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**NEW PERSPECTIVES FOR  
MODERNISATION IN CENTRAL AMERICA**

George Irvin  
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## Table of Contents

1. Introduction	1
2. US Hegemony	2
3. Theorisations of the Crisis	6
4. The Economic Model of the 1990s	16
5. Conclusions	23
References	25



## New Perspectives for Modernisation in Central America:

### 1. Introduction<sup>1</sup>

This purpose of this paper is to challenge the view that the crisis of the 1980s has greatly set back the process of modernising Central America's economic and political structures and, in consequence, the outlook for the 1990s is bleak.<sup>2</sup> Instead, we argue that the outlook for modernisation in the 1990s may well be brighter than at any time in the post-war period.

The argument is set out in three parts, each constituting a separate sections, and may be summarised as follows. First, with the emergence of a European interest in Central America and the collapse of the cold-war, US support for anti-communist regimes of the right in Central America (and its hostility towards any political force which attempts to challenge such regimes) will become increasingly difficult to sustain. Second, within the region, theorisations of the Central America's economic crisis and its resolution are converging. The eclipse of the central-planning orthodoxy offered by the left as well as of extreme neo-liberalism on the right opens the way to a more measured, detailed debate within the structuralist tradition. In particular, strategies of export-led growth (ELG) and import-substitution industrialisation (ISI) are no longer viewed as mutually exclusive but rather as mutually re-enforcing. Thirdly, it is argued that the restructuring of the Central American economies in the 1980s has set the stage for successful extra-regional export diversification in the 1990s. While external capital injections are unlikely to increase, the debt burden will be alleviated and new trading opportunities will present themselves. However, if Central America is to take full advantage of these opportunities, changes-

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<sup>1</sup> The original draft of this paper was prepared in March, 1990, for IESCARIBE, Florida International University, Miami.

<sup>2</sup> Recent publications which have expressed pessimism about the prospects for Central American economic recovery include Fagen (1987), Lindenberg (1988), ICCARD (1989) and Weeks (1990).

--particularly in its intra-regional pattern of trade---must be effected which result in a more equitable distribution of income both within and between countries.

This 'optimistic' scenario needs careful qualification. To argue that prospects are brighter for the region is not to say that all countries will do equally well. Politically, modernisation in Guatemala and El Salvador continues to look problematic. Economically, the degree to which economic restructuring has taken place in the 1980s varies greatly between the five republics; Costa Rica is in the strongest position to gain from trading opportunities in the 1990s while El Salvador and Nicaragua are in the weakest. Much will depend on whether the five republics recognise that regional co-operation can be strongly beneficial for all. Finally, whether world growth and trade does accelerate in the 1990s as we argue depends crucially on assuming that there is change with political stability in Eastern and Central Europe (ECE) and that the full economic integration of the European Community proceeds on schedule.

## 2. US Hegemony

In a recent radio interview,<sup>3</sup> Elliot Abrahams, one of the architects of the Reagan Administration's policy towards Central America, argued that the Sandinista defeat in the Nicaraguan general election fully vindicated US policies towards the region over the past decade. "Two down [Panama and Nicaragua]," he crowed, "and one to go [Cuba]".

Despite the hyperbole, it would be foolish to ignore the underlying logic of this position. Viewed against the backdrop of events in Eastern and Central Europe, the mixture of *dependendista* theorising and Leninist exhortation which characterises much Latin American revolutionary rhetoric appears increasingly anachronistic. On the Central American isthmus, the tide of political nationalism---whether in the populist version espoused by Torrijos or the nominally Marxist version of the Sandinistas---has been rolled back by the muscular diplomacy of economic boycott,

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<sup>3</sup> BBC World Service; 'Newsdesk', 27 February 1990.

counter-insurgency and (where feasible) direct intervention. This, together with the containment of guerrilla movements in Guatemala and El Salvador, appears to represent a major triumph for the US and, *pari passu*, an historic defeat for the region's progressive forces which at the beginning of the 1980s seemed poised for victory in their long struggle against US-sponsored local oligarchies.

Equally, the economic dimension of the populist project has been rolled back. Import substitution industrialisation (ISI) within the Central American Common Market (CACM)---whose genesis is in the progressive political coalitions of the 1940s---has been superseded by a new "outward looking" model informed by free-market ideology and under IMF and World Bank sponsorship. In short, when the political and economic dimensions are summed, the conclusion appears to be that the US has re-established its political hegemony over the region more fully than at any time since the Cuban revolution.

Although ostensibly a victory for the political right, our argument is that these changes opens vital political space for modernisation, space which the political left would be foolish to ignore. Historically, the defining characteristic of US policy towards the region is not anti-modernisation *per se* but rather the subordination of regional concerns to US global interest. In the early post-war period, these interests were defined almost exclusively in terms of superpower rivalry and anti-communism became the national obsession. Where radical modernisation coincided with anti-communism, as it did quite fortuitously during the Costa Rican 'revolution' of 1948, US support was assured; by contrast, the alleged communist leanings of the reformist Arbenz regime in Guatemala ensured its undoing in 1954. When the US latter attempted to foster political modernisation of the region during the Kennedy years, the project was fatally flawed by its 'two-track' nature; i.e. by the contradiction between implementing a programme of structural change and support for the region's armed forces, codified in the form of the 'national security' doctrine.

Today, three factors have combined to undermine the anti-communist barrier to modernisation. The first, obviously, is the current upheavals taking place in the 'communist' world which is rapidly undermining the cold war in general and East-West rivalry in Central America in particular; the proximate effect of this upheaval is that revolutionaries in the region can no longer count on the Soviet Union and its allies for material and moral support. The second is the rise of Europe as an external actor with its own well-financed modernisation programme for the region, whether Christian- or Social Democratic. The third is the profound impact which these changes are having on the Central American left itself which must now jettison revolutionary nationalism in favour of a pragmatic reformism which seeks alliances with key sections of US and European political opinion.

Moreover, the 'contradiction' inherent in the US-sponsored national security doctrine has assumed growing importance. The rise of the armed forces as an autonomous political force in the region, which progressed unabated in the 1970s and accelerated in the 1980s, has not always and everywhere served US interests. In Guatemala, the ultra-nationalist right of the military (whether under Lucas García, Ríos-Montt or Mejía Victores) proved so unresponsive to Washington's wishes that aid was cut off and only restored when civilian rule was re-established in 1984. The US-backed Cerezo government has proved so inept at controlling the military that its survival is in question. In El Salvador, it was the ultra-nationalism of Colonel Romero which led to the US-sponsored coup in 1979. Since then, the military has lived in uneasy partnership with the US and has continually frustrated US efforts to implement basic reforms (e.g., land reform, fiscal reform) and to create 'moderate' Christian Democratic power base capable of conferring some degree of legitimacy upon state power. In Honduras, it was US pressure in the late 1970s which forced the ultra-nationalist General, Policarpio Paz, from power. Most recently, and most ironically, the US has invaded Panama to oust a nationalist General formerly on the payroll of the CIA.

In short, there is good reason to believe that the US perception of its friends and enemies in Central America will



change in the 1990s. As the revolutionary left fragments, the tendency to see revolutionary left-wing nationalism as the main cause of destabilisation will recede; by contrast, the ultra-nationalist wing of the military increasingly will be seen as the main impediment to political and economic modernisation. US leverage on the Central American military establishment will decline in direct proportion to the US aid effort,<sup>4</sup> leading quite possibly to the 'narcotisation' of sections of the military establishment in Guatemala and El Salvador.

At the same time, greater resources will be available to moderate civilian governments---starting with the centrist alliance of Sra. Chamorro---through multilateral and European agencies. Pressure will grow to maintain in power a nominally centrist administration in Guatemala, and to negotiate a settlement based on some form of power-sharing in El Salvador. It is even conceivable that in Nicaragua the 'moderate' and 'Somocista' fractions of the UNO alliance will split, the latter attempting to renew the contra war. Under such a scenario, for the first time since the Second World War, the ultra-nationalist right would enter into open conflict with the US.

This process, it can be argued, will be strengthened by new economic developments. The relative decline of traditional exports---particularly coffee and sugar---not only will undermine the power base of the landed oligarchy but, more crucially, will diminish the need for a large rural proletariat opening the way to land reform in the northern republics. The patronage-state with its "caudillismo" antecedents rooted in a combination of military repression and lower-middle class populism gradually will wither. The region's 'under-developed' national bourgeoisie---in reality a broad alliance encompassing the financial and industrial wing of the oligarchy at one end and small business at the other---will gain decisive political hegemony enabling the modernisation and democratisation of the state to proceed. Nationalism of a stridently anti-imperialist character will decline, partly in

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<sup>4</sup> For 1990, US Economic Support Funds (ESF) to the region have been cut from US\$ 440 million to US\$ 309 million, a drop of 30 percent while grants also have been cut by 30 percent; see CAR, 23 February 1990.

consequence of diminished domestic polarisation though too because the region's *de facto* integration into the North American trading block will entail greater mobility of not just of capital but of labour, leading to an increased reflux into the region both of private capital and remittance earnings.<sup>5</sup> As FitzGerald (1989) argues, a pertinent political feature of the Central American adjustment process is the extent to which the different fractions of civil society have distanced themselves from state patronage.

### 3. Theorisations of the Crisis

The current section sketches the economic background to the crisis of the 1980s, critically examines 'conventional' competing explanations, and argues that the 1990s will be characterised by a convergence of economic prescriptions combining key elements of the neo-liberal and structuralist positions.

It is generally agreed that the crisis of the 1980s is the most serious Central America has known since the 1930s and, arguably, this century. The crisis has combined internal political upheaval and external economic shock in historically unprecedented proportions. The region's standard of living has declined precipitously. In the first half of the 1980s the region's growth rate was strongly negative, effectively wiping out the gains from twenty years of growth. Although growth rates have recovered during the second half of the decade, the overseas indebtedness of all five countries has increased dramatically, inflation has forced the region off the dollar standard, the intra-regional trading system has nearly collapsed, and poverty has grown.

In the 1960s and at least part of the 1970s, Central America achievements were notable. Real GDP per capita more than doubled between 1950 and 1970. The share of exports in GDP went up from under one-fifth in 1960 to over one-third in 1980. In some agro-export branches (e.g. cotton), yields were amongst the highest in the world. Under the impulse of the Central American Common Market established in 1960, intra-regional trade grew faster than

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<sup>5</sup> The importance of remittance earnings has already been noted by various authors including Montes (1987) and Kaimowitz (1990).

external trade as a whole until, at the end of the 1970s, it represented about one-quarter of total trade. Much of this trade was in final and intermediate manufactures. In consequence, the share of industry in regional GDP, which before the Second World War had been negligible, by 1980 averaged just under 20 percent for the five countries; by 1975 in Guatemala, manufactured and semi-manufactured products accounted for more than half of total exports.<sup>6</sup> In short, by the early 1970s it appeared that Central American import substitution industrialisation (ISI) was successful and the region well-established on a path of self-sustained growth.

The first signs of an economic slowdown appeared after the 1973 oil crisis which both worsened the region's net barter terms of trade (NBTT) and, because of the high energy content of domestically produced goods, raised the price of non-traded goods relative to traded goods. In the absence of devaluation, pressure on the external balance was alleviated by a brief improvement in the terms of trade---the coffee and cotton price increases of 1975-77---and more importantly by increased overseas borrowing. However, despite the highly open nature of the Central American economies,<sup>7</sup> external shock was not the only reason for the slowdown. The expansion of the private sector entailed a growing demand for state services, particularly in education, transport and energy, which required both capital and recurrent expenditure support. In the absence of reform, as trade-based tax receipts were eroded by import-substitution, Government deficits grew steadily throughout this period adding to the pressure on the external balance. In theory, such pressure could have been alleviated by an increase in domestic savings. In fact, although in the second half of the 1970s real wages were falling throughout the region, a rising profit share was not reflected in the growth of domestic savings but rather in the beginning of capital flight

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<sup>6</sup> See Guerra Borges (1988).

<sup>7</sup> In the 1970s the average share of trade in Central American GNP was just over 30 percent; see ECLAC (1985).

which, by the end of the decade, became a veritable haemorrhage.

The 1979 oil price rise turned a difficult situation into an economic impasse. This time, the shock was unrelieved by an upswing in commodity prices; instead, net barter terms of trade continued to deteriorate and export volumes stagnated. In 1980, coffee prices were only half their 1977 level. At the same time, all countries tried to maintain current consumption while some (e.g. post-Somoza Nicaragua, Costa Rica) attempted to raise both consumption and investment. This could only be financed by increased overseas borrowing which virtually doubled in the period 1979-82. The Mexican debt default of 1982 constituted the *coup de grace*; credit dried up and so began the extremely painful period of adjustment which characterises the 1980s.

What is clear from the above sketch is that the crisis was not simply the product of the 1980s; rather, its roots lie in the development model which dominated the two previous decades. On this point, most authors are agreed. Where there is disagreement is on how to theorise the weaknesses of that model. Viewed from the vantage point of the mid-1980s, competing theorisations of the crisis could be divided into three schools which for simplicity are referred to below as the neo-liberal, structuralist and radical-left views.<sup>8</sup>

The neo-liberal view, as the name suggests, locates the proximate cause of the crisis in the financial indiscipline which was incipient after 1973 and became endemic after 1979. The fundamental cause, however, is seen in the inherently inefficient nature of ISI which stunts industrial maturation, exacerbates the foreign exchange constraint and promotes rent-seeking behaviour.<sup>9</sup> This view informs the policy packages which have been put in place in most of the republics by the IMF and the World Bank; its ante-

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<sup>8</sup> I am well aware of the dangers of dividing a complicated universe of discourse into three neatly rounded parts. The 'radical-left' characterisation given below is particularly questionable since it lumps together a variety of positions; many Marxists would take strong exception to being grouped together with the *dependentista* school of which they have been highly critical.

<sup>9</sup> These views are well-known and have been set out *inter alia* by Kreuger (1974), Balassa (1983) and in World Bank (1988).

cedents go back at least to the debate in the late 1950s which opposed the US sponsored "free-trade" version of the CACM to the "customs union" favoured by ECLA.

The neo-liberal prescriptions are well-known and applied in standard form. Tariff rationalisation and real exchange rate adjustment serve to switch resources from the non-traded to the traded sector, while monetary discipline, public expenditure cuts, and privatisation are required to switch resources from the public to the private sector. The latter, although exposed to chiller competitive winds, benefits in the sense that domestic crowding out ceases and international commercial credit reappears. Growth becomes driven by a 'competitive' export sector specialising according to comparative advantage and incidentally enabling indebtedness to be reduced.

The second theorisation is that advanced by what may be called the 'structuralist' school. For present purposes, we shall take this to be synonymous with the views advanced over the previous decade by ECLAC. While ECLAC has conceded that certain IMF-style policies were necessary, its underlying model is significantly different from that proposed by the neo-liberal school. Industrialisation remains at the top of the agenda and "economic opening" (*apertura*) is merely instrumental to industrial revival. The fact that, historically, ISI often was accompanied by inefficient trade restrictions (or for that matter inefficient tax incentives) does not show ISI to be irrelevant. Numerous examples are cited both from DCs and NICs in which early industrialisation was accompanied by protection and, more generally, by selective state intervention. The particularity of the pre-1980 Central American model is that inefficient and unco-ordinated industrialisation was grafted onto a traditional agro-export base producing what has variously been termed 'additive' or 'hybrid' development.<sup>10</sup> In the 1980s, moreover, orthodox adjustment policies may have been necessary, but the speed of economic opening have been "excessive" in that

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<sup>10</sup> For a critical examination of the 'additive development' thesis advanced by ECLAC, see Irvin (1988). The 'hybrid model' argument is advanced by Bulmer-Thomas (1987).

despite the costs---borne mainly by the poor---a sustained process of private capital accumulation has not resulted.

The third or radical-left view sees revolutionary structural transformation as a necessary condition for growth, a transformation impeded politically by the oligarchy's monopoly of state power and, economically, by a world trading system in which the richer nations extract ever-growing surplus value from the poor. On this reading, as world markets weakened in the 1970s, Central American growth could only be maintained by squeezing real wages. It was this squeeze which precipitated the political crisis of the late 1970s, a crisis characterised by twin shocks---externally, deterioration of terms of trade and the debt problem; internally, by labour rebellion and capital flight---shocks which forced most of the region's governments into IMF receivership.

On this view, neo-liberal restructuring cannot bring about sustained growth because the real wage cut required to restore an 'acceptable' rate of profit to local capital is simply not possible; hence the region must remain chronically aid-dependent for the foreseeable future. The political corollary of this view is that the United States, having failed to create a centrist coalition based on Christian Democracy, must continue to extend *de facto* support to "oligarchic despotism"<sup>11</sup> since it perceives any nationalist and populist project of the left or right (e.g. Nicaragua or Panama) as inimical to its geopolitical interests. Any capitalist modernising project, therefore, is doomed to failure. In the words of one commentator, Central America's "crisis sin salida" will persist into the 21st century.<sup>12</sup>

For the radical-left, if modernisation is to be successful, two conditions to be met: politically, oligarchic despotism must be defeated by an alliance of popular forces; economically, a new, state-led model of development must be built which mobilises the

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<sup>11</sup> The term is from Baloyra (1983); ironically, the original version of his paper was prepared for the US State Department.

<sup>12</sup> See Reeks (1990).

necessary resources for accumulation and under which production for profit is subordinated to production for social needs.<sup>13</sup>

**Table I: Growth Rates of GNP in Central America, 1980-88**

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Costa Rica	0.7	-2.4	-7.3	2.7	7.9	0.9	5.3	5.1	3.8
El Salvador	-9.0	-8.4	-5.7	0.5	2.3	1.8	0.5	2.7	0.5
Guatemala	3.9	0.9	-3.4	-2.7	0	-0.6	0.3	3.1	3.5
Honduras	2.6	1.5	-1.9	-0.3	2.8	3.2	3.1	4.2	3.8
Nicaragua	4.5	5.4	-0.8	4.6	-1.6	-4.1	-1.0	-0.7	-8.0
Region	0.7	-0.9	-4.1	0.1	2.2	0.3	1.7	3.3	2.0

Source: CAR 5 Oct 1989

How do these theorisations square with the facts of the 1980s and how will they change in the 1990s? First of all, if one considers the evidence on GNP growth in the 1980s, what is striking is that, compared to Latin America as a whole, Central America has performed remarkably well in the second half of the decade. Table 1 shows rates of growth of GNP for the five Central American countries. According to ECLAC, for Latin America as a whole, the average GNP growth rate was negative in 1988 and the average level of GNP was 8 percent lower than in 1980. By contrast, only one of the Central American republics experienced negative growth in 1988, and the average annual rate of growth for the period 1980-88 was 5.3 percent. Moreover, since 1982, the countries which have grown fastest are Costa Rica and Honduras while that which has done worst is Nicaragua.

<sup>13</sup> In the case of Nicaragua, see Irvin (1983) in which I take this position, although I qualify the argument by insisting on the crucial need to generate a trade surplus to provide the forex for investment.

On the face of it, this evidence certainly does not support the rather dire predictions of the radical-left.<sup>14</sup> It might be argued, however, that the relatively good performance of Central America is explained by the degree to which countries have complied with wage cuts imposed by the IMF; hence, it is worth looking at the evidence on real wages.

**Table II: Movements in Real Wage Index, 1985-88 (1985 = 100)**

	1985	1986	1987	1988	1985-88
Guatemala	100	82	88	99	92
El Salvador	100	88	70	66	81
Honduras	100	96	94	89	95
Nicaragua	100	74	82	22	70
Costa Rica	100	106	96	95	99

source: CAR, 1 December 1989

Table 2 shows movements in the real wage index for the years 1985-88. Although no country records a growth in real wages, Costa Rica's average real wage index over this period has remained approximately while that of Honduras shows a slight fall. Guatemala appears to have dipped and recovered, though there is partial evidence that in 1989-90 real wages have fallen sharply. Nicaragua has done particularly badly because of the erosion of the real wage caused by inflation. In short, those countries which have experienced strong economic recovery in the second half of the 1980s are also those in which real wages have suffered least. This observation is certainly at odds with the radical-left view and provides some grounds for questioning the proposition that IMF-style policies necessarily lead to 'excessive' adjustment. What appears truer is that in countries such as Costa Rica which responded to the crisis relatively quickly by switching resources

<sup>14</sup> An example of such pessimism is Fagen (1987) who says: "if current conditions continue, no Central American country will register positive per capita growth between now and 1992...and even this scenario of stagnation cannot be maintained without very substantial levels of foreign assistance...estimated at approximately \$2.3 bn per year of external (non-military) financing for Costa Rica, Honduras, El Salvador and Guatemala" (p.31)



**Table III Percentage Shares of Non-traditional Exports in Total Exports, 1982--87.**

	1982	1983	1984	1985	1986	1987
Guatemala	31.9	33.3	32.0	25.7	23.0	23.8
El Salvador	8.4	8.1	10.4	11.3	10.7	9.7
Honduras	27.1	32.0	27.8	33.4	28.7	25.5
Nicaragua	8.9	7.9	5.1	4.0	4.2	6.0
Costa Rica	23.7	18.7	24.7	25.6	33.5	34.9

source: Fuentes, Garcia & Pira (1988), cuadro no. 9.

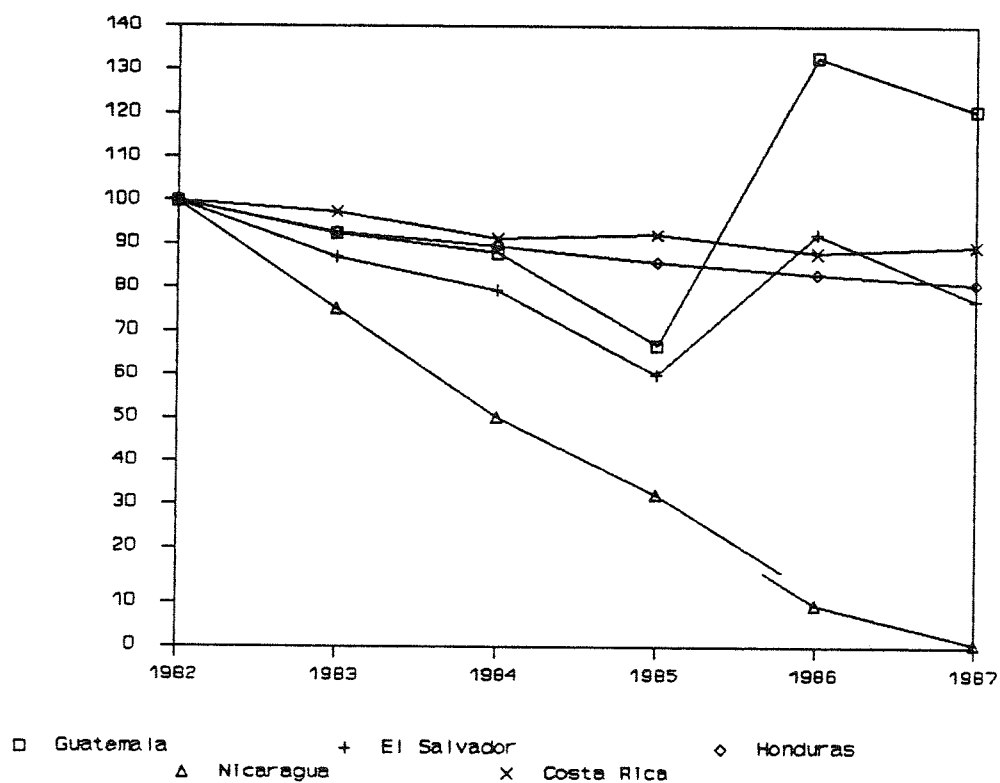
successfully to new exports, the adjustment process proved less painful than in countries which did not (or could not) respond.

In Central America, a benchmark of 'successful' adjustment has been the growth of non-traditional exports; i.e. the degree to which the region has succeeded in diversifying the narrow export base which characterised the pre-1980 growth model. Successful diversification, in turn, appears to be closely associated with maintaining the real exchange rate (RER) by a combination of anti-inflationary financial discipline and nominal devaluation. Table 3 shows the changing percentage share of non-traditional exports<sup>15</sup> in total exports for the five countries over the period 1982-87 while Table 4 shows movements in real exchange rates over the same period.

Taking the two tables together, the first point to note is that the countries which have maintained a relatively constant RER over the period, Costa Rica and Honduras, also show a trend increase in the share of non-traditional exports (NTX); Costa Rica

<sup>15</sup> by 'non-traditional export' is means any export other than the five traditional products of the region: coffee, bananas, sugar, cotton and livestock.

**Table IV Central America: Real Exchange Rates 1982-1987**



strikingly so, while in Honduras the share dips in 1987.<sup>16</sup> In the cases of El Salvador and Nicaragua, the NTX share is initially far smaller than in the remaining countries. In El Salvador, a deteriorating trend in the RER followed by a correction in 1985 is associated with a slight upward trend in the share of NTX; the movements, however, are too small to infer any causal relationship. By contrast, the declining share of NTX in Nicaragua appears strongly correlated by the highly adverse movement in the RER over the period. Finally, in Guatemala, a large nominal

<sup>16</sup> Since 1987, Costa Rica has followed much the same strategy. Although the final figures for 1989 are not yet available, the provisional estimates are that the share of non-traditional exports in the total is 51 percent; the rate of growth of GNP is 4.5 percent, and there is a surplus on trade account. See CAR, 19 May 1989.

devaluation in 1985 seems to have arrested the decline in the initially high NTX share.

If the economic evidence has undermined 'extreme' positions on Central America, changes on the ideological climate have played an even more decisive role. The proximate causes for these changes are not difficult to find. At a global level, the end of the 1980s has been marked both by the collapse of Eastern Europe's sclerotic communism and by the close of the Reagan-Thatcher-Pinochet era. In Central America, neither the radical left nor the radical right has proved adept at economic management. In particular, the lessons of the Sandinista experience have been, first of all, that in the absence of unlimited aid, no small country can resist a concerted campaign of military and economic destabilisation by the United States and, secondly, that a Government which proclaims itself deeply anti-capitalist is unlikely to be very good at managing a small, fledgling capitalist economy.<sup>17</sup> Nor has the record of the extreme Right been particularly encouraging either. Of the five republics, the two with the best growth record in the 1980s were those which had experienced progressive reform in the areas of land tenure, labour legislation and fiscal policy in the 1960s and 1970s: Costa Rica and Honduras.

How are ideological positions likely to evolve in the 1990s? Broadly speaking, it is likely that the radical-left will lose much of the intellectual high-ground it has held in the post-war years, and that there will be significant convergence---though continued lively debate---between the neo-liberal and structuralist schools. In particular, structuralists will take on board certain important neo-liberal principles such as the need to open the economy and streamline the state, though continuing to insist on the role of the State in redressing intra- and inter-country distributional inequity and sustaining accumulation. The extreme right-wing form of neo-liberalism---e.g. that which sees the

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<sup>17</sup> A critically sympathetic view of the difficulties in embarking upon a 'socialist' project in the face of US opposition is Helwege (1989); the author makes some telling points about under-estimating the importance of the foreign-exchange constraint. Dornbusch (1989) also is instructive on the perils of 'populist' economics though from a somewhat different perspective.

operation of the market as sacrosanct and denies any role to Government beyond that of acting as guarantor of property rights--will tend to fade at much the same rate as its homologue on the political left.

#### 4. The Economic Model of the 1990s

As Bulmer-Thomas (1989) has pointed out, the pre-1980 development model rested on three pillars---traditional agro-exports, the dollar standard and the growth of intra-regional trade (IRT)---all of which collapsed in the 1980s. Even if these pillars could be resurrected, there is another overriding reason for not wishing to return to the traditional model, notably the extreme income inequality which accompanied it.

What sort of long-run development model is now available to the region and what are the preconditions for its implementation? Abstracting away from the question of peace, already discussed above, at least three conditions must be fulfilled if the region is to grow again on a sustained basis: stabilisation must be completed; the financial constraint must be eased and both extra- and intra-regional trade must be placed on a new footing.

Of the five republics, Costa Rica is the only one which can be said to have completed the stabilisation phase successfully; it has brought inflation under control, restructured its export sector and achieved a healthy external position. Both Guatemala and Honduras are still in the process of stabilising their economies and, to a lesser degree, have succeeded in improving their external balance. In Nicaragua, after a notably unsuccessful attempt at stabilisation (the *Plan Cordoba*) in 1988 followed by hyper-inflation, the Sandinistas adopted an extremely tough stabilisation policy which, though hampered by the lack of an adequate foreign exchange cushion, began to pay off in 1989.<sup>18</sup> The election of the UNO government and the end of the contra war

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<sup>18</sup> Between January 1988 and January 1990, Nicaragua has carried out 40 mini-devaluations and the budget deficit has been cut from 25% to 5% of GDP. Prior to the February elections, the budget proposals put forward by the Sandinista government foresaw a reduction in the deficit to 4% of GDP which, on a per capita basis is equivalent to that of Guatemala, the second lowest in the hemisphere. See CAR, 8 December, 1989.

probably will bring immediate relief in the form of the lifting of the US embargo, fresh bi-lateral assistance and, most important, renewed access to multilateral funding; hence it is likely that stabilisation in Nicaragua will be consolidated within a two to three-year period.

The most difficult case appears to be that of El Salvador which, although it has avoided hyper-inflation, has become chronically aid-dependent. In 1989, it received 42 percent of US economic support funds for Central America. Since Congress wishes both to cut and to reallocate total aid to the region, it is clear that the US will now be pressing hard for a negotiated settlement to the civil war without which stabilisation cannot be achieved.

A second precondition for successfully re-launching sustained growth is greater access to external finance. Here the scenario is more problematic. One aspect of the problem is the drying up of direct foreign investment (DFI) which occurred in the 1980s. In the words of one commentator, "the base flows for DFI are so low that even a sharp recovery in percentage terms will not be sufficient to solve the financing problem".<sup>19</sup>

Another problem is the enormous build-up of debt which occurred in the 1980s.<sup>20</sup> Both the PEC (*Programa Especial para Centroamérica*)<sup>21</sup> and the 'Brady Plan' rightly place emphasis on debt reduction rather than its refinance. However, the Brady Plan is mainly concerned with swapping existing commercial debt on secondary markets; since over 90 percent of Central American debt is public, this does little to address Central American problems.<sup>22</sup> As to the PEC, while European Community assistance to the region

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<sup>19</sup> See Bulmer Thomas (1989), p. 9.

<sup>20</sup> The World Bank estimates the region's debt at the end of 1989 as US\$ 20.3 billion. The breakdown is: Guatemala US\$ 2.6 bn, El Salvador US\$ 1.8 bn, Honduras US\$ 3.3 bn, Nicaragua US\$ 8.1 bn, Costa Rica US\$ 4.5 bn. See CAR 12 January 1990.

<sup>21</sup> See United Nations (1988).

<sup>22</sup> Caballeros (1988) estimates that, for 1986, 94 percent of Central America's overseas debt is public or publicly guaranteed.

rose considerably in February 1989 and an important initiative was undertaken to help refinance Central American Common Market trade, little has been achieved on the debt front.<sup>23</sup> A particularly important question is what will happen to the Nicaraguan debt, owed largely to the Eastern block countries, under present conditions. It is possible that the US will place strong pressure Nicaragua's principle creditors to write off this debt as one of its conditions for extending aid. In short, although the region's debt burden is high and little appears to have been done to relieve it, the burden is extremely uneven resting chiefly with Nicaragua and Costa Rica. Significant steps have been taken towards easing Costa Rica's private debt, chiefly by means of swaps, while the solution of the Nicaraguan debt problem will depend on negotiations taking place in a far wider context.

As to the future of official development assistance (ODA), it is difficult to say whether this will rise or fall. It is possible, but by no means certain, that the decline in US direct assistance to the region will be offset by rising European Community and Japanese aid. The 1989 and 1990 rounds of the San José process have resulted in increased European aid while Japan recently has given significant assistance to Costa Rica. The 'Sanford Commission'<sup>24</sup> recently reported that in 1990 some 10 million people (40 percent of the region's population) will live in extreme poverty. The Plan calls for US\$ 11.3 bn over next 5 years or over US\$ 2 bn per annum, a 25 percent

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<sup>23</sup> In Costa Rica, of a total debt of US\$ 4.8 bn, US\$ 1.6 bn is owed to international commercial banks. Moreover, Costa Rica has been paying back only US\$ 5 mn per month on one-third of what is scheduled. On the secondary market, Costa Rican debt in 1989 sold at only 12 percent of its face value. However, there have been some interesting examples of "debt swap" initiatives on a modest scale. For example, the Netherlands government has initiated an 'ecological debt swap' and has bought up US\$ 33 mn of Costa Rica's debt from a US bank for US\$ 5 mn; the Dutch then traded the debt for the equivalent of US\$ 10 mn in colones and donated the sum to the Costa Rican government to finance a reforestation project. Similar schemes have been carried out with the World Wildlife Fund and Nature Conservancy. In total, about US\$ 75 mn of Costa Rica's debt has been exchanged for US\$ 30 mn and invested in the environment. However, when recent US and Japanese loans conditioned on structural adjustment are taken into account, in total Costa Rica has US\$ 170 mn of the US\$ 250 mn it needs to buy back US\$ 1.6 bn in commercial debt. Moreover, although it has devoted a fifth of its export earnings to interest repayment, for the past 3 year there has been a strong flow of capital into the economy. See CAR, 31 March 1989.

<sup>24</sup> See 'Sanford Commission listed in the references under ICCARD (1989).

increase in current levels aid level and its most important recommendations include the reorganisation of the Central American Common Market (CACM) as a customs union, the renegotiation of debt and measures designed to improve the region's terms of trade. Nevertheless, it is difficult to see any major rise in ODA taking place under conditions of aid-switching from the Third World to Eastern and Central Europe (ECE). However, as we argue below, this trade switching effect may be more than offset by an expansionary international environment bringing improved terms of trade.

Two further sources of non-traditional finance deserve mention. The first is the repatriation of 'flight capital'. Given the very substantial outflow which took place in the late 1970s and throughout the 1980s, sustained growth in the region over the first half of the 1990s could be expected to tempt some of this back into the region. Various schemes have been proposed for the issue of indexed, dollar backed bonds to absorb this capital.<sup>25</sup> The second is remittances from citizens living abroad which in grew rapidly in the 1980s and at present are estimated unofficially to be the most important single source of foreign exchange in three countries: El Salvador, Guatemala, and Nicaragua. Estimates reported in Kaimovitz (1989) of remittances to El Salvador in 1987 range from \$200 million to \$1300 million while in the case of Nicaragua the figures for 1989 vary between \$70 million and \$300 million. Since much of the money does not pass through the banking system, not only is it difficult to record, but it serves in part as a conduit for further capital flight.<sup>26</sup> Nevertheless, remittances will at least remain at their present level and possible grow during the 1990s; policies designed to attract remittances into the banking system, moreover, would increase the efficiency of their impact on the economy.

As regards the restructuring of extra-regional (ERT) and intra-regional trade (IRT), two points are crucial. Firstly, it is clear from the Costa Rican experience that, given the right

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<sup>25</sup> See for example FitzGerald and Croes (1988) and United Nations (1988).

<sup>26</sup> See Bulmer-Thomas (1989).

incentives, resources can be channelled into non-traditional exports quickly and the commodity composition of exports diversified. This process will be aided by a more favourable trading climate in the 1990s. The second principle is that to rebuild intra-regional trade, it will not be enough to resurrect the institutions of the Central American Common Market (CACM); the main objective will be shift the regional trade pattern away from the import-intensive consumer goods of the past towards basic grains, simple processed food products, and selected other 'basic need' goods including textiles and energy.

It has already been seen that those countries which have adjusted most rapidly in the 1980s are those which have diversified exports relatively successfully, the best example being that of Costa Rica. Despite some prospect for a lowering of tariff barriers as a result of the current Uruguay round of GATT negotiations, traditional export (TX) earnings are unlikely to rise significantly in the 1990s; indeed the Sanford Commission expected net barter terms of trade (NBTT) to fall slightly over the period. By contrast, prospects for NTX earnings appear more favourable. For one thing, the renegotiation of the Caribbean Basin Initiative (CBI), which expires in 1996, is likely to result in a relaxation of the restricted products list and the abolition of countervailing duties (such as those imposed on cut-flowers from Costa Rica).<sup>27</sup> More important, Central America still has much scope in capitalising on the extension of the Generalised System of Preferences (which covers trade in manufactures) to the region. The completion of the EC single market in 1992 will stimulate European growth, and with it the demand for non-traditional agricultural and semi-manufactured goods.

In this context it has been argued that the economic re-insertion of Eastern and Central Europe (ECE) into the world economy will result not only in aid diversion but in trade diversion from the Third World since, both in per capita income levels and pattern of output, the Eastern bloc countries resemble the middle-income LDCs. While this may be true in general, it is

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<sup>27</sup> See Bulmer-Thomas (1989).



difficult to see why trade diversion should be serious in the case of Central America since none of the region's most important traditional or non-traditional exports are produced in any quantity in Eastern and Central Europe (ECE).<sup>28</sup> It seems at least equally plausible to argue that the investment boom associated with the reconstruction of ECE will increase the demand for the region's non-traditional exports. Moreover, because the Federal Republic of Germany is a major importer of Central American coffee, German unification may increase coffee demand significantly. Also, since unification will hasten the demise of the common agricultural policy, the current European sugar surplus may disappear.

Turning to intra-regional trade (IRT), the key question is to what extent the region will succeed not only in regaining lost ground but in transforming the pattern of IRT and the institutions regulating it. First, some ground has been made up; IRT, since falling to a low of US\$ 375 million in 1985, in 1988 was worth US\$ 582 million, or just over half its high of US\$ 1.1 billion in 1981. This increase is accounted for by trade revival between three countries: El Salvador, Guatemala and Costa Rica. The recent decision of Honduras to rejoin the CACM together with the change of Government in Managua---undermining US reluctance to support CACM reactivation---will help hasten revival. Nevertheless, it is undesirable, and for that matter unlikely, that there will be a return to the *status quo ante*.

It is important to bear in mind that the current revival in IRT has taken place in those industries which in the first half of the 1980s managed to switch part of their output to the extra-regional market and which during the second half of the decade have faced far stiffer competition from outside the region as a result of the reduced protection. Moreover in some cases (e.g. Nicaragua), many of the firms engaged in IRT went out of business in the early 1980s. Hence, it is only the relatively efficient

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<sup>28</sup> The most important non-traditional exports from Central America are seafood, cardamon, timber, ornamental plants and flowers, pineapples, vegetables, pharmaceutical products, and clothes. See Fuentes et. al. (1988).

segment of regional industry which can be reactivated and the scope for further reactivation is probably quite small.

Further expansion of IRT can come from two non-traditional sources. First, in the services sector, there is significant potential for pooling regional resources in fields like marketing, shipping, and insurance on which account for much of the deficit on the region's invisible trade account. In infrastructure, trade in energy is a category which has expanded considerably in the past ten years and its potential is significant.

The second area in which non-traditional IRT can expand is food. Although there is at present a regional organisation for food self-sufficiency, individual governments have tended to pay lip-service to the principle while in practice meeting their net food deficit from outside the region. It is clear that differences in the main-land ratio between countries are such that countries like Nicaragua and El Salvador could benefit from could increased trade in food-grains; moreover, there is abundant evidence to show that the region's natural endowment in arable and irrigable land is extremely favourable, not just by Latin American but by World standards.<sup>29</sup> An advantage of encouraging regional food production and trade, moreover, is that this *campesino* activity is labour and land intensive, directly benefitting the poorest segment of the population. Moreover, by encouraging food-production, forward linkages will be generated with agro-processing, an industrial branch in which Central America's comparative advantage is assured for many years to come.

The institutions supporting these new areas of extra-regional and intra-regional trade already exist. In particular, ICAITI (*Instituto Centroamericano de Investigación y Tecnología Industrial*) and CADESCA (*Comité de Apoyo al Desarrollo Económico y Social de Centroamérica*) can help foment better regional co-ordination in industrial technology and food self-sufficiency; the recent association of Latin American and European countries with CABEI (*Central American Bank for Economic Integration*) will strengthen the latter's resource base, while the important EC

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<sup>29</sup> See Barraclough and Utting (1985).

programme to rebuild the regional Clearing House (*Cámara Centro-americana de Compensación*) will play a vital role in not merely in fomenting regional trade, but in strengthening those political current wishing to see the CACM evolve from a free trade area into a customs union.

## 5. Conclusions

In this paper, we have argued that favourable conditions now exist for the economic and political modernisation of Central America in the 1990s, something which the pre-1980 model of development conspicuously failed to deliver.

The most important precondition for political modernisation is that such a project have the blessing of the United States. Paradoxically, it is the current eclipse of the radical-left, the standard bearer of secular modernisation with social justice, which has made the achievement of this goal more likely. Because 'socialism' is no longer a realistic nor even a meaningful goal for the left, 'anti-imperialist' rhetoric will decline and a broad, centre-left coalition will emerge centrally concerned with democratisation of the state and the strengthening of civil society. This coalition will continue to be opposed by the extreme right and sections of the military. To tip the scales in favour of modernisation, it is not necessary that the United States side with the former but merely that it withdraws support for the latter.

The second key point of the argument is that the "long night" of the 1980s, however painfully, has produced genuine changes in economic structure. The primary constraint on further industrialisation in the 1970s was the foreign exchange constraint imposed by the region's dependence on a narrow base of traditional export activities using a large, casual labour force. The adjustment process of the 1980s, though not wholly worked through, has demonstrated the feasibility adopting policies designed to shift resources to the traded-goods sector without a major and sustained cut in real wages.

A possible economic scenario for the 1990s may be sketched as follows. Against a background of an upturn in world trade, growth

will be export-led, with non-traditional exports including manufactures and semi-manufactures assuming growing importance at the expense of traditional exports. The easing of the foreign exchange constraint will greatly facilitate the revival of the regional industrialisation albeit in modified form, this time more internationally competitive while underpinned by customs-union and, effective intra-regional financial payments system and eventually some form of association with the North American trade bloc.

Obviously, such a conclusion is not unproblematic. Economically, it is still unclear whether growth is sustainable in any of the five states save Costa Rica. Indeed, it may be argued convincingly that precisely because Costa Rica had already modernised prior to 1980 (i.e. has developed its social and economic infrastructure, carefully nurtured its financial system, etc.) that it is now in a position to capture the gains from outward-orientation. By contrast, if El Salvador is still afloat, it is due to massive injections of US aid, the highest *per caput* in Latin America, while in Guatemala the once-promising centrist project shows signs of terminal economic and political seizure.<sup>30</sup>

That the 1990s may turn out to be far more difficult than suggested in this paper is entirely plausible. What seems undeniable however---particularly given the events of 1989---is that capitalist development, far from being a gradual, orderly and unconflictive process, is one whose sudden shifts in speed and direction can upset the predictions of even the most astutely-trained observer of dialectical change.

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<sup>30</sup> See "Guatemala: Economic Modernization on the Rocks", CAR 16 March 1990.

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