely that it will become an important tool for regional industrial development in Central America.

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APPENDIX A

THE EFFECTS OF AN ENLARGED MARKET: THE CASE OF GINSA

Introduction

The main theoretical condition of the Integration Industries Scheme is based on what seems to be good logic. It is assumed that economic integration brings about the existence of an enlarged market and that this factor is conducive to the occurrence of economies of large-scale production. This remains to be subjected to empirical examination. Few attempts have been made to determine the magnitude of sales increases experienced by firms operating in an integration area. Even less effort has been directed toward an evaluation of the impact of increased sales upon plant efficiency.

Data are not sufficiently available to undertake a detailed study of these phenomena. However, the author was able to collect some empirical evidence while doing research in Central America. This appendix attempts to present these data in a meaningful manner.

Appendix A consists of an examination of the output, sales, and costs of production experienced by GINSA before

and after it became an integration industry. An effort is made to determine the extent to which this firm has been able to attract the demand historically expressed through the import sector. Although the statistics necessary to study costs of production are insufficient to be conclusive, an attempt is made to determine whether or not decreases in per unit costs were incurred because of GINSA's increased sales volume.

Theoretical Considerations

Literature on the theoretical effects of increased market size is relatively abundant. An important part of economic integration theory is centered around this phenomenon. Economic integration will bring about both a consumption effect and a production effect. Although analysis of a static nature can be applied to these phenomena, much of the effect of integration on production and consumption is of a dynamic nature. That is, over a period of time, it is maintained that the firm can become more efficient and that consumers can benefit from this through lower prices.

These dynamic effects are precipitated by the increased sales volume which is experienced by firms residing in an integration area. With larger sales, productive units can produce at a capacity conducive to lower per unit costs, assuming that economies of large-scale production exist. Eventually, the consumer benefits from the reduced costs through lower prices. The degree of consumer benefits

will be determined by the amount of competition and/or monopoly regulation.

The magnitude of an enlarged market and the resulting benefits derived from this phenomenon are rather obscure in developing areas. Although total demand for a given product can be roughly determined, the elasticity of this demand toward the import sector is subject to considerable uncertainty in spite of an external tariff. It may take a high tariff to shift consumption to internal sources, especially if imported products are superior in quality or assumed to be superior.

If demand is completely shifted to internal production, the resulting cost benefits are also uncertain, mainly because they depend upon the existence of an adequate economic infrastructure, financial institutions, technological knowhow, as well as other variables. These may or may not exist. More than likely they will be inadequate. Such institutional factors tend to cloud the theoretical issues involved.

A special problem often arises when attempts are made to examine sales and costs of production of integration industries. That is, integration firms are usually not constructed until they have been accorded the privileges of the Integration Industries Scheme. Hence, these firms actually begin operations in infancy within the context of the Common Market. There is, consequently, no

means of measuring, on a before-and-after basis, the impact of the enlarged market on firm efficiency.

In the case of the tire and tube plant, this problem is averted. GINSA produced within the Guatemalan market for approximately five years before it received integration status. Hence, this provides an opportunity to determine the magnitude of the change in demand for the products of the firm and the subsequent effect upon its costs of production.

A Historical Survey of GINSA

The tire and tube plant of Guatemala was founded on March 14, 1956, under the title of "General Tire and Incatecu, S.A. (GINSA)." The firm was constructed for the purpose of producing tires, tubes, camelback, masterbatch, boots, shoe soles, shoe heels, and rubber plates. Production began in 1958 with an agreement to utilize the technology of the General Tire and Rubber Company of Akron, Ohio. The initial capacity of the plant was approximately 120,000 tires and 96,000 tubes. In 1963, the official title of the firm was changed to "Gran Industria de Neumáticos Centroamericanos, S.A." but continued to be abbreviated as GINSA.[1]

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[1] Honduras, Consejo Ejecutivo, Vigesimonovena Reunión, septiembre 17-20, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo (SIECA/CE-XXIX/D.T.22, September 14, 1967) (Guatemala, 1967), pp. 6-8.

The initial paid-in capital in 1956 was $1,000,000. Since 1956 the firm has increased its capital four different times, and by March, 1963, it reached a total of $3,500,000. The current distribution of capital among private investors by country is as follows: Guatemala--66.01%; Costa Rica--14.45%; El Salvador--8.97%; Nicaragua--1.36%; Honduras--.02%; and Foreign--9.19%.[1]

On January 29, 1963, GINSA was declared an integration industry. It received all the privileges and benefits of the scheme with respect to the production of tires and tubes. GINSA could not begin operations under the auspices of the treaty until three of the contracting states ratified the protocol. Consequently, GINSA did not begin tariff-free sales in Costa Rica and El Salvador until July 1, 1965, and in Nicaragua on October 1, 1965.[2] Honduras, of course, has not ratified the protocol and still maintains tariff duties on tires and tubes coming from Guatemala.

In accordance with Article XXII of the first protocol, GINSA was obligated to increase its capacity to 225,000 tires and 180,000 tubes. This addition was to be completed one year after the protocol legally went into effect or by February, 1966.[3] Although the protocol requires that the

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[1] Ibid., p. 7.

[2] Interview with Mr. Dennis Downing, Treasurer of GINSA, Guatemala City, Guatemala, October 29, 1967.

[3] Ibid.

firm be able to produce only 225,000 tires, GINSA maintains (as of 1967) that it has undergone sufficient changes in the size of the plant to constitute a maximum capacity of 300,000 tires.[1]

In terms of employment, GINSA paid a monthly average of 393 employees in November, 1963. As of 1967, this figure had risen to 603. Approximately 98 per cent of these workers are from Guatemala, the remaining 2 per cent being foreign.[2]

The Magnitude of Regional Demand

Production and Sales of Tires

GINSA officially began negotiations for integration status almost immediately after the Integration Industries Treaty was signed. The period of time which lapsed until it received this position was approximately seven years. Consequently, GINSA has produced in response to Central America's demand for less than two years (1965-1966).

Table 9 contains data on the production and sales of GINSA for three relevant years--1961, 1964, and 1966.[3] The data of this table provide a comparison of the

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[1]Comentarios de la Secretaria a la Exposición del Gobierno de Guatemala, p. 6.

[2]Interview with Mr. Dennis Downing, op. cit.

[3]Data for the years 1962, 1963, and 1965 were not available.

TABLE 9

PRODUCTION AND SALES OF TIRES OF GINSA, SELECTED YEARS, 1961-1966

	Production (In thousands of units)	Percentage Change	Sales (In thousands of units)	Percentage Change
1961[a]	90,000	--	63,697	--
1964	102,895	14	88,992	40
1966	188,661	83	171,601	93

[a]The accounting period for GINSA is from December 1 to November 30.

SOURCE: Data for 1961 from: Guatemala, Consejo Ejecutivo, Segunda Reunión, diciembre 10-15, 1962, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Estudio de Evaluación Técnica-Económica de la Fábrica de Llantas y Cámaras para Automóvil (SIECA/CE-II/D.T.2, November 28, 1962) (Guatemala, 1962), Annex 21; Data for 1964 from: Nicaragua, Consejo Económico, Decimotercera Reunión Extraordinaria, junio 15-20, 1966, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Solicitud de Guatemala (Llantas) (SIECA/CEC-XIII.E/D.T.7, October 13, 1965) (Guatemala, 1965), Annex 3; Data for 1966 from: Honduras, Consejo Ejecutivo, Vigesimonovena Reunión, septiembre 17-20, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo (SIECA/CE-XXIX/D.T.22, September 14, 1967) (Guatemala, 1967), pp. 6-8.

production and sales of GINSA within the Guatemalan market (1961 and 1964) to that of the entire Common Market (1966).

During the period from 1961-1964, GINSA increased its production by approximately 14 per cent. During the same period, sales increased by 40 per cent.[1] Although the production change was not large, GINSA was able to make substantial headway in the Guatemalan market with respect to sales. These sales were consumated under the protection of a national tariff of 60 cents specific and 50 per cent ad valorem (cif).[2]

The initial effect of the Common Market can be ascertained by observing the data for 1966. GINSA sold tires and tubes tariff free in Central America (excepting in Honduras) during the entire year of 1966. The data indicate that from 1964 to 1966 tire production increased 83 per cent and sales increased 93 per cent. It appears as if the short-term effect of the Common Market was significant even though GINSA was in the process of making inroads into the market area.

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[1]The inventories of the firm seem rather high, particularly in 1961 and 1964. These inventories were apparently being built up in anticipation of increased sales when the firm received integration status.

[2]Naciones Unidas, Comisión Económica Para America Latina, Comité de Cooperación Económica del Istmo Centroamericano, Grupo de Trabajo ad hoc Sobre Desarrollo Industrial, Derechos Aduaneros Vigentes en Los Paises Centroamericanos (November 28, 1961) (New York, 1961), p. 6.

Imports of Tires and Tubes

The increase in production and sales of GINSA indicated in Table 9 could not logically be entirely attributed to the single market of Guatemala. However, these data do not give information regarding the magnitude of the change in operations directly caused by the Common Market. Therefore, to obtain some idea of the amount of the change in demand for GINSA's products brought about by the Common Market, it would be useful to examine the imports of tires and tubes of the respective countries of Central America from Guatemala. Since GINSA was the only firm producing tires and tubes in Central America until 1967, such information should be revealing. In accordance with the first protocol, the common external tariff was set at 90 cents specific and 10 per cent ad valorem.[1]

Data in Table 10 show the imports of tires and tubes from Guatemala, by value, of four Central American countries during the period from 1964 to 1966.[2] The imports of all countries during 1964 (when the tariff wall still existed) are relatively small. Data concerning imports for 1965 show a slight increase, with the exception of Nicaragua which imported less in 1965 than in 1964.

[1] Arancel de Aduanas Centroamericana (Guatemala: Secretaria Permanente del Tratado General de Integración Económica de Centroamerica, 1966), p. 6-12.

[2] Data for the years 1961 through 1963 were either inadequate or not available.

TABLE 10

IMPORTS FROM GUATEMALA OF TIRES AND TUBES
OF FOUR CENTRAL AMERICAN COUNTRIES,
BY VALUE, ANNUALLY, 1964-1966
(In millions of U.S. dollars)

	1964	1965	1966
TOTAL	$1,381,799	$1,807,810	$4,781,106
Costa Rica	275,974	595,454	2,175,183
El Salvador	525,903	654,631	1,615,122
Nicaragua	225,274	20,537	623,652
Honduras	354,648	537,188	367,149

SOURCE: Anuario Estadístico Centroamericano de Comercio Exterior, 1964-1966 (Guatemala: Secretaría Permanente del Tratado General de Integración Económica Centroamericana, 1966), Nauca 629-01-02.

This may be due to the following. The Nicaraguan government, having to give up tariff revenue on imported tires from outside countries, wanted to compensate for this loss by taxing the imports of tires from Guatemala. GINSA could not come to any agreement with Nicaragua until the end of 1965.[1] This possibly accounts for the small amount of trade with Nicaragua during that year.

In spite of the perceptible decrease in the case of Nicaragua, total trade increased in 1965. This seems reasonable since GINSA was accorded the regional market

[1]Interview with Mr. Dennis Downing, op. cit.

during the latter part of the year. In 1966, however, a more substantial effect is noticeable. Total imports were more than two-and-one-half times the figure for 1965. Costa Rica and El Salvador are the major new markets although the increase in the case of Nicaragua is also considerable. Consequently, the regional market was at least partially responsible for the increased sales and output which characterized the integration plant during 1966. The peculiar case of Honduras helps to confirm this statement. Since Honduras has not lowered duties, her imports from Guatemala showed no important change and, in fact, decreased slightly in 1966.

There is one more avenue left to be investigated. Even though the demand for GINSA's tires and tubes noticeably increased, this does not necessarily imply that imports were shifted from external sources to internal production. One would logically expect, however, that the common external tariff on tires and tubes would shift consumption to internal production.

The significance of this effect is revealed by the data shown in Table 11, which measures, by value, the level of imports of tires and tubes from outside areas. First of all, the imports of Guatemala need explanation even though they are relatively small. Since Guatemala has the integration industry on her own soil, one would expect a negligible import figure. Guatemala's imports apparently consist

TABLE 11

IMPORTS FROM OUTSIDE COUNTRIES OF TIRES AND TUBES
OF FIVE CENTRAL AMERICAN COUNTRIES,
BY VALUE, ANNUALLY, 1964-1966
(In millions of U.S. dollars)

	1964	1965	1966
TOTAL	$7,944,565	$6,844,488	$6,228,820
Costa Rica	1,857,534	1,857,251	1,213,535
El Salvador	2,352,125	1,371,248	810,731
Nicaragua	2,141,678	1,404,192	1,568,052
Honduras	1,054,986	1,401,981	1,828,996
Guatemala	548,242	809,816	807,506

SOURCE: Anuario Estadístico Centroamericano de Comercio Exterior, 1964-1966 (Guatemala: Secretaria Permanente del Tratado General de Integración Económica Centroamericana, 1966), Nauca 629-01-02.

either of tires which are not produced by GINSA or tires which are imported with vehicles coming into the country. In 1966, for example, the imports of motorized vehicles amounted to 1,059 units.[1]

An additional figure needing explanation is the considerable decrease in imports in 1965 to Nicaragua. The apparent reason for this decline is an excess accumulation

[1] Exposición del Gobierno de Guatemala, Problemas que afectan a la Industria de Integración--de llantas y neumáticos establecida en dicha República, p. 2.

of stocks during 1964 in anticipation of the common external tariff which was to be levied in 1965.[1]

Total imports from outside countries, as shown in Table 11, noticeably declined over the three years (1964-1966). However, an observation of figures for individual countries indicates that El Salvador is the only country to have undergone a substantial decline in outside imports. This is logical since El Salvador is geographically very near to Guatemala. The relatively buoyant market of Costa Rica also showed a noticeable decline. On the other hand, Honduras, which has not accepted the first protocol and still maintains a tariff against tires and tubes, experienced a slight increase in imports.

A summary of the imports of tires and tubes from Guatemala and from outside countries is presented in Table 12. This table attempts to determine the net change in internal and external trade in tires and tubes for the 1964-1966 period. Honduras is excluded because it did not sign the first protocol. Also, since the product under consideration is produced in Guatemala, the imports of this country are not considered in Table 12.

According to the data in this table, the total internal trade increase between 1964 and 1965 was $243,471 (Column 2). Yet, the external trade decrease was $1,708,646 (Column 4)--a much larger figure. Apparently, most of the

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[1]Interview with Mr. Dennis Downing, *op. cit.*

TABLE 12

IMPORTS OF TIRES AND TUBES FOR THREE CENTRAL AMERICAN COUNTRIES FROM GUATEMALA AND OUTSIDE COUNTRIES, BY VALUE, ANNUALLY, 1964-1966
(In millions of U.S. dollars)

		(1) Imports from Guatemala	(2) Change in Total	(3) Imports from Outside Countries	(4) Change in Total
1964	TOTAL	$1,027,151	---	$6,341,337	---
	Costa Rica	275,974		1,857,534	
	El Salvador	525,903		2,352,125	
	Nicaragua	225,274		2,141,678	
1965	TOTAL	1,270,622	+ $243,471	4,632,691	-$1,708,646
	Costa Rica	595,454		1,857,251	
	El Salvador	654,631		1,371,248	
	Nicaragua	20,537		1,404,192	
1966	TOTAL	4,413,957	+ 3,143,335	3,592,318	- 1,040,373
	Costa Rica	2,175,183		1,213,535	
	El Salvador	1,615,122		810,731	
	Nicaragua	623,652		1,568,052	
TOTAL CHANGE, 1964-1966			+ 3,386,806		- 2,749,019
NET TRADE INCREASE			---		- 637,787
			+$3,386,806		-$3,386,806

SOURCE: Adapted from Anuario Estadístico Centroamericano de Comercio Exterior, 1964-1966 (Guatemala: Secretaria Permanente del Tratado General de Integración Económica Centroamericana, 1966), Nauca 629-01-02.

countries were using up accumulated inventories during this period. Hence, the external trade decrease was not matched by increased purchases internally. Contrariwise, the data for 1965 and 1966 indicate a reversal of this trend. The internal trade increase was $3,143,335 while the external trade decrease was $2,749,019. Overall, the 1964-1966 period was marked by a trade increase in tires and tubes by the amount of $637,787.

This is, of course, not an earthshaking figure, and technically it cannot be called "trade creation" since, on the basis of these data, one does not know to what extent trade expansion occurred during the period from 1964 to 1966. These data do indicate, however, that the common external tariff established under the auspices of the Integration Industries Scheme noticeably decreased trade in tires and tubes with outside countries, but the removal of intra-Central American barriers has increased internal trade by a larger amount.

Although the integration firm apparently made significant inroads into the import market during the first years of the Common Market, the absolute volume of imports of tires and tubes from outside countries still remains high. This is true in spite of the fact that GINSA is not operating near full capacity. The firm maintains that it was able to use only 57 per cent of its capacity (in terms

of sales) in 1966.[1]

Costs of Production

The regional demand curve for GINSA's tires and tubes noticeably shifted as a result of the removal of tariffs. There is a possibility that this increased output has allowed the firm to enhance its productive efficiency. If there are advantages to be gained by large-scale production in developing areas, the sales increase should have permitted decreases in per unit costs of production.

Theoretical Limitations

There is not a large number of articles which deal with the measurement of production costs. Perhaps one of the main reasons for this vacuum is the unavailability of data regarding these phenomena. For obvious reasons, firms are usually reluctant to provide researchers with these statistics.

Almost equally exasperating, however, is the difficulty involved in interpreting production costs. First of

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[1] Exposición del Gobierno de Guatemala, Problemas que afectan a la Industria de Integración--de llantas y neumáticos establecida en dicha República, p. 3. It is significant to note that this claim may be exaggerated. GINSA states in 1967 that the capacity of the firm is 300,000 tires. The figure of 57 per cent is based upon this capacity. However, in 1966, the capacity of the firm probably was closer to the figure required by the first protocol or 225,000 tires. In this event, the capacity utilization of the firm would have been approximately 76 per cent, which is still less than full capacity but more respectable.

all, the material utilized must almost always be accounting data and the unit period for accounting purposes usually differs from the unit economic period.[1] Moreover, there is a problem regarding the elements that costs should include. Should they consist of strict costs of production as defined by the payments to the factors or should they include the total costs incurred by a plant during a given accounting period? Equally as disturbing is the problem of allocating costs over the principal product, especially since there are often many products produced by a given firm.[2]

Further complications are incurred when the end result of an investigation is the determination of economies or diseconomies of scale. The theory of economies of scale is founded on precise concepts. Defined, net internal economies of large-scale production refer to net reductions in cost to a particular concern arising from a long-run expansion in output when its unit is produced from a plant of the optimum scale for that output.[3] Economies of scale

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[1]A. A. Walters, "Production and Cost Functions: An Econometric Survey," Econometrica, XXXI (January-April, 1963), p. 42.

[2]Joel Dean, The Relation of Cost to Output for a Leather Belt Shop (Washington, D.C.: National Bureau of Economic Research, December, 1941), p. 59.

[3]Jacob Viner, "Cost Curves and Supply Curves," Readings in Price Theory, Vol. VI, ed. George Stigler and Kenneth Boulding (Homewood, Illinois: Richard D. Irwin, Inc., 1952), p. 213.

are typically a long-run phenomenon dependent upon the appropriate adjustment of the scale of plant to each successive output. These are not synonymous with economies resulting from spreading the overhead, which is a short-run occurrence.[1]

External economies of scale are economies accruing to a particular concern or concerns as a result of the expansion of output of an industry as a whole. If an industry enjoying net external economies of large production increases its output, the average costs of the member concerns of that industry will fall even though many firms maintain a constant scale of plant and a constant output.[2] Under this definition, external economies are not possible in a one-firm industry.

Economies of scale (both internal and external), then, refer to the long-run average cost curve or envelope curve where all costs are variable. If one considers only one scale of plant and, hence, only one cost curve, decreases in per unit costs are technically not economies of scale but, rather, are movements along the short-run average cost curve of a single firm. A legitimate question arises as to whether or not adjustments of plant size or alterations in a fixed plant (not the construction of a new plant) result in a movement along the long-run average cost

[1] Ibid.

[2] Ibid., p. 217.

curve. According to George Stigler, such alterations are not equivalent to movements along the long-run average cost curve because they are based upon changes in the existing plant and not the construction of a completely new plant.[1]

The author accepts Stigler's definition of the long-run cost curve. Even though this study is complicated by an addition to capacity, this will not be considered a long-run phenomenon. The determination of economies of scale are, therefore, technically not within the scope of this study. This analysis is mainly concerned with costs of production relevant to a single cost curve. Time series data are not sufficiently available to estimate the cost function; however, an attempt is made to quantify unit cost changes over three relevant years.

Unit Costs of Production

In order to consider the effect of increased sales upon costs of production, data are presented for three years--1961, 1964, and 1966. As before, two of the three years are concerned with operations before the first protocol went into effect. The data for 1966, though incomplete, permit some quantification regarding the impact of the Common Market.

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[1]George Stigler, "Production and Distribution in the Short Run," Journal of the Political Economy, XLVII (June, 1939), Reprinted in Readings in the Theory of Income Distribution, ed. William Fellner and Bernard Haley (Philadelphia: The Blakiston Company, 1946), p. 132.

Data for 1961 and 1964 are presented in Table 13. The cost items indicated in this table, although they do not constitute total costs for the firm, form the base for all calculations.

GINSA stated in 1966 that tires constitute about 77 per cent of production weight.[1] By assuming that this weight explains 77 per cent of total costs (Column 2), one can estimate a total cost figure for producing tires (Column 3). Unfortunately, this does not allow the calculation of changes in costs caused by increased efficiency in producing tires. The actual percentage of costs related to tires was not available for either of the years studied. Column 4 contains data on the number of tires produced by the firm in 1961 and 1964. By dividing these numbers into the total cost figures in Column 3, it is possible to roughly determine the unit cost of producing a tire in 1961 and 1964.

The calculations presented in Table 13 indicate that per unit costs of production changed by less than one dollar during the 1961-1964 period. This change was consumated while producing mostly for the Guatemalan market with limited sales to other countries. It seems reasonable to assume that unit costs were not significantly affected by

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[1] Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo, p. 25.

TABLE 13

PER UNIT PRODUCTION COSTS OF TIRES,
SELECTED YEARS, 1961-1964
(In U.S. dollars)

	(1) Total Costs of Production	(2) Per Cent of Costs Related to Tires	(3) Total Costs Related to Tires	(4) Units Produced	(5) Per Unit Costs of Tires
1961 -- TOTAL	$2,597,000	77%	$1,999,690	90,000	$22.23
Raw materials	1,538,600				
Labor	149,300				
Manufacturing expenses	678,400				
Administration costs	230,900				
1964 -- TOTAL	2,861,776	77	2,203,567	102,895	21.41
Raw materials	1,779,140				
Labor	186,722				
Manufacturing expenses	472,286				
Administration costs	423,628				

SOURCE: Data for 1961 from: Guatemala, Consejo Ejecutivo, Segunda Reunión, diciembre 10-15, 1962, Secretaría Permanente del Tratado General de Integración Económica Centroamericana, Estudio de Evaluación Técnica-Económica de la Fábrica de Llantas y Cámaras para Automóvil (SIECA/CE-II/D.T.2, November 28, 1962) (Guatemala, 1962), Annex 21; Data for 1964 from: Nicaragua, Consejo Económico, Decimotercera Reunión Extraordinaria, junio 15-20, 1966, Secretaría Permanente del Tratado General de Integración Económica Centroamericana, Solicitud de Guatemala (Llantas) (SIECA/CEC-XIII.E/D.T.7, October 13, 1965) (Guatemala, 1965), Annex 3.

the increase in production associated with the market of Guatemala during the period from 1961-1964.

Of more interest is the year 1966 since this should supply some preliminary information on the impact of the Common Market. The data for this year were only partially available and, consequently, estimates based on the known data have to be utilized. Table 14 provides information concerning this available data and the subsequent estimate based on the known figures.[1]

The estimate of total production costs found in Table 14 may be slightly high. That is, the plant of rubber by-products may constitute more than 15 per cent of total costs. This is possible because GINSA must pay import duties on the equipment and the raw material inputs used in the plant of rubber by-products.[2] These duties need

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[1]Although 1966 total production costs for the firm were not obtainable, the author was able to procure data for the plant of rubber by-products. Since GINSA does not have the privileges of the scheme in the production of by-products, the firm keeps separate accounts concerning their production. On the basis of this information, the method used to estimate total costs is the following.

GINSA stated in 1966 that the production of the plant of rubber by-products constitutes 14.98 per cent of the total production weight of the firm. An assumption is made that this weight explains approximately 15 per cent of total production costs. On the basis of this assumption, total costs can be estimated by dividing the known cost figure for the plant of rubber by-products by 15 per cent. The result is shown in Table 14.

[2]<u>Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo</u>, p. 30.

TABLE 14

ESTIMATED COSTS OF PRODUCTION FOR GINSA, 1966
(In U.S. dollars)

	(1) Costs of Producing Rubber By-products	(2) Percentage of Weight Associated with Plant of Rubber By-products	(3) Estimated Total Costs (1 ÷ 2)
Raw materials	$413,747		
Labor	83,391		
Manufacturing expenses	123,524		
Administrative costs	42,385		
TOTAL	$663,047	15%	$4,420,313

SOURCE: Honduras, Consejo Ejecutivo, Vigesimonovena Reunión, septiembre 17-20, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, <u>Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo</u> (SIECA/CE-XXIX/D.T.22, September 14, 1967) (Guatemala, 1967), Annex 5 and 6.

not be paid for inputs relevant to the production of tires and tubes.

Accordingly, Table 15 attempts to determine the per unit costs for production of tires in 1966. The method utilized is the same as that for the data in Table 13, except for the fact that these calculations are estimates

and, therefore, the author has allowed for a 3 per cent error in either direction. For example, if the costs of production for rubber by-products were as low as 12 per cent of total costs, the data in Table 15 indicate that unit costs would have been about 22 dollars. On the other hand, if they were as high as 18 per cent, unit costs would have been about 15 dollars. Because of the import duties paid on the materials used in producing these products, it is conceivable that costs for the by-products plant could have ascended to 18 per cent of total costs. However, on the basis of production weight, it seems more reasonable to assume that the costs for the plant of by-products constituted approximately 15 per cent of total production costs. If this assumption is correct, the per unit cost of tires was in the area of $18 in 1966. In 1964, this cost was found to be $21.40.[1] Consequently, for the cost factors considered, per unit costs are estimated to have decreased by over $3 after less than two-years operation within the context of the Common Market.[2]

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[1]See Table 13.

[2]Even if the estimation of costs is correct, one cannot state that the improved efficiency was totally the direct result of the increased output of the firm. That is, GINSA most likely incurred some normal changes in efficiency which were not related to the output expansion. The exact amount of the estimated unit cost decrease attributable to the integration program could only be subject to speculation.

TABLE 15

ESTIMATED PER UNIT PRODUCTION COSTS
OF TIRES FOR THE YEAR 1966
(In U.S. dollars)

(1) Percentages of Costs of Rubber By-products to Total Costs	(2) Estimated Figures For Total Costs	(3) Per Cent of Costs Related to Tires	(4) Total Costs Related to Tires	(5) Units Produced	(6) Per Unit Cost of Tires
18%	$3,683,594	77%	$2,836,367	188,661	$15.03
17	3,900,276	77	3,003,212	188,661	15.91
16	4,144,044	77	3,190,914	188,661	16.91
15	4,420,313	77	3,403,641	188,661	18.04
14	4,736,050	77	3,646,758	188,661	19.32
13	5,100,361	77	3,927,278	188,661	20.81
12	5,525,391	77	4,254,551	188,661	22.55

SOURCE: Based on data from: Honduras, Consejo Ejecutivo, Vigesimonovena Reunión, septiembre 17-20, 1967, Secretaria Permanente del Tratado General de Integración Económica Centroamericana, _Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo_ (SIECA/CE-XXIX/D.T.22, September 14, 1967) (Guatemala, 1967), Annex 5 and 6.

A question arises as to whether or not these unit costs of producing tires are realistic. It would be helpful to have some means of determining the approximate validity of the preceding calculations. Although little research has been completed on tire costs, one study done by the Office of Price Administration in 1941 calculated unit costs for several different sized tires for various manufacturers. On the basis of raw materials, labor, and factory overhead expenses, this study revealed unit production costs ranging from $5.29 for a small four-ply automobile tire to $30.27 for a large ten-ply truck tire.[1] Given the fact that more than 50 per cent of GINSA's tire production in 1966 was either for trucks or buses,[2] the calculated average costs in Tables 13 and 15 do not seem unreasonable.

The Possibility of Economies of Scale

Technically, the apparent reductions in per unit costs cannot be considered as economies of large-scale production. GINSA underwent a change in capacity during 1965; yet, according to Stigler's definition, this cannot be considered as the construction of a new plant and,

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[1]Office of Temporary Controls, Office of Price Administration, Economic Data Analysis Branch, _Survey of Rubber Tire and Tube Manufacturers_ ("An Economic Data Series Report," No. 10; Washington, D.C.: Office of Price Administration, 1947), Table 8.

[2]_Comentarios de la Secretaria a la Exposición del Gobierno de Guatemala_, p. 6.

consequently, it is not a long-run phenomenon. Nevertheless, given that GINSA virtually doubled its production between 1964 and 1966, it is likely that some benefits of scale were realized. Pecuniary factors or advantages in buying, such as quantity discounts, would be a likely occurrence. Also, the firm was no doubt able to spread its overhead over more units of production and, accordingly, reduce unit costs. In addition, some normal increases in efficiency due to the age of the firm may have been experienced.

It is worth noting that GINSA may have reaped some cost benefits as a direct result of the Integration Industries Scheme. As was mentioned earlier, GINSA is not required to pay duties on imported raw materials or equipment relevant to the production of tires and tubes. Since the import sector is important to producers in developing areas, this cost benefit may be significant. Statistics are not available regarding the exact amounts of duties paid by GINSA during the period from 1964 to 1966. Also, the firm received some import privileges under the fiscal incentive laws of Guatemala prior to receiving integration status. Still, however, duty reductions would not have had to be extremely large to discount a good percentage of the projected unit cost reduction over this period. This phenomenon is, of course, completely external to the firm.

There seems to be little likelihood that GINSA has, as yet, undergone significant changes which could be

classified as economies resulting from large-scale production. The time period was too short for the occurrence of such internal factors as improved methods of organization or reductions in technological coefficients. The most likely new advantage (other than the special import privilege) was probably the spreading of overhead costs.

Conclusions

During the period from 1964 to 1966, the sales of the integration firm nearly doubled. The imports from Guatemala of tires and tubes to Costa Rica, Nicaragua, El Salvador, and Honduras increased from $1,381,799 to $4,781,106 or more than tripled. This figure constituted over one-half of the total sales of GINSA which amounted to $8,065,274 in 1966.[1] Still, however, the imports from outside countries remained relatively high in spite of the fact that the integration firm apparently had substantial unused capacity.

The effect of the enlarged market upon the costs of producing tires was restricted due to limited data. During the period from 1964-1966, unit costs are estimated to have decreased approximately $3. Part of these gains may be attributable to import privileges associated with the scheme. Also, GINSA was able to spread its overhead costs over more

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[1] Opinión Sobre si una Planta Acogida al Convenio Sobre el Régimen de Industrias Puede Dedicarse a la Manufactura de Artículos Distintos de Aquellos que se Mencionan Expresamente en el Correspondiente Protocolo, p. 25.

units of output and probably experienced some normal changes in efficiency not directly influenced by increased sales.

The designation of more integration industries would be desirable if only to obtain more information regarding the theoretical soundness of the Integration Industries Scheme. The evidence presented in this chapter does not, by any means, confirm the theory supporting this system. Although the demand change precipitated by the Common Market was, in this case, rather impressive, the effect of this change upon production costs is much less certain. Data are scanty and results are inconclusive. More important, however, is the fact that available evidence does not deny that this mechanism could be an efficient method (in terms of theory) of promoting industrial development. The message of this chapter is not one of pessimism. Rather, the door is left open for more investigation and further empirical research regarding GINSA and other integration industries. Hopefully, in future years, data will tend to become more available.