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LETTER OF TRANSMITTAL

January 1, 1993.

To the Members of the Joint Economic Committee:

Transmitted herewith for use by the Joint Economic Committee, Congress, and the interested public is a study of economic issues in the Caribbean and Central America, known as the Caribbean Basin region.

The study examines performance, external debt, and integration among the countries of the region. It discusses the role of the Caribbean in the international economy and collective security in the post Cold War period. It also examines the possible consequences of trade liberalization efforts, initiatives such as the North American Free Trade Agreement, and prospects for U.S. economic development assistance.

We are grateful to the many authors who contributed papers to this project. They are from a wide range of professions and organizations, including the academic community, private research groups, government agencies, the United Nations Economic Commission for Latin America and the Caribbean, the Library of Congress, and the Joint Economic Committee. We owe special thanks to the Congressional Research Service of the Library of Congress for making available the service of Mark P. Sullivan to help plan, coordinate, and edit the study. Richard F Kaufman of the Joint Economic Committee staff directed the project. Clare Brigidini of the Congressional Research Service provided production assistance, and John Bartoli of the Government Printing Office prepared the study for publication.

The views and conclusions contained in the volume are those of the authors and not necessarily those of their respective institutions, the Joint Economic Committee, or individual Members.

Sincerely,

PAUL S. SARBANES
Chairman, Joint Economic Committee.

CONTENTS

THE CARIBBEAN BASIN: ECONOMIC AND SECURITY ISSUES

OVERVIEW

By Mark P. Sullivan *

With the end of the Cold War and the diminishment of civil conflicts in Central America, U.S. interests in the Caribbean Basin region have shifted from an emphasis on security concerns to a focus on economic issues. As defined in this volume, the so-called Caribbean Basin region consists of the five traditional Central American states and Panama, and the sixteen independent nations of the Caribbean region, which include the island nations, Belize (which is geographically located in Central America), and the two South American nations of Guyana and Suriname. (See Table 1 for basic information on these 22 nations.)

In many respects, these two regions are very different. With the exception of Cuba, the Dominican Republic and Haiti, most Caribbean nations did not achieve independence until the 1960s and 1970s. Almost 300 years of British colonial rule endowed many of these Caribbean nations with stable parliamentary political systems. In contrast, the five traditional Central American countries all became independent from Spain in the first half of the 19th century. Although these countries adopted republican forms of government, largely modeled on the U.S. system, the political systems were often dominated by authoritarian leaders, and political upheaval and instability were the norm in most of the region. Today, however, most nations of both regions are ruled by elected civilian governments.

In 1982, under the Reagan Administration, U.S. policymakers treated the two regions together as one entity in a broad foreign policy program known as the Caribbean Basin Initiative (CBI). The objective of the program was to promote economic development and political stability in the Caribbean Basin region. The program was initiated at a time when the Cold War was having a significant impact on U.S. policy toward the region and on civil conflict in the region. The centerpiece of the CBI was a preferential trade program providing Caribbean Basin countries with one-way duty-free access to U.S. markets for most categories of export products until 1995. In 1990, in so-called CBI II legislation, Congress made the preferential trade provisions permanent.

Also in 1990, the Bush Administration announced the Enterprise for the Americas Initiative (EAI), a new foreign policy program which espouses the vision of hemispheric free trade, a measure

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TABLE 1. Basic Information on Caribbean Basin Nations.

Region/Country	Population (1990, thousands)	Area (thousands, km²)	GNP Per Capita (1990, US$)
Caribbean			
Antigua & Barbuda	79	a	4,600
Bahamas	255	14	11,420
Barbados	257	a	6,540
Belize	188	23	1,990
Cuba	11,000	111	n.a.
Dominica	72	1	2,210
Dominican Republic	7,100	49	830
Grenada	91	a	2,190
Guyana	798	215	330
Haiti	6,500	28	370
Jamaica	2,400	11	1,500
St. Kitts & Nevis	40	a	3,330
St. Lucia	150	1	1,900
St. Vincent & Grenadines	107	a	1,720
Surinam	447	163	3,050
Trinidad & Tobago	1,200	5	3,610
Subtotal:	30,684	624	
Central America			
Costa Rica	2,800	51	1,900
El Salvador	5,200	21	1,100
Guatemala	9,200	109	900
Honduras	5,100	112	590
Nicaragua	3,900	130	n.a.
Panama	2,400	77	1,830
Subtotal:	28,600	500	
Grand Total:	59,284	1,124	

a = less than 500 square kilometers.
Source: World Bank. World Development Report 1992.

which would eliminate the current advantage of one-way duty-free access enjoyed by CBI countries. The EAI reflected the shift of U.S. priorities in Latin America in general to one of strengthened U.S.-Latin America economic relations. This shift, however, has raised concerns among Caribbean and Central American nations about their status in the movement toward hemispheric free trade. Now that the Cold War has wound down and U.S. security interests in the region have diminished, there are concerns that the United States will lose sight of the smaller nations of the Caribbean Basin in an attempt to forge greater economic ties with the larger economies of the region.

General Conclusions

This volume explores in detail numerous economic issues for the small nations of the Caribbean and Central America from a variety of perspectives. It looks at such issues as macroeconomic performance of the two regions, the role of U.S. assistance, external debt, and integration. It also discusses security concerns in both regions. It discusses Haiti's difficult path towards democracy, and provides an assessment of Cuba's rapid economic decline. Several general conclusions can be gleaned from the papers presented in this volume.

First, the 1980s were a difficult period economically for both regions, with some observers referring to it as the "lost decade of development." For most nations in both the Caribbean and Central America, per capita income levels were lower in 1990 than at the beginning of the decade.

Second, there have been significant changes in economic thinking in the region, among government and business leaders, with most Caribbean and Central American nations now committed to a reorientation of their economies to an outward-looking export-oriented development strategy. Because of this sea change in thinking (not only in the Caribbean Basin, but in most other nations in the hemisphere) and because of the significant economic reforms already implemented, some observers have labeled the 1990s a "decade of hope" for Latin America.

Third, over the last several years, there have been significant integration efforts in both the Caribbean and Central America, which in part have been spurred by the movement toward hemispheric free trade through the Enterprise for the Americas Initiative and the North American Free Trade Agreement. The Central American Common Market has been reactivated with plans for a common external tariff in early 1993, with a ceiling of 20 percent. The Caribbean Community and Common Market (CARICOM) has regained momentum, and within the nations of the Organization of Eastern Caribbean States (OECS), there is a chance for political union among several nations, most probably a federation of the Windward Islands.

Fourth, there are substantial concerns in both regions about how the movement toward hemispheric free trade will affect their export markets and the level of foreign investment. There is concern that the small economies of the Caribbean Basin will not be able to compete with the larger economies of Latin America, and that the result will be trade and investment diversion away from the CBI countries to Mexico. Some have suggested that the United States should extend to Caribbean Basin countries any preferences that it offers to other Latin American nations, but on a unilateral (nonreciprocal) and time-limited basis. This would give the smaller CBI economies time to enact needed economic reforms and prepare for international competition. Such an option would likely be difficult to bring about, particularly when remembering the difficulties of approving legislation for the CBI preferential trade program in 1983. For many observers, reciprocity is viewed as the key element of any U.S. trade arrangement.

Fifth, for both regions, it appears that U.S. foreign assistance in the 1990s will decline from the levels of the 1980s, in part because of U.S. budgetary constraints, but also because of competing foreign aid demands worldwide. In Central America, funding for Nicaragua—a new aid recipient—is expected to account for almost one-third of U.S. economic and development assistance to the region, resulting in significantly reduced aid levels for the other countries of the region compared to the 1980s. In the Caribbean, a justification for major new funding could arise if Cuba were to become democratic.

SUMMARY AND FINDINGS

THE CARIBBEAN REGION

Section I of this volume covers a range of Caribbean issues, including discussions of economic performance and prospects for the region, U.S. foreign assistance to the region, integration among the English-speaking or Commonwealth Caribbean nations, regional security in the Caribbean, Haiti's political crisis, and a study on the Cuban economy. An appendix at the end of Section I consists of a strategy report for economic assistance to the Caribbean in the 1990s prepared by the U.S. Agency for International Development (AID).

Overview of Caribbean-U.S. Relations

The paper by Mark Sullivan provides an overview of Caribbean-U.S. relations, highlighting such issues as economic growth and development, and democracy and human rights. The end of the Cold War has liberated many U.S. concerns from the shadow of the East-West conflict, and there is now a new focus on economic and other issues rather than an emphasis on security concerns. Amidst this U.S. shift, however, many Caribbean nations fear that U.S. policymakers will lose interest in the region and instead focus their attention on Mexico and the other larger economies of the region.

In the area of democracy and human rights, U.S. concerns have centered on Cuba, Haiti, and Guyana. In 1992, Congress approved legislation that would tighten trade restrictions against Cuba in order to hasten change in the hemisphere's only Communist country. Congress also went on record condemning the September 1991 coup in Haiti, but there was concern about the future direction of U.S. policy, which largely consisted of trade and economic sanctions against the de facto regime as well as diplomatic efforts by the Organization of American States to bring about a return of democratic rule. In addition, the Administration's policy of interdicting Haitian migrants at sea and returning them to Haiti provoked considerable congressional criticism. In Guyana, U.S. concerns have centered on the conduct of free and fair elections in that country. Elections were scheduled for early October 1992, and are seen as an important test of Guyana's return to democracy.

In the area of economic growth and development, the key question for U.S. policymakers is how to effectively promote development and economic growth in the Caribbean, a region that is home to the hemisphere's poorest as well as some of its richest nations. The United States utilizes three policy tools in this area: economic and food aid; trade and investment promotion; and debt-reduction. With regard to foreign aid, the United States provided about $3 billion to the Caribbean in the 1980s. Congress, however, has expressed concern in recent years about declining levels of assistance to the region. With regard to trade and investment promotion, Caribbean leaders are concerned about how their nations will fare within the framework of a North American Free Trade Agreement (among the United States, Canada, and Mexico) and the overall movement toward hemispheric free trade. In particular, they fear trade and investment diversion to Mexico will leave their region without an engine for economic growth. With regard to debt reduction, the United States has forgiven about $430 million of U.S. official debt owed by three Caribbean nations. Some observers view future debt reduction in the region as important because the debt is considered a constraint to Caribbean economic development. Others, however, are opposed to additional debt reduction because of the costs to U.S. taxpayers.

Economic Performance and Prospects for Sustainable Development

A study by Trevor Harker examines economic performance in the Caribbean region over the last decade, and then identifies key elements that will be needed to achieve sustainable development policies in the 1990s. According to Harker, the 1980s will be remembered as a turbulent decade, one in which changes came at an accelerating pace, straining the capacity of most countries in the region. The rate of growth of Caribbean economies has varied significantly in the past ten years, with performance conditioned by the mix of products contained in each country's export basket, the fortunes of each product in local and foreign markets over the decade, and the policy decisions these countries made to adjust to shocks or to take advantage of opportunities. Over the last decade, the sugar sector in the region declined significantly, whereas the tourism sector provided most of the prosperity that has been experienced. All major merchandise-export earning activities are now in decline.

The most successful economies were the high-growth economies of the Bahamas, Belize, and the members of the Organization of Eastern Caribbean States (OECS) whereas the worst performance was recorded by the economies of Guyana, Haiti, and Trinidad and Tobago. In between the two extremes were the moderate growth economies of Cuba and Jamaica and the low-growth economies of Barbados, the Dominican Republic, and Suriname. In the past five years, economic contraction has had negative effects on populations in six countries—the Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago—where people have became poorer.

In order to achieve sustainable development policies in the 1990s, Harker maintains that those policies will have to include elements that enhance the efficiency and competitiveness of the economies and those that help to build and sustain social cohesion. Both elements however, need to be framed within the context of long-term and environmental sustainability.

U.S. Assistance to the Caribbean

The study by Carole Henderson Tyson and Daniel Seyler, who both work for AID, examines U.S. foreign aid to the Caribbean region in the 1980s, describing the levels and types of assistance and the country recipients, and elaborating on what the authors judge to be AID success in several areas—economic policy reform, private sector development, the social sector, the environment, democracy programs, and regional cooperation. The study concludes with a brief look ahead to U.S. aid to the region in the 1990s, drawing from AID's economic strategy for assistance to the Caribbean (see the appendix to Section I of this volume). The study does not cover assistance to the region in the early years of the 1990s, a period of declining aid levels.

As noted by the authors, the size and content of aid to the region during the decade was partly shaped by political events in the region, and in Central America. (Beginning in 1982, U.S. policy often linked the Caribbean and Central America—despite their historical and contemporary differences.) Another factor shaping the size and content of aid was a shift of focus within the U.S. Agency for International Development to an increased emphasis on private sector development—trade, investment, and free-market economic policies.

During the decade, Economic Support Fund (ESF) assistance to the United States' closest allies in the region predominated, although its level waned considerably in the 1987 through 1989 period. ESF assistance funded balance of payments support rather than development projects. Much of the assistance was targeted for specific economic policy reforms. Development assistance averaged about $100 million annually during the decade, and focused increasingly on the private sector. Food aid averaged slightly under $100 million per year. Two other U.S. agencies, the Peace Corps and the Inter-American Foundation, funded small amounts of development assistance (which are not included in the aid tables presented in the paper.) Moreover, beyond foreign aid, other U.S. government agencies actively supported the emphasis on markets and the private sector in the Caribbean, mainly in the context of the Caribbean Basin Initiative (CBI).

A discussion of the impact of U.S. aid to the Caribbean in the 1980s focuses on the authors' largely positive views of the role of AID in administering the foreign aid program. According to the authors, major accomplishments of AID's program in the Caribbean were significant changes in macroeconomic and regulatory policies to open the economies to market forces and greater private sector involvement. Nevertheless, the record of economic growth and reform during the decade was mixed in the region. There was also evidence that the *phasing in* of economic reforms over time resulted in much more sustainable policies than with an accelerated drive to reform in a short period. AID's activities in private sector development often served as a hub supporting the CBI. Critics maintained that AID was transferring an inordinate amount of its resources from its "basic human needs" program to its private sector program. The authors note that although AID did reduce its emphasis on "basic human needs" in favor of "broad-based, sustainable, economic growth," the agency maintained its work in the social sector. Increasing democracy was also a principal goal of AID's program in the Caribbean, but AID's portfolio, with the exception of Haiti, was relatively small when compared to projects in other Latin American countries. Critics often labeled these projects as being too ambitious and dispersed among different institutions.

Looking ahead to the 1990s, Tyson and Seyler maintain that the objective of U.S. economic assistance will be to continue to stimulate broadly-based economic growth, with greater emphasis on a more productive private sector and improved democratic practices. In general, funding for the Caribbean will decline because of the winding down of the Cold War, various foreign policy challenges for the United States outside the Caribbean, and limited foreign aid resources. As the result of declining funds and staff, and the concomitant desire to achieve greater impact and results, AID will focus increasingly on the program and policy level impact rather the project level approach. A key objective of AID's strategy will be the heightened emphasis on increased trade and investment, focusing on the framework of the Enterprise for the Americas Initiative (EAI). The overwhelming challenge will be to consolidate progress of the 1980s toward market-oriented, export-led, democratic societies.

Caribbean Integration

The paper by Marvin Will surveys historical and current integration attempts in the Commonwealth Caribbean, from the West Indies Federation of the 1960s to efforts under the Caribbean Community (CARICOM), established in 1973. Professor Will states that increased regional integration, both economic and political, is in the interest of Caribbean leaders and the United States, and notes that since the 1980s, integration activity has reached near tidal intensity in the southeastern Caribbean.

According to Will, current integration efforts receive strength from the region's nationalism-compromising economic crisis, pragmatic leadership in the region, and the inducement of emerging megablocs. The region has experienced the worst economic downturn since the Great Depression and its worst intraregional trade ever. This, along with increases in human misery and crime, would seem to induce a loosening of state pride and power, and indeed, according to Will, the weakening of many of the region's political economies has led to increased rhetoric for expanded economic and political integration. Moreover, contemporary Caribbean leaders tend to be more and more pragmatic in their outlook than their predecessors. The most important factor spurring integration is the international environment and the pressure being mounted from regional blocs that appear to be forming in Europe, North America, and possibly the Asian-Pacific rim.

Will also maintains that much of the leadership and drive for further Caribbean integration will come from the small Eastern Caribbean states because these nations achieved the highest level of pre-independence integration while under British colonial rule, and because their less-developed economies have not experienced the recent shocks that the region's larger economies have faced. Moreover, major strides have already been made in the Eastern Caribbean in implementing shared functions such as banking and currency, defense and related coast guard patrols, and shared diplomatic posts.

Regional Security in the Commonwealth Caribbean

The paper by Neville Linton analyzes security concerns and problems in the CARICOM region, and suggests a framework for moving ahead with a collective approach toward security in the region. The paper discusses the record of regional security in the Commonwealth Caribbean, pointing out that the 1979 Grenada Revolution under Maurice Bishop's New Jewel Movement was a key factor in the development of regional attitudes toward security.

This ultimately led to the formation of the Eastern Caribbean Regional Security System (RSS) in 1982 and its involvement in the U.S. intervention in Grenada in 1983, the first such collective security operation in the region's history.

As noted by Linton, the Commonwealth Caribbean faces threats similar to those faced by other small states, including both domestic and external dangers. The range of domestic threats is wide, including military coups, succession struggles, riots, civil unrest, the seizing of hostages, disaster costs, and environmental problems. Prior to the 1990 crisis in Trinidad and Tobago, in which the government was threatened by a radical group, CARICOM balked at the concept of intervention. But in the Trinidad crisis, the CARICOM nations were quick to offer direct military help to Trinidad through the RSS. With regard to external threats, Caribbean nations in general have not been vulnerable because the United States has been a natural guardian of the region as a by-product of protecting Atlantic sea lanes. Nevertheless, arms and drug smugglers constitute a serious threat to governments unable to physically control national territories that often consist of numerous small islands.

Linton believes a commitment to a collective approach toward security is needed in the Caribbean. Such a commitment could involve the following: a mechanism for the peaceful settlement of disputes; agreement on what constitutes threats to security; a mechanism for calling rapid meetings of a relevant agency to deal with threats; research into nonmilitary sanctions that could be used as policy tools during a crisis; agreements on the size, nature, and training of regional forces; upgrading of regional communications information and intelligence systems and networking; an understanding that collective action could be undertaken by appropriate subgroups, like the OECS; and diplomatic initiatives through the Organization of American States (OAS) and the United Nations designed to persuade metropolitan centers that small state security requires their continuing financial and logistical support.

Haiti's Troubled Path Towards Democracy

The paper by Maureen Taft-Morales surveys Haiti's difficult path towards democracy since the overthrow of the Duvalier dictatorship in 1986, and discusses U.S. policy concerns in light of the current Haitian crisis since the military overthrow of President Jean-Bertrand Aristide in September 1991. Aristide had been elected in a landslide victory in 1990 in what was widely viewed as the first free and fair elections in the nation's history. The coup dashed optimism that, after years of blocking democratic efforts and of futile attempts at ruling, the Haitian army was now committed to democracy.

Since the overthrow of Aristide, the main U.S. foreign policy concern has been the restoration of democracy. The United States and the OAS called for Aristide's reinstatement and in October 1991 imposed a trade embargo against Haiti. The Bush Administration cut off most aid to Haiti, but still provides some humanitarian assistance through private voluntary organizations. In light of the embargo's failure to force the *de facto* government to allow Aristide's return (as well as the severe economic and ecological impact on Haiti, including the negative effects of the embargo on Haiti's poor), some observers argue that stronger action should be taken. Others argue for lifting the sanctions. The OAS had proposed a 500-member civilian democratic observer group to oversee a transition to democratic rule. Some observers, seeing that sanctions and diplomacy have failed to restore Aristide to office, have advocated military intervention, either by U.S. or international peacekeeping forces.

In addition to democracy, other U.S. concerns include immigration policy toward the increasing number of Haitians trying to migrate to the United States, a policy that has received considerable criticism, and the increasing use of Haiti as a narcotics transit point with the alleged involvement of the Haitian military. Until the September 1991 coup, U.S. concerns also focussed on selecting suitable levels and types of aid in meeting the basic needs of the Haitian people, who are the poorest in the world.

Cuban Economic Performance

The study by Richard Kaufman outlines recent Cuban economic performance and reviews economic challenges ahead for the country by surveying the available public-source literature. Given the extremely limited public source data on Cuba, Kaufman notes that it is difficult to produce any definitive summary of recent Cuban economic performance. Nevertheless, Kaufman concludes that the Cuban economy is in the midst of its most serious economic crisis, and that the economy is on a downward path that will persist and could worsen over the next several years.

Since 1986, Cuba has been experiencing either economic stagnation or decline. The beginning of that decline coincided with a dramatic change in Cuban economic policy called "rectification" which terminated market-type reforms that had been introduced in the mid to late 1970s. Following the 1989–90 upheavals in East Europe and the Soviet Union, Cuba's economic problems were compounded by the disruptions in relations with those countries, and delays and shortfalls in deliveries. In response, the Cuban government imposed a strict economic austerity program in 1990 known as the Special Period in Peacetime, with the rationing of many food products and consumer goods. In 1991, the government prepared a "Zero Option" contingency plan, suggesting a subsistence level economy, that would go into effect if trade with the former Soviet Union was cut off completely.

Looking ahead, Kaufman sees further contractions of the industrial base, more widespread shortages of supplies, increased erosion of the standard of living, and continued performance at lower levels. Additional shocks to the economy, like a complete termination of trade relations with the former Soviet Union, or a total suspension of foreign oil deliveries, could lead to a general economic breakdown. The author notes that the declining availability of Cuban government statistics intensifies suspicions that the economy is deteriorating at a rapid rate. He suggests that a major effort by Western governments or other institutions is required to fill the gaps of information about the Cuban economy.

CENTRAL AMERICA

Section II of this volume covers a range of Central American issues, including macroeconomic development in the region since the 1980s, the Central American debt situation, a study on Costa Rica's Brady plan debt reduction accord, U.S. foreign assistance to the region, and economic integration and policy reform in Central America. An appendix at the end of Section II consists of a strategy report prepared by AID on economic assistance to Central America in the 1990s.

Overview of U.S. Concerns in Central America

The paper by Nina Serafino provides an overview of continuing U.S. concerns in Central America, focussing on political stability and democracy, economic growth and development, and continuing security concerns. The author notes that while the five traditional Central American states—Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua—no longer constitute the flashpoint of U.S. foreign policy, as in the 1980s, the area nevertheless continues to be an area of continued U.S. concern. A decade of war and poor economic performance has left these countries worse off in many respects than they were in the 1970s, and some observers fear that these conditions could foreshadow future difficulties.

In the 1990s, the United States has reiterated its continued interest in social, economic, and political development in Central America, but its ability to offer foreign aid to the region has diminished because of U.S. budgetary constraints and other critical foreign aid needs worldwide. The author notes that the United States has determined to cope with this decline by undertaking additional bilateral initiatives involving other U.S. agencies in a broad range of areas, and by encouraging and cooperating in regional and multilateral initiatives for Central America.

In the area of political stability and democracy, the United States has, since the late 1980s, increasingly undertaken programs to strengthen democratic institutions and practices in the region. It has provided assistance and training to help Central Americans reduce the size of their militaries and to reinforce the importance of civilian authority. Assistance has been provided to help professionalize police and security forces in order to foster respect for human rights, and to help strengthen civilian democratic institutions.

In the area of economic growth and development, the United States has focussed on economic reform and the creation of conditions that will foster sustained economic growth. In the 1980s, U.S. assistance was aimed at reforms designed to create an hospitable macroeconomic climate for investment. In recent years, the United States has also supported debt reduction in order to reduce burdensome debt levels in the region that severely limit resources for investment and for government expenditures in critical areas. In addition, the United States has supported trade liberalization in Latin America through the EAI, which envisions a hemispheric free trade zone. In the Central American region, the signing of a regional trade and investment framework agreement with the United States was an important step toward that goal. Central

Americans, however, are concerned that a North American Free Trade Agreement may divert needed U.S. trade and investment shares to Mexico.

Continuing security concerns in the region include drug trafficking, the repatriation and reintegration of former combatants into civilian society, and negotiations in Guatemala to end the longest running guerrilla conflict in Central America. Serafino notes that continuing economic problems, weak democratic institutions, and the influence of the military all create uncertainties about future security and stability in these countries.

Central American Economic Performance

The study by Sylvia Saborio on Central American economic performance in the 1980s assesses the extent of economic adjustment, or tortuous reform as the author terms it, that has taken place in the region. The basic economic adjustment package consisted of prudent macroeconomic management, greater outward orientation beyond the Central American Common Market (CACM), and greater reliance on markets as opposed to government intervention. These policies are now widely accepted, in principle, by most governments and intellectuals in the region, but there are a variety of views regarding the pacing and sequencing of the reform package, trade-offs, and the proper mix of adjustment and financial support.

Saborio outlines the various elements of the reform agenda—fiscal reform, financial reform, exchange rate and trade reform, and privatization and deregulation. During the 1980s, fiscal deficits generally declined in the region, except in Nicaragua where the deficit hovered around 20 percent of gross domestic product (GDP) throughout most of the decade. Efforts to realign exchange rates in the region achieved mixed results—only Costa Rica and Guatemala managed both to streamline the foreign exchange regime and achieve a real effective devaluation of the currency in a sustained fashion. The shift to an outward-oriented strategy was more successful with a reduction in import protection levels (including the elimination of non-tariff barriers to trade) and the establishment of incentive systems for the promotion of nontraditional exports to markets outside the CACM. With regard to privatization, Costa Rica has had the most ambitious program, while in Nicaragua attempts are being made to denationalize and privatize many activities and enterprises that came under government control under the Sandinistas. Instances of deregulation in the region have tended to be isolated and sporadic, rather than a systematic dismantling of state controls.

The record of economic performance was dismal during the 1980s, with every country in the region far worse off in 1990 than it had been 10 years before. The cumulative GDP decline over the decade ranged from 6–8 percent in Costa Rica and Honduras, to 20 percent in Guatemala, to 25–30 percent in El Salvador and Nicaragua. However, all countries—with the exception of Nicaragua—were able to escape the spiralling hyperinflation prevalent elsewhere in Latin America. The author provides case studies of the economic performance records of the five Central American countries.

Central American External Debt

The study by Clarence Zuvekas provides an overview of Central America's external debt situation since the 1970s and provides a detailed analysis of trends in the 1980s. The paper also discusses debt relief under a variety of programs beginning in the late 1980s, and concludes with comments on the debt outlook for the 1990s.

The beginning of the debt crisis in Central America came in 1981 when Costa Rica suspended the servicing of its external debt to commercial bank creditors, an event preceding Mexico's similar action a year later. By the end of the decade, three additional Central American nations—Honduras, Nicaragua, and Panama—had similar or rivaling debt problems. El Salvador and Guatemala were able to keep their debt burdens from reaching severe proportions, although both experienced significant debt-servicing difficulties at times during the 1980s. Over the decade, the region's total external debt rose from $11.4 billion in 1980 to $29.3 billion in 1990.

With regard to debt relief, Zuvekas notes that the Central American countries have been able, since the late 1980s, to take advantage of programs offering debt relief (apart from the traditional commercial-bank and Paris Club debt restructuring). These have included discounted debt buybacks, more favorable rescheduling on official bilateral debt through the Paris Club, debt forgiveness and other benefits under several U.S. government initiatives, and debt swaps. In addition, in November 1989, Costa Rica became the only Central American country to have reached a Brady Plan debt reduction agreement with its commercial-bank creditors, an operation which lowered that nation's total debt outstanding from $4.6 billion at the end of 1989 to $3.8 billion at the end of 1990.

Looking ahead into the 1990s, Zuvekas believes that while Central America's debt problems remain significant, there is good reason to believe that the easing of the debt burden now under way in the region, through the various programs just described, should continue during the course of the 1990s.

Costa Rica's Brady Plan Debt Reduction Agreement

A second paper by Sylvia Saborio provides an interesting case study of Costa Rica's Brady Plan debt reduction agreement, the second to have taken place in Latin America. The author, who was a member of Costa Rica's debt negotiating team, focuses on the negotiation process and sets forth some policy lessons that might be applicable for other small developing nations attempting to negotiate reduction of their commercial bank debt.

Costa Rica began to look for a comprehensive long-term solution to its debt problem in 1986. At that time, the country's commercial bank debt was around $1.5 billion, out of a total public external debt of around $4 billion. While the debt was quite small compared to the debts of many other developing nations, in relative terms it was unsustainable for Costa Rica, since it was roughly equivalent to the economy's GDP and three and a half times the value of its exports. A successful agreement took four years to complete. When Costa Rica first sought some type of debt reduction agreement in 1986, the idea was considered anathema by all involved, i.e., the creditor banks, international financial institutions, and industrial-country governments. Not until 1989 was the idea legitimized when it became the cornerstone of the Brady Plan.

From her experience in the negotiating process, Saborio sets forth some basic principles that might serve as guidelines for other heavily indebted, small economies seeking to negotiate reductions in their commercial bank debt. These include the following: make a serious, sustained and credible commitment to economic stabilization and policy reform; do not politicize the debt issue internally to strengthen your position externally; avoid confrontation; stress the concept of *ability to pay*, making it clear from the start that you are unable and not unwilling to pay; exercise caution in matters of arrears, i.e., withholding; and recognize that net new commercial lending is unlikely to take place.

U.S. Foreign Aid to Central America

The study by Jonathan Sanford surveys U.S. foreign assistance to Central America from FY1980–1993, a period in which about $12 billion in U.S. aid flowed to the region. It looks at the evolution of U.S. aid policy during this period, changes in the composition of programs in the region, the goals and emphases of aid, and plans for future U.S. assistance to the region in the 1990s.

The author divides the evolution of U.S. aid policy to the region into four periods. In the first period, from fiscal year 1980 through 1984, U.S. aid to the region increased rapidly in the face of Central America's serious economic, social, and security problems. There were frequent conflicts between the President and Congress regarding the scope and purpose of this increased aid, particularly with regard to the rapid escalation of assistance to El Salvador. In the second aid policy period, fiscal year 1985 to 1987, there was greater consensus on even higher levels of aid to the region. It was in this period that the bipartisan Kissinger Commission found that the "acute crisis" in the region was of fundamental importance to U.S. security. As a result, the Reagan Administration proposed that the United States provide the region with $8.4 billion in economic assistance over the next five years: $2 billion in guarantees and $6.4 billion in foreign aid, or about $1.3 billion annually.

In the third U.S. aid period, fiscal years 1988 and 1989, the Kissinger Commission's annual aid targets were revised downward in light of budgetary constraints and in order to ensure solid economic and political progress in the region. During the period, Congress became concerned about events in El Salvador, but rejected measures that would have significantly limited assistance pending improvement in the human rights situation. With regard to Panama, the Administration had suspended aid in mid-1987 because of growing opposition to the *de facto* political rule of General Manuel Noriega. In 1988 and 1989 Congress approved legislation banning almost all aid to Panama unless certain democratic conditions were met.

In the final period of U.S. aid policy, fiscal years 1990 through 1993, U.S. aid levels declined as the perceived threat to U.S. security diminished in the region. During this period, the civil conflicts in El Salvador and Nicaragua came to an end, and following the U.S. intervention in Panama a legitimately elected government took office. With friendly governments in both Nicaragua and

Panama, those countries became major recipients of U.S. assistance. El Salvador, however, remained the largest U.S. aid recipient in the region, accounting for about 30 percent of aid to the region during the period.

Sanford describes in detail the functional components of U.S. economic aid to the region—development assistance, Economic Support Funds (ESF), and food assistance. Development assistance to the region amounted to $2.8, or almost 24 percent, over the entire period, with subtle but significant shifts in the ways that AID has used the assistance. The relative emphasis has shifted away from agricultural projects to an emphasis on education, health, and population projects. ESF assistance was the largest single U.S. aid program to the region, accounting for $5.9 billion, or 48 percent of total assistance. The author notes, however, that while much of the assistance was used to provide balance of payments support, a substantial portion was used to finance development projects. During the period, the success of efforts to use ESF assistance to encourage policy reform was in part dependent on the prevalence of U.S. security interests in the countries receiving the assistance; efforts were more successful in countries such as Costa Rica and Guatemala where the United States had no competing political concerns as opposed to El Salvador and Honduras where the opposite was the case. Food assistance amounted to about $1.4 billion, or about 11.6 percent of total aid to the region. During the period, food aid loans, as opposed to grants, accounted for a growing share of food assistance to the region; since FY1982, three-quarters of all U.S. food aid to the region has been provided on a loan basis, and in effect has been a form of balance of payments support to recipient countries.

Looking ahead, Sanford notes that AID's strategy for Central America in the 1990s is to emphasize support for the development of stable democracies, the achievement of broad-based sustainable economic growth, and the attainment of effective regional cooperation. AID anticipates declining U.S. Government assistance to the region, with more assistance from the private sector and the multilateral institutions; Nicaragua would be the largest recipient of assistance. The author notes that several factors could alter this strategy, including new U.S. aid goals for the region that could shift the functional emphasis of U.S. assistance to the region, unexpected foreign aid needs in other parts of the world that could decrease the amount of U.S. aid available for the region, or renewed or new crises in Central America that could prompt a new assessment and higher levels of assistance to the region.

Economic Integration and Policy Reform

The paper by Jose Manuel Salazar examines economic integration and policy reform in Central America. The author argues that there are grounds for optimism for a substantial strengthening of regional economic integration in the 1990s. Different from regional integration attempts in the 1960s, Central American policymakers view current efforts as part of a strategy of insertion into the world economy, based on boosting exports and becoming competitive internationally. For integration to be successful, the author argues that three conditions should exist: sustained policy reform efforts, including an improved investment climate and a continuation of perfecting the regional trade area; an aggressive trade policy in order to maximize access to third-country markets and enjoy the benefits of joint action in areas of trade, finance, and international cooperation; and joint action in several strategic areas aimed at increasing international competitiveness and stimulating productive specialization, flexibility, and complementarity at the regional level.

Salazar lays out several possible scenarios for regional integration in the 1990s—disintegration, growth with limited integration, and the acceleration of development with integration—but concludes that the third scenario is the most likely because of significant political advancement (the cessation of civil conflicts in El Salvador and Nicaragua) and economic reform progress in the region over the last few years. In the area of economic reform, the author describes significant strides in economic stabilization in all countries and a commitment to fiscal austerity. Tariffs have been reduced significantly since the mid-1980s, and strong efforts have been made in recent years to pursue a realistic exchange-rate policy in order to maintain export competitiveness. Private investment and private sector development are now viewed as guiding principles for government policy in the region. Over the last several years, governments have taken steps to deregulate and modernize financial markets, and privatization efforts have advanced.

As evidence of progress in integration, in June 1990, the Central American presidents reiterated a political commitment to restructure, strengthen, and reactivate the process. The presidents adopted an Economic Action Plan with numerous commitments and guidelines. Subsequent summits have followed up on this process, including a May 1992 summit in which Guatemala, Honduras and El Salvador committed themselves to accelerate their economic integration sooner than originally planned. As a result, the free trade area within Central America has been improved, and includes plans for the adoption of a new common external tariff (with a ceiling of 20 percent, but with some exceptions) that is to be in force by 1993. There have also been numerous institutional and legal reforms in the region.

Looking ahead, Salazar discusses Central America and the movement toward hemispheric free trade. He notes that Central America would benefit from its participation in a North American Free Trade Agreement not only because of increased exports to the U.S. market, but because of increased investment flows and productivity. Nevertheless, Salazar points out that there will also be costs involved for the region. Central Americans are concerned about the possible investment diversion effects, whereby the region may lose investment in favor of Mexico given the similarity in comparative advantages and resource endowments. Following from this point, the sequence of accession to a U.S.-centric free trade area will have an important bearing on the costs and benefits of joining. Salazar points out that latecomers to a free trade area will be disadvantaged not only by the postponement of benefits, but also by possible diversion of U.S. investment to those that join first. He also notes that the adjustment costs for Central America of free trade with the United States would be significant, and suggests that the challenge be met head on. He concludes with recommendations for joint actions to modernize the productive sectors in Central America and to improve international competitiveness.

TRADE AND INVESTMENT IN THE CARIBBEAN AND CENTRAL AMERICA

Section III of this volume discusses trade and investment in the Caribbean Basin region, including a discussion of U.S. trade and investment policy, the international economy and the Caribbean, the Caribbean and hemispheric free trade, and Central America and hemispheric free trade.

U.S. Trade and Investment Policy

The paper by Vladimir Pregelj provides a detailed background on U.S. trade and investment policy in the Caribbean Basin region. As noted by the author, in most aspects U.S. policy on foreign trade with and private investment in the countries of the Caribbean Basin does not differ substantially from comparable policy in effect with the world at large.

With regard to trade policy, virtually all Caribbean Basin nations are accorded most-favored-nation treatment in trade and are eligible for participation in the generalized system of preferences (GSP). Beyond this general trade treatment, the countries also benefit from the preferential tariff treatment offered to these countries since 1984 under the CBI, a comprehensive program to promote economic revitalization in the region and the expansion of investment in nontraditional export sectors.

The centerpiece of the CBI is the Caribbean Basin Economic Recovery Act (CBERA) which provides for one-way duty-free treatment for most imports from eligible Caribbean Basin nations. First implemented in 1984, the preferential program was scheduled to terminate in 1995, but so-called CBI II legislation approved in 1990 made the program permanent. At present, 24 out of 28 Caribbean Basin nations are designated beneficiaries of the program. There are several significant product exceptions to the CBI duty-free treatment, including textiles, canned tuna, and petroleum and its products. The CBI II legislation authorized a preferential reduction in tariff rates (rather than outright duty-free status) for footwear, handbags, luggage, flat goods, work gloves, and leather apparel, articles which were initially ineligible for the duty-free preference.

In assessing the CBERA, Pregelj concludes that the CBERA and other related provisions have not yet brought about substantial improvements in the overall export position of CBI countries—or indirectly in the diversification, restructuring, and/or expansion of Caribbean economies as a whole. He points out that the broad statutory product coverage of the program is somewhat deceptive as an indication of the program's actual or potential effectiveness for promoting exports from the Caribbean Basin region. Many Caribbean Basin products already entered the United States duty free under other tariff provisions; over one-half of the total value of U.S. imports from CBI countries as a group has been exempted from duty under the regular tariff regime or under the GSP. Moreover, between 43 and 45 percent of the value of U.S. imports from CBI countries has in recent years been for products that are ineligible for the CBERA.

With regard to investment policy, the CBERA preferential trade program was expected to encourage private investment in the CBI countries. To date, however, the program has not proven to be a major stimulus to investment in the region. Pregelj cites reporting by the U.S. International Trade Commission that although some of the new investment in the region has focused on products eligible under the CBI, in general the program has not "fueled economic growth and development in the region."

Another limited incentive for investment in CBI countries is provided in section 936 of the Internal Revenue Code which exempts U.S. companies doing business in Puerto Rico from U.S. corporate income taxes on profits deposited in the Puerto Rican banking system. These funds many be lent to finance development projects in CBI countries that have in force a Tax Information Exchange Agreement with the United States. CBI II legislation in 1990 required the government of Puerto Rico to take the steps necessary to ensure annual new Section 936 investments of at least $100 million in CBI countries. By mid-1992, $620 million in Section 936 funds had been invested in nine CBI countries, with another $267 million in the pipeline.

The Caribbean in the International Economy

The paper by Stephen Quick discusses what is needed for the insertion of the Caribbean into the international economy in the 1990s. The author asserts that the Caribbean's past development strategies are no longer effective, and that the new international economic environment (with sweeping changes in communications, technological innovation, and the liberalization of financial markets and trade) requires a systematic reorientation of economic policy toward exports and international competitiveness—a reorientation that is already underway in most countries.

The author lays out the predicament facing Caribbean nations. They remain in need of substantial external financing if they are to grow fast enough to absorb population increases and manage even a modest rise in per capita consumption levels. Since loans and grants from official sources will not be adequate to meet the region's needs, the nations will need to attract private capital flows. But private capital will have other markets equally eager to attract it. Moreover, the diminished value of Caribbean trade preferences, coupled with a general lowering of external barriers in major markets, will reduce the attractiveness of the islands since local costs are significantly above those prevailing in many other developing countries.

This tough international environment will require difficult policy choices in the region to help prepare it for what appears will be an increasingly competitive struggle for access to world export markets. For some of the poorer low wage islands—Haiti and the Dominican Republic—manufacturing investment may hold promise. For most, however, the service sector appears to be the more promising growth area. The challenge for governments in the region is to act as facilitator of this new strategy of enhanced export competitiveness, meaning that they must create a climate conducive to rapid expansion of export-oriented investment by both the domestic private sector and international corporations.

To ensure this conducive climate for investment, the author sets forth three guidelines for Caribbean governments. First, monetary autonomy is a major threat to macroeconomic stability. Limiting monetary autonomy could involve two options, following the lead of Puerto Rico and Panama in adopting the U.S. dollar as the national currency, or following the lead of the Eastern Caribbean states, which have established a multi-island central bank with strict limits on its ability to finance fiscal deficits in member states. Second, fiscal policy must be reshaped to improve the climate for export-oriented investment. This includes the challenge of improving the tax climate for investors while avoiding a regressive shift in taxes that could spark social conflict. Third, public spending to promote investment must expand significantly, possibly at the expense of more traditional governmental functions. This includes spending on both physical and human capital infrastructure, as well as spending on the promotion of local exports in global markets.

The Caribbean and Hemispheric Free Trade

The paper by Ambassador Richard Bernal discusses the Caribbean region and the movement toward hemispheric free trade under the proposed Enterprise for the Americas Initiative. As noted by the author, the Caribbean region consists of very small economies (many of which are microstates) and the region's trade and capital flows, both foreign investment and loans, are concentrated on the United States. Most of the region's exports enter the United States, Canada, and the European Community respectively under the preferential arrangements of the CBI, CARIBCAN (similar to the CBI), and the Lome Convention. As a result, adjusting to the loss of preferential treatment for exports will be severe on Caribbean economies, particularly the English-speaking nations which have been the beneficiaries of such arrangements for over 300 years.

Ambassador Bernal maintains that the Caribbean's movement toward free trade will require a change in the entire historical basis and structure on which production and trade have been conducted. Specifically, he raises questions about the compatibility of overlapping trade arrangements—i.e., the potential North American Free Trade Agreement, the regional Caribbean Community and Common Market (CARICOM), the Lome Convention, and even the CBI. He questions what the sequencing will be in the creation of a hemispheric free trade area, and points out that if there is a lag in creating a "level playing field," then the result could be trade and investment diversion in favor of Mexico.

Another issue raised is the treatment of countries with different development levels within a hemispheric free trade area. The author suggests that "asymmetrical," or nonreciprocal, adjustment is one way to recognize and compensate for differences in the levels of development, with specific criteria for graduation to reciprocal status. He notes that the Caribbean's fear of immediate and complete reciprocity derives less from the inability to undertake policy measures and institutional changes than from the social and economic costs of structural adjustment.

The author concludes that the Caribbean cannot count on the continuation of existing preferential trade arrangements and recommends that the region prepare a strategy for its survival and development in the new world economic and political environment. This strategy should include the following: the formulation of a growth-promoting strategy to enable Caribbean economies to survive in a global economy that is undergoing rapid and profound changes; an economic evaluation of the costs and benefits of participation in, or omission from, hemispheric free trade; and if a decision to participate in hemispheric free trade is made, then the Caribbean must decide what kind of Enterprise for the Americas Initiative it wants or needs and ensure that, as far as possible, the EAI is compatible with existing trade arrangements that the Caribbean participates in. The author argues that the Caribbean must not be a passive participant, but must be active in shaping the EAI, in converting the Enterprise *for* the Americas Initiative into an Enterprise *of* the Americas Initiative.

Central America and Trade Liberalization

The paper by Sylvia Saborio examines the evolution of Central American trade policy in recent years, provides a trade profile of the region, and discusses a number of considerations concerning the possible impact of the EAI on the region.

Although the Central American presidents in a July 1991 summit in El Salvador agreed to a series of regional trade commitments (e.g. liberalization of intraregional agricultural trade, reversion to a common external tariff), the process of trade liberalization in the region will not be easy or painless. Import liberalization will increase competitive pressure within the Central American economies and in the regional market, and as a result there will be some displacement of existing activity. Unemployment is bound to rise unless new job opportunities increase, presumably in export-oriented activities. Trade reform will require great discipline in the management of monetary and credit policies. One of the most daunting tasks will be to grapple with the fiscal implications of trade reform. Currently, import duties represent between 20 and 40 percent of total tax revenues in these countries. As a result, trade liberalization will require either a comprehensive tax reform to shift the tax burden to some other activity, or a downsizing of the state.

Despite these difficulties, the awareness that sweeping changes are occurring in the international arena, and that Central America cannot afford to remain at the margin of those events, is a powerful stimulus to action in the region.

Central Americans have some well-founded concerns about the movement toward hemispheric free trade as espoused in the EAI. Under the CBI program, the region has become accustomed to a special relationship with the United States (the largest and most dynamic market for its exports) based on one-way trade preferences. With the potential North American Free Trade agreement, trade and investment diversion away from the region to Mexico are important concerns. Since Mexico is a strong competitor of Central America in virtually all export products to the U.S. market, the mere leveling of access conditions to the U.S. market would pose a threat. Moreover, if Mexico were to obtain access conditions more favorable that those offered by the CBI, for instance in textiles and clothing and certain agricultural products, the region would then face negative preferences on those products in the U.S. market. With regard to investment diversion, the author maintains that there is growing anecdotal evidence of investors shelving plans to invest in Central America and going to Mexico instead, and of others, already in Central America, reconsidering expansion plans.

The author concludes with several observations and recommendations. While the benefits of entering into a free trade agreement with the United States might be limited, the costs of not doing so would be high. If Central America is to join a free trade area with the United States, it should do so as soon as possible in order to minimize the cost of exclusion and prevent a temporary competitive advantage from becoming a permanent investment loss. But the region must undertake a series of economic reforms before it is in a position to enter into a reciprocal free trade area with the United States. This gap could be bridged if the United States extended to Central America (as well as to the Caribbean) whatever preferences it grants to other countries in the region, but on a unilateral and time-limited basis. In turn, the Central American countries would commit themselves to continue the process of economic reform. Meanwhile, the region should focus on the development of an export culture that will require adjustment in the *modus operandi* of both government and business.

I. THE CARIBBEAN REGION

CARIBBEAN-U.S. RELATIONS

By Mark P. Sullivan *

CONTENTS

SUMMARY

The end of the Cold War has shifted U.S. interests in the Caribbean from an emphasis on security concerns to a new focus on economic and other issues. Some believe an important challenge for policymakers is to maintain an active U.S. interest in the region despite the cessation of Cold War tensions and the greater economic importance of the larger Latin American economies.

At present, U.S. policy toward the Caribbean has a variety of components that can be viewed as part of overall U.S. objectives for the hemisphere: consolidating democracy and advancing human rights; encouraging economic reform and development; and preventing the flow of illicit drugs into the United States. All three of these objectives are an integral part of U.S. policy toward the Caribbean region. An additional issue is migration, a high-profile matter in light of the increase of Haitian "boat people" since the September 30, 1991 coup in that country.

* The author is an Analyst in Latin American Affairs, Foreign Affairs and National Defense Division, Congressional Research Service. This paper is adapted from: U.S. Library of Congress. Congressional Research Service. *Caribbean-U.S. Relations: Issues for Congress*. Issue Brief 92047 (regularly updated), by Mark P. Sullivan.

In the area of democracy and human rights, U.S. policy concerns center on the countries of Cuba, Haiti, and Guyana. The United States maintains a policy of economic and political isolation toward Cuba, but given changed circumstances in the former Soviet Union, opinions in Congress vary about the appropriate direction of U.S. policy. In 1991, resolutions were approved in both houses condemning Cuba's human rights violations, and in 1992, legislation was approved to tighten restrictions against Cuba in order to hasten change in the hemisphere's only Communist country. Congress also has gone on record condemning the September 30, 1991 coup in Haiti, which overthrew that country's first democratically elected President. There is concern in Congress about the future direction of U.S. policy toward Haiti in which the United States has supported economic sanctions called for by the Organization of American States (OAS). In addition, the increase of migrants fleeing Haiti following the coup has provoked considerable congressional criticism of the Administration's policy of returning the migrants. In 1992, Congress also considered legislation conditioning assistance to Guyana on free and fair elections in that country.

In the area of economic growth and development, the United States uses three policy tools: economic and food assistance; trade and investment promotion; and debt-reduction. Congress has expressed concern in recent years about declining levels of assistance to the Caribbean region. With regard to trade and investment promotion, some in Congress are concerned about how the Caribbean will fare in the framework of a North American Free Trade Agreement and the movement toward hemispheric free trade. With regard to debt reduction, in 1990 Congress provided authority to reduce U.S. food assistance debt owed by Latin American and Caribbean nations, and in 1992 gave the Administration authority to forgive additional types of debt owed to the U.S. government.

In the war against drugs, the United States provides substantial assistance to the region through a variety of U.S. agencies. This assistance includes interdiction and law enforcement support. Most Caribbean nations cooperate with the United States in anti-narcotics efforts, but U.S. officials have expressed concern about the slow pace some Caribbean nations have maintained in adopting effective measures against drug money laundering.

Overview of Caribbean-U.S. Relations

U.S. Interests in the Region

U.S. interests in the Caribbean are diverse, and include economic, political, and security concerns. During the Cold War, security concerns tended to eclipse other policy interests. Today, while security is still a U.S. interest, the end to the Cold War has liberated other U.S. concerns from the shadow of the East-West conflict. These include democracy and human rights, economic growth and development, combating the production and transit of illicit drugs, and curbing the flow of illegal migration to the United States.

During the Cold War, some feared the Soviet-Cuban axis could threaten to disrupt U.S. access to vital sea lanes in the Caribbean. This could have endangered U.S. military resupplies to Europe in the event of a global conflict, and potentially could have posed a military threat to the continental United States. While the United States today is still concerned about keeping vital sea lanes open, including access to the Panama Canal, the end of the East-West conflict has diminished U.S. security concerns for the Caribbean region. Moreover, the Bush Administration's announcement of the Enterprise for the Americas Initiative (EAI) in 1990 reflects a shift in U.S. policy priorities for Latin America in general, from one emphasizing security concerns to a new focus on strengthened economic relations through trade and investment.

Amidst this shift toward economic issues, many Caribbean nations fear that the United States will lose interest in the Caribbean and focus its attention on Mexico and the other larger economies of Latin America. In some respects, the Caribbean is of minor economic importance to the United States. Although the United States has run a positive trade balance with the region over the last several years, the relative amount of trade is small. In 1990, U.S. exports to the region accounted for about 1.5 percent of U.S. exports worldwide, while imports from the region accounted for less than 1 percent of U.S. imports worldwide. From the Caribbean perspective, however, the United States is the region's most important trading partner for both exports and imports. U.S. foreign investment in the Caribbean region is concentrated in the finance and banking sectors.

Some observers maintain that, despite the Caribbean's relatively small economic insignificance for the United States, the United States has a special responsibility for supporting economic development and stability in a region often referred to as its own "backyard." As noted by one Caribbean diplomat, "the United States cannot be an oasis of well-being in a Caribbean sea of poverty." Observers point out that economic growth and political stability in the region could have important influences on drug and immigration issues. The region's geography, for example, makes it a prime area for the transshipment of illicit drugs from South America to the United States, and Jamaica is a marijuana producer for the U.S. market. The region contributes a large share of legal migration (9.3 percent in FY1989), as well as illegal migrants, to the United States, and political instability in Haiti and Cuba could further increase the stream of migrants.

U.S. POLICY: PAST AND PRESENT

U.S. involvement in the Caribbean region dates back to the Spanish-American War in 1898. In the aftermath of that conflict, the United States took possession of Puerto Rico and established a protectorate in Cuba. U.S. military intervention in the Caribbean (as well as in Central America) became the norm until the 1930s. The United States maintained military forces in Cuba, Haiti, and the Dominican Republic for extended periods during this time, with the objectives of maintaining stability, protecting U.S. economic interests, and forestalling European intervention. By 1933, however, with the pronouncement of President Franklin Roosevelt's "Good Neighbor Policy", U.S. policy shifted from one of military intervention to hemispheric cooperation and collective action. Following

World War II, this policy was codified in the signing of the Rio Treaty in 1947 and in the establishment of the OAS in 1948.

With the intensification of the Cold War following World War II, U.S. policy toward Latin America, particularly the Caribbean, shifted toward security concerns, as it had in the aftermath of the Spanish-American War. In the Caribbean, this policy was highlighted by the 1961 attempt to overthrow Cuba's Fidel Castro in the ill-fated Bay of Pigs invasion. Perhaps the height of the Cold War's affect on the region occurred in 1962 when the United States forced the Soviet Union to remove nuclear weapons during the Cuban missile crisis. Since that time, U.S. policy toward Cuba has been one of political and economic isolation. Largely to prevent further radical revolutions in the hemisphere, the United States in 1961 launched a massive ten-year foreign aid program—the Alliance for Progress—designed to support economic and social reforms. In the Caribbean, the main beneficiaries of the program were the Dominican Republic and Haiti, since most other Caribbean nations had not attained independence.

Even with its concentration on social and economic reforms, U.S. policy toward the region maintained an anti-communist focus, which continued until the diminution of the Cold War in the late 1980s. In 1965, the United States resorted to direct military intervention in the Dominican Republic and prevented the return to power of a democratically elected leader who had been overthrown in 1963. The primary objective of the intervention was to contain communism. In the 1980s, the Reagan Administration again intensified the anti-communist objective of U.S. policy exemplified in the Caribbean by the 1983 military intervention in Grenada. After the socialist regime of Maurice Bishop was overthrown violently by a hardline faction, the United States intervened—with support from several Caribbean states—to restore order in Grenada and to protect the lives of U.S. medical students on the island. Many analysts believed the most important U.S. objective in Grenada was to terminate the Cuban presence that had been established under the Bishop regime. In addition to military action in the region, the Reagan Administration launched a preferential trade program known as the Caribbean Basin Initiative, with the objective of improving the region's economic health through increased trade and investment.

Under the Bush Administration, U.S. policy toward Latin America has changed. In large part this is because of the end to the Cold War. But the policy shift can also be explained by the Bush Administration's propensity to advocate diplomacy and negotiation in the Caribbean Basin region rather than military measures, and by the Administration's emphasis of economic issues, as demonstrated by the Enterprise for the Americas Initiative.

Policy Issues and Approaches

U.S. policy toward the Caribbean has a variety of components and can be viewed as part of overall U.S. objectives for the hemisphere: 1) consolidating democracy and advancing human rights; 2) encouraging economic reform and development; and 3) preventing the flow of illicit drugs into the United States. All three of these objectives are an integral part of U.S. policy toward the Caribbean region. An additional issue is migration, a high-profile matter in light of the increase of Haitian "boat people" after the September 30, 1991 coup in Haiti. The United States has friendly relations with most Caribbean nations, with the exceptions of Cuba, where a policy of economic and political isolation is in place, and Haiti, where the United States supports the restoration of democracy.

DEMOCRACY, HUMAN RIGHTS, AND REGIONAL SECURITY

The Caribbean boasts some of the hemisphere's most stable democracies (with strong records of protecting human rights), which many attribute to a lengthy period of British colonial rule. In most nations, regular free and fair elections are the norm rather than the exception. In the last two years, regular successful elections were held in the Bahamas (August 1992), Barbados (January 1991), Dominica (May 1990), the Dominican Republic (May 1990), Grenada (March 1990), St. Lucia (April 1992), and Trinidad and Tobago (December 1991). In addition, Jamaica's ruling People's National Party in March 1992 chose a new Prime Minister, Percival James Patterson, following the retirement of Michael Manley. In the region's most recent elections, long-time Bahamian leader Lynden Pindling of the Progressive Liberal Party was turned out of office by the Free National Movement led by Hubert Ingraham. Pindling had served as Prime Minister since the Bahamas attained independence in 1973; in the 1980s, his government was criticized for reported involvement in drug corruption scandals.

While many Caribbean nations have maintained long democratic traditions, they are not immune from terrorist and other threats to their political systems. [1] The most recent example occurred in Trinidad and Tobago where in July 1990, the government was endangered by the coup attempt of a radical Muslim sect. Earlier in the 1980s, the government of Eugenia Charles in Dominica was threatened by a bizarre coup plot involving foreign mercenaries. The most serious break from the democratic norm of the region occurred in Grenada, under the socialist-oriented Bishop regime, 1979–1983.

The region is also home to the hemisphere's three current democratic holdouts—Cuba, Guyana, and Haiti—and one developing democracy, Suriname, which is trying to curtail the political power of its military. With the collapse of communism in the former Soviet Union, questions arise over how long Fidel Castro will maintain his grip on Cuba. In Guyana, although there has been significant economic liberalization under the administration of Desmond Hoyte, political reform has moved at a much slower pace. Elections, which were postponed in 1991 due to the inaccuracy of the voting list, were scheduled for October 5, 1992. They will be an important test of Guyana's return to democracy and its ability to end decades of elections manipulated by the ruling People's National Congress. In Haiti, following the September 30, 1991, military coup against the nation's first democratically elected President, the OAS has worked

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[1] For a discussion of security in the English-speaking Caribbean elsewhere in this volume, see: "The Future of Regional Security in the Caribbean," by Neville Linton.

actively, through economic sanctions and diplomacy, to help restore democratic rule. In Suriname, the civilian government has been taking measures to curtail the political power of the military headed by Lt. Col. Desi Bouterse.

U.S. Policy

A key question for U.S. policymakers is whether the United States is doing enough to help support democracy and advance the protection of human rights in nations where democratic traditions are weak or where democratic institutions need bolstering through financial support. The United States supports the strengthening of democratic institutions in several Caribbean nations through a variety of programs, including U.S. Agency for International Development (AID) democratic initiative projects and military assistance. AID assistance for strengthening democracy includes such programs as provision of scholarships, improvement of the judicial systems, and support for elections in Guyana. In most countries, small amounts of U.S. military assistance (consisting of International Military Education Training and foreign military financing) have had as one of its objectives the protection of democratic institutions.

Unlike the situation in Central and South America, there has been little fear of U.S. military assistance contributing to militarization in the Caribbean, largely because the levels of U.S. assistance are small and most Caribbean nations have only small defense forces. Military assistance to the region for FY1991 was estimated at about $11.7 million, whereas the Administration's requests for FY1992 and FY1993 are for about $15 million and $10 million respectively. While much of this assistance is for the larger countries of the Dominican Republic, Haiti, and Jamaica, some is also slated for supporting the seven-member Regional Security System of the Eastern Caribbean.

Congress has expressed concern about democracy and human rights in Guyana and Haiti. Foreign assistance authorization legislation considered in 1992 would have conditioned assistance to both countries. Assistance to Guyana would have been conditioned on free and fair elections, whereas assistance to Haiti would continue to be suspended until democracy was restored. Since the September 1991 coup in Haiti, the major congressional concern for U.S. policy toward Haiti has been how to help restore democracy. [2] In April 1992, legislation was introduced in both houses to further support the restoration of democracy beyond the current U.S. trade sanctions; additional measures called for in the legislation included support for an OAS civilian mission and sanctions against Haitian nationals who provided support for the coup or for terrorist acts after the coup. [3] Some Members of Congress have advocated military intervention, either by U.S. or international peacekeeping forces.

Another congressional concern has been improving respect for the rights of Haitian sugar cane workers in the Dominican Repub-

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[2] For further discussion in this volume, see chapter on "Haiti's Troubled Path Towards Democracy and U.S. Policy Concerns," by Maureen Taft-Morales.

[3] H.R. 4761, introduced by Representative Toricelli, and S. 2520, introduced by Senator Kennedy.

lic, who, according to some human rights groups, live and work under slave-like conditions. In 1992, Congress approved foreign aid appropriations legislation for FY1993 that conditioned $1 million in Economic Support Fund (ESF) assistance to the Dominican Republic on improvement in the treatment of the Haitian sugar cane workers.

U.S. policy toward communist Cuba has largely consisted of isolating the island nation, principally through a trade embargo in place since the early 1960s. As a result, Cuba does not participate in U.S. programs in the Caribbean, described below. The United States has attempted to expand the flow of information to the Cuban people since the mid-1980s, first through Radio Marti, begun in 1985, and then with TV Marti, which began operations in 1990. In 1992, Congress approved legislation to tighten restrictions on U.S. aid and trade with Cuba, and to impose sanctions against countries aiding or trading with Cuba. With changed circumstances in the former Soviet Union, opinions have varied about the appropriate direction of U.S. policy. Some favor a tightening of restrictions against Cuba in order to hasten change in the hemisphere's only Communist nation. Others argue that since Castro remains popular, a better approach is to begin normalizing relations in order to encourage movement toward a more open society. Both sides, however, have united in criticizing Cuba's human rights record.

ANTI-NARCOTICS ISSUES

Closely related to democracy and security is the struggle to combat illegal drug activities. Drug-related activities may threaten democratic institutions in the region through the corruption of law enforcement and government officials. In addition, increased drug activity has contributed to rising crime rates, addiction, and violence in the region.

Although only Jamaica is considered a major drug producer (marijuana) in the region, several countries—the Bahamas, Belize, Cuba, the Dominican Republic, Haiti, and Suriname, as well as Jamaica—are important transit points through which illicit drugs are transshipped for destination to the U.S. and European markets. For example, the Bahamas, a country of some 700 islands spread out over 100,000 square miles, is particularly vulnerable to drug traffickers. Moreover, several Caribbean nations have significant offshore financial centers with liberal regulations which, while contributing to economic growth in the region through legitimate business operations, also tend to attract drug and other money launderers. These include the Bahamas, the Dutch dependency of Aruba, and the British dependency of the Cayman Islands, which has the region's largest offshore financial sector and was a base of operations for the scandal-ridden Bank of Credit and Commerce International (BCCI).

U.S. Policy

Key questions for policymakers are whether eradication and interdiction efforts are proving effective in curbing the production of illicit drugs for the U.S. market, and whether efforts to prevent the region from being used as a transshipment point for illicit drugs to the United States are effective. A related question is whether Caribbean nations are cooperating with the United States in the anti-drug effort. In the Caribbean, U.S. anti-drug policy has three main elements: eradication; interdiction and law enforcement; and cooperation on issues related to money laundering.

Eradication support efforts take place principally in Jamaica and Belize, both marijuana-producing nations. In Belize, eradication efforts have resulted in that country becoming only a marginal producer of marijuana. In Jamaica, the United States has provided air support for Operation Buccaneer, Jamaica's marijuana eradication effort.

In the interdiction and law enforcement arena, U.S. officials claim that efforts in the Caribbean have caused South American drug transit routes to shift to the Pacific area. The United States provides substantial assistance through a variety of agencies, including the Department of State's Bureau of International Narcotics Matters, the Drug Enforcement Administration, the U.S. Customs Service, the U.S. Coast Guard, and the Department of Defense (DOD) and its service branches. The Coast Guard and the various military services are involved with Caribbean forces in land, sea, and air interdiction operations throughout the region. Several joint U.S.-Bahamian law enforcement bases have been established, operating under the umbrella of Operation Bahamas and Turks and Caicos (OPBAT), with the primary mission of apprehending airborne drug smugglers. In FY1991, 6.6 metric tons of cocaine were seized as a result of OPBAT, almost double the amount seized in FY1990. In addition, as noted above, the United States provides military assistance to most Caribbean nations. One objective of the assistance is to improve Caribbean counter-narcotics capabilities by providing equipment and training.

U.S. officials have been relatively pleased with Caribbean cooperation in eradication and interdiction efforts, but have expressed concern about the slow pace of Caribbean governments in adopting effective countermeasures against drug-money laundering. In June 1990, the region's nations gathered at a Caribbean Drug Money Laundering Conference hosted by Aruba, in which delegates agreed to refer a series of anti-laundering initiatives to their governments. A troublesome issue addressed by the conference was the rise of local drug service industries offering financial, transport, and other services to narcotics traffickers.

ECONOMIC GROWTH AND DEVELOPMENT

The Caribbean region is home to the hemisphere's poorest as well as some of its richest nations. [4] Both Haiti and Guyana are classified by the World Bank as low-income economies—that is, economies with per capita incomes of less than $610 in 1990. (The United Nations also classifies Haiti as a "least developed" country, which puts Haiti among the world's most underdeveloped nations.) On the other extreme, the Bahamas and many of the region's de-

[4] For a review and outlook for the region's economies, see chapter on "Caribbean Economic Performance and Prospects," by Trevor Harker, elsewhere in this volume.

pendencies are classified as high-income economies, with per capita incomes of $7,620 or greater. Most Caribbean nations are considered to be middle-income economies, with per capita income levels between $610 and $7,620. In terms of human development, Haiti ranks at the bottom of nations in the hemisphere in a United Nations Development Program annual index ranking countries worldwide according to life expectancy, literacy, and per capita income. For 1991, Haiti is the only Caribbean country considered to have a low human-development level, with a literacy level of just 48 percent. In contrast, five Caribbean nations—Antigua and Barbuda, the Bahamas, Barbados, Dominica, and Trinidad and Tobago—are considered to have high human development levels, the same category as most developed countries. Most of the nations in the region have small, open economies, ranging from the mini-state of St. Kitts and Nevis, with a GNP of $133 million in 1990, to the Dominican Republic, with a GNP of almost $6 billion. For most of the region's economies, export trade (often with a reliance on one or two commodities) is a major contributor to national income and for many nations the United States is the major export market.

The key question for U.S. policymakers is how to effectively promote development and economic growth in the Caribbean. To meet this objective, U.S. policy has three components: food assistance and a variety of economic assistance programs; trade and investment promotion; and debt-reduction.

U.S. Aid for Economic and Social Development

To help achieve AID's objective of promoting broad-based, sustained economic growth in the Caribbean, the United States provides a significant amount of foreign assistance to the region. [5] A little more than $3 billion was provided during the 1980s. In the last two years, $231 million was provided in FY1990 and $230 million in FY1991. Most aid to the Caribbean consists of development, ESF, and food assistance. In FY1990, these three categories accounted for 90 percent of foreign aid going to the region, while another 4 percent supported a Peace Corps presence. Just 4 percent was dedicated to military assistance.

Much of the economic assistance to the region has been concentrated in the three most populous countries of Haiti, the Dominican Republic, and Jamaica, but the United States also provides assistance to the six smaller Eastern Caribbean states through a Caribbean Regional program. In Jamaica, U.S. aid has helped support economic reform measures including the privatization of government-owned hotels and companies, and tax, foreign exchange, and trade liberalization measures. In the Dominican Republic, AID is working to encourage private sector development, to undertake selected social intervention that addresses critical needs of the poor, and to work with the government to bring about economic policy reform. Before its suspension after the 1991 coup, U.S. assistance to Haiti had the overall goal of improving the quality of lives in one of the hemisphere's least developed countries.

[5] For further information in this volume, see the chapter on "U.S. Foreign Aid to the Caribbean in the 1980s," by Carole Henderson Tyson and Daniel J. Seyler.

Congress has expressed concern in recent years about declining levels of assistance to the Caribbean. Aid to the region has declined from a high of $496 million in FY1985, to about $230 million for FY1991. Although Congress did not earmark assistance to the region in the FY1991 foreign aid measure (P.L. 101-513), it urged in the conference report that AID pay greater attention to the Caribbean island nations, and allocate no less than $20 million above the President's request in development assistance.

Some Members have wanted to take into consideration the views of Caribbean sectors and organizations in formulating U.S. development policy for the region. To achieve this goal, from 1987 to 1989 three congressional consultations were held in the Caribbean with governmental and nongovernmental representatives on key development issues. [6] The end result of these consultations was the Caribbean Regional Development Act, introduced annually since 1988, which would set priorities and policies for U.S. assistance to the Caribbean. These include such measures as: helping the poor participate in development; supporting environmentally sustainable development; promoting Caribbean self-reliance; supporting food production for national and regional consumption; promoting the diversification of industrial and agricultural production; and advancing the process of regional economic integration. In 1992, a non-binding version of the bill was contained in several versions of the foreign aid authorization bill which had not been approved by the end of the legislative session.

U.S. Trade and Investment Promotion Policy

The key question for policymakers is to what extent U.S. trade and investment promotion policy is helping to spur development in the region. Looking ahead, an important question is how Caribbean trade and investment will be affected by the movement toward a freer trading system in the hemisphere.

Caribbean Basin Initiative. Since 1984, the United States has offered a one way duty-free preferential trade arrangement for a wide range of products from Caribbean Basin nations, under the Caribbean Basin Economic Recovery Act (CBERA) (P.L. 98-67, Title II). (In implementing trade policy toward the Caribbean, the United States uses a broader definition of the region, referred to as the Caribbean Basin, which includes the Central American nations.) The preferential arrangement is the center of the broader Caribbean Basin Initiative (CBI), a program designed to expand foreign and domestic investment in the nontraditional export sectors of Caribbean Basin nations. To date, 24 out of 28 Caribbean Basin nations are beneficiaries of the CBERA, while Anguilla, the Cayman Islands, Suriname, and the Turks and Caicos Islands have not applied for the program. In 1990, so-called CBI II legislation

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[6] See the following congressional documents of the House Committee on Foreign Affairs: The Caribbean Basin Initiative: A Congressional Study Mission and Symposium. Hearings. September 18 and 19, 1987. 100th Congress, 1st session. 1988, 243 p.; United States-Caribbean Economic Relations. Report of a Congressional Study Mission and Consultation on Proposals to Strengthen United States-Caribbean Economic Relations, February 6-7, 1988. 100th Congress, 2d session. October 1988. 41 p.; and Caribbean Development. Report of a Congressional Study Mission and Consultation on A Caribbean Development Agenda for the 1990s, November 3-4, 1989. 101st Congress, 1st session. 30 p.

was enacted which somewhat enhanced the benefits of CBERA and made its provisions permanent.

Since the CBI trade program began, the overall performance of exports from the region has been mixed. [7] Although 1990 Caribbean exports to the United States amounted to $4.8 billion and were actually lower than the level of $6.6 billion in 1984, most of this decline can be attributed to the drop in the value of petroleum imports from the four oil-producing nations in the region (Aruba, Bahamas, Netherlands Antilles, and Trinidad and Tobago.) The U.S.-destined exports of non-oil-producing Caribbean nations actually increased from $2.1 billion in 1984 to $2.8 billion, with Jamaica and the Dominican Republic accounting for most of the increase (U.S.-destined exports from those two countries increased from $1.4 billion in 1984 to almost $2.3 billion in 1990.) For Belize and many of the smaller Eastern Caribbean states, exports to the United States have been weak, particularly from Barbados.

Some observers maintain that the CBI preferential trade program has been disappointing because several products (including most textiles and apparel, canned tuna, petroleum, footwear, handbags, luggage, flat goods, work gloves, and leather wearing apparel) are exempted from the program, and because the lowering of the U.S. sugar quota during the 1980s led to a substantial drop in Caribbean sugar exports to the United States. The original sponsors of the CBI II legislation wanted to substantially expand the CBI program by removing many of the exceptions from duty-free treatment and restoring the U.S. sugar quota for the CBI region to its 1988 level, but they were not successful. In the 102d Congress, legislation was introduced to eliminate most of the present exceptions to CBI duty-free treatment.

Hemispheric Free Trade. In 1990, the Bush Administration made two announcements that could affect the future of U.S.-Caribbean trade. In mid-June 1990, it announced its intention to negotiate a free trade agreement (FTA) with Mexico. This was later expanded to include Canada in negotiations for a North American Free Trade Agreement (NAFTA). In late June 1990, the Administration announced a broader Enterprise for the Americas Initiative with the ultimate goal of creating a hemispheric free trade area. According to the Administration, the NAFTA would be the first step toward hemispheric free trade, with the negotiations setting precedents for future FTAs. In the meantime, President Bush proposed the negotiation of bilateral trade and investment "framework agreements" with countries of the region as a step toward a hemispheric FTA. The United States has signed framework agreements with most nations of the hemisphere, including an agreement with the Dominican Republic and an agreement with 13 English-speaking nations of the Caribbean Community and Common Market (CARICOM).

Caribbean Basin nations have concerns about the potential adverse effects of a NAFTA agreement, negotiations for which were completed on August 12, 1992, as well as concerns about the broader movement toward free trade espoused under the EAI. In addi-

[7] For further discussion in this volume, see chapter on "U.S. Foreign Trade and Investment Policy In the Caribbean Basin Region," by Vladimir N. Pregelj.

tion, Caribbean nations appear somewhat fearful of losing their privileged position as a result of the 1991 Congressional passage of the Andean Trade Preference Act (P.L. 102-182, Title II), which provides CBI-type preferences to the Andean nations. In general, they fear that the United States will lose interest in the small economies of the Caribbean Basin, and focus its attention exclusively on Mexico and the other larger economies of Latin America. More specifically, they are concerned that the competitive advantages they enjoy under the CBI program will be eroded, resulting in substantial trade and investment diversion from the region to Mexico. Some believe that this erosion of trade and investment will make it extremely difficult, if not impossible, for the region to follow through with tough economic reforms and adjustment programs. They maintain that the region's export-led economic growth, made possible by economic reforms and the CBI preferential trade program, would be threatened. The result could be substantial economic hardship, that could prove especially damaging for some of the region's more fragile political systems.

Key questions are whether the small fragile economies of the region will be able to compete effectively in a wider hemispheric market, and whether U.S. trade and investment will be diverted from the Caribbean to Mexico. [8] Some claim that investment is already being diverted to Mexico (according to one Caribbean diplomat, Caribbean investment decisions "have been on hold since NAFTA negotiations commenced"), [9] but the Administration denies there is evidence to support this claim. Fundamental Caribbean questions regarding the NAFTA negotiations include: would the Caribbean nations be able to quickly join a NAFTA pact, and if so, what would be the criteria for joining; and how would NAFTA members deal with differing levels of development when considering additional members? Some observers have suggested that the NAFTA should allow the CBI countries to gradually remove trade barriers, over a period of 5 to 25 years, in order to allow time for these smaller economies to become more competitive.

U.S. Debt Policy

Important questions for U.S. policymakers are whether the U.S. policy of reducing the official debt of Caribbean nations will help restore economic growth to the region and, more fundamentally, whether the United States should forgive debt owed by foreign governments.

Although U.S. debt strategy in the 1980s was largely aimed at helping those countries with high levels of commercial bank debt, in June 1990, with the announcement of the EAI, the Bush Administration moved to extend debt reduction to official debt which Latin American and Caribbean nations owed to the U.S. government. The policy change was especially significant for those nations—particularly in Central America and the Caribbean—owing a significant portion of their debt to the United States. In 1990,

[8] For further discussion in this volume, see "The Caribbean and Hemispheric Free Trade," by Richard L. Bernal.

[9] Bernal, Richard L. Ambassador of Jamaica to the United States. Statement before the U.S. International Trade Commission. Hearings on U.S. Market Access in Latin America, Recent Liberalization Measures and Remaining Barriers. January 22, 1992, p. 7.

Congress approved legislation allowing for the reduction of food assistance loans for Latin American and Caribbean nations, and in 1992 approved legislation on authority to reduce additional types of debt.

In FY1991, the United States forgave about $430 million of U.S. official debt owed by three Caribbean nations—Guyana ($114 million in AID and food assistance loans), Haiti ($99 million in food assistance loans), and Jamaica ($217 million in food assistance loans). Only the debt reduction for Jamaica took place under the authority of the EAI; for Guyana and Haiti, the Administration used two other sources of statutory authority (Sec. 572 of P.L. 101-461, and Sec. 411 of P.L. 83-480, as amended in 1990) which permitted the United States to reduce the debt of least and "relatively least" developed countries.

Some observers are anxious for further debt reduction under the EAI because they judge that the debt has a negative impact on the region's economic development. Some in the Caribbean claim that servicing the debt is the region's most significant obstacle to economic growth, since it has diverted scarce resources from pressing domestic social needs in many Caribbean nations. According to the World Bank, three Caribbean nations—Guyana, the Dominican Republic, and Jamaica—have significant external debt problems. Guyana is classified as severely indebted, according to several key debt ratios, whereas the Dominican Republic and Jamaica are considered moderately indebted.

Some, however, oppose the U.S. decision to reduce official debt, citing the cost to the U.S. taxpayer. They maintain that debt forgiveness should only be granted to the least developed or most severely indebted countries. They point out that most Caribbean nations do not have significant debt problems, and most are moderate income nations. Moreover, those opposed to debt reduction point out that beginning in FY1992, any reduction of foreign debt must be provided for in foreign assistance appropriations (as required by the Federal Credit Reform Act of 1990) and therefore could reduce available foreign assistance.

MIGRATION ISSUES

For many Caribbean nations, migration to the United States has been an important economic and political escape valve. Several U.S. cities host large migrant communities from Cuba, the Dominican Republic, Haiti, and several English-speaking Caribbean nations. An estimated one-million Cubans reside in the United States, as well as an estimated 350-400,000 Haitian migrants, both legal and illegal. The number of migrants from English-speaking Caribbean nations is generally large compared to the home nation's population. For example, in 1985 it was estimated that some 63,000 Barbadians, legal and illegal, resided in the United States. This was about 25 percent of the population of Barbados. While migration serves as a safety valve for pressures on job creation and social services, it can also contribute to a "brain drain" of skilled workers which could have consequences for future development in the region.

Cuban and Haitian Migrants

An important question for policymakers is whether the United States should continue differing polices with regard to migrants fleeing Cuba and Haiti by boat. Since 1981, the United States has had a migrant interdiction agreement with Haiti to stop and inspect private Haitian vessels suspected of transporting undocumented Haitians, and to return the migrants to Haiti. Haiti is the only nation with which the United States has such an agreement, and from 1981 through 1990 only a handful of the thousands of the intercepted Haitian migrants have been granted asylum. Since the September 30, 1991 military coup, more than 38,000 Haitians have been interdicted. From November 1991 through January 1992, temporary restraining orders prohibited the United States from involuntarily returning the migrants to Haiti, and prompted the establishment of a camp at the Guantanamo U.S. military facility in Cuba. Beginning in February, following a U.S. Supreme Court decision, the United States began repatriating hundreds of Haitians from Guantanamo. On May 24, 1992, President Bush ordered the Coast Guard to interdict and return all Haitians in boats on the high seas to Haiti where they may apply for refugee status at the U.S. Embassy.[10] That policy has been challenged in the courts, and will be considered by the Supreme Court.

In contrast, it is U.S. policy that Cuban migrants intercepted at sea are brought to the United States and are able to adjust to permanent resident status. Over the course of Castro's 30-year rule, Cuba has generated large numbers of migrants to the United States, and Cuban interceptions have steadily grown over the past three years because of continued political repression and deteriorating economic conditions.

The differences in these two policies have prompted criticism of the Bush Administration for what some have alleged is a "racist" policy. In its defense, the Administration points out that the Cuban Adjustment Act of 1966 provides for the open-ended admission of most Cubans entering the United States. Administration officials also argue that Cuba is one of the world's few remaining communist dictatorships, where citizens have been jailed for trying to leave without a permit. In contrast, they maintain that Haitian conditions cannot be compared with the systematic repression in Cuba, and that most Haitians are migrating for economic reasons. Human rights groups have accused the Administration of ignoring widespread human rights abuses in Haiti. Some Members of Congress have condemned the Administration's policy, and have introduced legislation to provide temporary relief to Haitians until a democratic government is restored.

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[10] For further information on Haitian migrants elsewhere in this volume, see chapter on "Haiti's Troubled Path Towards Democracy and U.S. Policy Concerns," by Maureen Taft-Morales. For current information on the situation of Haitian migrants and U.S. legislation, see U.S. Library of Congress. Congressional Research Service. *Haitian Migration to the U.S.: Issues and Legislation.* Issue Brief 92021 (updated regularly), by Ruth Ellen Wasem.

CARIBBEAN ECONOMIC PERFORMANCE AND PROSPECTS: TOWARDS SUSTAINABLE DEVELOPMENT POLICIES

by Trevor Harker *

CONTENTS

INTRODUCTION

The decade of the 1980s will be remembered as a turbulent one in which changes came at an accelerating pace, straining the capacity of most countries to cope. Yet, as these changes contained within themselves challenges as well as opportunities, they were faced with apprehension and hope. Within the Caribbean region, countries demonstrated varying degrees of skill in managing change, based on their resource endowments and their capacities to formulate appropriate policies (Table 1). Projecting from the present to the immediate future, however, it is expected that the rate of change will accelerate, so that Caribbean countries will need to be even more responsive to the challenges of the coming decade than they have been in the past. Moreover, they will need to redouble their efforts to manage their resources, particularly human resources, if they are to make the best use of the development options that they will face. This reality has become evident since the decade has seen a qualitative change in the factors determining comparative advantage, to favor human skills, a trend which is unlikely to be reversed in the foreseeable future.

This paper is in two parts. The first provides a brief stocktaking of economic performance in the region, with the objective of presenting as complete a picture as possible of social and economic developments over the past 10 years. Based on these facts, it tries to

* The author is Regional Economic Adviser for the Caribbean, Economic Commission for Latin America and the Caribbean (ECLAC), located in ECLAC's subregional headquarters in Port-of-Spain, Trinidad and Tobago. This document is a revision and update of a previous paper by the author. Sustained Development for the Caribbean. *CEPAL Review*, No. 41, August 1990. p. 55–72.

TABLE 1. Selected Indicators—Caribbean Countries.

	Size km [2]	Popn. 1991	Life Exp. (1990)	GDP Growth [1]	GDP/ cap [2] 1974	GDP/ cap [2] 1991
Antigua/Barbuda	440	63	72.0	5.9	689	5,558
Bahamas	13,942	254	71.5	4.4 [3]	3,362	1,1097
Barbados	431	259	75.1	0.8	1,296	5,593
Belize	22,960	179	69.5	5.3	614	2,216
Cuba [5]	110,860	10,709	75.4	2.2 [3]	—	—
Dominica	750	80	76.0	4.1	378	1,847
Dominican Republic	49,000	7,350	66.7	1.5	639	740
Grenada	345	94	71.5	4.8	346	1,718
Guyana	214,970	755	64.2	−2.0	538	404
Haiti	28,000	6,647	55.7	−0.2	125	360 [4]
Jamaica	11,424	2,436	73.1	2.1	1,038	828
St.Kitts/Nevis	269	44	67.5	6.0	634	3,312
St. Lucia	616	152	70.5	4.8	448	2,759
St. Vincent/Gren.	388	117	70.0	6.2	310	1,526
Suriname	163,265	430	69.5	1.6 [3]	1,100	3,010 [4]
Trinidad/Tobago	5,128	1,253	71.6	−1.1	1,778	3,940
Puerto Rico	8,800	3,540	—	3.1	2,465	9,172

Source: ECLAC on the basis of official data; ECLAC Statistical Yearbook 1991.
[1] Average growth rate of GDP at constant prices for period 1982–1991.
[2] In current US dollars.
[3] Relates to the period 1982–1990 data.
[4] Relates to 1989 data.
[5] Gross social product.

draw some lessons from the 1980s, providing the context for the second part of the paper, which attempts to identify those elements which will be needed to achieve sustainable development policies in the 1990s. They include those that enhance the efficiency and competitiveness of the economies and those that help to build and sustain social cohesion. But both policies need to be framed within the context of long-term sustainability and particularly environmental sustainability. The challenge is, therefore, to discern and develop long-term development paths which integrate and make coherent diverse elements such as macroeconomic policies, population policies, national physical plans and environmentally-sustainable policies.

Some Reflections on Recent Economic Performance

The rate of growth of Caribbean economies, as outlined at Tables 1 and 2, has varied quite significantly in the past 10 years. The relative performance of individual Caribbean countries was conditioned by the mix of products contained in each country's export basket and the fortunes of each product in local and foreign markets over the decade. A further variable conditioning performance was the policy response, the degree to which appropriate policies were adopted to adjust to shocks or to take advantage of opportuni-

TABLE 2. Percentage Change in GDP.

(at constant prices)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	CU82–91
Antigua/Barbuda	0.4	6.9	7.5	7.7	9.7	9.0	7.7	5.2	2.8	1.6	58.5
Bahamas [1]	6.9	3.2	3.0	13.5	3.6	4.9	4.5	4.0	0.2	—	43.8
Barbados	−5.0	0.4	3.6	1.2	5.1	2.5	3.5	3.5	−3.1	−4.1	7.6
Belize	−0.8	0.8	0.8	2.3	2.6	12.5	6.6	14.7	8.9	4.2	52.6
Cuba [1, 2]	3.9	4.9	7.2	4.6	1.2	−3.9	2.2	1.1	1.0	—	22.1
Dominica	1.9	3.0	5.0	1.7	6.8	6.8	7.9	−1.1	6.6	2.1	40.7
Dominican Republic	1.5	4.6	0.3	−2.6	3.2	7.9	1.0	4.5	−4.8	−0.5	15.1
Grenada	5.3	1.4	5.4	4.9	5.5	6.0	5.8	5.7	5.2	2.9	48.1
Guyana	−10.4	−9.3	2.1	1.0	0.2	0.7	−2.9	−4.7	−3.1	6.1	−20.3
Haiti	−3.5	0.6	0.4	0.4	1.0	0.1	1.3	0.7	−0.6	−1.4	−1.0
Jamaica	0.5	2.3	−0.9	−4.7	1.7	7.4	2.9	6.5	4.8	0.2	20.7
St.Kitts/Nevis	6.8	−1.1	9.0	5.6	6.2	7.4	9.8	6.7	3.0	6.9	60.3
St. Lucia	3.2	4.1	5.0	6.0	5.9	1.5	12.1	4.6	4.0	1.7	48.1
St. Vincent	5.1	5.8	5.3	4.6	7.2	6.4	8.6	7.2	7.1	4.6	61.9
Suriname [1]	2.0	−4.1	−1.7	1.7	8.3	7.9	−0.2	2.0	0.2	—	16.1
Trinidad/Tobago	4.0	5.2	−7.1	−4.5	−1.0	−4.6	−3.8	−0.7	−0.2	1.8	−10.9
Puerto Rico	−4.8	1.7	6.6	2.2	3.5	4.9	6.5	4.9	3.5	2.0	31.0

Source: ECLAC estimates derived from country data.
[1] Cumulative variation relates to period 1982-1990.
[2] Global social product in 1981 prices.

ties. For convenience the economies might be placed into four categories.

Foremost amongst the categories, in terms of rate of growth, are the *small high-growth economies* comprising members of the Organization of Eastern Caribbean States (OECS), [1] the Bahamas, and Belize. As a group, the OECS recorded growth in excess of 5 percent per annum, as did Belize, during the 10 year period 1982–1991. The Bahamas averaged 4.4 percent growth per annum from 1981–1990. All of the small high-growth countries had vibrant and growing tourism industries. The country with the smallest tourist industry, Dominica, grew the slowest in the group. All countries in the group, with the exception of Antigua and Barbuda and the Bahamas, were also banana producers, selling an increasing quantity of fruit to the preferential United Kingdom market. Both sets of activities provided the necessary foreign exchange to sustain increased domestic activities in sectors such as construction, commerce and banking, insurance and real estate.

The next cluster of countries, the *moderate-growth economies*, had average growth rates of 2–3 percent and comprised Cuba, [2] Jamaica, and Puerto Rico. These countries had relatively diversified economies and the performance of the various sectors was mixed. All had significant tourism sectors which recorded growth, particu-

[1] The OECS comprises Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines. The British Virgin Islands is an associate OECS member.

[2] Care should be exercised in making comparisons between Cuba's Global Social Product and the Gross Domestic Product of the other countries, since methodologies differ.

larly in Cuba and Jamaica, both making rapid strides after years of stagnation. All suffered stagnant or contracting agricultural sectors, although agricultural export earnings increased significantly in Jamaica towards the end of the survey period. Both Jamaica and Puerto Rico showed increased manufacturing sectors, in the latter case the sector increasing from 36 to almost 39 percent of gross domestic product (GDP) between 1982–1991. Export earnings were fastest growing in categories such as garment manufacture in Jamaica and chemicals, drugs, and pharmaceuticals in Puerto Rico. In Cuba, industry decreased due to depressed domestic demand and the severe difficulties being experienced with traditional trading arrangements. In Jamaica, the performance of the minerals sector was inconsistent and conditioned by external demand for aluminum and the price of petroleum, the major imported input into the industry. Jamaican growth performance was severely affected by the cost of servicing its national debt, since an average of almost 72 percent of total revenues for each of the last five years had to be diverted to meet the costs of principal and interest. A large proportion of the earnings from exports of goods and services also needed to be diverted for servicing the external debt, 31 percent in 1991, down from a peak of 64 percent in 1987.

Barbados, the Dominican Republic, and Suriname fell into the category of *low-growth economies*, having an average growth rate of 0–2 percent. In Barbados, growth was positive though modest for the period 1983–1989. Severe contraction, however, was experienced in the period 1990–1991 due to the decreasing competitiveness of that economy which made it unable to compete for market share in the contracting tourist market, in its regional exports of manufactures, and in its traditional agricultural exports. Contracting foreign earnings required concomitant contraction in domestic activities such as commerce, construction, and government activities.

In the Dominican Republic, a major factor limiting growth was the cost of adjusting its economy from the traditional export activities to new ones, mainly tourism and activities in the export-processing zones. Notable was the secular decline in the perennial mono-crop, sugar. Export earnings from this product fell by half in value over the survey period, from 30 percent of merchandise exports in 1980 to 20 percent in 1991. Other factors limiting growth were large fiscal deficits incurred for non-liquidating activities in 1987–1988 and the consequences of this policy in subsequent years. Suriname suffered the plight of other minerals producers in the region, but internal political instability also caused dislocations to production and distribution and increased the level of uncertainty in the country.

The last category comprises the *contracting economies* of Guyana, Haiti, and Trinidad and Tobago, all of which experienced declines in GDP. Guyana and Trinidad and Tobago, as minerals producers, were affected by the declines in minerals prices, but all suffered declines in output of minerals as well, either due to management deficiencies in the industry or social unrest—or both. None of these countries benefited from the tourism boom experienced by other Caribbean countries and, since their tourism sectors were small, in some cases earnings declined. Guyana and Trinidad and Tobago also suffered declines in export earnings from sugar, while they almost ceased in Haiti. Reduced export earnings adversely affected domestic economic activities in Guyana and Trinidad and Tobago, since domestic consumption had to be sharply curtailed in sectors related to construction, distribution, finance, insurance, and real estate. Stringent measures were also needed to curtail government activities, this being a pervasive trend for most countries in the region.In Haiti, major declines were evident in manufacturing and commercial activities. While agriculture actually increased it share of GDP from 1980–1989, export earnings from the sector fell steadily from 1983. Earnings from the free zones increased over the survey period from 25 to 50 percent of exports between 1980–1988, but the rate of increase might have been faster and more sustained without the political disturbances endemic for the last years of the decade. This caused some firms to relocate elsewhere in the region and provided a setback for that country's efforts to diversify its economy.

SOURCES OF REGIONAL PROSPERITY

It is useful to briefly examine the performance of the various export products such as sugar, bananas, manufactures, minerals, and tourism—the principal sources of regional prosperity—in order to provide an explanation of country performance in the 1980s as well as prospects for the 1990s.

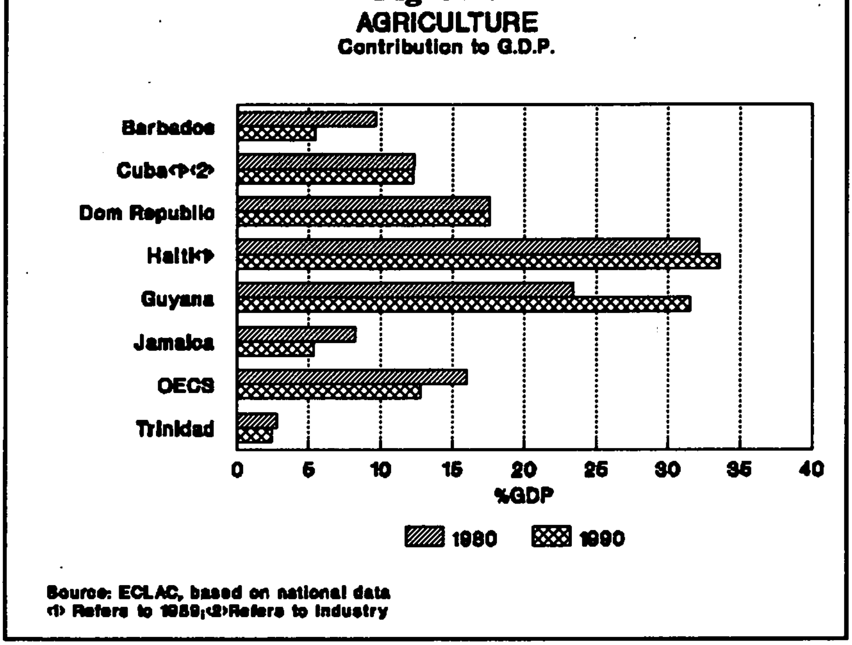
The first two agricultural products, sugar and bananas, come from a sector which has experienced weak or stagnant growth over the decade (Figure 1). This is due in part to policy which has given priority to manufacturing and, for those so endowed, to minerals development. The sector has become increasingly uncompetitive, accounting for a declining portion of GDP, except in Guyana and Haiti. While the decline in agriculture is in line with expected development trends, no viable export-earning activities have been identified (especially in the favored manufacturing sector) to supplant sugar and bananas, which continue to be of substantial importance and to exist because of artificial circumstances, i.e., support mechanisms.

The *sugar* industry continues on its secular decline. The industry is uncompetitive, surviving only on a life support system provided by the European Community and the United States or, in the case of Cuba, special trading arrangements with Eastern Europe and the former Soviet Union (Figure 2). All these special arrangements are uncertain: sugar quotas from the United States were cut by 35 percent in 1991, and arrangements between Cuba and former Council for Mutual Economic Assistance (CMEA) partners have been dismantled with the demise of that body, and replaced by various bilateral arrangements which are themselves insecure.

The export earnings derived from sugar by the region [3], declined over the survey period by about 36 percent. This represents a 40 percent decline in the volume of sugar shipped (Table 3). Declines were evident in all countries, with the exception of Jamaica which recorded growth in the last two years as a result of vigorous field

[3] The aggregate analysis excludes Cuba and Haiti, due to inadequate data. The mean for the period 1980–1982 was compared with the mean for the period 1989–1991 to provide an indication of performance changes over the decade.

Figure 1



rehabilitation. For some countries, such as the Dominican Republic and Belize, the constraints on further expansion are related to special arrangements to the United States market; for others, such as Barbados, the acreage under cultivation is being phased out and the efficiency of production has been declining. Output in Barbados in 1991 was the lowest in 60 years. For others, such as Guyana and Jamaica, the quest for foreign exchange has induced new measures to increase efficiency and output in the industry, but any efforts will ultimately be limited by the size of the preferential quotas available to the region, since sale on the world market is currently uneconomic.

The *banana* producers benefited from improved banana prices but they maximized their good luck by increasing output as well (Table 4). Accordingly, earnings grew on average by about 16 percent per annum between 1980–1991; volume increased by about 11 percent per year.

Fairly widespread increases of over 10 percent [4] per year were recorded in export volumes in Dominica, Jamaica, St. Lucia and St. Vincent. Yet, while the growth performance of the banana industry was one of the highlights of the period being surveyed, it is well to recall that for the three years prior to 1980, banana exports

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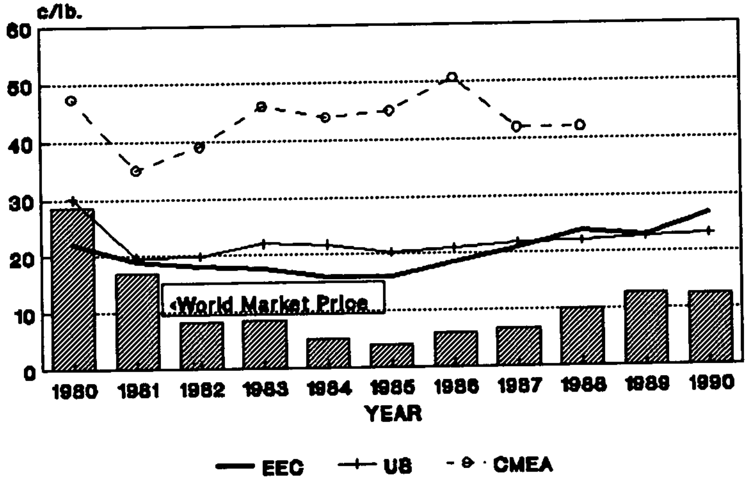
[4] Growth rates for bananas are estimated by a log regression of output or earnings over the time period 1982–1991.

Figure 2
INTERNATIONAL SUGAR PRICES
(In U.S. cents per pound)



Source: IMF

averaged 225,000 tons, a figure which was not surpassed by the region until 1986. Especially rapid growth in export volumes was recorded in Jamaica between 1986 and 1991, although this fell short of 1973 production levels by about 30 percent. Also noteworthy, banana production is still not efficient enough to compete on the open market. The picture remains fairly good as long as the United Kingdom market continues to be reserved for Caribbean producers, but this remains an uncertain prospect.

Manufacturing remains at a cross-roads and, in general, has not kept pace with overall GDP growth over the survey period. Producers are being exhorted to reorient their production to global markets. Yet, so far, the means to do so seems to have eluded most of them. This failure is due, in part, to a protective regime within the Caribbean Community and Common Market (CARICOM) which encourages high-cost production for the regional market.

Over the survey period the sector increased its contribution to the GDP of Guyana, Jamaica, Puerto Rico, and Trinidad and Tobago. Puerto Rico had the greatest growth in manufacturing and the greatest shift toward an economy based on manufactures (Figure 3). A similar shift also took place in Jamaica, mainly as a result of the increase in the garment-assembly sector. In Trinidad and Tobago, the sector increased its relative contribution to GDP due only to a declining petroleum sector and contracting output. For the OECS countries as a group, manufacturing contributed a

TABLE 3. Sugar Exports.

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
					Value (US$ Million)					
Barbados	36	27	32	32	31	36	34	26	34	31
Belize	33	34	33	23	32	31	33	36	43	42
Cuba [1]	3,808	4,078	4,123	4,442	4,069	3,987	4,087	3,914	—	—
Dominican Republic	266	264	272	159	134	127	123	157	143	132
Guyana	88	72	71	66	83	80	68	73	70	95
Jamaica	49	57	66	50	62	74	92	65	86	93
St. Kitts/Nevis	12	10	12	6	9	11	12	12	9	11
Trinidad/Tobago	22	26	29	22	23	21	27	31	30	—
					Volume ('000 tonnes)					
Barbados	89	74	87	84	99	70	68	52	57	53
Belize	98	109	94	89	99	79	75	77	95	94
Cuba	7,727	7,011	7,007	7,206	6,697	6,479	6,975	7,119	—	—
Dominican Republic	833	918	828	655	449	553	514	491	355	319
Guyana	250	212	206	214	214	205	171	170	129	150
Jamaica	138	137	157	152	143	134	153	132	146	157
St. Kitts/Nevis	33	23	28	24	26	23	23	22	14	18
Trinidad/Tobago	50	63	73	68	58	50	55	57	54	49

Source: ECLAC based on national data
[1] In Cuban pesos.

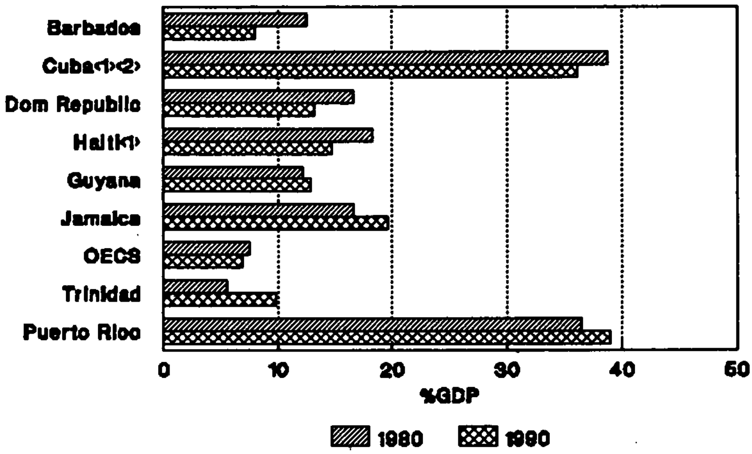
TABLE 4. Banana Exports.

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
					Value (US $ million)					
Belize	2	2	3	3	5	7	8	12	8	7
Dominica	10	11	11	13	29	31	37	24	30	30
Grenada	4	3	3	4	4	4	5	4	4	4
Jamaica	5	7	2	4	9	19	16	19	38	45
St Lucia	15	20	23	32	53	42	66	59	69	54
St Vincent	9	11	12	17	18	18	31	30	41	33
Total	44	55	54	73	117	121	163	148	190	173
					Volume ('000 tonnes)					
Belize	10	10	11	10	13	21	26	31	23	20
Dominica	28	29	33	34	51	61	71	50	57	55
Grenada	12	11	10	10	8	8	9	9	7	7
Jamaica	21	23	11	13	14	34	28	42	61	75
St Lucia	42	55	66	82	113	86	128	126	134	101
St Vincent	25	27	32	41	38	35	62	66	80	63
Total	138	155	162	190	237	246	324	324	362	321

Source: ECLAC, based on national data.

relatively small percentage of GDP—7.6 percent of GDP at the beginning of the decade—producing mainly light manufactures for domestic or regional consumption. By 1991, however, the sector had decreased its contribution to GDP to less than 7 percent.

Figure 3
MANUFACTURING
Contribution to G.D.P.



Source: ECLAC, based on national data
<1> Refers to 1989;<2>Refers to industry

The development and growth of the export processing zones (EPZs) or free zones, were noteworthy over the 10 year period, mainly because of their contribution to employment. Linkages to the rest of the economy remain few, and EPZs do not yet contribute significantly to GDP, since the value added by these activities is not high. They have been a source of much debate in the countries in which they have been introduced but are, nevertheless, expanding quickly in some of them. In general they seem, given the current level of manufacturing productivity and in the light of the prevailing unfavorable domestic policy framework, to be the only immediate viable option in this sector. But there is no compelling reason why these enterprises need remain as low-wage, low-value-added activities if workers and managers alike are able to upgrade their skills and move to more elaborate processes.

Minerals producers have fared badly over the survey period (Table 5). As energy importers, the metals producers in the Dominican Republic, Haiti, Guyana, and Jamaica were particularly hard-hit by energy price rises. Conversely, they were beneficiaries as energy prices fell, and most [5] regional producers regained some of their competitiveness in the second half of the decade. As a result

[5] The bauxite industries in Haiti and the Dominican Republic did not survive the second energy shock.

there was some resuscitation of the industry over the survey period, although it was slow and halting. In general, the sector was buffeted by extreme uncertainty and consequent fluctuation in earnings.

TABLE 5. Bauxite/Alumina Exports.

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
					Bauxite (US$ m.)						
Dominican Republic	16	5	0	0	0	0	4	2	1	1	—
Guyana	120	92	72	92	99	82	84	80	77	89	92
Haiti	17	21	0	0	0	0	0	0	0	0	0
Jamaica	172	170	109	160	78	97	116	105	126	103	112
Suriname	63	29	25	41	36	27	11	79	—	—	—
					Bauxite ('000 tonnes)						
Dominican Republic	457	141	0	0	0	0	328	207	0	0	0
Guyana	1,483	1,059	1,139	1,271	1,572	1,402	1,410	1,274	1,317	1,387	1,254
Haiti	480	622	0	0	0	0	0	0	0	0	0
Jamaica	5,294	4,079	3,009	4,559	2,325	2,900	3,711	3,494	4,190	3,886	4,261
Suriname	1,269	497	449	957	923	839	2,522	1,587	—	—	—
					Alumina (US$ m.)						
Guyana	33	12	2	0	0	0	0	0	0	0	0
Jamaica	588	344	315	284	212	205	221	307	432	616	550
Suriname	266	230	215	201	175	178	193	290	—	—	—
					Alumina ('000 tonnes)						
Guyana	170	73	29	0	0	0	0	0	0	0	0
Jamaica	2,549	1,755	1,907	1,713	1,622	1,600	1,572	1,576	2,145	2,889	3,032
Suriname	1,166	1,044	1,143	1,097	1,242	1,471	1,362	790	—	—	—

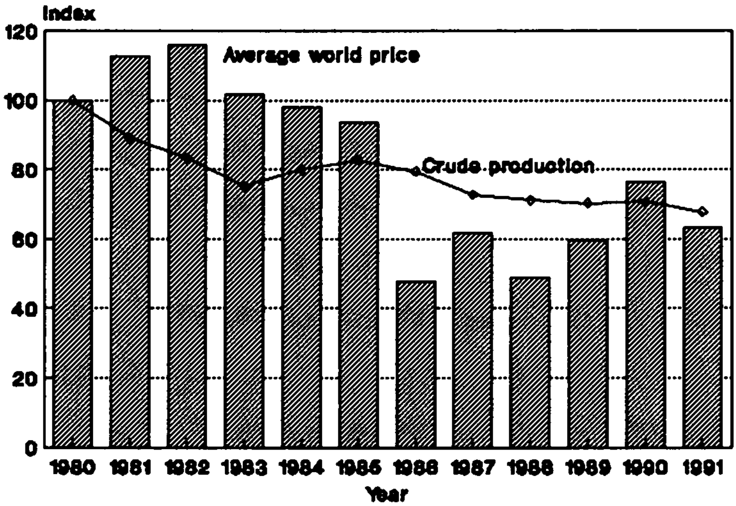
Source: ECLAC, based on national data.

While the metals producers benefited from the decline in oil prices, the *oil producers* were harmed. The situation in Trinidad and Tobago is illustrated in (Figure 4). After 1982, prices fell and so did export volumes and consequently earnings. As a result, domestic activity was reduced drastically, with the economy contracting for 7 of the last 10 years.

For the future, the long-term prospects of Caribbean metals producers will be shaped by the rate of growth in the industrial countries (and, consequently their demand for aluminum) the price of crude oil, and the extent to which Caribbean operations can be reconfigured to increase their energy efficiency, since new efficient international production has been added to compete with regional producers in the last three years. In the final analysis, a development path cannot be predicated upon minerals exports alone. The terms of trade have been against minerals since 1950, [6] and the amounts of minerals used to produce one unit of output have fallen steadily. Economies based on minerals producers have grown much

[6] It is estimated that in 1950, 100 units of minerals could buy 100 units of manufactures. By 1986, 100 units of minerals could buy only 14 units of manufactures.

Figure 4
PETROLEUM INDUSTRY
Trinidad and Tobago



Source: Central Bank

more slowly than, for instance, those specializing in manufactures. Consequently, the expectations of those who supported the concept of raw-materials based development, fashionable in the 1960s and 1970s, have not been satisfied in the 1980s. Minerals producers in the region will need to look at other resources to provide the main stimulus for growth in the future.

The *tourism* sector, by its steady growth, has provided most of the prosperity that has been experienced in the region over the decade. All the countries either had a tourism sector or were trying to develop one.

For the region as a whole, earnings averaged about 9 percent growth for the period 1981–1990 (Table 6). Earnings accelerated between 1985–1987, growing on average by 14 percent per annum. Thereafter, the rate of growth fell to 9 percent between 1988–1990 and is likely to be less in 1991. Above average growth was recorded by relatively new entrants to the industry (such as Antigua and Barbuda, Dominica, the Dominican Republic, the British Virgin Islands, St. Lucia, St. Kitts, and St. Vincent and the Grenadines) and by established destinations recovering from a past decline (such as Cuba, Grenada, and Jamaica). (Figure 5) Among the established destinations, growth was below average in the Bahamas, Barbados, Haiti, Puerto Rico, and the Netherlands Antilles. Tourist earnings contracted in Trinidad and Tobago.

TABLE 6. Tourist Expenditure.

(US$ M.)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Antigua	49.0	58.9	77.1	109.7	132.5	156.2	186.7	213.5	231.8	250.0
Bahamas	639.1	654.5	770.2	801.5	995.0	1,104.9	1,145.8	1,149.5	1,310.0	1,333.0
Barbados	261.9	251.1	251.6	284.2	309.0	326.9	378.7	460.0	527.8	493.5
Cuba	52.4	61.2	74.3	95.5	116.4	150.0	185.0	223.0	230.0	268.0
Dominica	3.0	4.0	7.3	8.6	8.7	11.2	12.8	14.0	18.5	25.0
Dom. Rep.	223.2	272.7	282.3	315.0	368.2	420.0	545.0	616.0	750.0	750.0
Grenada	17.3	17.2	18.7	22.7	32.4	39.6	42.1	46.0	28.8	34.4
Haiti	55.5	55.5	61.0	66.0	69.2	63.1	69.0	75.0	75.0	75.0
Jamaica	284.3	337.8	399.2	406.6	406.8	516.0	595.0	525.0	593.0	740.0
St.Kitts/Ne.	16.1	17.3	18.6	24.2	31.0	38.0	47.4	53.8	60.0	63.4
St. Lucia	29.4	32.4	39.7	68.4	90.0	118.0	126.2	134.2	144.6	154.0
St. Vincent	15.0	16.0	16.7	19.0	23.0	29.3	35.2	38.6	42.9	46.0
Suriname	40.6	32.8	17.9	13.3	9.0	7.8	10.5	7.9	7.9	10.7
Trin./Tobago	151.9	178.6	205.7	197.8	197.3	83.2	91.6	80.8	84.6	94.5
Aruba	156.4	163.1	114.5	118.4	120.8	158.1	203.6	279.3	309.8	353.4
Br Virgin Is	53.8	65.6	81.5	54.6	67.8	88.8	110.8	120.8	124.7	132.1
Montserrat	5.4	5.8	6.0	6.7	7.7	7.5	9.8	11.2	10.6	10.6
Neth. Ant.	280.2	258.7	205.0	199.9	225.0	255.5	279.7	321.6	371.7	449.0
US Virgin Is	317.5	312.5	356.3	434.0	507.4	509.8	639.4	657.3	682.1	706.5
Guadeloupe	93.5	107.5	116.0	98.0	95.0	163.0	188.0	220.0	183.0	230.7
Martinique	75.2	81.6	82.6	87.0	92.8	107.8	210.0	230.0	272.3	240.0
Puerto Rico	649.7	699.2	690.7	681.2	722.7	792.6	955.4	1,112.4	1,234.5	1,376.9

Source: Caribbean Tourism Organization.

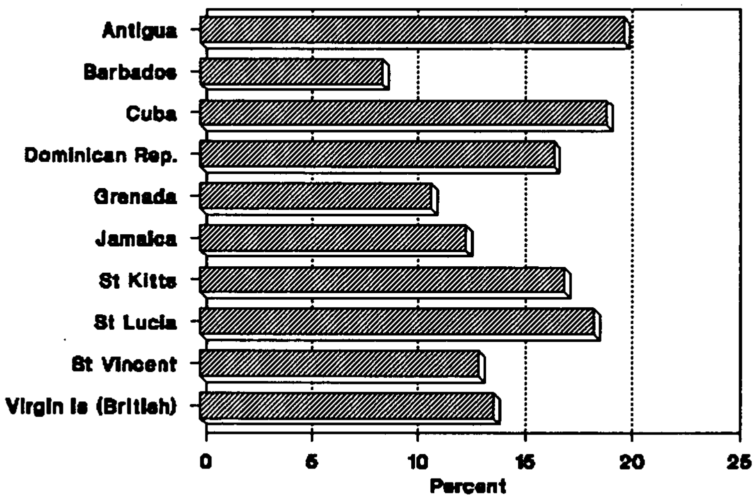
Despite a picture of overall success, warning signals are being provided by loss of North American market share and the declining productivity and profitability of many regional hotels. The specter of declining competitiveness and productivity is appearing in some of the traditional destinations, and there is a further danger of rigidity in adjusting to changing tourism leisure patterns.

In summary, the fact is that all major merchandise-export earning activities are in decline. Sugar is inexorably being phased out in some countries and is profitable only in protected markets. Bananas have staged a comeback in output but still depend on the preferential market in the United Kingdom. Since this market will not afford the same levels of protection in the 1990s, the industry will need to develop the means to stand on its own internationally. Minerals are of declining global importance, have unstable earning capabilities, and in the long run cannot be relied upon to provide the main development thrust. As a consequence of weak sectoral performance, merchandise earnings have not been able to keep pace with expenditures so that merchandise trade deficits are the norm. (Table 7) Only tourism has shown steady growth over the last five years and has served to reduce the deficit on current account.

Figure 5

TOURISM EARNINGS

Average annual rate of growth 1981-1990



Source: C.T.O.

TABLE 7. Merchandise Trade Balance.

(US$ m.)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Antigua/Barb.	−90.1	−71.1	−116.7	−140.5	−174.8	−245.8	−280.5	−259.3	−245.5	−236.3
Bahamas [1]	−482.9	−381.3	−480.7	−523.7	−607.0	−881.6	−785.3	−865.2	−922.7	−642.1
Barbados.................	−295.1	−301.5	−268.6	−256.0	−311.9	−403.7	−457.6	−552.1	−573.5	−548.8
Belize......................	−11.2	−21.7	−18.1	−12.4	−35.7	−24.5	−44.9	−67.8	−59.2	−105.0
Cuba [2]	−3,158.5	−2,105.8	−2,087.6	−2,144.9	−2,274.6	−2,211.0	−2,061.1	−2,732.0	—	—
Dominica..................	−22.4	−19.3	−30.2	−26.9	−11.1	−17.4	−30.5	−61.0	−62.0	−60.4
Dominican Rep.	−489.0	−494.0	−389.0	−556.0	−630.0	−881.0	−718.0	−1,040.0	−1,058.0	−1,071.0
Grenada	−59.1	−55.4	−38.2	−47.0	−52.2	−57.5	−59.4	−72.5	−82.9	−97.7
Guyana....................	−28.9	−55.0	3.3	−8.2	−49.6	−21.4	−1.0	−7.7	−45.7	−13.6
Haiti........................	−122.0	−138.0	−220.0	−226.0	−112.5	−101.1	−103.5	−111.0	−85.8	—
Jamaica...................	−613.7	−595.4	−480.8	−575.0	−383.6	−525.1	−566.3	−822.0	−784.9	−654.3
St Kitts/Nevis..........	−23.3	−32.7	−32.4	−31.8	−37.7	−51.5	−65.3	−73.9	−83.1	−76.5
St. Lucia	−76.5	−59.3	−70.7	−69.8	−71.9	−100.8	−101.9	−161.8	−144.0	−185.4
St.Vincent	−29.3	−28.6	−23.0	−16.9	−23.3	−46.3	−37.0	−52.8	−53.3	−60.1
Suriname.................	−31.7	−34.8	−17.5	26.6	33.0	64.5	119.0	218.3	91.5	—
Trinidad/Tob.	−625.3	−208.5	254.3	628.4	−115.9	254.2	283.9	356.8	818.9	319.7
Montserrat	−17.7	−15.5	−15.3	−17.1	−18.3	−21.7	−24.3	−29.4	−40.7	—

Source: ECLAC; World Bank.
[1] Excludes oil trade.
[2] Pesos (m).

Nevertheless, balance-of-payments deficits have been a chronic feature in the decade and have been financed by incurring foreign debt. For some countries, however, this is no longer a viable option, since the cost of debt servicing now constitutes an impediment to continued growth. (Table 8) On the domestic front, policy makers have increasingly come to realize that in small, open economies domestic economic space is defined by external performance. The assumption that external and domestic accounts could be insulated from each other, so that government action might be used to stimulate growth, has proven to be false. Accordingly, economic management over the decade has been characterized by a continuing quest to achieve balance in the fiscal and foreign accounts and to provide the policy measures which will stimulate the expansion of foreign-exchange generating activities. While some success is being achieved in attaining the fiscal and external balances, the search for new sources of income has been less successful.

TABLE 8. External Debt.[1]

(US $m.)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Antigua/ Barbuda [2]	84	89	58	76	181	232	243	261	269	253
Bahamas	228	234	213	193	216	193	171	220	268	322
Barbados	144	174	183	222	291	465	479	470	467	439
Belize	63	68	70	88	98	113	124	130	133	143
Cuba [3]	2,669	2,790	2,989	3,621	4,985	5,657	6,606	6,165	—	—
Dominica	34	41	44	49	57	65	66	72	86	91
Dominican Repub. [4]	2,966	3,313	3,536	3,690	3,812	3,899	3,883	4,090	4,482	4,244
Grenada [2]	32	47	48	49	54	67	69	70	87	90
Guyana [2]	807	963	1,114	1,308	1,542	1,736	1,778	1,801	1,802	—
Haiti	410	569	665	717	710	844	818	802	874	—
Jamaica	2,690	2,920	3,207	3,499	3,590	4,014	4,002	4,038	4,152	3,874
St. Kitts/ Nevis	11	12	17	19	19	21	27	32	36	37
St. Lucia	28	30	28	29	32	28	41	52	68	70
St. Vincent	21	23	23	24	30	38	45	51	55	60
Trinidad/ Tobago	1,115	1,306	1,398	1,643	1,898	2,082	2,012	2,097	2,520	2,431
Montserrat	2	3	4	4	3	3	4	3	3	3

Source: IMF; World Bank; LAC; OE; ECCB.
[1] Public sector incurred or guaranteed.
[2] Includes arrears
[3] Relates to convtible crency dt; in millions of pesos.
[4] Includes private debt.

THE EFFECTS ON PEOPLE

The analysis of economic indicators provides a useful picture of economic trends but is incomplete, since it says little about the distribution of the costs and benefits of such economic performance.

To the varying fortunes of the economies need to be added differing rates-of-population increase from country to country and varying impacts of economic contraction—especially of the reduction of government services—on varying groups within each country. While Table 2 illustrates the changing fortunes of Caribbean economies, it is not as easy to illustrate precisely how the poorest have been affected by these changes.

It is possible to conclude, nevertheless, that people in six countries—the Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago—have become poorer in the past five years. The decline in personal income, especially for the poorest, is made more onerous by the reduction in government services in all of these countries, given the high levels of public expenditures which prevailed, and the need in some of them to earmark large portions of public resources for the repayment of the debt.

The decline in economic activity has affected the lives of people in these countries in a number of ways. Jobs have been lost and, even for those fortunate enough to retain their employment, standards of living have fallen. The most readily observable symptom of such decline has been the steady depreciation of the currency, which in small, open economies has a much greater impact on all sectors than in bigger countries having a large reservoir of domestic production. [7] The rate of depreciation for those countries having to devalue their currencies is illustrated in Figure 6. All the currencies shown are in relationship to the United States dollar, with the greatest depreciation taking place in Guyana and leaving that country's dollar valued at less than one U.S. cent.

While personal standards of living were falling in these countries, the capacity of governments to provide a social safety-net for the poorest was also diminishing, due to a contracting revenue base. In order to reduce growing fiscal deficits and the accumulating debt burden, public expenditures had to be reduced, since revenues could not easily be raised. Caribbean people, for the most part, are fairly highly taxed (Figure 7), so increased tax rates did not automatically bring forth increased revenues. The reduction in expenditures sometimes resulted in a reduction in the delivery of social services, in areas such as health, education, housing and, in some cases, nutrition.

Any attempt at evaluating the social impact of expenditure cuts has to be treated with care. While the quantum of funds available for social services has in some cases been reduced, the proportions allocated for personnel emoluments and materials have also been skewed in favor of the former, further reducing efficiency. At the same time, new means might be used to deliver traditional services in a more efficient manner or to a more precisely defined target group so that a mere evaluation of expenditure might not signify reduced delivery. Finally, the backlog of social services might not be immediately quantifiable, as the deficiencies in health or education might not become observable until after a large lag; by then rectification, if still possible, might be protracted. Attempts had,

[7] In Jamaica, for instance, domestic food production meets only an estimated 10 per cent of domestic food needs.

Figure 6

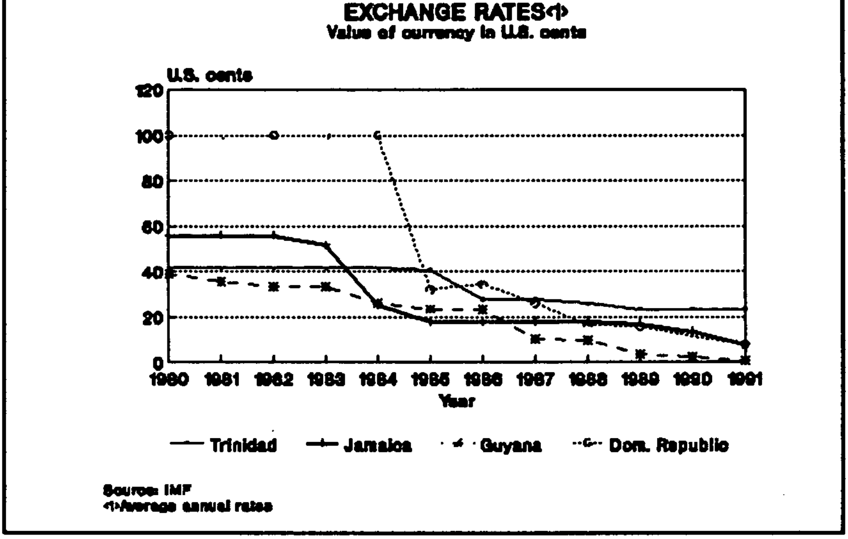
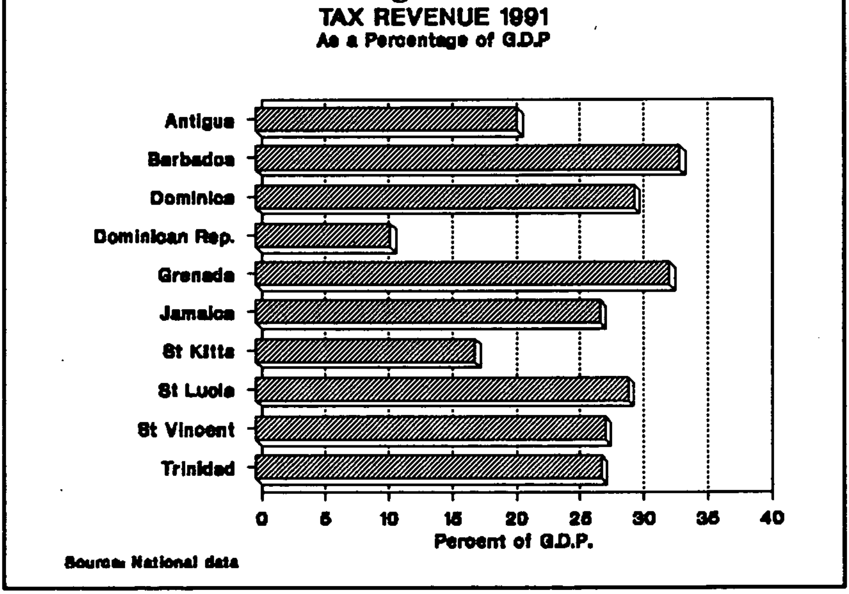


Figure 7



therefore, to be made to discern social trends despite the lack of precise data to measure them.

Bearing in mind the caveats noted above, it is possible, nevertheless, to arrive at a few tentative conclusions. In some countries, the vulnerable target groups among the poorest are pregnant and lactating mothers, children, and the aged. Where contraction has taken place for a period longer than the decade, signs of social erosion are discernible in health, education, and nutrition, so that relative standards have fallen as compared with countries having recorded more balanced growth over the decade. But absolute standards have also fallen in some instances, implying declining indicators in the same country over time. The significance of this erosion for future-development prospects should not be underestimated, especially as these will be predicated on human resourcefulness.

For some countries, the backlog in housing is quite considerable, leading to urban slums and often illegal squatter settlements. While high levels of unemployment have been endemic, the growth of the informal sector is a manifestation of the effort of the unemployed to devise and implement their own survival strategies. Yet the concentration on low-productivity activities, such as itinerant peddling and the provision of simple services, attests to the low levels of skills possessed by the hard-core unemployed.

LESSONS FROM THE 1980S

In terms of policy management, the decade of global uncertainty forced a new awareness on policy makers of the need to adopt more effective measures for short-term economic management. However, they realized, somewhat belatedly, the need to adjust to longer-term trends, such as changing taste patterns and dynamic shifts in comparative advantage. The ability to minimize the contradictions between short-term and medium to long-term planning was, moreover, uneven and especially difficult for those countries experiencing debt-service problems.

Small size also increases the vulnerability of Caribbean countries and complicates the adjustment process, since it ensures that production is concentrated on few products. Accordingly, fluctuations in the price of any one product have a magnified impact on short-term economic performance, while adjustments to shifts in comparative advantage are protracted and painful for the longer term.

Smaller countries are also discovering that they are denied some of the macroeconomic options available to larger countries, and the policy framework has had to be constrained accordingly. As a general observation, it is noted that the most open economies—and those least subject to restrictions on the movement of goods, skills, and capital—had the fastest growth. Those pursuing the most moderate fiscal and monetary policies, either through voluntary restraint or where central-bank statutes require it, also had the most moderate rates of price increase, the most stable currencies, and the lowest debt. The converse was also true.

In most countries, the social consequences of economic activities have been treated as a residual. This is partly because Caribbean countries have a tradition of extensive participation by government in the delivery of social services and, perhaps as a consequence, their social indicators relate favorably to comparator countries globally. Yet as some of these countries experience protracted economic decline, the customary role of government in providing social services has become less tenable, so that the deterioration in social indicators is becoming evident.

Many years of effort are in danger of being eroded. Yet one of the main lessons of the decade has been the importance of securing that blend of human skills and information to provide a flexible response to a rapidly changing environment. Any policies which downgrade the improvement of human resources, therefore, will render citizens less capable of facing the challenges of future decades.

Since the consequences of contraction are not evenly spread, there is the danger that income disparities are widening, further eroding social cohesiveness and public order. These concerns, no doubt, had been partly responsible for the reluctance of policy makers to initiate needed adjustment measures. As a result, their efforts to disguise the underlying economic weaknesses through increased government expenditures had complicated the adjustment process by increasing the debt and by postponing adjustment until it had to be especially severe.

The decade has seen an increased awareness of the finite nature of the environment. Caribbean countries are also becoming painfully aware of their own environmental degradation. It afflicts the high growth economies through the unsatisfactory disposal of solid and liquid waste, by urban sprawl, and by the profligate use of fertilizers and pesticides which pollute ground water and endanger marine life. Health standards are thus threatened, as is the very growth which causes practices detrimental to the environment, since growth for these economies is predicated on earnings from a high quality ambience and leisure services.

Yet the low-growth economies are no less immune from environmental degradation, which often takes the form of denuded and eroded hillsides, consequent on unscientific cultivation practices on scarce and marginal land and the need amongst the poorest to use wood as a source of fuel. All countries were affected by population pressures, inadequate land-use policies, the effects of oil spills, and the potential dangers caused by the dumping of toxic wastes. Most countries were inflicting damage to the environment at a faster rate than it could sustain itself. Most countries were incurring an environmental deficit which could not be sustained.

SUSTAINED DEVELOPMENT IN THE 1990s

For development to be sustained in the remaining years of this decade, emphasis will have to be placed on enhancing economic efficiency with the accent on vastly improved human skills, building social cohesion, and adherence to a development path that is environmentally sustainable.

In the past, rigidities and the sluggish response of Caribbean economies to change have caused many in the region to view rapid global change with anxiety. The orientation has, accordingly, been pessimistic and backward-looking. The major emphasis has been to protect and preserve existing and sometimes declining industries through special preferential arrangements. Yet, this path has often been followed at the expense of new and possibly more remunerative activities; and economic actors have seldom used the breathing space provided by these special arrangements to bring onstream new means of wealth.

As a consequence, many productive resources remain idle despite efforts to utilize them. Scarce land remains unutilized, while some of it which had been used for export crops has fallen into disuse as these crops are no longer profitable. Land that was used for export crops has fallen into disuse and remains unutilized, because it is no longer profitable to produce the traditional crops. Domestic savings are low, often not productively invested or sequestered abroad. But the most intractable problem and the most obvious indicator of unused potential remains the underutilization of manpower, since in many cases over one quarter of the labor force is unemployed, with a significant portion of the remainder underemployed or employed only in low-productivity occupations.

ENHANCED ECONOMIC EFFICIENCY

In order to reverse current trends and better fulfill development potentials for the remainder of this decade, economic efficiency will need to be increased so that the region can capture an increasing share of global trade. To do so will require a consistent macroeconomic framework that can maintain a stable, real-effective exchange rate, pursue conservative fiscal policies, and maintain trade policies which do not encourage production for the domestic or regional markets to the detriment of exports to third countries. Further supporting measures should include a diligent search for nontraditional industries or activities that are sufficiently specialized so as to be remunerative in relatively small-scale trading operations appropriate to Caribbean capabilities. Better knowledge of global-market trends will be needed as well as greater flexibility in phasing in and phasing out of activities. Greater knowledge, skills, and technologies will need to be incorporated into production. Better marketing and distributive skills will also be needed in the main export markets, whether they are obtained on contract, through joint ventures with foreign firms having such advantages, or indigenously developed. In sum, to penetrate the global market, it will be necessary to increase the productivity of the economy as a whole, since this is the only sustainable way of increasing living standards.

The concept of enhanced productivity often conveys many pejorative connotations to the workforce. Productivity increases often can be obtained in the short run only by reducing the returns to labor. As a consequence, it is often identified with the impoverishment of workers through currency devaluation or with exhortations to work harder and longer hours. In turn, this often raises the divisive issue of the distribution of the gains from productivity. While it is true that reduced remuneration is often the only way to buy time for declining industries, such policies should be regarded, at best, only as way-stations on the route to recovery.

An evaluation of the factors of production available in the Caribbean leads to the conclusion that most islands do not possess a surplus of highly arable land neither do they have an abundance of cheap capital. Expectations of rapid growth predicated on the exploitation of raw materials have not been rewarded, partly because most countries do not possess an abundance of raw materials, but also partly because rapid growth areas are now in services or in light manufactures which are sparing in the use of raw materials, but intensive in the use of knowledge. This leaves the region with the other two factors, labor and technology, which can usefully be linked as the latter is operationalized by labor through the use of tools.

Throughout history, productivity increases have been associated with the mastery of tools. Rates of pay have been linked with the worker's mastery, in the first instance of tools that had greater strength than man and latterly those that had greater speed or consistency or greater endurance. But as machines become more intelligent and sensitive, so they encroach more on the domain reserved for unskilled people. As a result, the skills needed to master them have become more complex and so the educational qualifications of people need to increase.

It is possible, therefore, to take a more positive and optimistic approach to the question of productivity and change. High productivity in this context is understood to mean the re-arrangement of those two components of work, the mental and the physical, to place increasing emphasis on the former. Curiously, we have now entered the stage beyond the mere acquisition of more efficient machines to the acquisition of tools developed to help the mind to work more effectively. They take much of the routine out of certain types of mental work, thus liberating the mind to increasingly more productive tasks. From this concept is derived the admonition to "work smarter", where previously emphasis was merely on working harder.

As we are in the throes of what is being referred to as the information revolution, it is well to bear in mind one of the unique features of information, which, unlike most material goods, increases when it is shared. Information, or "mind workers", therefore, have to be more cooperative than before. They also have to be more alert to learning things on the job, to sharing newly acquired information and to be more flexible in changing jobs within the team.

This shift will demand from us greater creativity, autonomy, and skills but in the process will provide greater awareness of the work process, enhanced job satisfaction, as well as better returns for enhanced productivity. It will also provide a better working environment for those skilled enough to hold their own in it.

A greater premium needs, therefore, to be placed on the development of human skills and qualities. This is understood to mean the continuing process of improving skills and knowledge throughout one's productive life and should apply to all people. But it is something over which all persons have some measure of control, both as individuals for personal skills development as well as for coming generations. This has implications for educational processes and requires a shift in attitudes of not only teachers and students, but from the society at large, to place increased demands on the educational system.

The available evidence seems to indicate that those countries which have moved fastest to achieve productivity increases have been able to do so with a good basic general education, which simultaneously provides the foundation for the necessary high level of job training and for flexibility. It goes without saying that computer skills should begin at the earliest level and be regarded simply as an indispensable mind tool which is also one of the keys to storing, sharing, and, therefore, to increasing information.

Links also need to be made early between the world of education and the world of work. Emphasis needs to be placed on helping young people to shoulder the responsibility for making themselves viable adults and the educational process should be seen as preparation for viability. Good general education is also beneficial in widening career prospects and providing operational flexibility.

Enterprises will need to be more alert to the types of skills and structures which need to be put into place, just as they will need to be aware of the technologies that are necessary and how to get them. They will need to explore more effective forms of organization and collaboration with research, financial and technical institutions, and with the trade unions.

But it is equally the responsibility of the worker to advise on the best and most effective ways of doing things and to exert continuing pressure for improved skills and responsibilities. This implies ongoing investment by the firm in training and the acquisition of technologies in order to enhance productivity.

The foregoing elements, when brought together, will contribute to the development of a culture of entrepreneurship which should pervade public and private-sector workers, technicians, and professionals, as well as institutions such as trade unions, chambers of commerce, and manufacturers associations. This culture, optimistic, outward-looking, and forward-looking, will be receptive to new ideas and the incorporation of technological change, and it will increase the likelihood that productivity increases become a self-generating process.

In the anxiety to address the pressing problems and find the "key" to development, many models have been evaluated, sometimes in their purest and most theoretical forms; yet, common sense will tell us that a judicious mix of elements will need to be used, based on an empirical evaluation of what will work. Deregulation is one such element that is currently in vogue. It is often prescribed as the remedy for rigid and unresponsive economies. And it is undeniable that a network of overlapping regulations have rendered regional economies unresponsive to change and have often created contradictions in policy. Moreover, the more impersonal mechanism of price might be the only viable solution where social disharmony, policy inertia, or vested interests oppose the removal of policies which discriminate against trade and a rational approach to planning, or in those areas where knowledge and foresight are limited and change is rapid and unpredictable. But deregulation is not a panacea; it should, therefore, not be applied indiscriminately, and it is not to be seen as an excuse to abdicate responsibility for development.

However, government/public sector intervention, where necessary, will need to be applied with restraint and humility. It might prove to be necessary to preserve a measure of equity in the delivery of those social services needed to improve social harmony and develop all the human resources to their fullest potentials. It will be necessary to create and preserve a stable legal and economic climate to encourage enterprise and to strengthen the educational system at all levels.

At the national level, the appropriate macroeconomic policies to maintain competitiveness so as to increase the country's share of international markets is a necessary, though not sufficient, condition for growth. The role of provider of infrastructure remains, with renewed emphasis on the educational and communications infrastructure. But there is need for an appropriate industrial policy. Selective interventions might need to be made to identify and support prospective sectors with a high, value-added potential realizable at the national level, and to encourage their growth. The public sector also has a role to play in encouraging an industrial atmosphere, between the state itself, the trade unions, and the private sector which is harmonious and cooperative, rather than conflict-oriented. Intervention is also necessary to discern and develop long-term development paths, since these will need to integrate and make coherent disparate elements such as macroeconomic policies, population policies, national physical plans, and environmentally sustainable policies.

Investment is the process through which ideas are transformed into productive output. It is the vehicle to increased growth and structural transformation. Yet if investment is the vehicle to increased growth, then savings provide the fuel for that vehicle. Nevertheless, while savings are necessary they are not a sufficient condition for achieving investment. A propitious investment climate and adequate investment institutions are also necessary if the stream of savings is to flow into productive investments.

It is also generally conceded that the rate of investment in the region is low, and this is believed to be as a result of low rates of saving. If individuals are to be persuaded to postpone spending in the present and to save, and if the investor is to take the risk of investing, the payoff will need to be sufficient to induce both sets of actors to do so, and it will need to be reasonably assured. Optimism about the future is a necessary element to induce a long-term perspective and, hence, a healthy investment climate. Macroeconomic policies can be used to limit rates of inflation, ensure positive rates of interest, and generally to preserve a measure of stability in the economy as a whole.

Some honest introspection is needed by workers, entrepreneurs, and the governments if the region is to determine why investment is not taking place at the desired rate in some countries and why a significant portion of savings are stored abroad, without much chance of being returned for regional development. Some analysts believe that if these funds were available to the region and used for productive investments, development would be quickened. The policymaker will need to isolate those factors which are inhibiting savings and investment, and take the necessary steps to eliminate them.

It goes without saying that the process of globalization that has accelerated so rapidly in the past two decades will continue. This region, which has historically had a global orientation, will need to relearn how to interface effectively with the wider world community. This knowledge is necessary in order to understand our markets, be sensitive to market shifts, and be responsive to new intellectual and technological currents.

This does not imply a diminished role for regional cooperation, although the last two decades have caused us to look skeptically at the concept of regional integration in the light of its failure to deliver on, perhaps unrealistic, expectations. Regional cooperation remains a viable option in the Caribbean despite a growing recognition that indigenous production is insufficiently broad-based to supply a sufficient range of domestic needs.

Cooperation can be beneficial to small producers to assist them to penetrate global markets. Regional competition can be used as a mechanism for strengthening enterprises to enable them to compete globally. Cooperation in joint marketing might also present a viable option, especially in areas such as light manufactures and tourism. A policy to encourage regional joint ventures and interregional investment can also be useful in reducing the risk faced by the Caribbean investor who has to locate all his assets in one small territory. Since the perception of risk provides the strongest motivation for capital flight, such a policy might serve to increase the quantum of resources retained in the region as a whole.

Cooperation can also be beneficial among small states to assist them to perform those tasks which they have difficulty in performing well on their own. For the smallest of them, some form of integration may be chosen to reduce the human and material costs through the delivery of joint services. But even for the region as a whole, there is much to be derived from cooperation at the level of public policy. Functional cooperation within CARICOM has been one of its successes, while in view of common producer interests, the development of joint strategies at the multilateral level has proven to be beneficial at the CARICOM level and is slowly being extended to the whole region.

But regionalism should not be used to provide the illusion of a safe haven or a permanently reserved secure market where enterprises can hide from the rapid developments in the wider global environment, for that is a prescription for continued stagnation.

CREATING SOCIAL COHESION

The discussion has focused so far on the capacity to strengthen our economies, but that alone is not sufficient for sustained development. This can only be achieved in the long run if a basic measure of social cohesiveness is created and preserved. Consistent policies become more viable in a political environment having a broad-based social consensus, whereby widely polarized interest groups have limited discontent on which to thrive. In this way, issues can take precedence over interests so that policies may be judged on their intrinsic merits.

At the level of ideas, the traditional dichotomy between growth and equity is slowly being reconciled by an emerging consensus that both growth and equity are essential and mutually supportive. Here, the real issue is how to distribute available wealth in a way that advances the goal of social cohesion. Questions of equity naturally become more acute in times of economic contraction, yet redistribution becomes politically more difficult with a shrinking pie. The resulting social antagonisms endanger the social cohesiveness necessary for a properly functioning economic system. Explicit policies are therefore needed to use contracting resources more efficiently, and to provide a safety net that would be precisely targeted at the most marginalized segments of the population and would focus on such areas as health, nutrition, retraining, and employment.

Many of the assumptions on which the social services in the region were built, and—particularly that which emphasized—the provision of free and comprehensive social services to all citizens, are currently being called into question. These assumptions are regarded by some to be unrealistic, while others also regarded them to be an inefficient way of delivering social services to the public at large. At best, such delivery will need to be held in abeyance while the economies are in a process of contraction and restructuring, and priority given to meeting the needs of the poorest people while those that have the capacity to do so will need to fend for themselves.

Primary and preventative health care is the most efficient form of expenditure on health. It also has its greatest impact on the neediest. Nevertheless, means will also need to be found to improve the performance of such physical facilities that have suffered from reduced maintenance as a result of economic contraction. This might take the form of improved management, better administration, and improved referral systems or, in appropriate cases, divestment. Where reduced funds have limited the procurement of pharmaceuticals, more careful targeting and better cost-recovery programs seem to be the only viable ways to ensure that scarce resources are directed to the neediest.

Nutritional deficiencies have been identified in clearly defined groups, children and pregnant and lactating mothers. Across the board food subsidies, which are expensive and have been demonstrated to be of limited benefit to the poorest, might need to be supplanted by programs linked to schools, pre- and post-natal clinics, or the outpatient departments of hospitals.

Employment has been a recurring concern in Caribbean countries, yet macroeconomic policies and institutional rigidities which provide incentives to substitute capital for labor continue to pervade our economies. These policies will need to be relaxed if any meaningful steps are to be taken to absorb the surplus manpower which is often endowed with only limited skills. Well-focused training programs can retrain persons for shifting demands in the labor market, while properly conceived public projects might have a limited applicability provided they are targeted to the hard-core unemployed, meet acceptable standards of economic return, and fit into existing sectoral priorities. But ultimately, the issue of remunerative employment will be addressed only through effective training, discussed above.

Essentially, the proposal is to treat the delivery of social services in a systematic plan, especially where the economy is in contraction. In so doing, efficient ways can be found to deliver basic social

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services to the neediest, and so minimize the negative social impacts to which they would be exposed.

ENVIRONMENTALLY SUSTAINABLE POLICIES

The economist has no difficulty understanding that a society cannot for long consume more than it produces. Deficits result in a debt which has to be repaid by future generations, often at the cost of their own development. This relationship is common knowledge, although it is often ignored. Yet until recently, economists and other policy makers have been curiously silent about the rapid consumption of the natural environment. They have tended to regard development as a process of conquering nature and growth to be correlated with the rate of consumption of our natural physical assets.

Fortunately, and perhaps just in time, we are becoming aware that the rapid exploitation of natural resources is neither the sole nor even the best way to produce growth. And as we destroy our hillside cover, erode our best lands, pollute our rivers with chemicals, and dump effluent onto our best beaches, we are slowly coming to the realization that we are taking more from the natural environment and faster, than it can heal itself. In fact, we have been incurring an environmental debt which will have to be repaid by our children. Indeed, even current generations are already paying for it in decreased yields, and the increased incidence of various diseases, not to mention the aesthetic damage done regularly to our landscape.

As the pressure to relieve material constraints is lessened, we will discover that factors other than material ones are necessary to insure our survival and to improve the quality of our lives. A healthy and pleasant environment ranks high on any list of such factors and is indispensable for the development of the high value-added recreational and leisure services which seem to hold good prospects for our future growth.

Meeting legitimate development needs, but within a framework that can be sustained, is the greatest policy challenge that must be faced for the future. The exercise need not be perceived as a zero-sum game, that is, a choice between the environment or development. There are many areas where the two can co-exist, for it has been amply demonstrated that many polluting practices in developing regions persist because of abject poverty and a paucity of options, and often impact most severely upon the poorest people. [8] Conversely, many policies necessary for development can also simultaneously benefit the environment, such as widespread education and policies to increase efficiency. Yet, it must also be faced that a continued rapid increase in population makes the equation infinitely more difficult to solve. Accordingly, the need to integrate population and environmental policies into the overall process of development planning has become a priority.

A number of issues need, therefore, to be placed high on the policy agenda for the remainder of this decade, so as to restore our

[8] Such areas refer especially to sanitation and the proper disposal of solid and liquid waste, the provision of clean water, air pollution, and land erosion.

environment to health and to preserve it for future generations. For the Caribbean these issues should include: [9] orderly land use planning; measures to stop the degradation of the coastal and marine environment; prevention and mitigation of the effects of oil spills; solid and liquid waste management; dumping of extra regional wastes; water quality and supply; forest and watershed management; preservation of genetic resources; the preservation of historic and cultural resources.

CONCLUSION

Sustained development in the decade of the 1990s can be achieved only if economic growth is sufficient to progressively improve the quality of life of the broad majority of the region's people. As if growth alone is not difficult enough to achieve, we need further to qualify the nature of such growth in at least two major ways. First, growth alone will not be enough to improve the quality of life of the broad majority of the region's people, since the benefits of growth will need to filter through to the most disadvantaged people in ways that will allow them to improve themselves and break out of the cycle of poverty which tends also to entrap their children. Second, this level of growth will have to be achieved in a way that does not foreclose the options of future generations by making demands on the environment that it cannot sustain over time.

The coming years will continue to present us with enormous challenges as well as with rich opportunities. The issue is whether we will have sufficient vision to focus on our possibilities, or whether we will merely seek to cling to the fading options of the past. If we are to do the former, I believe we need to develop all our people to be aware of their potential and to have the determination to realize it. For in its essence, this is what development is all about. But development cannot be achieved by the government, it cannot be achieved by entrepreneurs, and it cannot be achieved by workers. It has to be achieved by all these working together, to achieve commonly agreed goals that are sufficiently well thought out to be sustainable over time.

[9] For a complete list of the issues defined as priorities, see: "The Port of Spain Accord on the Management and Conservation of the Caribbean Environment."

U.S. FOREIGN AID TO THE CARIBBEAN IN THE 1980s

by Carole Henderson Tyson and Daniel J. Seyler *

CONTENTS

INTRODUCTION

The magnitude and content of U.S. foreign aid to the Caribbean in the 1980s was shaped largely by political events in the region and by the change in the focus of the U.S. Agency for International Development (AID). Both of these factors led U.S. assistance to focus on democratic, free-market societies as the primary aim of U.S. foreign aid. In retrospect, it is striking the degree to which Cold War conflicts (Cuba, Grenada, and Central America) shaped the overall context of aid to the Caribbean. Equally as striking were the rather drastic changes in AID's portfolio and how firmly these changes were institutionalized a decade later.

The political events that shaped U.S. foreign assistance to the Caribbean in the 1980s included, in part, the Cold War insurgencies in Central America. U.S. foreign policy often sought to unite the two regions despite their historical and contemporary differences. An example of that approach was the Caribbean Basin Initiative (CBI). Announced in 1982, the CBI was a package of aid,

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trade, and investment that largely dealt with these two subregions as one.

Political events in the Caribbean receiving attention from American policymakers included Jamaica's transition from defiant independent socialism to free markets, Guyana's non-aligned socialism shift toward democratic capitalism, and the rise and fall of a Marxist government in Grenada. A leftist military junta in Suriname, the overthrow of the Duvalier dictatorship in Haiti, and relative political calm in the Dominican Republic and the rest of the English-speaking Caribbean rounded out the region politically.

The most fundamental change that reconfigured AID's policies in the Caribbean was the increased emphasis on private sector development—trade, investment, and free-market economic policies. The purpose of this shift was to stimulate increased in-country growth and toward the end of the decade, to provide clear benefits to both the United States and its trading partners. Although this was a trend worldwide, the trend in the Caribbean was particularly pronounced because of the announcement of a formal program, the CBI in 1982, which marked the start of AID's private sector focus in the region. AID's emphasis was part of the Reagan Administration's overall policy of promoting free markets and the private sector both domestically and internationally. AID continued to work in traditional areas of education, population, health, agriculture, and infrastructural development, given the continued development problems in those sectors, but the overarching goal of all assistance was the development of efficient free-market economies with a prominent role for the private sector, even in the social sectors. This translated into: policy reform at the macroeconomic and sectoral levels; support to the private sector; encouragement of enhanced democratic practices; private options in education and health; agricultural diversification; and greater emphasis on sustainability and development gains.

Regional Overview

The major recipients of U.S. foreign aid to the Caribbean in the 1980s were Jamaica, the Dominican Republic, and Haiti—the three most populous countries, containing a combined population of 16 million, (see Tables 1 and 2 and Figure 1). U.S. foreign aid to the other Caribbean countries was only a fraction of the levels to these three largest countries because of their generally small size, tiny populations, and high per capita incomes. The islands of the Eastern Caribbean (Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines) followed in importance. [1] On a per capita basis, however, the inhabitants of the small islands of the Eastern Caribbean and Belize, with a total population of less than one million, received higher levels of assistance than Jamaica, the Dominican Republic, and Haiti. Belize and Grenada were the next major recipients.Guyana, Trinidad and Tobago, Suriname, and Barbados were minor recipients of aid. Although not insular territories of the Caribbean, Belize, Guyana,

[1] AID funded Grenada as both a bilateral mission and as part of its regional mission to the Eastern Caribbean during the 1980s.

TABLE 1. U.S. Foreign Aid Levels to the Caribbean in the 1980s.

('000)

Country/Region	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1981–1989
Barbados											
ESF	0	0	0	0	0	0	0	0	0	0	0
DA	0	0	0	0	0	0	0	0	20	250	270
PL-480	149	55	47	0	0	0	0	0	0	0	251
Military	58	50	70	0	71	69	0	0	0	135	453
Total	207	105	117	0	71	69	0	0	20	385	974
Belize											
ESF	0	0	0	10,000	0	14,000	2,549	5,395	0	0	31,944
DA	0	0	0	6,697	3,875	8,503	6,950	7,595	7,500	7,600	48,720
PL-480	0	0	0	0	0	0	0	0	0	0	0
Military	0	0	26	66	549	600	552	600	320	600	3,313
Total	0	0	26	16,763	4,424	23,103	10,051	13,590	7,820	8,200	83,977
Dominican Republic											
ESF	0	0	41,000	8,000	34,000	95,000	40,000	165	13,835	0	232,000
DA	34,640	17,393	19,047	26,526	30,346	30,568	27,188	19,882	18,612	20,126	244,328
PL-480	19,661	18,556	19,270	25,278	31,305	42,407	31,748	14,865	23,339	58,283	284,712
Military	3,450	3,430	5,465	6,597	6,335	8,721	4,519	3,372	1,250	700	43,839
Total	57,751	39,379	84,782	66,401	101,986	176,696	103,455	38,284	57,036	79,109	804,879
Eastern Caribbean											
ESF	4,000	0	20,000	35,000	30,820	20,000	27,575	23,800	3,000	10,225	174,420
DA	41,183	27,044	30,055	23,178	25,403	27,639	24,900	31,200	32,000	19,329	281,931
PL-480	643	0	16,597	0	17	22	15	1	9	906	18,210
Military	0	0	100	3,273	7,188	5,216	7,539	5,420	1,400	1,525	31,661
Total	45,826	27,044	66,752	61,451	63,428	52,877	60,029	60,421	36,409	31,985	506,222
Grenada											
ESF	0	0	0	0	46,966	11,129	0	0	0	0	58,095
DA	0	0	0	0	1,409	200	0	0	0	0	1,609
PL-480	0	0	0	0	0	0	0	0	0	0	0
Military	0	0	0	0	63	63	0	0	0	80	206
Total	0	0	0	0	48,438	11,392	0	0	0	80	59,910
Guyana											
ESF	0	0	0	0	0	0	0	0	0	0	0
DA	2,537	1,207	1,688	126	0	0	0	0	0	0	5,558
PL-480	2,392	27	145	47	0	80	3,240	6,522	7,007	7,000	26,460
Military	0	24	40	25	0	0	0	0	0	50	139
Total	4,929	1,258	1,873	198	0	80	3,240	6,522	7,007	7,050	32,157
Haiti											
ESF	1,000	0	0	10,000	5,096	5,000	21,321	35,960	342	12,200	90,919

DA	10,127	9,160	12,015	17,323	20,642	25,653	25,590	38,944	30,812	28,096	218,362
PL-480	15,761	24,476	22,151	18,444	19,823	23,147	29,251	23,492	7,980	22,088	206,613
Military	127	423	542	687	1,027	743	1,897	1,285	200	100	7,031
Total	27,015	34,059	34,708	46,454	46,588	54,543	78,059	99,681	39,334	62,484	522,925
Jamaica											
ESF	0	41,000	90,460	59,350	55,000	81,000	58,570	25,925	500	12,900	424,705
DA	2,684	12,924	28,949	22,181	32,639	34,262	26,073	18,094	39,238	51,821	268,865
PL-480	10,018	17,108	17,507	20,111	20,567	40,343	37,577	39,940	35,747	47,058	285,976
Military	0	1,661	2,075	3,426	4,200	7,643	7,954	3,338	300	3,800	34,397
Total	12,702	72,693	138,991	105,068	112,406	163,248	130,174	87,297	75,785	115,579	1,013,943
Suriname											
ESF	0	0	500	0	0	0	0	0	0	0	500
DA	0	0	0	0	0	0	0	0	0	0	0
PL-480	0	0	0	0	0	0	0	0	0	0	0
Military	26	33	23	0	0	42	39	0	25	25	213
Total	26	33	523	0	0	42	39	0	25	25	713
Trinidad & Tobago											
ESF	0	0	0	0	0	0	0	0	0	0	0
DA	0	0	0	0	0	0	0	0	0	0	0
PL-480	0	0	0	0	0	0	0	0	0	2,196	
Military	0	0	0	0	0	39	50	72	50	140	351
Total	0	0	0	0	0	39	50	72	50	2,336	351

Source: U.S. Agency for International Development, Overseas Loans and Grants, Series of Yearly Data.

TABLE 2. U.S. Foreign Aid Total Levels to the Caribbean in the 1980s.

('000)

Totals	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1981–1989	Average
ESF	5,000	41,000	151,960	122,350	171,882	226,129	150,015	91,245	17,677	35,325	1,012,583	101,258
DA	91,171	67,728	91,754	96,031	114,314	126,825	110,701	115,715	128,182	127,222	1,069,643	106,964
PL-480	48,624	60,222	75,717	63,880	71,712	105,999	101,831	84,820	74,082	137,531	822,222	82,222
Military	3,661	5,621	8,341	14,074	19,433	23,136	22,550	14,087	3,545	7,155	121,603	12,160
Grand Total	148,456	174,571	327,772	296,335	377,341	482,089	385,097	305,867	223,486	307,233	3,026,051	302,605
Economic Assist. Total	144,795	168,950	319,431	282,261	357,908	458,953	362,547	291,780	219,941	300,078	2,904,448	290,445

Source: U.S. Agency for International Development, Overseas Loans and Grants, Series of Yearly Data.

and Suriname were considered "Caribbean" because of historical and cultural factors.

Many Caribbean territories did not receive U.S. foreign aid for a variety of reasons. Cuba did not qualify because it was a communist country. Other islands were not favored for U.S. foreign aid because they were not independent and received funds from their own governments—the dependencies of the British West Indies, overseas French territories, and the Netherlands Antilles. The United States supported Puerto Rico and the U.S. Virgin Islands, but not through it foreign aid program. The Bahamas did not receive U.S. foreign aid because of its high per capita income. Suriname, Barbados, and Trinidad and Tobago were only minor recipients of U.S. aid because of their relatively high per capita incomes as well.

The United States was the major bilateral donor to the region during the 1980s. Other substantial bilateral donors, in order of importance as of 1989, were Canada, Germany, Japan, Italy, Britain, and France. [2] In many Caribbean countries the United States was also the largest overall donor, even after considering the multilateral donors, such as the International Monetary Fund (IMF), World Bank, Inter-American Development Bank, and the Caribbean Development Bank. The funding levels of multilateral institutions fluctuated more than bilateral assistance because they provided specific loans rather than annual amounts.

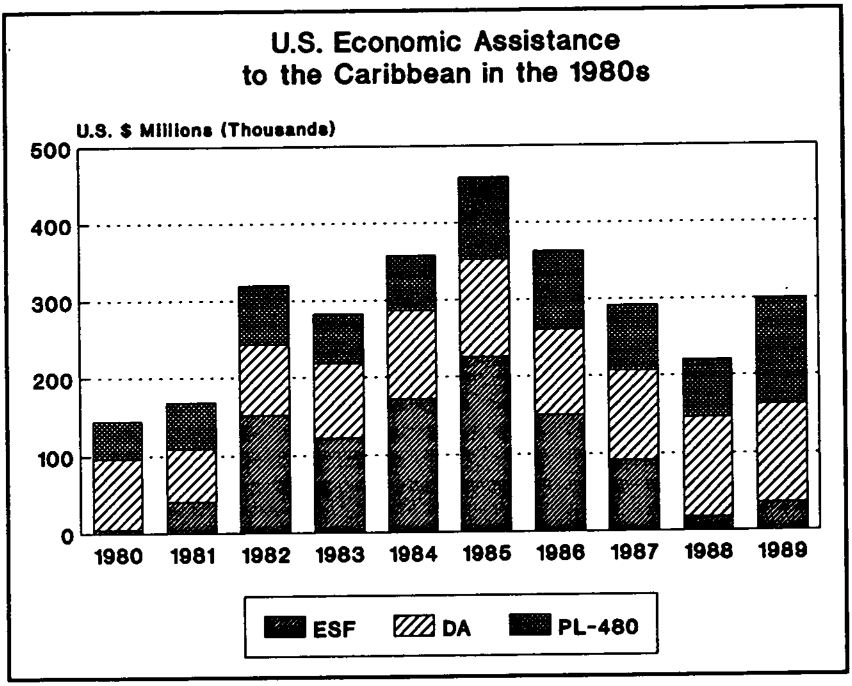
The overall levels of aid to the region during the 1980s were roughly average with the levels provided since the 1960s, although within that 30-year time period there were many fluctuations of the total level. Levels of aid were quite high in the 1960s given the political turmoil of the Cuban Revolution. Subsequent aid flows to the region, under the Alliance for Progress, greatly increased over previous levels. Aid declined considerably in the 1970s and increased anew in the 1980s, as the U.S. government once again emphasized the region, as symbolized by the CBI.

The type of U.S. foreign aid provided to the Caribbean in the 1980s was significantly different than that of the 1970s. Economic Support Funds (ESF) to our closest allies predominated in the 1980s, particularly in the 1981–1987 time period (See Figure 1). ESF provided monies for balance of payments support and policy reforms rather than being targeted for particular development projects. ESF assistance fluctuated more than any other U.S. assistance category in the 1980s, with the greatest shifts related to the CBI and Grenadian reconstruction after the 1983 coup and intervention. Project-related assistance, called Development Assistance (DA), averaged about $100 million per year during the decade. Food aid, often referred to as "PL–480" after its legislative authorization, was relatively consistent, like DA, averaging slightly under $100 million a year.

Prominent changes in the type of U.S. foreign aid to the Caribbean in the 1980s largely determined the content of the aid. AID often targeted large amounts of ESF for specific policy reforms.

[2] U.S. Agency for International Development. *Latin America and the Caribbean. Selected Economic and Social Data.* By Nassif, Joseph E., J. Peter McLain, and James W. Fox. Washington, April 1992.

FIGURE 1.



The objective of the leveraged policy reform was to encourage more market-oriented, export-led, and democratic societies: sustainable, growth-oriented democracies. ESF served as AID's major leverage in policy dialogue with host-country governments, which typically went beyond economics to include democratic elections, narcotics control, and other socioeconomic issues.

The most notable change in DA was the increased focus on the private sector. This private sector focus came on the heels of two decades of strengthening public sector institutions throughout the hemisphere. Other changes in the content of DA reflected growing Congressional use of earmarks for specific programs. Programs in child survival, micro-enterprise, and rural electrification were targets of such Congressional involvement.

U.S. foreign aid efforts to the Caribbean in the 1980s were greater than the total of AID's activities. For example, the Inter-American Foundation (IAF) and the Peace Corps also provided modest amounts of U.S. "development" assistance to the region. [3] The IAF, an autonomous agency, funded grassroots, self-help organizations. The Peace Corps played a similar role of local assistance but its

[3] These amounts are not included in our assistance tables in this report because they are only a very small percentage of overall aid.

mandate was broader than the IAF. Peace Corps volunteers participated in both AID and IAF projects in the region, but also ran many of their own small projects. The Peace Corps in the 1980s also expanded its focus on private sector development, typically in micro and small businesses.

Other U.S. government agencies actively supported the emphasis on markets and the private sector in the Caribbean, mainly in the context of the CBI. Although AID administered most assistance, the Overseas Private Investment Corporation, the Department of Transportation, the Export-Import Bank, and the Customs Service of the Department of Treasury all enhanced and expanded trade and investment efforts in the region. The Department of Commerce, through its Caribbean Basin Information Center and its normal regional offices, provided information packages, investment climate statements, economic trends, special product advice, investment missions, an active investor match program, and a monthly networking newsletter on the CBI. The Department of Agriculture similarly promoted the CBI through frequent agribusiness marketing workshops, technical assistance missions, and important regulatory information on U.S. import standards. The Office of the U.S. Trade Representative oversaw bilateral investment and textile agreements and, beginning in 1987, hired an ombudsman to direct an inter-agency task force on the CBI.

The U.S. private sector also helped create a strong private business and advocacy network to further the aims of trade and investment in the Caribbean. The result was an economic development program much greater than the sum of its parts. The close cooperation of the U.S. government and private sector boosted the optimism of local leaders, prompting important attitudinal changes in favor of the private sector as an engine of growth.

The United States provided military aid to the Caribbean throughout the decade. This article does not describe military aid in any detail, but does include those figures in Tables 1 and 2. [4]

COUNTRY PROFILES—MAJOR RECIPIENTS

JAMAICA

Jamaica was by far the greatest recipient of U.S. foreign aid in the Caribbean in the 1980s. In 1981 and 1982 alone, Jamaica received more assistance from the United States than it did during the entire previous postwar period. From 1981 to 1985, Jamaica ranked as the second or third per capita recipient of AID funding worldwide, or around the tenth in absolute terms. [5] Needless to say, the United States was by far the largest bilateral donor in Jamaica in this time period. Throughout the decade, the United States provided Jamaica with nearly US$1 billion, or more than one-third of total U.S. assistance to the Caribbean in the decade. Most funding consisted of ESF grants for economic policy reforms, many of which were in support of IMF and World Bank reforms.

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[4] The direct aid of U.S. government agencies other than AID is not included. The point of emphasis here is that the increased focus of these other agencies on the Caribbean had a significant impact, one that is not readily reflected in normal foreign aid statistics.

[5] Hudson, Rex A. and Daniel J. Seyler. Jamaica. *Islands of the Commonwealth Caribbean: A Regional Study*. Meditz, Sandra W. and Dennis M. Hanratty, eds. Washington, GPO, 1991.

American largess toward Jamaica in the 1980s was intended to show strong support for Edward Seaga, who headed Jamaica's Labor Party. Seaga, who placed strong emphasis on a market-oriented economy, replaced the People's National Party's Michael Manley, who presided over a socialist government in the 1970s. Seaga's electoral victory coincided closely with that of President Reagan in the United States. Seaga was the first head of state to visit the Reagan White House, and the two chief executives soon developed a close affinity in economic and foreign policy that lasted during each's two consecutive terms in office. [6]

Prime Minister Seaga engaged President Reagan in a dialogue concerning a "Marshall Plan for the Caribbean," which eventually took the form of the CBI. In his speech launching the CBI in February 1982, President Reagan singled out the island, stating that "Jamaica is making freedom work." [7] AID's Country Development Strategy Statement, its major long-term planning document, declared two years later that "ample opportunities exist for the Jamaican economy to become a private sector led growth example to the region." [8] In addition to encouraging macroeconomic policy reforms, the AID Mission to Jamaica also continued previous programs in health, population, and agriculture and started new ones in acquired immune deficiency syndrome (AIDS) and drug awareness, democracy and justice, private sector development, and natural resource management during the decade. AID continued its strong support of Jamaica after the 1989 re-election of Michael Manley who had subsequently embraced the principles of market economics.

DOMINICAN REPUBLIC

Trends in U.S. assistance to the Dominican Republic were not as dramatic as Jamaica, but the levels were significant. The United States was the major bilateral donor to the Dominican Republic, furnishing somewhere between one-quarter and one-half of its bilateral assistance. The Dominican Republic became one of the top recipients of U.S. aid in 1966, when US$100 million in economic assistance flowed in the aftermath of the U.S. occupation in 1965. Assistance slowed during the 1970s, averaging only $21 million a year. AID strengthened its presence in the 1980s, peaking with the CBI flows during 1984 to 1986, when U.S. assistance totaled $120 million per year. During this same period, however, severe cutbacks in the U.S. sugar quota with the Dominican Republic offset much of the foreign exchange gained through economic assistance.

The composition of U.S. assistance to the Dominican Republic changed distinctly during the 1980s. The overall portion of DA declined from 56 percent in 1979 to only 10 percent in 1985 and increased again to 26 percent in 1989. These changes in DA levels were the direct result of increased use of ESF, which jumped from 0 percent in 1979 to 29 percent in 1987, with a high of 57 percent in

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[6] For more on this theme, see: Tollefson, Scott D. Jamaica: The Limits of a Showcase Policy. *SAIS Review*, v. 5, no. 2, Summer-Fall 1985. p. 189-204.

[7] *Weekly Compilation of Presidential Documents*. v. 8, no. 8.

[8] U.S. Agency for International Development. *Country Development Strategy Statement FY 1986*. USAID/Jamaica. January 1984.

1985. By 1989, the Dominican Republic ceased to receive ESF because of the reluctance of the government to engage in meaningful economic reform. Food aid remained constant at about 45 percent.

The focus of AID's program in the Dominican Republic shifted considerably as well, from an emphasis on basic human needs in favor of economic policy reform and private sector development. The Dominican Republic became a showcase for private sector development and the CBI largely because of its activist free-zone policy rather than for its economic policy reform, which was lacking. From 1985 to 1989, the number of free zones more than doubled from 6 to 15; employment in the zones jumped from 36,000 to nearly 100,000; and the number of companies in the zones increased from 146 to in excess of 220. [9]

HAITI

Haiti's bilateral aid relationship with the United States was directly tied to its chronic problems with governance and its stark poverty. The United States was the most important source of bilateral economic assistance to Haiti in the 1980s and was the only donor country that maintained a resident AID mission. The U.S. foreign aid program in Haiti was a foreign aid bellwether, often determining the role of other bilateral donors. Although AID had a permanent presence in Haiti, AID briefly closed its operations on several occasions because of political disruptions.

Haiti did not participate in the Alliance for Progress and did not receive U.S. foreign aid until the United States resumed it in 1973 under Jean-Claude Duvalier. This aid continued in various forms until January 1986, a month before the end of the Duvalier era. The United States provided unprecedented amounts of aid to Haiti three weeks after Duvalier's exile, but severed non-humanitarian aid after the electoral violence of November 1987. AID funding averaged $43 million per year from 1981 to 1985 and doubled in 1986 and 1987, before returning to the early levels for the rest of the decade. Development assistance in the late 1980s remained tied to progress toward solving the chronic problem of democratic rule.

The implementation of U.S. assistance in Haiti was distinct from most countries. The most striking characteristic of most U.S. aid during the 1980s was that it circumvented the Haitian government. After limited success in the 1970s, AID in 1982 began to channel an increasing percentage of its assistance via nongovernmental organizations rather than Haitian ministries, a policy shift that the U.S. Congress legislated into the 1981 Foreign Assistance Act. [10] This approach provided the best means to bypass government corruption and military regimes that enriched a small elite rather than improved the lives of Haiti's poor, the poorest in the Hemisphere and among the most destitute in the world. Thus, private voluntary and relief organizations administered most American aid. The nongovernmental organization approach proved so much more efficient and effective that by the late 1980s AID distributed all of its hu-

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[9] Daniel J. Seyler. Dominican Republic: The Economy. *Dominican Republic and Haiti Country Studies*. Haggarty, Richard A., ed. Washington, GPO, 1991.

[10] Daniel J. Seyler. Haiti: The Economy. *Dominican Republic and Haiti: Country Studies*. Haggarty, Richard A., ed. Washington, GPO, 1991.

manitarian aid through a network of nongovernmental organizations.[11]

AID's major goals in Haiti were to augment the country's human resources by way of increased health and nutrition, family planning, and education opportunities; foster policy reform aimed at economic growth, private-sector development, and export promotion; and to ameliorate rural conditions through soil conservation, agro-forestry, and watershed management.

BELIZE

Formerly British Honduras, Belize gained its independence in 1981 and by 1983 became a recipient of U.S. foreign aid. Although located in Central America, Belize shares the British democratic and cultural tradition of the rest of the English-speaking Caribbean. Belize is also a member of the Caribbean Community (CARICOM), the regional organization of primarily English-speaking Caribbean countries. U.S. assistance to Belize from 1983 to 1989 averaged nearly $12 million, with more than half of that coming from DA funds. AID provided ESF in 1983 and from 1985 to 1987, but since then DA was the sole source of aid. Belize did not receive any American food aid in the 1980s. Given the country's small population of 200,000, it was a large recipient of aid in per capita terms.

U.S. aid to Belize favored private sector development. This came in the form of projects aimed at small business development, tax reform, investment promotion, and export growth. The AID portfolio in Belize also emphasized preservation of the country's rather pristine tropical natural resource base. By the late 1980s, environmental concerns were a high priority of U.S. assistance.

EASTERN CARIBBEAN

The Eastern Caribbean, as referred to by AID, included the English-speaking nations of the Leeward Islands (Antigua and Barbuda, St. Kitts and Nevis) and the Windward Islands (Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines), all of which were members of the Organization of Eastern Caribbean States (OECS). Barbados was the headquarters for AID's assistance to this subregion. British dependencies, particularly Montserrat and the British Virgin Islands, occasionally benefited from some regional programs.

The AID Mission to the Eastern Caribbean (Regional Development Office for the Caribbean) based in Barbados, operated programs and projects through regional organizations to the six Eastern Caribbean countries. Most projects functioned on a region-wide basis. Assistance to this subregion peaked in 1982 at $66 million. Assistance levels averaged $56 million per year from 1982 to 1987. U.S. aid declined to $30 million by 1989, and was expected to continue to decrease in the 1990s as these countries attained higher per capita incomes.

The Eastern Caribbean islands in the 1980s represented a microcosm of the challenges that the Caribbean at large faced. As a

[11] For a much more critical description, see: Dewind, Josh and David H. Kinley III. *Aiding Migration: The Impact of International Development Assistance on Haiti.* Boulder, Westview Press, 1988.

result of their small size, they were the most economically dependent nations of the Caribbean—dependent on trade, tourism, and usually either bananas or sugar for their economic survival. Their small size and dependence also made these islands vulnerable to international economic and natural forces, such as oil crises and devastating hurricanes. Independent since the 1970s and 1980s, the nations of the Eastern Caribbean had strong democratic traditions, with the exception of Grenada.

Grenada was a separate case in other ways as well. Grenada became a significant recipient of U.S. foreign aid after the events of October 1983. U.S. assistance after 1983 sought to stabilize the economy, reform economic policies, offset the departure of Cubans supporting the Grenadian social sector, and complete the building of their controversial airport at point Salinas. As such, in 1983 Grenada briefly became AID's only resident bilateral mission in the Eastern Caribbean.

AID's strategy in the Eastern Caribbean during the 1980s sought to consolidate the subregion's already solid gains in education and health, build on the results of British aid (since the 1940s), and begin the arduous task of economic diversification out of sugar and bananas as well as other traditional crops such as cocoa, arrowroot, and nutmeg. AID promoted economic diversification through macroeconomic reform to support these economies' greater responsiveness to market signals and to position the private sector to be the engine of economic growth. Economic diversification focused on the development of tourism, expansion of export manufacturing, information processing services, and increased export of nontraditional agricultural products, such as tropical fruits, "winter" vegetables, cut flowers, etc.

AID's assistance was not limited, however, to economic reform and growth. AID invested heavily to maintain and improve the subregion's excellent social indicators and democratic institutions. A major focus of the program was "child survival" activities, such as immunization and childhood disease control, especially diarrhea. Social sector support included primary education and AIDS awareness. AID also strengthened the justice systems in several countries and supported the first comprehensive research on the environmental status of these islands.

Country Profiles—Minor Recipients

BARBADOS

Barbados was a minor recipient of U.S. assistance because of its relatively prosperous economy, receiving about $250,000 in food aid between 1980 and 1982 and about $270,000 total in DA for 1988 and 1989. In the 1980s Barbados remained an important regional center—the home of the U.S. Embassy for several Eastern Caribbean islands, AID's Regional Development Office for the Caribbean, the Caribbean Development Bank, the Caribbean Association for Industry and Commerce, the Caribbean Tourism Organization, and the University of the West Indies (UWI), all of which affected its role in U.S. foreign aid.

GUYANA

U.S. foreign aid played a very minor role in Guyana in the 1980s. The United States provided slightly over $5.5 million in DA between 1980 and 1983. Other U.S. aid came in the form of food aid, which peaked in 1988 and 1989 when the U.S. government loaned the Guyanese government $7 million in food aid per year. A large country with considerable agricultural and mineral potential, Guyana suffered from economic mismanagement since the late 1960s. In the late 1980s, Guyana embarked on a strict program of economic reform with promises of political reforms as well. AID sought to increase its support for these economic and political reforms based on tangible progress in Guyana, particularly in elections.

SURINAME

Formerly Dutch Guiana, Suriname was a relatively harmonious multi-ethnic society until it stumbled in 1980 with the rise of a military-dominated government. As the political situation intensified in 1982, AID provided $500,000 in ESF in an attempt to moderate the military government of Desi Bouterse. Suriname anticipated one of the highest per capita levels of foreign aid in the world, coming from the Dutch, upon the resolution of its internal electoral problems which were not resolved during the 1980s.

TRINIDAD AND TOBAGO

As one of the few oil producing nations of the Caribbean, Trinidad and Tobago boasted one the region's highest standards of living. Trinidad's relative prosperity waned considerably in the 1980s with the plummeting of international oil prices and the realizations of subsequently needed structural economic reforms. Helping to cushion the effects of these reforms, AID provided a $2 million grant of food aid in 1989, which represented the only direct U.S. assistance. Trinidad also benefited indirectly from certain regional programs at UWI and the Caribbean Agricultural Research and Development Institute.

Impact of U.S. Foreign Aid to the Caribbean in the 1980s

The limited space of this paper does not allow for a comprehensive inventory of all AID's project successes and failures in the Caribbean during the 1980s. We provide a synthesis of some of the evaluation results along with a presentation of selected indicators to examine the overall impact of AID's assistance at the macro level. The indicators chosen are those that are meaningful and readily available for both AID-assisted countries and non-AID assisted countries. The quantity and quality of data on both sets of countries in the Caribbean is often poor. [12] In this section we also

[12] Data on Eastern Caribbean countries do not even appear in the comprehensive statistical appendices of the World Bank's annual *World Development Report* or several United Nations publications because of their small populations.
Comparing AID-assisted and non-AID-assisted countries allows one to examine the overall trends in social and economic performance of these countries. We do this conscious of the many caveats of the data of small island economies and a limited sample of countries.

introduce some of the criticisms of the AID program in the Caribbean for this period.

ECONOMIC POLICY REFORM

A major accomplishment of the AID program in the Caribbean in the 1980s was significant changes in macroeconomic and regulatory policies to open these economies to market forces and greater private sector involvement. The Caribbean countries achieved these reforms in the region wide push for increased foreign investment and non-traditional exports under the rubric of the CBI, often with direct AID support. Compared with the policy frameworks of Caribbean countries during the 1970s, progress in economic policy reform in the 1980s was significant, but inconsistent.

Using economic growth as a chief indicator of successful reform, several trends emerged. (See Table 3.) These trends appeared in the form of four basic outcomes. First, in the case where AID provided its most substantial absolute level of funds for reform, significant reforms were enacted, but growth was moderate at best—the case of Jamaica. Second, where AID provided its highest per capita levels for reform, reforms were enacted, and growth performance was excellent—the case of Belize and much of the Eastern Caribbean. Third, where AID provided substantial absolute levels of funds for reform, few reforms were enacted, but some growth occurred—the case of the Dominican Republic. Fourth, where AID provided substantial funds but little of the advice for reform was followed, and the growth that resulted was poor—the case of Haiti.

TABLE 3. Real GDP Growth Rate for Caribbean Countries in the 1980's.

(% Change)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1981-1989
Major AID-Assisted Countries											
Antigua	na	3.9	−1.3	6.4	6.5	6.7	16.9	8.8	7.7	3.7	6.6%
Belize	3.6	1.4	−1.7	−0.6	4.8	2.2	4.8	14.3	9.7	13.3	5.2%
Dominica	na	6.3	2.7	2.1	5.5	1.7	6.8	6.8	8.0	−1.5	4.3%
Dominican Rep.	6.1	4.1	1.8	5.2	0.5	−2.6	3.2	6.6	0.7	4.1	3.0%
Grenada	0.2	0.2	5.3	1.0	5.6	4.9	5.5	6.0	5.3	5.7	4.0%
Haiti	7.6	−2.8	−3.4	0.8	0.3	0.2	0.6	0.6	−1.5	−1.5	0.1%
Jamaica	−6.2	2.5	0.8	2.2	−0.9	−3.7	3.9	5.5	2.7	4.9	1.2%
St. Kitts-Nevis	na	6.5	2.2	−2.4	3.0	14.8	6.7	6.9	8.4	5.6	5.8%
St. Lucia	na	0.2	3.0	4.1	5.0	6.0	5.8	2.1	6.8	4.0	4.1%
St. Vincent-Gren.	na	9.2	2.5	5.1	9.6	4.6	7.2	6.3	8.6	5.9	6.5%
Minor AID-Assisted Countries											
Barbados	na	−1.9	−5.0	0.4	3.6	1.0	4.7	2.6	3.5	3.6	1.4%
Guyana	1.6	−0.3	−10.4	−9.3	2.1	1.0	−0.9	0.9	−2.6	−3.3	−2.1%
Latin America and Caribbean Region	2.3	0.9	−0.8	−3.3	3.4	3.6	4.0	3.3	0.8	1.7	1.6%

Source: "Latin America and the Caribbean. Selected Economic and Social Data." (AID), April, 1992.

AID learned specific lessons about the economic policy reform process. One important and specific lesson that AID learned concerned the pace of reform. Economic reforms attempted in Grenada after 1983 were under an accelerated timetable. The pace of these reforms, Grenadian government policies, and other factors caused many of these reforms to falter. [13] By contrast, AID-sponsored reform in Dominica occurred in phases, with strong government support, which resulted in much more sustainable policies. [14]

Those opposed to AID's policy reform program usually criticized the Reagan and Bush Administrations' propensity toward orthodox economics and export-led growth models. [15] Critics pointed to AID's often close relationship with the austerity policies prescribed by the IMF and the World Bank, which they argued placed a disproportionate share of the austerity on the poor. AID and other donors complemented subsequent reform packages with special funds to protect the poor during adjustment. The most notable case in the Caribbean was the food stamps program in Jamaica recognized by the World Bank's *World Development Report 1990* as a pioneering program. The issue of orthodox economics remained largely unresolved, but many critics of export-led growth, including certain Caribbean leaders, retreated from their once passionate criticism of such models. Many of these leaders changed their views on export-driven growth given the strong empirical evidence of the performance of export-oriented economies in East Asia.

PRIVATE SECTOR DEVELOPMENT

AID's impact in the Caribbean during the 1980s was most pronounced in the area of private sector development. As the agency's increasing priority, the private sector programs of AID functioned closely with many U.S. agencies. Data in Tables 4 and 5 demonstrate the superior performance of AID-assisted countries in the region in terms of investment, job creation, sales, and exports.

AID activities often served as a core of activities supporting the CBI—economic policy reform, privatization, firm-level assistance, dialogue on regulatory bottlenecks, and overall intensive investment and export promotion. [16] This was also true in non-CBI areas, such as tourism. The region's tourism industry benefited from the overall zealous promotion of the region in general and investment in particular. Although the strong growth of the U.S. economy was a strong factor in the increase in tourist arrivals, promotion of many of the AID-assisted countries contributed in a significant way to their internal development.

The more sobering impact of the activities of AID and the U.S. government's push toward private sector development was that this concerted and unprecedented effort was unlikely to ever be repeated with such high-level support and intensive implementation. However, the impact of this effort was significant, such that non-traditional exports (manufactured goods and agricultural products)

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[13] U.S. Agency for International Development., Bureau for Latin America and the Caribbean. Regional Development Office. *Project Assistance Completion Report: Grenada Economic Structural Adjustment Program.* Grenada, September 30, 1990.

[14] Lieberson, Joseph, Donald W. Bowles, and E. LeRoy Roach. *Impact Evaluation of A.I.D. Policy Reform Programs in Dominica and Grenada* (A.I.D. Impact Evaluation Report, no. 72). U.S. Agency for International Development, Bureau for Program and Policy Coordination, Center for Development, Information, and Evaluation. Washington, January 1990.

[15] See, for example: Barry, Tom, Beth Wood, and Deb Preusch. *The Other Side of Paradise Foreign Control in the Caribbean.* New York, Grove Press, 1984.

[16] For more on this topic, see Daniel J. Seyler, "The CBI and Caribbean Industrialization: An Assessment of the First Five Years and the Outlook under CBI II", Latin American Studies Association, December 1989, Miami, Fl.

TABLE 4. Caribbean Investment Performance.

(1984-1987)

	# of New Investments	Sales from All New Investments
AID-Assisted Countries		
Antigua and Barbuda	17	6,473,838
Belize	34	3,910,016
Dominica	7	11,535,184
Dominican Republic	134	142,714,457
Grenada	12	7,881,851
Haiti	21	1,500,000
Jamaica	100	140,018,499
St. Kitt/Nevis	13	10,150,000
St. Lucia	25	11,488,000
St. Vincent	4	14,592,592
AID-Assisted Total	367	350,264,437
Average	37	35,026,444
Non-AID-Assisted Countries		
Aruba	14	N/A
Bahamas	9	80,797,888
Barbados	14	24,330,313
British Virgin Islands	4	4,700,000
Montserrat	1	43,000
Netherland Antilles	1	N/A
Trinidad and Tobago	5	21,930,000
Non-AID Assisted Total	48	131,801,201
Average	7	26,360,240

Source: U.S. Department of Commerce, "Caribbean Basin Investment Survey", 1988.

to the United States increased by an average of 17 percent between 1983 and 1991 (see Table 6). Manufactured exports accounted for close to 18 percent with Grenada, Jamaica, Dominica, and the Dominican Republic showing the greatest increases. Where there were limitations, many of these could be seen as structural limitations of these unique island economies rather than a criticism of U.S. foreign aid policy.[17]

The most frequent criticisms of U.S. foreign aid to the Caribbean in the 1980s occurred with regard to the CBI and the private sector approach. The basis of this criticism was that AID transferred an inordinate amount of its resources from its "basic human needs" programs to its private sector programs. Some Members of the U.S. Congress and others adopted this criticism toward AID in general, not only toward the Caribbean. AID did in fact keep most of its social sector work of the 1970s. In many instances, AID in the 1980s also experimented with private delivery mechanisms for social services, such as health and education. These approaches often proved successful and sustainable. Increased funding allowed for much of the private sector program, but AID did curtail some social programs.

[17] For a different interpretation, see: Martin, Atherton, Steve Hellinger, and Daniel Soloman. *Prospects and Realities: The CBI Revisited.* Washington, The Development Group for Alternative Policies, 1985.

TABLE 5. CBI Job Creation.

(1984–1987)

	Export Jobs	Total Country—Jobs	CBI Share
AID-Assisted Countries			
Antigua and Barbuda	1,462	24,000	6.1%
Belize	1,036	45,000	2.3%
Dominica	700	20,000	3.5%
Dominican Republic	35,333	1,800,000	2.0%
Grenada	1,244	29,000	4.3%
Haiti	3,605	1,200,000	0.3%
Jamaica	21,237	570,000	3.7%
St. Kitt/Nevis	1,234	15,000	8.2%
St. Lucia	3,872	31,000	12.5%
St. Vincent	1,650	44,000	3.8%
AID-Assisted Total	71,373	3,778,000	
AID-Assisted Average	7,137	377,800	4.7%
Non-AID-Assisted Countries			
Aruba	871	18,000	4.8%
Bahamas	1,568	92,000	1.7%
Barbados	1,149	92,000	1.2%
British Virgin Islands	93	5,000	1.9%
Montserrat	36	5,000	0.7%
Netherland Antilles	21	62,000	0.0%
Trinidad and Tobago	235	400,000	0.1%
Non-AID Assisted Total	3,973	674,000	
Non-AID Assisted Average	568	96,286	1.5%

Source: U.S. Department of Commerce, "Caribbean Basin Investment Survey", 1988 and James W. Fox, "Is the Caribbean Basin Initiative Working?", AID, March 7, 1989.

The overall impact of these changes is still unknown, but virtually all AID-assisted countries were enjoying higher growth rates at the end of the decade than at the beginning. All child vaccination rates were up substantially, and per capita daily calorie supply remained level or increased. Haiti is the one exception to these improvements. Clearly, economic growth is necessary for social development, but not sufficient in itself. According to the World Bank, it is a mix of social expenditures with market and export-led growth that best maximizes the reduction of poverty. [18]

As detailed below, the social indicators for most AID-assisted Caribbean countries improved substantially during the 1980s (See Table 7). Some analysts say this improvement in social indicators is because of the private sector growth, and others say it occurred in spite of such policies. One of the more fascinating AID evaluations in the 1980s demonstrated that in the Dominican Republic the switch from basic human needs to private sector development programs resulted in greatly increased female employment, which in

[18] World Bank. *World Development Report 1990.*

TABLE 6. Nontraditional Exports of AID-Assisted Caribbean Countries to the United States, 1983–91

(millions of current U.S.$)

Country	1983	1984	1985	1986	1987	1988	1989	1990	1991	Annual Rate (%) 83–91
Dominican Republic										
Nontraditional	290.3	370.8	462.8	558.4	728.5	974.8	1,197.8	1,303.9	1,622.5	24.0
Manufactured	256.6	332.0	420.9	513.1	687.6	931.1	1,150.9	1,256.0	1,569.3	25.4
Fruit/vegetable/plant	33.7	38.9	42.0	45.3	40.9	43.7	46.9	47.8	53.2	5.9
Haiti										
Nontraditional	292.9	335.9	354.2	345.2	370.4	363.1	354.0	325.4	265.2	-1.2
Manufactured	288.1	330.4	348.7	339.6	364.5	358.0	347.5	318.9	257.4	-1.4
Fruit/vegetable/plant	4.8	4.9	5.5	5.4	5.9	5.1	6.4	6.5	7.8	6.3
Jamaica										
Nontraditional	24.6	42.7	88.5	142.1	229.6	252.3	275.2	293.9	304.5	37.0
Manufactured	18.9	33.5	75.4	129.5	219.2	242.1	266.2	281.3	293.4	40.9
Fruit/vegetable/plant	5.7	9.2	13.1	12.7	10.4	10.2	9.0	12.6	11.1	8.7
Antigua										
Nontraditional	6.2	6.9	10.2	9.3	7.0	4.2	2.8	1.4	1.0	-19.9
Manufactured	6.2	6.9	10.1	8.7	6.7	4.0	2.7	1.3	0.8	-22.9
Fruit/vegetable/plant	.001	.000	.066	.560	.351	.142	.118	.038	.269	101.2
Dominica										
Nontraditional	.2	.1	9.2	9.5	6.7	5.8	6.4	7.3	3.7	42.4
Manufactured	.2	.1	8.9	8.8	6.1	5.6	6.3	6.4	3.5	41.1
Fruit/vegetable/plant	.001	.014	.250	.692	.570	.186	.050	.873	.280	102.3
Grenada										
Nontraditional	.0	.2	.9	2.1	2.1	4.4	6.0	6.2	5.9	112.7
Manufactured	.0	.2	.9	2.1	2.1	4.4	5.9	6.1	5.7	115.9
Fruit/vegetable/plant	.002	.000	.007	.002	.011	.011	.017	.127	.190	76.7
Monserrat										
Nontraditional	.9	.9	2.2	2.6	1.9	2.0	2.2	.5	2.1	11.6
Manufactured	.9	.9	2.0	2.6	1.9	2.0	2.2	.5	2.0	11.6
Fruit/vegetable/plant	.000	.002	.154	.037	.024	.001	.015	.017	.013	N/A
St. Kitts-Nevis										
Nontraditional	9.5	16.4	13.6	17.4	20.1	16.7	16.9	15.0	11.5	2.5
Manufactured	9.5	16.4	13.5	17.4	20.1	16.7	16.9	15.0	11.5	2.4
Fruit/vegetable/plant	.005	.016	.059	.001	.000	.000	.000	.022	.026	22.9
St. Lucia										
Nontraditional	4.5	6.6	10.8	10.7	16.8	24.2	23.4	26.1	21.2	21.5
Manufactured	4.4	6.5	10.7	10.7	16.8	24.1	23.4	26.1	20.2	20.9
Fruit/vegetable/plant	.025	.021	.023	.003	.051	.012	.031	.003	.907	56.7
St. Vincent-Grenadines										
Nontraditional	4.2	3.0	7.6	7.6	8.3	13.2	8.9	6.7	4.5	1.0
Manufactured	4.2	3.0	7.5	7.4	8.3	13.2	8.9	6.6	4.3	.5
Fruit/vegetable/plant	.004	.002	.017	.161	.025	.043	.042	.085	.166	59.3
TOTAL										
Nontraditional	633.1	782.8	959.8	1,104.9	1,391.4	1,660.6	1,893.5	1,986.6	2,242.1	17.1
Manufactured	588.9	729.8	898.7	1,040.0	1,333.1	1,601.2	1,830.9	1,918.3	2,168.2	17.7
Fruit/vegetable/plant	44.2	53.0	61.1	64.8	68.3	58.4	62.6	68.1	73.9	6.8

Note: Nontraditional exports consists of manufactured exports plus fruit/vegetable/plant exports to the United States defined as follows: manufacutured exports include SITC 50 through 89, less Nonferous Metals, SITC 68; fruit vegetables, and plant exports include SITC 05 (fruit and vegetable) plus SITC 29 (crude vegetable) less SITC 057.3 (bananas, including plantains).

Source: U.S. Department of Commerce, Imports for Consumption, Customs Value.

turn caused the social indicators of their children to improve noticeably.[19]

[19] Management Systems International, Inc. and Arthur Young and Co. *Impact on the Poor of USAID's Private Sector Programs in the Dominican Republic.* Agency for International Development, April 1989.

TABLE 7. Selected Social Indicators.

	Population Growth Rate (%)			% DPT Vaccination Coverage			Daily Calorie Supply Per Capita		
	1981	1985	1989	1980	1985	1989	1980	1985	1988
AID-Assisted Countries									
Antigua and Barbuda	−0.4	−0.4	0.1	54	100	100	2,116	2,143	2,222
Belize	2.8	2.7	2.6	54	59	80	2,687	2,557	2,649
Dominica	0	1.4	1.6	63	91	94	2,493	2,810	2,877
Dominican Republic	2.4	2.4	2.3	35	18	47	2,288	2,341	2,357
Grenada	−1.4	−0.6	−0.4	25	61	87	2,623	2,893	2,979
Haiti	1.8	1.8	1.8	3	19	50	2,026	2,119	1,911
Jamaica	1.4	1.5	0.6	34	60	85	2,587	2,544	2,572
St. Kitt/Nevis	−0.6	−1.6	−0.1	56	92	100	2,321	2,608	2,801
St. Lucia	1.6	2.1	1.6	56	87	92	2,329	2,635	2,821
St. Vincent	1.6	1.3	1.3	26	90	98	2,480	2,694	2,818
Non-AID-Assisted Countries									
Barbados	−0.1	0.2	0	60	83	91	3,112	3,189	3,228
Bahamas	1.9	1.8	1.5	—	—	—	2,456	2,680	2,678
Bermuda	0.2	0.2	0.2	—	—	—	—	—	—
Cuba	0.6	1	1.1	—	—	—	—	—	—
French Guiana	4.6	3.6	3.5	—	—	—	—	—	—
Guyana	0.3	−0.1	−0.4	35	75	83	2,436	2,402	2,373
Montserrat	1.7	0.5	0.3	—	—	—	—	—	—
Netherland Antilles	0.7	0.8	0.2	—	—	—	—	—	—
Suriname	−0.5	1.3	1.4	—	—	—	2,541	2,718	2,809
Trinidad and Tobago	1.6	1.8	1.1	24	75	77	2,927	3,000	2,960
Latin America and Caribbean	2.3	2.1	2.1	37	53	60	N/A	N/A	N/A

Source: "Latin America and the Caribbean. Selected Economic and Social Data." (AID), April, 1992.

SOCIAL SECTORS AND THE ENVIRONMENT

AID reduced its emphasis on "basic human needs" in the 1980s in favor of "broadly based, sustainable, economic growth." The effectiveness of many of these previous activities is measurable at the macro level, however, data reliability and attribution become difficult. The policy change was initiated in order to bring about systemic change and policy sustainability for growth, reaching as many people as possible.

AID's assistance in the area of health often focused on health care delivery systems, and financial sustainability on a country-specific basis. for example, in Jamaica, AID successfully implemented a program of decentralization in health care administration. AID experienced some limited success in providing a wide array of health care services to Grenada after 1983. AID also worked in restructuring the Ministries of Health in the Eastern Caribbean countries. Numerous interventions in Caribbean countries in the area of child and maternal health, "child survival," such as the provision of inoculations and rehydration therapy, helped improve infant mortality.

The major regional projects undertaken in the social sector included AIDS awareness, drug awareness, and family planning. Although AIDS and drug abuse worsened throughout the decade, as they did worldwide, it is largely believed that AID's projects helped stem the increase and accelerated the recognition of these problems in the Caribbean.[20] The acknowledgment of these public health concerns was critical because the Caribbean suffered from much higher incidence rates of both AIDS and drug abuse than many sub-regions. Various polls throughout the region indicated that recognition of these health threats was increasing significantly.[21]

A regional population program also succeeded in lowering fertility rates and in raising awareness of the need for family planning and lowered fertility rates.[22] This progress translated into tangible improvements in the social indicators for the regions' citizens.

AID's assistance to education was much smaller than health. AID developed a primary school curriculum, which also helped provide low-cost, quality educational materials to students.[23] Apart from the primary school project, many of AID's education or human resource development projects sought to remove the bottleneck of a shortage of private and public sector managers through various regional programs. Although largely successful, many of these activities were characterized by the Caribbean wide problem of not being able to retain trained personnel who traditionally move to better opportunities outside the region.

AID increasingly integrated environmental concerns into its portfolio in the Caribbean during the 1980s. This came in two major forms. First, AID integrated a strong environmental component into many large agricultural projects, most typically in forestry and improved watershed management projects. This was particularly the case in Jamaica, the Dominican Republic, Haiti, and Belize. Haiti, of course, was the most dramatic case given that country's advanced stage of deforestation, which AID helped retard marginally through innovative agro-forestry projects. AID's disaster preparedness program also played a similar role in defining the threats to the unique environments of the Caribbean.

The second major component of AID's environmental program for the Caribbean in the 1980s was expanded knowledge of the environmental equation as it relates to economic and social development. AID accomplished this through in-depth environmental profiles for each Caribbean country, including those of the Eastern Caribbean. These profiles were the first serious stocktaking of the environmental status of these islands, or benchmarks against which later studies would be judged. The impact of these two components was still unclear in the early 1990s because of an inadequate time series of data.

AID's involvement in the social sectors and the environment was less controversial than in economic policy reform and the private sector. A limited number of critics of these latter programs felt

[20] See, for example: Roseberry, Wendy, and Dennis Foote, et al. *AIDS Communications and Technical Services (ACTS) Project: Evaluation of Phase One and Plan of Activities for Phase Two*. University Research Corporation, February 16, 1991.

[21] Increases in awareness alone may sound trivial to some. However, considerable research on "social marketing", such as campaigns to use seat belts or stop smoking, demonstrate strong successes in these types of programs.

[22] Guengant, Jean-Pierre, Faith Wiltshire, et al. *Final Evaluation Report: Caribbean Regional Population and Development Project (538-0039)—CARICOM Component*. U.S. Agency for International Development, December 1987.

[23] Massanari, Karl, and Errol Miller. *Report of the External Terminal Evaluation of the UWI/USAID Primary Education Project*. U.S. Agency for International Development, 1985.

that AID paid insufficient attention to the social needs in a rush to reform economies toward greater productivity of the private sector. Other critics alleged that the nontraditional agricultural and manufacturing products, promoted by AID also caused undue harm to the environment. On the whole, however, AID's program had a positive impact in both the social and environmental areas and also set the stage for greater systemic socioeconomic improvement.

THE DEMOCRACY PROGRAM

Increased democracy was a principal goal of AID's program in the Caribbean, but AID's portfolio in this area, with the exception of Haiti, was relatively small when compared to other Latin American countries. This was largely explained by the strong democratic tradition in the English-speaking Caribbean. AID helped Grenada in its return to democracy after 1983 and Guyana's move toward democracy in the late 1980s. Otherwise, with the exception of Haiti, AID's major activity in this area was the improvement of the region's judicial system through improved training, policy reforms, and renovated facilities. During the 1980s, AID projects trained more than 450 judicial personnel in the Eastern Caribbean alone. Legal reforms were not seen in isolation, however, as many reforms, such as improved court registries, sought an improved legal and regulatory climate for investment and commerce.

AID's major focus on democracy in the region was Haiti. Funding for democracy in Haiti concentrated on mass media publicity of elections, increased civic participation in elections, and the strengthening of certain local institutions dedicated to human rights and democracy. AID also collaborated with other institutions of the Inter-American system, mainly through the Organization of American States to promote democracy in Haiti.

There was less consensus on the development impact of AID's democracy program than the other programs, mainly because of the novelty of these activities, particularly those in the justice sector. Evaluations of AID's justice projects in the Caribbean and throughout Latin America often criticized these activities as being too ambitious and dispersed among different institutions. This was generally the case in the Caribbean as well. [24] As for the electoral component of the democracy programs, AID-assisted Caribbean countries that either remained democratic or became more democratic during the 1980s, especially Grenada. The Haitian electorate finally escaped the grip of the Duvalier dictatorship, but faced a long and difficult transition to true democracy.

REGIONAL COOPERATION

AID worked with scores of regional institutions through the implementation of its projects, especially through the Regional Development Office for the Caribbean. AID's explicit emphasis on institution building per se, however, was notably reduced compared with earlier years. AID began to stress more the use of institutions to reach other ends rather than an end in itself. An example of

[24] Mudge, Arthur, Joseph Archibald, and Duke E. Pollard. *Caribbean Improvement of Justice Project. (Eastern Caribbean and Belize): Mid-term Evaluation.* Washington, TVT Associates, July 1989.

this approach appeared in a successful AID project in helping Eastern Caribbean nations import pharmaceutical products at a reduced rate through volume purchases. The project succeeded in reducing unit costs by nearly half without strict dependence or the close political cooperation of regional institutions, yet the region and cooperation benefited.

Other examples of generally successful integration efforts included projects with the following institutions: UWI (law, agriculture, and education); Caribbean Epidemiology Center (health); Caribbean Agricultural Trading Company (agriculture and trade); Caribbean Agriculture Research and Development Institute (agriculture); Caribbean Family Planning Affiliates, Ltd. (population); Caribbean Financial Services Corporation (banking and commerce); and the Caribbean Development Bank (various sectors).

Other integration efforts were implemented by the OECS (investment promotion and export promotion and agriculture); CARICOM (trade, health, and population); the Eastern Caribbean Central Bank (infrastructure); and the Caribbean Association of Industry and Commerce. Many of these institutions faced formidable tasks, and performance varied. The performance of several institutions improved by the late 1980s.

Critics of U.S. foreign aid to the Caribbean in the 1980s often pointed to the lack of emphasis on regional integration as a major drawback of the program and the CBI in particular. [25] In the trade arena, for example, U.S.-Caribbean trade often benefited in the 1980s vis-a-vis intra-CARICOM trade. This, however, was often the conscious choice of Caribbean trading partners who realized the advantage of hard currency, a much more tangible goal than regional cooperation. Within the region, discussions of regional integration have focused on growth-oriented objectives, but often without concrete plans of action. Nevertheless, cooperation in specific areas improved during the decade.

OUTLOOK FOR U.S. FOREIGN AID TO THE CARIBBEAN IN THE 1990S

The objective of the U.S. economic assistance program in the 1990s will be to continue to stimulate broadly based economic growth, with greater emphasis on a more productive private sector and improved democratic practices.

U.S. foreign aid to the Caribbean in the 1990s will probably be less political in nature resulting from the winding down of the Cold War. Fewer Cold War conflicts in the Caribbean Basin, emerging foreign policy opportunities for the United States outside the Caribbean sub-region, and limited foreign aid resources will cause funding for the Caribbean in general to decline. Furthermore, continued substantial economic development in the Eastern Caribbean and Belize puts those countries on a path to greater and more sustained development. The most probable scenario for major new

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[25] See, for example: Hellinger, Steve, and Doug Hellinger. *Supporting Central America and Caribbean Development: A Critique of the Caribbean Basin Initiative and an Alternative Regional Assistance Plan.* Washington, The Development Group for Alternative Policies, 1982. Also, see: *The Caribbean Basin Initiative: Caribbean Views. Report of a Congressional Study Mission and Symposium on the Caribbean Basin Initiative.* September 18-19, 1987. Washington, U.S. Congress, House Committee on Foreign Affairs, December 1987.

funding to the Caribbean in the 1990s would be in the case of a democratic Cuba.

As the result of declining funds and staff, and a concomitant desire to greater impact and results, AID will most likely focus increasingly on the program and policy level impact rather than the project level approach. This broader-scope approach is considered less management intensive and more likely to increase return on investment. In education, for example, a likely scenario would be a greater emphasis on assuring that national primary education needs are met rather than providing funding for a specific vocational educational project.

The key strategic objective of AID's planned Caribbean Strategy for the 1990s will probably be the heightened emphasis on increased private sector development and overall economic growth.[26] This strategy for the early 1990s focuses on the framework of the Enterprise for the Americas Initiative (EAI), announced in June 1990. The EAI (as opposed to the CBI) will be reciprocal in nature, with the ultimate goal of hemispheric two-way free trade. Within the framework of the EAI, U.S. economic assistance for the Caribbean in the 1990s will be based on the achievement of broad-based, sustainable economic growth and the strengthening of stable, participatory democracies. AID plans to pursue these objectives through its own bilateral and regional programs, and through heightened collaboration with other U.S. government agencies, multilateral development institutions, and other bilateral donors. AID programs will increasingly support regional approaches, working with both government and private organizations in the Caribbean.

To stimulate economic growth, AID's planned strategy will: (a) help Caribbean nations liberalize their economies in order to increase and diversity trade and investment, and expand opportunities; (b) support efforts to improve management of natural resources; and (c) assist in human resource development.

To strengthen democracy, AID plans to help Caribbean nations promote and solidify democratic values and institutions through the strengthening of: (a) the competence, accountability, and responsiveness of key government institutions; and (b) public participation in democratic processes and institutions. [27]

This competition is already occurring in trade, investment, tourism, and other areas. Few Caribbean countries, if any, will be able to avoid this eventuality and the sweeping global movement toward trading blocs.

Certain traditional AID programs are likely to remain for some time, but the overwhelming challenge for U.S. foreign aid to the Caribbean in the 1990s will be to consolidate the progress toward market-oriented, export-led, democratic societies that transpired in the 1980s. AID, other donors, and Caribbean nations together will need to closely examine the special needs of these mostly island nations as they steer toward consolidating and expanding growth. This will be especially true in terms of preserving the beautiful natural resource base of these countries, their most precious re-

[26] U.S. Agency for International Development. Bureau for Latin America and the Caribbean. "Economic Assistance Strategy for the Caribbean Region. 1992-2000." (Draft). July 7, 1992.
[27] Ibid.

source. The Caribbean countries, as well as the donors, will need to closely monitor the economic, social, and environmental impact of hemispheric integration to ensure that broad-based, sustainable, economic growth and just societies are in fact the results.

SEIZING THE MOMENT: CARIBBEAN INTEGRATION AND THE ROLE OF ECONOMIC CRISIS, LEADERSHIP, AND U.S. POLICY

by W. Marvin Will *

CONTENTS

SUMMARY

Increased regional integration, both economic and political, appears very much in the interest of Caribbean regional actors and the United States government. Since the late 1980s, integration activity apparently has reached near tidal intensity in the southeastern Caribbean. But whether this latest high will lead to substantial integration or will be disparate activity, like many other movements, depends on whether both Caribbean and U.S. leaders seize the moment and diplomatically push the process forward. The timing appears propitious since the necessary combination of nationalism-compromising economic crisis, the inducement of emerging megablocs, and the coincidence of pragmatic leadership appears to be present both in the region and in Washington. The very economic crisis that has made new subnational linkages possible, however, has also weakened, or led to the political removal of several potential strong Caribbean leaders. This makes the degree and intensity of diligent, innovative, and multilateral effort the probable determinant of success. The crucial United States effort will probably be enhanced if it includes both strong and subtle pressure and carrot-like debt, aid, and trade inducements.

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INTRODUCTION

"Upon regarding the West Indies' position in the ... ocean [and] glancing at the map which shows them almost to be in touch with each other, one cannot help but think that they may well come together some day to form a distinct social body in the modern world. ... They might well unite in a confederation, joined by a common interest, and possess a merchant fleet, an industry, arts and a literature all their own. That will not come about in a year, nor in two, nor perhaps in three centuries, but come about it some day shall, for it is natural that it be so." A speech by the Prime Minister of St. Vincent, James Mitchell, in 1992 to the final constituent assembly of what he hopes will become the Windward Islands Federation? Part of the address by Trinidad and Tobago's Prime Minister, Patrick Manning, as he presented his vision to deepen economic and political ties among Barbados, Guyana, and his state in a southern confederated bloc of "more developed countries" (MDCs) within a deepening and widening Caribbean Community (CARICOM)? [1] No, these were the prescient projections of a European scholar nearly a century and one-half ago. [2]

And so it is even today. When non-West Indians fly over the Caribbean, whether in outerspace or much closer to Earth on an island-hopping British West Indies Airlines flight, the proximity of the separate territories is what is usually perceived—especially in the Eastern Caribbean—rather than the provincial distances that divide. Further, if metropolitan academics or employers have occasion to interact closely with Caribbean students or workers, they may marvel at the similarity of cultures and values projected. This is particularly evident when the interactions are with individuals from the former British West Indies (BWI), but it is true also of those from the multicultural circum-Caribbean which reflects the multitude of languages and political systems imposed by the many European colonizers. This cultural sharing has been emphasized by outstanding regional scholars such as Jamaican historian Franklin Knight, who finds fewer differences across the breadth of the Caribbean than across the United States; by Trinidadian sociologist Anthony Maingot, who finds many shared cross-cultural values among islanders, from the Lesser Antilles to the littoral of Central America; to some extent by St. Lucia's nobel laureate in economics, the late Dr. W. Arthur Lewis; and there is a reflection of the perceptions of both Knight and Maingot in the recently published magnum opus of the late Gordon K. Lewis of the University of Puerto Rico, a political scientist, philosopher and consummate Caribbeanist.

Each of this multidisciplined quartet also has been a promoter of Caribbean integration, but none more than Dr. Arthur Lewis. His brief but poignant *Agony of the Eight* should be required reading for all contemporary West Indians—both those who perceive the integration glass to be half full, and those who view it as half

[1] CARICOM membership includes 13 English-speaking Caribbean nations: Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

[2] Quote from Victor Schoelcher (1852) in preface to Morgan, Peter. *A High Tide in the Caribbean*. St. Michael, Barbados, Caribbean Communications, 1991. p. iii.

empty. [3] The failed effort to integrate in the three decades following World War II so exacted individual energies and poisoned the once-amicable relations of those West Indian leaders that Lewis predicted that a prerequisite for the region to again seriously push forward the integration process would be a new cast of far-thinking, pragmatic, and perhaps Sisyphus-like leaders. [4]

PRAGMATIC LEADERSHIP: A BOON FOR INTEGRATION

Today much of the pragmatism Dr. Lewis sought is in place (see Table 1), albeit with many leaders in a weakened position due to the faltering economies of their nations. Among current leaders, none appear more representative of what Lewis had in mind than Prime Minister James Mitchell of St. Vincent and the Grenadines. Mitchell has lent his mature vision of "real" realism [5] to the integration movement of the region. St. Lucia's Vaughan Lewis, Director-General for the seven-member Organization of Eastern Caribbean States (OECS), [6] has also been a tireless laborer in both the intellectual and practical vineyards of OECS consolidation, almost as a tribute to the memory of his late uncle, Arthur Lewis. And there are others who have come forward in recent months to advance the integration effort by promoting CARICOM's single tariff, assisting in the West Indian Commission's preparation of an integration package, or providing assistance as the four Windward Islands (Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines) of the OECS southern flank move through many sessions of planning to lay the groundwork for a federation plebiscite to be held by early 1993. [7]

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[3] This was brought home to me in extensive interviews in the Caribbean in the first half of 1992. All of those I questioned supported the *concept* of West Indies integration. Their nearly equally divided difference was between those who advocate continued advancement of the functional approach (i.e., deepening the economic community by embracing the common external tariff—the sentiment of Ambassador Patrick A. Lewis of Antigua-Barbuda—or by first achieving a common currency—a view noted by Erstein Edwards, a representative of the St. Kitts-Nevis Prime Minister) and those who feel there is no longer time for continuance of functional half measures, that CARICOM states must now advance directly to federation. The latter is the official position in St. Vincent, Grenada, St. Lucia, and is sometimes heard in Dominica, Trinidad, Barbados, and Guyana as well. For an excellent discussion of integration theory including economic functionalism and possible spill-over into politics, see: Axline, Andrew W. (Political Science Chair, University of Ottawa). The Comparative Analysis of Regional Cooperation Among Developing Countries. XV World Congress of the International Political Science Association, Buenos Aires, July 21-25, 1991; and Will, A Nation Divided.

[4] See Table 1 for evidence of the recent growth of pragmatic leadership in the region. Although not an analogy used by Lewis, his meaning was similar to the story of Sisyphus, a mythic figure, who, according to Homer, was condemned by the gods to roll a large stone up an almost impossible incline. Although failing repeatedly, Sisyphus continued to try, thus coming to symbolize futility. To French existentialist, Camus, however, the story has a manifestly different meaning. The fact that Sisyphus returns to try and try yet again is representative of mankind's tireless and courageous struggles. And thus it is with another of the valiant and still unended struggles for freedom and dignity in the Caribbean. Somewhat cynically, Peter Morgan, a former member of the Barbados House of Assembly, reflects on this ongoing process in his recent novel, *A High Tide in the Caribbean* (St. Michael, Barbados, Caribbean Communications, 1991). Having recorded earlier in the book another failure to "seize the moment" and decisively move toward integration, the novel concludes with new actors again "pushing the stone" in year 2004 (p. 282-83).

[5] Real realism for the post cold war era may be defined as the art of the historically possible with some predictive insight or anticipation of what is or could be likely. This latter element was anathema to cold-war and hot-war "realists" such as the late Hans Morganthau. See: Rosecrance, Richard. *The Rise of the Trading State.* New York, Basic Books, 1985; and Pearson, Frederic and J. Martin Rochester. *International Relations: The Global Condition in the Late Twentieth Century.* New York, Random House, 1988.

[6] The seven OECS members are Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Lucia, St. Christopher (Kitts) and Nevis, and St. Vincent and the Grenadines.

[7] This will be the first plebiscite on West Indies federation since the ill-fated 1961 tally in Jamaica, which produced the Williams equation, "ten minus one equals nought."

TABLE 1. The Rise of Pragmatic Political Leadership in the Independent Anglophone Caribbean. [1]

Country	Leader [2]	Term	Mesmeratic	Personalized-Rational-Legal	Pragmatic
Antigua & Barbuda	Vere C. Bird	1960–71, 76–	X	X [3]	
	George Walter	1971–76	X		
Bahamas	Lynden O. Pindling	1967–92	X	X	
	Hubert Ingraham	1992–			X [3]
Barbados	Sir Grantley Adams	1954–58	X		
	Errol W. Barrow	1961–76, 86–87	X	X	
	J.M.G.M. "Tom" Adams	1976–85			X
	Bernard St. John	1985–86			X
	Erskine Sandiford	1987–			X [3]
Belize	George Price	1965–84, 89–		X	X [3]
	Manuel Esquivel	1984–89			X
Dominica	Edward Le Blanc	1961–74	X		
	Patrick John	1974–79			X
	Oliver Seraphin	1979–80			X
	Eugenia Charles	1980–		X	X [3]
Grenada	Sir Eric Gairy	1961–62, 67–79	X	X	
	Maurice Bishop	1979–83	X	X	
	Herbert Blaize	1958–61, 62–67, 84–89	X		
	Benjamin Jones	1989–90			X
	Nicholas Brathwaite	1983–84, 90–			X [3]
Guyana	Cheddi Jagan	1957–64	X	X	
	Forbes Burnham	1964–85	X	X	
	Hugh Desmond Hoyte	1985–			X [3]
Jamaica	Norman Manley	1955–62	X	X	
	Sir Alexander Bustamante	1962–67	X		
	Hugh L. Shearer	1967–72			X
	Michael Manley	1972–80, 89–92	X		X
	Edward Seaga	1980–89			X
	P.J. Patterson	1992–			X [3]
St. Kitts-Nevis	Robert Bradshaw	1966–78			X
	Paul Southwell	1978–79	X		
	Lee Moore	1979–80			X
	Kennedy Simmonds	1980–			X [3]
St. Lucia	Allan Louisy	1979–82			X
	John Compton	1964–79, 82–	X	X [3]	
St. Vincent & the Grenadines	Milton Cato	1967–72, 74–84	X		
	James Mitchell	1972–74, 84–			X [3]
Trinidad & Tobago	Eric Williams	1956–81	X	X	
	George Chambers	1981–86			X
	A.N.R. Robinson	1986–91		X	X
	Patrick Manning	1991–			X [3]

[1] Sources: George Danns, "The Origins and Development of Political Leadership in the Caribbean," paper presented at XII Congress of the Caribbean Studies Association, Belize City, Belize, 27–29 May 1987; Percy Hintzen and W. Marvin Will, essays in *Biographical Dictionary of Latin American & Caribbean Leaders,* ed. Robert J. Alexander (New York: Greenwood Press, 1988). The leadership type categories are derived from the Danns essay.
[2] Prior to independence, Anglophone Caribbean leaders were designated Chief Minister or Premier; after independence the designation changed to Prime Minister, except in Guyana where the term President is utilized.
[3] Indicates incumbent leaders as of September 1992.

As if to stimulate this pending plebiscite, Prime Minister Patrick Manning of Trinidad and Tobago has recently proposed a new economic and political closeness with Barbados and Guyana that would simultaneously carve out a southern MDC bloc within CARICOM to better interface with a potentially tighter Windward bloc as well as with the somewhat different set of interests promoted by Jamaica, distant Belize, the Bahamas, and possibly the Leewards

(Antigua and Barbuda, Montserrat, and St. Kitts and Nevis)—not to mention a future non-English-speaking bloc of some or all CARICOM applicants (Suriname, Haiti, the Dominican Republic, and Venezuela). While there are the usual questioning of motives, many consider the Manning proposal a serious attempt to seize the integration moment when all of the three potentially strong economies of the region are faltering. Both Erskine Sandiford and Desmond Hoyte, the political leaders of Barbados and Guyana, respectively, have reacted positively to Manning. [8] This positions Manning as a leader of integration on the eve of the 1992 CARICOM Heads of Government summit in Trinidad, at the very time he becomes head of the organization.

Enthusiastic popular leadership is extremely important to break down suspicion and provincial orientations in these small insular communities. This is especially true if political leadership is to relate effectively to the increasingly important economic entrepreneurs and the bridging government-to-private-sector bureaucrats, both of whom are of increasing importance in the push for enhanced regional linkages. [9]

ADDITIONAL FACTORS INFLUENCING INTEGRATION

Of even greater importance to the outcome of the integration process in these small dependent states are the decline in nationalism in the Caribbean and external conditions such as the global recession and the policies of Washington and other regional powers.

In a recent article in the *Latin American Research Review*, for example, I drew on theory from the 1960s to test against the integration rhetoric and activities that emerged during the late 1980s and early 1990s, allowing the prediction that this would be a propitious period in Caribbean regional integration. [10] Especially relevant seemed Amitai Etzioni's generalization that if the economic, political, and social foundations of regional integration could not be established prior to the fervor of separate nationalism that accompanies the rise of state sovereignty and power, then the next most favorable time for it to occur would be when these factors have weakened. [11] In other words, when the separate passions of "us-vs-

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[8] While Prime Ministers Mitchell (St. Vincent) and Brathwaite (Grenada), and even Compton (St. Lucia), are more sure of their respective power bases by virtue of the support for integration (or lack of opposition to it), the major opposition in Barbados and potentially also in Guyana appear to favor strengthening regional ties. With regard to Guyana, there can be no serious talk of integration with Guyana—or of restructuring CARICOM—until there is absolutely no question that the 1992 general election in that country is generally perceived to have been both open and fair. Data from interviews by author in 1990-92.

[9] The leadership being assumed by the new, often multinational business entrepreneurs is one of the truly important breakthroughs in the present period. See: Giacalone, Rita. Challenges of Globalization and Integration for Jamaican and Trinidadian Entrepreneurs. Paper presented at XVII Annual Conference, Caribbean Studies Association, St. George's, Grenada, May 26-29, 1992; Stanley Lalta, who recently served as an economist in the Research Section, CARICOM Secretariat, Georgetown, Guyana, interview by W. Marvin Will, June 18, 1992, UWI-Mona [Jamaica].

[10] Will, A Nation Divided.

[11] See: Etzioni, Amitai. *Political Unification* . New York, Holt, Rinehart & Winston, Inc., 1965; Hurrell, Andrew. Latin America in the New World Order; A Regional Bloc of the Americas? *International Affairs*, v. 68, no. 1, 1992. p. 121-39; and Frambes-Buxeda, Aline. Dependent Integration and Globalization: Challenges and Perspectives of the Hispanic Caribbean in Terms of the North American Free Trade Zone. Paper presented at XVII Annual Conference, Caribbean Studies Association, St. George's Grenada, May 26-29, 1992. p. 7-8. Economic downturns also appear to hasten the impulse toward integration, or at least the formation (or reformation) of

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them" nationalism have cooled, opportunities for integration appear enhanced.

The passions of local nationalism have indeed been dampened throughout the region since the balmy days of nationalistic fervor that accompanied independence movements in Trinidad, Guyana, Barbados, and Jamaica in the 1960s. The nationalist excitement generated a decade later in the Bahamas by Pindling's leadership of the quiet revolution that politically toppled the Bay Street Boys has been somewhat muted in the face of the sober realities of economic downturns and drug smuggling allegations. The smaller states also had their charismatic nationalists and their new flags, but for many the instant euphoria generated at the time of independence during the 1970s and early 1980s has cooled dramatically under the pressure of lagging economies (Grenada, Dominica, and St. Vincent), fluctuating economies (Belize), or scandals (Antigua).

Thus the high tide of West Indian national passions was significantly diffused by the late 1980s. By 1987, CARICOM trade had collapsed to just half of its decade-opening level and crime had begun to soar in this region that once took great pride in its orderliness. Despite a declining population, homicides in Guyana have climbed 7–10 percent annually since the 1970s, almost in tandem with declining per capita gross domestic product (GDP), and from Trinidad to Jamaica insurance companies and personal safety have dictated more and more locks and security bars. Further, the International Monetary Fund (IMF), already a familiar face in Jamaica, had come knocking throughout the region by the early 1990s, bringing with it imposed and often politically destabilizing conditionalities and plummeting "J Curves" in living standards [12]—from approximately $800 to just over $300 per capita GDP in Guyana and nearly the same percentage decline in Trinidad—although the latter drop was from a much loftier, almost region-leading position.

In Jamaica, where the People's National Party (PNP) and Jamaican Labour Party (JLP) regimes have regularly alternated and have tried both socialism and market capitalism without significant developmental change, little progress has been achieved in the struggle to shed its dollar-and option-debilitating, debt-driven economy, or the influence of IMF, which is now midway in its second decade of imposing structural adjustments. The Jamaican economy that once led the Third World (in growth, albeit not classically-defined development) is hardly an object of nationalistic adoration today, while the Jamaican public from the impoverished and underemployed of Trench Town to the well-established business elite, no longer perceives that change in governments matter. [13] Even

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blocs, in Central and South America. But, while economic downturns and privation may induce change, it is hardly a recipe for enduring positive change. Rather, the chances for *sustaining* regional integration appear improved when there has been positive reinforcement from metropolitan powers for innovative policies by local leaders, policies that optimally encourage sustainable economic development—i.e., alleviation of human suffering while offering hope for long-term broadening of the economic base.

[12] This is a theoretical construct advanced by James Davies to indicate sharp economic decline.

[13] Carl Stone (in *Politics versus Economics: The 1989 Elections in Jamaica.* Kingston, Heinemann, 1989) reports a pre-election poll of business executives in Jamaica indicated nearly half (41 percent) felt there would be no significant policy change regardless which party (Peoples National Party or the Jamaica Labour Party) won, while 49 percent felt there would be some slow-

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the once robust, region-leading economy of the Bahamas has faltered, and the IMF has come calling in once fiscally-solid Barbados, leading to calls in 1991 for ouster of its just-elected government. This action propelled sweeping shock waves across the adjacent Windwards.[14] The present economic crisis also has been most disruptive in the Dominican Republic and Venezuela, two of the Hispanic Caribbean's democratic success stories. Both are currently seeking CARICOM membership, and both have recently faced food riots. Venezuela also experienced a recent economy-related coup threat.[15]

When the lurking fear of being left further behind by the rise of new, more powerful and potentially less penetrable megablocs in Europe and North America (and probably the Asian rim)[16] is added to these shocks, another explanation for the new stirrings on the integration front becomes evident. These new stirrings include: a push to deepen and possibly widen CARICOM, including giving *de facto* status to the once-fading ideal of a common market; enactment of a common external tariff (CET), although there is still considerable disagreement as to whether the tariff should be 45 per cent or 25 percent or even lower; the goal of convertibility for regional currencies;[17] plus the aforementioned efforts to give working and living reality to integrative theory, especially that emanating from the tiny Windward Islands in the region's southeast corner which lead the region in accomplishments and integration efforts.

Leadership from the OECS

There is a further logic that leadership for political and other forms of integration will come from the OECS. This group of states, even without union, has made major strides in implementing shared functions such as banking and currency; defense (the Regional Security System [RSS], which links the OECS with Barbados) and the related regional coast guard patrols of the complete archipelago; shared diplomatic posts; and, most recently, multinational purchase of medicines and medical equipment to secure cost-effective lots. Moreover, if peaceful, non-warring relationships

ing of investment until the new government made the "right" signals. The lowered expectation of change results partially because neither party has much room to maneuver outside IMF conditions. Much the same can be said of the December 1991 election in Trinidad and Tobago (as observed by author) between the victorious People's National Movement and the losing National Alliance for Reconstruction.

[14] Grenada, despite heavy U.S. attention since 1983, has also come under IMF scrutiny and the economy has perceptibly worsened since the 1990 elections.

[15] Although down economically, Venezuela remains a regionally important middle power that recently offered CARICOM members a one-way free trade arrangement—possibly to ease their own acceptance into CARICOM. Earlier, Venezuela (and Mexico) offered the region petroleum at discounted rates.

[16] Bloc restructuring (Central American Common Market), relaunching (Andean Pact—with hopes for a free trade area by 1995), and formation (a proposed Argentina-Brazil common market and another involving these two giants plus Uruguay and Paraguay) are also underway—partly in an attempt to recapture lost U.S. trade (the Latin share of U.S. exports) which is down from 17.5 percent in 1980 to 13.5 percent in 1989. See Hurrell, 1992, who suggests the megabloc story is certainly not all negative.

[17] Currency convertibility is probably five years or more down the road due to differences between the currencies now "floating" (Jamaica and Guyana) vs. those more closely tied to the U.S. dollar (Eastern Caribbean dollar in the Leewards and Windwards, Barbadian dollar, etc.) For the most comprehensive work on this issue, see: Worrell, Delisle. *A Common Currency for the Caribbean*, West Indian Commission Secretariat, Occasional Paper Series, No. 4 (St. Michael, Barbados: Cole's Printery, Ltd. The West Indian Commission Secretariat, 1992).

serve as an indicator or benchmark for significant integration, as argued by Karl Deutsch, [18] then could it not be said that integration chances are all the more positive among states that not only have avoided militaristic actions, but also have shared a common history and a common government? When, in an earlier essay, I titled the West Indian experience at integration "a nation divided," it was the Eastern Caribbean toward which my thoughts were directed.

From Colonial Disintegration to Federation: The Integration Process

CARICOM as a whole also has known success. Since the beginning of the Caribbean Community by treaty in 1973, probably no other region outside of the European Community (EC) has progressed as far. Still, many reversals have taken place—especially during the period of high ideologic division during the late 1970s and the early 1980s, which has contributed to failures to fully implement the four goals of the founders: a *de facto* free trade area; a CET; coordination of external policies; and a common policy to attract external investment. Real integrative movements have appeared, however, beginning with the Nassau accord of 1984, but especially since 1987.

Before further evaluating this process, some effort should be made toward defining integration and delineating its typologies. Integration is more than sharing a common sovereign, of course, and when that sovereign was a colonial overlord and the majority of the colonials were slaves or indentured servants, as was the case in the BWI, the odds would seem particularly rare for producing the desired attitudinal congruences. Integration is a difficult and complex process, even in economic theory, as reflected by Bella Balassa's five-step typology. The Balassa ideal type integration model suggests a range from free trade (with no internal tariffs), to *de facto* common markets (with CETs), to policy and institutional unification. Political integration is thought to be the most difficult to realize or to measure although CARICOM has constructed at least the ideal of policy coordination and has yet to achieve a *de facto* common market in the larger community. [19]

INDEPENDENCE THROUGH FEDERATION

Britain's demolished infrastructure and economic collapse as a result of World War II modified the British agenda for independence of the West Indian colonies, radically altering what had appeared prior to the 1930s to be a far-off policy of decolonization. The pre-World War II riots and rebellions in the West Indies and the 1948 loss of India accelerated the countdown of the demise of the second era of European colonialism. This pressure on Britain was reinforced by independence pressures from the Caribbean that had been forming since the rebellion-filled 1930s. Although there were intermittent British efforts for "closer union," as a 1932 con-

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[18] Deutsch, Karl W. *The Analysis of International Relations*. Englewood Cliffs, N.J., Prentice-Hall, Inc., 1988.

[19] Nye, J.S. *Peace in Parts: Integration and Conflict in Regional Organization*. Boston, Little, Brown and Co., 1971. p. 29.

ference was prosaically titled, Whitehall actions, from the days of initial settlement in the 1620s to discussions of federation in the post-war period (the 1945 Montego Bay conference), were committed much more to its economic interests than to the goal of national viability for an independent integrated British Caribbean. [20]

Britain's use of a weak federation as a primary means of advancing metropolitan colonial goals rather than assisting their West Indies colonies to achieve communication linkages and economically viable nationhood was instrumental in dooming the process. There were startling errors, even in the negotiation stage, that could be laid directly at the feet of Whitehall. These included: delay of the second federation conference until 1953, three years after the reports were submitted and after the individual islands learned they could gain separate independence; failure to follow the precedent in earlier colonial situations and inform the Jamaican premier that secession was unthinkable; and failure to use the Colonial Office's considerable weight in the resolution of pertinent issues ranging from retention of the Leeward and Windward subgroups, to site selection of the federal capital [21] to the all-important transferral of adequate power and funding to the central government of the federation.

For generations many Caribbean leaders have acknowledged what Gordon Lewis termed "the seminal truth," [22] that only an economically and politically integrated Caribbean can maximize the subregion's economic and political power and provide insulation against its provincial divisions. Thus, when formation of the West Indies Federation was under negotiation, there was no shortage of leaders who appeared to give federation their full support, at least in the abstract, with the more closely linked (physically and culturally) Eastern Caribbean especially well-represented. These efforts should have been more strongly supported by Britain and its North American allies.

British West Indian leaders who pushed the 1958–62 federation were, according to W. Arthur Lewis, "men of the highest quality, on any definition of that word" [23] (especially leaders of the three largest states in the federation—Norman Manley of Jamaica, Dr. Eric Williams of Trinidad-Tobago, and Sir Grantley Adams of Barbados—who were highly supportive throughout most of the negotiation period). Yet the personality politics and short-sightedness of these same leaders were largely responsible for the failure of that first serious integration effort. Like many Caribbean leaders since, they were first and foremost provincial nationalists, great heroic men in their home countries, but hesitant to accept compromise. [24]

[20] See: Lewis, Gordon K. *The Growth of the Modern West Indies*. New York, Monthly Review Press, 1968. p. 345; Mordecai, John. *Federation of the West Indies*, with Epilogue by W. Arthur Lewis. Evanston, Northwestern University Press, 1968. p. 18–74; and Levy Claude. *Emancipation, Sugar, and Federalism: Barbados and the West Indies, 1833-1876*. Gainesville, University Press of Florida, 1980. p. 138–159.

[21] The eventual selection of Trinidad as the federal capital certainly did not reassure Jamaica. The selection process itself was an example of the parochial and personality conflicts, economic concerns, and metropolitan mistakes hypothesized at the outset of this research.

[22] G. Lewis. p. 343.

[23] Lewis, W. Arthur. *The Agony of the Eight*. Bridgetown, Barbados, Advocate Press, 1965. p. 457.

[24] Ibid. p. 454–62. Manley's cousin, Alexander Bustamante, the Jamacian Premier, was a major force against federation.

Singular independence came quickly on the heels of the rejection of the West Indies Federation by Jamaica in a referendum on September 19, 1961. Alexander Bustamante and his JLP had mounted a year-long, door-to-door campaign against federation and, as survey data indicate, suspicion had evolved that the federation might impede eventual full self-government in Jamaica. [25] The referendum results in Jamaica and the negative reaction in Trinidad were fatal for the 1958–1962 federation.

By 1962, times had changed since Eric Williams had offered to fund small-island development. He was now evincing the bitterness of the past four years in an increasingly nationalistic tone. He abhorred the frequent battles with Grantley Adams of Barbados, as well as those with the even more provincial leaders of the Leeward and Windward islands, battles that severed lines of communication in some instances. Williams deplored the lack of true West Indian nationalism and the lack of coherence in the so-called Federal Labour Party. The best opportunity for positive change, he now felt, rested in his two-island state and his own newly formed party, the Peoples' National Movement (PNM). On January 14, 1962, therefore, Williams proposed formation of a unitary state centered in Trinidad. [26]

With Jamaica and Trinidad gone, only Barbados and the seven smaller islands remained of the ten original federation participants. If Jamaica, a leading bauxite producer, then with a population of nearly two million, and Trinidad, then with nearly one million inhabitants and the only substantial oil production in the West Indian territory, could not assume the reins and "carry" the smaller and poorer islands, how could Barbados with but a quarter million population, a scant 166 square miles of relatively unendowed land, and the lowest per capita income of the "Big Three" take the lead? The economic burden required to bring the remaining "Little Seven" up to Barbadian standards would be massive for the Bajan economy.

Errol Barrow, the newly elected premier of Barbados, was one of those most angered by the Williams-PNM announcement, since he felt the Trinidadian leader had given him assurance that further federation negotiations would ensue. Despite this setback, Barrow remained committed to federation *if* federation with his smaller neighbors could offer more positives than negatives to the economic and political well-being of his own island. What he most feared was that union with the "Little Seven" would engender economic disaster for Barbados and contribute to political defeat for him and his party. However, with apparent backing from Britain's Colonial Secretary Maudling and from Vere Bird, leader of Antigua and Barbuda, it was decided to initiate immediate action toward forming a Federation of the Little Eight.

On the day following the PNM announcement, Colonial Secretary Mauldling was informed of this preliminary intent and also of Barrow's two conditions: that there could be no waiting period for independence such as Britain had imposed on the 1958–1962 effort;

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[25] Bell, Wendell. Attitude of Jamaican Elites Towards Federation. *Annals of the New York Academy of Sciences*, v. 83, January 1960. p. 862–79.
[26] *The* [PNM] *Nation* . Trinidad and Tobago, 1962.

and that Britain would supply generous financial support to advance development of the poorer countries in the proposed federation. Unusually swift progress, just three days, in drafting a preliminary constitution and budget, was indicative of the substantial degree of interest elicited in the new federation. The constitution, which featured much stronger central authority than the previous ten-state effort, was on its way through the ratification process in the insular legislatures by June 1962. It included a national income tax, customs duties, excise taxing powers, and also provided for the formation of a national police, a federal judiciary, and sweeping regulatory powers.

In terms of constitutional quality and speed, the contrast with the 1958–1962 effort boded well, and ratification within two years seemed assured. Then came the increasingly insurmountable obstacles. An election in St. Lucia produced new faces and new problems; in Grenada the scandal-ridden, but pro-federation government of Eric Gairy was replaced with an administration, headed by Herbert Blaize, that was oriented to the unitary linkage offered by Trinidad; and by 1965 opposition movements had emerged in Antigua as well as in Montserrat, the smallest territory in the federation. "Economic factors were linked to much of this unrest, factors that could have been eased had Britain shouldered the financial burden for this subregion's development at the level determined necessary by a 1963 British-commissioned study. . . . As the most viable member of the new coalition, Barbados began to feel singled out to bear the responsibilities its larger neighbors had but recently rejected, responsibilities the Barrow government did not wish to assume." [27]

As if these hindrances were not enough to the faltering status of the Federation of the Little Eight, Britain once again did not dissuade the possibility of singular independence for these Eastern Caribbean states. Serious errors by provincial local leaders also became formidable stumbling blocks and again, as occurred with the West Indies Federation process, personal survival goals seemed to take precedence over those of the integration process. The bickering over minor items that once had seemed settled, including a Grenadian demand to issue its own postage stamps, suggested a refractory pattern. One governmental minister worried about the treatment they would receive after federation, expressing concern that after independence we would resign ourselves to a future of dictation by Barbados.

By December 1963, Barrow had reached his limit both with what he perceived as the "footdragging" of Britain and local "pettifogging politicians" and announced his government had moved to secure singular independence by 1966. And "if it is not granted, it will be declared," he defiantly concluded, "because I do not feel that we should have to ask for it!" [28] Thus, on November 30, 1966,

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[27] Government of Barbados. *The Federal Negotiations 1962–65 and Constitutional Proposals for Barbados*. Barbados, Government Printing Office, 1965. p. 2–9; O'Loughlin, Carleen. *A Survey of Economic Potential and Capital Needs of the Leeward Islands, Windward Islands, and Barbados*. [U.K.] Department of Technical Co-operative Overseas Research, No. 5. London, HMSO, 1963. p. 120–36; also O'Loughlin's *Economic and Political Change in the Leeward and Windward Islands*. New Haven, Yale University Press, 1968. p. 222–30.

[28] Errol Barrow, interview by W. Marvin Will, July 14, 1970. St. Michael, [Barbados] *Advocate*, 26 December 1963.

Barbados became the fourth Commonwealth Caribbean state to achieve independence, joining Jamaica, Trinidad and Tobago, and, just six months earlier in 1966, Guyana.

By this time Barrow appeared to place greater emphasis on functional economic linkages than on West Indies political integration. The formation of economic linkages would become the next focal point in the integration saga of the English-speaking Caribbean. [29]

FROM CARIFTA TO CARICOM

In 1965, one year prior to Barbadian and Guyanese independence, secret negotiations between their respective premiers built on existing and potential economic ties to produce an announcement of intention to form a free trade area by 1966. This decision was no doubt influenced by potentially successful integration movements forged in Europe and in Hispanic America, but the 1965 publication of a slender but prescient book, *The Economics of Development of Small Countries*, by the respected West Indian scholar William Demas, also had an impact.

Demas argued that although there had been substantial post-war GNP growth experienced by several territories in the British Caribbean, the results were far short of real economic development which has classically required a·substantial economic redistribution, a reduction in severe unemployment and underemployment levels, and an attack on socio-economic maladies that provoke the so-called "misery index." Promoting light industrial development and agricultural diversification could positively address these problems by better utilizing the well-developed infrastructure and highly-educated work force of the region while simultaneously broadening the market base, Demas found.

The proposed functional structure for achieving this goal was to be called the Caribbean Free Trade Association (CARIFTA). It invited the participation of other BWI territories. Although initially only proposing a free trade area, it also envisioned "creation of a Customs Union and a viable Economic Community for all the Caribbean territories who so desire." Cynical observers speculated the movement was part of a "get back at Williams" game, but if there was an understandable element of this, the open membership position soon outdistanced this personal dimension. The agreement establishing CARIFTA was signed on December 15, 1965, in Antigua. Designed to eliminate internal tariffs and import quotas, the treaty was to take effect in three years. [30]

The cause of regional economic integration was further advanced by several studies in the late 1960s, the most significant authored by academics attached to the now three-campus, multi-program University of the West Indies (UWI), as well as from the University of Guyana which has significant links to UWI including, at present, a common chancellor. Although Jamaica and Trinidad, the two largest BWI states, initially demonstrated little open support

[29] Much of Errol Barrow's integration theory was based on economic functionalism as a requisite step toward political integration. He had been schooled in economics at the London School of Economics.

[30] Payne, Anthony J. *The Politics of the Caribbean: Regional Intervention Among New States.* New York, St. Martin's Press, 1980. p. 56–66.

for integration, Trinidad did communicate its interest in ultimate Caribbean unity (and Prime Minister Williams earlier had gone on record in favor of West Indian economic linkages). It appeared positive support for CARIFTA and further integration of the West Indies was being forged. [31]

Thus, within three months of the May 1, 1968, inaugural of the CARIFTA treaty, membership had expanded to include the original ten states of the 1958-1962 federation, plus Guyana. This new inter-governmental organization (IGO) experienced relative success, as evidenced by an expansion of exports from U.S. $85 million in 1970 to U.S. $233 million in 1974, and a comparable expansion of imports during the same period.

Another incentive for affiliating with CARIFTA was expanded leverage opportunities in international negotiations. Britain's anticipated membership in the EC, for example, placed in jeopardy the region's preferred market status in the United Kingdom and a major success of Caribbean integration would be the negotiation of associate status in the EC for CARIFTA states (along with the ex-European colonies in Africa and the Pacific). [32]

Beyond the initial benefits member states garnered from CARIFTA, the reality remained that CARIFTA's economic potential was restricted because it was neither a customs union nor a common market. Caribbean integration could not maximize the region's potential or advance significantly without major acceleration in the relatively small functional steps CARIFTA had been able to implement. Steps toward corrective changes were anticipated with the Treaty of Chaguaramas (Trinidad) on July 4, 1973. The stage was now set for CARIFTA to evolve into CARICOM.

This newly restructured Caribbean IGO, projected and billed as a major functional advance over its predecessor, incorporated two distinct divisions, the Caribbean Community and the anticipated Caribbean Common Market, both controlled by the Heads of Government Conference—the supreme decision-making organ—and the Council of Ministers. The CARICOM organizational structure also included a Secretariat, based in Guyana, and several ancillary institutions, committees, and agencies, including the closely associated Caribbean Development Bank (CDB) based in Barbados.

A major goal of the Caribbean Community was—and remains—the harmonization among member states of seven Standing Ministerial Committees: Health, Education, Labor, Finance, Mines, Agriculture, and Foreign Affairs. Of these, the foreign policy harmonization goal, underscored in Article 17 of the Chaguaramas Treaty, holds the greatest integrative potential and has been a precedent-

[31] Brewster, Havelock and Clive Y. Thomas. *The Dynamics of West Indian Economic Integration*. Kingston, Jamaica: UWI, 1967; Beckford, George L., ed., *Caribbean Economy: Dependence and Backwardness*. Kingston, Jamaica: UWI, 1975; Best, Lloyd and Kari Levitt. *Eternally Propelled Industrialization and Growth in the Caribbean Since the War*,(mimeograph). Montreal, 1969; and Payne, *The Politics of the Caribbean*, p. 67-85. The 1967 study by Brewster and Thomas of the pros and cons of West Indies integration was the best and last significant study conducted. At the present important juncture, unfortunately, a lack of hard data exists regarding the consequences of deeper integration and an updating of the Brewster and Thomas study should be a priority. Metropolitan states could assist this process by encouraging and financing such a study.

[32] The EC's trade and aid relationship with African, Caribbean, and Pacific (ACP) countries, all former European colonies, was largely the result of coordinated diplomacy by Commonwealth Caribbean diplomats.

setting aspect, since not even the EC has structured this level of coordination. To quote from the treaty: "Member states aim at the fullest possible co-ordination of their foreign policies ... and seek to adopt, as far as possible, common positions in major international issues. ... The Committee shall have the power to make recommendations to the Governments of Member States represented on the Committee."The Treaty further states that decisions will be made by the "affirmative vote of all Member States ... participating."

As provided by an Annex to the Treaty, the Common Market is envisioned to encompass the overall economic dimensions of Caribbean integration including internal trade liberalization, a CET, and general coordination of economic policies and planning for development among the member states (e.g., fiscal policy, industrial promotion, and agricultural marketing). A special program is set forth for the Little Seven less developed countries (LDCs) of the Eastern Caribbean and there is delineation of a commitment to progressively remove non-tariff trade barriers, to harmonize fiscal incentives, and to free capital movements. If fully implemented, these are indeed prescient developments. [33]

THE UPS AND DOWNS OF CARICOM POLICY COORDINATION

The renewed and expanded integration attempt promoted optimism. Yet, problems are inevitable. The problems in CARICOM stemmed from flaws in the structure itself, from differing levels of development among the participating states, and from dissonance created by ideologically divergent policy goals and disparate perceptions among elites.

First, a look should be taken at instances of structural problems. When Belize joined CARICOM in 1974, it insisted on retaining its tariff policy and, in the process, created an anomaly within the agreement. As the result of a similar variance, a comparable dilemma was sparked by tiny Montserrat, the lone dependency within the CARICOM system. A second type of anomaly resulted from the co-existing Eastern Caribbean Common Market (ECCM), a subsystem formed on June 11, 1968 by the then seven Associated States—a domestic home-rule status bestowed by the metropole in the wake of federation. By 1981, the Little Seven had furthered their own subregional integration within the Caribbean Community by forming the OECS, which subsumed both the ECCM and the Secretariat of the Associated States and incorporated political, economic, and security functions. Thus, although CARICOM offered member states benefits as a result of enlarged membership and geographic scope, such expanded scope also brought potential problems in the form of specific variances that the smaller or weaker states negotiated as part of their association agreement to compensate for their LDC status. This, of course, is not unique to CARICOM.

A second obstacle presented by the expanded membership base of CARICOM was the increase in the potential among member states

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[33] Manigat, Mirlande. Caricom at Ten. *The Caribbean and World Politics*. Heine, Jorge and Leslie Manigat, eds. New York, Holmes & Meier, 1988. p. 95-97; Thomas, Clive. *The Poor and the Powerless: Economic Policy and Change in the Caribbean*. New York, Monthly Review Press, 1988. p. 308-09.

for a weakened sense of community and for divergent policy goals resulting from disparate elite perceptions and even ideological cleavages among member states. When CARICOM's membership number jumped to 13 with the admission of the Bahamas in 1983, for example, it signaled a major change since the Bahamas then had the highest per capita income in geopolitical Latin America. The Community also was faced with a potential dilution of regional consensus since the Bahamas is a sprawling 550-mile archipelago, situated as close as 50 miles to the U.S. mainland, which leads many Bahamians to perceive closer historic and cultural links with South Florida than with CARICOM member states.[34] But the Bahamian archipelago, which has not posed major problems within CARICOM aside from the earlier noted embarrassment stemming from alleged ties of the Pindling government to drug trafficking, does share centuries of British colonialism and Africanness with its CARICOM neighbors.

A perceived lack of shared norms has raised barriers to the admission of applicants from the Hispanic, Dutch-speaking, and Francophone Caribbean, specifically the Dominican Republic, Venezuela, Suriname, and Haiti. All are serious applicants who, along with Colombia, have been accorded observer status. Despite the expanded trade and prestige potential that could be realized from admission of these states, incongruous communication linkages could be problematic and serious difficulties could occur in attempts to coordinate policy. The fact that all but Haiti are now under civilian rule will hasten eventual membership, but problems with alleged banana dumping in Europe by the Dominican Republic (under the Lomé IV accords), is just one example of existing policy problems.

ECONOMIC AND IDEOLOGICAL OBSTACLES

There can be incongruity in policy coordination even when member states are not from differing linguistic blocs or from the geographic periphery of the region. During the late 1970s and the 1980s, the English-speaking member states of CARICOM came face-to-face with two additional variables, both extremely divisive, that severely affected the Community: 1) the sharp downturn—and resultant unevenness—of the regional economies; and 2) the injection of ideological cleavages, particularly as a byproduct of the 1979 Grenadian Revolution. Personality and insular politics—and also metropolitan inputs—compounded these variables that, in combination, were to severely test CARICOM's internal and external unity and threaten its very survivability.[35]

Since the 1970s, serious intra-CARICOM divisions have emerged as a result of differing trade and debt servicing policies and ideologies implemented in response to the massive economic crisis that

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[34] In the early 1980s, when I was invited to lecture at the College of the Bahamas, I found myself struggling to convince the students that they possessed a common destiny with the southern Caribbean. Unfortunately, this lack of "closeness" with the "south" and "east" is still a problem among all of the north and northwestern nations of CARICOM.

[35] Due to the constraints of this paper, many details of the divisions in CARICOM will be omitted, especially those related to ideology. I will note only that the Reagan Administration played a significant role with attacks on the CDB, and reduced funding largely because the CDB refused to discriminate against the then revolutionary government in Grenada. See: Will, "A Nation Divided," for details.

has engulfed the region. Massive economic and political problems were compounded during the 1980s as the four largest CARICOM economies—Jamaica, Guyana, Trinidad and Tobago, and Barbados—began to find themselves encountering breakdown. Petroleum-deprived, debt-burdened Guyana and Jamaica were the first to face economic crisis, driven in large part by attempts to transform their dependent economies and also by the perceived need, especially in Jamaica, to respond to clientelist electoral pressures. In both countries, the consequence was depletion of international reserves and the further imposition of severe IMF conditionalities in the form of mandatory program cutbacks. These actions produced domestic and political unrest during the 1980s that, in turn, exacerbated external problems with metropolitan countries that control the IMF, especially the United States. The IMF also made its presence felt in Barbados and Trinidad-Tobago, during the 1980s, although only temporarily in the case of Barbados.

In the 1990s, Caribbean community spirit has been rekindled somewhat although there is a continued economic downturn that especially affects the so-called MDCs, forcing many to enter deeply into the "valley of debt" and IMF conditionalities. These actions have severely affected regional trade and integration. By 1991-1992, the IMF had returned to Barbados as a "long-stay tourist"; had become a fourteen-year, multi-administration fixture in Jamaica; and had deeply attached its structural adjustment conditions to Trinidad and Guyana. The 1990s also brought the IMF to Grenada, although the government recently noted it "invited the IMF to make structural adjustments." There is fear that other small Caribbean countries will fall. A St. Lucian radio commentator noted in October 1991 that the subregion has looked to Barbados as a symbol of conservative economic management for a long time and now that it too has gone under IMF conditionalities, all the small Eastern Caribbean countries feel threatened.

CARICOM Resuscitation

If a significant resurgence of CARICOM is at all possible, a noteworthy contribution may have been made in July 1987 at the eighth Heads of Government Summit in Castries, St. Lucia. Stimulated by partial though significant measures taken in previous Heads of Government summits, especially Nassau in 1984, and reeling from the 1986 trade debacle that, as noted, reduced trade to just half what it had been six years earlier, an agreement was hammered out calling for removal of "all measures restricting intra-regional trade" by September 1988—a date that has since been extended to 1992, and most probably will be extended further. The participants in the St. Lucia summit also formulated a plan for development of a Caribbean Export Bank (CEB) to replace the now-defunct Caribbean Multilateral Clearing Facility. [36]

In other actions at the Castries Summit, plans were initiated for much-needed cooperation in resolving territorial claims, for securing access to and policing national oceanic economic and fishing

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[36] The CEB was to be structured on a sound business footing as a separate entity of the CDB in Barbados. Its formation has also been stalled.

zones, and for the promotion of a "Caribbean citizenship" status for CARICOM nationals. Much discussion also was directed to the issue of the drug trade; upgrading of inter-CARICOM communication; promotion of "Carifesta," an important but economically short-changed regional cultural event; and resolving soaring debt problems in the three largest CARICOM states, although few concrete solutions were submitted, other than hope for expanded trade.

Of greater importance, Barbados and Guyana initiated a call for work to proceed on regional integration of customs services and for cooperation among senior police, judicial, health, and legal services. With a view toward reducing costs, they proposed a system of sharing diplomats at international stations and conferences and also to share representation in IGO memberships, particularly those relating to the United Nations functional activities and agencies. The sharing of diplomats has historical precedence since the neighboring states of Barbados and Guyana once shared the services of a High Commissioner at the Court of St. James and the OECS states also have partially implemented this practice.

Selected integration, or at least cooperation, among regional police, court, and customs facilities is long overdue given the increasing flow of drugs and contraband through the region, not to mention the ongoing potential for terrorist acts, such as the attempted 1981 Ku Klux Klan intervention in Dominica and the 1977 sabotage and destruction of a Cubana plane as it exited Barbadian air space. Questions relating to maritime delimitation in connection with the new Law of the Sea Treaty must be addressed, and there remain serious problems relating to reform of the region's monetary system. Experts agree the latter is a key issue in potential expansion of integration within CARICOM during the 1990s. According to the Report of the Group of Caribbean Experts, efforts toward monetary reform must focus "on matters such as the CARICOM Multi-Lateral Clearing Facility, which should be progressively enlarged so as to finance a higher proportion of inter-regional trade . . .; prior consultation before changes are made in exchange rates; a greater degree of coördination of exchange control policies and practices; and the maintenance of a common intervention currency." [37]

No action at the 1987 Summit in St. Lucia was more important to regional economic integration, or required greater compromise from the CARICOM national governments, than revitalization of the goal of free trade within the Community. If CARICOM is to reach its full potential, it must perform as it was constituted in 1972-1973, yet free trade, a principal goal upon which CARICOM initially embarked and a policy it reiterated in 1987, has remained most illusive. As the region faces massive internal trade problems, it has been beset with possible trade restrictions from Europe resulting from the post-1992 change in market status, post-Cold War trade expansion strategies in North America, and new market tactics by the Pacific rim countries—in part to stave off threats to their own markets by Europe and North America. CARICOM has

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[37] Lewis, Vaughan A. Some Perspectives on Caribbean Community Integration. *Caribbean Affairs*, January-March, 1988. p. 90-91.

heightened its integration rhetoric but in 1992 there was still no firm agreement. In late 1991, in fact, St. Lucia announced it would not participate since the major regional economies were not buying its agriculture products. St. Kitts-Nevis and Antigua-Barbuda also have pulled back from previous pledges to legislate a uniform tariff. It is not unlike the recent novel, *High Tide in the Caribbean*, written by Barbados' former Minister of Tourism, Peter Morgan, in which the regional leaders are once again meeting to further regional integration, but, alas, several have a reason why the time is not right just then.

All is not negative. There were agreements at the July 1989 CARICOM summit in Grenada, including an agreement to proceed with the plan to revise local constitutions to move closer toward establishing a common Caribbean citizenship. In addition, Barbadian Prime Minister Sandiford and Guyanese President Hoyte agreed to support a plan to establish a long-needed Caribbean Court of Appeals—a plan that has received considerable support as demonstrated in a 1992 report by the West Indian Commission that features establishment of an appeals court as its centerpiece. The region, at least in principle, is also pledged to pursue discussions toward establishment of a Caribbean parliament, although this may be a non-starter in view of considerable opposition, due partly to anticipated economic costs.

Prime Minister Sandiford repeatedly reminds the press that he is "unapologetically a firm advocate of maximum Caribbean integration," a position that is certainly backed by his foreign minister, Maurice King, who in a May 1989 interview noted that "regional integration is the best way [Barbados] can achieve its primary national interests." King concluded with a very strong statement for a Barbadian: "We must be willing to sacrifice some sovereignty to bring it off." Guyanese President Hoyte, in much the same vein, has exhorted regional businessmen to "avoid the temptation of believing that we can act individually even to protect our individual national interests. Huge economic groupings are going to dominate the world economy and [we] cannot face these powerful groupings individually." [38]

And on the eve of the 1992 Port of Spain summit, Sir Shridath Ramphal, Chair of the West Indian Commission urged further integration, not only as protection against new blocs, but also to put the soul back into the movement. As a most important step, Ramphal urged adopting the West Indian Commission report, which includes a kind of integration package calling for the immediate establishment of a Caribbean Supreme Court. [39]

Thus, the region is pushing harder in many ways to realize economic and even political linkages. There is also no lack of appropriate theory to guide such new beginnings, notes UWI academician and a resident theorist for the Windward integration movement, Patrick Emmanuel, but, as noted, there is a lack of strong, widely-known leadership, especially from the larger territories. As the

[38] Braveboy-Wagner, Jacqueline. Tracking a Political Sea Change. *Hemisfile*, v. 1, no. 1, January, 1990. p. 9.

[39] The Commission's findings are to be reviewed in a special Heads of Government meeting in Trinidad in late 1992. A common CET is still possible, although there is presently a large range of desired tariffs.

Caribbean faces the uncertain 1990s, the essential stimuli and leadership is most often provided by the Eastern Caribbean states.

DEVELOPMENTS IN THE EASTERN CARIBBEAN

On June 18, 1991, the OECS [40] celebrated its first decade of existence. A major *raison d'etre* for its founding, to strengthen the common market of the one-time Leeward and Windward Island colonies in order to place this seven-state subregion "in a position to penetrate the CARICOM countries in terms of finding them as viable markets," [41] has not been a solid success. However, a second rational for founding the OECS, "to give our countries a greater international personality [and] to organize as a bloc for better dealing with the [European] Community" [42] has been much more successful.

Activity toward intra-CARICOM integration and the development of regional IGOs has been concentrated in the Eastern Caribbean since the late 1970s where, in addition to implementation of the earlier noted ECCM, there is a common central bank and a subregional court. Since 1981, the OECS has included both political and economic sectors in its permanent secretariat. In 1983, its Eastern Caribbean Currency Authority evolved into a central banking facility. Plans have been initiated to truly harmonize foreign and economic policies and to expand diplomatic cooperation to include shared missions such as the all-important post to the EC in Brussels, a matter of prime importance to these small states in view of the soaring expense of overseas postings.

Another important linkage now in place among the Eastern Caribbean states—although not without controversy—that harks back to the Grenada crisis is the previously noted RSS based in and largely financed by Barbados, but with significant OECS participation and a most welcome initial $15 million contribution from the United States for weaponry and training. This force, which includes a multinational coast guard, has its roots in a five-nation "Memorandum of Understanding" issued in 1982. It was formed ostensibly to protect fisheries, interdict drugs and smuggled goods, and provide rescue support, although Antigua's aging and increasingly opposed Prime Minister Vere Bird has provided fuel for new suspicions in suggesting the force should also be utilized to protect governments from domestic disorder. Nonetheless, this cooperative venture in the military sphere currently appears to be a positive force for the Eastern Caribbean both in rescue operations and in stymieing mercenary threats. [43]

[40] The OECS was formed with the signing of the Treaty of Basseterre (St. Kitts-Nevis). The Central Secretariat is located in St. Lucia, and the Economic Affairs Secretariat is in Antigua and Barbuda. The OECS is a subunit within the Caribbean Community. It differs from CARICOM by holding two Heads of Government conferences each year, thereby affording closer monitoring of its decisions—decisions which thus far have not suffered the postponements that have become almost endemic to the larger unit.

[41] Lewis, Vaughan A. The Eastern Caribbean States: Fledgling Sovereignties in the Global Environment. Paper prepared for World Peace Foundation, (mimeograph) June 1991. p.4.

[42] Ibid.

[43] Brana-Shute, Rosemary and Gary Brana-Shute. St. Lucia. *Latin America and Caribbean Contemporary Record*. Hopkins, Jack W., ed. New York, Holmes & Meier, 1985. p. 890-91; Thomas, p. 317-18.

Probably the most ambitious development has been the discussion since 1987 of a possible intra-OECS political union of from three to seven states—an idea promoted initially by Prime Ministers James Mitchell of St. Vincent and John Compton of St. Lucia. Noting a "strong sense of worry about the twentieth century closing and leaving us all stranded," [44] and feeling that such integration would probably facilitate increased U.S. assistance (a point that should be assured), Mitchell made the case for a unitary nation-state at a May 1987 conference in Tortola, British Virgin Islands.

Unity discussions continued in St. Lucia both during and after the July 1987 meeting of the CARICOM summit. At one point, six of the seven Eastern Caribbean leaders were endorsing political union by 1989. [45] Momentum cooled, however, as opposition surfaced from: Vere Bird, of Antigua (an original negotiator from the 1950s who was a firm supporter of federation); two other Leeward actors who often follow the Antigua lead, St. Kitts-Nevis and Montserrat; some opposition party leaders in the Windwards, especially in Dominica; and aspects of the always vocal, but often equally provincial local press. Uneven economic growth, debt, and excessive overlap of agricultural exports among the OECS states presented the most telling problems.

The possibility of uneven growth continues, presenting problems for integration which are already evident as Antigua and Barbuda has experienced a per capita GDP growth three to four times that of St. Vincent, Dominica, and Grenada. Both of the remaining Leewards also experienced substantial growth in the early 1990s as well—a probable factor in their coolness toward OECS federation. Thus, as has been the case previously, first with Jamaica in 1961, then Trinidad in 1962, and Barbados in 1966, there is always reluctance from the more solvent states who perceive that they may have to "carry" those who are weaker. [46]

The 1980s brought a sharp downturn in the economies of the CARICOM "Big Four"—Jamaica, Trinidad and Tobago, Guyana, and Barbados. As a result, instead of the "Big Four" producing a significantly expanding market for the OECS states to penetrate during the 1980s, the Eastern Caribbean was induced to expand trade within its own market. Ironically, by the end of the 1980s, the OECS had become the single largest market for CARICOM goods.

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[44] Mitchell's remark about "leaving us all stranded" no doubt anticipates a weakening CARICOM position within the expanding European system. With the addition of Iberian and eastern Mediterranean countries to EC, many traditional Caribbean products will no longer have sufficient access to these markets. Further, there is strong pressure to discontinue subsidizing specific crops and, instead, to buy from less expensive markets. Such a move will be detrimental to Eastern Caribbean banana sales.

[45] Taylor, Jeremy. Mini-states Plan to Merge as a Nation. *Times* [London], July 24, 1987; Richards, Mike. A Successful Summit. *Caribbean Contact*, August, 1987. p. 1,4, and 14.

[46] According to Patrick Lewis, Antigua and Barbuda's Ambassador to the United States and the Organization of American States (OAS), a foremost reason why the region should promote economic integration is that the region needs its twelve votes in the OAS and the UN. This is no doubt a good point, but each goes to the IMF and the World Bank alone. The region's motto, S. S. Ramphal notes, should be "We do it better when we do it together." "It is imperative," he told the Caribbean News Agency (*Guyana Chronicle*, January 9, 1992, p. 2), "that governments of the Caribbean Community foster the economic arrangements that would [induce] international multilateral financial institutions and aid donors or countries to deal with us as one."

According to Dr. Vaughan Lewis, the past decade has seen substantial progress in health, education, fisheries, legal areas, agricultural diversification, and, increasingly of late, the environment. In the area of health, the OECS has overcome one handicap related to the very small populations of the individual states through the Eastern Caribbean Drug Service, which is able to make bulk purchases of pharmaceuticals for the insular public sectors with the Eastern Caribbean Central Bank utilized as a source of payment. Further, through increased unity, the eight countries of the Leeward and Windward chains are now exploring the possibility of supplying common services in specialized medical areas. In education, enrichment and expansion has followed UNESCO, World Bank and European projects developed via the Lomé Convention—all programs which the subregion was able to negotiate and successfully utilize. Curricular, education-related infrastructural developments, and post-secondary programs were produced by these multilateral projects. Centers of Excellence, "where tertiary institutions can specialize in different areas" are now being developed, Dr. Lewis reported in 1991.

The OECS has given increased attention to the environment in the 1990s through the efforts of organizations such as the Natural Resources Management Unit and the Agricultural Diversification Unit. Concern over this ecological issue, which is shared not only with CARICOM, but with the small states in the South Pacific as well, is driven by the real possibility that rising sea levels or coral destruction may threaten their very survival. This should be an area of shared concern and support by the metropolitan countries.

Regulation of Eastern Caribbean fisheries has also become a reality as a result of the harmonization of appropriate laws within the subregion. This permits these very weak states to jointly patrol and monitor/regulate their common 200 mile Exclusive Economic Zone—with the crucial assistance of their joint regional defense force. This multilateral monitoring also provides security from massive inundation of the region by drug runners as well as from occasional saboteurs, and provides for the very real needs of regional and extra-regional shippers and passenger carriers. Intra-territorial legal correlation has contributed to other aspects of Eastern Caribbean integration, both political and economic. These are due to increase massively, of course, should the early 1993 Windward Island political-unity plebiscite among Grenada, St. Vincent, Dominica, and St. Lucia be supported by at least three states.[47] At present, it appears highly possible there will be a Federation of the Windward Islands. This goal is in the national interest of the United States.

CONCLUSION

There are several explanations for the surge of rhetoric and planning for regional integration in the Caribbean in the late 1980s

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[47] St. Vincent has announced it will join with any two. Dominica appears the least likely to support merger. St. Lucia has also experienced a mild economic boom due to tourism, but due to increased pollution, this boom may soon fade. Multilateral and U.S. aid, loan forgiveness (already granted in Guyana and Jamaica) and, most of all, multilateral negotiations would all benefit the integration process in the Windwards.

and early 1990s. First, there is the generalization offered by Amitai Etzioni, that if integration could not be fostered prior to the rise of state sovereignty and power—and accompanying nationalism—, then the next most propitious time for it to occur would be when these factors have weakened. As discussed in this essay, the region has experienced its worst economic downturn since the great depression and its worst intra-regional trade ever. This, along with the accompanying maladies of human misery and crime, would seem to induce a loosening of state pride and power and, indeed, the weakening of many of the subregion's political economies has been followed by a period of pronounced rhetoric for expanded political and economic integration. Second, as observed in Table 1, contemporary CARICOM and OECS political leaders tend to be more and more pragmatic in outlook than their frequently personalist and mesmeratic predecessors. As Dr. Arthur Lewis sadly noted in the 1960s: "The current political leaders are so scarred by the mutual hatred and contempt which they acquired for each other on the last round [of federation battles] that they are not likely to make [further] effort. However they will . . . yield to a new generation. Then West Indians will once more face their destiny, which is to come together as a nation." [48]

A new generation of increasingly younger, more pragmatic, better educated individuals is assuming leadership in the West Indies. What they lack is stature, especially with some of the most prominent and popular leaders lost due largely to the economy, while others have succumbed to untimely deaths (Tom Adams and Errol Barrow of Barbados). But with serious multilateral "carrot and stick" assistance, and support from their metropolitan friends (especially from Washington), the not-always-supportive press, and their usually practical West Indian constituents, there is still time and enough leadership potential to attain the new national destiny promoted by Arthur Lewis. This fact, no doubt, has contributed to the recent intensification of integrative activity in the English-speaking Caribbean. Also in the area of leadership, an increasingly important role by economic entrepreneurs and some parts of the bureaucracy has been noted. The development of a West Indies stock market, new advances in electronic communication, and initiation of a new shipping line in early 1992 falls into this category and bodes well for the future of the region. An essential element is for the political leadership to mesh with these new actors for change.

But the international environment is probably the most important factor affecting Caribbean integration in the early 1990s in view of the pressure being mounted from Europe, North America, and possibly in the Asian-Pacific rim. Europe is rapidly becoming a common market on a level with or larger than the United States. Not to be left behind by the emerging European market and the group led by Japan that is forming on the Pacific rim, the United States negotiated a Free Trade Agreement (FTA) with Canada that became effective January 1, 1989. In 1990, the United States announced it intention to enter into a FTA with Mexico. This was ex-

[48] Mordecai, p. 462.

panded in February 1991 to include Canada in negotiations for a North American Free Trade Agreement (NAFTA). If approved by Congress, such an agreement would produce a significant potential market since Canada is the number one trading partner of the United States, and Mexico number three, with U.S. trade in 1990 amounting to $175.3 billion and $58.6 billion, respectively. These three powers also have 370 million potential buyers and produce $6 trillion annually. Moreover, on June 27, 1991, President Bush announced his Enterprise of the Americas Initiative (EAI) which has the potential of leading to a Western Hemisphere Free Trade Area.[49] Against such giants, even a united CARICOM would still be a small population bloc (six million). Without its own common market and a CET, many feel CARICOM's fledgling industries, and its hope for a less dependent existence, could be lost. Thus, while there is no complete accord regarding the level of tariff or, certainly, what the future holds for the EAI—or even for intermediate power Venezuela's counteroffer of one-way free trade with the Caribbean states—the rapidly changing environment is a factor that should surely lead to intra-CARICOM restructuring.

Finally, it appears that much of the leadership for further Caribbean integration will be by the smallest Eastern Caribbean states, because their less developed economies have not experienced some of the recent shocks that have destabilized the larger states and, also, these are the states that experienced the highest level of preindependence integration. They were grouped as two colonial blocs, the Leeward Islands and the Windward Islands, a measure that aided communication; thus, not too surprisingly, it is among this small-state group that integration during the last decade has progressed the most, especially in the southern Windwards.

This momentum to merge three or four insular states should not go unnoticed by the United States. It should be encouraged, much as Canada bestowed major "no strings" financial aid and opportunities for trade, including the gift of two ships, to the first West Indies federation attempt. The United States should not merely draw on past examples established by its neighbor to the north however, but should seek to work with Canada and to draw on their superb contacts in the Caribbean region. The spirit of integration continues to be nourished by the Caribbean people, an industrious people who are neighbors and friends, who have many, many connections to North America, both the United States and Canada. Should further integration occur, this West Indian citizen input, in the final analysis, will probably be a crucial variable. But again, encouragement from the metropole is essential.

As hypothesized, metropolitan powers and local leadership have played and will continue to play crucial roles in the ultimate success or failure of integration in the Caribbean. In this area, the multilateral diplomatic role cannot help but be important, especially with the small Windward subset where aid and trade inducements could be a very worthwhile investment for the United States and its allies. For surely it is in the U.S. interest to help avoid further cases of regional fragmentation and to help set in motion the

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[49] Lewis, David E. The North American Free Trade Agreement: Its Impact on Caribbean Basin Economies. *Caribbean Affairs*, v. 4, no. 4, October-December, 1991. p. 56–72.

most optimal opportunities for viable development in these small democratic neighbors on its doorstep. A relatively small level of assistance at this crucial juncture could contribute significantly to long-term democratization and to regional order. But for this to happen this current crucial moment must be seized and must be addressed positively and sensitively. It is in the interest of the United States to do so. [50]

[50] Also, direct savings accrue to the United States when its number of embassies, staff, and associated expenses for a region can be reduced—a region that, while generally democratic, is presently on a per capita basis one of the world's most over-governed areas. But, as J. William Fulbright, late chairman of the Senate Foreign Relations Committee, has written: for aid to be effective, knowledge of and sensitivity toward local cultures must be demonstrated. See: *The Arrogance of Power*. New York, Random House, 1966.

THE FUTURE OF REGIONAL SECURITY IN THE CARIBBEAN

by Neville Linton *

CONTENTS

SUMMARY

The Commonwealth Caribbean is a region of largely island states too small to be able to defend themselves against any significant political threat, domestic or international. Over the last 20 years, the region has become more conscious of the need for special efforts to ensure the security and stability of member states, as the incidence of such threats has escalated in that period, including the notable crises in Trinidad and Tobago in 1970 and 1990, and in Grenada in 1979 and 1983. While there has been a reluctance to take collective action at the level of the Caribbean Community (CARICOM), the umbrella regional association, the association of small island states—the Organization of Eastern Caribbean States (OECS)—moved in 1982 to set up a Regional Security System (RSS) and a regional security force. That system played a crucial role in the dramatic events in Grenada in 1983 when the OECS states invited the United States to lead a combined military intervention into that territory.

However, since then there has not been much progress in institutionalizing an effective security system for these vulnerable small states, and appeals to the wider international community through the councils of the Commonwealth, the Organization of American States (OAS) and the United Nations (UN) for the establishment of a safety net for small states in general have not met with any satisfactory response. The paper analyzes some of the specific security problems in the CARICOM region, and suggests a framework for

* The author recently served as Assistant Director for International Affairs, Commonwealth Secretariat. This paper will be included in a forthcoming book to be published in 1993, entitled *Democracy in the Caribbean: Political, Economic, and Social Perspectives*. Dominquez, Jorge I., Robert A. Pastor, and R. Delisle Worrell, eds. The Johns Hopkins University Press.

taking this matter appreciably forward, as the problems did not depend upon the Cold War environment for succor and remain pertinent today.

Security concerns in this paper are political rather than economic and limited to the Commonwealth Caribbean as these territories have a common history, are linked by CARICOM and traditionally, in respect of security issues, have been associated together both of their own will and in the eyes of outside powers. In these territories, security has always been limited to passive defense since none was large enough to project its will beyond its shores, and defense has either been against an extraregional foe or in terms of maintaining domestic order.

The Record of Regional Security

In colonial days, the responsibility for security was clearly that of the colonial power; and in the century before independence, peace was the rule at the international level, save for the period when the imperial power was at war. In World War II, the alliance of the imperial powers with the United States meant that Washington established a network of military and communications bases in the region, some of which remain today. In the same century, social and political discontent often raised its head at the domestic level and could usually be contained by the local police, and occasionally, by the local military. Rarely was there need for a show of direct force from the metropole, as happened, for example, in the case of Guyana in 1953 when the Cheddi Jagan government was ousted and the constitution suspended.

Having inherited an external peaceful environment, most Caribbean states after independence decided on a low profile in respect of military establishments. Most were content to keep the colonial pattern of a police force and a volunteer militia. Initially, only the three largest territories decided to have armies—Jamaica, Trinidad and Tobago, and Guyana. Only the latter, with its long borders with Venezuela, Suriname, and Brazil, and facing territorial claims from the first two, could be said to have needed a military establishment for conventional external security purposes. Later, when the other land-based CARICOM country, Belize, became independent, its unresolved boundary problem led to the British government's keeping a military presence there up to the present. Initially the emphasis in all cases was on a security force related to domestic order and to controlling smuggling across borders, sea, and land. The fundamental reality is that, save for Guyana and Belize, CARICOM states started their independence phase with no sense of threat to their national security and territorial integrity. Therefore, each state felt it could deal adequately with national security, and there was no thought of treating security as a priority in the regional integration movement. When some sense of threat did develop, as at the domestic level in terms of dissident political movements and secessionist attempts, and at the international level in terms of fear of ideological subversion from, for example, Cuba, or challenges from drug or arms smugglers and associated mercenaries, it was still felt, especially at the "more developed countries"

(MDC) level, [1] that individual states could cope through the police, customs, and intelligence services, and through a certain amount intraregional cooperation.

Even Guyana and Belize, which had major territorial challenges to deal with, handled these problems independently, although they did rely heavily on, and did benefit from, coordinated regional diplomatic support. It should be noted that Guyana reached out widely in the international community for support using both the channels of the UN and the Non-Aligned Movement very effectively, apart from leaning on neighboring Brazil, while Belize depended upon British military assistance apart from the diplomatic support it gained from neighboring Mexico. It is instructive that in both these cases, a neighboring state was ready to appreciably assist a small state threatened by another neighbor—experiences indicative of elements which could be used for a regime of collective security cooperation in the Caribbean Basin.

The region's casual approach to security issues changed significantly in the 1970s under both domestic and international pressures. At the domestic level, the desire for regional cooperation surfaced in the late 1970s when the small Eastern Caribbean states faced a series of political challenges. There were insurrection attempts in Dominica and St. Vincent and a claim of a coup plot in Antigua. [2] After a coup threat in Dominica early in 1979, and an aborted mercenary "invasion" plot against Barbados, the government of Prime Minister Tom Adams in Barbados took the forefront in advocating regional cooperation by calling for joint coast guard patrols with Antigua, St. Lucia, and St. Vincent, and later by sending troops to assist St. Vincent during an uprising—a first in regional military initiatives; in 1981, Barbados sent military advisers to a parallel situation in Dominica. It is noteworthy that Barbados, having made a new assessment of its security needs, abandoned its policy of not having a military establishment and developed a Defense Force in 1979, while Dominica terminated its Defense Force in 1981 in view of the frequency with which soldiers had been involved in political initiatives over the preceding decade.

The year 1979 was important in the development of regional attitudes toward security. The Grenada Revolution of Maurice Bishop's New Jewel Movement occurred in March, and in October the U.S. government both announced a new policy towards the Caribbean and assumed a new militancy towards Cuba, involving the establishment of a new Caribbean Joint Task Force. The U.S. government also initiated action for a program of security assistance to selected Eastern Caribbean countries. Within the region itself, Tom Adams, on his first official visit to neighboring Port-of-Spain, signed a Memorandum of Understanding (MOU) with Prime Minister Eric Williams of Trinidad and Tobago in which they noted the growing complexity of the security problems of the Caribbean; it was significant that the problems highlighted did not include any ideological reference, but focussed instead on terrorism, piracy, and

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[1] MDC and "less developed country" (LDC) are terms used within CARICOM to distinguish member states.

[2] See Young, Alma H. and Dion E. Phillips, eds. *Militarization in the Non-Hispanic Caribbean*. Boulder, Colorado, Lynne Rienner, 1986.

the use of mercenaries. As yet, there was no major concern about drugs.

Following its agreement with other regional governments on joint coast guards patrols, Barbados sought to upgrade its military establishment and Britain agreed to provide coast guard training and assistance. The trend toward a properly institutionalized regional security system came to a head in October 1982 when the Eastern Caribbean RSS was established in Roseau on October 30; the member states were Antigua and Barbuda, Barbados, Dominica, St. Lucia, and St. Vincent and the Grenadines. The agreement was for cooperation to provide for "mutual assistance on request" in "national emergencies, prevention of smuggling, search and rescue, immigration control, maritime policing policies, protection of off-shore installations, pollution control, natural and other disasters, and threats to national security. [3] After independence in September 1983, St. Kitts and Nevis joined, and finally Grenada joined on January 1, 1985. Thus, at present the RSS consists of seven island states.

The RSS came one year after the establishment by the smaller Eastern Caribbean states of the OECS in June 1981. In Article 8 of the OECS charter, provision had been made for a Defense and Security Committee whose responsibilities suggest the awakening security concerns of these newly independent small states, and perhaps their heightened awareness of vulnerability in a region where both the United States and Cuba had recently become more vigorous politically, and where the People's Revolutionary Government of Grenada was asserting novel foreign policy positions which aligned it more with the Soviet bloc than with traditional CARICOM postures. Thus, the Defense and Security Committee had responsibility "to advise the Authority on matters relating to external defence and on arrangements for collective security against external aggression, including mercenary aggression, with or without the support of internal elements and for co-ordinating the efforts of Member States for collective defence and the preservation of peace and security against external aggression and for the development of close ties among the Member States of the Organisation in matters of external defence and security, including measures to combat the activities of mercenaries, operating with or without the support of the internal or national elements, in the exercise of the inherent right of individual or collective self-defence recognized by Article 51 of the Charter of the United Nations."

It does not appear that initially there was a clear idea as to the type of mechanism that would be set in train to operationalize Article 8, and it would seem that it was at the impetus of Barbados, and specifically of Prime Minister Tom Adams, that led to the emergence of the RSS as a practical instrument in this respect. Barbados was outside of the OECS, but had similar security concerns and imperatives as the OECS states. It was the only MDC which had been the subject of a couple of quite ineffectual attempts at mercenary invasion and also the MDC most openly concerned about political developments in Grenada. By contrast, it would

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[3] Regional Security System Headquarters Staff. The Roles of the RSS in the East Caribbean. *Bulletin of Eastern Caribbean Affairs*, v. 11, no. 6, January 1986.

seem that at the time, Jamaica, Trinidad and Tobago, Guyana, Belize, and the Bahamas made little headway in the wider grouping of CARICOM in terms of collective security arrangements, and felt that their defense needs could be handled by national mechanisms and by ad hoc regional diplomatic cooperation. [4]

With the shattering events of Grenada in October 1983, [5] the arrangements provided for under the OECS treaty and the MOU were brought into play in crisis circumstances that could not have been predicted and that probably were more demanding than the framers of these two instruments might have anticipated. The RSS members acted decisively and commissioned an intervention, with U.S. government forces playing a leading role. This was the first such collective security exercise in the region's history and the intervention, especially the U.S. factor, led to serious divisions in the Caribbean Community. [6]

It might be logical to expect that this traumatic experience would have stimulated serious, systematic, and urgent attention both to the question of mechanisms for regional collective security and to the conditions, sources, and nature of external bilateral or multilateral assistance. However, once the dust had settled, the wider CARICOM region relaxed and settled back into its regular pattern with the concomitant focus on regional economic issues. This would seem to suggest that the Grenada case was seen as an aberration, and that the fundamentals of the region's security situation had not changed. For the RSS states, however, the Grenada intervention was an eye-opener. Thereafter the RSS, which in 1983 had only been in existence for a year, became a more established institution with well-equipped units under continuous training for cooperative action. [7] The RSS forces did not participate in the actual fighting in Grenada, but were part of the subsequent occupying force. A senior officer commented, "without the RSS it would have been difficult, if not impossible, for police, Special Service Units (SSUs), and soldiers from six member states to be landing on the island on D-Day, 25 October 1983. In this case, as in all likely scenarios speed of action was critical. This quick reaction would have been impossible without the mutual co-operation and understanding between governments and commanders that the MOU had generated." [8]

In the aftermath of Grenada, Prime Minister Tom Adams sought energetically to strengthen the regional defense system by upgrading the RSS into a standing regional force. The various estimates about size and cost mentioned at the time ranged from about 1,000 to 1,800 strong with establishment costs from U.S.$10 million to U.S.$100 million. The proposal was actually discussed with Secre-

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[4] Trinidad and Tobago joined the 1974 Inter-American Treaty on Reciprocal Assistance (Rio Treaty); the Bahamas signed it but did not ratify.

[5] See: Davidson, J. Scott. *Grenada: A Study in Politics and International Law.* Aldershot, Avebury, 1987.

[6] See: Lewis, Vaughn A. International, National and Regional Security Arrangements in the Caribbean. *Peace, Development and Security in the Caribbean.* Bryant, Anthony T., J.Edward Greene and Timothy M. Shaw, eds. New York, Macmillan, 1990.

[7] Training has been provided by both the United States and the United Kingdom. At RSS Headquarters in Barbados, U.K. personnel are a part of the command structure; there is a gradual training of regional officers to replace these. The United States sends ad hoc teams to participate as trainers in RSS-run training courses.

[8] See: The Roles of the RSS in the East Caribbean, p.7.

tary of State George Schultz in his visit to the Eastern Caribbean in February 1984, but nothing developed; the United Kingdom was also lukewarm to it. More importantly, there were doubts even within the RSS states, especially from St. Vincent and St. Kitts and Nevis, about the need for such a force and the cost of maintaining it. [9] In addition, there were important political sensitivities underlying the reluctance to deepen the relationship, principally a fear in some quarters that the RSS might be deliberately used in the case of questionable claims of coup attempts to crush left-leaning political movements.

The RSS remained in its original form, but in the years immediately after 1983 its military equipment was improved significantly and regular training from U.S., British, and Canadian sources was institutionalized. The equipment and training of the regular forces of the member states were also upgraded, especially those of the Barbados Defense Force. When Caribbean leaders met with Canada in Jamaica in March 1985, Prime Minister Adams had anticipated that the post-conference communique would reflect an agreement that members had negotiated with one voice on issues of security assistance from external powers. This did not materialize, and security has not been a priority issue on the CARICOM summit agenda since then.

While the Grenada events led to the firming up of the RSS, the exercise underlined the inadequacy of the RSS and the limited role which it could play. It is particularly clear that in any major operation there would be need for logistical and communications support from outside powers. Indeed, quite apart from crisis situations, the basic routine surveillance work of the region—of seas, territorial waters, and air-space—cannot be adequately done by the present coast guard and air arm services. The fact is that no single Caribbean country has the assets by itself to deal with major pollution control problems, fisheries protection, search and rescue operations, and natural disasters. In such a situation, collective security does seem to be a minimum option, and has the advantage of providing a basis around which outside assistance could be organized.

In the post-Grenada crisis period, Jamaica continued the pattern of cooperation that had started with its participation in the intervention by joining the annual war games exercises of the RSS. Trinidad and Tobago, which initially was only an observer at the war games, joined in 1991.

But what the Grenada crisis pointed out even more was the gulf in getting agreement on collective security action, whether or not such action involved assistance from outside powers. The specific arguments of the Grenada intervention case which arose at the CARICOM Heads of Government Meeting have been discussed [10] elsewhere and need not detain us here. However, the case does demonstrate what are perceived to be the problems in establishing a collective security system. A positive aspect was the universal assumption that a government established by violent and unconstitutional means was unacceptable, but disagreement was really over

[9] See: McIntyre, Alister. Whither CARICOM? *CARICOM Perspective*, no. 25, May-June 1984. p. 11.

[10] See: Lewis, Vaughn A.

whether there should be a negotiated solution or a military one, particularly given a frank recognition that a military solution required extraregional military assistance.

It was quite traumatic for regional elites that such assistance was from the United States, as the region had always looked somewhat askance at the historic role of power in U.S. relations with its Latin American and Caribbean neighbors. There was an acute awareness of the implications of getting further into the U.S. zone of influence and of developing armies trained to American ways of thinking and acting, armies that might begin in the Latin-American pattern to see themselves politically as guardians of the society. In fact, in the ensuing years it would seem that the command of the RSS has deliberately sought to balance the U.S. influence by keeping up the traditional reliance on British linkages.

Grenada was seen as an aberration in a region that has always prided itself on its democratic tradition and stable societies and thus, after that crisis, there was no serious impetus to follow through toward instituting adequate machinery for political crisis management. Yet in July 1990, there was an attempted coup against the Trinidad and Tobago government; another aberrant case undoubtedly, but it did happen and demonstrated again the inherent vulnerability of these small states. [11]

Over the last two years, the CARICOM region has been involved in a comprehensive review of regionalism and an examination of proposals for enhancing regional welfare and development that were put forward by the West Indian Commission established in 1989. It is to be hoped that the implementation of the program to this end, which was agreed on by governments in mid-1992, will significantly contribute to improving regional security.

The Range of Threats

The threat scenario in which collective security could be helpful is much the same in the Caribbean as with other small states, and includes both external and domestic threats.

EXTERNAL THREATS

Save during periods of Great Power conflict, the small Caribbean states have not in practice been vulnerable to external threat. A fundamental contemporary reason is that the United States has been a natural "guardian" of the whole region as a by-product of Washington guarding its own Atlantic sea lanes. There is also the increasing possibility that both Mexico and Venezuela might also see themselves in guardian roles vis-a-vis small Caribbean states. [12] Certainly the fact that arms transshipped in Antigua eventually made their way to the drug network in Columbia must be a matter of concern to Latin neighbors.

[11] See: *Vulnerability: Small States in the Global Society*, Commonwealth Secretariat, London, 1985. In that study, a small state was defined as essentially being a state of up to 1 million population; exceptions of over one million were included in the definition when such were members of a regional group where small states were the majority.

[12] In both recent cases of domestic political crises in Trinidad and Tobago, Venezuela offered military help that was not accepted.

The Caribbean situation is such that intraregional conflict is unlikely (save for the only land-border case between the Dominican Republic and Haiti) as long as the Belize and Guyana cases continue on their patient, sedate trend to settlement. At the hemispheric level, so far only the United States has been seen as a likely invader. Given the decline of the Cold War, situations for direct U.S. invasion are not easily conceivable; but the substantial military presence of the United States in the Caribbean remains, including military installations in the Commonwealth Caribbean. However, situations of extreme civil war, or of takeover controlled by drug- and arms-related mercenaries, could possibly lead to interventions by Venezuela or Mexico, the regional powers whose surrogate security role in the region could increase in a non-Cold War environment.

In other island regions, piracy has re-emerged as a major problem and arms and drug smugglers are a serious threat to governments whose territories often consist of a number of small islands over which their physical control is slight. A heightened Caribbean consciousness about the drug problem as a security threat was reflected in recent initiatives, especially by Jamaica and Trinidad and Tobago in international fora, including the UN, to get a multilateral force to assist states in intelligence and interdiction, and to establish commissions of inquiry and an international criminal court for offenses related to drug trafficking. In the case of Dominica in 1981, it seems that if the mercenaries had been successful, a puppet government might have been set up to do their bidding. The same, incidentally, was said to be the game plan in the Indian Ocean case of the Maldives in 1988.

Increasingly, the control over maritime resources is being recognized as a problem area. [13] The region lacks the resources for adequate fisheries zone protection and for routine surveillance flights. Control over other natural resources could also at times be a problem, for example, illegal trading in precious minerals which leapfrog over borders through the sophisticated networking, communications, and transport equipment of international operators. This, of course, has already happened with drugs in the Bahamas, Belize, and Jamaica. The simple reality is that narcotics and terrorist activities are threats that by their nature require international cooperation to meet them.

DOMESTIC THREATS

The range here is wide: military coups, succession struggles, riots, civil unrest, seizing of hostages, disaster relief, and environmental threats. It has been at the domestic level that security threats have usually arisen. These could be threats to a regime or to domestic order, although external threats could also be threats to sovereignty. While CARICOM states have balked at the concept of intervention hitherto, it was largely because it did not seem necessary. However, the Trinidad and Tobago case in 1990, coming relatively soon after the 1983 Grenada crisis should underline the necessity. The CARICOM states were quick to confer at the level of

[13] See: Francis, Anselm. The New Law of The Sea and The Security Interests of the CARICOM States. *Journal of Interamerican Studies and World Affairs*, v. 31, no. 3, Fall 1989.

Heads of Government and to offer direct military help through the RSS although this was not used by Trinidad and Tobago during the actual confrontation. [14] Since the RSS has had training specifically for dealing with domestic challenges, [15] its use earlier in the process, however limited, would have provided an excellent opportunity to promote regional cooperation and further the idea of regional collective security. A more integral involvement might well have speeded up settlement as it would have sent a message to the coup leader that his crime was against the region; moreover, it would have been a salutary warning to others in the region who might have such illegitimate ambitions. But here the traditional insular approach triumphed as both the Trinidad Defense authorities and the government wished to show that they could handle the problem without outside help. It should be stressed that the participation of outside forces does not necessarily have to be in a combat situation; the fact of their presence makes a contribution, both politically and operationally. Moreover, the affair had an important international dimension that was of importance to the whole region; it seems beyond doubt that the substantial arms hoard of the insurrectionists, the Jamaat-Al-Muslimeen, came from Arab sources, probably Libya. Given the earlier evidence of Libyan political activity in the Eastern Caribbean, the need for a regional approach to terrorism is surely underlined.

Threats from natural disasters occur even more often than political problems. The Caribbean is a hurricane zone whose security is threatened annually in the most fundamental way. A fair amount of regional cooperation exists with respect to disaster relief, and the commitment toward this was heightened in the wake of the devastation of Hurricane Hugo in 1989. Immediately thereafter, a process was started to set up a permanent joint CARICOM disaster relief task force based on the region's military, and with special training and equipment to this end.

External Assistance

BILATERAL

The Trinidad and Tobago 1990 crisis did raise the question of the possibility of extraregional assistance, since the flushing-out of dissidents, if it came to a pure military confrontation, would best be done by troops trained in counterinsurgency methods. The question of inviting the British Security Air Services (SAS) [16] was mooted at the time in some quarters both in Trinidad and in the region.

There is a natural reluctance to call upon bilateral assistance either from the former colonial power, the hemisphere's hegemonial power, or from others. If however, there was an understanding

[14] The RSS was used after the coup collapsed to assist in maintaining law and order under the continuing state of emergency, as well as to permit the strained national forces adequate rest breaks.

[15] This RSS training includes some training, specifically in negotiating techniques for cases where there are hostages at risk. For a comprehensive survey of the RSS, see: Brigadier-General R. Lewis. Eastern Caribbean RSS as a Model for UN Action in Relation to the Security of Small States. Course paper, Royal College of Defence Studies, London, 1990.

[16] Particularly after the Grenada crisis in 1983, there was little possibility of inviting the U.S. forces; apart from the political aspects, there are strong doubts in the region about both their efficiency and techniques.

in CARICOM that such requests be made only after consultation with the other CARICOM powers, that would be an improvement, although it could still make for strong intraregional discontent as in the case of the 1983 Grenada crisis. On that occasion, Trinidad and Tobago would have been equally upset if Grenada had, for instance, invited the Venezuelans to deal with the anti-Bishop forces, or if a rump of the Bishop government had asked the Cubans to quell and mediate the situation. Clearly, inviting foreign armed activity into the region can be said to affect the interests of other states and CARICOM states need to come to terms with this issue. Admittedly a situation wherein a regional concurrence becomes necessary for such invitations, bilateral or multilateral, would in effect be a surrender of some sovereignty, but the realities of the security situation would suggest that the time is ripe for these larger security issues to be handled at the regional level.

MULTILATERAL

If requests for assistance could be to a multilateral agency rather than bilaterally to another state, the proposition of seeking outside assistance would be much more acceptable to CARICOM member states. Even so, such assistance would usually be for cases of external aggression rather than for domestic coups. The obvious options are the OAS and the UN and beyond these, although not as clear cut an option, the Commonwealth. A fundamental consideration, however, is that multilateral agencies cannot respond as quickly and suitably as with the bilateral option.

The *OAS machinery* as it exists could theoretically be used to mobilize hemispheric military assistance, but it has no track record in this respect. However, given the weight in numbers of the CARICOM states, it might be worth exploring whether a special regime of assistance for small member states can be agreed upon. The OAS has the advantage that, like the UN, there is a standing agency in Washington and quick decisions are theoretically possible. However, the problems involved in activating the machinery at the military end, plus the problems of Latin American troops operating in the significantly culturally different CARICOM area, loom as major drawbacks; but it would still be useful to have such a regime in place even if the military machinery was hardly used, since many situations are measurably affected by economic sanctions, political leverage, and moral pressure. Now that the OAS includes both the United States and Canada, all these can be more meaningfully used. There is reason to assume that Canada is likely to advocate measures by the organization to support small member states.[17]

The *United Nations* has seriously addressed the problem of the security of small states, when the Maldives, after its 1988 coup attempt, took the lead in the General Assembly in getting passed a resolution mandating the Secretary-General to explore mechanisms for the protection of small states.[18] The Secretary-General report-

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[17] See: Baranyi, Steven and Edgar Dosman. Canada and the Security of the Commonwealth Caribbean. In *Peace, Development and Security in the Caribbean.*

[18] United Nations General Assembly Res. No. 45/51, 8 December 1989.

ed to the General Assembly in 1991, but the subsequent debate was inconclusive with the question being remitted for further consideration in 1994.

The possibilities could include both the already existing watchdog facility in the Secretary-General's office, which monitors potentially explosive situations, and a version of the Palme Commission proposal of 1982, which could be tailored to suit small states rather than the wider ambit of non-Cold War issues among Third World small states therein originally suggested. The need is for mechanisms which could mobilize appropriate diplomatic and military assistance at short notice; the UN can provide the former within its present set-up and with imaginative use of the Secretary-General's powers, but the latter could require arrangements allowing forces with the relevant equipment and training to be deployed quickly.[19]

Even within the UN process, therefore, there is an obvious advantage of giving priority to the use of regional arrangements, as the UN Charter recognizes. But regional politics can itself be on occasion a hurdle and a small state may not wish intervention to be led by a regional hegemon. And since coups in small states can occur and be entrenched very quickly, it is worth considering whether a regime vis-a-vis small states should not have procedures by which the UN Security Council could rapidly either utilize or bypass regional mechanisms.

Given the end of traditional East-West confrontation and signs of increasing relevance for the United Nations, a security regime relating to small states and involving their specific acceptance would seem to be, both politically and militarily, a manageable area in which the organization could vigorously flutter its security wings. The CARICOM states should be in the forefront in ensuring a positive and creative outcome to the Secretary-General's exercise.

The *Commonwealth*, in the wake of its special report on the security of small states, *Vulnerability: Small States in the Global Society*, has not taken any concrete collective measures in respect of its own recommendations vis-a-vis political security, although there has been increased intra-Commonwealth bilateral cooperation. Both Australia and New Zealand have close ties with nearby small Pacific states, while India demonstrated its willingness to act supportively to the Maldives in 1988. Canada is the closest Commonwealth power to the Caribbean but is not a neighbor; thus while it did give the region some increased security technical assistance after 1983, it is unlikely to play the more committed role which close regional proximity fosters elsewhere.

While Commonwealth powers are ready to give bilateral assistance, they are clearly shy of any multilateral commitments. A basic reason is that the larger states do not perceive the Common-

[19] Independent Commission on Disarmament and Security Issues. *Common Security*. London, Pan Books, 1982. p. 162-167. The essence of the commission's proposal for implementing this modified version of the UN Charter collective security system is for a political partnership between the permanent members of the Security Council and Third World countries in order to prevent conflicts from being settled by armed force. The commission had specified proposals on organization of stand-by forces. See also: Harden, Sheila, ed. *Small is Dangerous*. London, Pinter, 1985, chap. 5, for suggestions for peacekeeping forces through the United Nations and the Commonwealth.

wealth as a security community, and in terms of security, most states terms are obviously more comfortable operating at a regional level than across the wide range which the Commonwealth covers. Some would argue that once the arena gets beyond the region, it should be a concern of the global community, that is the United Nations system. Of course, since World War II, nonregional security alliances such as like NATO have come into being, but such alliances are linked by a sense of common threat. Since contemporary economic, trade, cultural, and communications linkages make for a global village, our concepts of security arenas need not hold to the traditional patterns. A Commonwealth commitment that implied a willingness, where necessary, to mobilize immediate moral and material support for small state security victims could be a valuable buttress for the regional efforts of such states,[20] particularly when the common purpose would be the security of a set of states admittedly incapable of defense against both significant external attack and bold domestic coups.

Conclusion and Recommendations

CARICOM states undoubtedly would like to maintain the image of a region with no chronic instability and thus no need for a major security perspective. On the other hand, in recent years a school of thought has emerged that has been raising a specter of militarization in the region. Much of this analysis assumes an innocent Caribbean and a scheming United States and certainly stretches the meaning of "militarization."[21] The reality, however, is that in today's global village the vulnerability of these islands has increased, especially because their fragile regimes cannot easily cope with the economic and social problems which beset them. Obviously, a continuous strengthening of democratic and egalitarian practices should be the pattern of regional development. But they also require both time and domestic order if they are to achieve social justice and "develop" adequately, and in order to do so, they need to take more deliberate steps to defend and preserve the polity. The region has a strong democratic tenet and its peaceful history has meant that it tends not to deal harshly with political rebels; thus yesterday's revolutionaries, after causing considerable economic and social upheaval, loss of development momentum, and even loss of life, usually end up either living quite respectably in the society or, consistent with the traditional regional pattern, migrating to a middle-class life, in greener pastures.

The time is ripe for concrete regional action to deal with what no longer can be considered a marginal problem or problems that arise largely because of psychotic hegemonical policies. Indeed, there is even a possibility that the United States could retreat into a navel-gazing phase in which "minor" problems could be left to stew in their own juice, since Washington would have no sense of

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[20] Commonwealth emphasis both in bilateral and multilateral programs has been on economic assistance and cooperation.

[21] See: Garcia Muiz, Humberto. Boots, Boots, Boots: Intervention, Regional Security and Militarization in the Caribbean. Caribbean Project for Justice and Peace, Puerto Rico, 1986; Phillips, Dion E. Barbados and the Militarisation of the Eastern Caribbean. *Bulletin of Eastern Caribbean Affairs*, v. 11, no. 6, Jan/Feb 1986; Simmons, David. Militarization of the Caribbean; Concerns for National and Regional Security. *International Journal*, v. 40, no. 2, Spring 1985.

an ideological threat and clearly has never had a sense of being responsible for nurturing the progress of the CARICOM area. Regional security will have an economic cost, but prevention often runs cheaper than cure, and the suggested emphasis herein is on a system rather than on creating a substantial military establishment. There may well be advantageous impacts on foreign policy since the region will be seen from the outside world as being one security arena, which should be of some significance for relations with the United States, Venezuela, and Brazil. In some domestic circles, the development of a regional security agreement might be looked at as both premature and dangerous, since it would be arriving before regional political unity. Such objections should not be a hindrance, as the security system would not be such as to increase "militarization" and its presence and functioning is likely to deepen the integration process. Moreover a security arrangement of limited scope would be for defensive proposes and need not commit any member state with respect to extraregional issues; however, its existence could have the added advantage of encouraging prudence in the foreign policy of individual member states.

What is required then is a commitment to a collective approach to security. A regime to that end, which requires both urgent research and discussion, would involve the following:

1. A mechanism for peaceful settlement of disputes through good offices, mediation, and conciliation. According to the circumstances, this could be collectively triggered through the CARICOM Secretariat or bilaterally.
2. Agreement on what constitutes threats to security involving regional consultation and, in certain cases, action. The sticky points here would be the political cases since regional consensus should be easily achieved vis-a-vis the regime of the seas, drugs and arms trafficking and disaster cooperation. Guidelines would need to be developed with regard to the type of situations in which intervention is acceptable. Equally necessary would be agreements and machinery to ensure that immediately after a successful intervention, there would be steps to arrange for a genuine democratic assessment of the wishes of the populace.
3. A mechanism for calling rapid meetings of a relevant agency to deal with a "threat" scenario. In the July 1990 case of Trinidad and Tobago, for instance, the meeting of the Heads of Government was ad hoc and fortuitous (as a meeting was already scheduled). The rules of operation of such an agency would be crucial and would cover questions on whether a request for a meeting and for "action" could come from any government or only from the beleaguered government, the vote necessary for "action" (consensus or majority), and the authority for requesting extraregional security assistance. In the 1983 Grenada situation, for instance, it was argued in some quarters that an invitation to an outside power should only proceed on a consensus vote.
4. Research into the types of sanctions, other than military force, that could be effectively applied in the case of a crisis. In the Grenada crisis, regional governments clearly lacked any expe-

rience with such alternatives. But if a sanctions regime had already been in place, and ready for activation, it might have served as a constraint on the radical faction.

5. Agreements on size, nature and training of regional forces and their possible roles. It is true, for instance, that Port-of-Spain's reluctance in July 1990 to accept the RSS was conditioned by the lack of an agreed formula for inviting such troops and of understandings as to their role. The routine priority use of regional force units would be in combating narcotics and terrorism, and in helping with civil assistance operations. There is no suggestion here that such forces need be any larger than present establishments, though they would need better training and equipment. The training should also be oriented to heighten their regional consciousness, civic sensibilities, and democratic values. In the July 1990 Trinidad and Tobago case, there were some signs of an uneasy balance between the military command and the "rump" government that was in charge during the crisis. There was an unfortunate impression of a "strong" military command that was clear about what it wished to do, capable of doing it, and thus in command of the situation in contrast to a "weak" regime that could not really command respect and that did not solve either the political/economic problems of the state or the immediate crisis. A government in such a crisis, negotiating only with its own military could be at a disadvantage, and the public's confidence in the government might waver; however, if there were a regional force, this psychological aspect should not arise.
6. Significant upgrading of the regional communications information and intelligence system and networking.[22] The need here cannot be overstressed; a comprehensive outline can be found in the *Vulnerability Report*[23] which also stresses the need for linking into and receiving support from metropolitan networks. An adequate regional intelligence network could have alerted CARICOM both to the developing tensions in Grenada in 1983 and the arms supplies in advance of the Trinidad 1990 crisis. Domestic regimes also demonstrate major weaknesses in terms of the use of information, and the Port-of-Spain authorities were constrained by this factor in handling the crisis.[24]
7. An understanding that collective action could be undertaken by appropriate sub-groups, e.g., the OECS, or that there could be an ad hoc arrangement.
8. Diplomatic initiatives through the UN and the OAS aimed at achieving an implicit understanding in friendly metropolitan centers that security in small states requires continuing financial and logistical support from those sources. Equally important is the need for post-crisis financial and economic support,

[22] Security cooperation is a new concept for the region and needs fostering. Whereas intelligence cooperation seems to flow smoothly between the RSS states and Jamaica, the links with Trinidad and Tobago have not been satisfactory in practice to date.

[23] See: Commonwealth Secretariat. *Vulnerability*. p. 47–51.

[24] Small states in such situations are particularly vulnerable to the phenomenon of prestigious international media getting access to sensitive areas where the government might itself not have access. Such media intervention itself sometimes leading to further complications.

since the early restoration of confidence is a vital aspect in achieving a stable society.

At the same time that an agreement on collective security is achieved, it would be necessary to establish agencies which underpin the maintenance of democratic practices in the territories so that normal and valid protest would not be frustrated. Such arrangements would include at the formal level, a CARICOM Commission on Human Rights and a CARICOM Court of Appeal, and at the informal level, a regional undertaking that no government would hinder the invitation by private bodies of outside unofficial observers to national elections.

Regional governments should signal that in the future they would not feel restrained in condemning a CARICOM regime or other regional government for internal repression as such matters impact on regional security and welfare.

A collective approach also implies collective action in respect of extra CARICOM security issues; machinery for "coordination of foreign policies" already exists through the CARICOM Committee of Foreign Ministers. Contemporary international relations make such coordination even more necessary than ever, and there are security issues within the wider region that are best dealt with collectively, e.g., the cases of Cuba and Haiti. With the end of the Cold War, U.S. pressure on Cuba is increasing and CARICOM states should stretch their diplomatic wit to ensure that the ultimate resolution is not harmful to their regional interests. With regard to Haiti, it is in CARICOM's interest that it be an integral partner in the settling of the crisis there. A useful contribution is clearly within its capacity, but would require a more vigorous role in OAS councils.

CARICOM member states should be aware of the necessity for continuous "confidence-building" efforts vis-a-vis the United States so as to avoid major misunderstandings, given the strategic location, for the United States, of the Caribbean region, and given the know-how and information which is available in that country.[25] More attention should be paid to lobbying in the United States with relevant interest groups and both governmental and non-governmental agencies. Similar activity is also needed with regard to the key Latin American neighbors—Brazil, Mexico, and Venezuela—and the United Kingdom.

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[25] The U.S. foreign presence in the region, apart from that of France, the Netherlands, Britain, and Venezuela has meant that the 1979 OAS proposal to declare the Caribbean a "zone of peace" has had little chance of getting off the ground.

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HAITI'S TROUBLED PATH TOWARDS DEMOCRACY AND U.S. POLICY CONCERNS

by Maureen Taft-Morales *

CONTENTS

SUMMARY

The overthrow of Haiti's first democratically elected president in September 1991 propelled Haiti into its worst crisis since popular protests brought down the 29-year dictatorship of the Duvalier family in 1986. Father Jean-Bertrand Aristide was elected President of Haiti in a landslide victory on December 16, 1990, in what was widely heralded as the first free and fair elections in the country's 186-year history. A Catholic priest of the radical left, he was inaugurated on February 7, 1991, only to be overthrown by the military on September 30. The army pressured the legislature into naming a supreme court judge as interim President; blocked an agreement that the Organization of American States (OAS) brokered between legislative leaders and Aristide calling for Aristide's return; and negotiated an agreement with the parliament in June 1992 that made no mention of Aristide and installed the army's own candidate, Marc Bazin, as Prime Minister. The coup dashed optimism that, after years of blocking democratic efforts and of

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futile attempts at ruling, the Haitian army was now committed to democracy. Given the climate of violence since the downfall of the Duvalier dictatorship in 1986, many were concerned over the level of violence that the post-coup crisis continued to produce.

The United States and the OAS called for Aristide's reinstatement, which is apparently desired by the mostly poor populace who elected him but resisted by several influential sectors of Haitian society. On October 8, 1991, the OAS voted to impose a trade embargo against Haiti after sectors of the army, legislature, and business class refused to negotiate Aristide's immediate return to power. The Bush Administration cut off all aid to Haiti immediately following the coup, and formalized participation in the OAS embargo on October 29, 1991, banning almost all trade with Haiti. At first, the only exceptions were for humanitarian aid, such as medicine and food, and air travel. In February 1992 the Administration lifted the embargo for some assembly plants. In May the OAS tightened its trade embargo against Haiti, in response to the military-backed government's refusal to cooperate with the OAS-brokered agreement.

The main U.S. foreign policy concern is the restoration of democracy to Haiti. In light of the embargo's failure after 10 months to force the *de facto* government to allow Aristide's return, some observers argue that stronger actions should be taken to put muscle into the embargo, such as a multilateral military intervention. Others argue that the embargo should be ended because it is causing irreparable economic and ecological damage to Haiti. If the OAS can secure an agreement for Aristide's return, it wants to send a civilian democratization mission. If the reluctant Haitian sectors agree to Aristide's return, other troubling issues will arise, including: the assurance of Aristide's personal security; the possibility of a violent popular backlash; and whether Aristide can govern effectively—and democratically—if returned to office by force of external pressure, which many Haitians view as foreign intervention in sovereign Haitian affairs. The degree of stability and democracy in Haiti also affects other U.S. concerns. These include U.S. immigration policy toward the increasing number of Haitians trying to migrate to the United States; selecting suitable levels and means of aid in meeting the basic needs of the Haitian people, who are among the poorest in the world; and the increasing use of Haiti as a narcotics transit point with the alleged involvement of the Haitian military.

VIOLENT AND AUTHORITARIAN TRADITIONS

Politics in Haiti have been generally violent and authoritarian, ever since Haiti became an independent republic in 1804, when African-descended slaves revolted against their French colonial masters. Between the end of the rule of Toussaint Louverture (leader of the slave rebellion) in 1803, and Francois Duvalier, founder of the 30-year dictatorship that fell in 1986—both of whom declared themselves president for life—were some 30 other despotic rulers. This legacy will be difficult to overcome. In addition, most of the traditional centers of power in Haiti, such as the military, the Catholic and Protestant churches, the business sector, and the traditional elite, find reformist ideas threatening. The government apparatus is still staffed principally by Duvalierist appointees, many of whom have resisted change during the numerous post-Duvalier governments and will most likely continue to do so.

LONG-STANDING RACIAL CONFLICT

Haitian history is marked by conflict between two racial groups: the mulatto elite and the majority blacks. The vast majority of Haitians are black, poor, illiterate peasants. The mulattos established their economic power and elite status principally by controlling the business sector. Both groups enjoyed periods of political dominance. Black rulers generally emphasized Haiti's African roots and traditions, including the African-based folk religion, voodoo. The mulatto elite emphasized a European, Catholic tradition. Because of their superior education, mulattos held some government positions even during black rule.

Race relations have improved in recent years—the once disdained Creole dialect of the majority is now an official language spoken by all Haitians; interracial marriages are common; and the government is no longer as dominated by mulattoes. But recent political events have again heightened racial and class tensions within Haiti. The poor black majority's only access to power has been through public protests, when tolerated, and the recent elections. The mulatto elite wield most of the economic and political power in Haiti, and generally resist dramatic changes suggested to improve the lot of the poor majority.

U.S. OCCUPATION OF HAITI AND THE DUVALIER LEGACY

For much of this century, Haitian history was also marked either by occupation government or the authoritarian Duvalier regime. The United States intervened in Haiti in 1915, under the rationale of stopping civil strife and preventing Germany from establishing a foothold there. The Marines stayed until 1934, overseeing public works, tax collection, treasury management, and the development of a native constabulary. Some of these contributions were welcome and much needed. But the U.S. presence was also deeply resented as an affront to Haitian sovereignty. Many Haitians charged the United States with discriminating against blacks by placing mulattoes in positions of power.

Francois Duvalier and his son Jean-Claude ruled Haiti for nearly 30 years, leaving behind a legacy of repression and corruption. Francois, or "Papa Doc," Duvalier became President in 1957 through elections marred by numerous irregularities. Although Duvalier ran on a platform calling for political liberty and social reform, within a year he had established himself as a dictator. Under his rule, arbitrary imprisonment, torture, and unexplained deaths became commonplace. The Duvaliers' private militia, the Tontons Macoutes, carried out most of the repression. The Macoutes—Creole for "bogeymen"—were loosely organized armed gangs enlisted by the Duvaliers to eliminate opposition to their rule through violence and extortion. The Macoutes also served to counterbalance the army's power, which the Duvaliers kept in check to prevent military coups. In 1964, the elder Duvalier had the constitution amended to make himself president-for-life. In 1971, three months before his death, he had it amended again so that he could name his 19-year-old son Jean-Claude president-for-life.

In the 1980s, "Baby Doc" Duvalier's marriage to a prominent mulatto and their opulent lifestyle stirred up much resentment among the poor black majority who lived in absolute poverty. In addition, fiscal corruption was so rampant in Jean-Claude's government that it became known as a "kleptocracy." As popular dissatisfaction rose, his regime grew increasingly repressive. In the face of massive popular demonstrations and pressure from abroad, Jean-Claude Duvalier fled the country for France on February 7, 1986. The United States encouraged and helped arrange his departure.

Difficult Path Towards Democracy

A NEW CONSTITUTION THWARTED BY MILITARY-DOMINATED GOVERNMENTS

Aristide's ouster ushered in the seventh government in the five and one-half years since Duvalier's departure. The first interim government was a 6-man, military-dominated National Council of Government (CNG) that disbanded the Tontons Macoutes and allowed the drafting of a new constitution. The new constitution, which over 99 percent of Haitian voters reportedly approved in a plebiscite, guaranteed personal liberties; distributed power among a president, a Prime Minister, and two legislative houses; and transferred the police to the department of justice. It also created an independent electoral council to oversee elections leading to the inauguration of a civilian government in February 1988. Members of the armed forces and anyone closely associated with the Duvalier family dictatorship were barred from running for office. But Duvalierists, in collaboration with the army, thwarted the November 1987 elections by mounting a violent campaign that culminated in the killing of dozens of voters on election day; as a result of the violence, the elections were suspended.

In January 1988, the CNG ran its own elections, widely viewed as rigged in favor of Leslie Manigat, a long-exiled academic. But less than 6 months later, on June 20, 1988, Manigat was ousted in a military coup when he tried to replace officials and reform the government. Lt. General Henri Namphy, CNG president and close friend of Papa Doc's, seized power. During the 31 months that Namphy ran the government (February 1986 to September 1988), human rights violations increased, with numerous political killings. Namphy was succeeded by Lt. Gen. Prosper Avril, who promised a transition to democracy. But under Avril's regime, human rights continued to be routinely violated, as reported by the U.S. State Department, human rights groups, and others. Violent popular protests forced Avril to resign after 18 months.

CIVILIAN-APPOINTED INTERIM GOVERNMENT

As a result, in March 1990, a civilian government was appointed with the mandate of holding elections as soon as possible. A coalition of political and civic organizations selected Ertha Pascal-

Trouillot, the only woman on the Supreme Court, as provisional President. A State Council was established with the objective of giving policy guidance to the executive branch. The Council severed relations with the executive branch, however, after the executive branch failed to consult the Council or to take action against political violence. President Trouillot headed what was generally considered a weak civilian government, unable or unwilling to stand up to the military. She established and cooperated with an independent electoral council that organized successful elections at the end of the year.

ELECTION AND OVERTHROW OF THE ARISTIDE GOVERNMENT

Hopes that Haiti would leave behind its authoritarian past were raised on December 16, 1990, when Haitians elected a President, national legislators, and municipal officials. Despite security concerns and lack of a democratic tradition, voter turnout was estimated to be 70 percent on election day, and international observers declared the elections generally free and fair. The elections were in part the result of a strong democratic movement that had emerged in the late 1980s in support of an elected government that would establish order in a non-repressive manner. The democratic movement encompasses many elements of Haitian society, including political parties as well as peasant, labor, human rights, and professional organizations. Many observers also credited the success and relatively peaceful nature of the elections to the heavy presence of international observers, whose presence the government of Haiti had requested, and to the economic and material support provided by many nations and international organizations.

Jean-Bertrand Aristide was elected President with 67.5 percent of the vote, and was inaugurated on the fifth anniversary of the collapse of the Duvalier dictatorship. A 37-year-old populist Roman Catholic priest, he was the most controversial of 11 candidates ruled eligible to run by the independent Provisional Electoral Council (CEP). To his supporters, Aristide is a martyr, willing to risk his life to defend the poor. An advocate of "liberation theology," Aristide spoke out against Duvalier and the military rulers who followed him. In September 1988, an armed group attacked and burned Aristide's church, killing 13 and wounding 70; surrounded by his parishioners, Aristide escaped unharmed. To his detractors, Aristide is a potentially dangerous demagogue, whose inflammatory oratory they say encourages the rampages, known as *dechoukajes*, or "uprooting" in Creole, in which suspected Tontons Macoutes are attacked or killed by angry mobs. Aristide reportedly denies that his book, *100 Verses of Dechoukaj*, condones violence. Nonetheless, the Salesian religious order expelled him for preaching politics from the pulpit, including what the order called "class struggle."

When Aristide became a candidate, he toned down his revolutionary and anti-U.S. rhetoric. Aristide previously opposed democratic elections in Haiti, arguing that free and fair elections were impossible as long as Duvalierists still had a hold on economic and political power. Nonetheless, he joined the race in response to former Tontons Macoutes chief Roger Lafontant's potential candidacy.

Lafontant was ruled ineligible to run for the presidency, and in early January 1991, he led an attempted coup against President Trouillot in an effort to prevent Aristide—whom he called an "ultra-communist"—from taking office on February 7, 1991. Lafontant seized the national palace and tried to declare martial law. Instead, the army arrested Lafontant and promised to have him tried in the civilian courts. The popular celebration that followed turned violent as crowds hunted down and lynched dozens of suspected Macoutes. Mobs also burned down the 220-year old cathedral, in apparent retaliation for a homily by the Archbishop—whose relations with Aristide have long been tense—that warned of a coming "regime of authoritarian politics." Many foreign diplomats criticized Aristide for not condemning the street violence quickly or forcefully enough.

President Aristide was faced with some of the most serious and persistent social, economic, and political problems in the western hemisphere. After 8 months in office, Aristide had received mixed reviews. He was credited with curbing crime in the capital, reducing the number of employees in bloated state enterprises, and taking actions to bring the military under civilian control. But some observers questioned the new government's commitment to democracy. Neither Aristide nor his Prime Minister belonged to a political party, and leaders of other political parties criticized him for not reaching out and establishing a spirit of cooperation among the democratic elements. Many legislators, including some from Aristide's own coalition, protested the President's appointment of Supreme Court judges and ambassadors without consulting the Senate as required by the constitution. Aristide later agreed to consult the legislature, but relations between the two branches remained strained.

Aristide was also criticized for his attitude toward the judicial system. Lafontant was tried in July 1991 for his role in the failed January coup attempt. Aristide called for a life sentence—which Lafontant received—although the constitution limited sentences to 15 years. Aristide declared the next day a national holiday. Many observers expressed concern over the trial, saying it differed little from trials under the Duvaliers—it lasted for over 20 consecutive hours, important witnesses were not called, and the court appointed five lawyer trainees to defend Lafontant because even his own lawyer felt it too dangerous to defend him.

Initially criticized for not having a clear plan, the Aristide government in July 1991 presented a macroeconomic reform and public sector investment plan to representatives of several nations and international lending institutions, who lauded the plan and pledged $440 million in FY1992 aid. Most of that aid was suspended because of the coup that overthrew Aristide's government on September 30, 1991.

Some observers believe that as President, Aristide helped to polarize the situation in Haiti by refusing to condemn violent acts of retribution, and holding out the threat of mob violence against those who disagreed with him. For example, Aristide refused to condemn the practice of "pere lebrun", or burning someone to death with a tire necklace. After the former head of the Tontons Macoutes was sentenced to life in prison, Aristide gave a speech in which he noted that without popular pressure and the threat of "pere lebrun" in front of the courthouse, the life sentence would not have been chosen. [1] In exile, Aristide has condemned the practice of necklacing.

The September 1991 coup began just four days after Aristide addressed the United Nations, an event he reportedly said marked the end of Haiti's dark past of dictatorship. Upon his return to Haiti, he gave a speech that observers thought appeared to threaten the bourgeoisie for not having helped his government enough. [2] Some saw it as another factor leading to his overthrow days later, and say that members of the bourgeoisie are financially supporting the coup leaders. The State Department estimated coup-related deaths at 300–500, while Amnesty International estimated them to number over 1,500.

CONFRONTING THE COUP

INTERNATIONAL RESPONSE

The leaders of the 1991 coup faced stronger international sanctions than did previous coup leaders, largely because a democratically-elected government was overthrown. The United States, France, and Canada, Haiti's largest foreign aid donors, suspended all aid to Haiti, as did Venezuela and the European Community (EC). Most international aid to Haiti had been only recently renewed, having been cut off when the 1987 elections were thwarted. In addition, Haiti is a test case for a new commitment on the part of the OAS to defend western hemisphere democracies. For the first time in its 40-year history, the OAS's members were all elected democracies, some still facing threatening militaries. With this membership, the OAS in June 1991 set up a new automatic mechanism for convening OAS foreign ministers to respond within 10 days to a coup against an elected government. Within two days of the coup, the OAS had demanded Aristide's immediate reinstatement; meeting resistance from several Haitian sectors, the OAS then imposed a trade embargo against Haiti. In February, the OAS facilitated an accord between Haitian legislative leaders and Aristide that called for Aristide's eventual return.

Among the complaints lodged against Aristide to the OAS were charges that he had violated the constitution in his dealings with the legislature, appeared to advocate mob violence, and was training an elite militia to be under his direct command. The OAS acknowledged the validity of some of these concerns, and was willing to negotiate their resolution, but does not accept them as justification for a coup. Aristide accepted the idea of a coalition government, and stated he would condemn mob violence if he were returned to Haiti. The question of the militia remains unclear, but a report by several human rights groups says that Aristide was cre-

[1] Foreign Broadcast Information Service. Daily Report, Latin America. President Aristide Addresses Youth Rally. August 8, 1991, p. 4–5.

[2] Eaton, William. "Haitian Coup Leader Meets OAS Delegates". Los Angeles Times, October 6, 1991, p. A15.

ating a small, well-trained security force to ensure his personal protection, similar to the U.S. Secret Service. [3]

A week after sending President Aristide into exile, the military pressured the legislature into appointing a figurehead President and Prime Minister. The regime resisted international demands that Aristide be restored to office; blocked the OAS-sponsored agreement; proposed an alternative agreement that made no mention of Aristide; and proposed new elections but with no timetable. In June 1992, the government installed Marc Bazin, a conservative economist and Aristide rival, as Prime Minister. The interim President stepped down, leaving the presidency vacant and Bazin to form a consensus government. Bazin says he will meet with Aristide "without conditions" to find a solution to the post-coup crisis. Bazin won only 13 percent of the vote in the December 1990 presidential elections, compared to Aristide's 67 percent. The Bush Administration and the OAS have said they will not accept any agreement that does not recognize Aristide as the legitimate President of Haiti.

Meanwhile signs of dissension have been reported within the Haitian military, raising questions over the future of Brig. General Raoul Cedras—an Aristide appointment—who participated in the coup. Some military elements argue for Aristide's return, while others have threatened to overthrow the military or kill Aristide if he returns. The State Department and human rights groups reported serious human rights abuses under the interim government, including arbitrary arrests, tortures, extrajudicial killings, and disappearances.

The OAS has been frustrated in its efforts to restore Aristide to office. Elements of the military and the economic elite have consistently rejected OAS efforts to negotiate a solution. The OAS-sponsored agreement would grant a general amnesty, reportedly meant to include the coup-makers. But Aristide has since said several times that Cedras and others must be brought to justice. Many observers express concern over Aristide's unclear stance, and say it weakened support for the agreement. The OAS embargo has not been fully effective, either. The EC could not agree on an embargo, and continues to ship goods to Haiti; sporadic oil shipments, some linked to OAS members, have kept the country fueled. Moreover, in February the United States eased the embargo for some largely U.S.-owned assembly plants.

U.S. RESPONSE

U.S. policy, as of July 1992, is to pressure the government that came to power to restore the democratically elected government of President Aristide. Toward that end, the United States joined members of the OAS and other nations in imposing an embargo and other sanctions, such as cutting off foreign aid.

Some U.S. observers advocate a long-term policy of supporting the democratic movement within Haiti, even under unconstitutional governments, by encouraging leadership and other grassroots de-

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[3] Americas Watch, National Coalition for Haitian Refugees, and Caribbean Rights. Haiti: The Aristide Government's Human Rights Record. November 1, 1991. p. 16–18.

velopment programs through private voluntary organizations (PVOs). Supporting democratic elements in Haiti poses certain problems, especially under autocratic governments: the democratic movement is not united; Duvalierists have targeted those they consider a threat to their political or economic power; and PVOs say there is a limit to the funding they can contribute. Nonetheless, there is a strong democratic movement within Haiti, and democratic elements can be found within most sectors of Haitian society. Others in the policy community question the priority of U.S. interests in Haiti and the rationale for significant U.S. investment of resources, effort, and risk in Haitian affairs.

In its immediate response to the coup, the Administration reaffirmed the U.S. Government's "unequivocal support for constitutional rule in Haiti and for the democratically elected government of President Aristide." President Bush refused to recognize the military junta, and said that the United States would continue to recognize President Aristide as the duly elected President of Haiti. The President also called for Aristide's immediate return to power, and said the Administration would be working closely with the OAS to achieve that goal. The Administration acknowledged as legitimate some of the concerns expressed by the military, the legislature, and the business sector, but maintains that they do not justify the illegal military overthrow of a democratically-elected government.

In accordance with current legislative restrictions [4] prohibiting foreign assistance to countries whose elected governments are overthrown in a coup, the United States suspended most aid to Haiti for FY1992 as well as most aid that was left in the pipeline for FY1991. The Administration froze Haitian government assets in U.S. banks, and threatened to freeze U.S. assets of wealthy Haitians found to be financing the coup. In October 1991, the State Department ordered the departure of all nonessential embassy personnel, and warned U.S. citizens in Haiti to leave "as a precaution against a possible deterioration in the security situation." Although several hundred U.S. Marines were deployed to the U.S. base in Guantanamo, Cuba, to evacuate U.S. citizens if their lives were threatened by ongoing violence, President Bush said that he would be "reluctant" to use U.S. troops to restore Aristide to office. On January 27, 1992, the Administration recalled U.S. Ambassador Alvin Adams to protest a Haitian police attack on a political meeting attended by Rene Theodore, Aristide's designated Prime Minister. The Ambassador returned a month later.

Many observers praised the Administration's initial forceful response to the coup, but accused the Administration of diminishing its efforts once the number of Haitians trying to reach U.S. shores swelled. The severity of human rights violations committed by the *de facto* government and the military were understated, these critics charged, in order to justify the return of Haitian migrants. They further criticized the White House for not acting more forcefully against those who supported the coup financially: the Administration did not carry out its threat to freeze the U.S. assets of

[4] P.L. 102-266, Joint Resolution making further continuing appropriations for FY 1992.

coup backers, nor did it cancel their tourist visas until eight months after the coup. The Bush Administration denied that its policy of preventing Haitian migrants from reaching U.S. shores—which required cooperation from the *de facto* government—affected either its human rights reporting or the strength of its response to that government.

U.S. POLICY CONCERNS

The chief concern of the United States is how to promote the democratic process and stability in Haiti. The lack of security engendered by gross violations of human rights impedes the democratic process and is also an important concern. Other U.S. concerns include determining to what extent and how to help meet the basic needs of the Haitian people—amidst the U.S. trade embargo—and responding to the increasing use of Haiti as a narcotics transit point. Closely related to the issues of democracy, human rights, and basic human needs is the issue of Haitian immigrants and the U.S. policy of interdicting migrants fleeing Haiti by boat.

DEMOCRACY, STABILITY, AND HUMAN RIGHTS ISSUES

In the past, the United States has been somewhat concerned about stability in Haiti as part of a broader security interest in the Caribbean region, but in general, humanitarian concerns have been more important. Despite its location 50 miles across the Windward Passage from Cuba, Haiti has not been considered particularly vulnerable to leftist radicalism or outside intervention, if only because of the severity of domestic repression. Now, however, popular expectations have been significantly raised regarding democratic and social changes, and many observers worry that the current regime's refusal to allow Aristide's return or the desire for revenge following his return could, like the September 1991 coup attempt, result in widespread violence.

Up until Aristide's overthrow, many observers had been cautiously optimistic about Haiti's transition to democracy, encouraged by the smoothness of the December 1990 electoral process and the army's quelling of a coup. Others, however, remained concerned about security during the early stages of the elected government. Elements that opposed the elections, some of whom threatened violence against their opponents, included anti-democrats on the far left, and elements of the army, Duvalierists, and the Tontons Macoutes on the right. Many believe that rightist groups were threatened by Aristide's revolutionary rhetoric and by his ability to tap into the resentment of the poor majority and its desire for change. Once the election was over and international attention shifted away from Haiti, the old guard felt freer to resort to violent means to prevent Aristide—the target of several earlier assassination attempts—from making the sweeping changes he had promised.

Since the downfall of Duvalier, U.S. policy has advocated a democratic process in Haiti. Beginning in October 1987, the United States suspended most assistance to the Haitian government until it adhered to the democratic process set forth in the 1987 Haitian constitution. In March 1990, following the appointment of Trouillot's civilian government, some U.S. aid was restored. The United States provided $3 million in technical and budgetary support to the Haitian elections, which included U.S. observer missions. The United States also provided the OAS with about $0.5 million to assist in monitoring the election process. Following the installment of an elected civilian government, the United States allotted $84 million in FY1991 aid to Haiti, a 55 percent increase over FY1990 funding, and requested $87 million in assistance for FY1992. However, all aid to the current Haitian regime is now suspended. To underscore U.S. commitment to the democratic process, President Bush met with Aristide at the White House after the coup, and has demanded Aristide's reinstatement and supported OAS efforts toward that end. Some critics charge, however, that the Administration's concern over the high number of Haitians trying to reach U.S. shores has weakened the Administration's resolve to pressure the regime for Aristide's return.

Obstacles to Change

For decades, the army has been responsible for widespread human rights violations. Under the military-dominated interim governments, the army frequently impeded the democratic process. After the departure of the last military dictator in March 1990, however, some observers believed there had been a transformation of the army to one supportive of democracy. Throughout the 1990 electoral process, the 7,000-man army proved itself capable of establishing and maintaining order. Several factors accounted for the change, including attrition of anti-democratic elements with the downfall of the various interim governments; the army's inability to form a viable government; a new generation of officers interested in reform and professionalization of the armed forces; and growing domestic and international pressure for a civilian democracy. Initially, the army accepted Aristide's assertion of authority, including his purge of the Haitian army high command. Brig. General Cedras, who oversaw security for the December elections, was reportedly a reluctant participant in the coup. But as its spokesman, he said Aristide was ousted for "meddling in army affairs." Some analysts argue the army does not want to relinquish control so that it can continue to profit from contraband- and narcotics-trafficking.

In its attempts to implement provisions of the Haitian constitution that impose civilian authority over the military, the Aristide government met significant army resistance. For example, the constitution calls for the separation of the police from the army, with the police under the command of the Ministry of Justice. The law also mandates that cases involving military abuses against civilians be tried in civilian courts, not by the military. The military had resisted previous efforts to execute those laws. No military personnel were prosecuted for human rights abuses under any of the interim governments. When he was overthrown, Aristide was trying to attack corruption, carry out reforms in the army, and create a civilian police force.

The military's trend toward improved human rights under the Aristide government was reversed after the coup, according to the State Department's 1991 human rights report. That and other human rights reports state the military uses violence to intimidate political opposition, popular organizations, the urban poor, and the media. The resulting climate of fear and repression, and communications and travel difficulties have made gathering information on human rights abuses extremely difficult.

Many former members of the army and the Tontons Macoutes still have weapons and terrorize the populace. Dealing in contraband, robbery, and extortion, they profit from insecurity and chaos. None of the interim governments prosecuted perpetrators of past human rights violations or sent consistent signals that Macoute violence would not be tolerated. An angry public sometimes took matters into its own hands, carrying out "popular justice" or summary public executions of suspected Macoutes. The Aristide government has been charged with appearing to condone such tactics, but was also credited with lowering the crime rate in the capital, and with detaining many "terrorists". There has reportedly been a resurgence of Tontons Macoutes activity since Aristide's ouster.

Many Haitians consider remaining former Duvalier officials a threat to a return to democracy. In July 1990 the return to Haiti of prominent Duvalierists widely believed responsible for the 1987 election violence prompted a general strike that closed down Port-au-Prince and many of the provinces. Police ignored warrants issued for their arrest.

IMMIGRATION ISSUES

The 10-year U.S. policy of interdicting Haitian migrants on the sea has come under attack since the coup. In a series of court challenges, the courts imposed three temporary restraining orders prohibiting the forced return of Haitian boat people. The U.S. Supreme Court lifted the ban on repatriations on January 31, 1992. Opponents of the program charge that it violates international law, and discriminates against Haitians for racial reasons. They also argue that the interview process aboard U.S. cutters did not allow Haitians a full and fair hearing: those found to be subject to persecution upon return to Haiti were allowed to apply for political asylum; economic migrants fleeing poverty were repatriated to Haiti. Haitians interdicted for a second time since the coup, known as "double backers", say they were targeted for retribution upon their return. On February 24, 1992, the Supreme Court rejected an emergency appeal to halt repatriations until these charges could be investigated. On May 24, 1992, President Bush issued an Executive Order for the immediate return of all Haitians in boats on the high seas to Haiti, where they may apply for refugee status at the U.S. Embassy. The Administration's new policy of returning all Haitians found at sea without conducting asylum interviews was challenged in the courts as being in violation of international accords. The legal challenge has gone to the Supreme Court, which announced that it will rule on the policy. Until that time, the Supreme Court has allowed the process of immediate repatriation to continue. In 1992, legislation was introduced in the U.S. Congress to suspend deportations of Haitians until a democratic government is restored in Haiti. [5]

The interdiction policy is based on a bilateral agreement negotiated between the Reagan and Duvalier governments in September 1981 that permitted the U.S. Coast Guard to interdict boats on the high seas and to return undocumented passengers to Haiti. Haiti is the only country with which the United States has such an agreement. In 1980 and 1981, as many as 2,000 undocumented Haitian migrants a month sought to enter the United States. U.S. aid to the Haitian government was partially conditioned on its cooperation with U.S. efforts to control illegal immigration. Haitian migrant interdiction operations were exempted from the 1987 aid suspension, and continued to receive cooperation from the Haitian government despite the cutoff of other aid. The Aristide government reportedly wanted to review the agreement. The *de facto* regime cooperated with the repatriation of would-be migrants to date, but some question whether it will use its cooperation as leverage with the U.S. government.

From September 1981 through October 1990, the Coast Guard interdicted 22,651 Haitians at sea. During those nine years, less than a dozen of the interdicted Haitians were allowed into the United States to apply for asylum. The year 1990 saw the lowest level of interdictions in 7 years, and the Coast Guard reported that, during some months of Aristide's 1991 term, it did not encounter a single Haitian refugee boat. Both Haitian and U.S. officials reportedly attributed this to the new hope Haitians had for improved conditions under the newly elected government. After Aristide's ouster, the exodus rose sharply, with over 38,000 Haitians picked up at sea between the coup and July 1992. Five months after the coup, the Immigration and Naturalization Service (INS) had found about 35 percent of the Haitian migrants interviewed to have plausible claims to asylum. After the policy of immediate return was implemented, the number of Haitians attempting to flee the island dropped sharply.

After the courts first barred the U.S. government from returning any Haitian boat people, temporary camps were set up on the U.S. Naval Base at Guantanamo Bay, Cuba. Interviews to pre-screen possible asylum claims were conducted at the base. Soon after the Supreme Court lifted the ban, the Bush Administration resumed repatriation of Haitians and some interviewing aboard cutters.

The crux of the current debate is twofold: what is the cause of the Haitians' flight; and are those that are being forcibly returned being persecuted. The Administration argues that the majority are fleeing poverty, and are therefore ineligible for political asylum, and further states that there is no evidence that repatriated Haitians have been harmed. Refugee advocates argue that many are likely to face political persecution at home from the current military-dominated government—which is not recognized by the Administration—and that conducting inadequate or no interviews result in returning many who might have legitimate claims to refu-

[5] For further discussion of U.S. policy on Haitian migration, see U.S. Library of Congress, Congressional Research Service. *Haitian Migration to the United States: Issues and Legislation.* Issue Brief 92021 (regularly updated) by Ruth Ellen Wasem.

gee status. They also argue it is extremely dangerous and difficult to investigate claims of persecution.

The Administration has expressed concern that a policy shift might encourage large numbers of Haitians to attempt a dangerous journey that leads to the death of half of those who try it. The Administration also argues that repatriation of Haitians spares U.S. taxpayers the economic burden brought on by a flood of refugees.

Some critics have argued that emigres should not be returned as long as information regarding what is going on in Haiti remains so sketchy. Until human rights and other conditions can be better assessed, argue some, Haitians should be granted temporary protected status, so that no Haitians facing harm at the hands of the Haitian military are returned. (Such status was granted to Kuwaitis when their country was invaded by Iraq.) Others argue that such status should be granted because the United States shares responsibility for the increased economic hardships brought on by the embargo. The Administration reportedly fears that providing temporary haven will swell the number of Haitians attempting to flee to the United States.

Some Members of the U.S. Congress and others have also expressed concern that there may be an element of racism in U.S. refugee policy toward Haiti. Very few Haitians seeking asylum were granted it, in contrast to the almost automatic granting of permanent residence to Cubans. Some critics argue that it is racist not to give Haiti the same designation "of special humanitarian concern" given Cuba, considering Haiti's decades-long record of oppression. In response to such criticism, the Administration said it was reorganizing part of the INS and reducing the role of the State Department in the asylum-seeking process to make it more equitable and consistent for all nationalities. The INS also instituted new guidelines in March 1991 to improve the interviewing of Haitian emigres. When the Administration began returning Haitian "boat people" without any interviews, charges of racism were renewed. Refugee advocates argue that the policy violates a United Nations convention prohibiting all countries from sending back to a country persons who have legitimate claims of political persecution. The Bush Administration argues that Haitians are not being interdicted in U.S. waters, and so are not entitled to the protection of either the U.S. Constitution, or the Immigration and Nationality Act, which embodies the U.N. convention.

SOCIOECONOMIC DEVELOPMENT IN HAITI

Haiti is one of the poorest countries in the world. Living conditions for the poor majority in Haiti have not changed significantly in many decades. National income per capita is $370, [6] and about half the population is unemployed. The vast majority of Haiti's 6.3 million people live in absolute poverty and about 63 percent of the population is illiterate. Only 33 percent of the population has access to potable water. Infectious disease is widespread among the poor; in addition, acquired immune deficiency syndrome (AIDS) became a significant health threat in the 1980s. More than half the

[6] World Bank. *World Development Report 1992*. p. 218.

population reportedly suffers from malnutrition. The infant mortality rate is 92 per 1,000 births. Life expectancy is about 56 years (as compared to 76 years in the United States). Only one-third of Haitian soil is cultivable, yet some 70 percent of the population depends on agriculture, most engaged in small-scale, subsistence farming. [7] Overpopulation and overcultivation of arable land have led to considerable deforestation and erosion, a process exacerbated by embargo-driven fuel shortages.

Disorder and labor strikes before and since Duvalier's departure have led to significant economic deterioration and the collapse of the once important tourism industry. In the past, foreign manufacturers successfully recruited and trained Haitian work forces, but the current embargo closed down most of the export assembly industry. Some firms reopened after the Bush Administration eased the embargo for some largely U.S.-owned assembly plants in February. But many firms have relocated elsewhere because of the political and economic instability.

Many news reports indicate the embargo is having a devastating economic and ecological impact on Haiti. The U.S. Embassy reportedly estimated that 120,000 jobs had been lost in the assembly, service, and local industrial sectors. Fuel shortages have led to power blackouts, limited, more costly public transportation, and serious ecological damage as Haitians cut trees for charcoal in an already eroded landscape. Health problems are expected to worsen as well: a measles epidemic has been reported; lack of refrigeration for vaccines has diminished some immunization programs; some health and sanitation projects have been suspended under the sanctions; and unconfirmed reports say cholera may have reached Haiti. In June 1992, a leader of a major development organization in Haiti noted that since the coup, the situation has deteriorated from extreme poverty to "a state of virtual famine in some parts of the country." [8] The OAS has provided some food and medicine through a humanitarian program to offset the impact of the embargo on the poor, but many observers believe a much broader humanitarian program is needed.

The United States has provided economic aid to Haiti since 1973, primarily through development and food assistance. U.S. aid was limited in the past largely because of concern about the corruption, inefficiency, and repression associated with the Duvalier government. U.S. aid to the Haitian government was increased after Duvalier fled, but then was suspended after the election day massacre in November 1987. The State Department deemed the Trouillot government to have met the conditions for restoration of aid set forth in the FY1990 foreign assistance appropriations act (P.L.101-167), including taking adequate steps to provide electoral security; as a result, $57 million in economic and humanitarian aid was provided to Haiti in FY1990 (most of the humanitarian aid was given through nongovernmental organizations, or NGOs). The FY1991 aid package included almost $38 million in development assistance,

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[7] U.S. Agency for International Development. Congressional Presentation Fiscal Year 1991. Annex III, Latin America and the Caribbean. p. 148,150-151.

[8] Testimony of Kim Johnson, CARE, before the House Select Committee on Hunger. June 11, 1992. p. 1.

and $32 million in P.L. 480 food aid. While assistance to the Haitian government was suspended after the coup, humanitarian assistance in the form of food and some development assistance has continued, with delivery through NGOs.

DRUG TRAFFICKING

Since 1983, Haiti has become the second most important transit point, after the Bahamas, for cocaine shipments between Colombia and the United States, according to the Drug Enforcement Administration (DEA). In January 1988, a DEA informant testified in Federal court that top officials in the Haitian government were smuggling cocaine from Colombia to Miami. Well-informed analysts say that some members at all levels of the military have been involved in drug trafficking. While President, Aristide had said combating drug trafficking was a top priority of his government. According to a March 1992 State Department report, the same is not true of the *de facto* government, and drug activity has grown since the coup. [9]

The 1991 U.S. aid suspension included suspension of any narcotics programs carried out with the Haitian army. Narcotics interdiction funds had not been included in the 1987 aid suspension, and continued to flow to the interim governments, and the DEA opened an office in the U.S. embassy in Haiti that year. The U.S. and Aristide governments had signed an agreement providing for joint support of Haitian counter-narcotics projects. Because of the September 1991 coup, this accord has not been implemented.

POSSIBLE FUTURE ACTION

How the United States and the rest of the international community further respond to the overthrow of Haiti's first democratically-elected President depends in large part on whether the ruling Haitian forces continue to oppose Aristide's reinstatement or negotiate his return. The latter seems more unlikely as the months go by without any movement in that direction.

Some observers feel that the economic and political isolation of Haiti are the strongest sanctions that should be taken against the current regime. Proponents of continuing sanctions such as the embargo argue they are an indispensable source of leverage for the United States and other nations to press for the restoration of the constitutional order. They hope that the embargo will so isolate Haiti's military and economic elite that they will eventually be forced to agree to return Aristide to office. Some of these observers believe the *de facto* Haitian government will allow Aristide's return if his power is greatly limited, for example, as head of a coalition government that guarantees the participation of those sectors that felt excluded by Aristide.

If an agreement for Aristide's return is reached, the OAS has proposed sending a 500-member civilian observer group to oversee Aristide's return and democratic institution-building. This option raises concerns over the safety both of Aristide and of a non-mili-

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[9] U.S. Department of State, Bureau of International Narcotics Matters. International Narcotics Control Strategy Report, March 1992, p. 40.

tary group, and whether the military will respond to strictly diplomatic pressure. It is also uncertain whether the international community is willing to fund such a mission.

Other analysts believe that the ruling Haitian forces will continue to refuse to allow Aristide's reinstatement, and will insist on new elections. Many of the poor majority, who are basically excluded from any negotiating process, have reportedly said they would boycott any new election, and insisted that Aristide, who was already elected by the majority, must be reinstated. Many observers worry that such diametrically opposed stances between the ruling elite and the Haitian majority will lead to violent social unrest within Haiti.

Numerous observers are calling for an end to the embargo for a variety of reasons. Some have opposed such sanctions from the beginning, arguing that they would not solve the problem of a military unwilling to accept civilian authority and would contribute to social upheaval. Sanctions would also eliminate what leverage the United States has, they argue, and therefore be counterproductive to other U.S. interests such as efforts to control illegal migration. Others are concerned that the embargo has only served to unite the various elite sectors in face of what they perceive as foreign intervention in their sovereign affairs. Rather than hurting those groups that represent obstacles to democracy, they argue, the embargo is hurting the poor the most, and exacerbating already dire economic and ecological conditions. Because the embargo is not serving its purpose of hastening Aristide's return, and is causing so much damage, many argue it should be ended.

Some Members of the U.S. Congress and of the OAS have advocated military intervention, either by U.S. or international peacekeeping forces, because sanctions and diplomacy so far have failed to restore Aristide to office. The Bush Administration is hesitant to use military force because Haiti is not viewed as a major security threat; many Haitians still resent the U.S. occupation of Haiti earlier this century; and U.S. officials are wary of a long-term commitment in a chronically unstable and destitute country. A U.S. military specialist reportedly estimated that it would require an invasion force of up to 25,000 troops and take three years to establish control and security in Haiti.

Many observers are concerned that if stronger action is not taken soon to force the military-backed government's hand, the embargo could simply fall apart, and the international community, weary of the intransigence some perceive on both sides of the stalemate, could gradually accept the *de facto* government.Although Prime Minister Bazin has expressed a willingness to meet with Aristide, few in or outside of Haiti believe he will work seriously for Aristide's return. Some argue that he will make an effort to appear willing to negotiate, in hopes of making Aristide—who initially refused to meet with him—look inflexible, and make himself look more acceptable to the international community. Even if Bazin is sincere, many fear that as soon as he makes any serious effort to restore Aristide or carry out reforms the army will oust him, just as they did Leslie Manigat in 1988.

Still others recognize concerns over Aristide's commitment to the democratic process, but argue that the international community has an obligation to restore Aristide, a democratically elected head of state, as a matter of principle. If Aristide is found to be violating the constitution, they say, then the community should encourage Haiti to address the problem through the democratic process—including impeachment if necessary—rather than through a coup.

Some Haitian politicians and other analysts see the elimination of the Haitian military and its replacement with a domestic police force as the only way to resolve the power struggle between the military and democratic civilian governments. This solution is not likely to occur without outside military force.

THE CUBAN ECONOMY: CRISIS AND CHANGE IN THE 1990s

By Richard F Kaufman *

CONTENTS

INTRODUCTION

In the wake of the collapse of communist systems in the former Soviet satellites in East Europe and in the Soviet Union itself, questions are raised about the viability of the smaller communist countries such as Cuba. Cuba's economy has been deteriorating and is now in a vulnerable position, if for no other reason, because of its dependence upon the former Soviet Union and the dramatic reductions of trade with and aid from Russia and the other successor states. These changes in its relations with the former Soviet Union significantly darken Cuba's economic prospects.

Whether Cuba undergoes the kind of upheaval that has occurred elsewhere in the communist world will be determined by a number of factors.Recent experience shows that the state of the economy will be one of the key factors and could be decisive. For this reason alone, it is important to understand economic developments in that Caribbean country.

This report surveys the available public-source literature on the performance of the Cuban economy, in an attempt to pull together in a single document the broad outlines of recent Cuban economic performance, along with a review of the economic challenges ahead for the country.

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* The author is General Counsel of the House Joint Economic Committee, U.S. Congress.

This has not been an easy task. As the appendix notes, there has been no concentrated effort on the part of official U.S. government sources to maintain comprehensive data on Cuban economic performance. No alternative private sector source of comprehensive data has been developed, in part because the U.S. trade embargo limits the need of U.S. corporations for information about Cuba. Academics with an interest in the Cuban economy are sharply divided in their assessment of Cuban performance and even on the nature of data on the Cuban economy.

As a result of these limitations, and in the absence of comprehensive and reliable official statistics, it is extremely difficult to produce any definitive summary of recent Cuban economic performance. This report focuses, therefore, on issues where there is broad agreement among sources. Where such a consensus does not exist, the report attempts to describe the principal alternative positions in the debate over the issues.

Measurements of Performance

Measuring the performance of centrally planned economies is difficult because of the problems of access to information. Most experts recognize that in state-managed systems, government controls over prices and other aspects of economic activity distort measures of performance, creating uncertainties about the trends. False reporting by enterprises to the government, hidden inflation, official secrecy, and misleading government figures, are among the typical problems found in such systems. For these reasons, experts disagree over the appropriate indicators and their precise meaning. There is always a wide range of uncertainty about the performance of centrally planned economies. [1]

GROWTH AND DECLINE

The statistical series commonly used in market systems to assess at a glance the state of the economy is growth of gross national product (GNP) or gross domestic product (GDP). The closest Cuban measure is called global social product (GSP), a much narrower concept than GNP. The term GSP refers to the gross value of output of the "productive" sector, comprised mostly of industry, agriculture, and construction, and excludes services not directly connected with the production of material goods. Excluded from GSP are government administration, defense, education, health, banking, personal services, and other activities considered "non-productive." The Cuban measure thus excludes activities considered as part of overall economic output in the West. On the other hand, GSP is a gross value concept (as opposed to the Western concept of value added) which includes the value of intermediate stages of production. The inclusion of the intermediate stages involves considerable double-counting. Despite these and other limitations, the official GSP statistics are widely employed in the West to estimate the size of the Cuban economy, and whether it is growing or contracting.

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[1] See the Appendix to this paper for a discussion of data problems and implications for monitoring the Cuban economy.

The most recent official Cuban figure for GSP is for 1989 when it was reported as 26.7 billion pesos. It is not easy to convert this figure into terms meaningful in the West, such as U.S. dollars. The U.S. Central Intelligence Agency (CIA) estimate for Cuba's 1990 GNP in dollars is $20.9 billion, and $2,000.00 per capita. [2]

The rates of change of GSP are more important than its size, for assessing the trends and the present state of the economy. Keeping in mind the fact that there are many uncertainties about statistics published by the Cuban government, the figures show that since the revolution of 1959 the economy has gone through alternating periods of stagnation, growth, and decline. There is disagreement among Western experts about the actual growth rates. Some believe the growth rates were substantially below official figures, some believe they were close to the official figures. The consensus seems to be that although the official figures exaggerate the rates somewhat, there was growth in the years for which growth is reported.

Two things stand out from the historical record. One is that the period from the early 1970s through the first half of the 1980s was one of sustained although uneven growth. The second feature is the stagnation and decline that has occurred since 1985. Figure 1 shows the growth rates of GSP for 1963–89, in 5-year annual averages. The period 1966–70 shows very little growth. There were two years in which the economy declined (1966 and 1969) and one in which growth was close to zero (1970). In the early 1960s, Cuba confiscated the holdings of U.S. firms and the U.S. trade embargo against Cuba was imposed. There was very rapid growth in the first half of the 1970s and better than average growth in the first half of the 1980s.

There are, characteristically, differing explanations for the trends. One view holds that to the extent that the Cuban economy expanded in the past, it was a consequence of the shift to market type reforms and massive economic aid from the Soviet Union. Those who share this view point to the change in government policy from the collectivization efforts and the heavy emphasis on consumption during the 1960s, resulting in poor economic performance, to the increasing use of market mechanisms, material incentives, and greater investment during the 1970s and the early 1980s. This change in policy, together with the substantial transfers from the Soviet Union and the East European countries in the form of economic assistance and trade preferences, allegedly brought about the improved performance. But, it is argued, Cuba remains a monoculture economy whose most important industry is sugar. The economy has been vulnerable to the vagaries of the world sugar

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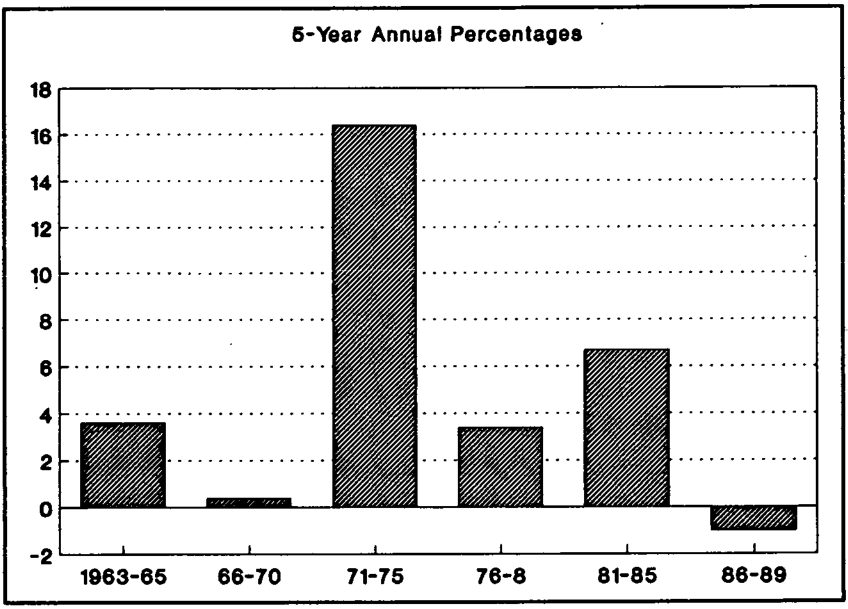
[2] *Anuario Estadistico de Cuba, 1989*, p. 82; U.S. Central Intelligence Agency, *The World Factbook, 1991*, p.76. Although the CIA has not fully explained the methodology underlying its figures, the agency has provided generally more accurate estimates of the size of other centrally planned economies than have been provided by the foreign governments themselves. However, disclosures made since the communist governments of East Europe were overturned show that the CIA and other Western estimates of the size of those formerly centrally planned economies tended to be too high; some experts believe the CIA's estimates of the size of the Chinese economy are too low. Many observers suspect that the CIA's estimates for Cuba may also be imprecise. There is presently no way to prove or disprove their accuracy with the available information and methodologies.

Figure 1. Growth Rates of GSP, 1963-89

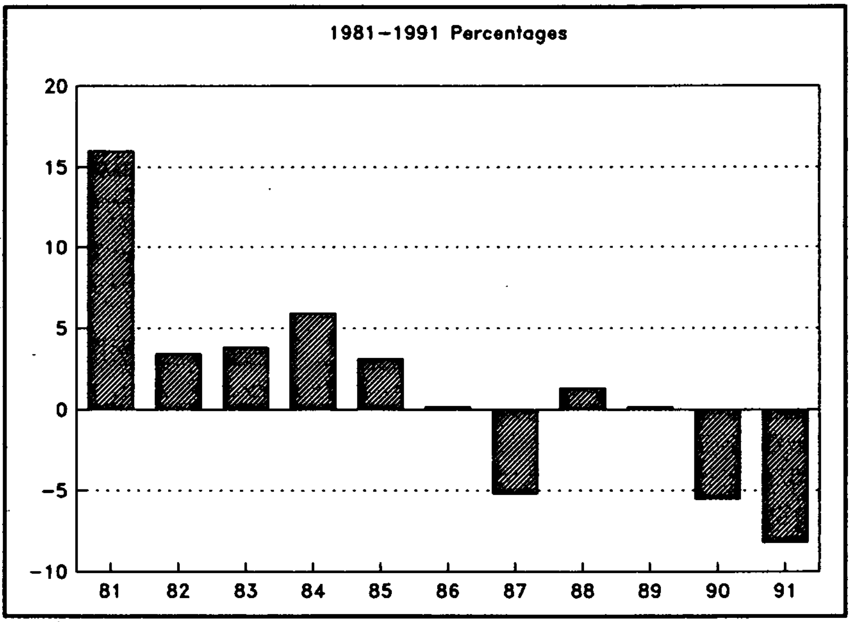


market, limited by the rigidities of communism, and propped up by Soviet aid.

Another group of analysts see the period from 1971 through the mid-1980s as one of sustained growth. They maintain that the period of strong growth that began in the 1970s was a result of government policies designed to counteract the U.S. embargo through the establishment of new industries and the enlargement of foreign trade. They emphasize the improvements in health, education, health care, and other social services provided by the government, the more equitable income distribution, and the progress towards diversification of agriculture and manufacturing. They also argue that Cuban economic performance has been better than that of many other Latin American countries, and would have been better still were it not for the U.S. embargo.

In the 1980s, there was a dramatic turnaround in Cuba's fortunes. The long period of growth ended in 1986 and the economy has been going down hill ever since. Figure 2 shows the annual growth rates of GSP since 1981. It can be seen that after above average growth in the first half of the decade a period set in of stagnation or decline. (The last year for which official figures are available is 1989. The figures for 1990 and 1991 are estimates.) In light of the disruptions in economic relations between Cuba and the East European countries and the Soviet Union, unofficial reports of shortages and deterioration of living conditions, it is reasonable to assume that the economy is continuing to contract. However, in the absence of official statistics, there is no comprehensive body of data on which to base firm estimates of economic performance after 1989.

Figure 2. Annual Growth Rates of GSP



POLICY CHANGES

The 1986 turnaround coincided with a dramatic change in Cuban government policy. To place the policy change in perspective, it is necessary to go back to the mid and late 1970s. In that period, Cuba introduced its first 5-year plan (1976–80), tightened discipline in the economic system, and paradoxically, also gradually introduced reforms intended to decentralize parts of the economic system. A two-track policy of tighter central controls and selected market reforms was followed. The farms were collectivized while farmers were allowed to sell surplus items in free markets where prices were set by supply and demand. The state budget was reintroduced and the statistical system was improved. Private activity was authorized in personal services, handicrafts, and homebuilding. State enterprises were decentralized and given authority to hire and fire workers, pay wage differentials, borrow money, and make investment decisions. The enterprises were also required to be self-financing, that is, to meet their expenses out of revenues, and to show a profit.

In 1986, Castro announced a new policy which he called "rectification." In a stroke, most of the market type reforms were terminated on the grounds that they had led to immoral, wasteful, and corrupt behavior. The farmers' free markets and private homebuilding were abolished. Enterprise decisionmaking was recentralized.

Expert opinion is divided over the motivation for this campaign. Some attribute it simply to an ideological desire to re-impose control over society, while others see it as a result of the growing scarcity of resources caused by reduced foreign exchange earnings and a reaction against the corruption and other excesses that accompanied liberalization.

By 1987, a modest austerity program was put in place alongside or perhaps as a part of rectification. But, it is argued by some, the reforms were not completely halted. Private market activities in housing and services were curbed and more tightly regulated, not completely prohibited, and some private price setting was allowed. From this perspective, rectification was largely a consequence of economic problems and the economic decline precipitated by difficulties in the international sector, not a cause of the decline. [3]

RESPONSES TO THE PRESENT CRISIS

Havana took a number of steps during the mid and late 1980s, in addition to the modest austerity measures mentioned above, in response to the economic slide, and in anticipation of worse conditions to come. The government knew that Soviet and East European trade and aid would diminish and that the effects would be adverse.

One initiative was the formation of labor "brigades" and elite "contingents" of workers in 1986 and 1987, ostensibly as part of the rectification program. The stated purpose was to increase production in certain areas such as housing and agriculture, and to improve productivity. A food self-sufficiency program was begun in 1988 which included the establishment of youth villages for young volunteer farmers, construction of a large number of storage centers, and greater attention to transportation and distribution. [4]

Official figures for investment in the second half of the 1980s show a shift in this period from heavy to lighter industries such as those involving food production. The shift suggests a decision to emphasize import substitution industries. Such decisions are normally taken for the purpose of capturing home markets and reducing reliance on imports. Some experts believe Cuba has been pursuing both an import substitution and export promotion policy since 1986. [5]

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[3] For different viewpoints on the causes and effects of the Rectification Program, see: Mesa-Lago, Carmelo. Cuba's Economic Counter-Reform (*Rectification*): Causes, Policies and Effects. *The Journal of Communist Studies*, December 1989; Perez-Lopez, Jorge F. Rectification At Three: Impact on the Cuban Economy. *Studies in Comparative International Development*, Fall 1990; and Zimbalist, Andrew. Reform and Economic Performance in Cuba, paper presented at the Annual Meetings of the American Economic Association, December 1990.

[4] Haines, Lila. Food Self-Sufficiency Assessment. *Cuba Business*, February 1991. p. 8-11.

[5] *Cuba Business*, August 1991. p. 6-7; *Annual Statistical Yearbook of Cuba, 1989*; *Cuba Business*, June 1991. p. 7.

There were renewed efforts in this period to increase tourism and to attract foreign investment from the West. Ambitious targets were set for construction of hotels and recreational facilities and in 1988 Castro went so far as to proclaim this plan "economic priority number one." [6] The policy of diversifying trade away from the communist countries was also given added impetus.

Cuba's economic problems were greatly worsened by the disruptions in relations with the East European countries following the 1989–90 upheavals in those countries, and the growing delays and shortfalls in deliveries from the Soviet Union. By the end of the decade, Castro was acknowledging the crisis publicly. A comprehensive austerity program was imposed in 1990. Known as the Special Period in Peacetime, the austerity program encompasses strict conservation measures, efforts to increase food production, cuts in the Communist Party bureaucracy, and rationing of many food products and consumer goods. In 1991, the government prepared a "Zero Option" contingency plan which would go into effect if trade with the Soviet Union was cut off completely. The zero option suggests something like a subsistence level economy.

The combined effect of the deterioration of international conditions and austerity has been to send the economy, already weakened by several years of stagnation and contraction, into its deepest downturn. While experts differ over precise magnitudes, there is agreement that GSP declined sharply in 1990. Living standards have been hit hard, especially in Havana and the larger cities where the public transportation and health care systems have been undermined by the lack of fuel and medicines. In addition to its other conservation measures, the government is importing hundreds of thousands of bicycles and promoting their use to replace motor vehicles. Large numbers of people are being relocated to rural areas to work in food production. On the farms, oxen and horses are replacing mechanized equipment.

The government's efforts to conserve resources include a scale-down of public services, cutbacks of administrative costs, and reductions of industrial operations. Steps were also taken to increase food production and expand trade with non-socialist countries.

Further belt tightening and hardships are inevitable, as Castro himself has warned the public. The senior economist of the Bank of Cuba said in September 1991 that the economic situation was the worst he had seen in the 24 years he had been at the bank, and he expected very difficult times for the next 3 or 4 years. [7] Castro reiterated this idea at the Fourth Party Congress, where he said, "we have not yet entered what could be described as the most critical phase of a special period." [8] How deep and prolonged the crisis will be depends to a great extent on what happens in the sugar and energy sectors, and what happens there will be determined largely by Havana's relations with the former Soviet Union and the international community.

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[6] Radio Marti Program, United States Information Agency, *Cuba—Quarterly Situation Report, Third and Fourth Quarters 1988*. p. 157.

[7] Fraser, Damian. Cuba to face "zero-option." *Financial Times*, September 13, 1991.

[8] Speech by Fidel Castro, Havana Radio and Television Networks, October 11, 1991, in BIS *Daily Report, Latin America*, October 15, 1991. p. 4.

TWO KEY SECTORS: SUGAR AND ENERGY

The sugar and energy sectors are important to the Cuban economy for different reasons, but they are linked together by the roles they play in international trade. Sugar has long been Cuba's most important product, a major employer, and the leading source of exports. Before the revolution, it was thought that the country was too dependent on sugar and too vulnerable to the wide fluctuations in world market prices. In the first few years of the revolution, there were efforts to de-emphasize its production, but these were soon abandoned. Average annual sugar production rose steadily from about 5.5 million tons in the early 1970s to 7.8 million tons in the early 1980s. Sugar receives about 20 percent of total investment, and lands for sugarcane cultivation have increased in recent years. [9]

Cuba's comparative advantage as a relatively efficient producer of sugar has enabled the country to become the world's largest exporter of that commodity. Domestic consumption in the past few years has been about 11 percent of production. The remainder has been sold abroad. Cuba has benefitted from its ability to produce more sugar than it consumes, but the dependency on this product can be a disadvantage if production or world prices fall. Sugar accounted for 73 percent of merchandise exports in 1989.

In the 1990/91 crop year, 7.6 million tons were produced, a slight decline from the year before, in part because of shortages of fuels, lubricants, and parts. According to CIA figures, annual sugar exports were about level at 7.0 -7.1 million tons during 1988–1990. Other sources indicate sugar exports declined during this period. [10]

In the late 1980s, about 54 percent of Cuba's sugar exports went to the Soviet Union, 14 percent to East Europe, 11 percent to China, and the remaining 21 percent was sold on the world market. In 1990, exports to East Europe declined and, although the volume of sales to the USSR declined slightly, the share of sales to the USSR increased slightly. In the past, sales to the Soviet Union and East Europe were based on five-year bilateral trade agreements which covered a multitude of products. The prices in the agreements are believed to have favored Cuba and, because they were stable for the duration of the agreements, insulated Cuba against the sugar price fluctuations of the free market.

Cuba's most important import from the Soviet Union, or any other country, has been oil. Through the late 1980s, Soviet annual oil shipments averaged 13 million tons per year. This constituted about 70 percent of Cuba's energy requirements and over 90 percent of apparent oil consumption. In 1990, Soviet oil shipments were reduced to 10 million tons. [11] Table 1 shows Cuban sugar exports worldwide and Cuban imports of oil from the USSR.

Havana has been seeking, with only limited success, to reduce its foreign energy dependence. Domestic oil production reached 936,000 tons in 1986, about four times the amount of production in

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[9] Perez-Lopez, Jorge F. Sugar and the Cuban Economy: Implications After Thirty Years. *Journal of International Food & Agribusiness Marketing*, v. 3(2), 1991. p. 31.

[10] Hagelberg, G. B. Sugar File—Production and Exports Drop. *Cuba Business*, August 1991, p. 3; Lichts, F. O. *World Sugar Balances*, February 14, 1991.

[11] Mazza, Julia. Reworking the Oil Equation. *Cuba Business*, October 1990. p. 5.

TABLE 1. Cuban Worldwide Sugar Exports and Oil Imports From the USSR 1986–90.

(million tons)

	1986	1987	1988	1989	1990
Total Sugar Exports	6.7	6.5	7.0	7.1	7.2
Oil Imports From USSR	13.1	13.5	13.5	13.3	10.0

1981, but declined to just over 700,000 tons in 1989 (the most recent year for which figures are available). The first Cuban offshore oil drilling platform was assembled in Cardenas Bay in 1991. A nuclear power facility has been under construction at Juragua for a number of years, with the help of technicians from the former Soviet Union. In 1992, Russia reportedly agreed to assist in the completion of the nuclear plant.[12] Plans for two additional nuclear facilities may be in jeopardy. Small amounts of energy are supplied by hydroelectric facilities and other sources such as sugarcane bagasse, biogas, solar power, and windmills.[13]

In the past, petroleum and other products imported from the Soviet Union were part of the five-year bilateral agreements and gave Cuba what are believed to be favorable prices and stable supply commitments. Cuba was thus able to avoid the price shocks and supply disruptions that other oil consuming countries were subjected to. In addition, Soviet oil deliveries regularly exceeded Cuba's consumption requirements, allowing Cuba to re-export the excess for hard currency.

FOREIGN TRADE AND AID

As the discussion of the sugar and energy sectors shows, the Cuban economy has strong links abroad. It is not unusual for a small country to emphasize foreign trade. Some developing nations have used a trade-oriented strategy to promote industrial development and growth. Cuba followed a different course which has not enabled it to restructure the economic base in a way that would substantially reduce dependency. Its dependence on sugar and a single large trade partner has not changed much since the revolution.

THE SOVIET UNION AND EAST EUROPE

The economic relationship with the former Soviet Union and the former bloc countries of East Europe served, until recently, to offset the effects of the U.S. trade embargo. It allowed Cuba to exchange sugar and other goods and services for the goods and services it needs. Cuba's trade with Western and developing countries has been a small share of its total trade. In the 1980s, trade with the Soviet Union and East Europe accounted for more than 80 percent of Cuba's total trade, most of which was with the Soviet

[12] Haines, Lila. Nuclear Plant Way Behind Schedule. *Cuba Business*, July/August 1992. p. 2.
[13] *Cuba Business*, February 1991, p.12; Zimbalist, Andrew and Claes Brundenius, *The Cuban Economy*, Baltimore, 1989. p. 149–150.

Union. Table 2 shows the distribution of trade with the Soviet Union and other trade partners in 1988.

TABLE 2. Total Cuban Trade By Trading Partner 1988.

(Percentages)

Soviet Union	69.1
East Europe	14.4
Latin America	3.4
China	3.1
Spain	1.7
Japan	1.5
West Germany	1.1
Others	5.7
Total	100.0

The role played by the former bloc countries in the Cuban economy was pervasive. The East European countries were a source of financing for development projects and a wide variety of imported food items and manufactured goods, especially manufacturing, agricultural, and transportation equipment. East European technical advisers helped build and staff Cuban industrial plants.

The former Soviet Union's role has been much larger as evidenced by the high bilateral trade volumes and its deep involvement in Cuba's development. Several hundred construction and other economic projects have been completed with Soviet assistance. During 1985-90, 174 projects received Soviet support. At the beginning of 1990 there were 3,000 Soviet technicians in Cuba. In 1991, the Soviets were involved in more than 80 construction projects valued at over $500 million. Fifteen percent of Cuba's gross industrial capacity is reportedly of Soviet vintage. [14]

As might be expected, there was great Soviet activity in the energy sector. Among the Soviet-assisted energy projects in Cuba are the construction of the Juragua nuclear power plant, the East Havana thermoelectric plant, the Cienfuegos petroleum refinery, construction of an oil supertanker port at Matanzas, and a new oil pipeline. Other ongoing projects include the construction of two nickel plants, construction or expansion of factories for the production of steel, cement, weapons, and textiles, and the refurbishing or overhaul of various industrial facilities.

QUESTIONS ABOUT ECONOMIC AID

Many believe that Cuba received billions of dollars worth of aid annually from Moscow, and lesser amounts from East Europe. [15] It is not possible to be precise in measuring the amount of Soviet aid, and the methodology used to make dollar estimates of Soviet aid is questionable. One obstacle to measurement is the fact that trade transactions with Cuba prior to January 1991 were ostensibly priced in rubles or Cuban pesos, both nonconvertible currencies.

[14] Radio Marti Program, United States Information Agency, *Cuba Situation Report*, December 1989, p. 22-23; *Cuba Business*, February 1991, p. 15.

[15] CIA, *The Cuban Economy: A Statistical Review*, Washington, 1989, p. 39, 40.

Estimates of the value of aid based on conversions of these ruble and peso prices into U.S. dollars are not reliable.

Undoubtedly, Cuba benefitted from its relationship with the Soviet Union, but most of what is termed economic assistance is the trade subsidy believed to be implicit in the prices for the products that are exchanged. In addition to the trade subsidies, Cuba received modest amounts of direct aid for development projects and trade credits.

For 1990, the largest single aid component was the implicit sugar subsidy, estimated at $2.5 billion for that year. An examination of this component of the estimate will demonstrate part of the problem.

The trade subsidy is defined as the difference between the price paid for a product and the world market price for that product. The USSR is said to have paid prices for Cuban sugar far above the world market. Therefore, it is reasoned, the sugar subsidy is the amount per ton above the world price paid by the USSR, multiplied by the tons of sugar purchased.

The price allegedly paid by the Soviets for Cuban sugar was 42 cents per pound. The world market price is about 10 cents per pound. Cuba, many conclude, received a 32 cents per pound subsidy. But the price is set in rubles, not dollars. To derive the dollar value of the ruble price, rubles are converted to pesos, and pesos are then converted to dollars.

The official exchange rate of the ruble and peso, according to the Soviet and Cuban governments, is 1 ruble equals 1.1 pesos. The Cuban official exchange rate of the peso and dollar, is 1 peso equals one U.S. dollar. The Soviet official exchange rate of the ruble and dollar has varied recently. For purposes of the U.S. estimates of Soviet aid to Cuba, a ratio of 1.10 rubles to the dollar has been used.

It should be obvious that the official exchange rates greatly overvalue the ruble and peso relative to the dollar. The unofficial "street" value of the ruble in Moscow was about 20 rubles per dollar in 1991. The street value of the peso was about 6 pesos per dollar in 1991. If these rates were used to calculate what the Soviets are paying for sugar in dollars, the amount would be at or below the world market price and there would be no sugar subsidy.

There is a more fundamental problem with estimates of Soviet aid. Relationships between the Soviet Union and its client states have been notoriously difficult to sort out by the partners themselves. Before the East European countries broke away from Moscow, there were many disputes over who was benefiting and by how much, and the short and longer term consequences of the trade arrangements among them. Each side claimed it was subsidizing the other.

Part of the difficulty is that it is not possible for communist systems to know the real values of goods and services because of the national accounting systems they use, because prices do not reflect market values, and because of inadequacies in the statistical systems. Another problem is that Soviet aid and trade are typically tied and the selection and nominal prices of Soviet products involve opportunity costs for the recipients. There are many complaints about the poor quality of manufactured goods that communist partners are required to accept from one another.

All of these factors were present in Cuba-Soviet economic relations. Some observers have tried to get around the subsidy measurement difficulties by viewing the relationship as basically a barter arrangement with sugar and oil as the principal products of exchange, and by comparing changes in the relative amounts that are exchanged. The question they ask is, how much sugar must Cuba export to receive a given amount of Soviet oil? If a ton of sugar is exchanged for more barrels of oil in one year than in some prior year it may be argued that the implicit subsidy has risen. Or, if the ratio of sugar to oil exchanged in a given year goes up it may be argued that the sugar subsidy has been reduced. In fact, the amount of oil ostensibly obtained per unit of sugar declined over the past decade, indicating a reduced subsidy. [16]

This approach has the virtue of highlighting the underlying economic reason for Cuba's dependency on the former Soviet Union. Its limitation is that it ignores the other goods and services that are exported and imported, changes in supply and demand among the trade partners, world price changes, and the value of financial credit and development aid provided by the former Soviet Union.

BREAKING RELATIONS

The process of change in Cuban relations with its traditional socialist trade partners began in the late 1980s and accelerated in the early 1990s. All bilateral trade agreements between Cuba and the East European countries expired in 1990 and new agreements have not been entered into. There was a substantial reduction of Cuban trade with these countries in 1990. By January 1991, most of them shifted their trade to a hard-currency basis and were reorienting it towards the West.

Changes in the sugar trade illustrate East Europe's new commercial outlook, as well as the unrealistic basis for the previous relationship with Cuba. In the past, about one million tons of Cuban sugar were exported annually to the region, despite the fact that there is usually ample supplies of beet sugar from East European production. Poland, for example, is a net sugar exporter. [17] Most of the Cuban sugar was formerly re-exported for hard currency. Presently, this trade has been largely discontinued. Except for small purchases by Bulgaria and Czechoslovakia in the six-month period ending April 1991, sugar exports to the region have been halted. [18] In general, most bilateral trade appears to have ended, most of the East European technical advisors have left Cuba, and most of the Cuban guest workers in East Europe have returned home.

The situation with the former Soviet Union is less clear. Some ties are being broken; some may remain for the foreseeable future. The relationship is under stress because Russia wants to reduce what it believes has been the burden of its involvement in Cuba. The Castro government has resisted change and is having difficulty

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[16] *Cuba Business*, February, 1991, p. 2; Turits, Richard. Trade, Debt, and the Cuban Economy. In *Cuba's Socialist Economy Toward the 1990s*, Zimbalist, Andrew, ed. Boulder, 1987. p. 175.

[17] Lichts, F.O. *International Sugar And Sweetener Report*, February 8, 1990.

[18] *Cuba Business*, February 1991, p. 2.

Congress in October 1991, Castro said that trade with East Europe "has practically disappeared." [21]

The change in relations with the former Soviet Union will cause a greater shock. Cuba's trade with the USSR has been about 70 percent of its total trade. While the amount and significance of Soviet economic aid to Cuba has been exaggerated, the importance of Soviet trade with Cuba cannot be. Cuba's industrial development and ability to transfer resources to social programs and foreign activities were made possible through its commercial relations with the Soviet Union.

Different scenarios of change are possible. If there is a rapid, complete break with the former Soviet Union, the Cuban economy could be reduced close to a subsistence level. The sugar crop and much of the citrus and other goods could probably be sold elsewhere at market prices, but the hard currency earned would not be sufficient to pay for the oil, manufactured items, wheat and other food products that Cuba requires. Industrial activity would plummet and there would be severe erosion of the standard of living.

A complete break is not beyond the realm of possibility. Castro was angered over the Soviet decision to pull military forces out of Cuba and the fact that he was not consulted before the decision was announced. There were bad feeling between the leaders and a sense of betrayal on Cuba's part. The collapse of the Soviet empire was another blow for Cuba. Before the breakup, Republic officials had been urging the end of trade preferences for all developing countries and in 1992 they were apparently ended for Cuba.

The likelihood is that the governments will do what is in their economic self-interests and that trade volumes will decline over a period of years, not all at once. The former Soviets need the sugar it gets from Cuba and would have to pay hard currency to obtain it elsewhere. Cuba needs the oil and many other products it has been receiving. In June 1992, the Cuban trade ministry announced that sugar and oil agreements had been signed with Russia and Kazakhstan for the first half of 1992, and agreements for the exchange of sugar and foodstuffs had been signed with Belarus and Latvia.

The key factor will be the rate of the decline of trade. There was a modest reduction of trade in 1990 and a greater decline in 1991. As mentioned above, Cuban sources indicate another large cutback in 1992. [22]

The economic effects of the military disengagement will depend on the real amount and composition of former Soviet military aid (which is not precisely known), the rate that it is phased down, and Cuba's response. Withdrawal of a few thousand troops and their families will have little effect on the economy. Assuming most of the aid consists of the costs of weapons and equipment transferred to Cuba, and some share of their operations and maintenance, the question for Havana is whether to reallocate resources to make up for what Moscow stops providing.

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[21] Speech by Fidel Castro, October 11, 1991, ibid.

[22] Official statistics reportedly showed only 38 percent of the goods which the USSR agreed to ship had arrived in Cuba by September, 1991. Nearly all of the promised fuel shipments had been received but less than half of the grain and wheat flour, and very little of other foodproducts, fertilizers, and lumber. Mexico City *NOTIMEX*, October 18, 1991, in FBIS *Daily Report*, Latin America, October 21, 1991. p. 3.

In 1989, Cuba spent the equivalent of about $1.4 billion for defense, or an estimated 6 percent of GNP. [23] A decision to replace Soviet military aid would mean diverting resources from the already strained civilian sector and could add substantially to the defense burden. If the government decides otherwise, or defers a decision, the immediate economic effects will be minor.

NEW TRADE PATTERNS

In an attempt to offset the losses in East European and Soviet trade and assistance, Cuba has been working to expand export earnings and commercial ties with other countries. This strategy faces several hurdles. Many potential Western partners are constrained from entering into relations with Cuba because of her heavy foreign debt and shortage of hard currency. Havana has relatively few goods to offer for export and its most important commodity, sugar, is usually available in abundance from other sources. The government's trade bureaucracy has a reputation for being inefficient and not always fulfilling commitments. The U.S. trade embargo places the American market off limits and presumably inhibits many foreign firms from doing business with Cuba.

Cuba is burdened with heavy foreign indebtedness in both nonconvertible and convertible currencies. According to one of the Academy of Sciences institutes in the former USSR, Cuba's debt to the Soviet Union was 15.5 billion rubles as of November 1989. [24] Although it is difficult to place a real value on the ruble debt, and one may argue that it was never intended that it be repaid, its existence makes it possible for Moscow to try to use it as leverage in future negotiations. Cuba's ruble debt to East Europe has been estimated at 1.4 billion rubles. [25]

Cuba's hard currency debt, estimated at about $7 billion, is owed mostly to commercial banks and bilateral creditors from the Paris Club countries. Cuba and her creditors entered into debt rescheduling agreements in the early 1980s, but payments have not been made since 1986 and talks about a new rescheduling agreement are at a standstill. Poor trade performance and chronic trade deficits are the underlying cause of Cuba's foreign indebtedness. Cuba is not a member of the World Bank or the International Monetary Fund.

As Cuba's trade with its traditional socialist partners declines, other trade will increase as a *share* of the total. At the same time, Cuba's overall *volume* of trade will probably decline. In terms of shares, impressive gains have been made with Latin America, the Middle East, some West European countries, and China. However, unless these portions of Cuba's trade volume expand, the losses with East Europe and the Soviet Union will not be fully offset.

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[23] Central Intelligence Agency, *The World Factbook 1990*, Washington. p. 77. *The Military Balance 1990–1991*, estimates Cuba spent $1.83 billion on defense in 1989.

[24] Moscow *INTERFAX*, August 9, 1991, in FBIS *Daily Report, Soviet Union*, August 12, 1991. p. 19-20. The report states that the bulk of the debt is technological and military aid, and that one-third of it has been "forgiven."

[25] Perez-Lopez, Jorge F. Swimming Against The Tide: Implications For Cuba Of Soviet And Eastern European Reforms In Foreign Economic Relations. *Journal Of Interamerican Studies and World Affairs*, Summer 1991. p. 97–98.

Trade with China has been growing rapidly. A trade agreement reached at the end of 1990 provided for $500 million in two-way trade between Cuba and China, a planned increase of 11 percent over 1989. In essence, Cuba is bartering sugar, citrus, and light industrial goods for Chinese bicycles, industrial spare parts, and textiles. China is reportedly helping Cuba construct a factory for manufacturing bicycles, and will provide technical assistance for construction of a factory in Cuba for the manufacture of electric motors. [26] A steady stream of Chinese trade officials have visited Cuba in recent months, along with delegations from Western countries including France, Germany, the Netherlands, Spain, and the United Kingdom.

Some diversification is occurring in exports and in trading partners. A modest amount of textiles from a new Cuban facility was exported to Italy in 1990. Textile sales agreements have been signed with firms in Canada, India, Italy, the Netherlands, Panama, and Spain. Production of white cement, intended for export, was begun in 1989 with the help of technology purchased from a Japanese firm. In recent years, Cuba has placed a high priority on exporting biomedical products such as pharmaceuticals and medical equipment. Substantial quantities of vaccines have been sold to Brazil. The two countries have been planning a joint venture to build a facility to produce meningitis B vaccine in Brazil. But a predicted large increase in sales of biomedical products to Brazil and to the former Soviet Union appears not to have occurred. [27]

Moderate progress has also been made in promoting foreign investment, joint ventures, and tourism in Cuba from the West. The most potentially important joint venture could be an offshore oil exploration agreement recently signed with a French consortium, the first such agreement under the Castro regime. The hope, of course, is to expand Cuba's domestic oil production. In the past, foreign investors were limited to a 49 percent interest in joint ventures, and most were in the tourism sector. These restrictions are being lifted. The President of the Cuban Chamber of Commerce said early in 1991 that Cuba would consider offers of up to 100 percent investments in enterprises and debt for equity swaps. He also asserted that since the beginning of 1990, joint venture and production sharing agreements, worth tens of millions of dollars, had been negotiated with firms from many West European countries. In September 1991, Cuba and Iran signed an agreement for a nuclear energy cooperation program, the details of which were not disclosed. [28]

The number of foreign tourists has increased greatly since 1980 when 130,000 visited the island. Most of the increase in tourists have been from Canada, Mexico and other Latin American countries, and West Europe. The number of hotel rooms has been expanding at a fairly rapid rate and new hotels are under construction or planned through joint ventures with firms from Spain, Fin-

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[26] *Cuba Business*, February 1990. p. 14; *Cuba Business*, June 1991. p. 8; *Cuba Business*, August 1991. p. 14.

[27] *Cuba Business*, April 1990. p. 7; *Cuba Business*, June 1991. p. 8-12.

[28] Mexico City *NOTIMEX*, October 1, 1991, in FBIS *Daily Report, Latin America*, October 4, 1991. p. 3.

land, Austria, Germany, France, and Britain. Several years ago, the government set a target of one million tourists generating $700-800 million in revenue by 1995. This target is unlikely to be met.[29]

CONCLUSIONS

The Cuban economy is in the midst of its most serious economic crisis. The economy is on a downward path that will persist and could worsen over the next several years. Cuba has experienced what amounts to a series of shocks that are disrupting industry, transportation, and other key sectors. These came at a time when the country was already weakened by more than five years of stagnation or decline. A general economic collapse cannot now be confidently forecast, but is not beyond the realm of possibility.

The most likely outlook is further contractions of the industrial base, more widespread shortages of supplies, increased erosion of the standard of living, and continued performance at lower levels. The worst case could occur if there were additional shocks to the economy. A sudden, complete termination of trade relations with the former Soviet Union, or a total suspension of foreign oil deliveries, could lead to a general breakdown.

The disruption of economic relations with the former Soviet Bloc countries in East Europe, and the elimination of trade preferences from the former Soviet Union, have increased the pressures on Cuba. Assuming bilateral trade flows with the former USSR are maintained at about present levels, the economic decline could slow down or be contained temporarily. The best case would be a major new oil discovery, an influx of Western capital, a dramatic increase in foreign trade, or some combination of the three. The chances of such developments occurring are remote, given the rigidities of Cuba's economic system, the lack of incentives for foreign investors, Havana's shortage of hard currency, and the limited products it can export.

Discontinuance of the U.S. trade embargo is a highly unlikely prospect, but even if the embargo was lifted the outlook for the near term would not greatly improve. Large numbers of American tourists might want to visit the island and U.S. business interests would explore investment and trade opportunities. However, tourism could not expand rapidly enough to substantially affect the economy, and it would take several years, at best, for investment and trade volumes to reach meaningful levels.

Western economic studies of Cuba frequently comment on the gaps in the data base. Because of official secrecy, weaknesses in the statistical systems, distortions created by state controls, and other difficulties, it is not possible to have a high degree of confidence in assessments of centrally planned economies such as Cuba's. The revelations of the true conditions in the former Soviet Union and East Europe following the upheavals in the countries of that region, demonstrate that official statistics were systematically biased to conceal shortcomings and exaggerate achievements.

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[29] Melendez, Ernesto. Keynote Address to a conference on "Cuba: Business, Trade and Investment Opportunities," in *Cuba Business*, July/August 1992, p.4; *Cuba Business*, August 1991, p.2; *Cuba Business*, June 1990, p.10.

The declining availability of Cuban government statistics intensifies suspicions that the economy is deteriorating at a rapid rate. The possibility that conditions in Cuba are worse than are reflected in the official statistics that have been made available should not be ruled out.

This situation underlines one aspect of the overall problem of economic intelligence. What should be done to improve our understanding of the state of the economy in Cuba and other centrally planned or government controlled systems? The appendix to this report discusses the data problems in Cuba and efforts by the U.S. Government, international institutions, and private persons to fill the gaps. The United States is not doing enough in this regard, and the international institutions are doing little, if anything. Individual scholars and researchers do not have the resources to construct alternative data bases or make systematic adjustments to official Cuban figures.

APPENDIX: MONITORING THE CUBAN ECONOMY

Careful and systematic monitoring of the Cuban economy is not being done by the U.S. government. Assessments made outside the government are incomplete and not always reliable. There are several reasons for this.

DATA PROBLEMS

The real performance of the Cuban economy is obscured by the haze of official Cuban secrecy and inadequate, incomplete, and delayed government statistics. Although the Cuban government publishes a substantial amount of statistics and other material, it withholds much information about the economy, sometimes on the grounds that the information is "classified" for national security reasons, and fails to provide other information in a complete and timely fashion. Statistics on inflation, income distribution, and capital stocks seem not to exist. Some time series are of limited usefulness because they are too highly aggregated or inconsistent. [30] According to the CIA, Cuba's foreign trade statistics are fairly accurate, but statistics on production, distribution, and growth are less reliable due to several factors including ideological bias. [31]

Glasnost, the former Soviet policy of openness introduced by Mikhail Gorbachev, has not come to Cuba. On the contrary, many describe Fidel Castro's policy as *encerrado,* or closed. The fact that Castro often cites economic figures in his speeches, which are not documented and cannot be confirmed, underlines part of the problem.

An example of the inadequacy of official Cuban information is the government's annual yearbook of economic statistics, the primary source of official data about the economy. The yearbook for 1989 was not published until April 1991, and contained significant

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[30] Shortcomings in Cuban economic statistics are discussed by Perez-Lopez, Jorge F. *Measuring Cuban Economic Performance,* Austin 1987, Ch.1; Zimbalist, Andrew and Claes Brundenius, in *The Cuban Economy, Measurement and Analysis of Socialist Performance,* Baltimore 1989, pp. 18–20, identify a number of data problems but conclude that Cuban statistics are "fundamentally reliable and of high quality."

[31] CIA, *The Cuban Economy: A Statistical Review,* April 1989. p. iii.

omissions.[32] Among the more important missing data is the series concerning the composition of exports and imports by country, which was provided in previous editions. As of September 1992, the yearbook for 1990 had still not been published.

U.S. GOVERNMENT EFFORTS

A major effort by Western governments or other institutions is required to fill the gaps of information about the Cuban economy. The U.S. government does more than any other government or group in this regard, but what is done falls short of what would be necessary for a full-scale monitoring program. In addition, most of the information gathered and the analysis performed is held by a relatively small circle of officials within the Executive Branch and is not widely disseminated.

The U.S. intelligence agencies probably do the most useful work in this area. However, in general, the lion's share of intelligence resources has been allocated for military rather than economic intelligence. Resources allocated for economic intelligence were directed, in the past, at the former Soviet Union and other threats to U.S. security. Economic intelligence about smaller countries such as Cuba has not been given a high priority. Much of the intelligence analyses of Cuba that is performed is classified and contributes little, if at all, to public understanding.

The CIA periodically produces an unclassified statistical review of the Cuban economy. This document, based largely on official Cuban sources, provides a wealth of information about Cuba's major economic sectors and economic assistance from the Soviet Union. There are two limitations on the usefulness of these reports. First, they are statistical compilations only. There is no interpretative commentary or explanation of the trends. Secondly, they tend to be outdated. The edition published in 1989, covers the period 1980–86.[33] If the previous practice is maintained, the next update will be based on information through 1989.

The Office of Coordinator for Cuban Affairs in the State Department follows developments in the Cuban economy. It obtains information from the U.S. Interests Section in Havana and has access to the reports of the CIA and other intelligence agencies including the State Department's Bureau of Intelligence and Research. This office issues no reports for public dissemination.

There are no major government programs outside the intelligence agencies and the State Department whose primary purpose is to collect and analyze information about the Cuban economy. The Office of Foreign Assets Control of the Treasury Department monitors some aspects of trade with Cuba to determine whether the U.S. embargo is being honored. It recently published the latest in its series of reports on licensed trade with Cuba by foreign subsidiaries of U.S. firms. The report consists of a series of tables and

[32] *Anuario Estadistico de Cuba 1989.*

[33] CIA, *The Cuban Economy: A Statistical Review,* Ibid. The document contains some information for 1987. The principal sources are Cuban official publications, "supplemented with some non-Cuban sources."

charts showing the recent trends but lacks an introduction or any narrative commentary.[34]

The Commerce Department collects economic information about U.S. trade relations with Caribbean countries; Cuba, because of the U.S. trade embargo, is not included. The Centrally Planned Economies Branch in the Department of Agriculture publishes studies on China, the Soviet Union, and East and Central Europe, but not on Cuba. The Foreign Agricultural Service of the Department of Agriculture publishes information about the worldwide production and distribution of sugar including Cuban sugar.

The Foreign Broadcast Information Service (FBIS) publishes daily compilations of media reports from Latin America, translated into English. These reports contain a selection of newspaper articles and other materials from all the countries of Latin America. There is a small section on Cuba in each report, some of which concern the economy. FBIS daily reports for other countries, such as the Soviet Union and China, sometimes contain media stories about Cuba.

The Radio Marti Program, a division of the U.S. Information Agency, broadcasts information into Cuba, along the lines of the Radio Liberty broadcasts into the Soviet Union. From 1985 through 1989, the staff of Radio Marti compiled information from Cuban media and other Cuban sources about a number of topics, including the economy. These were published together with interpretative commentaries as *Situation Reports* three or four times a year until the series was discontinued in 1989.

INTERNATIONAL ORGANIZATIONS AND OTHERS

The United Nations Economic Commission for Latin America and the Caribbean (ECLAC) publishes comprehensive overviews of the economies of that region. Because of Cuba's restrictive economic information policy, the overviews provide substantially less information for Cuba than for the other countries. Thus, the preliminary ECLAC overview for 1990 contains a series of twenty-two tables of economic indicators for Latin America and the Caribbean. The tables cover, among other things, growth of GDP, urban unemployment, consumer prices, average wages, exports and imports, terms of trade, and the balance of payments. Information about Cuba, however, appears only in the GDP growth table.[35] ECLAC also publishes annual economic surveys of Latin America and the Caribbean which contain somewhat more information about Cuba, including foreign trade and balance of payments data. These publications are significantly delayed. The one covering 1989 was published in November 1990.[36]

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[34] U.S. Department of the Treasury, Office of Foreign Assets Control, *An Analysis Of Licenses Trade With Cuba By Foreign Subsidiaries Of U.S. Companies*, July 1991. The report contains no introduction or other explanatory material.

[35] United Nations, Economic Commission for Latin America and the Caribbean, *Preliminary Overview Of The Economy of Latin America and the Caribbean 1990*, December 1990. The figure for Cuba in the GDP table refers to Global Social Product (GSP) which follows the system of national accounting used in centrally planned economies.

[36] United Nations, Economic Commission for Latin America and the Caribbean, *Economic Survey of Latin America And The Caribbean, 1988*, November 1990.

Neither the World Bank nor the International Monetary Fund collect information or perform studies about Cuba on a regular basis. Occasional studies are performed. In 1985, the World Bank published a study on Cuban growth rates written by two outside specialists. In 1990, the newsletter of the Socialist Economies Unit of the World Bank contained an article on Cuba written by the same two specialists. [37]

Western academics and professional analysts have contributed information and provided interesting insights about the Cuban economy. Some have taken advantage of opportunities to conduct studies in Cuba, and there are increasing numbers of journalistic accounts based on visits to that country. The quality of these efforts is uneven and some are marred by the ideological preferences and the controversy that frequently surrounds attempts to measure communist economies. [38] Reports by journalists are useful mainly as anecdotal evidence of conditions and attitudes at particular times and places

For a number of years following the revolution, American studies of Cuba were done mostly by Cuban emigres and others opposed to or disillusioned with the changes. More recently, Cuban studies programs have been established in several universities and private institutions. [39] There are also Cuban studies centers and experts in other Western countries.

There is an impressive body of work on Cuban economics, but authors are divided into camps that sometimes contradict and attack one another in the harshest terms. These divisions make it difficult to assemble a consensus of informed academic opinion about either the facts of Cuban economic performance or the precise nature of Cuban economic policies.

As a consequence of the government's low-level monitoring and intelligence efforts and the lack of consensus among private experts, policymakers in Congress and the Executive Branch often have been left without a firm factual basis on which to make judgments about the Cuban economy. There is general agreement among Cuba watchers about some of the trends. For example, there is no dispute over the stagnation and decline over the past several years and the negative effects of the disruption of trade with the East European countries and the decline in trade with the former Soviet Union.

But experts have disagreed over the causes and significance of the slowdown, the trends with respect to other indicators, the nature of Cuba's economic system, the reasons for changes in policies, the consequences of trade disruptions with the former Soviet Union and its former bloc, and Cuba's future prospects. In the light of recent developments in the former Soviet Union, most experts foresee continued economic decline and deterioration.

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[37] Perez-Lopez, Jorge and Carmelo Mesa-Lago, *Study of Cuba's MPS, Its Conversion to SNA and Estimation of GDP/capita and Growth Rates*, World Bank, 1985; Cuba: Counter-Reform Accelerates Crisis. *Transition*, November 1990.

[38] The controversy over Western methodologies used to measure the Soviet economy was recently examined by a number of experts in a conference organized by the National Research Council. The results of the conference are summarized in *Estimating the Size of the Soviet Economy*, Alexeev, Michael and Lee Walker, eds. Washington, 1991.

[39] For a discussion of some of the history of Cuban studies, see: Valdes, Nelson P. evolution and Paradigms: A Critical Assessment of Cuban Studies. *Cuban Political Economy: Controversies in Cubanology*. Zimbalist, Andrew, ed. Boulder 1988.

APPENDIX: ECONOMIC ASSISTANCE STRATEGY FOR THE CARIBBEAN 1992-2000

Agency for International Development

(Draft, August 1992)

CONTENTS

EXECUTIVE SUMMARY

The Caribbean – a region rich in cultural, linguistic, and developmental diversity – faces an unprecedented challenge in the 1990s. The profound economic and political changes that are occurring around the world and in the Western Hemisphere will have a direct impact on the future of the Caribbean nations. As other countries liberalize their economies and strengthen their democratic institutions, Caribbean nations must adjust as well, or they risk being left behind. Caribbean leaders recognize these trends and many are implementing reforms essential for broadly based, sustainable economic growth and stable, democratic societies.

Economic development strategies that depend upon foreign assistance and special trade preferences are no longer viable. Global assistance levels from the international donor community are declining, including U.S. levels, and the pressing needs of other regions are competing with the Caribbean for access to those resources. The value of preferential trade regimes will gradually erode as trade barriers are reduced for others. As a result, Caribbean nations will have to depend more on increased competitiveness in international trade and private investment flows to generate the economic growth needed for sustained development.

In order to enhance their capacity to produce and trade, Caribbean nations will have to implement more effective economic integration to achieve economies of scale and bargaining leverage. Reforms at the national level will be required, as well, to eliminate economic and business distortions and reduce obstacles to business development. Areas of competitive advantage will have to be cultivated and strengthened, such as the environment for tourism. A healthy and educated workforce and popular participation in vigorous democratic institutions will be necessary to assure political stability and preservation of broad access to the benefits and opportunities of economic growth.

The United States, through the Enterprise for the Americas Initiative (EAI), has called for an eventual hemisphere-wide free trade zone, enhancing trade and investment opportunities for all nations in the Western Hemisphere, including the Caribbean. Within the framework of the EAI, U.S. economic assistance for the Caribbean in the 1990s will be based on the achievement of broad-based, sustainable economic growth and the strengthening of stable, participatory democracies. The U.S. Agency for International Development (USAID) will pursue these objectives through its own bilateral and regional programs, and through heightened collaboration with other U.S. government agencies, multilateral development institutions, and other bilateral donors. USAID programs will increasingly support regional approaches, working with both government and private organizations in the Caribbean.

To stimulate economic growth, USAID will: (a) help Caribbean nations liberalize their economies to increase and diversify trade and investment and expand opportunities; (b) support efforts to improve management of natural resources; and (c) assist in human resource development.

To strengthen democracy, USAID will help Caribbean nations promote and solidify democratic values and institutions through the strengthening of: (a) the competence, accountability and responsiveness of key government institutions; and (b) public participation in democratic processes and institutions.

By the year 2000, the strategy emphasizes the following goals, to be realized with international community support:

- *The Caribbean region will have a more active role in the world economy, with market-oriented economic polices that lead to increases in employment and productivity based on the region's comparative advantages.*

- *Government policies will increasingly focus on facilitating business development, encouraging sound management of the natural resource base, and broadening the economic base by improving access to quality basic education and health care.*

- *The private sector will be more disposed to responding to the improved policy environment with increased private investment, employment and income, and with a diversification of the industry base, particularly in the manufacturing, service and agri-business sectors.*

- *The entire Caribbean region will be characterized by more stable, more participatory democracies. Free and open national and local elections will be the norm; judiciaries will increase respect for the rule of law and human rights; legislatures will function more effectively; the influence of the military in political and economic processes will be diminished; civic participation in the democratic process will be broader and more unfettered; and the press and other media will be freer and a more credible force for informing public opinion.*

II. INTRODUCTION: THE CARIBBEAN IN A CHANGING WORLD

A. A CHANGING WORLD DEVELOPMENT ENVIRONMENT

The decade of the 1990s is witnessing some of the most fundamental changes in world political and economic systems since the Second World War. Countries are moving rapidly to adopt increasingly democratic political systems and economic competition is replacing Cold War political tensions and related conflict. Trade is becoming increasingly liberalized, leading to a more efficient world-wide economy which maximizes national and regional comparative advantages and more rapidly improves living standards for all peoples.

The changes are equally profound and pervasive in the Western Hemisphere. Popularly elected governments are now the accepted norm, market-based economic policies have achieved renewed stability, and regional cooperation has been revitalized on the basis of free trade among neighboring countries.

In the Caribbean region, a number of countries are moving to adjust their economies toward greater competitiveness and dynamism. A renewed effort is underway to integrate the economies in the Caribbean in order to improve the region's competitive stature in the world economy.

The Enterprise for the Americas Initiative

In order to promote economic growth and political stability in Latin America and the Caribbean, the United States inaugurated the Enterprise for the Americas Initiative (EAI) in June 1990. The EAI aims to forge a mutually beneficial partnership of free market reform through trade expansion, increased investment, and debt reduction. In announcing the EAI, President Bush set the tone for future U.S. development policy for the region by noting that ultimately "prosperity in our hemisphere depends on trade, not aid" and that "the future...lies with free government and free markets."

The United States is actively pursuing the long-term EAI objective of creating a hemisphere-wide free trade area. The vigor and enthusiasm of the response by the nations of Latin America and the Caribbean is demonstrated by the conclusion of trade and investment framework agreements with more than thirty countries, including a multilateral agreement with the Caribbean Common Market (CARICOM).[1] In recognition of significant progress toward economic reforms conducive to more liberalized investment climates, the U.S. in 1991 reduced the stock of official debt in the Caribbean by $429 million ($113 million for Guyana, $99 million for Haiti, and $219 million for Jamaica).

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[1] CARICOM member-states include: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago.

While the EAI envisions an eventual hemisphere-wide free trade area, a number of trade cooperation arrangements have already been established, or are under negotiation, in the Western Hemisphere, demonstrating the pervasiveness of the liberalized trade trend which is underway. Canada, the United States, and Mexico have negotiated a North American Free Trade Agreement (NAFTA); the Central American Common Market is being revitalized; Colombia, Mexico and Venezuela, known as the Group of Three (G-3), have established a trade relationship; MERCOSUR -- a common market among Southern Cone countries (Argentina, Brazil, Paraguay, and Uruguay) -- was launched in 1991; and the Andean countries have agreed to consolidate their grouping into a single market. Inter-regional trade and investment liberalization arrangements are also increasing. Mexico, in addition to its NAFTA and G-3 relationships, is developing free trade arrangements with Chile, Central America and the Caribbean.

B. THE CHALLENGE FOR THE CARIBBEAN

This period of world-wide change and transition, including within the Western Hemisphere, poses a special challenge for the diverse countries of the Caribbean. The region's economies have been among the smallest, most highly protected and import-dependent in the Hemisphere. Their relatively similar economies and their natural resource bases are vulnerable to external shocks and natural disasters.

In contrast to the region's common characteristics, living standards and growth prospects of the region vary dramatically. Haiti and Guyana are the two poorest countries in the Hemisphere -- yet, other Caribbean countries have the highest per capita gross domestic product (GDP) south of the Rio Grande (see Tables 1a and 1b). Any regional review must acknowledge this diversity: in culture, language, and colonial heritage; in living standards, economic status, and health and education indices; and in legal and political systems.

Table 1a: Caribbean Socio–Economic Profile
Independent Economies

Country	Demographics			Socio–Economic Development Indicators					Trade		
	Area Km2	1991 Pop. in (000)	1991 Pop. Growth Rate	1990 GDP per Capita (U.S. $)	1990 Human Development Index	1987–91 Real GDP Growth Rate	1991 Under 1 Infant Mortality (per 1000)	1990 Rate of Literacy (%)	1991 U.S. Trade with the Caribbean ($Millions) Exports	Imports	Total
Group 1 – Large Low–Income Economies											
1. Haiti	28,000	6,596	1.8%	370	0.296	−2.5%	92	53	392.1	284.3	676.4
2. Guyana	215,000	744	−0.5%	340	0.589	−2.8%	54	96	86.1	73.7	159.8
3. Dominican Republic	49000	7,343	2.3%	830	0.622	−0.1%	61	83	1,742.7	1,976.6	3,719.3
Group 2 – Mixed Profile											
1. Jamaica	11,000	2,392	0.7%	1,631	0.761	0.6%	18	97	962.9	561.2	1,524.1
2. Belize	23,288	195	2.4%	1,973	0.700	11.7%	50	93	114.2	35.6	149.8
3. Cuba (est.)	110,860	10,736	1.1%	1,170	0.754	N/A	11	94	1.4	0.0	1.4
4. Suriname	166,120	402	1.4%	3,050	0.792	2.2%	32	95	134.5	51.7	186.2
5. Trinidad and Tobago	5,000	1,285	1.1%	4,127	0.876	3.4%	15	96	468.9	819.7	1,288.6
6. Bahamas	14,146	252	1.4%	10,565	0.920	0.2%	26	95	720.9	465.3	1,186.2
Group 3 – Small Higher–Income Economies											
1. St. Vincent	394	114	1.4%	1,620	0.636	6.7%	25	82	43.5	7.5	51.0
2. Grenada	315	84	−0.4%	2,000	0.751	4.4%	34	96	31.6	8.1	39.7
3. St. Lucia	625	149	1.7%	2,414	0.699	3.5%	21	82	88.6	21.7	110.3
4. Dominica	750	86	1.7%	2,049	0.800	3.9%	18	94	42.5	5.9	48.4
5. St. Kitts and Nevis	310	40	0.1%	3,559	0.719	5.4%	28	90	35.0	15.6	50.6
6. Antigua and Barbuda	284	64	0.3%	4,965	0.832	4.6%	22	95	74.7	3.9	78.6
7. Barbados	436	256	0.1%	6,683	0.945	0.7%	11	96	166.5	31.5	198.0

Table 1b: Caribbean Socio–Economic Profile
Dependent Economies

Country	Area Km2	1991 Pop. in (000)	1991 Pop. Growth Rate	1990 GDP per Capita (U.S. $)	Rate of Literacy (%)	1991 U.S. Trade with the Caribbean ($ MILLIONS) Exports	Imports	Total
1. Anguilla (U.K.)	91	6.9	0.6%	5,906	95	11.4	1.4	12.8
2. Cayman Islands (U.K.)	260	27.5	4.2%	13,670	98	116.4	17.6	134.0
3. Guadeloupe (France)	1,780	345	0.8%	3,300	90	83.4	1.5	84.9
4. Martinique (France)	1,100	345	0.9%	6,000	93	36.6	0.8	37.4
5. Montserrat (U.K.)	100	12.5	1.0%	6,133	97	8.1	2.2	10.3
6. Netherlands Antilles	960	184	0.2%	5,500	94	628.8	620.8	1,249.6
7. Puerto Rico	9,104	3,295	0.1%	6,100	89	10,700	18,500	29,200
8. Turks and Caicos (U.K.)	430	10	2.2%	5,669	98	39.8	4.2	44.0
9. Virgin Islands (British)	150	12.4	1.1%	9,946	98	41.7	2.6	44.3
10. Virgin Islands (U.S.)	352	99	0.7%	9,000	90	1,226.0	2,645.0	3,871.0

SOURCES and NOTES for TABLE 1a:

1. A.I.D. Report: Latin America and the Caribbean, Selected Economic and Social Data, April 1992 (Population, Population Growth Rate, and Real GDP Growth) "Real GDP Growth" is a constant annual rate. Guyana, Belize and St. Kitts use 1987–90; Suriname, Trinidad and Tobago, and Bahamas use 1987–89.
2. Caribbean Development Bank (GDP per Capita). GDP per Capita figure for Cuba is a GNP per Capita figure from UNICEF and is a 1989 estimate. GDP per Capita figures for Suriname, Haiti, and the Dominican Republic are "GNP per Capita" from the World Bank's "World Development Report".
3. Department of Commerce (U.S. Trade with the Caribbean)
4. World Development Report (Size)
5. United Nations (Under 1 Infant Mortality and Human Development Index–HDI): The HDI combines national income with adult literacy and life expectancy to give a composite measure of human progress. Under One Mortality Rate is the annual number of deaths of infants under one year of age per 1,000 live births.
6. UNICEF (Rate of Literacy): The percentage of persons aged 15 and over who can, with understanding, both read and write a short simple statement on everday life. Coverage rates other than 1990 are: Grenada(1984), St. Kitts(1970), and Trinidad and Tobago(1985). Rate for the Bahamas(1986) is from the CIA's "World Factbook".

SOURCES and NOTES for TABLE 1b:

Sources:

1. The World Factbook, 1991 (Area, Population, Population Growth, and Rate of Literacy) Literacy rate coverage includes: Anguilla(1984), Cayman Islands(1970), Guadeloupe(1982), Martinique(1982), Netherlands Antilles(1981), Turks and Caicos(1970), British Virgin Islands(1970), Puerto Rico(1980), and Montserrat(1970). The rate for the U.S. Virgin Islands is from the CIA's "World Factbook, 1989".
2. Department of Commerce (U.S. Trade with the Caribbean): except Puerto Rico (Puerto Rico Economic Development Administration) and the U.S. Virgin Islands (Bureau of Economic Research of the Virgin Islands). Trade with the U.S. Virgin Islands are 1990 figures.
3. Caribbean Development Report (GDP per Capita): except Guadeloupe(1987), Martinique(1986), Cayman Islands(1989), Netherland Antilles(1988), Puerto Rico(1989), and U.S. Virgin Islands(1985) which are from the "World Factbook, 1991". Puerto Rico uses GNP per capita instead of "GDP per Capita".

The Regional Cooperation Challenge

The recent world economic and political changes are drawing together the Caribbean nations, despite individual differences. In a paper presented to CARICOM in July 1989, the Honorable A.N.R. Robinson, then Prime Minister of Trinidad and Tobago, concluded that "against this background of historic change and historic appraisal, the Caribbean could be in danger of becoming a backwater, separated from the main current of human advance into the twenty-first century...." It is critical that the Caribbean nations address the new global challenges by deepening regional integration in order to prepare their peoples for the future. Many of the region's countries have small populations and need economies of scale, pooled technical expertise and common services.

The Economic Challenge

The Caribbean's traditional reliance on preferential trade arrangements and foreign aid from Europe and North America is becoming less viable. The focus of EAI on a region-wide free trade area offers far greater long-term benefit to the Caribbean countries, if they adopt the reforms necessary to be eligible. International donor assistance levels are small compared to the potential gains from increased trade and investment flows, as well as from official debt reduction. The Caribbean cannot rely upon the continuation of relatively high assistance levels, as changing world conditions create new priorities.

The Caribbean region is reacting slowly to this situation and has yet to achieve either competitive integration into the world trade system or sustainable long-term growth. Economic productivity tends to be low, and production generally is not based on economic comparative advantage, especially in agriculture. Significant local economic distortions, including tariffs and quotas, remain in place. With little incentive to the domestic producer to be more efficient, many Caribbean economies are characterized by high-priced domestic goods, an inability to export in the open market, and diversion of resources toward inefficient production.

In June 1992, the Barbados-based Caribbean Association of Industry and Commerce (CAIC) recommended that a comprehensive study of the implications of a lower regional tariff on foreign imports. "CARICOM business have to focus on a future in which increased productivity, consistently high quality, and overall international competitiveness are the essential guidelines," CAIC reported.

As world trading conditions continue to liberalize, failure to further free trade can be expected to have serious adverse effects on the region. Conversely, improvements to the trade regime, as witnessed by results observed in neighboring Central America and Mexico, can be expected to have a major positive impact on diversification, investment, employment and, importantly, national household income and welfare.

The Political Challenge

The English-speaking states in the Caribbean generally have strong traditional, democratic structures. The Dominican Republic has also established a practice of peaceful transitions of duly-elected governments. But for a number of other Caribbean nations, problems are evident which present both challenges and opportunities. Haiti is currently engaged in the complex process of attempting to restore constitutional democracy. Guyana continues to struggle with the challenge of institutionalizing free and fair elections. And, for the first time in over thirty years, change in Cuba, with consequences for the whole Caribbean region, appears to be on the horizon.[2]

It is important for all nations of the Caribbean to establish and strengthen democratic institutions as commonly shared democratic values and basic human rights are becoming a critical component of regional integration. The opportunities for increased economic growth through regional integration are enhanced through participation of the people at all levels in the democratic process. There is growing evidence that open societies that value individual rights, respect the rule of law and have open and accountable governments, will provide better opportunities for sustained economic development than closed systems which stifle individual initiative.

[2] Because the profound implications of an end to the current regime in Cuba cannot be calculated at this time, Cuba is not addressed in this strategy.

III. ECONOMIC ASSISTANCE STRATEGY FOR CARIBBEAN PROGRAMS IN THE 1990s

A. MOVING TOWARD A SHARED VISION

A shared vision of economic and political development in the Caribbean will require sensitivity, understanding and effort from all sides. Donors and recipients are cognizant of increasingly constrained foreign assistance budgets and the eroding value of trade preferences for the region. Partially on their own initiative, and partially as a reaction to external trends, the Caribbean nations are becoming aware they must look to private sector trade activity as the motor of their own development. This requires substantial rethinking of the respective roles of public and private sectors.

U.S. economic assistance programs for the Caribbean[3] need to be responsive to this evolving global context of public and private sector change, and work to implement the vision of the EAI.

The Future of Regionalism

During the CARICOM Heads of Government Conference in June-July of 1992, the heads of government reaffirmed their commitment to the creation of a CARICOM single market and economy. This commitment recognizes that in order for the Caribbean nations to assure long-term economic growth and in order to improve their competitive position in the world economy, regional cooperation and integration are critical.

The West Indian Commission, established by CARICOM's Grand Anse Declaration of 1989, submitted its final report to the CARICOM June-July 1992 Conference, in which 200 recommendations are outlined for addressing the challenges facing the Caribbean region, proceeding with regional integration, and preparing the region's economies for long-term growth. The report was favorably received and the newly appointed chairman of CARICOM, Trinidad and Tobago Prime Minister Patrick Manning, called for early implementation of the recommendations.

U.S. assistance programs will increasingly support regional approaches to common objectives in the Caribbean in the 1990s at three different levels:

- ***Sub-regionally***, USAID will support efforts to enhance integration within CARICOM, and will encourage cooperation on the island of Hispaniola.

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[3] USAID-assisted countries in the Caribbean currently include Haiti, Dominican Republic, Jamaica, Belize, and the six Organization of Eastern Caribbean States (Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines). Guyana, Barbados, Suriname, and Trinidad and Tobago are occasional recipients of minor assistance from USAID, essentially through regional programs.

- On a *Caribbean-wide* basis, USAID will support greater collaboration among CARICOM, Haiti, the Dominican Republic, and other Caribbean islands. The West Indian Commission report calls for a "widening of the process of integration" to the rest of the independent island states of the Caribbean Sea, as well as the Commonwealth of Puerto Rico, the island communities of the French West Indies, the Dutch Islands of Aruba and the Netherlands Antilles, the U.S. Virgin Islands and the remaining British dependencies. Puerto Rico, already a center for trade and finance in the Caribbean, has the potential to become a major force in some aspects of broader regional cooperation.

- USAID will also support stronger *inter-regional* cooperation, especially with countries that border the Caribbean Sea. The longer-term implications of current U.S. free trade negotiations with Mexico and the EAI objective of a hemisphere-wide free trade zone should lead to this type of regional collaboration in the future. The West Indian Commission report also recommends that CARICOM "reaching out" to Latin American countries of Central and South America whose shores border the Caribbean Sea. The convening in Honduras in January 1992 of the first Ministerial Conference between CARICOM and the Central American countries, as well as the development of a trade and investment agreement between Venezuela and CARICOM, are examples of how CARICOM's "reaching out" effort is already underway.

B. FRAMEWORK FOR ECONOMIC ASSISTANCE IN THE CARIBBEAN IN THE 1990s

In the Caribbean, as in the rest of the Hemisphere, the longer-term potential for development is based on all countries participating actively in reciprocal trade and investment relationships. The EAI provides a framework which can help guide the needed restructuring. The further liberalization of Caribbean economies will eliminate over time the economic distortions that discriminate against sustainable growth and limit individual opportunity. Increased tax revenue from economic growth will enable governments to finance public investment and services in education, health, nutrition, and other aspects of the quality of life that are necessary to improve living standards and support sustained growth. Increased attention to sound management of the natural resource base--one of the Caribbean's unique assets--will help assure that it remains a competitive advantage, leading to lasting economic growth and well being for future generations.

Broad-based and sustained economic growth will create jobs, increase income and improve the overall living standard for the Caribbean. At the same time, this growth will create larger markets in which U.S. businesses can export and invest, creating additional jobs and revenues in the United States. U.S. economic assistance is, thus, mutually beneficial. Additionally, the emphasis on free trade and sustainable private sector-led growth will tend to lessen dependence on external donor assistance.

The longer-term potential for development in the Caribbean is also based on full participation of people at all levels in the democratic process. The guarantee of self-determination, human rights, the rule of law, and political freedom will not only enhance individual opportunity but will strengthen the prospects of economic growth and prosperity.

Within the framework of the EAI, U.S. economic assistance to the Caribbean will be based on the following premises:

- USAID will participate in economic policy dialogue in the region to encourage reforms without which liberalized trade and development of a competitive investment climate cannot take place;

- USAID will work closely with Caribbean and U.S. businesses interested in trade and investment opportunities in the region, providing information, contacts, and targeted outreach services (e.g., trade missions and seminars);

- USAID will support sound natural resource management and development of the human resource base, which are critical to sustained economic growth, political development, and the broadening of participation in the benefits of growth;

- USAID will assist Caribbean efforts to strengthen democracy;

- in order to maximize the impact of its limited resources, USAID will seek to complement other donor flows to the region; and

- by virtue of the presence of its missions throughout the region, USAID will serve as a point of coordination with regional institutions, other U.S. government agencies and bilateral donors, and international financial institutions.

C. TARGETS FOR THE YEAR 2000

Within the framework outlined above, the Caribbean region can be a vibrant, increasingly prosperous and democratic region by the year 2000. With a combination of U.S. assistance and complementary, adequate international support, the following broadly stated targets should be attainable:

Broad-based, Sustainable Economic Growth

- The Caribbean region will have a more active role in the world economy, with market-oriented economic policies that make possible steady and sustainable increases in employment and productivity based on the region's comparative advantages.

- Government policies will increasingly focus on facilitating, rather than impeding, business development and will provide a more level playing field for all entrepreneurs within the framework of the rule of law.

- Government policies will encourage sound management of the natural resource base necessary to long-term economic viability and growth.

- There will be steady movement toward broadening the economic base by improving access to quality basic education and health care.

- The private sector will be more disposed to responding to the improved policy environment with increased private investment, employment and income, and with a diversification of the industry base, particularly in the manufacturing, service, and agri-business sectors.

Stable, Participatory Democracies

- Free and open national and local elections will be the norm.

- Strengthened judiciaries will increase respect for the rule of law and human rights, and will provide greater protection for the security of person and property.

- Legislatures will function more effectively.

- The influence of the military in political and economic processes will be diminished.

- Civic participation in the democratic process will be broader and more unfettered.

- The press and other communications media will become freer and increasingly become a more credible force for informing public opinion.

Some base-line data are included in Tables 1a and 1b. Specific quantitative goals will be reflected in individual USAID country strategies and annual Action Plans. This is particularly important due to the diversity that exists in the region in the quality of life, conditions and prospects for economic growth, and the stability and development of its democratic institutions.

IV. STRATEGY OBJECTIVE NUMBER ONE: ACHIEVEMENT OF BROAD-BASED, SUSTAINABLE ECONOMIC GROWTH

The principal objective of USAID's strategy for the Caribbean region is to support Caribbean nations in their efforts to achieve broad-based, sustainable economic growth. USAID has identified three areas of focus which will facilitate that growth: (a) the rapid liberalization of Caribbean economies to increase trade and investment, (b) the optimal management of natural resources to sustain growth and employment, and (c) complementary human resource development.

A. INCREASED TRADE AND INVESTMENT

Constraints

The principal constraints to increased trade and investment in the region include:

- distorted resource allocations,
- limited world market competitiveness,
- legal and regulatory obstacles,
- inappropriate public and private sector roles,
- obstacles to (or suspicion of) foreign investment,
- fragile natural resource base, and
- markets unused to competition.

Strategic Elements

To address these constraints, USAID proposes a program of assistance based on five strategic elements:

1. *To further liberalize participation in regional and global trade*

USAID will collaborate with multilateral donors in assisting Caribbean private and public sectors liberalize and harmonize their trade regimes. Key areas of cooperation include:

- reduction (and eventual elimination) of tariffs, quotas, and non-tariff barriers;
- access to all resources, including foreign exchange, through market-based systems;
- development of growth-enhancing fiscal systems, through decreased reliance on taxation of international trade;

- greater budgetary control, rationalized public expenditures, and greater efficiency in social accounts;
- development of competitive financial markets; and
- development of attractive investment climates.

Assistance will be provided at both the country and regional level, working through both government and non-governmental organizations. USAID will also work to stimulate greater awareness of, and public debate on, the need for growth-oriented trade and investment policies.

2. ***To overcome legal, regulatory, and judicial obstacles to a competitive business environment and enhanced productivity***

USAID will support national and regional efforts to streamline and harmonize the business regulatory environment. Close cooperation with business, governments, selected regional organizations (e.g., University of the West Indies, Caribbean Law Institute, CAIC), as well as the interaction with other U.S. agencies, is required to identify bottlenecks to business growth and to work toward their elimination on a national and regional basis. Areas of particular focus will be:

- the adoption of international standards of accounting and auditing;
- customs and port handling;
- transparency in the administration of business, taxation, and investment codes;
- the recognition and protection of property rights, including intellectual property;
- legal and judicial systems which fairly and efficiently administer commercial laws and business regulations; and
- the use of market-based pricing mechanisms in the allocation of resources.

3. ***To stimulate private investment in the Caribbean***

In collaboration with other U.S. and international agencies, the USAID will:

- encourage wider private sector participation in the economy and assist the public sector in reducing its control and ownership of productive sectors;
- assist individual nations and groups of nations in their efforts to become more efficient through streamlined and decentralized administration, private or non-governmental organization provision of public services, appropriate cost sharing, and divestiture of parastatals;

- help individual nations and groups of nations create an investment climate which facilitates private investment, and encourage those nations to utilize the Multilateral Investment Fund and investment and financial sector loans (administered by the IDB and the Caribbean Development Bank (CDB)) to improve the investment climate on a regional basis;

- facilitate the private sector's policy, business, and regulatory dialogue with governments;

- work closely with Caribbean and U.S. businesses interested in trade and investment opportunities in the region, providing information, contact, and targeted outreach services (e.g., trade missions and seminars) to facilitate commercial linkages; and

- foster public and private understanding of the linkages between trade and investment efforts and necessary supporting infrastructure, including requirements for financing (by international financial institutions or local capital resources), cost recovery, privatization, efficient management, and maintenance.

4. To help the Caribbean private sector achieve greater competitiveness

USAID will assist the Caribbean nations to strengthen areas of comparative advantage and to enhance private enterprise efficiency and collaboration to improve upon that advantage. Specifically, USAID will:

- assist the private sector in assuring that marketing information, new technology, and service training is widely available in competitive sectors; and

- foster privatization and public and private sector partnerships to enhance investments in human resources, facilitate technology transfers and adaptations, and improve business management, on a sustainable, cost-sharing basis.

5. To ensure that all segments of the populace participate in and benefit from trade and investment expansion

USAID will monitor the social and equity impact of trade and investment expansion, designing selected interventions, as necessary, to encourage optimal participation by all in the benefits of growth. Trade and investment expansion will produce employment gains for the poorer segments of society in the long run. However, since such an expansion based on comparative advantage is a sharp departure from current practice, some of the more economically disadvantaged may be adversely affected in the short-term transition. Consequently, USAID will:

- finance analyses and develop baseline data on wages, incomes, and expenditures to assist in monitoring impact on various segments of the population;

- help to ameliorate short-term market imperfections, as required, through support of small and micro-enterprise sustainable credit and technical assistance programs; and

- join with international financial institutions in transition efforts to cushion the short-term impact of adjustments on the poor.

B. SUSTAINED NATURAL RESOURCES MANAGEMENT

Constraints

The wise use of natural resources is crucial to achieving sustainable development. The region's fragile natural resource base is one of its unique assets and should provide excellent opportunities for development, but will require special care to ensure its sustained use. For example, the strong comparative advantage in marine-based development can be undermined by the soil erosion, sewage, and fertilizer run-off which kill coral reefs, damage fisheries, and destroy the resource base upon which the tourism industry depends.

Selected political and social characteristics of the region also contribute to special natural resource vulnerability:

- environmental degradation tends to be greatest in coastal areas, where most people live and earn their livelihood;

- small countries are challenged by the high cost of effective resource management and should look for ways to work collectively to achieve economies of scale;

- environmental issues frequently transcend national boundaries (e.g., Hispaniola and a shared Caribbean Sea); and

- weak public and private institutions and the lack of appropriate technologies hamper sustainable economic growth.

Strategic Elements

1. *To recognize the economic opportunities provided by natural ecosystems and to promote their conservation and judicious use*

USAID will finance the training and institutional development of public entities in support of efforts to integrate environmental considerations into overall economic decision-making. Particular emphasis will be placed on strengthening economic accounting methods and improving market functions to reflect the true costs of resource degradation. Current problems include pricing policies that undervalue common goods, subsidies, inadequate rents and user fees, and tax policies that lead to inefficient use of resources.

2. To stimulate key environmental policies and reforms

USAID will promote public and private awareness of environmental issues in an effort to improve local policies. Environmental education in schools, universities, business fora, local communities, and governments will help develop an informed citizenry that plays a more effective role in defining the development agenda and encouraging formulation of key environmental protection policies and necessary reforms. By increasing participation and empowerment of citizens in environmental initiatives, the laws, regulatory systems, and enforcement mechanisms to support sustainable use of resources and to improve the human environment will be strengthened.

3. To support governmental capacity to formulate and implement environmental and natural resource management policies

USAID will assist public entities to:

- establish baseline monitoring systems and collect and analyze data;
- provide environmental education and training for employees and managers of policy and planning units;
- strengthen capacities to enforce environmental and natural resources policies, laws, and regulations; and
- improve coordination among institutions responsible for environmental protection and resources management.

In this effort, Caribbean experience, knowledge, and expertise must be fully utilized to harmonize environmental protection laws on a regional basis.

4. To develop and strengthen regional institutions addressing environmental and natural resource management issues

USAID will collaborate with CARICOM:

- to support the program expansion of a regional entity involved in environmental monitoring, data analysis, provision of services to national environmental protection agencies, and identification of viable environmental and economic policy alternatives; and
- to stimulate regional information exchanges to expand knowledge of policy and technology options.

5. To support disaster preparedness and mitigation

A special characteristic of the Caribbean islands is their vulnerability to natural (e.g., hurricane) and man-made (e.g., oil spill) disasters, on a fairly regular basis. Inadequate prevention and mitigation result in health problems, injury and loss of life, especially among the poor, the unnecessary destruction of homes and basic infrastructure, major economic dislocation, and accelerated environmental degradation. USAID will support Caribbean nations in their efforts to:

- improve environment and natural resources planning and management; and
- undertake structural risk assessments, code modification and enforcement, involvement of private insurers in prevention, and community readiness.

6. To support the development and use of sustainable technologies (such as, competitive farming systems, watershed and coastal zone management, management of parks and protected areas, and alternative energy resources)

USAID, in conjunction with the private sector, will facilitate the exchange of technology and information among Caribbean nations, concentrating efforts in farming systems, watershed and coastal zone management, management of parks and protected areas, and alternative energy resources. USAID will cooperate with local PVOs to enhance and expand their innovative approaches and pilot programs to improve the state of the art and facilitate the transfer of such technology. USAID will participate on or act in collaboration with the environmental councils established under EAI in consonance with this strategy.

USAID will consult closely with the IDB, the World Bank, CDB, and other bilateral donors in working toward these aspects of this strategic objective. In the formulation and management of its activities, USAID will engage the expertise of the U.S. Department of Agriculture (USDA), the U.S. Environmental Protection Agency (EPA), the U.S. Department of the Interior, the U.S. Peace Corps, the U.S. Coast Guard, the Commonwealth of Puerto Rico, and individual nongovernmental organizations active in environmental issues.

C. HUMAN RESOURCE DEVELOPMENT

Health and basic education services are under significant stress in most of the Caribbean as populations increase and public sector resources decrease. In a few countries, these services are significantly below standard and are major constraints to development. The special challenge narcotics pose for human resources development in the Caribbean must also be addressed. These areas are closely related to this strategic framework for the Caribbean, in that:

- a vibrant economy requires a healthy, educated workforce, as well as a fiscally-prudent public budget with appropriately allocated social expenditures;

- increased growth enhances prospects for greater disposable income for choice among social services options; and

- democratic participation will ensure that quality public social services are relevant and responsive to popular needs.

Family Health

In the English-speaking Caribbean, health is not a constraint to development, and only limited investments in health and family planning services, financing reform, and policy development will be undertaken on a country-by-country basis.

In Haiti and, to a lesser extent, the Dominican Republic, poor health status and high fertility are major constraints to improving living standards. With life expectancy in the mid-50s and fertility and population growth rates on the rise, Haiti's population is projected to double to 13 million by 2025. Most of this increase will be among people living in poverty, placing an even greater strain on the environment and already over stressed social institutions, and making it all the more difficult for democracy to flourish. Child survival indices in Haiti are among the worst in the Hemisphere. In the Dominican Republic, infant mortality is also too high and life expectancy too short. While the annual population growth rate is declining, it is still high at 2.3%.

USAID will support institutional and policy reforms in both public and private sectors that increase access to primary health care and remove obstacles to better resource allocation, increased efficiency, and more cost recovery in family health service delivery. AIDS is a growing problem throughout the region, particularly in Haiti, the Dominican Republic and Jamaica. USAID will assist those countries address the problems of AIDS through an intensive impact-oriented program. Finally, the region will continue to receive prompt support to prevent and control anticipated cholera outbreaks, using a Washington-based region-wide cholera program.

Education

Assistance in basic education will be important in Haiti and the Dominican Republic, where the local systems need to extend basic education to a larger proportion of the population. Assistance efforts will focus on restructuring government budgets and decentralization; reforming the curriculum; providing instructional materials and text books; and developing innovative approaches to encourage greater private sector support to sustain improved public and select private school systems.

USAID's programs in the rest of the Caribbean will respond to the diversity of human resource development levels among Caribbean countries. To support increased trade and investment, USAID will target training for labor leaders, businessmen, government officials and opinion makers. Management and vocational education will be geared to productive employment and increased efficiency in globally competitive enterprises. To the extent feasible, programs will be implemented by the Caribbean private sector, on a sustainable, cost-sharing basis.

Counternarcotics Efforts

Narcotics production, trafficking, and transshipment threaten to corrupt the fabric of society and to create a permanent underclass. While the Caribbean serves mainly as a transit point for drugs moving to the U.S. market, there is also production in some of the larger countries. Narcotics pose a growing threat to the development of the islands, with important economic and societal implications. The lack of viable economic alternatives for the unemployed, low public awareness of the dangers of narcotics, and inadequate judicial systems lead directly to increased corruption, ineffective government, and severe debilitation of drug users.

USAID, in cooperation with the U.S. Department of State, the United States Information Agency (USIA), the U.S. Department of Defense (DOD), and the U.S. Drug Enforcement Administration (DEA), will contribute to the counternarcotics effort by assisting Caribbean countries to increase public awareness of narcotics-related problems, to improve efforts for broad-based growth and employment, and to strengthen overall financial and administrative accountability.

V. STRATEGY OBJECTIVE NUMBER TWO: STRENGTHENING OF STABLE, PARTICIPATORY DEMOCRACIES

The opportunities for increased economic growth are enhanced through participation of the people at all levels of governance to ensure that services are equitably distributed and policies are relevant to their needs.

The status of democratic development in the Caribbean varies from country to country. In the Commonwealth Caribbean, democratic traditions tend to be strong. Guyana, with its multi-ethnic population is grappling with pluralism and the challenge of institutionalizing free and fair elections. In the Dominican Republic, there exists generally good respect for civil liberties, although the need for greater popular participation in governance and for improvements in the judicial system are issues under active debate. Haiti faces difficulties with political instability and intimidation, anti-democratic forces, and human rights violations, as it seeks to re-establish constitutional democracy.

Strategic Elements

The United States seeks to help Caribbean nations solidify their democratic institutions and shared values of self-determination, human rights, the rule of law, and political freedom. While external assistance in this area is helpful, strengthening democracy ultimately depends upon the political will and popular expectations of Caribbean societies.

Assistance in support of democracy in the Caribbean has two objectives:

1. *To strengthen the competence, accountability, and responsiveness of key government institutions, that they might better govern and merit public confidence*

   USAID will support:

   - political system development, including electoral and legislative reforms;
   - improvements in the regulatory and judicial environments;
   - decentralization of bureaucracies and expanded citizen participation at the local level; and
   - better financial management.

2. *To strengthen public participation in democratic processes and institutions*

   USAID will:

   - encourage public debate and greater consensus on public policy issues;

- promote the teaching of democratic values, knowledge, and practices;
- support private organizations participating in an emerging civil society; and
- finance leadership training.

These actions will simultaneously help improve the overall business climate and thereby complement the first objective of this strategy.

The level of effort will differ in each Caribbean nation, reflecting the region's diversity in democratic development. USAID will operate within the context of the country team in the U.S. Embassy in the individual country, which will ensure coordination with the U.S. Department of State, the U.S. Information Agency, DOD, DEA, the U.S. Department of Justice, and the Peace Corps.

In Washington, USAID will consult with labor, human rights, and legal organizations, as well as the academic community, to continuously update and refine its strategic concerns and program design efforts.

USAID will work closely with individual key donors such as Canada, the United Kingdom, other European donors, the United Nations' Development Program, the Organization of American States, and the international financial institutions (IFIs), to ensure coordination.

VI. RESOURCES, ORGANIZATIONAL RELATIONSHIPS, AND MANAGEMENT CONSIDERATIONS

A. RESOURCES

Existing Resource Flows

Total resource flows to the Caribbean, from all sources, approached $9.2 billion during 1989, constituting a modest decrease in nominal terms from flows registered at the beginning of the decade. Despite the size and nature of these flows, the Caribbean countries did not record positive per capita growth during the 1980s.

EXISTING RESOURCE FLOWS

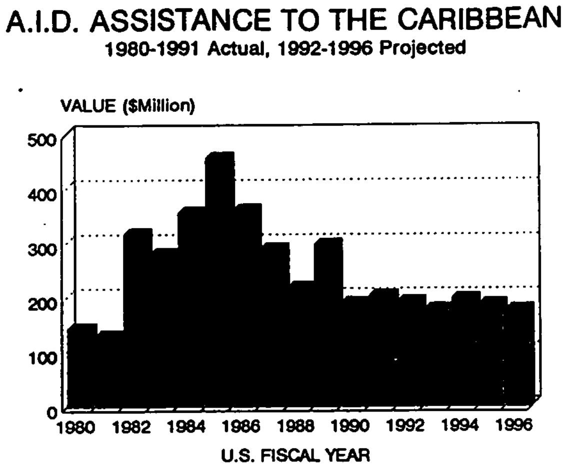
Total Resource Flows	**$9.2 Billion**
Merchandise Exports	$6.6 Billion
Tourism Receipts	$2.6 Billion
Private Flows	-$334 Million
Net Official Flows	$370 Million

Merchandise exports, currently responsible for 70-80% of foreign exchange flows into the Caribbean, have declined over the decade to $6.6 billion in 1989. Tourism receipts advanced 110% over 1981-89, reaching $2.6 billion at the end of that period. Private flows, consisting of commercial bank lending, direct foreign investment and export credits, were negative throughout 1981-89, representing minus $334 million in 1989. This was primarily repayment of principal and interest. Net official flows, including official development assistance, amounted to $370 million in 1989. This total is down from a peak of $1.1 billion in 1982. Key lenders include the World Bank, the International Monetary Fund (IMF), the IDB, the CDB, the European Economic Commission (EEC), the United States, Canada, and the United Kingdom.

Future Resource Trends

As a longer-term trend, the Caribbean cannot depend on U.S. and other donor economic assistance flows to fill future resource gaps in a sustained, significant way. U.S. government assistance has gradually declined (see Table 2) and levels in the year 2000 are expected to dip below the $200 million mark in nominal terms.

Table 2:



NOTE: In most Caribbean nations, USAID assistance will be limited and focused on realizing the vision of the EAI. Haiti will be the principal recipient of significant resource transfers by USAID.

Under the EAI, those nations which maintain sound economic policies and are progressing toward liberalized investment regimes are eligible for official debt reduction. Table 3 provides the stock of debt which Caribbean nations owe the United States and other creditors (in the aggregate).

TABLE 3. CARIBBEAN COUNTRIES: SELECTED DEBT INDICATORS

Country	Total External Debt Outstanding ($ million)	Owed to U.S. Government ($ million)
Antigua and Barbuda	n/a	21
Barbados	n/a	7
Belize	158	32
Dominican Republic	4,400	780
Grenada	104	2
Guyana	1,960	4
Haiti	874	49
Jamaica	4,598	691
St. Kitts and Nevis	37	10
St. Vincent and the Grenadines	59	2
Trinidad and Tobago	2,307.	118

SOURCE: World Bank, World Debt Tables, 1991-92; U.S. Treasury, Status of Active Foreign Credits of the U.S. Government, December 31, 1991.

B. ORGANIZATIONAL RELATIONSHIPS

To maximize the impact of scarce and declining resources, future implementation of USAID activities will require greater focussing and even selected phasing out of activities which diverge significantly from the strategy framework. To provide clearer organizational focus at the regional level, it is expected that the regional mission in Barbados (RDO/C) will work closely with the bilateral missions to develop and coordinate selected region-wide programs, as appropriate, in consultation with Washington. Additionally, USAID will develop a more concerted working relationship internally, with other U.S. government agencies, and with the international donor community.

Coordination Within USAID

Field missions and Washington jointly prepare bilateral and regional program statements which define strategic objectives and expected accomplishments. Progress against these objectives is reviewed annually, with participation of offices from USAID and other U.S. government agencies. To enhance coordination and more effectively integrate bilateral and regional programming, a new management oversight structure will be established for USAID Caribbean programs. The Assistant Administrator will chair a Steering Committee, to be comprised of the directors of USAID missions in the Caribbean, and the Office of Caribbean Affairs, with the director of the Office of Caribbean Affairs serving as Executive Secretariat. This committee will convene at least annually to review overall priorities, address region-wide issues, assess progress against strategic objectives, and to provide input to the Caribbean Group for Cooperation in Economic Development (CGCED), part of the World Bank consultative group process. Finally, planning conferences will be held on special topics, as needed, to ensure optimal coordination.

U.S. Government Coordination

A number of U.S. government agencies have a mandate to provide expertise and funding in areas related to the objectives of this strategy. Close coordination with these agencies is essential to ensure maximum impact of overall U.S. assistance to the region, and judicious use of limited U.S. government resources. Consultations on EAI will occur through existing committees, coordinated at the Cabinet level by the EAI Policy Coordination Committee. The Treasury Working Group on Debt, the Joint Trade and Investment Councils, and the Environment for the Americas Board bring USAID into operational relationships with the U.S. Department of Commerce, EPA, Interior, State, the U.S. Department of Treasury, USDA, and the Office of the U.S. Trade Representative. In improving natural resource management, USAID will coordinate with and gain access to the expertise of EPA, the Park Service and the Fisheries and Wildlife Service, Peace Corps, U.S. Coast Guard, and the USDA. USAID also will work closely with DOD, Justice, Peace Corps, State, and the USIA on democratic development and with the DEA and the U.S. Department of State's Bureau of International Narcotics Matters (INM) on drug awareness programs. Finally, USAID will engage the Puerto Rican public and private sectors to increase trade and investment and to supply natural resource management technology. The Caribbean stands to derive significant gains if it can more effectively use Puerto Rico's Section 936 monies.

Donor Coordination

Implementation of the strategy necessitates convergence of policies and practices among the international donor community. The principal donor coordination forum in the Caribbean is the CGCED chaired by the World Bank. While the United States has been actively engaged in past bi-annual CGCED meetings, we plan to become even more active in that forum in the future. In order to implement the EAI, USAID will continue to coordinate with the IDB and the CDB in supporting trade and investment reform through access to sector loans and the Multilateral Investment Fund.

Congressional Collaboration

Considerable funding flexibility will be needed to enable USAID to respond effectively with declining resources to the region's needs, to ensure adequate program and financial accountability, and to demonstrate program impact. Congress and USAID can collaborate meaningfully in the achievement of these strategic objectives (a) by providing relief from the rigidities of functional accounts and earmarks and (b) by appropriating sufficient funds available for activities currently financed from the Private Sector, Energy, and Environment account.

EAI is the cornerstone of the Caribbean strategy which seeks to promote an economically vibrant region due largely to increased trade and investment flows by active participation of the private sector. Congress could enhance prospects of achievement of these strategic objectives through (a) enactment of those elements of the EAI which have not yet been authorized by law and (b) appropriation of sufficient resources.

C. MANAGEMENT CONSIDERATIONS

As USAID increasingly focuses its activities and concentrates resources on major objectives, options will be explored which permit greater management efficiency. Important considerations include the need (a) to reduce non-strategic targets of opportunity, (b) to increase use of non-project assistance, and (c) to selectively expand reliance on regional institutions for program implementation. USAID will attempt to:

- restructure its overseas staff mix in order to place stronger emphasis on expertise needed to implement the Caribbean Strategy, particularly in the area of trade and investment;

- continue to improve management capacity of missions;

- as appropriate, utilize the staff of The Caribbean Regional Development Office (RDO/C) to support bilateral missions and engage Caribbean nations in regional programs to advance the EAI process.

Given the likelihood that program and staff reductions will continue throughout the remainder of the 1990s, the LAC Bureau Steering Committee for the Caribbean will review the management of overseas operations as part of its regular oversight functions.

ACRONYMS

CAIC	Caribbean Association of Industry and Commerce
CARICOM	Caribbean Common Market
CBI	Caribbean Basin Initiative
CDB	Caribbean Development Bank
CGCED	Caribbean Group for Cooperation in Economic Development
CLAA	Caribbean Latin American Action
CLI	Caribbean Law Institute
DEA	Drug Enforcement Administration
DOD	Department of Defense
EAI	Enterprise for the Americas Initiative
EEC	European Economic Community
EPA	Environmental Protection Agency
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IMF	International Monetary Fund
INM	Bureau of International Narcotics Matters (State)
LAC	Bureau for Latin America and Caribbean (USAID)
MIF	Multilateral Investment Fund
NAFTA	North American Free Trade Agreement
RDO/C	Regional Development Office/Caribbean (Barbados)
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
USG	United States Government
USIA	United States Information Agency
USTR	United States Trade Representative
UWI	University of the West Indies

II. CENTRAL AMERICA

CENTRAL AMERICA: CONTINUING U.S. CONCERNS

By Nina M. Serafino *

CONTENTS

INTRODUCTION AND BACKGROUND

No longer the flashpoint of U.S. foreign policy that it was in the 1980s, Central America, nonetheless remains a troubled area and one of continued U.S. concern. A decade of war has left most of the five nations defined as Central America—Nicaragua, Honduras, Guatemala, El Salvador, and Costa Rica—worse off in many respects than they were in the 1970s. Many of the dismal socioeconomic conditions that led to the outbreak of revolutions there during the late 1970s remain, and some fear these conditions could foreshadow future difficulties. The region has made headway in the creation of modern democracies, but governments in the region still face numerous challenges. Because these countries are highly dependent on the United States for aid and trade, small acts of the United States can have large effects. Central Americans still look to the United States for cooperation and assistance in resolving persistent economic, social and political problems.

The threat posed by the Soviet Union's links with groups in the area was widely viewed as the driving force for U.S. interest in the

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area during the 1980s. Most important were the Soviet links with the leftist Sandinista National Liberation Front (FSLN) which took power in Nicaragua in 1979, and the subsequent Soviet upgrading of Nicaraguan military facilities. Also of concern to the United States was the concurrent threat of takeover by the leftist Farabundo Marti National Liberation Front (FMLN) guerrillas in El Salvador. As expressed by the 1984 "Kissinger Commission" report, prepared by a bipartisan group of prominent North Americans, the U.S. security goal was to deny enemies of the United States the possibility of establishing political or military fronts close to U.S. shores

Other goals identified by the Commission were: (1) the promotion of peaceful political change and the advancement of democracy and democratic self-determination; (2) the strengthening of the economies in the region; and (3) improvement in living conditions in order to enhance the quality of life for all citizens of the hemisphere.

Similar interests were stated in 1989, when Senator Terry Sanford convened a bipartisan, multilateral International Commission for Central American Recovery and Development. Dubbed the Sanford Commission, it proposed an "immediate action" program to generate productive employment by focusing on food security, health and nutrition, basic education, safe drinking water and sanitation, temporary housing, infrastructure, and human rights. However, the Commission also noted that the solution to Central American poverty must be sought by addressing fundamental social and economic structural problems and by broadening opportunities for political participation.

The Central Americans themselves put forth these goals in numerous documents signed by the presidents during regional peace summits, beginning in the early 1980s.

Despite the acknowledgement that structural causes must be addressed, for many analysts and U.S. officials, external security threats often led the United States to, in the opinion of a U.S. Ambassador, "focus on security problems to the detriment of economic, social and environmental policies." Yet, "as the nature of our relationship with Central America changes, these shortcomings are being laid bare." [1]

Since the early 1990s, the United States has reiterated its continued interests in social, economic and political development in Central America, and its intention to assist Central American countries in all areas. But its ability to offer aid has diminished. With the disintegration of the Soviet Union, the East-West conflict rationale for a U.S. strategic interest in the area has evaporated, while at the same time the United States faces increasing domestic constraints on foreign aid.

At the end of a decade of conflict, sources of concern in Central America seem only to increase in the view of many analysts. The tough political problems remain—in particular, how to strengthen democratic governments and improve socioeconomic conditions for a majority of the people in the region. The increasing use of Cen-

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[1] Arcos, Cresencio S. Managing Change in Central America. *Miami Herald*, July 21, 1991. p. 1C, 6C.

tral America as a transit point for drug trafficking has also become a source of concern for U.S. policymakers.

Planning for a steadily decreasing foreign aid package, the U.S. Agency for International Development (AID) in 1991 viewed its task as sustaining, as efficiently as possible, "the positive but still very fragile trends towards political freedom and economic growth" [2] in the region. The United States has determined to cope with this decline in assistance not only by undertaking additional bilateral initiatives involving other U.S. agencies in a broad range of areas, but also by encouraging and cooperating in regional and multilateral initiatives for Central America.

Promoting Political Stability and Democracy

During the late 1980s and early 1990s, the United States increasingly undertook programs to strengthen democratic institutions and practices in Latin American countries. A push for democratization began in the early 1980s, when the United States recognized the elitist nature of these societies as one cause of the turmoil.

At the end of the 1970s, many analysts agreed that all governments in the region, except that of Costa Rica, were concentrating on protecting the interests of wealthy individuals or small groups. Military governments that initially supported these elites developed and protected their own group interests. At the time of Nicaragua's 1979 Sandinista revolution, all of the other countries in the region, except Costa Rica, were under military rule. Combined with U.S. pressure and domestic pressures in Central America, Nicaragua's revolution provided an impetus for the military to relinquish ostensible control of government in Guatemala, El Salvador, and Honduras; many feared that the Sandinista example could provoke similar uprisings in other countries where the social inequities and degree of repression were as bad as in Nicaragua under the Somoza regime. The shift to governments with formal, "democratic" institutional frameworks was possible because, to many, it represented a bulwark against undesired change. Many others realized that substantial work would be needed for democracy to flourish and make a change in the lives of ordinary citizens sufficient to forestall future social unrest.

SIZE OF THE MILITARY AND ITS INFLUENCE IN GOVERNMENT

One of the most important constraints on democracy has been the continuing large size, influence, and relative independence from civilian authority of the military and security forces in all countries in the region with the exception of Costa Rica, which has a civilian-controlled police force. U.S. officials have urged reform of the region's military forces, not only to curb human-rights violations, but also to encourage the supremacy of civilian rule. U.S. officials have stated that the United States can help Central American governments take the necessary steps of reducing heavy military expenditures by helping the armed forces "redefine their role with military and civilian training programs, and by stressing con-

[2] U.S. Agency for International Development. Congressional Presentation Fiscal Year 1992, Latin America and the Caribbean. p. 713.

stantly the importance of civilian authority." [3] One difficulty, however, will be breaking the pattern of "vested interests that have developed among officer corps and civilian groups that benefit from large military institutions." [4]

In El Salvador, the peace accords of January 1992 have put in train a process of demobilization and demilitarization designed to significantly curtail the influence and power of the military. The accords specify that the armed forces be reduced significantly, with some of their functions transferred to civilian controlled agencies, and that violators of human rights be identified and removed. As of mid-1992, however, there were claims that the military had not complied with these provisions. Nevertheless, a process was underway to reduce the size of the officer corps and remove violators of human rights, with scheduled completion in early 1993.

In Guatemala and Honduras, where the influence of the military is in part due to perceptions that military officers are more efficient at running government than civilians, the militaries have managed to preserve their positions to a much greater degree. In Guatemala, the Department of State has found that the military operates with "significant institutional and legal autonomy, particularly in security and military matters." [5] (Because of Guatemala's lack of sufficient progress on human rights, the United States has not resumed the military aid program it suspended in December 1990.) Many observers make similar assessments of the situation in Honduras, and the United States Ambassador was almost expelled in 1991 for criticizing the situation there. Further, military officers are increasingly perceived to be operating as a personal interest lobby rather than as a professional institution. [6]

In Nicaragua, the autonomy of the military and police forces and the influence of army Commander General Humberto Ortega is compounded by their identification with the FSLN, which was defeated at the polls in February 1990. This political identification leads some analysts to charge that Sandinista radicals can instigate action to undermine the elected government of Violeta Barrios de Chamorro with impunity. In particular, they charge that the military and police allow FSLN labor sectors to undertake crippling strikes against the government designed to counter its economic policies, and allow former Sandinista soldiers to participate in land takeovers. Some even charge that the military and the police have deliberately assisted or fomented these activities to disrupt the Chamorro government. Others, however, view the process of bringing the military under civilian control as a slow one, as in other Central American countries, and note as evidence of progress a reduction in the military from about 70,000 to some 20,000 forces in 1992, with a sizable reduction in the officer corps. Certain portions of U.S. aid totaling about $100 million were held up by the U.S. Congress in FY1992, in part because of the issue of the continuing

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[3] Arcos, Cresencio. p. 1c, 6c.
[4] Ibid.
[5] U.S. Department of State Country Reports on Human Rights Practices for 1991. p. 613.
[6] Hockstader, Lee. Honduras Embattled After Decade of Aid. *Washington Post*, July 13, 1992. p. A13, A15. Recent charges have surfaced in the case of Honduras, that military officers had pocketed U.S. money for personal use, and that the military, as an institution, has begun acquiring businesses which earn profits of about $40 million a year for the military.

presence of Sandinista commander Humberto Ortega as head of the army.

HUMAN RIGHTS

U.S. activities to assist with the professionalization of police and security forces, which began in the early 1980s, were carried out because of serious concerns that the military and security forces in all countries except Costa Rica were regarded as among the major violators of human rights. These programs focused on police forces in attempting to provide professional training for police investigators of crimes, but they also tried to imbue members of Central American military and police forces with professional knowledge and standards.

Nevertheless, serious human rights problems remain. According to the Department of State Human Rights reports for 1991:

- In Guatemala, the military, civil patrols, and the police are cited as responsible for most of the major human-rights abuses, including extrajudicial killings, torture, and disappearances. Those whose rights have been abused include human-rights activists, unionists, indigenous people, and street children. Although the report notes the presence of an ongoing civil conflict as a rationale for strong measures, it also notes that the security forces are virtually never held accountable for human-rights violations.
- In Honduras, "the principal human rights problems are extrajudicial killings, arbitrary and incommunicado detentions, torture and abuse of detainees, and the impunity of members of the Armed Forces who commit such violations. As in past years, when members of the Armed Forces committed acts of murder or torture, the military often tried to cover up the violations." In addition, the report notes that the judicial system cannot "protect systematically the rights of ordinary citizens owing to the Government's failure to exercise the political will to insist on accountability for human-rights violations, to ensure the independence of judges and courts, to establish a transparent and just military judicial system, and to set up a mechanism to resolve jurisdictional issues between the civilian and military court systems." [7]
- In El Salvador and Nicaragua, where intense decade-long civil conflicts have abated, human-rights problems continued in 1991 and early 1992. In El Salvador, the military and police forces have been responsible for significant human-rights abuses in previous years and in 1991. In Nicaragua, major human-rights problems in 1991 included "continued extrajudicial killings, mistreatment of detainees, and other abuses by security forces; violence by paramilitary bands in rural areas ... and the Government's continuing failure to investigate and prosecute those responsible for human rights abuses." There, human-rights abuses by security forces have become part of a larger debate on Sandinista participation in the government.

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[7] U.S. Department of State Country Reports on Human Rights Practices for 1991. p. 643.

WEAKNESS OF CIVILIAN INSTITUTIONS

U.S. aid strategy for Central America calls for increased support for consolidating democracy. [8] Weak institutions and lack of civilian capacity to manage government have been sometimes perceived as leaving power vacuums that the military has filled. Corrupt individuals and institutions have undermined trust in government. Recent U.S. efforts have focused on strengthening the efficiency and accountability of government institutions, which have been largely underfunded and malfunctioning. These efforts are complemented by a variety of U.S. programs, some through nongovernmental organizations, designed to encourage democratic practices and oversight.

A primary objective of the United States has been to improve judiciaries in the region, which have notable weaknesses, including poor pay and working conditions, and low educational standards for local judges. The United States pays special attention to judicial assistance through the Administration of Justice program because the judicial process is viewed as a cornerstone of democratic government. A weak or malfunctioning judiciary can translate into a breakdown of society's trust in governmental institutions on many levels: corruption is not punished, the average citizen feels that the court system cannot deliver even basic justice, and police forces justify extraordinary measures against criminals on the grounds that the courts will not punish them.

Some U.S. assistance has also been channeled to other governmental institutions. Although legislatures have existed and functioned in all countries, strong executives have often rendered their activities ineffective. The United States has sought to help legislatures become an effective counterweight to the Executive Branch. It has also devoted resources to improve the public administration of Executive Branch agencies, to strengthen electoral systems, to assist decentralization of political authority and resources through the strengthening of democratically-elected local governments, and to promote civic participation in order to hold governments more accountable. [9] To accomplish the latter, the United States has funded programs for civic education, the news media, community organizations, labor unions, and business associations.

ECONOMIC STABILIZATION, GROWTH, AND DEVELOPMENT

The small, resource-poor, and still agriculturally-based Central American economies present many challenges as well as obstacles to the governments of the region in their pursuit of economic growth and development, and to the United States in its efforts to aid those governments. During the 1960s, a regional integration effort spurred high rates of growth for several years, with an increase in regional manufacturing activities and the development of export-oriented agriculture. These same events, however, were responsible for the displacement of peasants (*campesinos*) from their

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[8] Congressional Presentation Fiscal Year 1992. Latin America and the Caribbean. p. 713.

[9] From "Ten Principles of A.I.D.'s Strategy in the 1990s," in U.S. Agency for International Development, Economic Assistance Strategy for Central America, 1991 to 2000, Washington, January 1991, reprinted as an appendix to Section II of this volume.

lands and the substantial urbanization that helped created the bases for social unrest during the 1970s and 1980s.

Now, despite the peace accords in place in El Salvador and Nicaragua, and negotiations underway in Guatemala, political stability and economic and social development seem constrained by low levels of economic growth and the persistence of high levels of poverty. The circular relationships among political stability, democratic consolidation, economic growth, and equitable development add a troublesome element to the prospects for peace and development in Central America. As expressed by one Central American: "In Central America ... the fundamental obstacles of extreme poverty, weak production capacity, fragile political institutions, and scarce financial and entrepreneurial resources are deeply entrenched. Unless these obstacles are addressed, export-oriented policies and the liberalization of economic life will lead to impoverishing growth—much as they did a century ago." [10]

AID has recognized these relationships. In defining the goals of its assistance program, AID has stated that it is "clearly in the United States' interests to assist its neighbors in proving that the expectations of democracy are well founded. If elected governments, with their market-based economic policies, cannot demonstrate that their principles work in practice for the benefit of all segments of society, then desperate people may again be tempted by extremists. And today's bright prospects for long-term stability and broadly based growth in the Hemisphere may be in jeopardy." [11]

U.S. EFFORTS TO PROMOTE GROWTH

Economic growth is widely viewed as a necessary, but not the only, condition needed to advance Central American development goals. As a result, U.S. economic efforts now largely center on aid and other forms of assistance to remove development obstacles and create conditions for growth. In the early and mid-1980s, the focus was on providing a hospitable macroeconomic and legal climate for domestic and foreign investment. During that period, assistance to small businesses and microenterprises became a significant part of U.S.-supported employment-generation activities. Recently, efforts have also included debt reduction and environmental assistance. The United States has also become interested in fostering regional cooperation by placing greater emphasis on implementing Central American regional initiatives, including reforms to liberalize trade within the region.

DEBT REDUCTION

Burdensome foreign debt levels have become a particular concern of the United States because the debt severely limits resources available for investment, economic growth, and social welfare. In 1991, the U.S. Government reduced portions of debt owed to it by two Central American countries. In 1990, Central America had a combined external debt of almost $23 billion, with figures ranging

[10] Garnier, Leonardo. Beyond Trade. *Hemisphere*, v. 3, no. 3, Summer 1991. p. 2.
[11] Congressional Presentation FY1992. p. 704.

from $2.1 billion for El Salvador to $10.5 billion for Nicaragua. Not only are the figures high, but the ability of the countries to pay these amounts is constrained, because annual debt service payments are large in comparison to export earnings.

In 1991, through congressionally-approved debt reduction schemes for least-developed countries, the United States reduced substantial amounts of concessional debt (i.e., AID and P.L.-480, or food aid loans) for Honduras (about $433 million) and for Nicaragua (about $287 million).[12]

ENVIRONMENTAL CONCERNS

Another constraint on growth now receiving greater recognition is the deteriorating state of the environment. Deforestation is of particular concern, as forests in Central America are disappearing at a greater rate than in any other place except West Africa. According to some analysts, the economic consequences of deforestation include the siltation of hydroelectric dams and adverse effects on farm production as erosion washes fertile soils from the land to the sea.[13]

Demonstrating the vicious circles of many development problems, deforestation results, in part, because much of the population of Central America still relies on wood for cooking, and because certain types of economic activity, such as the development of cattle ranching for export, calls for the clearing of huge areas for grazing. Even Costa Rica, which has made a determined effort to preserve its tropical rainforests, still loses its forests to wood gatherers, squatters, pastures, and large banana companies.[14]

The economic consequences of environmental degradation, analysts point out, can be dire as "most people in Central America are directly dependent upon the natural resource base for their livelihood," and "about 25 percent of total domestic economic production. . . . comes from agriculture, forestry, fishing, and related activities."[15] These problems are compounded by the heavy use of pesticides in Central America, some restricted or not allowed in the United States, and by other forms of air and water pollution, all of which pose major health threats to Central American populations.[16] Sewage contamination of water supplies in Central America was, as of early 1992, responsible for over 1000 cases of cholera a month.[17]

In addition to AID programs aimed at helping promote sound natural resource management practices and environmental conservation, the United States is promoting environmental preservation through the debt-reduction component of President Bush's 1990 En-

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[12] For further information on Central American debt and U.S. policy, see the chapter on "Central American Debt," by Clarence Zuvekas elsewhere in this volume.

[13] Johnson, Tim. Barren Future Looms for Central America. *Miami Herald*, June 14, 1992. p 20A.

[14] Christian, Shirley. There's a Bonanza in Nature for Costa Rica, But Its Forests Too Are Besieged. *New York Times*, May 29, 1992. p. A6.

[15] Leonard, H. Jeffrey. Natural Resources and Economic Development in Central America: A Regional Environmental Profile. Study published by the International Institute for Environment and Development. Executive Summary, p. 11.

[16] Otis, John. Banana Growers Under Attack for Toxic Pesticides. *Miami Herald*, August 30, 1992. p. 1K, 3K.

[17] Dewar, Heather. Endangered: Environment. *Miami Herald*, May 31, 1992. p. 1A, 28A.

terprise for the Americas Initiative (EAI). Contingent on authorization legislation and a Congressional appropriation of funds to offset income losses to the United States, debt reduction under the EAI program reduces a country's concessional debt and directs interest payments on the remaining debt to an "EAI" fund established by the country and the U.S. Government. This fund would then provide a continuing flow of money to mutually agreed upon environmental programs.

TRADE AND INTEGRATION EFFORTS

The surest path to economic recovery and long-term growth, many analysts have argued, is increased trade, both through liberal access to the U.S. market, and through increasing trade within the Central American region. The United States has undertaken efforts to improve trade relations with the region. Since 1984, the Caribbean Basin Initiative (CBI) has afforded the countries of Central America preferential one-way access to the U.S. market (except Nicaragua, which was not accorded the access until 1990), but Central Americans are fearful that the adoption of the North American Free Trade Agreement (NAFTA) with Mexico and Canada will eliminate what gains they have made in the U.S. market. They believe that, as the smallest and poorest countries, they may lose markets and investment once Mexico has access to the U.S. market, including access for products once denied to Caribbean Basin countries. In 1990, President Bush announced the EAI which aspires to a hemispheric-wide free trade zone. The announcement stimulated both hopes and fears in Central America about future trade relations with the United States. [18]

Preferential access has been important to Central America, particularly to Costa Rica, which has seen its trade with the United States increase by 180 percent between 1983 and 1991. [19] Moreover, Costa Rica has achieved substantial diversification of its exports, in part because of U.S. efforts accompanying the CBI to encourage a trend towards liberalization and diversification. Because of this, the Central American countries wish to be granted the same preferences as Mexico obtains in a NAFTA at about the same time: some suggest an "accession" or "docking" clause which will allow them to join the NAFTA. While the recently signed NAFTA has a general accession clause, the United States has not yet taken a position on how this would be implemented, with divisions apparent within the government. Some observers have suggested that Caribbean Basin nations should be extended the same preferences afforded to Mexico under NAFTA, on a unilateral, but time-limited basis. Costa Rica, which has restructured its economy to meet U.S. criteria for economic reform, has been seeking a separate free trade agreement with the United States, but the United States has held to its position that it prefers to deal with regions rather than individual countries, with the exception of Chile. [20]

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[18] For further information in this volume, see the chapter on "Central America in the 1990s: The Challenge of Trade Liberalization," by Sylvia Saborio.

[19] Department of Commerce statistics, as reproduced by the Office of Regional Economic Policy, Bureau of Inter-American Affairs, Department of State, November 1991.

[20] In May 1992, the Bush Administration announced that it would seek to negotiate a free trade agreement with Chile after the completion of NAFTA.

The Central Americans have also made efforts to advance regional integration efforts. These were first enunciated in the Esquipulas accords of 1987. Intraregional trade was an important component of the vigorous growth in Central America in the 1960s and early 1970s, and the breakdown of trade caused by the intensification of civil conflicts in the 1980s has been often cited as one factor in the economic difficulties of Central America during that decade. Strengthening of integration has been viewed as an important component of renewed growth. Various efforts to bring all the countries together have resulted in some liberalization of trade, but the major achievement thus far is the May 1992 agreement signed in Ocotepeque, Honduras, by Guatemala, El Salvador, and Honduras to establish a free trade regime by January 1993. In attempts to expand trade throughout the hemisphere, the Central American countries and Mexico agreed to establish a free trade area by 1996, and they have held discussions with Venezuela about a similar arrangement.[21]

Whether growth can be stimulated through the intensification of intraregional trade efforts and the diversification of production has become an important issue as markets have weakened for Central America's primary export product—coffee. With raw coffee bean prices dropping steadily since 1989 to a 20-year low in May 1992, the economies of all Central American countries have been adversely affected, both economically and socially. Low coffee prices are seen as especially hurtful to economic and social development since much of the coffee grown in the region is produced by small farmers, particularly in Costa Rica where the 100,000 small coffee farmers have been described as the backbone of Costa Rica's rural economy.[22]

EFFORTS TO ALLEVIATE POVERTY

In the long-run, sustained economic growth would be expected to greatly ameliorate poverty. But for the present, the persistent high levels of dire poverty, even after conflicts abate, have raised humanitarian concerns, since without assistance the survival of many people may be at stake.[23] While some statistics show improvement in some health and education indices, the situation has not substantially improved since the conflicts began in the late 1970s. Statistics of the Pan American Health Organization for the late 1980s and 1990 show large portions of Central America's population living in absolute poverty. With regard to income distribution, Guatemala is the most inequitable in the region and Costa Rica the least inequitable.

In its evaluation of poverty in Central America in 1989, the Sanford Commission concluded that $850 million per year or $2.55 billion over three years would be required to assure the survival of the 2.3 million neediest people in the region, i.e., displaced persons and refugees, and people in extreme poverty in the areas where

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[21] For further information in this volume on regional integration, see "Policy Reform and Economic Integration in Central America in the 1990s," by Jose Manuel Salazar-Xirinachs.

[22] Johnson, Tim. Anxiety Rises As Coffee Prices Fall. *Miami Herald*, May 18, 1992. p. 1A, 11A.

[23] Even though the World Bank categorizes the Central American countries, as lower middle-income (with the exception of Honduras which is classified as low income), high levels of poverty and social inequalities persist.

these people would resettle. The Commission estimated that 10 million people in the region were living in extreme poverty.

U.S. interest in improving this situation continues, despite a sharp decrease in the levels of U.S. economic assistance during the 1980s and despite the shift in focus over the 1980s from direct basic-needs assistance towards support for structural reforms, institutional improvement, and economic growth. AID still provides significant support for a variety of child survival, primary and rural health care, and education programs in Central America. Some criticize the new focus on structural reform, but AID sees it as also targeted at alleviating the misery of poverty because it judges that "rapid and sustained economic growth ... provides governments with more revenue with which to expand primary education, primary health and nutrition programs, family planning programs, and other basic services ..." [24]

In addition, the United States has looked to multilateral financial and development institutions and to bilateral donors for additional assistance to fulfill basic needs. It has tried to encourage and systematize bilateral and multilateral assistance through an international coordination mechanism dubbed the Partnership for Democracy and Development.

CONTINUING SECURITY CONCERNS

Weak democratic institutions and practices, continuing human-rights violations, the size and influence of partially-reformed military institutions, continuing economic problems, and the emergence of drug trafficking in the region all create uncertainties about the future security and stability of these countries. At the current time, security concerns focus on three major areas: drug trafficking, the status of former combatants, and the continuing guerrilla war and violence in Guatemala.

DRUG TRAFFICKING

U.S. concerns over the use of Central America as a transshipment point for illegal narcotics to the United States and production there of narcotics have intensified over the last several years. Opium poppies are now grown in Guatemala and Belize in large enough quantities to attract U.S. attention. As cocaine interdiction has become more efficient along routes to the U.S. market through the Caribbean and Mexico, transshipments reportedly have increased through Central America. Large quantities have been seized within the past two years in Guatemala, in a Salvadoran port, off the coasts of Costa Rica and Honduras, and in Nicaragua. [25]

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[24] U.S. Agency for International Development. Economic Assistance Strategy for Central America 1991 to 2000. Washington, January 1991.

[25] Christian, Shirley. Central America: A New Drug Focus. *New York Times*, Dec. 16, 1991. p. A10; Hockstader, Lee. U.S. Technology Gleans Data on Drug Corridor. *Washington Post*, June 26, 1992. p. A25, A26.

REPATRIATION AND REINTEGRATION OF FORMER COMBATANTS AND REFUGEES

The difficulties of reintegrating former combatants into the daily life of El Salvador and Nicaragua have posed ongoing challenges to the governments of those countries. In both countries, the United Nations, and in the case of Nicaragua, the Organization of American States (OAS), have served indispensable roles in advancing and guaranteeing the reintegration process, and the United States has supported those international efforts financially.

In Nicaragua, some 28,000 contras have demobilized since peace accords were signed with the Chamorro government in mid-1990, and the Nicaraguan government states that the Popular Sandinista Army (EPS), has been reduced by over 50,000 members, from over 70,000 to some 18,500 as of July 1992. Despite this progress, there are concerns of renewed conflict as some of the disarmed members of both forces began taking up arms in mid-1991; as the economy has stagnated many ex-combatants have lost hope that economic conditions would improve and provide them with jobs.

With the signing of the peace accord on January 16, 1992, El Salvador faces a lengthy process of disarming the leftist guerrillas of the FMLN and reducing the army. For the estimated 6,800 guerrillas, the process is scheduled to culminate in October 1992, by which time the FMLN is to be disarmed and its military command structure is to be dissolved. Under the January 1992 accord, the Salvadoran military must cut its forces by half, reducing the army from about 62,000 to about 31,0000 men, by January 1994. The Salvadoran government must also purge corrupt officers and human rights abusers, terminate military intelligence services, and disband paramilitary entities and special counterinsurgency battalions.

Despite the valued role that the international peace guarantor forces have played in both countries, funding for them has been constantly in jeopardy. The mandate of the OAS operation in Nicaragua has been extended several times since 1990. Since then, the mission has demobilized the contras, collected and destroyed over 137,000 weapons, and quelled numerous potentially violent incidents. As of early fall 1992, the mission, scheduled to shut down in September, was to be extended through June 1993. [26]

The United States has also supported the repatriation of refugees through various bilateral projects and through the Central American Conference for Refugees, Returnees, and Displaced Persons (CIREFCA). Organized in 1989, CIREFCA was designed to attend to the needs of these persons (who at the turn of the decade numbered an estimated two million) and is an integral part of the Special Plan of Economic Cooperation for Central America, approved by the United Nations General Assembly on December 8, 1988.

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[26] Christian, Shirley. O.A.S. Goes in Peace (That's What It Came For). *New York Times*, July 16, 1992. p. A4.

NEGOTIATIONS IN GUATEMALA [27]

Guatemala is expected to prove the most intractable democratization problem in Central America, as it is the country with the largest social and economic disparities and the longest running guerrilla movement in the region. An important step forward will be a successful conclusion to negotiations begun in March 1990 to end an insurgency stretching over three decades during which 100,000 have died and 40,000 more have "disappeared." Although the United States has contributed substantial amounts of assistance to the country, it has had little influence over the course of peace negotiations, as military-to-military ties were virtually nonexistent since Guatemala indicated in 1977 that it was not interested in receiving U.S. aid conditioned on human-rights criteria. (Although the United States resumed military aid in 1986, it suspended it again in 1990.) Negotiations are also made difficult because the rebels have decreased from a high of 12,000 full time fighters about a decade ago, to an estimated 800–1,500, with some estimates as high as 3,500, in 1992. This gives them sufficient force to disrupt the country politically, but not enough to provide substantial leverage for negotiations.

Although peace negotiations have continued through several rounds in 1991 and 1992, they reportedly are stymied by various differences, the most contentious of which is the existence of the civil self-defense patrols, in which more than 300,000 peasants participate. The guerrillas see these patrols, organized by the military, as a continuing threat, and have refused to demobilize until they are dismantled; some analysts view the patrols largely as efforts by the indigenous people of highland Guatemala to retain their communities under their own control by keeping both the guerrillas and the army out of their villages.

[27] Information taken from: Golden, Tim. Guatemalans Lag in Quest for Peace. *New York Times*, February 27, 1992. p. A6; Hockstader, Lee. Mediator's New Peace Initiative Seen Spurring Guatemalan Talks. *Washington Post*, May 26, 1992. p. A13; Johnson, Tim. Patrols in Guatemala Keep A Tenuous Peace. *Miami Herald*, July 3, 1992. p. 12A; and Johnson, Tim. Inequities Persist As Guatemalan War Starts to Wind Down. *Miami Herald*, July 6, 1992. p. 10A.

CENTRAL AMERICA IN THE 1980s: THE TORTUOUS PATH OF REFORM

by Sylvia Saborio *

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INTRODUCTION

In assessing the extent of economic adjustment that has taken place in Central America in the 1980s, it is important to bear in mind that issues of war and peace, not economic reform, tended to dominate the agenda in much of the region. But of course, whether or not they were at the top of the political agenda, economic problems had to be addressed. And they were, but usually with the greatest reluctance and in ways that were dictated more by domestic political constraints than by sound economic reasoning.

While in Washington technocratic circles economic policy reform may be viewed as an organic and coherent process, among policymakers in the region, reform has often seemed less a matter of orderly, deliberate change than a haphazard, crisis-management exercise fraught with uncertainty and risk, and imposed from abroad, to boot. In any case, it would probably be unrealistic to expect countries immersed in the worst crisis since the Great Depression, engaged in war, and facing a hostile external environment to be

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able to tackle the crisis, the war, and the long-standing structural rigidities and distortions embedded in their economies at the same time. If they had such capabilities, they probably would not have been in such straits in the first place. Even so, the 1980s probably ushered in more economic policy reforms than any other decade in recent history.

The paper first focuses on the nature of the advice emanating from Washington and the extent to which it has been followed by countries in the region. It then examines the results attained and attempts to explain differences in the breadth and depth of reform and performance among the countries.

THE PROCESS OF REFORM

THE BLUEPRINT FOR REFORM

The "Washington consensus" [1]—as the basic reform package came to be known—was largely transmitted to the region via three channels: the U.S. Agency for International Development (AID), the International Monetary Fund (IMF), and the World Bank, with the Inter-American Development Bank (IDB) playing an increasingly supporting role in recent years. [2] If one were to assume a degree of influence commensurate with the amount of financial assistance provided, AID's views would surely have prevailed.

Actually, whether they have prevailed or not really depends on which AID views one has in mind. The economic/technocratic structure within AID has generally supported the strict conditionality associated with IMF stabilization programs and the World Bank structural and sectoral adjustment loans, and indeed, AID has often made its own disbursements contingent upon compliance with them. On the other hand, political/security concerns within and outside the AID have sometimes overridden economic considerations and resulted in the provision of plentiful financial assistance with virtually no economic conditionality attached. Honduras and El Salvador—the largest recipients of U.S. assistance in the region and also the least prone to reform—are cited as prime examples. On the whole, though, dissonance was minimal, and these institutions conveyed a pretty coherent and mutually reinforcing message from Washington.

In terms of the broad thrust and direction of reform—prudent macroeconomic management, greater outward orientation beyond the Central American Common Market (CACM), and greater reliance on markets as opposed to government intervention—the Washington view is by now broadly shared, *in principle*, by most governments and intellectuals in the region. It is also generally recognized that stabilization is a precondition to structural reform. On the other hand, there is considerably less uniformity of views, both among the Washington institutions and in Central America,

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[1] The term was coined by John Williamson to denote the package of policy reforms espoused by official Washington in the mid to late 1980s. See: Williamson, John, ed. *Latin American Adjustment: How Much Has Happened?*

[2] IDB project lending now typically requires an adequately managed exchange rate, positive real interest rates, non-subsidized utility rate structures and the like, that far exceed the conditionality traditionally associated with project loans. In addition, in recent years the IDB has also become involved in policy-based lending.

regarding the pacing and sequencing of the reform package, how best to resolve trade-offs and inconsistencies contained therein, and the proper mix of adjustment and financial support.

Does this amount to a consensus with Washington's views? Not entirely. Conditionality is still resented, and most countries wait until they have no other choice before coming to Washington for help. Except in the heady days of a new administration, reform is generally seen less as a positive goal than as a cross to bear, and policymakers everywhere are painfully aware of the costs. To some degree, of course, these contrasting attitudes merely reflect the fundamental difference between *giving* advice and *taking* it.

THE CONTEXT OF REFORM

A complex array of political and economic factors originating both within and outside the region made economic management extremely difficult in Central America in the 1980s. Among them:

War. All countries in the region suffered—albeit with different intensity—the consequences of war and social unrest. Nicaragua, El Salvador, and Guatemala bore the heaviest costs in terms of: human lives; damage to infrastructure; production losses due to destruction and/or abandonment of productive activities; dislocation in factor markets caused by the displacement of workers; conscription of civilians into the armed forces; emigration and capital flight; and, of course, the steep cost of the war effort itself. But even countries not directly involved in armed conflict, such as Costa Rica, suffered the side effects of the conflict via the influx of refugees; the disruption of intraregional trade and payments flows; the destabilizing effect on investment, capital movements, and tourism; and, last but not least, the considerable amount of time, energy, and resources dedicated to the pursuit of peace in the region.

External Shocks. In the late 1970s and early 1980s, all countries in the region suffered a sharp deterioration in their terms of trade—in the range of 15–30 percent—because of the rise in oil prices (all but Guatemala are oil importers) and the steep decline in the price of primary commodities, which constitute the bulk of the region's exports. (See Table 1.) In the course of the decade, adverse movements in terms of trade, coupled with weak export performance, resulted in declines in the purchasing power of exports of around 50 percent in Nicaragua and El Salvador and nearly 30 percent in Guatemala. The external position of these countries was further strained by the rise in international interest rates and the virtual suspension of new commercial lending to the region. The severity of these external constraints made it necessary to pursue extremely restrictive domestic policies which, given recessive trends elsewhere in the economy, resulted in significant output losses.

The unraveling of the "traditional model." Since the early 1960s Central America had followed a two-pronged growth strategy: the expansion of traditional agricultural exports to world markets and an inward-oriented industrialization process under the protective umbrella of the CACM, which was largely propelled by extraregional exports, but had an important regional multiplier effect. The strategy worked quite well in the prosperous 1960s, began to

TABLE 1. Central America: Price Indicators, 1983–1991.

(1980=100 except where noted)

	1983	1985	1987	1989	1990	1991
Change in consumer prices (percentages)						
Costa Rica	33	15	17	17	19	29
El Salvador	13	22	25	18	24	14
Guatemala	6	19	12	11	41	33
Honduras	8	3	3	10	23	34
Nicaragua	31	220	1,012	4,770	7,486	2,747
Real Minimum Wage						
Costa Rica	95	104	103	100	101	95
El Salvador [a]	97	84	75	64	62	64
Guatemala [b]	146	115	100	107	89	NA
Honduras [c]	91	86	83	75	80	81
Nicaragua	49	58	20	9	39	53
Terms of trade						
Costa Rica	88	88	97	84	73	75
El Salvador	82	69	61	80	53	52
Guatemala	84	83	85	94	87	81
Honduras	78	82	90	91	84	86
Nicaragua	83	98	101	107	99	102
Purchasing power of exports						
Costa Rica	92	96	116	131	124	136
El Salvador	68	58	51	42	40	43
Guatemala	73	71	68	75	75	77
Honduras	77	83	92	98	91	89
Nicaragua	97	71	67	70	73	68
Real effective exchange rate [d]						
Costa Rica	108	112	129	133	137	144
El Salvador	69	51	70	58	71	66
Guatemala	91	77	136	136	159	135
Honduras	78	72	78	73	128	136
Nicaragua	46	28	3	54	45	42

[a] Agricultural sector.
[b] Real average wage, 1987 = 100.
[c] Industrial sector.
[d] An increase in the index reflects a devaluation.
Sources: Consejo Monetario Centroamericano and Economic Commission for Latin America and the Caribbean.

experience serious difficulties in the late 1970s on account of the instability in international commodity markets and political problems in the region, and ran aground in the 1980s in the face of increasing hostilities and generalized payments problems among regional trading partners.

Thus, policymakers in the region were confronted with the dual challenge of trying to restore macroeconomic balance under uncommonly adverse conditions while, at the same time, attempting to steer these inefficient and vulnerable economies towards a new outward-oriented growth model.

The complexity of the situation and the generally adverse, often critical, conditions in which policy actions had to be undertaken posed serious problems of a technical, as well as a political, nature. Devising and implementing technically sound, consistent, and comprehensive policy packages to deal with the myriad problems afflicting these countries was a task that surpassed the capabilities of most bureaucracies in the region. Furthermore, creating the political space necessary for such an ambitious undertaking was also far beyond the capacity of most governments in the region.

Instead, authorities generally took a minimalist approach to economic reform, trying to tackle problems one at a time and doing as little as necessary in order to muddle through. As a result, policy changes have been somewhat erratic as to their timing, sequencing, and calibration; important policy reversals have occurred as governments yielded to opposing pressure groups; and, possibly in an effort to reduce such risks, reforms have often been circuitous and contrived rather than straight-forward and transparent.

THE REFORM AGENDA

FISCAL REFORM

Enormous pressure was brought to bear on countries to reduce fiscal deficits in order to curb inflationary pressures, external imbalances, and the crowding out of private investment. Structural rigidities in the budget, the automatic escalation of certain items—notably the accrual of interest payment obligations on public internal as well as external debt—and, in most cases (except Costa Rica), high and rising defense expenditures, made budget cutting extremely difficult. Nevertheless, deficits generally declined, except in Nicaragua, where half the budget was absorbed by the war effort, and the deficit hovered at around 20 percent of gross domestic product (GDP) (40 percent if the total public sector is included) throughout most of the decade. (See Table 2.)

The reduction of fiscal deficits was accomplished through a mix of expenditure cuts and revenue increases, in varying proportions among countries and over time, although it generally proved more difficult to raise revenues than to compress expenditures. On the other hand, the pattern of expenditure cuts was quite similar across countries. A disproportionate share of the cuts were made on the capital account, by scaling down or postponing new investments and by simply failing to give periodic maintenance to the existing infrastructure. As a result, the ratio of public investment outlays to GDP fell across-the-board from a range of 7–9 percent in 1980 to only about 3–4 percent. Among current expenditures, the structure shifted in favor of defense (except in Costa Rica), general administration services, and interest payments (on an accrual basis) at the expense of social and developmental outlays.

On the revenue side, efforts were made to mobilize resources basically through increased indirect taxation and through the reduction of implicit subsidies in the pricing of public utilities and other direct-price subsidies to consumers, such as basic grains for local consumption. No clear trends are discernible regionwide in terms of the overall tax burden (tax revenue/GDP). Where this ratio had traditionally been low, in the range of 6–12 percent (i.e. Guatemala and El Salvador), it tended to remain so, although it rose somewhat in the former, whereas in the latter it declined instead. In Honduras and Costa Rica, tax/GDP ratios remained in the neighborhood of 15 percent. Finally, in Nicaragua, after having risen to about 35 percent in the mid-1980s, the tax/GDP ratio plummeted to around 17 percent, largely as a result of the "Olivera-Tanzi effect," i.e., the

TABLE 2. Central America: Public Finance Indicators, 1983–1991.

	1983	1985	1987	1989	1990	1991
Current Revenues (percentage of GDP) [a]						
Costa Rica	16.6	16.2	15.6	15.4	14.6	15.2
El Salvador	12.4	13.4	11.9	8.1	8.6	9.1
Guatemala	8.2	7.7	9.4	9.5	7.9	9.1
Honduras	13.3	15.6	16.4	14.8	16.4	17.3
Nicaragua	31.2	32.3	27.7	12.8.	15.3	20.9
Total expenditures (percentage of GDP) [a]						
Costa Rica	19.9	18.2	17.7	19.5	19.0	18.3
El Salvador	21.2	17.1	15.5	13.1	11.9	13.6
Guatemala	11.2	9.6	11.9	13.2	10.2	9.3
Honduras	23.6	24.6	23.3	22.1	24.1	20.3
Nicaragua	56.4	54.8	44.3	14.8	36.3	28.7
Fiscal deficit (percentage of GDP) [a]						
Costa Rica	3.3	2.0	2.1	3.9	4.4	3.2
El Salvador	3.4	2.7	1.3	4.9	3.2	4.4
Guatemala	3.0	1.8	2.5	3.8	2.3	0.2
Honduras	10.4	9.0	7.0	7.3	7.7	3.5
Nicaragua	24.0	21.9	16.2	1.9	21.0	7.5
Domestic financing (percentage of deficit)						
Costa Rica	82	2	71	82	93	50
El Salvador	15	30	8	53	NA	27
Guatemala	70	61	62	66	74	0
Honduras	46	32	59	66	16	2
Nicaragua	88	97	100	26	93	NA
Central Bank losses (percentage of GDP)						
Costa Rica	4.9	5.2	3.5	2.7	2.0	1.5
El Salvador	0.0	0.0	0.0	0.0	1.0	0.3
Guatemala	0.0	4.2	1.7	0.7	2.4	1.5
Honduras	0.0	0.0	0.0	0.0	3.1	0.0
Nicaragua	4.0	2.8	5.3	NA	NA	NA

[a] Central government only.
Sources: Consejo Monetario Centroamericano and IMF.

erosion in the real value of receipts between the time taxes accrue and the time they are collected due to hyperinflation.

In terms of tax reform proper, the record is almost universally bad. A number of factors appear to have conspired against an increase in the tax effort. Most of these countries rely heavily on traditional export taxes, especially on coffee. This naturally subjects tax revenues to a boom-bust pattern dependent on the vagaries of international primary commodity prices, and has the additional disadvantage of making fiscal and balance-of-payments crises go hand-in-hand. However, the sporadic, temporary fiscal relief that comes about every time there is a surge in primary commodity prices obscures the need and reduces the pressure to switch to more permanent and stable sources of revenue.

Another factor impeding an increase in the tax effort was the erosion in the tax base due to the decline in GDP, inflation, and the expansion of the informal relative to the formal sectors of the economy. But even within the formal economy, the existence of numerous loopholes—and a patchwork of exemptions, exonerations, and tax holidays linked to various incentive schemes to foster investment, production, and exports—provide plenty of opportunities to legally avoid taxation. In addition, deficient tax-collection systems, and weak powers to enforce compliance when anomalies are detected, probably make tax evasion the rule rather than the exception in most places. The irony is that *on paper* tax rates are often high; and although nobody really pays them, high tax rates constitute a formidable weapon to sabotage efforts to increase taxes whenever the subject comes up.

An additional problem is that some of the reforms implemented as part of the "new model" have also strained the public purse. Export-promotion schemes effectively delink fiscal revenues from the most dynamic sector of the economy or, worse, constitute outright drains when the incentives also include tax rebates. At the same time, import liberalization measures in the face of constrained overall import capacity, also result in a loss of tariff revenues.

All those reasons make integral tax reform both a pressing need and a very risky political proposition. The power to tax is simply very weak. For instance, in Guatemala and El Salvador, where tax burdens are extremely low (below 10 percent), tax increases that had been already decreed were subsequently rolled back and a subsequent tax-reform package in Guatemala is expected to yield a net reduction of revenues. In Costa Rica it took a whole year to pass through the legislature a tax-reform bill whose provisions became so complex and confusing along the way that it was practically impossible to assess its impact. If these precedents are any guide, a fair, simple, transparent, and efficient tax system is a long way off.

A separate but related matter to the size of the deficits and the manner in which they were cut, is the issue of how those deficits were financed. This is dealt with at some length in the section below on "Financial Reform," but the general pattern was as follows. In the early 1980s, as access to foreign credit became increasingly difficult to procure, countries tended to rely rather heavily on domestic financing by the banking system, either through direct loans by central banks or through the more or less involuntary purchase of government paper by the commercial banks.

Over the years, less reliance was placed on this type of borrowing, and deficits were increasingly financed through a combination of external credit and grants (where available), domestic borrowing from non-banking sources, and the accumulation of both external and internal arrears (floating debt).

Several aspects of fiscal management are worth pondering about. The overriding concern throughout the 1980s was to compress fiscal deficits and in this, as noted, most countries succeeded to some extent. How this was done is another matter. It is worrisome that the restoration of macroeconomic balance was done in ways that exacerbate the social cost of adjustment and that jeopardize future growth. In a period of declining incomes, falling wages, and high unemployment, the share of social services in the budget ought to have been at least maintained. Similarly, the decay in physical infrastructure through neglect and, in some cases, war damage as well, impairs economic recovery and structural transformation. In order to free the resources for this badly needed physical and social investment, fundamental changes will be necessary on both sides of the budget. This will require, in turn, that hard choices be made regarding the role, size, and efficiency of the public sector and the manner in which it will be financed.

FINANCIAL REFORM

Financial reform has been another uphill battle. In most of these countries, the financial sector is segmented into a formal system of not-very-efficient, highly-regulated, and often state-controlled institutions, alongside a network of informal channels that handle the overflow. In the formal system, interest rates on both loans and deposits have been traditionally set by the central banks, along with guidelines for credit allocation to various categories of borrowers, including the government and state-owned institutions. Like the exchange rate, interest rates have tended to be kept low and fixed in nominal terms, with only occasional adjustments to their level and structure.

In the 1980s, a series of shocks buffeted these countries' already weak financial sectors. The failure of large numbers of firms and the virtual insolvency of others on account of the sharp downturn in economic activity, left banks with large, uncollectible debts. Inflationary surges wrecked havoc on the level and structure of domestic real interest rates. (See Table 3.)

TABLE 3. Central America: Monetary Indicators, 1983–1991.

	1983	1985	1987	1989	1990	1991
Total liquidity (percentage of GDP)						
Costa Rica	50.0	44.3	44.2	50.7	49.9	51.7
El Salvador	34.0	37.4	32.2	26.0	26.2	28.0
Guatemala	25.3	29.7	25.9	25.6	21.5	21.1
Honduras	30.4	30.0	32.7	33.8	32.7	30.0
Nicaragua	50.6	56.1	55.6	NA	9.1	18.4
Net domestic credit (percentage of GDP)						
Costa Rica	44.2	36.4	37.0	30.1	30.5	26.3
El Salvador	51.5	49.0	36.5	29.0	26.2	26.8
Guatemala	34.6	34.9	22.9	20.8	16.0	10.1
Honduras	46.8	48.8	50.1	48.3	41.6	32.9
Nicaragua	101.5	77.8	49.7	NA	258.9	326.1
Net claims on public sector (percentage of total domestic credit)						
Costa Rica	35.7	47.0	48.5	46.0	48.0	45.2
El Salvador	42.1	40.4	34.5	25.1	27.1	27.1
Guatemala	39.8	43.3	24.8	22.2	18.6	NA
Honduras	30.3	28.7	27.2	30.5	25.2	20.8
Nicaragua	65.9	78.9	73.4	20.7	38.4	25.6
Real interest rates (annual percentage rate)						
Loans						
Costa Rica	−5.1	9.7	5.3	14.5	11.0	12.3
El Salvador	1.1	−5.2	−3.8	2.0	−1.6	5.0
Guatemala	8.1	−5.5	1.5	−36.3	−27.5	14.5
Honduras	9.9	14.2	13.1	5.9	−3.5	−5.2
Nicaragua	−11.1	−51.4	−85.5	−5.2	−22.0	19.4
Deposits						
Costa Rica	−8.0	5.0	3.2	12.3	5.3	2.9
El Salvador	−2.7	−8.6	−8.1	−1.0	−4.8	1.0
Guatemala	5.3	−8.1	−1.2	−8.7	−29.0	8.2
Honduras	1.6	6.3	6.2	−1.0	−10.8	−13.4
Nicaragua	−15.6	−51.9	−85.5	−5.7	−25.1	13.4

Source: Consejo Monetario Centroamericano.

Meanwhile, rising international interest rates, coupled with the reluctance of foreign commercial creditors to extend new loans or roll over old ones put a further squeeze on the banks. Heavy valuation losses accrued to all holders of external liabilities, including the banks, in the face of depreciating local currencies. Additional strains were caused by the heavy losses incurred by central banks through their interventions in the various foreign-exchange markets and by the need to accommodate the sizable borrowing requirements of the non-financial public sector, whose external sources of finance had suddenly dried up.

Thus, on top of their traditional, structural deficiencies, financial systems became the catch-all for the unresolved problems and policy shortcomings in other areas. Money creation was essentially driven by the financial needs of governments and the losses of central banks in their defense of overvalued exchange rates and, in some cases, their direct absorption of the external obligations of public—and sometimes even private—debtors. While this transfer of liabilities to central banks resulted in deficits for the non-financial public sector lower than they would otherwise have been, it still did not meet all the financing requirements of the sector, especially since the shortfall in external credit had to be made up with domestic resources.

This often put central banks on a collision course with treasuries over whether the remaining public sector deficit ought to be financed directly by the banking system or whether they both should scramble for funds in what became very short term money markets. (Indeed, inflation and expectations of continued instability so enhanced liquidity preference among prospective lenders, that only high-yield, no-risk, highly-liquid instruments could be sold on a voluntary basis in the market.) How this conflict got resolved was instrumental in determining the profile of domestic real interest rates, as well as the trade-off between internal and external stability.

As it happened, the treasuries initially won out: there was substantial direct financing of public deficits by the banking system, as reflected in increases in the share of net claims on the public sector within total domestic credit in every country in the region. By the mid-1980s, however, this trend was reversed (except in Nicaragua), and a rising proportion of the banking system's domestic credit went to the private sector. Correspondingly, as noted, governments resorted to other internal and external sources of finance and, when all else failed, they built up arrears.

The crowding out—first of the private sector and then of the public sector—from access to credit from the banking system put upward pressure on underlying domestic interest rates. Where these pressures were repressed, (i.e., El Salvador, Nicaragua, and, until recently,Guatemala), capital tended to shift from the formal to the informal sectors and often out of the country altogether. Meanwhile, rent-seeking behavior on the part of economic agents with access to subsidized credit distorted even more the allocation of credit and the distribution of income. Where government intervention in rate-setting was reduced and interest rates were essentially market-driven (i.e., Honduras, Costa Rica), real rates became and remain very high. While, other things being equal, this discourages capital flight, it also tends to discourage productive investment and aggravates the fiscal deficit.

The abandonment of interest-rate setting and credit rationing on the part of the central bank also poses the question of how to control monetary and credit expansion? In industrial countries this is done mainly through open market operations, but none of these economies has fully developed financial markets. So, money market operations on a large scale would pit the central bank against the treasury in fierce competition for essentially the same limited pool of funds. Instead, central banks (in Costa Rica and to a lesser degree in Honduras) relied heavily on the discount rate and legal reserve requirements to control monetary aggregates. The former was set at prohibitive levels, not only in real terms, but also in relation to commercial lending rates, thus effectively discouraging anyone from even approaching the discount window. At the same time, legal reserve requirements against deposits were raised to very high levels, in the range of 30–40 percent. The excessive reliance on legal reserve requirements to contain credit expansion unduly increased the cost of financial intermediation and the profitability of banks, thus feeding back into further upward pressure on lending rates.

Thus, by the late 1980s it became apparent that the financial-liberalization process could not proceed much further without first tackling the fundamental causes of money creation and fiscal imbalances. In the case of Honduras, there was room for relieving financial pressures through further budget cuts, since the fiscal deficit was still high (around 7 percent of GDP), as was subsequently done. In the case of Costa Rica, the situation was more complex, since the non-financial public sector was practically in balance, and it was the losses of the central bank that caused the problem. Since those losses accrued mainly from the revaluation of the stock of foreign debt every time the currency was devalued (whether the debt was actually paid or not), and the pace of devaluation could not be slowed down without impairing the export drive, a reduction of the external debt overhang was clearly called for. This argument was used by Costa Rica to press for its debt-reduction deal. [3]

EXCHANGE RATES

The battle to realign exchange rates has been an intense and difficult one. All countries in the region had a longstanding tradition of fixed nominal exchange rates, and keeping them that way had been a matter of national pride. Honduras, for instance, had the lempira pegged to the dollar at a rate of 2L=$1 since 1918, and currency realignment was viewed in some circles as the ultimate indignity. Elsewhere, there was concern that in small, undiversified economies, where import dependency is high and supply elasticity is low, nominal devaluations of the currency would simply lead to inflation and trigger a vicious cycle of devaluations negated by price instability that would then require further devaluations and so on.

[3] See: Saborio, Sylvia, "The Costa Rican Debt Accord: Lessons and Implications", elsewhere in this volume. Prior to the debt deal, the external debt overhang was the main cause of the central bank losses; subsequently, interest obligations on domestic debt became the main culprit.

For all these reasons, by the early 1980s exchange rates in the region were way out of line. Despite the countries' misgivings, an uncommon combination of adverse events—the second oil shock, collapsing primary commodity prices, the virtual standstill of the CACM, the global recession, high and rising international interest rates, and practically no external credit—forced them to capitulate one by one. But they did so in circuitous ways, so as to avert a clear-cut devaluation of the currency. Instead, the preferred approach was to create intermediate parallel markets between thriving black markets already in place and the official exchange rate. Authorities then proceeded to shift imports and export receipts from the official market onto the others until the exchanges stabilized. By managing the flows in that manner, they effectively devalued without actually having to change the official parity. In the process, though, the authorities created an extremely complex web of separate but interconnected markets that became a nightmare to administer, provided vast opportunities for corruption, and ultimately did not shield them from the need to openly devalue.

But, having bothered to devise a mechanism for surreptitious devaluation, were currencies actually realigned? Only Costa Rica and Guatemala managed both to streamline the foreign exchange regime and attain a real effective devaluation of the currency in a sustained fashion (some 40–45 percent with respect to 1980 levels). By decade's end, the others were still saddled with cumbersome exchange systems and hopelessly overvalued currencies, but have since made important strides towards rationalizing their foreign exchange regimes.

TRADE REGIME

The need to shift to a more outwardly-oriented strategy beyond the CACM was one of the most persistent themes in the policy dialogue between the Washington institutions—particularly AID and the World Bank—and these countries. And in this area some tangible results were actually achieved. Aside from the realignment of exchanges rates—where the record is mixed, as noted above—a two-fold approach to reduce the anti-export bias was suggested: 1) a reduction in the level of effective import protection afforded by the Common External Tariff (CET), along with the elimination of nontariff barriers to trade; and (2) the establishment of specific systems of incentives to promote nontraditional exports to markets outside the CACM.

At any other time during the last two decades, talk of dismantling or weakening the CACM would have drawn fire, but after the virtual collapse of the Common Market on its own in the early 1980s, authorities were more prone to consider new options.

As a result, the 1980s witnessed two rounds of tariff-cutting of the CET. The first, spearheaded by Costa Rica, aimed not only at reducing import protection but also at rationalizing the trade regime. It converted specific tariffs into ad valorem rates, switched the nomenclature to the Brussels code, and eliminated all exemptions under the Central American Agreement on Fiscal Incentives, as well as the existing regional investment incentives and import surcharges under the San Jose protocol. As a result of this exercise, which entered into force on January 1, 1986, the maximum tariff was lowered from 220 percent to 100 percent, the mean tariff was halved from 53 percent to 26 percent, and tariff dispersion as measured by the standard deviation was reduced from 52 percent to 21 percent.

The second round was initiated in 1987 by Costa Rica alone, under safeguard provisions of the CACM, as part of its second Structural Adjustment Loan (SAL II) agreement with the World Bank. The reform lowered the maximum tariff to 40 percent, reduced the average tariff to 16 percent, and cut tariff dispersion to 13 percent. Other countries in the region subsequently initiated tariff cutting reforms of their own, also under safeguard provisions of the CACM. As a result, the common external tariff ceased to be "common," but countries have agreed to revert to a unified tariff schedule within a range of 5 to 20 percent by 1994. [4]

The notion of export promotion was championed by AID, and export-incentive schemes began to be introduced in most countries (Honduras, El Salvador, Costa Rica) in the mid-1980s. These schemes typically involved such provisions as duty exemptions on imports of intermediate and capital goods for export, income tax holidays for a number of years, the establishment of free zones and temporary admission regimes, preferential access to credit, licenses to sell all or part of foreign exchange proceeds from nontraditional exports in the parallel market at more favorable rates, and tax rebates linked to the value of exports.

While nontraditional exports have expanded rapidly—partly as a result of the incentives—so have the problems associated with the schemes. First, the fiscal cost has become increasingly burdensome and adds to the inflexibility of the budget through automatic escalation. Second, incentives create distortions, whereas the whole thrust of the reform is supposedly to remove them. Finally, export incentives are being challenged through countervailing action, notably in the United States.

In sum, an inevitable winding down of export-promotion schemes cannot be far off. The question is then, how is the export momentum going to be maintained? In countries where the exchange rate is still overvalued, currency realignment is the obvious place to start. But in cases where there has already been a large and sustained real effective devaluation of the currency (i.e. Costa Rica and Guatemala), it is not obvious that further devaluation is advisable, particularly in view of its implication for central bank losses and domestic inflation.

In the case of Costa Rica, my view is that incentives, particularly tax rebates, have been far too generous and could probably be significantly reduced without unduly curtailing export activity, provided the exchange rate policy is maintained and indirect benefits, such as improvements in ports and transportation facilities, custom-clearing procedures, etc., are stepped up. But even if export growth suffered in the short run, a change of signals is important to ensure that those exporters that remain or enter the arena are lured by the activity itself and not by the pursuit of fiscal rents.

[4] See: Saborio, Sylvia "Central America in the 1990s: The Challenge of Trade Liberalization", elsewhere in this volume.

PRIVATIZATION/DEREGULATION

Another item high on the agenda of both the World Bank and AID has been the need to reduce the size and role of the state through divestiture and deregulation. In this vein, the sale of public enterprises, as well as the privatization of certain activities heretofore performed by the state, was recommended as a means not only to reduce fiscal deficits, but also to reap efficiency gains. While this is a sensible idea, its potential should not be overestimated. Many of those enterprises were in the public sector in the first place because they were either deemed to have strategic value, or constituted natural monopolies in the small economies of the region, or required large and lumpy investments with long recovery periods that private firms could not be expected to make; many of these reasons remain valid today.

To be sure, over time governments have gotten involved in activities that far transcend the scope of the minimalist tradition—cement, fertilizers, marketing, financial intermediation. Harsh fiscal realities warrant a reassessment of the benefits of such involvement. Still, the zeal for privatization as a cure-all should probably be toned down in favor of a less ideologically-motivated efficiency drive in both the public *and* the private sector; while government inefficiency may be flagrant all around, markets in all of these countries are likewise concentrated, fragmented, and notoriously inefficient.

The most ambitious privatization program in the region was undertaken by Costa Rica, where AID funds were used to essentially dismantle the state holding company (CODESA): of over 40 companies held in the early 1980s, all but 2 have been sold, liquidated, or otherwise disposed of. There, the process has probably reached its tolerance limit, at least for the time being, but in other countries in the region further movement is underway. El Salvador has decided to privatize the banking system, along with other public agencies and activities. Honduras has plans for a major divestiture program of public enterprises. And in Nicaragua attempts are being made to denationalize and privatize a great many of the activities and enterprises that came under government control under the Sandinistas.

Like state ownership, the tradition of government intervention is well entrenched in Central America, although abundant regulation does not really translate into very effective control: it is mostly red tape. But effective or not, there is a tremendous resistance to relinquish formal controls and probably more deregulation has occurred by default (i.e., through inability to control) than by design. Some progress has been made in the area of prices, wages, the financial sector, and the surrender of control implied in the divestiture of public enterprises and the privatization of certain activities. In a similar vein, attempts have been made, if not to deregulate, at least to simplify procedures (i.e., the creation of one-stop centers for the promotion of foreign investment and exports). On the whole, however, the instances of deregulation have tended to be isolated, sporadic episodes rather than a systematic dismantling of state controls. The seachange in attitude required to tackle that task with a vengeance has not yet occurred.

Economic Performance

The 1980s were struggling, immiserizing years. Every country in the region was far worse off in 1990 than it had been 10 years before. (See Tables 4 and 5.) GDP losses were staggering: in per capita terms, the cumulative GDP decline over the decade ranged from 6–8 percent in Costa Rica and Honduras, to 20 percent in Guatemala, and 25–30 percent in El Salvador and Nicaragua. Meanwhile, neither internal nor external balance was attained anywhere, although all countries, except Nicaragua, managed to escape the spiralling hyperinflation prevalent elsewhere in Latin America. Within this dismal regional picture, however, there are important differences among countries that derive from disparate initial conditions, the differential impact of exogenous shocks, and the exercise of diverse policy options.

TABLE 4. Central America: Real Sector Indicators, 1983–1991.

	1983	1985	1987	1989	1990	1991
Real GDP growth (percentages)						
Costa Rica	2.9	0.7	5.4	5.5	3.7	1.3
El Salvador	0.8	2.0	2.7	1.1	3.4	3.5
Guatemala	−2.6	−0.6	3.1	4.1	3.1	3.2
Honduras	−0.2	3.2	4.9	4.3	0.1	2.2
Nicaragua	4.6	−4.1	−1.1	−5.1	1.0	−0.7
Real GDP per capita (1980=100)						
Costa Rica	85.1	87.7	90.5	94.0	95.1	93.8
El Salvador *	73.4	74.9	74.8	73.8	74.8	75.5
Guatemala	87.1	82.0	80.9	82.8	83.1	83.5
Honduras *	88.9	88.9	94.2	96.2	93.2	92.3
Nicaragua	74.3	87.1	74.8	74.0	72.1	69.3
Investment as share of GDP (percentages)						
Costa Rica	24.2	25.9	28.2	26.0	28.3	23.3
El Salvador	12.1	10.8	12.1	15.3	11.8	12.9
Guatemala	11.1	11.5	13.8	13.5	13.2	12.9
Honduras	14.9	18.1	14.7	17.6	22.3	21.6
Nicaragua	22.5	23.1	15.8	26.4	20.2	19.8
Export Volume (1980=100)						
Costa Rica	101	108	118	143	155	166
El Salvador	83	86	86	64	78	84
Guatemala	86	88	83	99	110	121
Honduras	90	105	101	111	120	114
Nicaragua	118	75	70	68	78	70
Import Volume (1980=100)						
Costa Rica	64	75	86	115	127	117
El Salvador	93	94	98	113	94	108
Guatemala	73	77	99	107	98	113
Honduras	67	81	89	89	90	88
Nicaragua	99	110	109	77	79	81

* 1978=100.
Sources: Consejo Monetario Centroamericano and Economic Commission for Latin America and the Caribbean.

COSTA RICA

After three decades of practically uninterrupted economic growth with social progress and political stability, Costa Rica plunged into a severe recession in 1980-1982. Over the years the country had accumulated large internal and external imbalances as it tried to compensate for the income loss imposed by the oil price shocks of the 1970s through domestic expansionary policies financed by additional foreign borrowing. The situation became untenable in the face of a sharp decline in terms of trade, coupled with a steep rise in interest rates (given the large stock of short-term and variable-interest debt), and the withdrawal of virtually all external commercial credit.

TABLE 5. Central America: External Sector Indicators, 1983-1991.

	1983	1985	1987	1989	1990	1991
Trade balance (percentage of GDP)						
Costa Rica	−1.5	−1.8	−3.1	−7.8	−11.6	−6.5
El Salvador	−2.0	−5.0	−7.2	−11.5	−12.6	−13.8
Guatemala	0.4	−0.3	−5.0	−7.3	−6.2	−6.4
Honduras	−1.9	−2.6	−1.2	−0.7	−3.5	−3.3
Nicaragua	−13.2	−20.5	−17.9	−27.5	−24.4	−21.0
Current account balance (percentage of GDP) [a]						
Costa Rica	−9.1	−3.3	−6.0	−8.0	−9.1	−2.2
El Salvador	−0.9	−1.4	3.0	−3.2	−2.5	−2.8
Guatemala	−2.5	−4.0	−6.5	−5.4	−4.0	−3.0
Honduras	−7.3	−5.9	−5.5	−5.2	−3.8	−7.1
Nicaragua	−21.1	−30.6	−36.4	−38.6	−36.3	−23.1
Unilateral transfers (percentage of GDP)						
Costa Rica	1.5	4.5	2.7	2.9	2.9	2.0
El Salvador	4.4	4.8	8.2	4.9	4.2	3.0
Guatemala	0.0	0.0	1.9	1.4	0.9	0.6
Honduras	1.1	3.8	2.9	1.4	7.1	3.8
Nicaragua	2.8	4.5	7.6	10.6	12.8	33.2
Public external debt (percentage of GDP)						
Costa Rica	102.3	94.6	83.4	73.3	55.0	57.2
El Salvador	50.8	49.8	37.9	26.4	29.0	30.1
Guatemala	23.7	39.4	37.9	39.5	37.7	27.9
Honduras	57.4	62.1	66.7	77.0	106.9	93.6
Nicaragua	122.9	180.9	226.9	NA	751.1	671.8
Debt service (percentage of exports)						
Costa Rica	54.8	52.1	44.3	40.9	NA	NA
El Salvador	41.1	41.5	41.9	NA	35.1	58.2
Guatemala	28.3	40.9	30.0	16.2	16.8	15.7
Honduras	23.6	24.4	36.0	40.5	59.9	51.1
Nicaragua	19.7	14.7	NA	188.0	187.0	500.0

[a] Inclusive of unilateral transfers.
Sources: Consejo Monetario Centroamericano and Economic Commission for Latin America and the Caribbean.

At the trough of the recession, income per capita had plunged 15 percent below its peak (1979) level; the rate of unemployment was nearly 10 percent; inflation reached 100 percent; the fiscal and current account deficits hovered at around 15 percent of GDP; the exchange rate veered out of control, multiplying 5-fold in a matter of months; foreign reserves were all but depleted and, having lost access to virtually all credit sources, the country had to suspend most external payments.

Upon taking office in May 1992, the Monge administration immediately adopted a 5-point economic stabilization plan aimed at:

1) restoring order and stability to the foreign exchanges; 2) drastically reducing the fiscal deficit; 3) ensuring equitable burden-sharing of the adjustment costs through an incomes policy designed to protect the most vulnerable groups from the worst onslaughts of the crisis and the policies; 4) restructuring all external debt obligations and 5) renewing orderly financial relations with multilateral agencies and friendly governments.

The "shock treatment" was remarkably successful. Within two years the foreign exchange market had been consolidated and stabilized and a crawling-peg system had been put in place to prevent the overvaluation of the colon. The fiscal deficit had been cut back to 6 percent of GDP. Inflation had receded to an annual rate of 10–15 percent. The decline in national income had been halted, and the rate of unemployment was diminishing. Within this two-year period, the country also entered into a stand-by agreement with the IMF, restructured its official bilateral debt at the Paris Club, rescheduled its commercial bank debt, and started preliminary discussions with the World Bank on a structural adjustment loan.

In subsequent years, the emphasis shifted toward the consolidation of the stabilization process, the reactivation of economic activity, and the outward reorientation of the economy. It took several years of consciousness-raising and consensus-building, but the country is by now fully committed to a process of outwardly-oriented structural transformation.

A major preoccupation in those years centered on relieving the country's precarious external payments situation: full servicing of the external debt on contractual terms would have absorbed over 45 percent of export earnings and nearly 75 percent of national savings. An outward transfer of that magnitude would have precluded any real growth. The economy was able to expand at an average annual rate of 4.5 percent largely because it did not fully meet its external financial obligations. It was not until May 1990 that the country was able to normalize relations with its commercial creditors, through a Brady-type debt deal that reduced by two-thirds its outstanding commercial debt. [5]

At present, internal debt is the larger problem. Indeed, while fiscal deficits have been on the decline, the external resources available to finance those deficits have declined even more, so that deficits are now almost entirely financed domestically through the issuance of high-yield, short-term bonds. Apart from the crowding-out of other potential borrowers and the generalized upward pressure on domestic interest rates that this causes—and that feeds back into the public budget—the extremely short-term structure of the internal debt requires constant refinancing and obstructs the proper use of open market operations by the Central Bank. A critical review and radical reform of public finances—the amount of resources to be allocated, the purposes to be served, the efficiency with which those resources are used, and how they are financed—will be one of the main challenges for Costa Rica in the 1990s. In the years ahead, the country will also have to face up to its social and environmental debts.

[5] For a discussion of the agreement, see Saborio, Sylvia "The Costa Rican Debt Accord: Lessons and Implications", elsewhere in this volume.

EL SALVADOR

Rather than big upheavals, the Salvadorean economy experienced a long decade of stagnation. Following a sharp decline when the insurrection first broke out in the late 1970s, real GDP per capita has remained essentially unchanged at a level 25 percent below its peak in 1978. With violence in the countryside undermining the country's agricultural base, the shrinking local and regional markets depressing industrial activity, and sabotage damaging much of the country's infrastructure, El Salvador has suffered a significant drain of its productive resources: human, physical, and financial. The economy settled into a pattern of low resource utilization (25–30 percent open unemployment) and low output generation.

Throughout most of the 1980s, large infusions of external transfers—mostly AID grants and remittances from Salvadoreans in exile—financed as much as 80 percent of the country's import bill and a similar portion of the fiscal deficit, masking the need to adjust the highly overvalued currency and correct the negative real interest rates. In effect, El Salvador suffered from an aid-induced "Dutch disease."

The Cristiani administration has undertaken a radical change of course. Its "Economic and Social Development Program" is a blueprint for reform that fully takes account of the Washington consensus. It aims to redress macroeconomic imbalances, increase efficiency through greater reliance on market forces, protect the poor from the adverse impact of adjustment measures, and reduce absolute poverty. The program calls for: monetary restraint and positive real interest rates; a two-tier foreign exchange regime with market forces playing a role in determining the exchange rate; reducing tariff protection to a maximum nominal tariff of 20 percent by the end of 1992 and eliminating all non-tariff barriers; reducing the public deficit through privatization of public enterprises and activities (including the banking system), higher taxes and better tax administration, and through expenditure cuts, (i.e., a freeze on public employment and wages, an early retirement program, and the elimination of subsidies); and liberalizing most prices.

GUATEMALA

After a prolonged period of relatively rapid growth, the Guatemalan economy contracted sharply: from 1980 through 1986, GDP per capita fell annually, for a cumulative decline of 20 percent in per capita income levels. In order to counteract the contractionary impact derived from the decline in terms of trade and the precipitous fall in exports (in 1980–85, the purchasing power of exports fell by 30 percent), the authorities pursued an expansionary domestic policy financed by external borrowing. As it happened, external debt trebled between 1980 and 1985 (from $934 million to $2,695 million), but did not produce the intended reactivation of domestic activity, as political instability and a severely overvalued exchange rate caused most of the inflow to be dissipated in capital flight.

The crisis erupted in 1985 when, unable to continue borrowing abroad, the central bank proved no longer able to support the highly overvalued official exchange rate; a black market developed and eventually the authorities established a parallel market where the rate was nearly three times the official rate. In turn, imports contracted by nearly 20 percent from 1984 levels, external arrears began to accumulate, and domestic inflation soared from 3 percent in 1984 to over 30 percent in 1986.

The Cerezo administration, which took over in early 1986, launched the "Programa de Reordenamiento Economico y Social de Corto Plazo" (PRES) to stabilize the foreign exchanges, cut back the fiscal deficit, reduce internal liquidity so as to contain inflationary pressures, and improve the external payments position. The PRES was a watershed: it restored confidence within Guatemala and, very importantly, it helped to secure large amounts of external support for the country.

Within a year, improvements were evident in several areas: for the first time in seven years the decline in per capita GDP was arrested. Price escalation reverted to a rate of around 10 percent, aided by the easing of speculative pressures against the quetzal and the very large increase in imports (50 percent), which boosted domestic supplies. Even though the deficit of the nonfinancial public sector expanded somewhat, 70 percent of it was externally financed—half of it through grants—so that the pressure on domestic financial markets was actually reduced. Further relief was derived from a sizeable reduction in the losses of the central bank due to the stabilization of foreign exchange markets and the decision that public agencies, not the central bank, would, from then on, absorb the exchange risk of their own external indebtedness.

Despite a large trade deficit, the balance of payments position was eased by large capital inflows in the form of official credits, unilateral transfers, and foreign direct investment, as well as some reflow of domestic capital that had previously fled the country. The external payments situation was further eased by the fact that Guatemala rescheduled a portion of its external public debt.

These positive trends have generally continued, and Guatemala seems to be well on its way to consolidating its internal balance. Investment—both public and private—has been rising; economic activity is expanding moderately at around 3.5 percent annually; and through a combination of adroit foreign exchange management and fiscal incentives, nontraditional exports have been growing at an average annual rate of 18 percent over the last three years. Nevertheless, there are signs of increasing tension between the government and the private sector about the present and future course of economic policy, and the recent wave of political assassinations may yet destroy the climate of confidence painstakingly built over the last few years.

HONDURAS

Like El Salvador, throughout most of the 1980s Honduras experienced a prolonged period of slow decline or semi-stagnation rather than a severe crisis; and it, likewise, settled into a pattern of low savings, low investment, low growth, low inflation, high unemployment, and heavy reliance on external transfers—mostly grants from AID—to help finance both its fiscal and current account deficits.

By decade's end, Honduras too had to mend its ways. Confronted with the prospect of a significant decline in U.S. transfers, it had to undertake major policy reforms in order to regain entry into the international financial community from which it had been shunned because of its massive arrears. Partly out of conviction and partly out of lack of choice, the Callejas administration adopted a reform plan strictly in line with the Washington consensus.

NICARAGUA

Throughout the 1980s, Nicaragua was in a virtual state of war. Apart from the heavy toll in terms of human lives, the war caused profound dislocations in production and population and inflicted severe damage to the infrastructure, and the war effort itself stretched public finances to the breaking point. In addition, political ramifications from the conflict—such as the barring of Nicaragua from access to multilateral credit sources and the U.S. trade embargo—seriously compounded the country's internal political and economic difficulties.

Against this background, the degree of impoverishment and disarray that came to pass is not difficult to fathom. By 1988, real GDP per capita was 40 percent below its peak (1978) level, real wages stood at only 9 percent of their 1980 level, open unemployment was conservatively put at 26 percent of the labor force, and consumer prices were escalating at an annual rate of over 14,000 percent. In addition, the public sector deficit (including external arrears and central bank losses) reached nearly 50 percent of GDP, while the current account deficit of the balance of payments stood close to 30 percent of GDP, and the external debt/exports ratio exceeded 3,000 percent.

The road to hyperinflation was a simple and familiar one: the central bank accommodated whatever public deficit was left unfinanced by other sources. As the generous external support Nicaragua received during the initial years of Sandinismo began to wane, a rising share of the cost of the war, the revolution (i.e., the political commitments of the new regime), subsidies, and other current expenses came to be financed through monetary emission.

Several attempts were made to rectify the course when it became obvious that things were getting increasingly out of control. Thus, in 1986 and 1987 several large devaluations of the cordoba were effected and nominal interest rates and reserve requirements were increased; but, in both cases, inflation quickly eroded the nominal adjustments; and, in real terms, the exchange rate remained highly overvalued and real interest rates stayed very negative (-80 percent). Similarly, in an attempt to reduce the deficit, expenditures were compressed, indirect taxes were raised, and surcharges were imposed on foreign exchange transactions, but then the smaller deficit was entirely financed by the central bank, feeding anew the inflationary spiral.

By late 1988, it was evident that nothing short of an "orthodox shock" would do. Accordingly, a monetary reform package was put in place that changed the currency base; unified the exchange rate markets, thereby transferring the exchange risk from the central bank to the users of foreign currencies; and realigned relative prices through the selective indexation of some key variables—the exchange rate, interest rates, public utility rates, fuels, basic consumer goods, and certain indirect taxes on consumption and imports—and the deregulation of private sector wages and other prices. At the same time, the reduction in hostilities made it possible to roll-back public expenditures and lay-off some 30,000 public employees, half of them from the security forces.

However, it fell upon the Chamorro administration to take decisive steps to restore macroeconomic balance and start the painful process of economic and political reconstruction. While the country still has a long way to go, Nicaragua seems well on its way to taming the worst imbalances and restoring orderly relations with foreign governments and the international financial institutions.

Concluding Remarks

Central America is in bad shape, but there are winds of change everywhere in the region. For the first time in a decade, people are preoccupied with peace, not war. And the lowering of hostilities will not only permit but indeed, demand, that reconstruction and development—rather than political survival—become the top national priorities. One clear lesson from these troubled years is that, if peace is to be lasting, Central America must begin to service, in earnest, the hefty social debt that it has incurred over many years of indifference and neglect.

The economic crisis, likewise, has taught some valuable, if costly, lessons. The first is that there is no real alternative to biting the bullet, but that how this is done is instrumental in determining the associated costs and ultimately, the success of the effort. In order for reform to succeed, a "critical mass" of mutually-reinforcing and compensatory changes appears to be necessary. But the ability to act on many fronts at once requires both a highly qualified technocratic/bureaucratic elite and a broad base of political support. The latter requires, in turn, that the social costs of adjustment be explicitly factored in and addressed and that alliances be forged with the potential beneficiaries of the changes in order to be able to withstand the pressures from the losers.

Another important lesson relearned is that appropriate domestic policies are not enough. If anything, the process of trade liberalization will make Central America even more vulnerable to external conditions. Thus, even though policy response to exogenous shocks may have improved, developments in the region will continue to be largely dominated by events outside these countries' control.

CENTRAL AMERICAN DEBT

by Clarence Zuvekas, Jr. *

CONTENTS

INTRODUCTION

The onset of Latin America's most recent external debt crisis is commonly dated from Mexico's decision in August 1982 to suspend the servicing of its external debt to commercial-bank creditors. But Costa Rica can fairly lay claim to triggering the crisis, having made the same decision more than a year earlier, in July 1981. Costa Rica's action did not make a large splash on the international financial waters because the absolute size of its external debt was small; but in terms of other debt-burden indicators, its problem had become more serious than Mexico's.

Before the decade of the 1980s came to a close, three other Central American countries—Nicaragua, Panama, and Honduras—also had debt problems rivaling or exceeding those of Mexico.[1] El Salvador and Guatemala, on the other hand, kept their debt burdens from reaching Mexican proportions, although both experienced significant debt-servicing difficulties at one time or another during the 1980s.

Costa Rica was the first country in Central America to undertake economic stabilization and structural adjustment programs in response to the hemisphere-wide economic crisis of the last decade, whose dimensions are well known and need not be repeated here. Guatemala began to address its economic problems in a serious manner in the mid-1980s; so did Panama, although its efforts were not sustained for a combination of internal and external reasons.

* The author is an International Economist with the U.S. Agency for International Development (AID), Bureau for Latin America and the Caribbean. The views expressed in this paper are those of the author alone and should not be interpreted as representing the policies of AID or any other part of the U.S. Government. The author wishes to thank James Elliott and Gary Linden for helpful comments on an earlier draft of this essay, while absolving them of any remaining errors of fact or interpretation.

[1] For this essay, Central America is defined to include Panama as well as the five traditional Central American countries of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

In El Salvador, Honduras, and Nicaragua, major economic reforms came only at the end of the decade.

This essay will briefly review changes in Central America's external debt during the 1970s, then provide a more detailed analysis of trends in the 1980s.[2] A subsequent section will discuss debt relief under a variety of programs beginning in the late 1980s. The concluding section will comment on the debt outlook for the 1990s.

Debt Buildup in the 1970s

Central America's external debt in 1970 was relatively modest. Long-term debt for the six countries combined totalled just under $1.0 billion (see Table 1).[3] The average ratio of long-term debt to gross national product (GNP) was 17 percent, and servicing of this debt averaged 11 percent of goods and services exports. Most of the long-term debt, in all countries except Panama, was owed to official creditors; the unweighted average for the six countries was 69 percent (see Table 2).

[2] For a detailed analysis of trends through the mid-1980s, see Caballeros, Rómulo. "External Debt in Central America," *CEPAL Review*, No. 32, August 1987. p. 123–148.

[3] Debt with a maturity of more than one year. Short-term debt figures for 1970 are not available. In 1980, short-term debt accounted for 22 percent of the region's total debt.

TABLE 1. Central America: Total Debt Outstanding, 1970–1990.

(millions of dollars)

	1970	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Costa Rica—Total	n.a.	n.a.	2,738	3,301	3,640	4,177	3,988	4,399	4,575	4,720	4,544	4,603	3,772
Long-Term	246	649	2,107	2,578	2,772	3,490	3,497	3,834	3,930	4,009	3,877	3,863	3,380
Public [1]	134	421	1,695	2,206	2,391	3,142	3,180	3,532	3,624	3,707	3,560	3,559	3,076
Private [2]	112	228	412	372	381	348	317	302	306	302	317	304	304
Use of IMF Credit	0	35	57	103	93	192	156	189	172	132	71	35	11
Short-Term [3]	n.a.	n.a.	575	620	775	495	335	377	472	579	596	705	380
El Salvador—Total	n.a.	n.a.	911	1,130	1,443	1,740	1,826	1,854	1,850	1,975	1,987	2,070	2,132
Long-Term	176	392	659	851	1,108	1,507	1,590	1,660	1,661	1,739	1,733	1,857	1,924
Public [1]	88	196	499	704	974	1,386	1,476	1,556	1,578	1,669	1,678	1,818	1,898
Private [2]	88	196	161	147	134	122	114	104	83	70	55	39	26
Use of IMF Credit	7	21	32	67	129	139	125	111	62	22	11	5	0
Short-Term [3]	n.a.	n.a.	220	212	206	94	111	84	127	214	243	208	209
Guatemala—Total	n.a.	n.a.	1,166	1,264	1,538	1,799	2,353	2,654	2,768	2,769	2,605	2,594	2,777
Long-Term	120	243	831	1,017	1,312	1,540	2,052	2,272	2,387	2,428	2,222	2,201	2,306
Public [1]	106	143	549	807	1,144	1,386	1,947	2,166	2,268	2,312	2,109	2,078	2,179
Private [2]	14	100	282	210	168	154	105	106	119	116	113	123	127
Use of IMF Credit	0	0	0	111	106	140	150	116	70	59	88	73	67
Short-Term [3]	n.a.	n.a.	335	136	120	119	151	266	311	282	295	320	405
Honduras—Total	n.a.	n.a.	1,470	1,704	1,842	2,125	2,284	2,728	2,973	3,302	3,305	3,333	3,480
Long-Term	109	360	1,165	1,408	1,571	1,822	1,935	2,278	2,503	2,818	2,857	2,906	3,226
Public [1]	90	264	974	1,236	1,412	1,627	1,773	2,137	2,378	2,703	2,758	2,822	3,159
Private [2]	19	96	191	172	159	195	162	141	125	114	100	84	66
Use of IMF Credit	0	20	33	54	119	161	149	147	110	77	37	35	32
Short-Term [3]	n.a.	n.a.	272	242	152	142	199	303	361	407	410	391	222
Nicaragua—Total	n.a.	n.a.	2,170	2,439	2,516	4,058	4,751	5,736	6,730	7,864	8,587	9,568	10,497
Long-Term	147	593	1,661	2,076	2,076	3,366	4,059	4,892	5,726	6,349	6,885	7,508	8,067
Public [1]	147	593	1,661	2,076	2,076	3,366	4,059	4,892	5,726	6,349	6,885	7,508	8,067
Private [2]	0	0	0	0	0	0	0	0	0	0	0	0	0
Use of IMF Credit	8	18	49	25	19	14	9	0	0	0	0	0	0
Short-Term [3]	n.a.	n.a.	460	338	421	678	683	843	1,004	1,514	1,703	2,060	2,430

Panama—Total	n.a.	n.a.	2,974	3,366	3,923	4,389	4,365	4,755	4,896	5,629	6,044	6,268	6,676
Long-Term	194	771	2,271	2,429	2,917	3,145	3,181	3,320	3,533	4,026	4,005	3,935	3,987
Public [1]	194	771	2,271	2,429	2,917	3,145	3,181	3,320	3,533	4,026	4,005	3,935	3,987
Private [2]	0	0	0	0	0	0	0	0	0	0	0	0	0
Use of IMF Credit	0	21	23	94	84	193	271	311	353	346	328	320	272
Short-Term [3]	n.a.	n.a.	680	843	922	1,051	913	1,124	1,010	1,256	1,711	2,013	2,417
Central America—Total	n.a.	n.a.	11,429	13,204	14,902	18,288	19,567	22,126	23,792	26,259	27,072	28,436	29,334
Long-Term	992	3,008	8,694	10,359	11,756	14,870	16,314	18,256	19,740	21,369	21,579	22,270	22,890
Public [1]	759	2,388	7,649	9,458	10,914	14,052	15,616	17,603	19,107	20,766	20,995	21,720	22,366
Private [2]	233	620	1,046	901	842	819	698	653	633	602	585	550	523
Use of IMF Credit	15	115	194	454	550	839	860	874	767	636	535	468	382
Short-Term [3]	n.a.	n.a.	2,542	2,391	2,596	2,579	2,392	2,997	3,285	4,252	4,958	5,697	6,063

Source: World Bank, World Debt Tables 1991–92 (published version and diskette).
[1] Public and publicly guaranteed.
[2] Private nonguaranteed.
[3] Including interest arrears on long-term debt.

The 1970s, on balance, were a period of strong economic growth in Central America. In the 10 or so years prior to the sharp declines in per capita income at the end of the decade or early in the 1980s, per capita gross domestic product (GDP) rose at an average annual rate of 2.6 percent and per capita consumption by 2.5 percent.[4]

TABLE 2. Central America: Long-Term Public Debt by Creditor, 1970–1990.

(percentage distribution)

	1970	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Costa Rica													
Official	71.6	56.5	46.0	41.2	45.0	44.1	44.7	49.0	51.1	55.8	59.9	61.8	77.2
Private	28.4	43.5	54.0	58.8	55.0	55.9	55.3	51.0	48.9	44.2	40.1	38.2	22.8
El Salvador													
Official	79.5	74.0	97.6	98.0	90.1	83.6	86.4	89.7	92.4	94.7	94.6	91.9	91.6
Private	20.5	26.0	2.4	2.0	9.9	16.4	13.6	10.3	7.6	5.3	5.4	8.1	8.4
Guatemala													
Official	50.9	90.2	97.3	91.6	87.2	78.9	59.1	62.1	67.2	70.1	79.4	80.8	81.9
Private	49.1	9.8	2.7	8.4	12.8	21.1	40.9	37.9	32.8	29.9	20.6	19.2	18.1
Honduras													
Official	95.6	92.4	72.0	70.6	73.1	74.5	76.5	78.1	78.3	81.1	82.6	85.3	88.2
Private	4.4	7.6	28.0	29.4	26.9	25.5	23.5	21.9	21.7	18.9	17.4	14.7	11.8
Nicaragua													
Official	69.4	41.3	54.0	59.9	59.9	68.9	68.0	72.0	75.8	78.0	79.7	81.2	82.2
Private	30.6	58.7	46.0	40.1	40.1	31.1	32.0	28.0	24.2	22.0	20.3	18.8	17.8
Panama													
Official	47.9	34.9	26.2	28.6	29.1	32.6	33.1	35.8	36.7	39.1	37.8	37.6	37.7
Private	52.1	65.1	73.8	71.4	70.9	67.4	66.9	64.2	63.3	60.9	62.2	62.4	62.3

Source: World Bank, World Debt Tables, 1991–92 (published version and diskette).

Economic growth in the 1970s, however, was uneven. All countries were affected adversely by the first petroleum-price shock in 1973–74, with only El Salvador avoiding a modest decline in per capita GDP for at least one year (1974 and/or 1975).[5] Subsequently, favorable commodity export prices contributed to a spurt of rapid economic growth. Another contributing factor to this expansion was an increase in external borrowing, which was relatively easy—and relatively cheap—because of the glut of "petrodollars" in world financial markets. Central American countries tapped these resources to help cushion the negative impact of higher oil prices on their foreign exchange reserves, and therefore on their capacity to import in order to maintain GDP growth rates. The second petroleum-price shock, in 1979–80, stimulated additional borrowing for similar reasons.

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[4] Zuvekas, Clarence Jr. and Joseph Nassif, *Trends in Per Capita Consumption in Central America*, Staff Working Paper No. 4, Bureau for Latin America and the Caribbean, U.S. Agency for International Development Washington, May 1992. p. 5. These figures are unweighted averages for the five traditional Central American countries. Per capita GDP began to decline first in Nicaragua, in 1978. El Salvador was next to experience a downturn, in 1979, followed by Costa Rica and Honduras in 1980 and Guatemala in 1981. In Panama the decline in per capita GDP did not begin until 1983.

[5] Guatemala is the only Central American country producing any of its own petroleum, and this production covers only a small proportion of its total consumption.

By 1975, Central America's long-term external debt had risen to $3.0 billion, with 81 percent of the increase since 1970 accounted for by public-sector or public-sector-guaranteed borrowing. An even greater expansion occurred in the next five years, with the regional total rising to $8.7 billion by 1980. More than half of the increase since 1975 was accounted for by Costa Rica and Panama, each of which added about $1.5 billion to its long-term debt. Central America's total external debt outstanding in 1980 amounted to $11.4 billion, with short-term debt accounting for $2.5 billion and use of International Monetary Fund (IMF) resources for $0.2 billion (see Table 1).

The so-called "debt crisis," however, was not yet evident.[6] Arrears on long-term debt had not accumulated in any country (see Table 3). Net transfers on debt (disbursements minus repayment of principal and interest payments) exceeded $500 million in 1980 (see Table 4). On the other hand, one or more debt-burden indicators had become ominous in all Central American countries except El Salvador and Guatemala: debt-service/export ratios exceeded 20 percent in Costa Rica, Honduras, and Nicaragua; debt/GNP ratios had climbed to 92 percent in Panama and 112 percent in Nicaragua, and were around 60 percent in Honduras and Costa Rica; and per capita debt had reached $1,220 in Costa Rica and $1,520 in Panama (see Table 5).

TABLE 3. Central America: Interest Arrears on Long-Term Debt, 1980–1990.

(millions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Costa Rica	0	84	228	15	66	13	80	220	280	385	80
El Salvador	0	0	0	0	0	2	4	5	9	23	6
Guatemala	0	0	0	0	10	50	59	83	96	117	198
Honduras	0	2	4	11	30	44	63	107	135	164	112
Nicaragua	0	0	18	103	158	296	455	809	1,038	1,342	1,696
Panama	0	0	0	1	1	1	0	16	311	613	1,017
Total	0	86	250	130	265	406	661	1,240	1,869	2,644	3,109

Source: World Bank, World Debt Tables, 1991–92 (published version and diskette).

The Economic Crisis of the 1980s

A Regional Perspective

The second oil-price shock of 1979–80 triggered a worldwide recession, depressing the prices of Central America's primary-product exports and lowering the demand for its nontraditional exports, which then were of only modest proportions. At the same time, world interest rates rose sharply, raising the cost of servicing the debt to commercial banks acquired in the latter half of the 1970s.[7]

[6] The term "debt crisis" is somewhat misleading in that some observers have associated the economic problems of Central America (and Latin America as a whole) in the 1980s too closely with debt issues, while paying insufficient attention to shortcomings in domestic economic policies, depressed prices for the region's primary commodity exports, other unfavorable trends in the world economy, and political turmoil.

[7] One of the most dramatic increases was in Costa Rica, where the average interest rate on new debt commitments from private creditors rose from 7.1 percent in 1970 to 15.8 percent in

Continued

Large-scale capital flight further contributed to the loss of foreign-exchange reserves. To help mitigate the heavy blows inflicted on their economies by these adverse trends, Central American countries borrowed even more money from foreign commercial banks—despite its increasingly unattractive costs—until the banks realized the dimensions of the regional economic depression that was occurring (and the weakening prospects for repayment) and stopped new lending.[8]

TABLE 4. Central America: Net Transfers on Debt, 1980–1990. [1,2]

(millions of dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Costa Rica	202	109	−1	−150	−183	−76	−268	−242	−236	−215	−315
El Salvador	53	184	240	194	41	−82	−106	−43	−35	17	−87
Guatemala	25	208	189	166	2	46	−166	−309	−108	−126	−60
Honduras	167	119	81	100	72	209	−41	−84	−87	−11	−183
Nicaragua	151	142	80	209	283	686	787	626	388	615	445
Panama	−84	−50	131	45	−67	−59	−362	−80	197	22	−221
Total	514	712	720	564	148	724	−156	−132	119	302	−421

Source: World Bank, World Debt Tables, 1991-92 (published version and diskette).
[1] Net transfers on debt = disbursements minus repayment of principal and interest payments.
[2] Excludes short-term loan disbursements prior to 1985.

For Latin America as a whole, the details of the debt saga of the 1980s are widely known and need not be reviewed here.[9] Those familiar with the Mexican and Brazilian cases will recognize many of the same patterns in Central America. It is useful to take a brief look at these patterns on a region-wide basis before examining the debt situation in the individual countries.

1980. In Honduras, where there was no long-term borrowing from commercial banks in 1970, interest rates on new long-term loans from private creditors in 1980 averaged 16.0 percent (World Bank, *World Debt Tables, 1991-92*). In addition, interest rates were adjusted upwards on previously acquired debt to commercial banks, which generally called for changes every six months based on movements in LIBOR (the London inter-bank offered rate) or the U.S. prime rate.

[8] Cumulative declines in per capita GDP were as follows (in percent and years: Costa Rica, −14.6 (1979-82); Honduras, −14.3 (1979-86); El Salvador, −26.5 (1978-83); Nicaragua, −57.5 (1977-89); Guatemala, −20.1 (1980-86); and Panama, −4.3 (1982-84). Sources: Zuvekas and Nassif, p. 13 and World Bank, *World Tables* for Panama; does not take into account the steep decline in Panama's per capita GDP between 1987 and 1989.

[9] Two of the best studies with a hemispheric focus are Kuczynski, Pedro-Pablo. *Latin American Debt*. Baltimore: The Johns Hopkins University Press, 1987 and Devlin, Robert. *Debt and Crisis in Latin America: The Supply Side of the Story*. Princeton, N.J.: Princeton University Press, 1989.

TABLE 5. Central America: Debt Burden Indicators, 1980–1990.

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
				A. Total Debt Service (TDS) (millions of dollars) [1]							
Costa Rica..........	353	330	244	698	424	526	499	334	402	345	501
El Salvador.........	96	93	129	202	237	259	286	260	203	170	214
Guatemala..........	145	249	148	189	272	334	382	341	376	299	211
Honduras............	207	235	244	203	197	228	299	342	370	140	432
Nicaragua...........	115	223	201	107	86	64	40	40	26	14	16
Panama..............	488	517	643	491	566	472	516	459	28	11	227
Total.............	1,404	1,647	1,609	1,890	1,782	1,883	2,022	1,776	1,405	979	1,601
				B. TDS/Exports of Goods and Services (percent) [2]							
Costa Rica..........	29.0	27.5	21.3	59.5	32.3	41.4	34.7	22.4	24.2	17.7	24.5
El Salvador.........	7.5	9.6	14.9	19.7	22.2	24.0	23.9	23.3	17.5	14.6	23.7
Guatemala..........	7.9	16.3	11.3	15.6	21.6	28.0	31.7	29.2	28.0	19.6	13.3
Honduras............	21.4	26.1	31.1	24.9	22.9	24.9	29.2	34.8	35.9	12.7	40.0
Nicaragua...........	22.3	38.4	44.2	21.2	18.4	18.5	13.8	12.1	9.6	4.1	4.1
Panama [3]...........											
				C. Interest/Exports of Goods and Services (percent) [2]							
Costa Rica..........	14.6	11.8	10.3	46.7	19.9	28.4	18.2	12.6	13.8	8.7	10.1
El Salvador.........	4.7	5.7	8.6	9.1	9.4	8.8	7.7	8.0	6.8	5.9	9.3
Guatemala..........	3.7	4.7	6.8	8.3	8.8	11.2	14.2	14.3	9.8	8.5	6.9
Honduras............	12.4	15.3	19.3	14.6	13.0	13.9	13.9	12.9	15.4	6.3	19.4
Nicaragua...........	13.4	19.4	31.2	11.0	11.1	9.0	8.2	4.8	4.5	1.4	3.0
Panama [3]...........											
				D. Total Debt Stock/Gross National Product (percent)							
Costa Rica..........	59.5	141.8	167.2	148.4	119.0	120.8	110.6	111.4	106.2	95.2	69.2
El Salvador.........	25.9	33.5	42.8	48.5	45.8	49.2	48.4	43.4	37.0	36.8	40.4
Guatemala..........	14.9	14.9	17.9	20.1	25.4	27.8	39.4	40.2	34.0	31.6	37.5

TABLE 5. Central America: Debt Burden Indicators, 1980–1990.—Continued

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Honduras	61.5	65.0	68.7	74.2	74.8	82.3	83.9	86.3	91.5	109.3	140.9
Nicaragua	112.1	106.2	110.7	172.3	219.7	272.2	247.0	n.a.	n.a.	n.a.	n.a.
Panama	92.3	94.6	101.3	110.0	102.9	105.7	102.3	113.9	146.8	154.0	152.4
E. Total Debt Outstanding Per Capita (dollars)											
Costa Rica	1,220					1,710					1,290
El Salvador	200					390					410
Guatemala	170					330					300
Honduras	420					670					740
Nicaragua	780					1,750					2,710
Panama	1,520					2,180					2,760

Source: World Bank, World Debt Tables 1991–92 (published version and diskette). Population data are from U.S. Agency for International Development, Latin America and the Caribbean: Selected Economic and Social Data (Washington, D.C., April 1992).

[1] Interest and prinicpal on long-term debt; IMF repurchases and charges; interest on short-term debt.

[2] Services include workers' remittances.

[3] The published debt service ratios for Panama are not included in this table because they are misleadingly low. Export data in the source are bloated by the way free-zone and financial-sector transactions are recorded.

Table 1 shows that the region's total debt outstanding rose from $11.4 billion in 1980 to $22.1 billion in 1985 and $29.3 billion in 1990. This increase of 157 percent over the decade exceeded the 78 percent rise in the debt for Latin America as a whole.[10] Most of the increase—at least through 1986—was accounted for by long-term public and publicly-guaranteed debt. Private long-term debt fell by 50 percent, while use of IMF credit rose in the first half of the decade and then fell in the second half. Short-term debt rose slowly at first, from $2.5 billion in 1980 to $3.0 billion in 1985, then jumped to $6.1 billion in 1990, with 88 percent of the 1985–90 increase representing interest arrears on long-term debt (see Table 3).

Trends in the distribution of long-term public debt by creditor are shown in Table 2. In all of the more aggressive borrowing countries—Costa Rica, Honduras, Nicaragua, and Panama—the share of the long-term public debt owed to private creditors (mainly commercial banks) was significantly higher in 1980 than in 1970. But by 1990, these shares had all declined dramatically, except in Panama, a reflection of the near-cessation of commercial-bank lending after the early 1980s as well as debt buybacks in Costa Rica and swaps in both Costa Rica and Honduras. In El Salvador and Guatemala, the least-indebted countries in Central America, only 2–3 percent of the long-term debt in 1980 was owed to private creditors. This share rose to 41 percent in Guatemala (1984) and 16 percent in El Salvador (1983), then declined over the balance of the decade.

Table 4 shows net transfers on debt based on principal and interest actually paid. (If unpaid amounts were taken into account, positive flows would be less and negative flows greater.) For the region as a whole, net transfers on debt were positive from 1980 through 1985, but with no clear trend and considerable variation from the annual average of $564 million.

The regional tables, however, are distorted by Nicaragua, where significant debt arrears accumulated beginning in 1983 (see Table 3), while new lending was available from a variety of external sources.[11] Excluding Nicaragua, net transfers were negative from 1984 through 1990 (except for a small positive figure in 1985), with annual flows averaging −$464 million. On the other hand, these outflows were offset—especially in Costa Rica, El Salvador, and Honduras—by Economic Support Fund (ESF) grants from the U.S. government, the great bulk of which were provided for balance-of-payments support.[12]

Debt-service indicators, based on payments actually made, are shown in Table 5. Panel A shows that regional debt-service pay-

[10] World Bank, *World Debt Tables, 1991-92,* Vol. I, p. 136. The 1970–80 regional average is distorted to some extent by the large jump in Nicaragua's debt. Excluding Nicaragua, Central America's debt rose over this period by 103 percent.

[11] See Stahler-Sholk, Richard. "Foreign Debt and Economic Stabilization Policies in Revolutionary Nicaragua," in *The Political Economy of Revolutionary Nicaragua,* ed. Rose J. Spalding. Boston: Allen & Unwin, Inc., 1987. p. 151-168.

[12] Average annual ESF assistance to Central American countries between U.S. fiscal years 1984 and 1990 (in millions of dollars, including a modest amount of soft loans) was as follows: Costa Rica $114; El Salvador $198; Guatemala $56; Honduras $87; Nicaragua $35 (virtually all in 1990); Panama $64 (88 percent in FY 1990); for a total of $554. Source: U.S. Agency for International Development.

ments were $1.4 billion in 1980, then rose to $2.0 billion in 1986 before declining to an average of $1.0 billion in 1988–90. Through 1987, Costa Rica and Panama consistently accounted for 50–63 percent of the regional total. Their combined share fell to 45 percent in 1987, then dropped dramatically to 33 percent in 1988–89, when Panama's politico-economic crisis left it with few resources to service its debt. The resolution of the Panamanian crisis in 1990 brought the combined Costa Rica-Panama share back to 45 percent. The other notable pattern in Panel A is the sharp decline in Nicaragua's debt-service payments after 1983.

Panel B of Table 5 shows the ratio of debt-service payments actually made to exports of goods and services. The regional ratio rose in the early 1980s, then displayed generally unclear trends for the rest of the decade while remaining relatively high except in Nicaragua. For the entire period 1980–90, the average ratios (percentages) in the individual countries were as follows: Costa Rica 30.4; El Salvador 18.3; Guatemala 20.2; Honduras 27.6; and Nicaragua 18.8.[13] Panel C shows the interest component of total debt servicing.

The ratio of the total debt stock to GDP is shown in Panel D. For all four aggressive Central American borrowers, the debt/GNP ratio exceeded 100 percent for at least some years, with Costa Rica, Nicaragua, and Panama all having joined this club of dubious distinction by 1982; Honduras was a latecomer, joining in 1989. In an interesting comparison, the debt/GNP ratio in Mexico—perhaps the most publicized Latin American debtor nation—peaked at 82 percent in 1986–87, and by 1990 was down to 42 percent. The latter figure is only slightly higher than the ratios for Central America's cautious debtors, El Salvador (40 percent) and Guatemala (38 percent) in the same year.

Panel E shows data on debt outstanding per capita. Panama edges out Nicaragua for first place in 1990, $2,760 to $2,710, although a more realistic population estimate for Nicaragua would result in a switch in the top two places.[14] Costa Rica ($1,290) and Honduras ($740) occupied the intermediate positions, while El Salvador ($410) and Guatemala ($300) had relatively modest burdens in terms of this indicator. (Mexico's per capita debt in 1990 was $920.) In all Central American countries, nominal per capita debt in U.S. dollars was higher in 1990 than in 1980; real per capita debt was lower only in Costa Rica.

Table 6 provides information on debt restructuring since 1985.[15] All six countries had some debt restructuring activity during this period, with the most occurring in Costa Rica and Nicaragua and the least in El Salvador.

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[13] The debt-service ratios for Panama are not included in Table 5 because exports as reported in the source are misleadingly high.

[14] Nicaragua's reported annual population growth rate of 3.3 percent between 1978 and 1989 is difficult to believe in view of the deaths, outmigration, and other disruptions created by the civil war and its aftermath.

[15] Data on earlier debt restructuring in Costa Rica are not available in the World Bank's *World Debt Tables*.

TABLE 6. Central America: Debt Restructurings, 1985–1990.

(millions of dollars)

	1985	1986	1987	1988	1989	1990
Costa Rica						
Principal rescheduled	488	172	10	0	111	20
Interest rescheduled	33	3	0	0	79	151
Principal forgiven	0	0	0	0	0	0
Interest forgiven	0	0	0	0	0	187
Disbursements from rescheduling	555	174	10	150	189	640
Debt stock rescheduled	0	0	0	149	0	469
Debt stock reduction [1]	10	0	145	189	46	668
El Salvador						
Principal rescheduled	60	0	0	0	4	42
Interest rescheduled	0	0	0	0	4	43
Principal forgiven	0	0	0	0	0	0
Interest forgiven	0	0	0	0	0	0
Disbursements from rescheduling	60	0	0	0	17	86
Debt stock rescheduled	0	0	0	0	0	0
Debt stock reduction [1]	0	0	0	0	0	0
Guatemala						
Principal rescheduled	17	141	46	0	0	13
Interest rescheduled	0	0	0	0	0	7
Principal forgiven	0	0	0	0	0	0
Interest forgiven	0	0	0	0	0	0
Disbursements from rescheduling	17	156	46	253	38	30
Debt stock rescheduled	0	14	0	253	38	8
Debt stock reduction [1]	0	0	0	152	20	0
Honduras						
Principal rescheduled	0	12	0	0	14	93
Interest rescheduled	0	3	0	0	10	88
Principal forgiven	0	0	0	0	3	0
Interest forgiven	0	0	0	0	13	7
Disbursements from rescheduling	0	14	0	0	101	180
Debt stock rescheduled	0	0	0	0	0	0
Debt stock reduction [1]	0	0	0	0	74	41
Nicaragua						
Principal rescheduled	112	14	5	121	0	0
Interest rescheduled	124	128	18	178	54	30
Principal forgiven	0	0	0	0	0	0
Interest forgiven	0	0	0	0	0	0
Disburesments from rescheduling	268	370	33	500	54	30
Debt stock rescheduled	31	180	8	200	0	0
Debt stock reduction [1]	0	0	0	0	0	0
Panama						
Principal rescheduled	221	369	0	0	0	0
Interest rescheduled	0	0	0	0	0	0
Principal forgiven	7	0	2	0	0	0
Interest forgiven	0	0	0	0	0	0
Disbursements from rescheduling	225	376	0	0	0	0
Debt stock rescheduled	0	0	0	0	0	0
Debt stock reduction [1]	0	0	0	0	0	0

Source: World Bank, World Debt Tables, 1991–92.
[1] Reductions through debt conversion schemes.

COUNTRY TRENDS

The primary focus of this essay so far has been on regional trends. It is useful to complement this analysis with a summary of what happened in the individual countries.[16] As Richard Feinberg has argued, debt problems differ among these countries, calling for different strategies for dealing with them.[17]

Costa Rica. When the government of Costa Rica suspended debt service in July 1981, the amount of the country's external debt was unknown because resources had been borrowed by a number of different government entities with no central monitoring. Outside consultants computed a total public external debt of nearly $2.6 billion as of July 15, 1981, and they estimated that scheduled debt service, plus payment of arrears on interest and principal, would total $927 million in the 15 months from October 1981 to December 1982, or about 65 percent of commodity export earnings during this period.[18] The import compression required to service this debt fully would have been politically unsustainable, and traditional debt restructuring or some other type of debt relief was clearly in order.

By the end of 1981, interest arrears on the long-term debt had reached $84 million; a year later they had risen to $228 million. In 1983, the government concluded the first of a series of debt renegotiations with its private creditors as well as with its official creditors through the Paris Club.[19] Discussions with private banks during the 1980s were often protracted. The Government came to look upon extraordinary debt relief as inevitable, and sought especially favorable terms. The banks, after coming to the same conclusion themselves, wanted to minimize their losses and avoid setting a precedent for renegotiated terms with large debtors such as Brazil and Mexico.

Traditional reschedulings, of course, did nothing to lower Costa Rica's debt, and the capitalization of interest increased the amount of long-term debt outstanding, as did a modest amount of new borrowing from commercial banks made possible by generally good macroeconomic policies. But in the second half of the decade interest arrears again became a serious problem, as Costa Rica was paying only part of its interest obligations in an effort to save foreign exchange for imports to sustain a moderate rate of economic growth—and in the expectation that the international financial community would devise some sort of plan for, or at least stumble into, debt relief on a worldwide basis. Even so, it is worth noting that Costa Rica's ratio of actual debt service paid to exports between 1980 and 1990 averaged 30.4 percent, the highest in the region.[20] This performance clashes with the notion in some financial circles that Costa Rica was a deadbeat, and illustrates the severity of its debt burden.

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[16] Data are from Tables 1–6 unless otherwise indicated.

[17] Feinberg, Richard. "Central American Debt: Genuine Case-by-Case Studies," in *Central American Recovery and Development: Task Force Report to the International Commission for Central American Recovery and Development*, eds. William Ascher and Ann Hubbard Durham, N.C.: Duke University Press, 1979. In Feinberg's view, "the industrial nations that manage the international debt strategy claim to be operating on a case-by-case basis, but in fact a single basic formula has been applied to all countries across the board," p. 260.

[18] Zuvekas, Clarence, Jr. "Costa Rica: A Review of Macroeconomic Conditions, with Projections to 1985," [prepared for USAID/Costa Rica], September 12, 1981.

[19] Major reschedulings with both commercial-bank and Paris Club creditors occurred in 1983 and 1985, and additional Paris Club agreements were reached in 1989 and 1991.

[20] Even during 1986–89, when interest arrears climbed from $13 million (at the end of 1985) to $385 million (at the end of 1989), the debt service/exports ratio averaged 24.8 percent, and net transfers on debt averaged −$240 million.

In late 1989, after a long period of negotiations, Costa Rica reached a debt relief agreement with its commercial-bank creditors under the umbrella of the Brady Plan.[21] The details of the agreement are described in the next section.

Costa Rica's economy, despite large debt-servicing payments, grew at an average annual rate of 4.0 percent between 1982 and 1991. This growth was facilitated by improved macroeconomic policies (including a large real depreciation of the exchange rate), a rapid expansion of nontraditional exports, and significant economic assistance from the U.S. government.

El Salvador. El Salvador's external debt remained relatively modest by Latin American standards throughout the 1980s. After rising from $911 million in 1980 to $1,740 million in 1983, it grew rather slowly to $2,132 million in 1990. The share owed to private creditors peaked at 16 percent in 1983, then fell to an average of 7 percent during 1986–90. The debt/GNP ratio peaked at 49 percent in 1985, then fell to 40 percent in 1990. Interest arrears did not appear until 1985 and were never large. Only a modest amount of debt was restructured.

Debt service, peaking at 23 percent of exports during 1984–87, was facilitated by large inflows of remittances and of grant assistance from the U.S. government. Even though net transfers on debt were negative for all but one year between 1985 and 1990, these net outflows (an average of −$56 million) were not as great as in some other Central American countries.

Improved economic policies, and better prospects for peace, boosted the GDP growth rate from an anemic 1.6 percent a year between 1982 and 1989 to 3.4 percent in 1990 and 3.5 percent in 1991, even with depressed prices for coffee, El Salvador's principal export.

Guatemala. Historically a country with conservative fiscal, monetary, and debt-management policies, Guatemala responded to the economic difficulties triggered by the second oil-price shock by significantly increasing its fiscal deficit to an average of 5.4 percent of GDP during 1980–82. While most of the deficit was financed internally, external financing also increased. The total external debt rose from $1,166 million in 1980 to $2,654 million in 1985. The share of the long-term external debt borrowed from private creditors jumped from less than 3 percent in 1980 to nearly 41 percent in 1984. Servicing of this debt, requiring less than 8 percent of exports in 1980, became burdensome at an average of nearly 28 percent between 1984, and 1988. Interest arrears began to accumulate in 1984, and by the end of 1990 amounted to $198 million, including arrears to the World Bank and the Inter-American Development Bank (IDB). Net transfers on debt turned negative in 1986 and were especially large (−$309 million) in 1987. A modest amount of debt was rescheduled.

Economic policy has been erratic since 1985, and a stand-by arrangement negotiated with the IMF in late 1988 soon became inactive due to noncompliance. Still, policy was on the whole better than in the first half of the decade, and between 1986 and 1991 the

[21] See: "The Costa Rican Debt Accord: Lessons and Implications," by Sylvia Saborio, elsewhere in this volume.

GDP grew at an annual rate of 3.5 percent. There was very little growth in the external debt between 1985 and 1990. Interest arrears are now being reduced.

Honduras. Honduras' external debt had increased sharply before the second oil price shock, from $360 million in 1975 to $1,165 million by 1980. It then rose inexorably through the next decade, reaching $3,480 million in 1990, or 141 percent of GNP. Interest arrears appeared as early as 1981 and by 1987 exceeded $100 million. The great bulk of the external debt was owed to official creditors, with the share owed to private creditors falling from 28 percent in 1980–82 to 15 percent in 1988–90. During 1986–90, debt service actually paid averaged 30.5 percent of exports even as interest arrears rose.

Honduras postponed major economic reforms until 1990. The fiscal deficit averaged almost 9 percent of GDP between 1980 and 1990. Net transfers on debt turned negative in 1986, but the negative flow averaged a modest −$56 million a year before reaching −$183 million in 1990. These outflows were offset by large inflows of U.S. assistance, which facilitated GDP growth averaging 3.4 percent a year between 1983 and 1989. GDP remained virtually unchanged in 1990, as long-delayed policy reforms began to be implemented, then grew by 2.2 percent in 1991.

A major event in 1990 was the clearance of approximately $250 million in interest and principal arrears to the IMF, World Bank, IDB, and one bilateral creditor. This action—made possible by external loans and grants—gave Honduras renewed access to the resources of these institutions. Improved economic policies have also permitted debt relief from the U.S. government and favorable rescheduling terms for official bilateral debt under the Paris Club (see below).

Nicaragua. As early as 1980, Nicaragua's debt/GNP ratio, at 112 percent, was the highest in Central America. By 1986, it had reached 247 percent, reflecting both a sharp increase in external indebtedness and a significant drop in GDP. Although the World Bank does not publish debt/GDP ratios for subsequent years, the figure clearly rose as additional indebtedness accumulated—interest arrears alone rose from $455 million in 1986 to $1,696 million in 1990—and GDP continued to fall. The cumulative decline in GDP between 1981 and 1991 was 21 percent.

By the end of 1990, Nicaragua's total external debt outstanding was nearly $10.5 billion. So little of its debt-service obligations were actually being paid that the debt-service ratio on a much reduced level of exports was down to a mere 4 percent in 1989–90.

With the change of government in 1990, economic policies began to improve, especially when a major stabilization program was introduced in March 1991. This facilitated external assistance to enable Nicaragua to clear its arrears with the World Bank and the IDB and to negotiate a stand-by arrangement with the IMF. In December 1991, Nicaragua concluded a favorable debt-rescheduling agreement with its Paris Club creditors (see below). In addition, negotiations with Mexico and Venezuela reduced Nicaragua's debts to these countries ($1.1 billion and $243 million, respectively) to 5 percent of face value.

Panama. By 1980, Panama was already a heavily indebted country, with a total debt outstanding of nearly $3.0 billion, equivalent to 92 percent of its GNP. Its per capita debt of $1,520 was the highest in the region. By the end of a turbulent political decade, the external debt had reached almost $6.7 billion (152 percent of GNP), including interest arrears of $1.0 billion and $1.4 billion of other short-term debt. Of the $4.0 billion in long-term public debt outstanding, 62 percent was owed to private creditors. Net transfers on debt were negative in most years between 1980 and 1990, and were especially large in 1986 (−$362 million) and 1990 (−$221 million).

Economic policy since 1980 has been erratic, with occasional bursts of policy reform interspersed with periods of fiscal laxity. Although the economy is open in many respects, including the use of the U.S. dollar as the country's currency, Panama continues to protect its small manufacturing and agricultural sectors more than any of its neighbors in Central America. Despite economic policy shortcomings and political travails, the GDP in 1991 was higher than in 1980. The average annual GDP growth rate of 1.6 percent, however, lagged behind the annual population growth of 2.2 percent.

In November 1990, Panama reached an agreement with its official bilateral creditors for rescheduling debt-servicing arrears through the Paris Club. In February 1992, having adopted a major economic policy reform program, it received external assistance to help clear about $640 million in principal and interest arrears to the international financial institutions. A stand-by arrangement was approved by the IMF. Negotiations with commercial-bank creditors were expected to begin later in 1992.

New Forms of Debt Relief

Apart from the traditional commercial-bank and Paris Club debt restructurings discussed above, Central American countries have been able since the late 1980s to take advantage of one or more programs offering debt relief through discounted debt buybacks, more favorable reschedulings on official bilateral debt through the Paris Club, and debt forgiveness and other benefits under several U.S. government initiatives. Costa Rica, Guatemala, and Honduras have also been able to retire a modest amount of external debt through other swap mechanisms.

The Brady Plan. U.S. Treasury Secretary Nicholas Brady proposed, in an address to a conference at Bretton Woods on March 10, 1989, that the Baker Plan of October 1985 [22] be augmented by a menu of options including debt-for-debt swaps under which poor-quality debt would be exchanged for new, higher-quality debt with a lower face value and/or lower interest rates, with the World Bank and IMF replenishing foreign exchange used by debtor coun-

[22] The Baker Plan was announced on October 8, 1985 by then U.S. Treasury Secretary James A. Baker III at the joint IMF-World Bank annual meeting in Seoul. Its key elements—continued under the Brady Plan—were: (1) structural policy reforms by debtor countries to promote more rapid economic growth; (2) significant new financing for developing-country debtors from both commercial banks and official lenders; and (3) case-by-case solutions to developing-country debt problems. The Baker Plan was unduly optimistic about the amount of financing likely to be forthcoming, especially from commercial banks.

tries for debt buyback operations.[23] Such funding from the international financial institutions, of course, would be contingent on a country's following sound programs of stabilization and structural adjustment. Moreover, these institutions could be expected to provide only part of the development finance needed by developing countries. Increased domestic savings would also have to play a major role, as would direct foreign investment, international capital markets, and the return of flight capital.[24] Access to these sources of financing, too, would require sound economic policies in recipient countries.

Costa Rica is the only Central American country to have reached an agreement with its commercial-bank creditors under the Brady Plan.[25] Under that agreement, made in November 1989 and covering $1.6 billion in debt (including $366 million of past-due interest), Costa Rica bought back $990 million in debt in May 1990 at a cost of $158 million (16 percent of par value); the balance was exchanged at par for bonds with interest rate of 6.25 percent. This operation lowered Costa Rica's total debt outstanding from $4.6 billion at the end of 1989 to $3.8 billion at the end of 1990, and its debt/GNP ratio fell from 95 percent to 69 percent. Although the debt-service/exports ratio in 1990 was 24 percent, and net transfers on debt were −$315 million, the buyback operation greatly improved Costa Rica's debt status.

Paris Club. The major industrial nations (the "Group of Seven"), at their July 1990 economic summit in Houston, agreed that the Paris Club should offer special debt relief arrangements to lower-middle-income countries that were severely indebted (with debt/GDP ratios of more than 50 percent) but not so poor as to qualify for the more generous "Toronto terms" offered to sub-Saharan African countries in the fall of 1988.[26] Among the Central American countries, El Salvador and Honduras have negotiated bilateral debt reschedulings on these terms, which extend repayment periods to 20 years with a 10-year grace period for Official Development Assistance (ODA) and to 15 years with 8 years of grace for non-ODA loans.[27]

In December 1991 Nicaragua became the first country to renegotiate its debt with the Paris Club creditors under the so-called "Trinidad terms." This had the effect of reducing debt service in

[23] Both the Baker and Brady Plans are discussed in Truman, Edwin M. "U.S. Policy on the Problems of International Debt," *Federal Reserve Bulletin*, v. 75, November 1989. p. 727-735. The author was then Staff Director, Division of International Finance, Board of Governors of the Federal Reserve System.

[24] The importance of these other resources is emphasized in Truman, *op. cit.*

[25] Other Latin American countries for which Brady Plan arrangements have been negotiated are Chile, Mexico, Uruguay, Venezuela, Argentina, and, most recently, Brazil.

[26] The Toronto terms take their name from proposals to the Paris Club made by the Group of Seven at their 1988 summit meeting in Toronto. Three options were offered: debt reduction, extended maturities, or concessional interest rates. Countries eligible for IDA-only assistance for the World Bank, and having IMF adjustment programs, are eligible for Toronto terms. See William B. Milam, "Strategy for an LDC Debt Workout: A U.S. Perspective," Current Policy No. 1100, U.S. Department of State, August 1988) for a brief summary of the Toronto terms. The author was then Deputy Assistant Secretary of State for International Finance and Development.

[27] Through mid-1991 Congo, Morocco, and Nigeria also benefited from such reschedulings. See: U.S. Department of State. "Gist: Developing Country Debt," *U.S. Department of State Dispatch*, July 29, 1991, p. 557.

half during 1992-94 and could lead to a reduction in the debt stock ($750 million) at the end of this period.

Section 572. Section 572 of the Foreign Operations Appropriations Act of 1989, which took effect in Fiscal Year 1990, permitted eligible poor countries to service their Development Assistance and ESF debts to the U.S. government in local currency, and also provided for complete debt forgiveness. Sub-Saharan African and other relatively least developed countries were eligible if they had IMF and World Bank adjustment programs and were in compliance with the conditionality for at least one of these programs. Honduran debts to the United States of $325 million, and Nicaraguan debts of $262 million, were forgiven under Section 572 in September 1991.

Enterprise for the Americas Initiative (EAI). The EAI, announced by President Bush in June 1990, offers Latin American and Caribbean countries benefits in the areas of trade, investment, and debt relief. To be eligible for the debt-relief provisions of the EAI, countries must adopt stabilization and structural adjustment programs (generally with IMF and World Bank support), liberalize their investment regimes (to the extent needed to become eligible for an IDB investment sector loan), and, if appropriate, negotiate agreements with their commercial-bank creditors.[28]

The EAI proposed that relief be granted on both concessional (A.I.D. loans and PL-480 food aid) and nonconcessional (Export-Import Bank loans and Commodity Credit Corporation food sales) debt, the latter through swap mechanisms. Nonconcessional debt owed to the United States by the Central American countries is relatively small, amounting to only $55 million at the end of 1990. Concessional debt, however, totalled nearly $2.2 billion in the spring of 1991. (See Table 7). As of July 1992, Congress had authorized EAI relief only for PL-480 debt.

TABLE 7. Concessional Debt Outstanding from Central America to the U.S. Government.

(in millions of dollars)

	AID	PL-480	Total
Costa Rica	331.1	121.5	452.6
El Salvador	275.3	349.7	625.0
Guatemala	175.6	83.8	259.4
Honduras	321.4	96.3	417.7
Nicaragua	205.2	17.5	222.7
Panama	183.3	0.0	183.3
Total	1,491.9	668.8	2,160.7

Source: U.S. Agency for International Development. The AID data are as of March 31, 1991; the PL-480 data as of May 31, 1991.

[28] For a brief summary of the EAI, see U.S. Department of State, Bureau of Public Affairs. "Gist: Enterprise for the American," February 18, 1992.

Under the EAI program for concessional debt, the stock of debt outstanding would be significantly reduced, the amount of the reduction depending on the situation in individual countries. Payments on this smaller debt would be applied to retirement of principal. In the medium term, annual principal payments might not be reduced by much, since the smaller debt would be repaid over a shorter period of time. Over the long run, however, debt relief would be substantial.

EAI beneficiaries negotiating environmental agreements with the United States may make interest payments on their renegotiated debt in local currency, to be deposited into a country environmental fund managed by a commission whose members would comprise representatives of the U.S. government, the debtor government, and non-governmental organizations from the country in question. Environmental agreements were signed with Bolivia and Jamaica in 1991 and Chile in 1992, but not yet with any of the Central American countries.

Section 411. PL–480 debt relief was also made available to low-income countries, with less stringent conditionality, under the provisions of Section 411 of the Agricultural Trade Development and Assistance Act of October 1990.[29] Honduras ($109 million) and Nicaragua ($25 million) have received debt forgiveness under this legislation.

Debt Swaps. In August 1986, Costa Rica experimented briefly with a debt-for-equity swap program, authorizing a maximum of $180 million in these types of conversions with the objective of stimulating investment in export enterprises and other priority economic activities. The program was terminated at the end of the year, with $123 million in debt having been converted to equity instruments. A well-informed evaluation of this program concludes that its balance-of-payments impact was difficult to determine; its net fiscal impact was probably negative; and the expansionary monetary impact was such that limiting its size was a good idea.[30]

Beginning in 1987, swaps were limited to small debt-for-development programs, mainly of the debt-for-nature variety. Between 1987 and 1990 Costa Rica retired debt with a face value of $86 million through this mechanism, far more than any other country in the world, but still only about 2 percent of its total external debt.

Elsewhere in Central America, Honduras has used a debt-swap program since 1987 to retire about $150 million in commercial bank debt through debt-for-equity and other types of exchanges. In Guatemala, stabilization bonds held by nonresidents were rescheduled into long-term securities denominated in either *quetzales* or dollars and held mainly by residents.

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[29] Section 411 benefits are available to low-income countries eligible for placement on the World Bank's Civil Works Contracting Preference List, or food-deficit countries eligible for Title III food aid from the U.S. Government.

[30] Rodríguez, Ennio. "Reconversión de deuda y desarrollo en el caso de Costa Rica," in *Conversión de deuda externa y financiación del desarrollo en América Latina,* eds. Roberto Bouzas and Ricardo Ffrench-Davis, Buenos Aires: Grupo Editor Latinoamericano, 1990. p. 97–124.

The Outlook for the 1990s

Central America's debt problems remain significant. Table 8 shows that projected net annual transfers on the existing debt, assuming no change in the pattern of debt-servicing obligations after 1990, would average –$2.2 billion during 1991–94 before falling to –$1.8 billion in 1995–97 and –$1.2 billion in 1998–2000. Nicaragua is by far the most burdened country, both in terms of absolute amounts (about –$985 million in 1991–93, before subtracting actual and prospective relief in these years) and the size of its burden relative to GNP. Panama's net outward transfers would be heavy early in the period (about –$405 million annually in 1991–93) but light at the end. The projected net outflow in Costa Rica remains roughly constant at an annual average of about –$330 million. Honduras' outward transfers, temporarily eased in 1991, average about –$285 million a year for the rest of the decade—much more of a burden relative to the size of its economy than Costa Rica's. Guatemala and El Salvador, as would be expected, have relatively modest (but far from painless) projected net outflows.

There is good reason to believe that the easing of the debt burden now under way in Central America should continue during the course of the 1990s. Debt relief, or at least old-fashioned rescheduling, will clearly still be needed in some countries, and a variety of mechanisms for providing this relief are now in place. Improved economic policies throughout the region, and the end of most of the armed conflicts, should be reflected in higher GDP growth rates due to better resource allocation alone. The prospects for nontraditional exports—already growing rapidly [31]—should remain bright, especially if progress continues to be made toward a North American Free Trade Area (NAFTA). This would offset the gloomy outlook for primary commodity prices and the possible loss of some banana sales in the European Community (EC) market.

While commercial banks are not likely to lend much to Central America in the 1990s, the region's need to borrow externally to support a given growth rate should diminish. Better economic policies should raise both public and private savings—a trend already under way in some countries. They will also encourage private capital inflows, for both direct and portfolio investment. In addition, good economic policies will facilitate continued access to the international financial institutions, although perhaps not at the high levels hoped for in some circles.

Sound economic policies in the industrial countries would also benefit Central America, e.g. by raising demand for the region's traditional as well as nontraditional exports, creating additional export opportunities through further trade liberalization, and keeping nominal interest rates relatively low by controlling inflation.

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[31] Central America's nontraditional manufactured and agricultural exports to the United States rose from $328 million in 1983 to $1,674 million in 1991, an annual growth rate of 22.6 percent (U.S. Department of Commerce, Imports for Consumption, Customs Value). Most of the 1991 exports were from Costa Rica ($723 million) and Guatemala ($441 million). Nontraditional export growth rates have accelerated recently in Honduras and El Salvador. These figures include the full value of assembled goods and thus overstate the importance of nontraditional exports to the Central American economies; but the strong upward trend is impressive.

TABLE 8. Projected Net Transfers on Outstanding External Debt, 1991–2000. [1]

(millions of dollars)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Costa Rica—Balance	−331	−282	−303	−345	−362	−362	−361	−332	−314	−292
Disbursements	242	223	159	111	71	40	21	4	3	1
Principal	−372	−314	−274	−275	−264	−247	−241	−209	−204	−193
Interest	−201	−191	−188	−181	−169	−155	−141	−127	−113	−100
El Salvador—Balance	−93	−131	−148	−224	−151	−137	−134	−132	−131	−125
Disbursements	97	88	59	28	15	9	3	0	0	0
Principal	−114	−133	−128	−179	−104	−89	−84	−81	−85	−83
Interest	−76	−86	−79	−73	−62	−57	−53	−51	−46	−42
Guatemala—Balance	−197	−183	−253	−261	−239	−219	−214	−177	−133	−125
Disbursements	179	167	115	79	48	26	17	9	6	2
Principal	−247	−230	−261	−249	−210	−181	−177	−142	−103	−97
Interest	−129	−120	−107	−91	−77	−64	−54	−44	−36	−30
Honduras—Balance	−110	−242	−290	−304	−309	−311	−303	−286	−267	−236
Disbursements	243	139	75	41	15	6	1	0	0	0
Principal	−200	−211	−206	−199	−190	−195	−194	−190	−183	−164
Interest	−153	−170	−159	−146	−134	−122	−110	−96	−84	−72
Nicaragua—Balance	−1,143	−980	−830	−666	−587	−500	−422	−384	−312	−231
Disbursements	45	16	6	3	1	0	0	0	0	0
Principal	−927	−785	−650	−514	−431	−366	−307	−285	−228	−159
Interest	−261	−211	−186	−155	−157	−134	−115	−99	−84	−72
Panama—Balance	−442	−421	−355	−301	−252	−229	−202	−97	−80	−74
Disbursements	16	12	9	8	7	6	5	3	2	0
Principal	−310	−310	−264	−230	−197	−188	−175	−77	−64	−60
Interest	−148	−123	−100	−79	−62	−47	−32	−23	−18	−14
Central America—Balance	−2,316	−2,239	−2,179	−2,101	−1,900	−1,758	−1,636	−1,408	−1,237	−1,083
Disbursements	822	645	423	270	157	87	47	16	11	3
Principal	−2,170	−1,983	−1,783	−1,646	−1,396	−1,266	−1,178	−984	−867	−756
Interest	−968	−901	−819	−725	−661	−579	−505	−440	−381	−330

Source: World Bank, World Debt Tables, 1991–92.

[1] Excludes projected new borrowings; does not reflect any changes in repayment patterns due to rescheduling or other factors that may have occurred after 1990.

This is an optimistic scenario, of course, not a projection. Within the region, it could be dashed by such factors as a resumption of political turmoil or the revival of populist economic policies. Externally, the specter of protectionism is still in the picture. Success in the GATT and NAFTA negotiations cannot be taken for granted, and the impact on Central America of the new EC 92 arrangements remains unclear. Nevertheless, there are good reasons for believing that the 1990s can be a much better decade for Central America than the 1980s.

THE COSTA RICAN DEBT ACCORD: LESSONS AND IMPLICATIONS

by Sylvia Saborio *

CONTENTS

INTRODUCTION

In May 1990, Costa Rica concluded an agreement with its commercial creditors, which is by far the most successful debt reduction package reached to date under the Brady Plan. Because there are important policy lessons to be learned from that experience, and because a clear understanding of the forces at play is crucial in assessing negotiation results, the following account focuses not so much on the agreement actually reached as on the negotiation process itself. Before dwelling on the specifics of the Costa Rican case, however, certain key elements which constitute the essential parameters of any negotiation are briefly reviewed.

THE CAST, THE SETTING

The first general point to bear in mind is that a commercial debt negotiation is not, ordinarily, a strictly bilateral affair between a debtor country and its creditor banks. Typically, four main players are involved:

Debtor countries. While negotiations are conducted on a case-by-case basis, fear that precedents set in one case might spill over to others, effectively injects *other debtors* into the proceedings. For all intents and purposes, their presence is as real as if they were right there, sitting at the table.

Creditor banks. A country typically does not negotiate with *all* its creditor banks (which may number several hundred) but with a select group of them: its Bank Advisory Committee. During the ini-

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tial years of the crisis, since the banks acted as a *cartel*, the matter of representation was not an issue. Over time, important rifts developed between regional and money center banks and between U.S., European, and Japanese banks, reflecting differences both in bank corporate strategies towards individual debtors and in the accounting, tax, and regulatory environment in which banks operate. Accordingly, committees have been torn by internal dissent and by charges that they do not adequately represent the interests of the universe of banks. In order to break deadlocks, negotiators often have had to by-pass the advisory committee structure altogether, both to reach higher levels of management in banks within the committee and to consult banks outside the committee.

World Bank/International Monetary Fund (IMF). Collectively, their role in the debt workout process has been to design and enforce "appropriate" economic reform packages for debtors, provide financial support for such stabilization and structural adjustment processes, and act as catalysts for funds from other sources. Under the Brady Plan, the international financial institutions (IFIs) have also become the main vehicles through which official resources in support of debt and debt service reduction schemes are channeled. The mediating role of these institutions—particularly the IMF—is crucial to the outcome of most debt negotiations. And yet, over time and across countries, IFI involvement in debt matters has lacked both consistency and predictability, largely as a result of conflicting mandates from shareholders, institutional in-fighting and differences of opinion between staff, management and the respective Boards as to how to deal with individual cases.

Industrial-country governments. Their first and foremost concern throughout the debt crisis has been to avert the collapse of the international financial system. As the systemic risk has declined in recent years—through increased provisioning and capitalization of banks and reductions in their exposure via write-downs and sales of sovereign debt—a rift has developed among industrial governments concerning the treatment of debtors. The Europeans, in particular, never keen on the Brady Plan and increasingly preoccupied with Eastern Europe, have progressively tried to distance themselves from Latin America's debt debacle. The United States and Japan are still engaged but less intensely so, as the systemic risk continues to recede, the most obvious candidates for Brady-type treatment are duly processed, other potential "success cases" become harder to come by, and Eastern Europe moves center stage.

The second point to bear in mind is that the "debt strategy"—that is, the official views on the debt problem at a particular point in time—constitutes the essential backdrop of any negotiation.

Since the onset of the debt crisis in 1982, one can distinguish roughly three stages of official thinking on the subject:

1982–85: Muddle-Through Approach. The debt problem was seen as a *temporary liquidity problem.* The prescribed solution involved: recessive adjustment with severe import compression in debtor countries + restructuring of existing external obligations + some additional financing to keep interest payments current. To be sure, this approach *did not solve* the debt problem, but to its credit, it did avert a generalized financial collapse, set in motion actions by banks that over time strengthened their financial position and forced debtor nations to adopt policy reforms that in many cases were long overdue.

1985-88: Baker Plan. This strategy recognized that the debt problem was more akin to *insolvency* than illiquidity, that the mere reallocation of *existing* domestic resources towards debt servicing would be insufficient to fill the gap and that in order to be able to pay and regain creditworthiness, countries needed to *grow*. Accordingly, it prescribed: continued adjustment on the part of debtors; faster growth and enhanced market access in developed countries, so that growth impulses would trickle down to the debtors through export expansion; and new lending to ease cash-flow difficulties. In terms of its stated purpose, the Baker Plan failed miserably: debtors did not grow out of their payments difficulties, creditworthiness was not restored, and voluntary lending did not resume. On the other hand, the plan did "buy" additional time for the banks to improve their financial position and further reduce their external vulnerability.

1989-present: Brady Plan. This strategy recognized that *voluntary lending* to the highly indebted countries was not likely to resume any time soon and moreover, that in many cases debt levels were already *excessive*, so that what was needed was not so much additional lending as a *reduction* in the size of the debt and/or in the stream of debt service payments. It prescribed: continued adjustment on the part of debtors; the pledging of some official resources through the World Bank/IMF to secure debt and debt service reduction in exchange for certain enhancements [1] on the remaining bank claims; and new commercial lending.

To date, seven deals have been concluded under the Brady Plan—Mexico, Philippines (twice), Costa Rica, Nigeria, Uruguay, and Venezuela—and agreements in principle have recently been reached by Argentina and Brazil with their creditor banks. Few of the deals would have come to pass without rather intense involvement on the part of the U.S. Treasury. Even so, the outcomes have been quite modest. With the exception of the Costa Rican package which reduced eligible debt by 77.5 percent (in present value terms), other deals have done little more than provide limited breathing space to the debtors: Philippines, 14 percent; Venezuela, 22 percent; Mexico, 26 percent; and Uruguay, 46 percent.

Costa Rica's Debt Trap

Costa Rica's road to over-indebtedness was a well-travelled one: the country over-borrowed in the 1970s to absorb the oil shocks, and was then doubly squeezed in the late 1970s and early 1980s by a severe deterioration in terms of trade, coupled with a sharp increase in interest rates. In addition, at just about that time, the Central American Common Market virtually collapsed and a wave of political instability began to sweep the region. By late 1981, having run out of reserves and credit, the country had little choice but to declare a moratorium on all external payments.

[1] Such enhancements might take the form of a collateral on the principal and/or partial guarantees on interest payments. In any case, the purpose is to reduce the risk to the bank associated with the remaining claims on a particular debtor.

Soon thereafter, the nation set to the task of restructuring its domestic economy and restoring its external financial relations. Through drastic internal adjustment measures, within two years, the free fall in income was halted, both the fiscal and current account deficits were cut back by about two-thirds (from around 15 percent of gross domestic product [GDP] to less than 5 percent), and the annual rate of inflation was rolled back from a peak of nearly 100 percent to a more manageable 12 percent. Meanwhile, two Stand-by Agreements were signed with the IMF (1983, 1985), a Structural Adjustment Loan was negotiated with the World Bank (1985), and the country went through two rounds of Paris Club reschedulings (1983,1985) and two rounds of conventional commercial debt restructurings (1983, 1985).

The 1983–1985 period was, thus, an era of virtually continuous debt negotiations and, at the end of the day, there was little to show for it: the country had managed, barely, to stay current with its multilateral obligations, but it was falling into arrears with other creditors practically before the deals were even signed, and some accords never got implemented.

The year 1986 was the turning point. When Oscar Arias came to power in May of that year, he instructed his economic team to search for a *comprehensive, long-term* solution to the debt problem, compatible with the country's capacity to pay and development objectives.

Arias may, or may not, have fully realized the implications of his mandate, but the team entrusted with that task certainly did not anticipate the difficulties involved, or the fact that it would take nearly *four* years to deliver on that request!

THE QUEST FOR A DEBT SOLUTION

In principle, Costa Rica's debt problem should have been easy to solve: in *absolute* terms, Costa Rica's public external debt was quite small—around $4 billion—of which only about $1.5 billion was owed to commercial banks. In *relative* terms, however, the debt burden was clearly unsustainable: at the time (end 1985) the stock of external debt was roughly the same as the country's GDP and three and one-half times the value of its exports. Interest payments alone (on a contractual basis) would have absorbed some 7–8 percent of GDP, one-third of export earnings, or the equivalent of nearly one-half of total domestic savings.

Thus, without doubt, Costa Rica urgently *needed* a significant reduction of its debt overhang. Moreover, having undergone drastic internal adjustment, the country also felt that it *deserved* some measure of debt relief. So, why was it so difficult to work out a deal? It was partly a matter of *size* and partly a matter of *timing.*

Small may be beautiful, but it doesn't carry much weight, either with the banks, the IFIs or Washington officials.

From the point of view of the *banks*, Costa Rica was mainly a "nuisance" case that they would rather not take on at all. It could neither make them nor break them, and yet, it posed a conundrum: a "conventional" solution was out of the question, both because the banks refused to put up new money, given the existing debt overhang, and because the Costa Rican government had made it clear

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that it was looking for ways to *reduce* the debt, *not increase* it. On the other hand, a "non-conventional" approach to actually reduce debt payments seemed unthinkable at the time, not because the banks could not afford it—they clearly could in this case—but out of fear that it would set an ominous *precedent* for their negotiations with other, *larger* debtors. Indeed, the specter of Brazil, Mexico and Argentina was never far away from these deliberations.

Official Washington was, likewise, reluctant to get involved. Debt strategy has been driven, primarily, by the need to safeguard the integrity of the international financial system, not to solve individual debtor's problems. Nevertheless, because of their systemic impact, much time and energy has been spent rescuing the big debtors and making sure their crises do not overlap. On the other hand, smaller debtors have tended to be neglected, since they neither pose challenges of systemic proportions, nor constitute the yardsticks against which the success of the strategy is measured. Only through considerable persistence and ingenuity was Costa Rica able, from time to time, to get on the policy agenda.

With the *IFIs*, the issue was not so much a matter of neglect since, after all, they are compelled to pay attention to *all* their member countries. For them, Costa Rica posed a thorny policy challenge.

During the initial years of the crisis, the IFIs, as a matter of policy, refused to enter into agreements with debtor countries that were not current in their obligations to commercial banks, serving, in effect, as "collecting agencies" for the banks.

Beginning in mid-1986, as part of its new debt initiative, Costa Rica quietly began making only *partial* payments on its external debt, as its foreign exchange availability allowed. As a result, arrearages began to build up.

By late 1987, after a year of fruitless talks with the banks, Costa Rica challenged the IMF to formalize a "shadow" program under whose guidelines it had been acting and with which it was in full compliance, except for the arrears. It argued that, having done everything under *its* control, and having sought in good faith—but without success—an agreement with the banks, the country should not be penalized for the failure, since it obviously could not *force* the banks into a deal.

The ensuing debate sent shock waves through the system. The IMF's eventual consent marked a turning point in Costa Rica's relationship with the banks, for by *legitimizing* the arrears, it altered the balance of power in the negotiations. [2]

The IMF's decision also had an immediate impact on Costa Rica's relations with the World Bank. As part of its overall financing plan, Costa Rica had negotiated a structural adjustment program with the World Bank, with assurances from high ranking officials at the Bank that approval of the loan would not be explicitly conditioned on an agreement with the commercial banks, but only on the customary Stand-by Arrangement with the IMF. This

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[2] That this policy reversal at the IMF has fundamentally altered the debtor/creditor relationship is amply acknowledged in a publication by the Institute of International Finance, Inc., *Debt Strategy: Arrears Are Not The Way*, Washington, May 1990.

seemed like a safe and ingratiating promise for the Bank to make, on the premise that the IMF would never go ahead with a Stand-by Arrangement without a commercial bank accord. When the IMF did precisely that, the Bank attempted, in various and sundry ways, to go back on its commitment. As a result, the Bank did not formally rescind the Structural Adjustment Loan agreement, but it did find numerous mechanisms to delay the loan disbursements.

As these incidents suggest, another important reason for the delay in reaching a debt accord was that Costa Rica was ahead of the times and had to play a pioneering role in changing official views on the issues.

Back in 1986, when Costa Rica proposed that the only way to attain a durable solution to its debt problem was through some measure of debt reduction, coupled with a restructuring of the remaining obligations in a manner compatible with the country's capacity to pay, it was considered *anathema* by all concerned. Later on, of course, such a proposition became the cornerstone of the Brady Plan!

In time, the pieces began to fall in place, laying the foundation for a workable compromise. The banks accepted the notion of debt reduction—the question was how and how much—provided that no new money from them would be required and that Costa Rica be somehow penalized for having built up a sizeable amount of interest arrears. Costa Rica accepted penalty on arrears, though not their pre-payment, and agreed not to seek new bank financing, provided that the reduction of its debt burden were deep enough. The IFIs mediated as "arbiters" of how much debt reduction was necessary, and as contingent "guarantors" of some provisions of the agreement. Finally, the U.S. Treasury played a crucial role in steering everyone towards a compromise on the eve of the October 1989 Hemispheric Summit of Heads of State in San Jose. President Bush was to attend the meeting which featured *debt*—along with development, democracy, disarmament, drugs, and deforestation—as the main items in the agenda, and the White House thought it would be a splendid idea to mark the occasion with a breakthrough in the debt stalemate of the host country.

The Debt Agreement

The agreement was finally reached in November 1989 and signed on May 5, 1990 (two days before the end of the Arias administration), with the following terms:

1) It covered *total commercial bank debt*: $1.8 billion, including some $366 million in interest arrears, held by some 220 banks. U.S. banks held about a third of the claims, and European banks another third.

2) It contained two *sine qua non* conditions (Costa Rica's): a) that at least 95 percent of the claims participate in the transaction (to minimize free-riding); and b) that at least 60 percent of the debt be tendered in the cash repurchase option (to guarantee a minimum amount of debt reduction).

3) It was a debt and debt/service reduction package *only*, with no new money provisions. The agreement offered banks two options: a) a cash repurchase of their claims at 16 cents/$1.00; or b) a debt ex-

change of the unrepurchased claims, as follows: i) banks tendering at least 60 percent of their total individual claims were entitled to exchange their unrepurchased claims for "A" bonds, at par, 6.25 percent interest, 20 years maturity/10 years grace, unsecured but with an 18-month rolling interest guarantee; ii) other banks were entitled to "B" bonds, at par, 6.25 percent interest, 25 years maturity/15 years grace, without collateral or interest guarantee.

4) *Past Due Interest.* Interest arrears were recognized as separate claims; 20 percent would be paid in cash upon closing, and the balance could either be tendered at 16 cents per $1.00 or be exchanged for new instruments at par, at LIBOR plus 13/16, with a 36-month rolling interest guarantee, to be amortized over 15 years on a mortgage-like schedule.

5) *Value Recovery Clause.* The agreement contains a formula for raising bond yields in keeping with the country's rising ability to pay over time. The provision kicks in once real GDP exceeds 120 percent of 1989 GDP, is linked to the difference between the ratio of total interest payments to GDP in a given year and that same ratio in 1990, and has an upper limit on the amount that can be recaptured in any given year.

6) *Debt Conversion Feature.* $100 million worth of claims could be converted over 5 years to cover the local cost of investment projects for exports and tourism. The scheme gives preference to "A" claims and is to be effected through an auction process.

OUTCOME

Of total outstanding claims, some 63 percent were repurchased at 16 cents per dollar of face value, around 17 percent were exchanged for "A" bonds, and some 18 percent were exchanged for "B" bonds. Free-riding was minimal, about 1 percent. The total upfront cost of the transaction was $226 million, required to finance the cash buyback, the down payment on the arrears and the guarantees on "A" bonds and past due interest claims. The financing came from Costa Rica's own reserves ($43 million), and official credits ($183 million), including bridge loans from Mexico, Venezuela, and the United States. Remarkably enough, neither the IMF nor the World Bank provided financial support for the deal. It is unconscionable that these institutions would have been willing to jeopardize a deal their own staff had helped to craft and they knew to be in the best interest of the country, so as to have more leverage over the incoming administration.

In present value terms, net debt reduction amounted to $1.08 billion, [3] or nearly 60 percent of the commercial debt outstanding prior to the deal. In terms of cash flow, the accord represented a net savings to the country equivalent to 73 percent of its previous contractual obligations to the commercial banks. This, however, did not translate into significant *additional* financial relief to Costa Rica, given that the country had been paying, on average, only about a third of its commercial debt servicing obligations in the years preceding the agreement. What the arrangement essentially

[3] In present value terms, the gross reduction in commercial claims was $1.23 billion, equivalent to 67 percent of the outstanding claims. However, $151 million new resources had to be borrowed from official sources to finance the transaction.

did was validate *de jure*, the cash flow relief that Costa Rica had, *de facto*, given itself over this period.

The agreement did provide significant benefits to Costa Rica, not the least of which is that it enabled the country to put the debt issue behind it and get on with the business of development. Nonetheless, Costa Rica's external financial position will remain constrained well into the medium term, with little margin to cope with adversity. In addition, the country's debt structure has become much more rigid, as a large share of it is now made up of non-reschedulable, multilateral obligations and other official claims, and even the remaining commercial obligations, being essentially "exit" bonds, are less amenable to rescheduling.

As far as the banks are concerned, the accord provided them with an opportunity to rid themselves quickly of Costa Rica's claims in exchange for cash, and they chose to liquidate in this manner nearly two-thirds of their claims. The banks also succeeded in subjecting interest arrears to terms that are much more onerous than those applicable to the rest of the debt, not only to penalize Costa Rica, but also to discourage other debtors from resorting to arrears. They also prevailed in incorporating into the agreement a debt conversion feature, which the government did not want, but was prepared to concede. And last, but not least, the value recovery clause will enable the banks to cash-in on Costa Rica's future prosperity.

LESSONS

We set out on these uncharted waters armed only with a clear sense of purpose and full awareness that Costa Rica's lack of clout made it imperative that we actively engage in the process as much the official establishment in Washington, as the banking community in New York. Other than that, we did not have a script so much as a "radar" to try to avoid head-on collisions.

Throughout the negotiations we followed many leads, pursued many courses, used many tactics, and even pulled a few tricks—but when all was said and done, what appears to have worked, in retrospect, narrows down to a few basic principles that might serve as guidelines for other heavily indebted, small economies seeking to negotiate reductions in their commercial bank debt:

1) Make a serious, sustained and credible commitment to economic stabilization and policy reform, not only for the sake of reform itself, but also because in order to generate goodwill and official support for your cause—which are essential in order to succeed—you need a good track record. Thus, before setting out to solicit concessions from others, make sure you have done enough domestic adjustment to warrant such external support.

2) Do not politicize the debt issue internally in order to strengthen your external bargaining position. This may sound counter-intuitive, but to do so would actually *reduce* your room for maneuver. Whatever you might be tempted to say for domestic consumption is bound to play very badly abroad. Inflammatory public statements about what you will or will not do are counter-productive for they define "success" in terms you are unlikely to attain. If you were in a position to dictate your conditions, you would not be in this pre-

dicament in the first place! Likewise, keep the debt issue above the fray of domestic party politics: it is hard enough to deal with the banks and the Washington establishment, without having the political opposition barking at your heels as well!

3) Avoid confrontation: it is never a good tactic when you challenge from a position of weakness. *Persuasion* should be your weapon of choice. Accordingly, be open to dialogue at all times, not just with the banks, but with anyone who could conceivably have anything to do with this matter. Be alert to the notions in vogue at the moment, so that you can continuously recast your case in those terms. And, last but not least, be sensitive to the needs of those from whom you seek help: they are only likely to give it if they see what is in it for them!

4) Make it clear from the start that you are *unable*, not *unwilling*, to pay and, indeed, make the notion of *ability to pay* the center of your discussions with the banks. To avoid a situation in which it is your word against the banks', get the IFIs squarely behind you as "arbiters" of the concept, making sure enough room for growth is duly factored in. Be tenacious on this point, for it is crucial to the outcome. On the other hand, be extremely flexible regarding the "menu of options" for debt relief. In fact, let the banks do their *own* financial engineering, provided they work around *your* notion of "ability to pay".

5) Exercise extreme caution in matters of arrears, for both the banks and the authorities strongly oppose this "anomaly" and will only tolerate it as a last resort measure. In truth, withholding of payments may be the *only* leverage a debtor has with its creditors, but if used frivolously as a mere negotiating chip, it is bound to backfire. In resorting to arrears, one has to make a strong case that there is really no alternative. In that case, the clearance of the arrears naturally becomes a part of the overall financial package, rather than a *precondition* for the negotiation. Having said that, bear in mind that occasional "goodwill" payments do tend to help the negotiations along.

6) Finally, recognize that, realistically speaking, net new commercial lending is unlikely to take place, no matter what you do. Focus instead on deep cuts in debt and debt service payments. This will also do away with the inherent contradiction of asking the banks simultaneously to write-down bad loans and offer new credits to the same uncreditworthy customers.

WHITHER THE BRADY PLAN?

While rumors about the demise of the Brady Plan may be premature, there is no doubt that the debt work-out process is riddled with difficulties.

1) There are serious *process* problems that render the exercise extremely costly, time-consuming and unsatisfactory. The Bank Advisory Committee process has unravelled: committees at this point neither advise the countries, nor do they really represent or are able to act on behalf of the universe of banks. Because negotiations take such a lot of time, the level of representation at these committees has dropped considerably, so that members often cannot speak authoritatively even for their own institution. As a result, all deals

so far have been struck essentially *outside* the advisory committee structure.

The negotiations have become incredibly complex in terms of the actors involved, either directly or indirectly: the IMF (various departments), the World Bank (ditto), the Inter-American Development Bank, the Federal Reserve Board, the U.S. Office of the Comptroller of the Currency, the U.S. Treasury, the U.S. State Department, the U.S. Congress, Japan, the Paris Club, the banks *in* the advisory committee, the banks *outside* the committee, the country's financial advisors, the country's legal counsel and so on, and there is no *ringmaster!*

The legal complexities are mind-boggling: the implementation of new agreements often requires waivers of restrictive clauses in past contracts, which must be granted by unanimity—including the consent of banks that have already disposed of their claims and are no longer involved with the country. Meanwhile, differences in the accounting, tax and regulatory environment in which banks operate make it necessary to design lengthy "menus of options" rather than rely on more general mechanisms, all of which adds to the complexity of the exercise.

2) There are certain *conceptual* problems in the strategy itself that must be resolved somehow in the negotiating process. For instance, how can one eliminate free riders and ensure equitable burden-sharing among banks within a strictly voluntary framework? Who decides who gets debt relief, and on what grounds? How much debt relief should be granted? Is debt relief a reward for good behavior in the past or in the future? Can debt reduction and new money really be reconciled when country risk is not materially altered? Are the resources currently available to support the process sufficient? Are the existing guidelines ruling the use of those resources adequate? Would greater flexibility in the use of those funds increase their effectiveness? Would it result in an unacceptable transfer of risk to the multilateral financial institutions?

At bottom, this is a process of *burden-sharing*, of adjudicating losses between debtor countries, creditor banks and industrial country governments. In the past, industrial countries had always sided with the banks, but under the Brady Plan, responsible, reform-minded debtors are supposed to be rewarded with debt relief.

That this constitutes a major realignment of forces is best illustrated by the rift that has developed between the U.S. Treasury and the commercial banks. The banks are particularly incensed at what they consider to be official condoning of arrears to the banks, but they also claim that industrial governments are not doing enough in terms of providing sufficient credit enhancements to attain significant commercial debt reduction.

3) Everyone is suffering from *debt fatigue*. There is increasing frustration and restlessness among the various players, and a feeling that the outcome is not worth the effort. The *banks*, as noted, resent having to shoulder what they consider to be a disproportionate share of the burden and claim that industrial countries are not doing enough to reduce the burden of their own official debt. Many *debtors*, on the other hand, feel that for all the conditions, commit-

ments and attendant costs, they are not getting the kind of relief they need. The *IFIs*, for their part, are frustrated at having to juggle the interests of all sides, without ultimately having the clout to bring about better deals. Moreover, they are increasingly concerned about the transfer of risk from the banks to their own portfolios and dread the day when they will have to reschedule their own claims. Finally, the *U.S. Treasury*, which has been instrumental in forging past deals, may not be prepared, except in special cases, to continue to invest the amount of hands-on effort and political capital that have been required in each deal so far, especially since the alarm over the systemic risk is receding. And, without the Treasury squarely behind it, how far will the process go?

My own view is that, without intense involvement on the part of the IFIs and the U.S. Treasury, the concerted debt work-out process will begin to crumble, and that such decisive official participation will only be forthcoming in cases such as Brazil, where the stakes are high and the country has earned, through drastic domestic action, a certain amount of external support. The prospect for smaller debtors is not encouraging. Without strong official involvement, those debtors would have to confront the banks essentially on their own. Given the asymmetry in the balance of power, if they manage to maintain the concerted process going at all, debtors may at best get only marginal concessions. More likely, the process would splinter and debtors would quietly begin to retire as much of their discounted claims as they could, work out deals one-on-one with banks when possible, and simply not pay the rest.

The choice for the future would appear to be, either to have a strengthened debt strategy, or to be willing to tolerate arrears and a certain amount of chaos.

It is significant that now that the immediate threat to the international financial system has receded, nobody in Washington talks about a *debt crisis* anymore. For most debtors, of course, debt remains a serious problem. While declining interest rates in recent years have eased the debt burden, a reversal of this trend would once again put them in jeopardy.

If and when it happens, the next episode in this unfolding drama will not be a mere replay of the 1980s, however. The 1990s version will feature a whole new cast of characters—Eastern Europe and the former Soviet Union readily come to mind—and is likely to revolve around *official debt*, both bilateral and multilateral. Thus, the next episode is likely to take place at the Paris Club and feature the Bretton Woods sisters.

U.S. FOREIGN ASSISTANCE TO CENTRAL AMERICA: POLICY AND PROGRAMS, FY1980-1993

by Jonathan E. Sanford *

CONTENTS

INTRODUCTION

The year 1979 was an eventful one for Central America and one that completely changed the nature of its relations with the United States. In Nicaragua, the Sandinista-led insurgents took power after an intense civil war. In El Salvador, a coup by reformist military officers brought new efforts to deal with the country's social and political problems and more intensified conflict with the guerrillas. The oil shock of 1979, which doubled world oil prices for the second time in a half decade, shook the economies of the Central American countries to their roots. Falling world prices for their exports and the rising cost of imports seriously damaged their balance of payments and cut their rates of domestic economic growth. Many of them turned to the World Bank, the International Monetary Fund (IMF), and the United States for economic aid to bolster their economies. In the process, they often agreed to make (or at least consider) major changes in their economic policies.

The U.S. Government has been especially concerned about events in Central America since the late 1970s. Many analysts saw the 1979 Sandinista victory in Nicaragua and the guerilla wars in El

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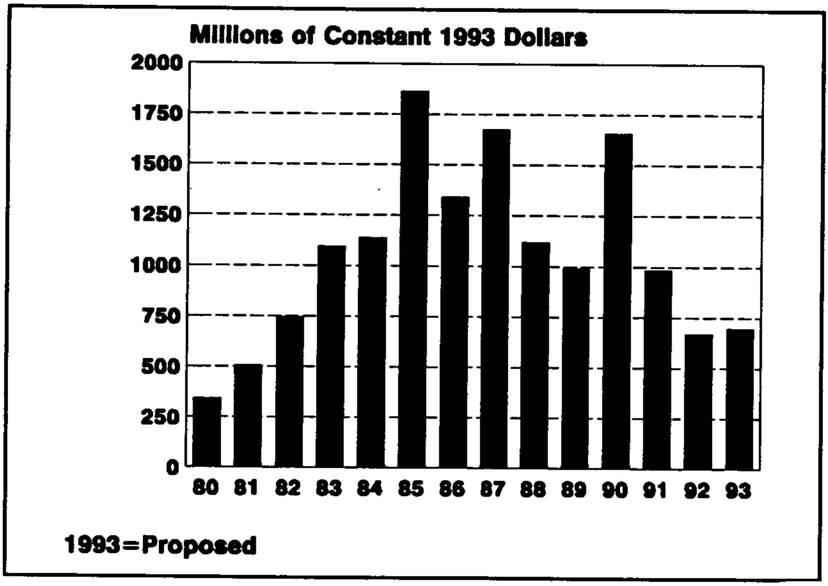
Salvador and Guatemala as major threats to U.S. strategic interests. The volume of U.S. foreign aid to the region grew substantially in the 1980s, to help the regional countries cope with their problems. U.S. aid commitments to the region jumped from $194 million in fiscal 1980 to $1.4 billion by fiscal 1985 and averaged more than $1.1 billion a year through fiscal 1990. More recently, though, the U.S. aid program in the region has shrunk considerably, with proportionally the largest share of the reduction coming in military aid programs. In fiscal 1992, the Administration programmed $658 million in Central America and it is seeking $702 million for fiscal 1993. The last two amounts are less, in real terms, than what the United States provided Central America in fiscal 1982. Figure 1 shows the amount the United States has provided the region (in constant 1993 dollars [1]) since 1980.

Figure 1. U.S. Foreign Aid to Central America, FY1980-93



[1] It is necessary, when comparing aid levels over a 14 year period, to use a measure that adjusts for inflation. In this chapter, a common unit of measurement ("constant dollars") is used to translate the amounts of aid provided in any particular year ("current dollars") into dollars of equal purchasing power. This can have a major effect on the analysis. In current dollar terms, for instance, the U.S. aid program in Central America was bigger in 1992 ($658 million) than in 1982 ($497 million). Adjusting for inflation, however, the relationship is reversed. In real terms, the United States provided more in 1982 ($743 million in constant 1993 dollars) than in 1992 ($680 million in constant 1993 dollars). A constant 1993 dollar is the future purchasing power, estimated by the Office of Management and Budget (OMB), that a U.S.dollar will have in fiscal 1993 (October 1992 through September 1993).

This paper discusses major trends in the programs the United States has funded in Central America since October 1979 (the start of fiscal 1980). It looks at the evolution of U.S. aid policy, changes in the overall composition of U.S. foreign aid in Central America, the goals and emphases of U.S. economic aid, and plans for future U.S. aid to the region. The study is based on data supplied by the U.S. Agency for International Development (AID) and other U.S. agencies. Eleven tables at the end of this paper show the amounts provided yearly to Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, and Panama by the 12 U.S. foreign aid programs active in the region between fiscal 1980 and 1992; they also show the amounts proposed for fiscal 1993. [2]

Four Periods for U.S. Aid Policy Towards Central America

THE EVOLUTION OF U.S. CENTRAL AMERICAN AID POLICY

The U.S. foreign aid program for Central America in the past dozen years can be divided into four periods. The first, fiscal years 1980 through 1984, was a time of rapid increases in the level of U.S. aid and much conflict between the President and Congress regarding the scope and purpose of U.S. policy toward the region. The second, fiscal years 1985 through 1987, was a time of substantial executive-legislative agreement about the broad goals of U.S. aid policy and high levels of U.S. aid to the region. The third, fiscal 1988 and 1989, was a time of reorientation and adjustment in U.S. goals in the region and declining levels of U.S. aid. The most recent period, fiscal 1990 (after January 1990) to the present, has been a time of major shifts in the political situation and consequent changes in the focus and distribution of U.S. foreign aid.

Build-Up: Fiscal 1980 to 1984

The first four years of the 1980s were a period of continuing conflict between the executive and legislature about general U.S. policy towards Central America, the amounts of aid the United States should provide, and the composition and goals for U.S. aid policy in the region. The level of U.S. aid increased rapidly, in the face of Central America's serious economic, social, and security problems. The Administration and Congress both sought to respond to the changes taking place in the region. Their perceptions of the problem differed, however, as well as and the relative priority they attached to particular issues. Major struggles took place between the President and Congress, between the House and Senate, and among the authorizing and appropriating committees and subcommittees themselves, regarding the appropriate "balance" between economic and military aid. Congress appropriated substantial amounts of money for the U.S. Central American aid program during this period. Its approvals often fell short of the President's requests, however, and they sometimes carried restrictions not welcomed by the Administration.

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[2] For more information on the goals and composition of the U.S. aid programs in Central America during most of this period, see CRS Report 89-374F, *Central America: Major Trends in U.S. Foreign Assistance, Fiscal 1978 to Fiscal 1990*, June 19, 1989. For more on relevant Congressional action and executive-legislative interaction, see CRS Issue Brief 84075, *Central America and U.S. Foreign Assistance: Congressional Action* (updated regularly.)

The funding levels for El Salvador grew most rapidly during the early years of the period, from $64 million in fiscal 1980 to $276 million in fiscal 1982 to $412 million in fiscal 1984, a five-fold increase in real (constant dollar) terms. The build-up in aid levels for other countries started later in the period. Between fiscal 1980 and 1984, however, U.S. aid to Costa Rica went up almost nine-fold in real terms. In fiscal 1983 and 1984, that country received almost as much economic assistance from the United States as El Salvador did and more of it took the form of fast-disbursing balance of payments aid. U.S. aid to Honduras also more than doubled, in real terms, with Economic Support Fund (ESF) assistance and military aid grants accounting for almost all the increase. The modest rise or decline in U.S. aid levels for the other countries of the region were not significant by comparison.

During this period, most of the controversy about U.S. aid policy in Central America centered on El Salvador. The Carter Administration had provided that country with some military aid in fiscal 1981. The Reagan Administration decided to increase the level of U.S aid when it took office. [3] It claimed the El Salvador war was a test case in the struggle against communism. The State Department issued a White Paper charging that the Salvadoran guerrillas were getting arms from Soviet-bloc countries via Nicaragua and other channels.

Many in Congress saw the Salvadoran situation not as a struggle against indirect Soviet aggression, but as a test of the War Powers Act (where gradually escalating involvement might drag U.S. personnel into war) and an erosion of previous U.S. standards regarding human rights and democracy. Congress and the Administration disagreed whether increased aid would lead to a settlement by strengthening the Salvadoran government's hand or delay a settlement by giving it more capacity to resist the pressure for settlement and negotiation.

Over the next several years, Congress approved significantly less than the Administration sought for security assistance to El Salvador (military and ESF aid) and adopted tight policy conditions regarding such aid. It required that the President certify semi-annually that the Salvadoran government was making progress (among other things) in its adherence to human rights, its economic and political reforms, its assertion of civilian control over the military forces, and its progress towards early, open and free elections. [4] It also said some of the Salvadoran military aid funds could not be obligated until the President certified that progress had been made

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[3] The Carter Administration originally proposed, and Congress agreed, to provide $5.4 million in non-lethal military aid in fiscal 1981. It suspended that aid in early 1981, pending investigation of the murder of several U.S. citizens and members of the Salvadoran opposition. After the Salvadoran guerrillas launched a major new military offensive in mid-January, however, the Carter Administration released the funds. It also gave El Salvador $5 million worth of arms and equipment from Defense Department stocks, using the President's authority under Section 506A of the Foreign Assistance Act (which needs no Congressional assent.) The Reagan Administration provided the country with $20 million more from DOD stocks, using the same Section 506A authority and gave an additional $20 million in reprogrammed ESF funds.

[4] For a detailed account of U.S. policy issues regarding El Salvador, see: CRS Rept. 90-149 F, *El Salvador Highlights, 1960–1990: a Summary of Major Turning Points in Salvadoran History and U.S. Policy.* March 13, 1990. See also the review of congressional action on Central American policy prepared by CRS and published as a committee print by the House Committee on Foreign Affairs each year under the title *Congress and Foreign Policy, [Year].*

on issues of concern. (These included, for example, prosecution of the persons responsible for murdering certain U.S. citizens and continued implementation of the Salvadoran land reform program.)

During the latter part of the build-up period, Nicaragua was also the focus of controversy. The United States had provided economic aid to Nicaragua in the early 1980s. [5] By fiscal 1982, it was also providing funds to help the anti-Sandinista contras put military pressure on the Sandinista regime. Congress generally supported the Administration's overall approach, although the House voted twice to end all funding for the contras. In 1982, Congress eventually agreed to allow continued some "covert" funding for the contras (through the U.S. intelligence agencies), although it put limits on funding levels, on the activities of the contras based in Honduras, and on U.S. goals (barring any use of U.S. funds to overthrow the Nicaraguan government or provoke a conflict between Nicaragua and Honduras).

The money the United States gave to the Nicaraguan contras was not foreign aid money and it was not channeled through normal foreign aid programs. It is relevant to a discussion of U.S. foreign aid policy in Central America because of the effect it had on U.S. policy towards Nicaragua and the influence that U.S. policy toward Nicaragua (and the conflict between the President and Congress on this issue) had on U.S. foreign policy and aid funding levels in the region. The rapid growth in U.S. aid to Costa Rica and Honduras was influenced largely by the perceived threat of the military build-up in neighboring Nicaragua. There was concern over the possible instigation of terrorist acts by the Sandinistas in these countries and over the fact that contra groups were based (with implicit consent) on those countries' soil. Similarly, the United States held a series of military exercises and built military facilities in Honduras in part to make it more secure against foreign attack and to pressure the Nicaraguan regime. Some observers worried (or hoped), after the U.S. invasion of Grenada in 1983, that the Administration might use the facilities and U.S. troops in Honduras as the staging area and forward troops for a similar strike against the Sandinista government.

Consensus on Higher Levels of Aid: Fiscal 1985 to 1987

In January 1984, the National Bipartisan Commission on Central America, chaired by former Secretary of State Henry Kissinger, issued its report on conditions in the region. The Commission found that the "acute crisis" in the region was of fundamental importance to U.S. security. The countries of the region needed $24 billion in external assistance in the next seven years, it said, to help

[5] Following the Sandinista victory in the 1978–79 civil war, the Carter Administration wanted to provide aid to Nicaragua in order to develop good relations and to influence the character of the post-war government. Congress approved the Administration's proposal (for fiscal 1980) for $75 million in ESF aid, but it required that the funds not be obligated until fiscal 1981. It also said the President must certify that the Nicaraguans were not aiding international terrorism or helping the Salvadoran guerrillas. The Carter Administration obligated $53 million in October 1980. In November, however, as U.S. relations with Nicaragua deteriorated, it quietly blocked release of the remaining funds. President Reagan announced, in April 1981, that the funds were frozen. His Administration later tried to provide $5.1 million in aid, through the Nicaraguan private sector and the Roman Catholic Church, to keep hopes for a pluralist society alive. Only about $700 was spent before the Sandinistas forbade further disbursements in August 1982, arguing that church officials were getting funds from U.S. intelligence sources.

alleviate their significant economic and social problems. Of this, it said, the private sector might provide as much as $6 billion in new loans and investments, the international financial institutions and other countries perhaps $6 to $8 billion in new loans, and the United States $10 to $12 million in new aid. Some U.S. assistance could be market-rate guarantees and some could be budgeted foreign aid. It also proposed that the United States provide an increase in military aid to El Salvador and Honduras (no amount was specified) and it said future U.S. military aid to El Salvador should be linked to improvement in the country's human rights situation. It said the United States should continue applying external pressure (through the contras and other means) on the Sandinista regime in Nicaragua.

President Reagan had appointed the Kissinger Commission the previous year, in response to a bipartisan Congressional initiative, in an effort to end the conflict about U.S. policy towards the region. [6] By mid-1983, it seemed clear that the Administration and its critics in Congress were both influential but neither had enough strength to get its way in the executive-legislative policy process. As a result, the composition of the U.S. aid program for Central America was often more the product of struggle and compromise than it was the result of any overall plan. The size and terms of the U.S. program could vary with the changing alignment of political forces and the result satisfied few participants on any side of the policy debate. President Reagan had asked the Commission to assess the situation in Central America and to advise the President and Congress on "a long-term United States policy that will best respond to the challenges of social, economic, and democratic development in the region, and to internal and external threats to its security and stability."

Following release of the Kissinger Commission's report, the Administration sent its Central American Democracy, Peace, and Development Initiative to Congress. In this, it proposed that the United States provide Central America with $8.4 billion in economic assistance during the next five years (fiscal 1985 to 1989)—$2 billion in guarantees and $6.4 billion in foreign aid. It also recommended substantial, though unspecified, increases in U.S. military aid.

The Kissinger Commission's report helped knit together a consensus regarding U.S. foreign aid policy towards Central America. Also, and perhaps more important, the election of reform-minded Jose Napoleon Duarte, from the Christian Democratic party, as President of El Salvador in March 1984 softened Congressional resistance to increased Salvadoran military aid. In early 1984, to carry out the Commission's recommendation that urgent attention be given to the region's immediate needs, the Administration asked Congress to approve $364 million in economic aid and $259 million in military aid as supplemental fiscal 1984 appropriations for Central America. The House initially rejected the request. After President-elect Duarte visited Capitol Hill in May 1984, however, Con-

[6] Twelve respected individuals from both political parties and many walks of life were appointed and 11 Members of Congress from both parties were named "senior counselors."

gress approved legislation appropriating $364 million in economic and $183 million in military aid for the region. [7]

Congress considered several bills that sought to enact some of the Kissinger Commission's major aid proposals. They were not approved, however, as several broader issues blocked agreement on possible changes in the overall U.S. foreign aid program. Nevertheless, in the appropriations enacted in subsequent years (fiscal 1985 to 1987), Congress approved more aid funds for Central America and enacted less restrictive policy guidelines for U.S. aid than before. It also enacted fewer measures limiting U.S. aid levels for countries in the region. As more Central American countries elected democratic governments, Congress sometimes said that certain countries should receive no less aid than the amounts proposed by the Administration.

There was no consensus, however, on the Commission's recommendation that the United States continue exerting covert paramilitary pressure on Nicaragua. Nicaraguan policy issues remained a major flash point for executive-legislative tensions. The Administration urged that funds be given to the contras to protect other countries from Nicaraguan aggression and to make the Sandinistas accept a settlement that preserved freedom for their citizens. Critics argued, on the other hand, that the external pressure was making the Sandinistas more repressive and less willing to accommodate their opposition. They urged support for the peace initiatives by Central American leaders. They also worried that U.S. foreign aid, especially to Honduras and El Salvador, tended to strengthen the forces most resistant to a regional settlement.

The Administration asked Congress to approve large amounts for the contras during this period. Congress, particularly the House, was resistant and refused to allow further "covert" funding of the contras through the intelligence budget. It voted, however, to provide specific amounts for direct funding ($27 million in 1985 for non-lethal aid and $100 million in 1986 for military and non-lethal aid.) The debate on contra funding was particularly contentious, as the Administration and its critics maneuvered for advantage in the broader controversy about U.S. policy towards Nicaragua and Central America.

Adjusting U.S. Goals Downward: Fiscal 1988 and 1989

During fiscal years 1988 and 1989 (calendar years 1987 through 1989), the United States revised its foreign aid goals for Central America in light of budgetary realities. It also shifted policy on Panama and adopted a new strategy towards Nicaragua.

The Kissinger Commission had recommended that the United States provide Central America with about $1.3 billion annually in economic aid during the five-year period. [8] In the three years after

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[7] Analysts disagree whether fiscal 1984 was the last year of the buildup period or the first year of the second period. It is treated here as the last year of the first period. Congress treated the regular 1984 appropriation bill much as it had treated the bills for prior years. The 1984 supplemental was enacted late in the fiscal year. Most of the supplemental military aid was obligated in the last weeks of fiscal 1984. Most of the economic aid, however, (the majority of the funds) was obligated early in fiscal 1985.

[8] For a review of congressional action, see: CRS Rept. 87-291 F, *Kissinger Commission Implementation: Action by the Congress through 1986 on the Recommendations of the National Bipartisan Commission on Central America.* March 7, 1987. The report maintains that Congress generally supported the Commission's major recommendations.

the Commission's report appeared (fiscal 1985 to 1987), the Administration asked Congress to provide $3.298 billion for U.S. economic aid to the region, a level somewhat smaller than anticipated by the Commission. For reasons having more to do with the overall budgetary situation than with any opposition to Central American aid, however, it was only able to program $2.692 billion for this purpose. [9] Congress made no major cuts in funding for U.S. aid programs in Central America during these years. It did, however, appropriate less than the Administration requested for the total level of U.S. foreign aid worldwide. A large share of the total aid was also earmarked (at or near the request level) to assist specific countries. This meant that the programs without protective earmarks (for example, those in Central America) had to absorb all the cuts required by the funding "shortfall."

In March 1987, responding to legislation directing the Administration to submit a plan in 1987 for "fully funding" assistance to Central America in keeping with the recommendations of the Kissinger Commission, President Reagan proposed that U.S. foreign aid goals for the region be recast. [10] The aid target for the multiyear period should be raised by $500 million, he said, and the committment period stretched out an additional three years (through fiscal 1992). This would reduce the annual aid target to $860 million, a more realistic figure given the budgetary situation. The Administration also said, in the report accompanying the President's message, that the new aid target was a realistic reflection of the political, security, and economic realities affecting the region. A three-year extension of the Central American initiative would ensure, the report stated, solid progress towards democratization, reform and stabilization of the regional economy, and broader distribution of the economic benefits of growth.

Congress took no explicit action on the revised timetable for implementing the Kissinger Commission proposals, although key Members and committees were supportive. For fiscal 1988 and 1989, the Administration requested $845 million and $752 million, respectively, for economic aid to Central America. As in previous years, less was appropriated for the overall foreign aid program than was sought. Nevertheless, total allocations for economic aid to the region were $785 million and $784 million in fiscal 1988 and 1989. [11]

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[9] The aid allocations for Central America for fiscal years 1985, 1986, and 1987 were, respectively, $973 million, $893 million, and $826 million. It should be noted that the aid allocation figures are different from the aid obligation figures reported in the appendix. The Administration must inform Congress within 30 days after enactment of a foreign aid appropriation act how it plans to allocate the funds among countries. The funds are not obligated, however, until the United States and the recipient country sign a formal agreement as to how they will be used. The funds appropriated and allocated in one fiscal year may be obligated in another fiscal year. The final disbursement (expenditure) may not occur until several years after the funds are obligated.

[10] *Report to the President and the Congress: A Plan for Fully Funding the Recommendations of the National Bipartisan Commission on Central America.* Special Report No. 162. Prepared by the U.S. Department of State, Agency for International Development and Office of Management and Budget. Washington, U.S. State Department Bureau of Public Affairs, March 1987. The report includes President Reagan's message to Congress of March 3, 1987.

[11] The Administration also requested $216 million and $166 million for military aid to the region for those years. It was able to allocate $132 million and $137 million for such aid in fiscal 1988 and 1989. Note that these and the totals for regional economic aid are the amounts allocated, not the amounts obligated. Some funds allocated from the fiscal 1988 appropriation were obligated in later years, while some of the funds obligated in 1988 were appropriated earlier.

In El Salvador, President Duarte's government was faltering at this time, as rival wings of the Christian Democratic party struggled for priority. The rightist Nationalist Republican Alliance (ARENA) won control of the national legislature in 1988 and the presidency in early 1989. Many in Congress were concerned that the level of human rights violations in El Salvador might increase and the new Salvadoran government might back away from some of the reforms implemented by the Duarte administration. Congress rejected by close votes several measures that would have limited U.S. aid to El Salvador pending improvement in the human rights situation and movement toward a negotiated settlement to the war. It approved other less far-reaching measures, however, that gave effect to its concern and showed its willingness to adopt legislation directly affecting U.S. policy in Central America. It specified, for example, that some of the U.S. military and security-related economic aid provided to El Salvador in fiscal 1988 and 1989 would be available only if the Salvadoran government took (or refrained from taking) certain steps. It also cut the U.S. military aid level for El Salvador in 1989 by $10 million.

A major shift also took place in U.S. policy towards Panama at this time. In the early 1980s, a period in which the United States sought Panama's cooperation on a range of Central American issues, the United States had a small but significant aid program for that country. In mid-1987, however, the Administration suspended U.S. aid, because of growing opposition in Panama to the de facto political rule of General Manuel Noriega and charges that Noriega was trafficking in illegal drugs. Congress voted in December, in the fiscal 1988 foreign aid appropriations act, to bar further U.S. aid to Panama. The President imposed economic trade sanctions in 1988. He also directed secretly that $10 million be provided covertly to help the Panamanian opposition prepare for the May 1989 elections. After the elections were nullified by the Noriega regime (when it became evident that the opposition would have won by a 3-to-1 margin), Congressional leaders issued a bipartisan statement supporting new steps for "restoring democracy" in Panama. Congress voted in late 1989 to continue the ban on U.S. aid through fiscal 1990, unless the President certified that certain democratic conditions had been met. Congress also suggested that, if a democratic regime were established, U.S. aid would be restored and increased levels would be considered.

During this period, the United States also changed its approach to Nicaragua. Support in Congress for the policy of military pressure declined after 1986 as more lawmakers became dissatisfied with the results of the Administration's approach. The crash of a contra supply airplane in October 1986 also brought to light a series of illegal actions by executive branch officials (the so-called Iran/Contra scandal). Congressional leaders sought to shift the focus of U.S. policy away from the military onto the political track. They urged that, instead of pressing with outside force for change in Nicaragua, the United States should push the Sandinistas to adopt democratic reforms through negotiations and other diplomatic means. Helped in part by the U.S. efforts, the Central American presidents adopted a peace plan (Esquipulas II) that opened up prospects for an end of the wars and a restoration of civil liberties in the regional countries. [12] In October 1988, Congress approved an amendment (to a Montana wilderness bill) which said that failure by the Sandinistas to comply with the terms of the peace plan would "very likely" cause Congress to resume military aid (including lethal military aid) to the contras. [13]

Congress voted funds during this period for some special aid for Nicaragua. In March 1988, for example, it approved legislation providing $17.7 million for non-lethal aid to the contras and an equal amount for medical aid to children "who are victims of the Nicaraguan civil strife." (AID was given responsibility for delivering the aid.) In August 1988, Congress voted to give the Catholic Church of Nicaragua $5 million for medical assistance to the civilian victims of the Nicaraguan conflict. (Another $4.2 million for this purpose was subsequently approved in April 1989.) In September 1988, $2 million was earmarked in the fiscal 1989 foreign aid appropriation (through the National Endowment for Democracy) for Nicaraguan opposition groups not affiliated with the contras. In mid-1989, Congress earmarked another $3 million in fiscal 1990 foreign aid funds for this purpose.

New Departures and Recipients: Fiscal 1990 through 1993

As the political and military situation in Central America has changed in recent years, the priorities of U.S. foreign aid to the region have also changed. The level of U.S. aid has declined as the perceived threat to U.S. security has diminished. The focus of the U.S. aid program in El Salvador has shifted. New aid programs have opened in Panama and Nicaragua as regimes that were previous opponents of the United States have been replaced by more friendly democratic governments. Other countries (Costa Rica and Honduras, for example) have seen their aid levels decrease.

In 1990, Congress enacted legislation once again (as it had during the early 1980s) that sought to substantially affect U.S. policy and events in El Salvador. For example, it withheld half the military aid provided for El Salvador in the fiscal 1991 foreign aid appropriation act, pending action by the government and guerrillas to move towards a negotiated settlement of the Salvadoran conflict. [14]

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[12] The Central American governments signed the peace plan in August 1987. In the agreement, they promised to reach ceasefires in their internal wars, to stop aiding insurgents in other countries, to hold talks with their unarmed opposition, to declare amnesties, and to take steps towards political liberty that included freedom for the press and political parties and free elections. The Central American presidents subsequently met in January 1989 to confirm that progress had been made in implementing the peace plan. Congress had voted in October 1986 to provide $100 million in military aid to the contras, $40 million of it for lethal aid. After the peace plan was signed, Congress approved no further lethal military aid for the contras, although it did approve several allocations of "humanitarian" aid (non-lethal military support) to help keep the contra forces intact during negotiation and implementation of an agreement between the Nicaraguan government and the contras.

[13] Congress had just approved an allocation of $27 million for non-lethal aid to the contras through the fiscal 1989 Department of Defense appropriation act. No lethal aid for the contras was subsequently approved. Legislation approved in April 1989 provided $49.8 million more in non-lethal aid for the period through February 1990 (the date of the presidential election in Nicaragua.) For more information, see: CRS Rept. 89-611 F, *Contra Aid: Summary and Chronology of Major Congressional Action, 1981-1989.* November 1, 1989.

[14] For the funds to be available, the President would have to certify that the Salvadoran government was willing to negotiate in good faith, that it was prepared to prosecute the persons responsible for the murder of several Jesuit priests in 1989, and that it was controlling acts of violence against civilians by the military or security forces. On the other hand, the funds would also be released if the President determined that the guerrillas were not ready to negotiate in

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President Bush later kept the suspension in effect on his own authority, after making some of the required determinations, in order to encourage negotiations. Congress retained the suspension in its fiscal 1992 foreign aid appropriation act.

The Salvadoran government and the guerrillas reached a comprehensive cease-fire and peace agreement on December 31, 1991 which was formally signed on January 16, 1992. Congress passed legislation in April 1992 shifting $63.8 million (all except $21.3 million) of the fiscal 1992 military aid funds to the Demobilization and Transition Fund (an account established earlier under U.S. law). The fiscal 1993 foreign aid appropriation bill approved by Congress in October 1992 limited military aid to $11 million (non-lethal assistance only) and transferred $29 million more to the Demobilization and Transition Fund. It also cut El Salvador's ESF funding by $10 million (to $150 million).

Following the U.S. invasion of Panama in December 1989 (Operation Just Cause), a new government, consisting of opposition leaders who were widely believed to have won the May 1989 elections, took office. In January 1990, President Bush announced an economic package of just over $1 billion to help that country. It included $551 million in emergency and long-term economic aid and $500 million in preferential market access, market-rate loan and guarantees, and investment initiatives through various U.S. programs. In February, Congress provided $42 million for emergency construction, help to small business and to reactivate public services. In May, it appropriated an additional $420 million in ESF aid. Of this, $130 million was used to clear Panama's payment arrears to the international financial institutions and $355 million was designated for programs to revitalize the private sector, rebuild infrastructure, and otherwise promote long-term economic recovery. The combined $462 million allocation made Panama the largest recipient of U.S. aid in Latin America and the fifth largest worldwide in fiscal 1990. Obligation of the money would be stretched out over two years, however. No new funds were requested in fiscal 1991 and only small amounts were sought in fiscal 1992 and 1993. [15]

Nicaragua also went in early 1990 from the status of a pariah state to the status of a major recipient of U.S. foreign aid. Conforming with the Central American peace accords, Nicaragua held a free election in February 1990. Violeta Chamorro, supported by a broad coalition of opposition groups, won the vote for President and the Sandinistas turned over administration of the country to its opponents. In May 1990, in the same fiscal 1990 act providing funds for Panama, Congress appropriated $300 million for ESF aid to Nicaragua. The Administration later allocated $150 million more in ESF aid and $11 million in development aid from the fiscal 1991

good faith, that they were receiving significant shipments of lethal military equipment from abroad, that they were undertaking military action that jeopardized the government, or that they were attacking civilian targets.

[15] The General Accounting Office subsequently reported, in a draft report cited in the *Washington Post* on June 13, 1992, that the U.S. aid program has had "no significant impact" on the Panamanian economy. It reportedly said that too much of the U.S. aid had gone to bolster the Panamanian banking sector and that 70 percent of the money for development projects had not yet been disbursed. Senior AID officials challenged the report and said a panel of impartial experts would study the issue. For the AID response, see the *Congressional Record*, June 30, 1992, pp. S9188–90.

appropriation and $140 million in ESF aid and $17 million in development aid from the fiscal 1992 appropriation.

Nonetheless, U.S. assistance to Nicaragua still was controversial among U.S. policymakers in 1992. At the request of Senator Jesse Helms, ranking minority member of the Senate Foreign Relations Committee, the Administration blocked the obligation of a portion of the Nicaraguan aid funds.[16] The Senator, other Members of Congress, and some observers were concerned that many expropriated properties of U.S. citizens had not been returned to their owners. They also were concerned that the Sandinistas still had substantial influence in Nicaragua through their control of the armed forces, national police, and other major Nicaraguan governmental institutions.[17] State Department officials essentially agreed with some of these concerns and pressed President Chamorro to remove from office a number of former Sandinista officials. In early September 1992, President Chamorro announced the removal from office of the chief of the national police and 11 other police commanders who were holdovers from the previous Sandinista administration. The newly appointed chief of the national police also had Sandinista affiliations, however. State Department officials held several consultations with the Nicaraguan government on this matter during this period, but the U.S. aid funds were not released.

In October 1992, the House and Senate conferees for the fiscal 1993 foreign aid appropriation bill addressed this issue. Since Chamorro's election they reported progress in Nicaragua towards the reconciliation, democratization, and economic reform of the country and the compensation of private property confiscated by the Sandinistas. They stated that continued progress toward economic recovery depends on prompt use of the U.S. economic aid funds, and that they "believe that the fiscal year 1992 funds appropriated for Nicaragua should be obligated." Once those funds were made available, they said, several conditions should apply to any fiscal 1993 U.S. economic aid for Nicaragua.[18] State Department officials say that, despite the new proposal by the leaders of the House and Senate appropriations committees, they will continue to respect the earlier hold placed on release of the Nicaraguan aid funds. They report that consultations with Congress and with the Nicaraguan government on this matter are continuing.

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[16] As of mid-August 1992, this totalled $100 million in ESF funds slated for balance of payments support and $17 million in ESF and development aid intended for project aid.

[17] For a statement of these concerns, see the letter from Senator Helms to AID Administrator Ronald Roskins, the letter from 24 Congressmen to the Government of Nicaragua, and the letter in response from the Government of Nicaragua, printed in the *Congressional Record,* June 12, 1992, pp. S8126–8. See also: U.S. Congress. Senate. Committee on Foreign Relations. *Nicaragua Today. A Republican Staff Report to the Committee on Foreign Relations.* August 1992.

[18] These include: the implementation by Nicaraguan military and police forces of a code of conduct on human rights; judicial reform; further resolution of bona fide claims for compensation of expropriated property; and continued monitoring by the AID inspector general and GAO of U.S. aid expenditures to be sure they are not misused or subject to corruption. See: Joint Explanatory Statement of the Committee of Conference (for H.R. 5368), Congressional Record. October 4, 1992, p. H11337.

OVERALL COMPOSITION OF THE U.S. AID PROGRAM

Annual Levels

To show trends, it is useful to compare the average annual amounts of foreign aid the United States channeled to Central America during the four periods discussed here. (See Figure 2.) During the build-up period (1980 through 1984), the Central American countries received an average $764 million each year (in constant 1993 dollars) in U.S. aid. During the next period (1985 to 1987), by contrast, the U.S. aid level was more than twice as high when the countries of the region got an average $1.6 billion annually (in 1993 dollars) from the United States. In the last years of the decade (1988 and 1989), the level of U.S. aid declined by more than one-third, to an average $1.06 billion annually (in 1993 dollars). It has averaged about $1 billion annually since fiscal 1990, though the amounts provided in the last few years have been decidedly below this level. In real terms, the United States programmed less foreign aid money in the region in 1992 than it did a decade earlier in 1982.

Composition

The U.S. foreign aid program in Central America has had three functional components: development assistance,[19] balance of payments support aid,[20] and military assistance.[21] In some cases, several agencies (AID, the Peace Corps, and the Inter-American Foundation, for example) may provide aid that serves a similar function. Similarly, one agency (AID, for example,) may also finance programs that serve different functions.

In the years proceeding the build-up of U.S. assistance, development aid accounted for 80 percent of all U.S. foreign assistance to Central America. During the 1980s, however, balance of payments aid accounted for almost 45 percent and military aid over 18 percent of all U.S. assistance to the region. These two forms of aid accounted for 47 percent and 18 percent, respectively, of all U.S. aid to the region between 1980 and 1993.

Figure 2 shows how the composition of the U.S. foreign aid program in the region changed during each of the four periods discussed in this chapter. Balance of payments assistance has accounted for a growing share of the U.S aid provided to Central America

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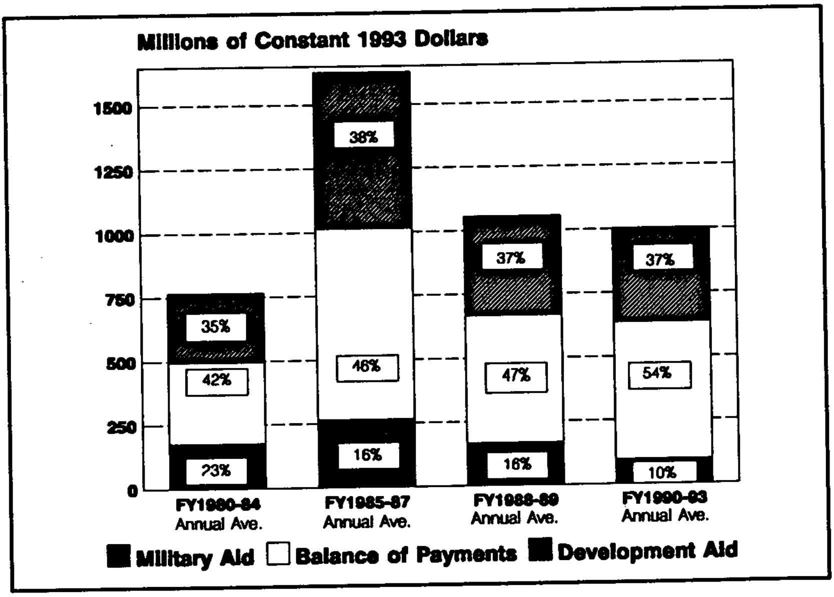
[19] For purposes of this paper, development aid consists of six programs: the development aid program funded through the Agency for International Development (AID), project aid funded by ESF assistance and implemented by AID, P.L. 480 Title II grant aid providing direct humanitarian food aid to needy individuals, the Peace Corp person-to-person technical aid program, Inter-American Foundation grants to cooperatives, microenterprise, and other small-scale private development-oriented organizations, and emergency relief provided by the State Department's Office of Foreign Disaster Assistance (OFDA).

[20] For the purposes of this paper, balance of payments support programs include the commodity import and cash transfer programs funded by ESF assistance and credits provided by the P.L. 480 Title I food loan program. Between fiscal 1980 and fiscal 1993, ESF aid accounted for about 85 percent of all such balance of payments assistance to Central America.

[21] For the purposes of this paper, military aid consists of the International Military Education and Training (IMET) program, the Foreign Military Financing (FMF) grant aid program (and its predecessor before fiscal 1988, the Military Assistance Program), and the FMF concessional and market-rate loan programs. The IMET program makes grants to finance the participation by individual members of foreign military services in U.S. training programs designed to help improve their professionalism and military skills. The three FMF programs provide funds (on various repayment terms) to help foreign governments buy U.S. military equipment and services.

since 1980. Beginning at 42 percent of U.S. aid during the early 1980s, it increased to 54 percent of the total by the early 1990s. Development aid accounted for more than a third (35 and 38 percent) of U.S. aid to the region during each of the four periods. Military aid, the smallest category, accounted for a declining share of U.S. assistance. It reached its peak, as a share of U.S. assistance (23 percent) in the early 1980s, and then declined (to less than 10 percent of the total) in the period since 1990. In dollar terms, of course, the Central American countries received their largest allocations of development, military, and balance of payments aid when the flow of U.S. aid to the region was at its peak between 1985 and 1987.

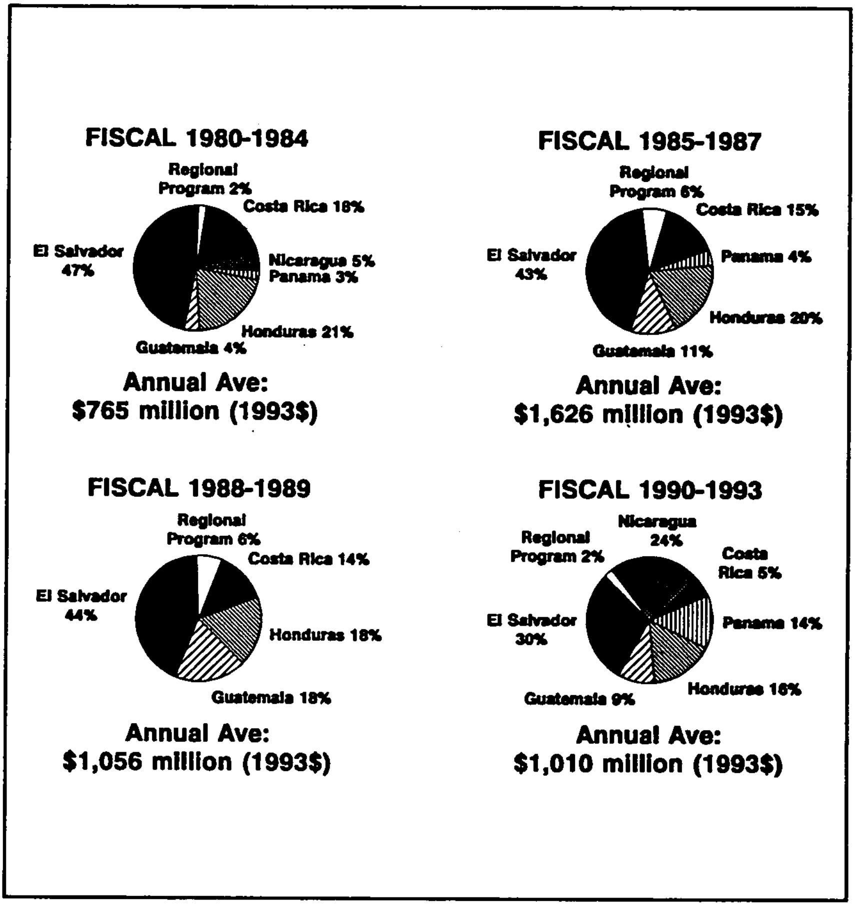
Figure 2. Purposes of U.S. Aid to Central America, FY1980-93



Recipients

The principal recipients of U.S. aid in Central America have also changed significantly in the past dozen years. During the 1980s, for example, El Salvador accounted for well over 40 percent of total U.S. assistance to the region. Since 1990, as Figure 3 indicates, that country has received about 30 percent of U.S. Central American aid. (Though larger in dollar terms, this is a smaller share than the one-third of total that El Salvador got in fiscal 1980.) The share of U.S. regional aid going to Costa Rica also declined. In the 1980s, as Figure 3 indicates, a great deal of U.S. aid went to that country. In part, the United States wanted to stabilize it against possible subversion by neighboring Nicaragua. In part, the United States also wanted to encourage Costa Rica to adopt major economic reforms, both for its sake and for the positive example it might set for neighboring countries whose economies also needed reform. Since 1990, as Figure 3 shows, with the bulk of their reforms behind them and a diminished threat from Nicaragua, the Costa Rican share of U.S. aid in the region has dropped to about one-third its previous level.

Figure 3. U.S. Aid to Central America: Recipients, FY1980-93



By contrast, Nicaragua and Panama have received a much larger share of U.S. aid in recent years. The U.S. aid level for Nicaragua fell rapidly after 1981, as tensions between the United States and that country increased. After the Chamorro government was elected in early 1990, however, the volume of U.S. assistance grew sharply. As Figure 3 shows, Nicaragua received about 24 percent of U.S. regional aid in the period since 1990. (This is comparable to the share it got in fiscal 1980 and 1981.) Panama's share of U.S. Central American aid also went up rapidly after a democratic regime was installed. It jumped from 4 percent or less of the total in the 1980s to 14 percent in the period since 1990.

U.S. Economic Aid Programs in Central America

DEVELOPMENT ASSISTANCE

In 1984, the Kissinger Commission presented four major policy goals for the U.S. foreign aid program in Central America: (1) stabilization and adjustment of the regional countries' economies, (2) long-term economic growth, (3) sharing the benefits of growth more broadly, (4) and the promotion of democracy. The Administration embraced these goals in its Central American Initiative in 1985 and made them the basis for its Central American aid policy for the rest of the decade. [22] In 1991, AID consolidated these goals into two general objectives: (1) the achievement of broadly based, sustainable economic growth and (2) the development of stable democratic societies. AID says its aid program would deal with any problems that hamper attainment of these goals. [23]

U.S. development aid programs mainly finance projects or activities which are intended to promote economic growth, alleviate poverty, provide basic human needs, and strengthen democratic institutional and procedures in the recipient countries. Economic stabilization and adjustment are also development goals, in the sense that a basic reform of a country's economic policies and its economic institutions may be necessary before it can realize sustainable growth, the alleviation of poverty, and the other development goals. In practice, the United States in most cases has used balance of payments (BOP) aid programs, rather than development aid programs, as the primary tool for getting countries to adopt fundamental economic reforms. The two principal vehicles for this aid, ESF assistance and the Public Law 480 Title I food loan program, are discussed later in this paper.

Since fiscal 1980, the U.S. Government has channeled over $2.82 billion in development aid, about 24 percent of the total to the countries of Central America through the regular U.S. programs. [24] This figure does not count, however, the $1.5 billion in development assistance funded through other accounts. [25] When these funds are included, the count for U.S. development aid totals $4.38 billion, about 36.6 percent of all U.S. foreign assistance to the region since fiscal 1980. Of this, 58 percent was funded through the regular AID development aid account. Another 28 percent was for projects implemented by AID but funded by the Economic Support Fund. Humanitarian grant assistance funded through the U.S. food

[22] AID described these goals more fully and discussed ways of implementing and realizing them in its annual presentation to Congress. See, e.g., AID *Congressional Presentation, Fiscal Year 1990*, Annex III, *Latin America and the Caribbean*, pp. 20–29.

[23] AID *Congressional Presentation, Fiscal Year 1992*, Main Volume, p. 708 and *Congressional Presentation, Fiscal Year 1993*, Main Volume, p. 572.

[24] Of this, over 90 percent was funded by the AID development aid program. The rest was funded by the Peace Corps, Inter-American Foundation and the U.S. disaster assistance program. These programs are discussed in the text below.

[25] This includes $1.23 billion in project aid funded by the Economic Support Fund (ESF) and $321 million in humanitarian grand aid funded by the U.S. food aid program.

aid program accounted for another 7 percent of the total. The remaining 6 percent was funded through the small specialized development aid programs discussed below. Both ESF and food aid are discussed at length in the two sections below.

In the early 1980s (fiscal 1980 to 1984), the United States made aid commitments totalling an average $265 million annually (in constant 1993 dollars) for development assistance to Central American countries. (This includes an average $25 million annually into development projects funded through the ESF account.) The volume of U.S. development aid nearly quadrupled after the publication of the Kissinger Commission report, reaching an average $989 million annually (in constant 1993 dollars) between fiscal 1985 and 1987. (This includes an average $185 million annually in development aid funded by the ESF.) Most recently, the volume of U.S. development aid to the region has declined. Since fiscal 1990, the United States has provided Central America with an average $332 million annually (in constant 1993 dollars) in development aid. Nearly half of this ($136 annually) has been development aid funded through the ESF program.

Honduras and Costa Rica received about the same amount of development assistance from the United States each year, in real terms, during most of past 14 years. By contrast, U.S. development aid for El Salvador went from an average $71 million annually in the early 1980s (in constant 1993 dollars) to $154 million annually between 1985 and 1987. It then fell to an average $62 million a year after 1990. Likewise, for Guatemala, the average annual level of U.S. development aid jumped from $17 million in the early 1980s to $65 million (in constant 1993 dollars) between 1985 and 1987. It also declined after 1990, to about $31 million a year. The Central American regional program—an activity strongly endorsed by the Kissinger Commission report—grew from an average $18 million annually during the early period to more than $56 million yearly (in constant 1993 dollars) between 1985 and 1987. Since 1990, however, the U.S. has channeled most of its aid into programs dealing with a single country and the regional program has shrunk to an average $19 million a year.

Until fiscal 1992, AID allocated its DA funds in Central America through five functional accounts: (1) Agriculture, Rural Development and Nutrition, (2) Population, (3) Health [26], (4) Education and Human Resources, and (5) Selected Development Activities. [27] Since fiscal 1980, AID has obligated 46 percent of its DA funds for agriculture, 19 percent for selected development activities (private sector, etc.), 15 percent for health, 15 percent for education, and 5 percent for population programs.

There have been subtle but significant shifts since the early 1980s, however, in the ways AID has used its development funds.

[26] For purposes of this discussion, the Child Survival and AIDS Prevention and Control functional accounts are treated as part of the Health account.

[27] In 1991, the last category was renamed the Private Sector, Environment, and Energy functional account. For simplicity of wording and for continuity, the old name is used here. In fiscal 1992, only the funds for population and health were appropriated in functional accounts. In fiscal 1993, only the money for population programs were approved in a single-use account. The rest was appropriated in a multisector development assistance account. AID projects are categorized by function after the agency decides what activities it will finance through this account.

For one thing, its relative emphasis on the five functional accounts has changed. The share allocated for agriculture has gone, for example, from 60 percent of all DA in Central America in the early 1980s to 42 percent since fiscal 1990. (This parallels the comparable trend de-emphasizing agriculture in AID's world-wide operations.) The shares allocated for education, health, and population programs in Central America, on the other hand, have increased. In part, this reflects the strong emphasis the Kissinger Commission put on the need for more assistance for basic health care, education, and related services. AID commitments in the education sector went from 7 percent of all regional DA in the 1980-84 period to almost 15 percent of the total after 1990. Meanwhile, programming in the health sector went from 12 to 18 percent and activity in the population area went from 4 to 8 percent of all regional DA. AID's emphasis on projects in the Selected Development Activities account increased some after the publication of the Kissinger Commission report. Overall, though, AID channeled about 18 percent of its development aid through this account during both the early 1980s and the period since 1990.

More importantly, AID has also changed the kinds of activities it has funded through its functional accounts. In the late 1970s and early 1980s, for example, most of the programs funded through the agriculture sector focused on basic human needs, rural development, and targeted assistance to the needy. More recently, AID says it has put increased emphasis on programs to support commercial agriculture, expand nontraditional exports, and related activities. Similarly, before 1981, the Selected Development Activities account focused mainly on activities—such as the development of alternative energy supply systems or the funding of municipal improvements—that were designed to meet the needs of individuals. AID says it has since put more emphasis on programs designed to help make private firms more productive and to strengthen private sector institutions, to supply credit and needed support services, and to help companies take advantage of new export opportunities created by the U.S. Caribbean Basin Initiative (CBI). [28]

In the education sector, meanwhile, AID has put increased emphasis on scholarship programs (bringing Central American students to colleges and universities in the United States) and on vocational or non-academic training programs designed to provide workers with new skills and resources. AID has financed programs for rural or primary education and for strengthening the capacity of the recipient countries' educational systems. AID's programs in the health area in Central America are similar to those it funded in the early 1980s, with an additional emphasis on child survival and acquired immune deficiency syndrome (AIDS) prevention. On the whole, AID says it continues to put most emphasis in this area

[28] In 1992, controversy arose as a result of media and press reports that some U.S. foreign aid projects in Central America might be causing jobs to be transferred from the United States because of AID efforts to stimulate the growth of private sector employment in recipient countries. In October 1992, Congress adopted legislation (section 599 of the fiscal 1993 foreign operations appropriations act) prohibiting any use of U.S. foreign aid funds: (a) for programs encouraging firms to move jobs or production from the United States to another country; (b) for the establishment of export processing zones abroad (for example, under the CBI program) where local tax, labor, and environment laws do not apply; and (c) for activities that help violate internationally recognized worker rights as defined by U.S. law.

on programs to support the health system, to provide rural and village level services, and to build the new infrastructure needed for clean water and improved sanitation.

Apart from the regular AID development program discussed above, the United States also provides development aid to Central America through several smaller programs. The largest is AID's Office of Foreign Disaster Assistance, which allocated $82 million since 1980. Three-quarters of this went to El Salvador for emergency relief following the 1986 earthquake. (The ESF also provided $100 million in 1987 for earthquake reconstruction.) Although aimed at meeting emergency needs, the expenditure of these funds has meshed with the broader efforts to meet the recipient countries development needs. (For example, U.S. emergency assistance provided portable generators after the Salvadoran guerrillas destroyed many electric transmission lines. Emergency relief put people back to work rebuilding their country after public facilities were damaged and homes and workplaces were destroyed by natural disasters.) Large sums have also been programmed for development purposes using local currency generated by the U.S. balance of payments programs.

Lesser sums have also been spent for development purposes through the Peace Corps and the Inter-American Foundation (IAF). The Peace Corps has programmed $122 million in Central America since fiscal 1980 for education, village level training, and other activities using U.S. volunteers. Almost all of its activities have centered in Honduras (the largest program), Guatemala, and Costa Rica. The Inter-American Foundation has channeled an additional $72 million to Central America, since fiscal 1980, to help cooperatives, micro-enterprise, and other small scale activities. [29] This aid has been distributed relatively evenly throughout the region. For a while, the IAF was the principal program through which the United States provided economic aid and maintained foreign aid contacts within Nicaragua and Panama.

ECONOMIC SUPPORT FUND

The Economic Support Fund is the largest single program through which the United States has provided aid to Central America, accounting in real terms for about 48 percent of all U.S. aid to the region since fiscal 1980. The ESF program has also been perhaps the most controversial U.S. assistance program in the region. ESF aid is allocated on the basis of foreign policy rather than development criteria. It is economic aid, although it is authorized and appropriated (along with military aid) through the security assistance portion of the U.S. foreign aid law and goes mainly to countries of special political and security importance to the United States.

Analysts have come to very different conclusions about the purposes of the U.S. foreign aid program in the region depending on

[29] The Inter-American Foundation is an independent development agency that works directly with local private organizations in Latin America and the Caribbean to target assistance to low-income individuals. The members of its Board of Directors are appointed by the President and confirmed by the Senate. By law, six members are from private organizations and three are from the U.S. Government.

how they categorize the ESF program. Critics of U.S. aid policy have argued, on the basis of aid data, that U.S. policy in the region has been too militarized insomuch as security assistance has accounted for 65 percent of all U.S. aid. They say more emphasis should be put on development programs and on efforts to meet countries' economic needs. By contrast, defenders of U.S. policy say that economic aid accounts for nearly 84 percent (and military aid only 16 percent) of all U.S. assistance to Central America in the past dozen years. The amount spent on military aid has not been disproportionate, they argue, compared with other concerns.

Both arguments are correct, although both are also incomplete. ESF aid is both security aid and economic aid. It is used mainly to fund fast-disbursing balance of payments aid programs for countries of high foreign policy significance to the United States. Nevertheless, development projects also account for a significant share of ESF resources. Since 1980, about one-fifth of all ESF funds in Central America have gone to fund development projects and activities to help strengthen democratic institutions in recipient countries. Often, especially in Central America, the United States has asked recipient countries to adopt economic policy reforms as a condition for access to this aid. The local currencies generated by the ESF program have often been used to finance development-type activities.[30]

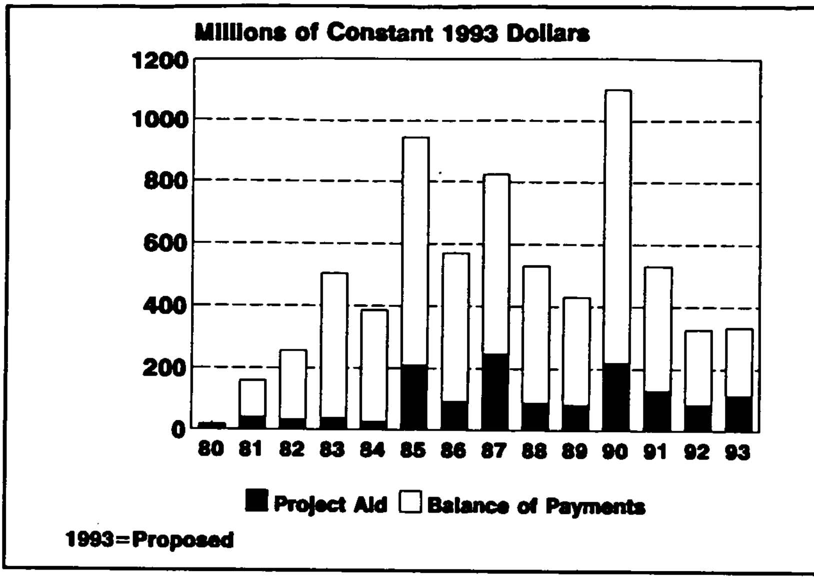
Four other points about the ESF aid program in Central America might be made. First, as Figure 4 shows, most ESF money in the region has been used to provide BOP support. By definition, this means it has been used to help countries pay for imported goods in situations where they lack the necessary foreign exchange. Among other things, this helps prevent sharp declines in the value of their national currencies and helps avoid the major political, social, and economic dislocations such declines may portend. In practice, however, the U.S. BOP aid often has been used, not just to pay for general imports, but to give the private sector in the recipient countries access to foreign exchange so it can buy needed imports and avoid bottlenecks or shortages that can hamper economic growth.[31]

Second, as Figure 4 also shows, a major share of ESF funds in Central America have also been used to finance development projects and other related activities. In many years since 1985, the United States channeled one-third to one-half as much money into project assistance through ESF as did AID's regular development

[30] See, for example, the discussion of the uses of ESF aid and ESF-generated local currency in CRS Report 89-369 F, *El Salvador, 1979-1989: A Briefing Book on U.S. Aid and the Situation in El Salvador*, April 28, 1989, esp. pp. 31-60.

[31] The United States and the recipient country sign agreements specifying the conditions and limits on the way the BOP money and the local currency it generates may be used. Individuals and private sector firms may purchase the BOP aid dollars from their central bank, in exchange for an equivalent value in their own national currency, to finance purchases of qualifying imports. The local currency generated by the BOP aid program belongs to the recipient country government. As such, it is not included in the foreign aid totals reported in this paper. Nevertheless, it must be used, as specified in the aid agreements, to finance activities compatible with U.S. foreign assistance laws. In many countries, the local currency is used to finance special development projects or to fund the country's share of the cost (counterpart funds) of development projects supported with foreign aid. For more information, see the chapter titled Composition of the U.S. Aid Program and the Uses Made of the Funds in CRS Rept. 89-369 F, *El Salvador Briefing Book*.

Figure 4. ESF Aid to Region, FY1980-93: BOP and Project Aid



assistance accounts.[32] (Congress passed legislation in 1990 requiring that at least one-quarter of all ESF assistance to El Salvador be used for project aid.) Many of the ESF projects in Central America have been geared to special concerns, such as encouraging the democratization process or strengthening democratic institutions. Some, particularly in El Salvador, were designed to fund the repair of war-damaged or earthquake-damaged facilities and to help displaced persons. Many were projects that were similar to (or sometimes the same as) projects funded through AID's regular development aid accounts.

Third, there has been change in the countries receiving ESF aid. The ESF is a flexible tool which responds quickly to changes in U.S. foreign policy. Unlike the development aid program, the ESF mainly finances quick-disbursing assistance that can be turned on or turned off relatively quickly, as the foreign policy situation requires. In fiscal 1981, Nicaragua was the largest recipient in Central America of ESF aid. From 1982 to 1987, by contrast, Nicaragua had ceased being a major recipient of U.S. aid. El Salvador received 42 percent of all ESF aid to the region during this period, followed by Costa Rica (28 percent) and Honduras (18 percent). Between

[32] Between fiscal 1980 and 1989, 19 percent of all ESF funds in the region were used for project assistance. Since 1990, the figure has been approximately 24 percent. Overall, for the period from fiscal 1980 to fiscal 1993, about 21 percent of ESF resources have been used for project aid.

1990 and 1992, Nicaragua (with 33 percent of the total) was again the largest recipient of ESF aid in Central America, followed by Panama (24 percent). El Salvador (with 21 percent) had become the third-ranking recipient of ESF regional aid.

Fourth, the United States has attached tighter conditions, in the past decade, on countries' access to its BOP support. Before 1981, the main condition for U.S. BOP aid was a requirement that the local currency proceeds be used primarily for activities designed to help the poor or meet basic human needs. There were few if any requirements concerning economic reform. Since 1981, the United States has required in many instances that—as a condition for access to ESF aid—recipient country governments implement major programs of economic reform. Among other things, the United States has urged them to cut budget deficits and subsidies for domestic production or consumption. It has urged them to limit the growth of their domestic money supply (to help control inflation) and to adopt more realistic exchange rates for their currencies (to better align their domestic prices with world market prices and thus to make their economies more efficient and productive).

The capacity of the United States to persuade countries to adopt economic reforms has often depended on the broader political situation. U.S. efforts to promote economic stabilization and adjustment have been most successful in countries, such as Costa Rica and Guatemala, where the governments have recognized the need for reform and the United States has had no competing political and security concerns. (The U.S. program in Costa Rica also operated in conjunction with similar adjustment loan programs funded by the World Bank and IMF.) AID and the General Accounting Office (GAO) both say the U.S. aid program in Costa Rica was largely successful in its efforts to encourage economic policy reform.[33] In Guatemala, AID reports, "Macroeconomic policy has improved dramatically since 1985, and steady progress continues to be made." The GAO also says the country's economic situation has markedly improved and that "U.S. ESF balance-of-payments assistance . . . was timely, appropriate, and of critical importance to Guatemala's success." [34]

The U.S. efforts to encourage economic policy reform have been less successful in the Central American countries where competing political and security goals make it difficult for the ESF to apply policy leverage.[35] In Honduras in 1985, for example, the U.S. AID

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[33] U.S. General Accounting Office. *Central America: Impact of U.S. Assistance in the 1980s.* GAO/NSIAD-89-170. Washington, D.C. July 11, 1989, pp. 39-41. Agency for International Development. *The Effectiveness and Economic Development Impact of Policy-Based Cash Transfer Programs: the Case of Costa Rica.* [AID Evaluation Highlight No. 1.] Washington, D.C. October 1988. Clarence Zuvekas, Jr. *Costa Rica: the Effects of Structural Adjustment Measures on the Poor, 1982-90* [Staff Working Paper No. 5] AID Bureau for Latin America and the Caribbean, June 1992.

[34] Memorandum to the AID Administrator from Frederick W. Schieck, Acting Assistant Administrator for Latin America and the Caribbean, March 10, 1989, titled "Central American Program Assessment." Quote comes from the Guatemala section, p. 2. The GAO quote and assessment comes from *Central America: Impact of U.S. Assistance in the 1980s*, p. 40.

[35] For a further discussion of these situations, see: General Accounting Office. *Providing Effective Assistance to El Salvador and Honduras: a Formidable Task.* GAO/NSIAD-85-82. Washington, D.C., July 3, 1985. See also the report of a team of experts from the Agency for International Development, Department of State, and Office of Management and Budget. *Economic Assistance to Central America; Conclusions of an AID/State/OMB Team.* [No date, but after June 4, 1988.] Provided to CRS by AID.

mission held up release of some ESF funds when Honduras balked at implementing some promised economic reforms. The Honduran President appealed to the White House and the BOP money was released anyway. In Panama in 1985, a similar situation prevailed. AID ultimately disbursed the funds, but it reduced Panama's access to ESF money the following year. In 1986, the United States persuaded the Salvadoran government to adopt some economic policy reforms, although not the full range of changes that U.S. analysts thought necessary. The United States could not cut its ESF aid program in El Salvador to signal its dissatisfaction, as it had in Panama, however, due to its broader foreign policy concerns.

The political/security situation in Central America has since changed. The new governments that took office in El Salvador and Honduras in 1989 and 1990 have adopted a number of far-reaching economic reforms. [36]

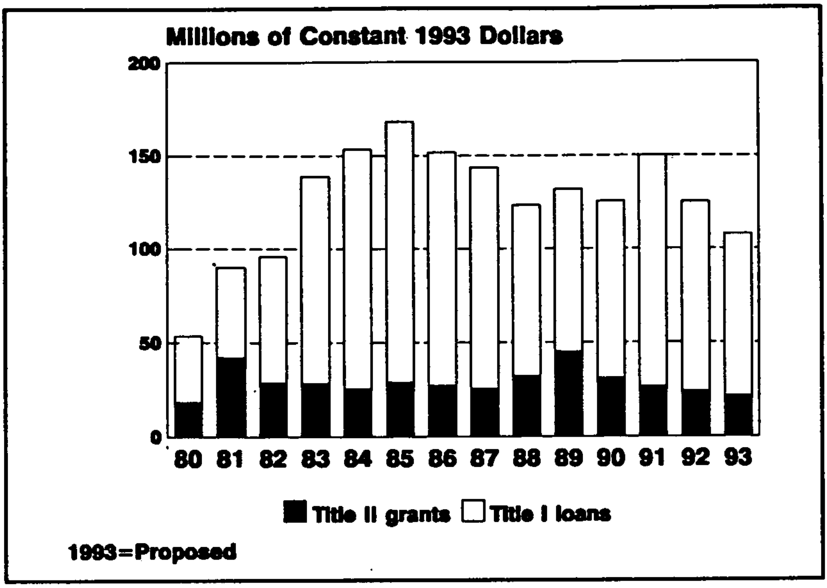
FOOD ASSISTANCE

Aid through the Public Law 480 (P.L. 480) international food assistance program has accounted for about 11.8 percent of all U.S. expenditures for foreign aid to Central America since fiscal 1980. In real terms, allowing for the effects of inflation, the level of P.L. 480 aid has increased substantially during this period. In fiscal 1980, the United States provided food aid worth $53.63 million (in constant 1993 dollars) to the region. The food aid program reached its peak in constant dollar terms in 1985, at $168.2 million, before gradually drifting downward to its present (fiscal 1992) level of $125.2 million. In the 1970s and early 1980s, grant aid through the Title II program accounted for a substantial share of U.S. food aid to the region. Beginning in fiscal 1982, however, as Figure 5 indicates, Title I loans have accounted for a growing share of this aid. Since fiscal 1982, three-quarters of all U.S. food aid to Central America has been provided on a loan basis.

This shift from grants to loans represents more than a mere switch in its repayment terms. The P.L. 480 program consists of two very different kinds of activities. The Title II program ships food for direct distribution on a grant basis to needy people by private voluntary organizations though supplementary feeding, food for work, and other emergency feeding programs. The Title I program, by contrast, makes low-interest loans to foreign governments so they can buy agricultural products from U.S. commercial exporters. The imported food is distributed in the recipient country through the regular marketplace. The imported food may help increase the stock of food available in the country and it may thus reduce food prices in time of scarcity. In the main, however, the imported food mostly benefits the people who have the money to purchase it. For the most part, the Title I food loans are a form of balance of payments support to recipient countries, providing long-term low-interest loans to finance commercial purchases of agricul-

[36] See, for example, the evaluation of the impact of the adjustment programs in Honduras, El Salvador, Guatemala, and Costa Rica in: Juan J. Buttari, "Economic Policy Reform in Four Central American Countries: Patterns and Lessons Learned," *Journal of Inter-American Studies and World Affairs* 34:1 Spring 1992, pp. 179–214. See also the relevant chapters discussing recent economic changes in the Central American countries in The World Bank, *Trends in Developing Economies, 1992*. International Economics Department, 1992.

Figure 5. Food Aid to Region, FY1980-93: Loans and Grants



tural products in situations where the recipient country would probably have purchased the goods anyway (though maybe from another source). The U.S. loan frees up for other use the country's foreign exchange resources that would have been used to pay for the purchase.

Like the recipients of ESF aid, the recipients of P.L. 480 Title I aid have been required to undertake "self help" procedures in order to improve agricultural productivity. In the early 1980s, the U.S. food aid program mainly required countries to improve their food storage facilities and to use some of the local currency proceeds from their P.L. 480 Title I food sales to finance agricultural development projects or programs meeting basic human needs. Since the mid-1980s, however, the conditions on P.L. 480 Title I loans have been tightened and synchronized more closely with those for ESF aid. In general, borrowers are required to take steps to improve their domestic agricultural institutions, to reduce or eliminate price controls and food subsidies for consumers, and to give farmers more incentives to help increase production.

In Central America, U.S. food loans have gone mainly to countries of high foreign policy significance to the United States. In real terms, since fiscal 1980, about 44 percent of the P.L. 480 Title I food loans to the region have gone to El Salvador and 15 percent each have gone to Guatemala, Honduras, and Costa Rica. Title II food grant aid has been allocated on the basis of broader humanitarian concerns. Since 1980, the main recipients have been Guatemala (32 percent), El Salvador (31 percent), and Honduras (26 percent of the total).

U.S. AID TO CENTRAL AMERICA: PROSPECTS FOR THE FUTURE

Since the Kissinger Commission published its report in 1984 and the Administration sent its Central American Initiative to Congress in 1985, a number of changes have taken place in Central America. The United States has provided the region with $8.6 billion in economic aid and $1.6 billion in military aid since the report appeared [37]. The guerrilla war in El Salvador has been brought to a negotiated settlement. The Sandinista regime in Nicaragua has been replaced through free election by a new government supported by opposition groups. The U.S. military intervention in Panama deposed the regime of General Noriega and enabled a new civilian government to take office. For the first time in recent memory, the six countries are all governed by elected democratic governments. Most are seeking to achieve growth through economic reform and market-based economic policies. The countries of the region also signed a series of agreements in 1990 pledging their cooperation to resolve regional conflicts, promote democracy, and rebuild their economies.

With these changes, and with the end of Cold War tensions that seemed to make instability in Central America a threat to U.S. security, questions arise about the nature of any future U.S. foreign assistance programs in the region.

The Presidents of the Central American countries agreed, in declarations adopted at Puntarenas and Antigua, Guatemala in 1990, that three goals should guide their policies in future years: (1) the development of stable, democratic societies; (2) the achievement of broad-based, sustainable economic growth, and (3) the attainment of effective regional cooperation. In January 1991, the Agency for International Development announced that these three goals would guide its economic assistance program in Central America for the rest of the century. [38] To promote democracy, AID said it would increase its support for democratic institutions in order to improve their effectiveness, expand public participation, strengthen public finances, and deepen support for democratic values. To promote economic growth, AID said it would encourage the Central Americans to adopt new programs of policy reform that strengthen the private sector, protect natural resources, and improve the efficiency and effectiveness of their basic social services. To foster regional cooperation, AID said it would encourage intraregional trade and help strengthen regional economic institutions. The Administration has also proposed, through its Enterprise for the Americas Initiative, that international trade and private foreign investment should play a larger role in promoting growth in Central America as well as in the rest of Latin America.

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[37] The comparable figures for the entire period (fiscal 1980–93) are $10.1 billion in economic aid and $1.9 billion in military aid, as the tables at the end of this paper indicate.

[38] *Economic Assistance Strategy for Central America, 1991 to 2000.* Agency for International Development, Washington, D.C., January 1991, p. 1. [Reprinted in this volume as the appendix to Section II.] As noted earlier [note 23], AID also announced, in its annual program presentation document sent to Congress in early 1991, that the promotion of economic growth and democracy would be its principal goals in Central America.

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In terms of resources, AID says that its new strategy for Central America assumes that less money would come from the United States and more will come from the private sector and multilateral institutions. (This means, among other things, that the repayment terms for this aid will be stiffer, since most U.S. economic aid to the region to date has been grant aid while most multilateral assistance has been market-rate loans.) AID says that U.S. economic assistance to the region (both development and ESF aid) will shrink by about $50 million annually, to perhaps $430 million by fiscal 1996, and that Nicaragua will be the largest single future recipient of this aid. On the other hand, AID predicts, disbursements from the World Bank and Inter-American Development Bank should more than double if the regional countries continue to follow sound economic policies. [39]

If one had been asked to predict in 1975 what the U.S. Central American aid program might look like in the 1980s, the response would have probably erred with regard to its future size, content, and principal recipients. Too many unanticipated events occurred for accurate foresight. Similarly, one can not predict with accuracy now what the future U.S. aid program for Central America will be. The preceding AID plan is a largely projection of its current policies and the current regional situation.

The U.S. aid program may go forward in Central America largely as AID predicts. On the other hand, the goals of the U.S. bilateral aid program may change. A new Administration or new legislation may shift AID's emphasis to more poverty alleviation and basic human needs programs, for example. Alternatively, AID may be asked to fund more capital projects in developing countries in order to promote U.S. exports and expand future U.S. trade opportunities. In those cases, the composition and focus of the U.S. aid program in Central America would be different from that which AID predicts. Similarly, efforts to cut the U.S. Government budget deficit through reductions in Federal spending might have a negative impact on the size of the U.S. foreign aid program. In that situation, less money might be available for programs in Central American than AID currently expects.

The United States put large amounts of money into Central America during the 1980s as a result of wars, revolutions, changes in the world economy, and their resulting impact on the region's political situation. Unanticipated crises (Eastern Europe or Central Asia, for example) or new political opportunities (a friendly post-Castro government in Cuba) may prompt the United States to shift some aid money (in the absence of corresponding increases in the size of the U.S. foreign aid budget) from Central America to other regions. Alternatively, a new crisis in Central America (intensification of the guerrilla war in Guatemala or new concerns over the Panama Canal, for example) may prompt the United States to increase its allocation of aid to the region.

Barring such changes in the focus and size of the U.S. aid program and in the world situation, however, AID's description of its plans for Central America is probably the best prediction available

[39] Ibid.

for the probable direction of U.S. foreign aid in that part of the world. If its underlying assumptions are correct, the level of U.S. aid to the region will decline, Nicaragua will be the largest recipient of U.S. aid, and AID's main emphasis in the region will be given to programs for bolstering the private sector and strengthening indigenous democratic institutions.

Tables

A NOTE ON THE TABLES: CURRENT AND CONSTANT DOLLARS

Tables 1 through 9 show the amounts of money the United States provided to Central America (for each country and each program) between fiscal years 1980 and 1992. They also show the amounts proposed for fiscal 1993. Tables 10 and 11 show the total amounts provided for each country and each program) during this period in constant dollars. Constant dollar tables for each country are not provided.

To compare the amounts spent in different years, one must convert current dollars into constant dollars. This removes the effect of inflation and allows all expenditures to be recorded in money having the same value. To convert the amounts shown in country tables 1 through 9 into constant 1993 dollars, multiply by the factor specified for each year and then divide by 124.74: 70.58 (1980); 77.76 (1981); 83.55 (1982); 87.02 (1983); 90.85 (1984); 94.32 (1985); 97.12 (1986); 100 (1987); 103.63 (1988); 108.23 (1989); 112.67 (1990); 117.09 (1991); and 120.72.

Table 1. U.S. ASSISTANCE TO COSTA RICA

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	13,561	11,475	11,540	27,159	15,400	25,922	13,095	18,305
Economic Support Fund	---	---	20,000	157,000	130,000	169,591	126,032	142,466
PL 480 Title I Food Loans	---	---	18,000	28,000	22,500	21,400	20,000	17,200
PL 480 Title II Food Grants	380	1,814	1,092	184	---	232	263	103
Peace Corps	1,445	1,746	1,007	1,690	1,826	2,892	2,639	2,950
Inter-American Foundation	800	295	933	698	1,331	2,038	1,224	610
Disaster Assistance	---	---	14	80	25	10	---	---
Intl Military Ed & Training	---	35	58	125	133	231	222	228
Foreign Mil Finan Grants**	---	---	2,000	4,500	9,000	11,000	2,393	1,500
FMF Concessional Loans	---	---	---	---	---	---	---	---
FMF Market-Rate Loans	---	---	---	---	---	---	---	---
TOTAL (current dollars)	16,186	15,365	54,644	219,436	180,215	233,316	165,868	183,362

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	11,261	21,338	11,300	11,750	6,579	8,000	206,685
Economic Support Fund	90,001	93,462	63,540	25,000	10,000	10,000	1,037,092
PL 480 Title I Food Loans	15,000	---	---	15,000	10,000	10,000	177,100
PL 480 Title II Food Grants	95	3,368	210	---	---	---	7,741
Peace Corps	3,517	3,547	2,240	1,387	1,224	1,414	29,524
Inter-American Foundation	95	750	650	1,100	647	800	11,971
Disaster Assistance	105	125	1	529	194	---	1,083
Intl Military Ed & Training	230	230	230	340	230	230	2,522
Foreign Mil Finan Grants**	---	---	---	---	---	1,000	31,393
FMF Concessional Loans	---	---	1,500	---	---	---	1,500
FMF Market-Rate Loans	---	---	---	---	---	---	---
TOTAL (current dollars)	120,304	122,820	79,671	55,106	28,874	31,444	1,506,611

* 1992=Estimated, 1993=Proposed ** Military Assistance Program before 1989

Table 2. U.S. ASSISTANCE TO EL SALVADOR

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	43,155	33,345	39,573	58,785	41,136	91,120	86,225	132,956
Economic Support Fund	9,100	44,900	115,000	140,000	120,234	285,000	181,945	281,497
PL 480 Title I Food Loans	3,000	26,200	19,900	39,000	49,000	49,000	44,000	42,000
PL 480 Title II Food Grants	2,465	9,077	7,687	7,738	5,563	8,840	10,447	6,403
Peace Corps	514	---	---	---	---	---	---	---
Inter-American Foundation	16	413	---	---	---	12	323	805
Disaster Assistance	25	3,030	11,899	---	75	---	---	51,334
Intl Military Ed & Training	247	492	2,002	1,300	1,300	1,500	1,431	1,521
Foreign Mil Finan Grants**	8	25,000	63,500	33,500	176,750	124,750	120,367	110,000
FMF Concessional Loans	---	---	---	---	---	10,000	---	---
FMF Market-Rate Loans	5,700	10,000	16,500	46,500	18,500	---	---	---
TOTAL (current dollars)	64,230	152,457	276,061	326,823	412,558	570,222	444,738	626,516

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	70,712	62,288	61,800	55,900	55,000	55,000	886,995
Economic Support Fund	195,006	190,887	136,360	126,280	120,000	160,000	2,106,209
PL 480 Title I Food Loans	35,500	40,000	40,200	35,000	30,000	30,000	482,800
PL 480 Title II Food Grants	12,878	13,869	6,810	6,420	2,810	---	101,007
Peace Corps	---	---	1,500	---	---	419	2,433
Inter-American Foundation	1,370	1,500	1,900	1,534	1,520	1,500	10,892
Disaster Assistance	---	---	544	---	---	---	66,907
Intl Military Ed & Training	1,500	1,400	1,590	1,040	1,400	1,400	18,123
Foreign Mil Finan Grants**	80,000	80,000	79,640	65,940	21,250	40,000	1,020,705
FMF Concessional Loans	---	---	---	---	---	---	10,000
FMF Market-Rate Loans	---	---	---	---	---	---	97,200
TOTAL (current dollars)	396,966	389,944	330,344	292,114	231,980	288,319	4,803,271

* 1992=Estimated, 1993=Proposed ** Military Assistance Program before 1989

Table 3. U.S. ASSISTANCE TO GUATEMALA

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	7,764	9,135	8,182	12,311	4,491	63,172	37,063	37,999
Economic Support Fund	---	---	---	10,000	---	12,500	52,750	115,485
PL 480 Title I Food Loans	---	---	---	---	6,650	19,950	18,050	22,700
PL 480 Title II Food Grants	327	7,554	5,617	5,349	6,480	8,245	5,821	8,492
Peace Corps	1,813	2,046	1,653	1,949	2,605	3,040	2,931	3,076
Inter-American Foundation	400	1,389	462	283	134	1,009	560	1,116
Disaster Assistance	---	---	289	127	696	---	15	---
Intl Military Ed & Training	---	---	---	---	---	455	356	490
Foreign Mil Finan Grants**	---	---	---	---	---	---	5,000	5,000
FMF Concessional Loans	---	---	---	---	---	---	5,000	5,000
FMF Market-Rate Loans	---	---	---	---	---	---	---	---
TOTAL (current dollars)	10,304	20,124	16,203	30,019	21,056	108,371	127,546	199,358

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	30,126	34,169	29,480	29,380	24,043	21,000	348,315
Economic Support Fund	79,400	80,000	56,480	30,520	15,000	10,000	462,135
PL 480 Title I Food Loans	13,205	17,100	18,000	18,000	15,000	15,000	163,655
PL 480 Title II Food Grants	5,382	11,541	8,490	10,920	10,210	9,840	104,268
Peace Corps	4,118	4,173	2,630	1,785	1,847	2,016	35,682
Inter-American Foundation	1,430	1,400	1,900	1,500	1,732	1,250	14,565
Disaster Assistance	---	---	---	---	---	---	1,127
Intl Military Ed & Training	375	400	490	414	400	400	3,780
Foreign Mil Finan Grants**	9,000	9,000	2,890	---	---	---	30,890
FMF Concessional Loans	9,000	9,000	---	---	---	---	28,000
FMF Market-Rate Loans	---	---	9,000	---	---	---	9,000
TOTAL (current dollars)	152,036	166,783	129,360	92,519	68,232	59,506	1,201,417

* 1992=Estimated, 1993=Proposed ** Military Assistance Program before 1989

Table 4. U.S. ASSISTANCE TO HONDURAS

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	45,824	25,660	31,167	31,226	30,995	54,367	45,301	42,659
Economic Support Fund	---	---	36,800	56,000	40,000	150,198	66,508	131,786
PL 480 Title I Food Loans	2,000	3,600	7,000	10,000	15,000	15,000	15,000	12,700
PL 480 Title II Food Grants	3,137	4,646	3,091	5,467	5,238	4,406	4,601	5,418
Peace Corps	1,920	2,442	2,621	3,210	3,788	4,983	5,235	5,169
Inter-American Foundation	900	531	57	656	586	545	657	558
Disaster Assistance	25	---	58	---	---	7,525	---	---
Intl Military Ed & Training	441	535	1,275	796	940	1,104	1,045	1,200
Foreign Mil Finan Grants**	11	---	11,000	38,500	76,500	66,300	60,114	60,000
FMF Concessional Loans	---	---	---	---	---	---	---	---
FMF Market-Rate Loans	3,530	8,400	19,000	9,000	---	---	---	---
TOTAL (current dollars)	57,788	45,814	112,069	154,855	173,047	304,428	198,461	259,490

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	44,941	38,007	34,640	38,300	34,468	31,600	529,155
Economic Support Fund	85,000	15,000	130,020	60,900	30,000	30,000	832,212
PL 480 Title I Food Loans	12,000	18,000	12,000	10,650	14,000	14,000	160,950
PL 480 Title II Food Grants	8,348	10,169	9,600	5,720	6,270	6,050	82,161
Peace Corps	6,495	6,269	4,010	226	2,012	2,017	50,397
Inter-American Foundation	920	1,000	1,150	1,405	792	1,347	11,104
Disaster Assistance	---	---	81	---	---	---	7,689
Intl Military Ed & Training	1,200	1,100	1,050	1,570	1,275	1,100	14,631
Foreign Mil Finan Grants**	40,000	40,000	20,160	31,900	5,000	8,000	457,485
FMF Concessional Loans	---	---	---	---	---	---	---
FMF Market-Rate Loans	---	---	60,000	---	---	---	99,930
TOTAL (current dollars)	198,904	129,545	272,711	150,671	93,817	94,114	2,245,714

* 1992=Estimated, 1993=Proposed   ** Military Assistance Program before 1989

Table 5. U.S. ASSISTANCE TO NICARAGUA

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	18,306	1,825	679	---	---	---	---	---
Economic Support Fund	1,125	56,574	5,100	---	---	---	---	---
PL 480 Title I Food Loans	15,000	---	---	---	---	---	---	---
PL 480 Title II Food Grants	2,998	1,240	350	---	---	---	---	---
Peace Corps	98	141	---	---	---	---	---	---
Inter-American Foundation	1,300	265	450	383	106	730	6	---
Disaster Assistance	152	31	33	---	---	---	---	---
Intl Military Ed & Training	---	---	---	---	---	---	---	---
Foreign Mil Finan Grants**	---	---	---	---	---	---	---	---
FMF Concessional Loans	---	---	---	---	---	---	---	---
FMF Market-Rate Loans	---	---	---	---	---	---	---	---
TOTAL (current dollars)	38,979	60,076	6,612	383	106	730	6	---

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	---	---	1,400	11,000	17,000	42,000	92,210
Economic Support Fund	250	3,500	242,910	226,840	140,000	125,000	801,299
PL 480 Title I Food Loans	---	---	15,100	23,800	25,000	17,000	95,900
PL 480 Title II Food Grants	---	---	2,750	1,910	3,860	5,810	18,918
Peace Corps	---	---	---	310	502	747	1,798
Inter-American Foundation	---	550	650	1,766	2,476	2,000	10,682
Disaster Assistance	---	---	---	---	40	---	256
Intl Military Ed & Training	---	---	---	---	---	---	---
Foreign Mil Finan Grants**	---	---	---	---	---	---	---
FMF Concessional Loans	---	---	---	---	---	---	---
FMF Market-Rate Loans	---	---	---	---	---	---	---
TOTAL (current dollars)	250	4,050	262,810	265,626	188,878	192,557	1,021,063

* 1992=Estimated, 1993=Proposed   ** Military Assistance Program before 1989

Table 6. U.S. ASSISTANCE TO PANAMA

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	1,043	8,639	11,686	6,230	10,720	24,286	20,070	12,132
Economic Support Fund	---	---	---	---	---	50,000	13,174	---
PL 480 Title I Food Loans	---	---	---	---	---	---	---	---
PL 480 Title II Food Grants	1,038	1,850	1,358	1,046	1,353	80	78	12
Peace Corps	---	---	---	---	---	---	---	---
Inter-American Foundation	200	667	107	481	68	656	929	876
Disaster Assistance	---	---	95	---	---	9	---	25
Intl Military Ed & Training	289	378	401	445	500	589	557	618
Foreign Mil Finan Grants**	2	---	---	---	8,000	10,000	3,828	2,900
FMF Concessional Loans	---	---	---	---	---	---	3,830	---
FMF Market-Rate Loans	---	---	5,000	5,000	5,000	---	---	---
TOTAL (current dollars)	2,572	11,534	18,647	13,202	25,641	85,620	42,466	16,563

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	1,228	---	---	---	14,500	8,400	118,934
Economic Support Fund	---	---	394,490	44,370	10,000	10,000	522,034
PL 480 Title I Food Loans	---	---	---	13,400	4,000	---	17,400
PL 480 Title II Food Grants	---	254	220	40	30	---	7,359
Peace Corps	---	---	---	384	544	748	1,676
Inter-American Foundation	940	950	1,150	1,900	2,423	1,850	13,197
Disaster Assistance	257	---	4,088	181	39	---	4,694
Intl Military Ed & Training	---	---	---	---	---	---	3,777
Foreign Mil Finan Grants**	---	---	---	---	---	---	24,730
FMF Concessional Loans	---	---	---	---	---	---	3,830
FMF Market-Rate Loans	---	---	---	---	---	---	15,000
TOTAL (current dollars)	2,425	1,204	399,948	60,275	31,536	20,998	732,631

* 1992=Estimated, 1993=Proposed ** Military Assistance Program before 1989

Table 7. U.S. ASSISTANCE TO REGIONAL PROGRAMS

(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	4,156	9,698	13,130	19,399	15,458	35,713	47,508	49,012
Economic Support Fund	---	900	---	---	---	70,895	15,358	9,340
TOTAL (current dollars)	4,156	10,598	13,130	19,399	15,458	106,608	62,866	58,352

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	51,149	44,032	26,700	17,280	14,717	15,120	363,072
Economic Support Fund	7,404	3,563	70	500	---	---	108,030
TOTAL (current dollars)	58,553	47,595	26,770	17,780	14,717	15,120	471,102

* 1992=Estimated, 1993=Proposed

Table 8. TOTAL AID (CURRENT $) TO CENTRAL AMERICA: COUNTRIES
(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Costa Rica	16,186	15,365	54,644	219,436	180,215	233,316	165,868	183,362
El Salvador	64,230	152,457	276,061	326,823	412,558	570,222	444,738	626,516
Guatemala	10,304	20,124	16,203	30,019	21,056	108,371	127,546	199,358
Honduras	57,788	45,814	112,069	154,855	173,047	304,428	198,461	259,490
Nicaragua	38,979	60,076	6,612	383	106	730	6	---
Panama	2,572	11,534	18,647	13,202	25,641	85,620	42,466	16,563
Regional Programs	4,156	10,598	13,130	19,399	15,458	106,608	62,866	58,352
TOTAL (current dollars)	194,215	315,968	497,366	764,117	828,081	1,409,295	1,041,951	1,343,641

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Costa Rica	120,304	122,820	79,671	55,106	28,874	31,444	1,506,611
El Salvador	396,966	389,944	330,344	292,114	231,980	288,319	4,803,271
Guatemala	152,036	166,783	129,360	92,519	68,232	59,506	1,201,417
Honduras	198,904	129,545	272,711	150,671	93,817	94,114	2,245,714
Nicaragua	250	4,050	262,810	265,626	188,878	192,557	1,021,063
Panama	2,425	1,204	399,948	60,275	31,536	20,998	732,631
Regional Programs	58,553	47,595	26,770	17,780	14,717	15,120	471,102
TOTAL (current dollars)	929,438	861,941	1,501,614	934,091	658,034	702,058	11,981,809

** 1992=estimated, 1993=proposed

Table 9. TOTAL AID (CURRENT $) TO CENTRAL AMERICA: PROGRAMS
(thousands of current U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	133,809	99,777	115,957	155,110	118,200	294,580	249,262	293,063
Economic Support Fund	10,225	102,374	176,900	363,000	290,234	738,184	455,767	680,574
PL 480 Title I Food Loans	20,000	29,800	44,900	77,000	93,150	105,350	97,050	94,600
PL 480 Title II Food Grants	10,345	26,181	19,195	19,784	18,634	21,803	21,210	20,428
Peace Corps	5,790	6,375	5,281	6,849	8,219	10,915	10,805	11,195
Inter-American Foundation	3,616	3,560	2,009	2,501	2,225	4,990	3,699	3,965
Disaster Assistance	202	3,061	12,388	207	796	7,544	15	51,359
Intl Military Ed & Training	977	1,440	3,736	2,666	2,873	3,879	3,611	4,057
Foreign Mil Finan Grants**	21	25,000	76,500	76,500	270,250	212,050	191,702	179,400
FMF Concessional Loans	---	---	---	---	---	10,000	8,830	5,000
FMF Market-Rate Loans	9,230	18,400	40,500	60,500	23,500	---	---	---
TOTAL (current dollars)	194,215	315,968	497,366	764,117	828,081	1,409,295	1,041,951	1,343,641

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	209,417	199,834	165,320	163,610	166,307	181,120	2,545,366
Economic Support Fund	457,061	386,412	1,023,870	514,410	325,000	345,000	5,869,011
PL 480 Title I Food Loans	75,705	75,100	85,300	115,850	98,000	86,000	1,097,805
PL 480 Title II Food Grants	26,703	39,201	28,080	25,010	23,180	21,700	321,454
Peace Corps	14,130	13,989	10,380	4,092	6,129	7,361	121,510
Inter-American Foundation	4,755	6,150	7,400	9,205	9,590	8,747	72,412
Disaster Assistance	362	125	4,714	710	273	---	81,756
Intl Military Ed & Training	3,305	3,130	3,360	3,364	3,305	3,130	42,833
Foreign Mil Finan Grants**	129,000	129,000	102,690	97,840	26,250	49,000	1,565,203
FMF Concessional Loans	9,000	9,000	1,500	---	---	---	43,330
FMF Market-Rate Loans	---	---	69,000	---	---	---	221,130
TOTAL (current dollars)	929,438	861,941	1,501,614	934,091	658,034	702,058	11,981,809

* 1992=Estimated, 1993=Proposed ** Military Assistance Program before 1989

Table 10. TOTAL AID (CONSTANT $) TO CENTRAL AMERICA: COUNTRIES

(thousands of constant 1993 U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Costa Rica	28,606	24,648	81,584	314,553	247,441	308,565	213,039	228,726
El Salvador	113,517	244,566	412,158	468,489	566,456	754,129	571,217	781,516
Guatemala	18,211	32,282	24,191	43,031	28,911	143,323	163,819	248,679
Honduras	102,132	73,493	167,319	221,979	237,599	402,612	254,901	323,688
Nicaragua	68,890	96,372	9,872	549	146	965	8	---
Panama	4,546	18,502	27,840	18,925	35,206	113,234	54,543	20,661
Regional Programs	7,345	17,001	19,603	27,808	21,224	140,991	80,744	72,788
TOTALS (CONSTANT 1993 $)	343,247	506,865	742,567	1,095,334	1,136,982	1,863,820	1,338,272	1,676,058

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Costa Rica	144,811	141,556	88,205	58,706	29,836	31,444	1,941,720
El Salvador	477,830	449,428	365,733	311,199	239,705	288,319	6,044,263
Guatemala	183,007	192,225	143,218	98,564	70,504	59,506	1,449,470
Honduras	239,422	149,307	301,926	160,515	96,961	94,114	2,825,947
Nicaragua	301	4,668	290,964	282,981	195,168	192,557	1,143,439
Panama	2,919	1,388	442,793	64,213	32,586	20,998	858,353
Regional Programs	70,481	54,855	29,638	18,942	15,207	15,120	591,748
TOTALS (CONSTANT 1993 $)	1,118,770	993,426	1,662,477	995,119	679,946	702,058	14,854,941

* 1992=Estimated, 1993=Proposed

Table 11. TOTAL AID (CONSTANT $) TO CENTRAL AMERICA: PROGRAMS

(thousands of constant 1993 U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987
Development Assistance	236,488	160,059	173,124	222,345	162,292	389,588	320,150	365,567
Economic Support Fund	18,071	164,225	264,111	520,347	398,501	976,262	585,383	848,948
PL 480 Title I Food Loans	35,347	47,804	67,036	110,377	127,898	139,327	124,650	118,004
PL 480 Title II Food Grants	18,283	41,999	28,658	28,360	25,585	28,835	27,242	25,482
Peace Corps	10,233	10,227	7,885	9,818	11,285	14,435	13,878	13,965
Inter-American Foundation	6,391	5,711	2,999	3,585	3,055	6,599	4,751	4,946
Disaster Assistance	357	4,910	18,495	296	1,093	9,977	19	64,065
Intl Military Ed & Training	1,727	2,310	5,578	3,822	3,945	5,130	4,638	5,061
Foreign Mil Finan Grants**	37	40,104	114,214	109,660	371,062	280,440	246,220	223,784
FMF Concessional Loans	---	---	---	---	---	13,225	11,341	6,237
FMF Market-Rate Loans	16,313	29,517	60,466	86,725	32,266	---	---	---
TOTALS (CONSTANT 1993 $)	343,247	506,865	742,567	1,095,334	1,136,982	1,863,820	1,338,272	1,676,058

	1988	1989	1990	1991	1992 *	1993 *	TOTAL
Development Assistance	252,076	230,318	183,030	174,299	171,845	181,120	3,222,301
Economic Support Fund	550,167	445,357	1,133,554	548,019	335,823	345,000	7,133,768
PL 480 Title I Food Loans	91,127	86,556	94,438	123,419	101,263	86,000	1,353,246
PL 480 Title II Food Grants	32,143	45,181	31,088	26,644	23,952	21,700	405,151
Peace Corps	17,008	16,123	11,492	4,359	6,333	7,361	154,401
Inter-American Foundation	5,724	7,088	8,193	9,806	9,909	8,747	87,504
Disaster Assistance	436	144	5,219	756	282	---	106,051
Intl Military Ed & Training	3,978	3,607	3,720	3,584	3,415	3,130	53,644
Foreign Mil Finan Grants**	155,278	148,678	113,691	104,232	27,124	49,000	1,983,525
FMF Concessional Loans	10,833	10,373	1,661	---	---	---	53,670
FMF Market-Rate Loans	---	---	76,392	---	---	---	301,678
TOTALS (CONSTANT 1993 $)	1,118,770	993,426	1,662,477	995,119	679,946	702,058	14,854,941

* 1992=Estimated, 1993=Proposed ** Military Assistance Program before 1989

POLICY REFORM AND ECONOMIC INTEGRATION IN CENTRAL AMERICA IN THE 1990s

By José Manuel Salazar-Xirinachs *

CONTENTS

INTRODUCTION

Is the idea of economic integration in Central America to be abandoned in the 1990s, given the adoption of policies of freer trade, outward-oriented growth and entry into world markets? What is the logic of regional economic integration and what are the new foundations for this process in the 1990s? What actual progress has Central America achieved in policy reform and economic integration efforts in the last few years?

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These are the main questions tackled in this paper. On the basis of recent experience, it is argued that there are grounds for optimism regarding a substantial strengthening of Central American economic integration in this decade. Economic integration is being promoted in Central America under new foundations and is seen by policy makers as functional to a strategy of insertion into the world economy, based on successful exporting and the achievement of international competitiveness. It is argued that for integration to meet this challenge three basic conditions should be met:

1) a sustained policy reform effort, an improved investment climate, and a continued process of perfecting the regional free trade area;
2) a successful transition from a traditional static, passive trade policy to an alert and active policy in order to maximize access to third-country markets and achieve the benefits of joint action in the areas of trade, finance, and international cooperation; and
3) joint actions in several strategic areas aimed at increasing international competitiveness and stimulating productive specialization, flexibility, and complementarity at the regional level.

THE HERITAGE OF THE 1980s

In the 1980s, Central America walked towards economic and social disintegration. The United Nations Economic Commission for Latin America and the Caribbean described the disintegration as follows: "Since the end of the 1970s, the region lives a deep crisis, that has resulted in the loss of almost 25 years of its development, and whose painful consequences shall project themselves for many years into the future. The engines of growth of the past are showing signs of exhaustion. . . . The majority of indicators disclose a dramatic deterioration in living conditions. With important differences between and among countries, populations in conditions of extreme poverty are growing, and unemployment and underemployment have increased alarmingly. Due to sociopolitical conflicts and lack of employment opportunities, there have been mass migrations affecting 15 percent of the population. This has resulted in a deep social division, with disarticulation of families and uprooting of villages, as well as a significant loss of human resources. Likewise, there has been significant capital flight, productive systems have been weakened and are losing capital, and some intersectorial links have suffered deterioration." [1]

The experience has been heterogeneous, but within such a diversity, a common denominator has been a deterioration of industrial sectors and the paralyzation of intraregional trade: between 1980 and 1986, intraregional trade suffered a reduction of 60 percent. The trade pattern of the Central American Common Market (CACM) had two characteristics: the imposition of barriers to in-

[1] Comisión Económica para América Latina (CEPAL). Comisión Interinstitucional para el Cumplimiento de las Decisiones del Comité de Cooperación Económica del Istmo Centroamericana. *Documento de discusión para la cumbre económica centroamericana.* Guatemala, May 28, 1990.

traregional trade, which generated an inefficient process of national import substitution and a return to national protectionism, and an increase in the weight of extraregional imports. [2]

Several elements were determinant of the economic deterioration during the 1980s: 1) An important factor was the long-term exhaustion of the internal dynamism of the model of import substitution itself, coupled by the fact that there was no timely review of the incentives for exportation nor of exchange rate policies, in order to make exports profitable. 2) Lack of foreign currency and delay in payment of debts between member countries led to imposition of strong trade and exchange restrictions. This caused the collapse of the Central American Clearing Chamber and ended free convertibility between Central American currencies. [3] 3) Governments responded to the crisis with recessive stabilization and adjustment policies, seeking adjustment on an individual basis, and to a certain extent, at the expense of other members of the CACM. [4] 4) The reduction in demand and the increase in uncertainty and risk provoked a drastic reduction of investment, both in new investments and in maintenance of the existing facilities. Adding this to the damage caused by natural disasters and armed actions to productive plants and to supporting infrastructure, the result is a deterioration of competitive capacity. Therefore, to reactivate the CACM means, to a good extent to reconstruct it. [5]

THREE SCENARIOS FOR THE 1990S

The conditions of the early 1990s suggest three general scenarios for economic integration and development in Central America in this decade, with certain internal consistency and probability of occurrence.

DISINTEGRATION

The most negative scenario is one dominated by economic and social stagnation in several countries of the region, perhaps worsened by socially inefficient, exclusionary, and expensive adjustment processes, lacking sufficient mechanisms of social compensation. A catastrophic variant of this scenario could occur if there are setbacks with regard to peace and democracy. Diplomatic efforts and negotiation energies would then have to be focused again on peace and democracy. As pointed out by the Sanford Commission Report, the key for economic recovery is the cessation of armed conflicts: "... a cease of hostilities would end the enormous draining of resources caused by mass migration, capital flight, destruction of cultivations and roads, allocation of resources to military budgets in-

[2] Fuentes, Juan Alberto. La erosión y desviación del comercio intracentroamericano. In Vargas, Juan R. and Félix Delgado, eds., *Progreso Técnico y Estructura Económica: Dimension interna y comercio internacional.* San José, Costa Rica, Centro de Economia Aplicada, 1989.

[3] Brock, Philip. La convertibilidad monetaria, la Cámara de Compensación Centroamericana y la revitalización del comercio intrarregional en el Mercado Común Centroamericano. In Ascher, William and Anne Hubbard, eds., *Recuperación y Desarrollo de Centroamérica.* Durham, Duke University, 1989.

[4] Weeks, John. Un panorama macroeconómico de las economías centroamericanas. In Irvin, George and Stuart Holland, eds., *Centroamérica: El Futuro de la Integración Económica.* San José, Costa Rica, CRIES, Editorial DEI, 1990.

[5] Irvin and Holland. p. 31.

stead of using them in productive investments, and the pathetic climate for investment in a region stricken by war." [6]

In both cases, the manuevering room to increase regional economic integration would be reduced to a minimum, and intraregional trade would remain at the same low levels of the 1980s, which does not necessarily imply a full abandonment of the integration program, but means that the inefficient process of national import substitution of the 1980s would not be reversed. Under this scenario, relatively more developed countries, such as Costa Rica, or those able to maintain a minimal consensus within their own borders, would be tempted to drop out of the integration process and advance their own individual national strategies. Even without the most catastrophic elements that might be imagined in this scenario, the existing degree of economic and social deterioration has led certain analysts in the region to be pessimistic about the perspectives of integration. For example, John Weeks concluded that: "Whatever promise that Central American economic integration might or might not have had in the long run, it has joined the ranks of lost causes for the foreseeable future." [7]

GROWTH WITH LIMITED INTEGRATION

This scenario is characterized by a gradual consolidation of peace and democracy in each country, more confidence for investment and some degree of economic reactivation as a result of structural reforms. Each country, however, continues its policies of stabilization and adjustment on an individual basis without coordinating with others. Exchange and price instability and diverse rhythms of stabilization and adjustment would allow only a moderate increase in intraregional trade, which in turn, would constrain the possibilities of greater integration. To the extent that incentive regimes are not harmonized, both for export promotion and for investment attraction, inequalities in the amount and distribution of investment would increase; and there could be "incentive competition" at high fiscal costs and with negative results for all participants.

Policy coordination and distribution of the costs and benefits of integration were always two controversial subjects that limited the potential for greater integration, even during the best times of the process. With the setback in the 1980s, it could be even more difficult to find satisfactory solutions to these problems, although their nature changes in the context of the new strategy of international insertion. While this scenario includes benefits resulting from the adjustment and reactivation of individual economies and a moderate increase of intraregional trade, it also involves costs for not taking advantage of the potential involved in joint actions in strategic areas, such as trade negotiations, and for the inability to exploit complementarities and economies of scale at the regional level.

[6] Informe de la Comisión Internacional para la Recuperación y el Desarrollo de Centroamérica (Sanford Commission Report). *Pobreza, conflicto y esperanza: un momento crítico para Centroamérica.* Durham, Duke University, 1989. p. 91.

[7] Weeks, John. p. 48.

ACCELERATION OF DEVELOPMENT WITH INTEGRATION

In this scenario, the processes of national structural reform and policy and legal harmonization between countries intensify in such a way that the investment climate improves throughout the region. Increased flows of investment will be helped by clear rules of the game and reduced public sectors but with states strongly committed to actions in strategic areas such as support for competitiveness, international negotiations, and social policies.

A virtuous circle would be operating in this scenario: progress in policy reform, both at the national and regional levels, will send the right signals for investment. This in turn would have a favorable impact on local efforts and expectations. A continued focus on development and economic integration would strengthen peace and democracy throughout the region, which would improve the international perception of the region as a whole and would further boost confidence for investment. This virtuous circle would be greatly helped by success in achieving an increased degree of access to major markets, particularly to the North American Free Trade Agreement (NAFTA), thus further improving the attractiveness of the region as an investment site.

Under this scenario, the possibilities of finding concrete solutions to the problems posed by differential degrees of development among countries would be maximized. Integration may thus become a positive-sum game for the region as a whole and for each participant. This would be the most favorable scenario to achieve the goals established by Central American Presidents at successive summit meetings.

PROSPECTS FOR THE REGION

There are several reasons for optimism that events during the rest of the decade could unfold around the features of the third scenario, acceleration of development with integration. First, in the political arena, the progress achieved by governments in the areas of peace and democracy has strengthened faith in the outcome of dialogue and negotiation and has forged the political determination of governments. Overcoming great obstacles, the efforts of the 1980s culminated in the Esquipulas I and II meetings, at which, apart from reaffirming their decision to be masters of their own destiny, the presidents of Central America assumed formal commitments with respect to amnesty, cease-fires, the consolidation of peace, arms limitations, democratization and free elections, civil and political rights, care of displaced persons and refugees, and acceleration of development. [8] From early 1989 to 1990 there were free elections in five countries, including Nicaragua. In the last 150 years there has never been such democratic and political uniformity nor greater peaceful conditions, although the situation is certainly vulnerable in several countries. In January 1992 the government of El Salvador signed a peace agreement with the guerrilla

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[8] Guido Fernández offers an insider's view of those efforts, particularly of the genesis and development of the peace plan of Dr. Oscar Arias, President of Costa Rica (1986–1990), which served as the basis for the Esquipulas I and II agreements. See: Fernández, Guido. *El Desafío de la Paz en Centroamérica.* San José, Costa Rica, Editorial Costa Rica, 1989.

forces. The political climate for investment and business activity has radically improved.

Second, there is a strong determination in the region's governments and private sectors to concentrate on development, economic reconstruction, trade, and investment issues. At the meeting held at Montelimar, Nicaragua, on April 3, 1990, the presidents of Central America reaffirmed the thesis that peace, democracy, and development are an inseparable trilogy; and decided that, in view of the progress achieved in the first two factors, the time had come to concentrate attention and energy on the third, i.e., on development and economic reconstruction. [9] Starting with the economic summit of Antigua, Guatemala, in June 1990, there have been five summit meetings dedicated almost exclusively to economic development and integration issues. [10]

A third reason for optimism is the interest and the willingness of the Central American business sector, increasingly more organized and articulate, to make progress on the issues included in the Central American Plan for Economic Action (CAPEA) and even to move beyond it. At the Antigua economic summit, the business sector, regionally organized in the Federation of Private Enterprise of Central America and Panama (FEDEPRICAP), proposed to the presidents of the Republics to establish a Central American Economic Community, a goal that has since been adopted by governments. [11] Since the economic summit of El Salvador, the private sector has also been insisting on the need to improve the institutionalized participation of different social sectors on integration issues. [12] It has also been actively involved in technical work with regional integration organizations. In sum, the Central American private sector has been very active at several levels of participation in the economic integration process and has produced a number of influential policy position papers. [13]

Fourth, the record of economic reform in the last two to three years shows that despite ingrained interest-group resistance, the governments of Central America have had the will and the capacity to take very significant steps in economic modernization. This progress is reported in the next section.

Notwithstanding all these positive developments, it should be observed that democracy and participation are still imperfect and vulnerable in several countries. In particular, some black clouds on

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[9] As the Sanford Commission Report noted: "Starting from the Esquipulas II agreement, Central Americans have made an extraordinary effort to coordinate actions and proposals. This process, which includes activities ranging from presidential and vice-presidential meetings to regional caucuses of numerous private associations, reflects enthusiasm for integration and has laid some foundations for institutionalized coordination among Governments." Sanford Commission Report, 1989. Since the publication of this report, institutionalized coordination has been greatly developed.

[10] The chronology of these meetings is: Antigua, Guatemala, June 1990; Puntarenas, Costa Rica, December 1990; San Salvador, El Salvador, July 1991; Tegucigalpa, Honduras, December 1991; Managua, Nicaragua, June 1992.

[11] FEDEPRICAP, *Propuesta del Sector Empresarial Organizado a los Presidentes de los Países del Istmo Centroamericano.* San José, 1990.

[12] To this end, the private sector has proposed the formation of a Central American Consultative Committee, integrated by the entrepreneurial, labor, academic, and other sectors, and which governments and regional authorities would be obliged to consult.

[13] Among the most important are: FEDEPRICAP-Federation of Central American Industrial Chambers and Associations (FECAICA). *Hacia un nuevo model de integración en Centroamérica.* San; José, April 1991; and FEDEPRICAP. *Declaracion de Tegucigalpa,* 1991.

the horizon are fed by the extremely deteriorated social conditions of the region.

Recent Progress in Policy Reform

STABILIZATION AND FISCAL ADJUSTMENT

As recently as 1990, Nicaragua was suffering from hyperinflation and Guatemala had an inflation rate of 60 percent. (See Table 1.) At present inflation is under control in all countries, including Nicaragua. Fiscal deficits remain a major issue in stabilization efforts but are being tackled through successive negotiations with the International Monetary Fund (IMF) and the World Bank, which closely monitor economic management. Most important, all governments are strongly committed to fiscal austerity and are introducing important measures to control expenditure and to reduce the size of the public sector.

TRADE LIBERALIZATION

Up until the mid-1980s, nominal tariffs were extremely high in most countries and effective rates of protection were widely dispersed. Quantitative restrictions were used for trade on basic grains and other essential products. Intraregional trade of agricultural products was also subject to import licenses. Until 1987, Nicaragua was the only Central American country member of the General Agreement on Tariffs and Trade (GATT). Today all countries are members or have committed to become members of the GATT. In the last 3 years, tariffs have been substantially reduced in all countries. Today, the external tariff ceiling of the Central American countries varies from 20 percent to 40 percent. At the July 1991 summit meeting in El Salvador, the presidents reached a commitment to the following: (a) achieving a Common External Tariff (CET) ceiling of 20 percent by December 1992; (b) adopting a common tariff system instead of quotas for extraregional imports of four main agricultural products (rice, maize, sorghum, and soya beans) by July 1992; and (c) liberalizing intraregional trade for a number of agricultural goods by June 30, 1992.

EXCHANGE CONTROL REGIMES

Exchange rate policies in all Central American countries were restrictive in the early to mid-1980s. Highly overvalued exchange rates and heavily controlled exchange markets, plus a fixed exchange rate policy led to multiple exchange-rate regimes. Over the last several years, all countries have eliminated multiple exchange-rate regimes, and strong efforts have been made to pursue a realistic exchange-rate policy in order to maintain export competitiveness. Structural adjustment efforts, the reduction of inflation, and the reduction of fiscal deficits have allowed a larger degree of internal and external balance than at anytime during the 1980s. This convergence in economic policies has in turn permitted stability and predictability of relative movements of exchange rates among countries. Exchange regimes have become more transparent and flexible. There is free currency convertibility between Guatemala, El Salvador, and Honduras.

TABLE 1. Central America Comparative Economic Indicators & Forecast for 1992.

Country	Guatemala			El Salvador			Honduras			Nicaragua			Costa Rica			Panama		
	90	91	92	90	91	92	90	91	92	90	91	92	90	91	92	90	91	92
Macroeconomic Indicators																		
GNP at market prices, 1958 [1]	3.1%	3.2%	4.0%	3.4%	3.5%	3.9%	0.1%	2.2%	3.5%	1.0%	−0.7%	4.7%	3.7%	1.0%	2.6%	4.6%	7.2%	8.5%
Per Capita, GNP real [1]	0.2%	0.3%	0.1%	1.1%	1.2%	1.6%	−3.1%	−1.0%	0.2%	−2.5%	−3.9%	1.6%	1.1%	−1.4%	0.1%	2.5%	5.1%	6.3%
GNP by industrial origin [1]																		
Agriculture	3.2%	3.0%	3.6%	7.4%	−0.3%	4.5%	1.1%	3.4%	4.0%	5.5%	−5.7%	10.9%	—	—	—	4.2%	3.2%	3.5%
Manufacturing	2.2%	1.6%	2.9%	3.1%	4.9%	5.0%	0.7%	0.0%	2.5%	−3.1%	7.1%	2.0%	—	—	—	11.9%	11.2%	3.2%
Commerce	1.6%	2.4%	6.0%	3.1%	4.4%	5.7%	−0.8%	3.0%	3.0%	1.0%	−0.2%	4.2%	—	—	—	14.2%	12.6%	12.0%
Construction	−10.5%	8.8%	10.0%	−12.8%	10.1%	11.5%	−9.9%	3.2%	6.0%	−9.3%	−13.9%	30.0%	—	—	—	38.9%	56.0%	16.0%
Finance Sector																		
Lending rate [2]	22.5%	26.78%	—	20.0%	20.0%	15.0%	19.6%	26.7%	28.0%	—	—	13.25%	32.6%	38.9%	—	—	—	—
Short-term, Deposit Rate	—	—	—	10.0%	8.0%	5.0%	12.0%	14.0%	18.0%	—	—	20%	21.2%	27.3%	—	—	—	—
Exchange rate at Dec. 31	5	5.05	5.4	8.13	8.15	8.60	4.47	5.40	6.1	—	5.00	5.00	104.60	136.8	160.50	—	—	—
Unemployment																		
Open Unemployment	7.0%	7.5%	7.4%	—	—	—	5.0%	5.2%	5.6%	—	—	—	4.6%	5.0%	ne	17.2%	15.7%	15.3%
Inflation																		
Consumer Price Inflation	59.8	10.0%	12.0%	19.3%	9.8%	11.0%	36.4%	21.4%	25.0	13,490.0%	785.0%	15.0%	27.3%	25.3%	20.0%	0.6%	1.6%	1.5%
Foreign Trade																		
Exports FOB [1]	7.4%	2.0%	6.1%	16.9%	3.2%	7.3%	−4.5%	−0.5%	7.0%	6.1%	−19.4%	10.8%	3.0%	9.3%	4.4%	10.0%	2.8%	10.0%
Imports CIF [1]	0.5%	12.2%	8.0%	8.7%	8.1%	11.6%	4.4%	−1.7%	9.7%	4.1%	19.5%	−8.6%	17.0%	1.1%	—	14.3%	33.3%	11.9%
Reserves (excl gold)	282	8.7	—	449	473	551	−32	59	147	−1,128	−1,105	−1,090	521	865	—	406	499	—
External Debt MM de Us$	2,777	2,700	—	2,132	2,200	—	3,480	3,150	—	10,497	9,300	—	3,772	4,000	—	6,676	6,700	—
Government Finances																		
Current expenditure [1]	11.9%	23.1%	18.0%	15.3%	38.8%	9.2%	32.5%	10.1%	15.8%	147.0%	260.0%	34.0%	39.4%	—	—	17.8%	29.8%	—
Current revenue [1]	14.9%	54.2%	12.0%	34.0%	22.1%	24.9%	34.5%	37.5%	0.4%	21.0%	531.0%	30.0%	36.4%	—	—	124.0%	18.0%	—
Total expenditure [3]	10.2%	9.2%	9.3%	11.9%	14.2%	13.1%	24.1%	20.3%	18.8%	36.3%	28.7%	28.3%	19.0%	18.1%	18.0%	23.9%	28.7%	—
Deficit [3]	2.1%	0.0%	0.5%	3.2%	5.1%	3.5%	7.7%	3.0%	4.9%	21.0%	7.5%	7.9%	4.4%	3.1%	2.9%	−2.3%	0.0%	—
Investment																		
Stock formation [3]	8.4%	8.6%	9.1%	11.8%	13.5%	14.7%	15.6%	17.7%	18.9%	14.6	12.9%	17.0%	24.2%	21.0%	21.9%	18.5%	13.8%	20.4%
Private Stock Formation [3]	5.8%	5.9%	6.3%	9.0%	10.0%	10.5%	11.8%	12.9%	13.4%	—	—	—	19.2%	16.4%	17.1%	—	—	—

Source: FEDEPRICAP. Algunos indicadores comparativos de la actividad económica y proyecciones para 1992, Dirección de Programas de Desarrollo Económico. Junio 1992.

[1] Annual changes in percent.

[2] Average.

[3] As percent of GNP.

INVESTMENT REGIMES

During the 1970s and 1980s, the incentive regimes for investment were oriented towards import substitution within the CACM. Extraregional trade was not a priority. The trade regime and legal framework were inward looking with respect to goods and capital movements across borders. During the 1970s, governments tried to overcome sluggish growth and the limits of a narrow market by increasing public sector investment in productive projects through state-owned enterprises.

Today, private investment and private sector development is the guiding principle for government policy and is seen in all countries as the key to economic growth and development. Neutral incentives for external trade and integration with larger markets are the basis of the new strategy for investment promotion in all countries. All governments have significantly improved the legal framework in order to define clear and reliable rules for the private sector. These improvements include laws regulating: (a) the establishment of Free Trade Zones which assure free trade of goods and capital, including free foreign exchange management plus tax exemptions; (b) draw-back schemes; and (c) free trade status for exporters of nontraditional goods.

In several countries, foreign investment is treated under specific foreign investment laws, like the ones recently issued in Nicaragua and Honduras which, among other things, guarantee free remission of profits, payment of interest on foreign loans, and other benefits and guarantees.

Most countries are undertaking further modernization of treatment to foreign investment as a result of reforms geared to improve the investment climate, particularly in the context of negotiating Sectoral Investment Loans with the InterAmerican Development Bank (IDB) or as part of an effort to qualify to negotiate a free trade agreement with the United States.

FINANCIAL SECTORS

At the beginning of the 1980s, almost all the Central American countries had a seriously repressed financial sector characterized by credit rationing, administered interest rates, negative real interest rates, increasing financing from the Central Bank to the central government, and special treatment or subsidized credit to selected sectors. By 1985, only Costa Rica had a working stock exchange.

During the late 1980s and in the last 2 years, the Central American governments have taken several steps to deregulate and modernize financial markets. Credit rationing has been completely eliminated (except for Nicaragua which is a special case). All countries have liberalized interest rates. Credit subsidies are almost nil; and, where still present, are being financed by the central government budget instead of being a burden on the financial institutions. Efforts have been made to modernize financial intermediaries and introduce new financial services and instruments. El Salvador successfully privatized two of its major banks and is proceeding with the other two. Costa Rica is currently negotiating a Sectoral Investment Loan with the IDB in order to further promote competition in the banking sector, reduce costs, establish clear information disclosure rules, and achieve more efficient intermediation.

With the inauguration of El Salvador's Stock Exchange on February 13, 1992, all Central American countries, except Nicaragua, will have an operating stock exchange, which is an important component in their emerging capital markets. Important steps to harmonize legislation and operating procedures concerning capital markets and financial instruments are being taken with the purpose of facilitating intraregional capital movements.

PRIVATIZATION AND REFORM OF THE PUBLIC SECTORS

A first stage of the privatization effort is quite advanced in most countries in the region. This is the dismantling of state-owned holding companies such as the Development Corporation (CODESA) in Costa Rica and the National Investment Corporation (CONADI) in Honduras. The analytical groundwork for privatization has been completed and intense public discussions on the issue are currently being held. It is only a matter of time before important new steps are taken.

PRICING POLICY

Traditionally, public utilities' prices were administered by the government and heavily subsidized. In most countries there were long lists of products with prices controlled by the Government, particularly basic consumption and other essential goods. In the last 2 years, all countries have reduced the list of products with government price controls. For example, El Salvador recently liberalized the price of 230 different products. Prices in most countries of the region are now determined by market forces, except for public services, gasoline, diesel fuel, and a few basic grains.

REGIONAL ECONOMIC INTEGRATION

NEW FOUNDATIONS FOR THE 1990S

Classic economic-integration theory distinguishes four basic models of economic integration, which are conceived as successive stages of a process that advance towards the final goal of a completely integrated economic space: Free Trade Area (FTA), Custom Union (CU), Common Market (CM), and Economic Union (EU).

Table 2 illustrates the main elements that define each of these models. The distinguishing features refer to the degree of mobility of goods, services, and factors of production; the type of protection vis-a-vis the rest of the world; the degree of development of physical infrastructure that could allow effective economic activity and interdependence within the region; and the scope of monetary integration and fiscal harmonization.

The last column of Table 2 contains a profile of the elements of theoretical integration schemes that can be combined with an outward-looking development strategy. This scheme, that we could call a model of *Integration for Outward-Oriented Growth (IOOG)*, corresponds in general terms to the elements of economic integration that have been derived from the presidential decisions in successive summit meetings. Elements F through I in Table 2 refer to possible

TABLE 2. Models of Economic Integration.

	FTA	CU	CM	EU	IOOG
A. Intraregional Mobility					
1. Goods	Yes	Yes	Yes	Yes	Yes
2. Services	Yes	Yes	Yes	Yes	Yes
3. Factors of Production	No	No	Yes	Yes	Yes
B. External Tariff					
1. Unilaterally Fixed	Yes	No	No	No	No
2. Common External Tariff (CET).	0	Yes	Yes	Yes	Yes
3. Common Fiscal Administration.	No	0	0	0	0
C. Common Infrastructure	Yes	Yes	Yes	Yes	Yes
D. Monetary Integration	No	No	No	Yes	0
E. Fiscal Harmonization	No	No	No	Yes	D
F. Joint Actions to Promote Exportation & Investment.	0	0	0	0	Yes
G. Joint Actions in Science, Technology & Enviroment.	0	0	0	0	Yes
H. Coordinated Negotiations					
1. Trade	0	0	0	0	Yes
2. External Debt	0	0	0	0	Yes
3. Investment	0	0	0	0	Yes
4. External Cooperation	0	0	0	0	Yes
I. Social Policies					D

Abbreviations:
FTA = Free Trade Area.
CU = Custom Union.
CM = Common Market.
EU = Economic Union.
IOOG = Integration for Outward-Oriented Growth.
0 = Optional.
D = Desirable.

areas of joint action and coordination, and do not correspond to traditional definitions of economic integration. Nonetheless, they represent areas of cooperation that are essential in the new IOOG model.

Having made these simple distinctions, let us emphasize some general aspects of the new foundations for the Central American integration process, over which there is increasing consensus.

Integration for Entry into World Markets. Perhaps the most important aspect is that the new model of economic integration should be functional and complementary to the new development strategy based on international competitiveness and on greater integration of the Central American economies into world markets. The gradual and negotiated incorporation into increasingly wider trade and investment relationships is seen as the key to economic progress. Regional integration and cooperation are seen as important instruments to make the most of the opportunities opened by freer trade and access to larger markets.

Global Plans Versus Consensus-Building. All-embracing approaches and comprehensive programs, with their inherent risks of exaggerated abstraction and grandiosity, must be set aside, together with the linear models of classic economic integration theory, which propose successive stages of progress towards increasingly greater integration. This perspective must be replaced by a more versatile and adaptive rationality and a more pragmatic approach which takes into account the heterogeneity of existing conditions, respects national strategic orientations, and seeks to achieve partial advances by means of a persistent pursuit of consensus-building processes in which areas for joint action can be discovered.[14] Consensus-building, within and among countries, encompasses a whole style of planning and is the basis for making the scenario of accelerated development with integration, defined above, viable.

Realistic Expectations. Integration must be seen as a process of support for national strategic policies and domestic efforts, and not the other way around. Several authors have noted that the CACM crisis was more a crisis of expectations than of achievements.[15] Excessively high hopes were vested in the integration process and it came to be thought of as synonymous with development, when actually integration could not solve problems for which it was not conceived. As a result, problems of Central American societies and economies—unequal income distribution, concentration of land ownership, excessive protection, and other phenomena that would have taken place with or without integration—were attributed to the CACM, and led to disenchantment with the integration process. The right perspective is that integration and joint regional action can support, but never replace, adequate national economic and social policies.

THE LOGIC OF REGIONAL ECONOMIC INTEGRATION UNDER AN OUTWARD-ORIENTED DEVELOPMENT STRATEGY

Some have argued that under a full-fledged FTA with the United States, there would be no logic for a regional economic space. In this view, the new model of integration, at best, can be only of a temporary or transitional nature, otherwise it would not be possible to talk about free trade. Once fully integrated into the world market or into larger trading blocs, such as NAFTA, it is claimed that there can be no subregional integration. This is an important argument which calls for the following observations.

First, the transition to free trade with other trading partners can take one decade or more. This is a long time. In the meantime, Central America can deepen its own single market in a broad range of issues with important benefits in terms of increased intraregional trade, larger flows of local and foreign investment, and

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[14] This approach has been proposed by various analysts. See: Guerra-Borges, Alfredo. *Desarrollo e Integración en Centroamérica: del pasado a las perspectivas*, CRIES-IIEC-UNAM, Ediciones Cultura Popular, Mexico, 1988; Lizano, Eduardo, Perspectivas de la integración económica regional. Ascher and Hubbard; CEPAL, *Documento de discusión para la cumbre económica centroamericana*, Comision Interinstitucional para el Cumplimiento de las Decisiones del Comité de Cooperación Económica del Istmo Centroamericano, Guatemala, May 28, 1990.

[15] Rosenthal, Gert. Algunas Lecciones de la Integración Económica en América Latina: el caso de Centroamérica. *Comercio Exterior*, 12, Mexico, 1983; Lizano, Eduardo in Ascher and Hubbard; Fuentes, Juan Alberto. El desafío de la integración ante la adversidad en Centroamérica. *Desafíos del la Integración Centroamericana*. FLACSO-ICAP, San Jose, Costa Rica, 1989.

a better environment for the mobility and upgrading of factors of production. During the transition, a 20 percent tariff vis-a-vis other trading partners would give a significant degree of discrimination for trade creation in favor of the members of the FTA.

Second, at least as important as achieving free trade with particular trading partners, is how to get there. Major benefits can be obtained in two ways: by cooperation that enhances negotiating power vis-a-vis third parties and by cooperation in areas such as common infrastructure, training and upgrading of human resources, science and technology, and other policies to develop long-term competitiveness. Joint actions vis-a-vis trading partners, economic blocs, governments, and multilateral agencies can generate benefits in trade and debt negotiations and in terms of the flow of technical and financial cooperation, even after free trade has been reached with particular trading partners.

Third, deepening regional integration would allow a more integrated regional production structure, and would facilitate the exploitation of economies of scale and of complementarities in production, distribution, and marketing.

PROGRESS IN RECENT YEARS

At the Antigua Summit, June 1990, the presidents of Central America reiterated a political commitment to restructure, strengthen, and reactivate the integration process. The ultimate goal was defined as the establishment of the Central American Economic Community as an instrument for the improvement of Central America's position in the world economy. The presidents adopted the Central American Economic Action Plan which includes the following commitments and guidelines: 1) to establish a new legal and operative framework, adequate to the new strategies. (Specific commitments include the establishment of a new regional payments system, compliance with a scheduled Program for the Elimination of Intra-Regional Trade Barriers, and the establishment of a CET.); 2) to promote a physical infrastructure, construction and reconstruction program in support of commercial integration, with a view to comprehensive inward-looking and outward-looking development; 3) to tighten regional coordination of external trade, foreign investment and tourism, including coordinated action for joining and participating in the GATT; 4) to promote dynamic and comprehensive procedures for consensus-building, consultation and participation processes between governments and different social sectors; 5) to promote industrial restructuring and productive transformation policies, geared towards achieving a competitive and regionally-integrated production structure; 6) to support the transformation of state enterprises, encouraging a broad-base of stock ownership and economic democratization; 7) to formulate and apply a coordinated agricultural policy; 8) to formulate and apply a regional science and technology policy; 9) to promote the coordination of macroeconomic adjustment processes; 10) to promote social compensation programs for economic adjustment; and 11) to establish a consultation and coordination forum on foreign debt.

In successive summit meetings and in an intense process that has involved economic cabinets and economic integration organizations, an even broader and more detailed agenda has emerged, that is monitored at the highest political level by the presidents at each summit meeting. As a result, progress towards economic integration has been quite substantial in the last two years.

Improvement of the Central American Free Trade Area

The following points should be highlighted (partly as a result of these measures intraregional trade has increased from U.S. $450 million in 1986 to U.S. $750 million in 1991):

- The subscription on July 1991 of the Transitory Multilateral Agreement on Free Trade between Honduras and the rest of the Central American countries by which Honduras rejoins the regional Common Market;
- The execution since January 1990 of a Program for the Dismantling of Obstacles and Barriers to Intrarregional Trade in order to completely liberalize trade among Central American economies and improve transport and payments systems; [16]
- Adoption of a new CET with a tariff ceiling of 20 percent and a tariff floor of 5 percent, with some exceptions, that will be in force by the beginning of 1993 (mid-1993 for Costa Rica);
- Adoption in the near future of the Harmonized Tariff System to facilitate commercial relations with extraregional partners and as a basis to negotiate rules of origin in future FTA negotiations;
- Adoption of a GATT-compatible Anti-dumping Code;
- Approval of a wide range of measures to improve the handling and transportation of merchandise within the region such as the application of the International Transit Guide;
- Acquisition of modern equipment to improve communication within the 23 border posts and the construction and remodelling of the physical infrastructure; and
- Opening of a 24-hour window to deal with commercial transactions, harmonization of services, elimination of tourist and commercial visas for Central American and Panamanian nationals, and adoption of a single Migratory Control Card.

Institutional and Legal Reforms

In addition, there have been numerous institutional and legal reforms in the region:

- There has been a restructuring and strengthening of the regional institutions (Secretariat of Central American Economic Integration and the Central American Bank for Economic Integration [CABEI]) in order to make them able to respond to current priorities and challenges.
- At the Tegucigalpa, Honduras, Summit in December 1991 an agreement was reached to establish the Central American Integration System (SICA), with clear institutional responsibilities in different policy areas.
- Policy dialogue between the public and private sectors in each country and at the regional level has greatly improved.

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[16] Currently Nicaragua, Costa Rica, and Honduras still have to eliminate trade surcharges, but there is an agreement to do so by the end of 1992.

- Through the FEDEPRICAP system of entrepreneurial organizations, the private sector of Central America has increasingly achieved a predominant role in policy dialogue, particularly concerning regional integration and external trade policies.
- On May 12, 1992, Guatemala, Honduras, and El Salvador signed the New Ocotepeque Agreement, by which they commit themselves to accelerate their economic integration, by complying with a number of points sooner than contemplated in the existing schedules for the five countries as a whole.
- The Central American Parliament is already a functioning organization although with limited legislative powers. Costa Rica has not yet ratified the corresponding treaty.

Central America's Insertion into World Markets

As explained, Central America has been increasing its insertion into the world economy and has made a significant contribution to a freer world trading system in the last few years. Entering into a FTA with a country of the size and competitive muscle of the United States is, however, a crucial decision and would represent a new phase in the reform process. Some, including U.S. officials, have expressed fears that Central American countries are not yet prepared to enter into mutually beneficial free trade in a full-fledged FTA with the United States. In this view, the best strategy in the short term is to negotiate free trade with its immediate neighbors Mexico, Venezuela, Colombia, and the Caribbean—this is already occurring with Mexico and Venezuela—and to proceed with the necessary structural reforms both to be eligible and to be prepared to take advantage of free trade with the United States in the future.

Although widening markets via integration with Mexico and other neighbors would have benefits, the option of postponing integration with the United States or NAFTA would likely have more costs than benefits, and Central America should try to avoid it for several reasons.

The benefits for Central American countries joining in a FTA with the United States, or a wider NAFTA, include the possibility of a substantial increase in exports to the United States associated with trade creation; a substantial increase in investment flows; and improvements in productivity, skills, and technological capabilities associated with foreign investment and the efforts to develop long-term competitiveness. However, none of the these effects would be as large by integrating with countries other than the United States. With regard to exports, trade with neighbors pales in comparison with trade with the United States: more than 60 percent of Central American exports go to the United States, which in turn represent less that 1.5 percent of total U.S. imports. This means that the trade-creation, export-expansion effect with the United States could be very substantial for Central America, making a major difference for the region, but representing only a minor impact for the U.S. economy.

The most important benefit of a FTA on Central America would be the dynamic effect associated with increased investment. Over the medium to long term, investment precedes trade and not the other way around. This is particularly true for Central America which, during the 1980s (with the exception of Costa Rica), had rates of investment well below the 20 percent threshold necessary for a sustainable and healthy growth process. By increasing the attractiveness of the region as a location for foreign and local investment Central America could exploit its comparative advantages in the new context of globalization in production and investment flows. Again, this effect would not be as intense with neighboring countries as would be the case in a FTA with the United States.

In short, for Central America to sustain a gross domestic product (GDP) growth rate above 5 percent for one or two decades, necessary to increase living standards and provide productive employment to its growing population, it needs a rate of investment that could only be achieved by the dynamism of integrating into a market of the size of the United States or NAFTA. Even a regional market widened to Mexico and Venezuela could hardly be expected to provide enough dynamism, particularly given the very reduced basis of existing trade.

MAXIMIZING THE BENEFITS AND MINIMIZING THE COSTS OF FREE TRADE WITH THE UNITED STATES

For years, trade and development experts have dismissed the possibility of FTAs between developed and developing countries by pointing out the difficulties that are likely to arise when countries at different levels of development join in a FTA. Numerous efforts to establish FTAs among developing countries have foundered over perceived inequities in the distribution of costs and benefits: the least developed members of the group invariably feel shortchanged, a feeling reinforced by the tendency of new investment to concentrate in the more developed regions of the integrated area. A critical issue posed by the Enterprise for the Americas Initiative (EAI), therefore, is how to design a satisfactory reciprocal arrangement between the United States, Canada, and a large and heterogeneous group of far less developed countries. [17]

For Central American countries, the effort to maximize the benefits and reduce the costs of free trade with the United States requires, among others, the following conditions:

1) Effective access to the U.S. market: removal of tariff and nontariff barriers to virtually all products, discipline in the use of U.S. trade remedies and trade sanctions, rules of origin that do not discriminate against non-American investors.

2) Increased levels of international competitiveness: these cannot be expected to be the automatic by-product of liberalization. Exploiting investment opportunities posed by improved access requires success in reform efforts geared towards reducing uncertainty, providing a stable macroeconomic environment, and establishing clear and consistent rules for long-term investment.

3) It also requires complementary support measures and productive modernization policies to eliminate supply constraints: inad-

[17] This issue is discussed in more detail in Salazar-Xirinachs, José with Eduardo Lizano. A Latin American Perspective on Free Trade in the Americas. In Saborio, Sylvia and contributors. *The Premise and Promise: Free Trade in the Americas.* New Brunswick, Transaction Publishers, 1992.

equate infrastructure, segmented and inefficient capital markets, insufficient managerial and technological capacities, inefficient and rigid public sectors, and other institutional constraints.

4) The dynamic costs of free trade with the United States for Central America are likely to be very significant. Import penetration under conditions of unemployed or underemployed resources and capital scarcity involves adjustment costs that should not be underestimated. "Adjustment fatigue" due to deteriorating social conditions has been an important concern and a painful experience in Central America during the 1980s. This challenge has to be confronted in order to ensure the viability of both transition strategies and the final result.

5) Finally, the sequence of accession to a U.S.-centric FTA will have an important bearing on the costs and benefits of joining the FTA: early joiners will generally face advantages in terms of both export expansion and investment attraction. Latecomers will be disadvantaged not only by the postponement of benefits but also by possible investment diversion toward those that join first. The costs of exclusion will tend to rise over time and as FTA membership expands. The larger the size and number of countries that join first, the more benefits will be diluted among a broader base of countries and the tougher the competition for gaining import shares into the U.S. market. Latecomers also will probably find the United States less willing to accept further structural adjustment resulting from increased market access.

PRESENT CENTRAL AMERICAN CONCERNS

Central Americans are concerned about the several issues relating to the movement toward hemispheric free trade. First, even though unintended, NAFTA may induce investment diversion effects. That is, Central America might lose investment in favor of Mexico given the similarity in comparative advantages and resource endowments, and the advantages that Mexico will have given the agreement itself and close proximity to the U.S. market.

Second, the Sanford Commission warned of the possibility that once the hostilities in Central America were over, external economic assistance could be suspended and the doors opened to Central American exports could be closed, because the region would no longer constitute a zone of geopolitical crisis. [18] In addition, the region's leverage to obtain trade preferences could be reduced by the extension of similar preferences to the countries of Eastern Europe and Mexico and by other sweeping concessions made in the context of the Uruguay Round. Some of these elements are already occurring: U.S. economic support for the region has substantially decreased in the 1990s in comparison to the 1980s; in November 1991 the United States approved the Andean Trade Preference Act which extends CBI-type trade preferences to Colombia, Ecuador, Bolivia, and Peru.

Third, Central Americans fear that their leverage can be limited by the EAI itself and that their access to the U.S. market can be reduced to the extent that other Latin American countries, carry-

[18] Sanford Commission Report, 1989.

ing greater economic and political weight, manage to position themselves and negotiate larger access into the U.S. market.

One conclusion is clear from this analysis: joint actions on the trade negotiation front and an alert, active trade strategy are essential under the new conditions. While the CBI trade preferences were basically given to Central America as part of an East-West confrontation and heavily determined by geopolitical reasons, there has been a sea change in conditions. During the 1990s Central America can expect to get, at best, only what it can skillfully negotiate.

SHORT-TERM ACTION AGENDA IN THE CONTEXT OF THE EAI

At present there seem to be two principal ways to improve access for Central American exports into foreign markets, particularly in the U.S. market: 1) a successful outcome of the Uruguay Round, complemented by a special effort to improve access into the U.S. market of products not included in the CBI (sugar, textiles); and 2) the much talked about "docking" or accession clause into the NAFTA, which would allow small Central American and Caribbean countries to join a generic NAFTA. The latter would be the most immediate and attractive alternative and would avoid the much-feared trade and investment diversion effects.

Central Americans understand that any improvement of access to the U.S. market that could be achieved by any of these options will entail reciprocal concessions of the type contemplated in the EAI, and have expressed their willingness to talk and consider United States requests regarding such possible concessions. [19]

JOINT ACTIONS FOR THE DEVELOPMENT OF INTERNATIONAL COMPETITIVENESS AND THE MODERNIZATION OF PRODUCTIVE SECTORS

Competitiveness and technology are complex and systemic concepts. The more open an economy the more competitiveness and economic performance depend on technological capabilities. A simple framework to present the determinants of national competitive advantage has been provided by economist Michael Porter and is known as "Porter's Diamond." [20] These competitive determinants are categorized into four basic elements:

Factor conditions. The nation's position in factors of production, such as skilled labor, infrastructure and knowledge base, necessary to compete in a given industry.

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[19] The United States should not fear including the Caribbean Basin countries in NAFTA. CBI exports to the United States represent less than 3 percent of total U.S. imports. Even with the greater access to the U.S. market provided by the Caribbean Basin Economic Recovery Act, Caribbean Basin countries have faced serious structural difficulties in increasing exports to the United States. In fact, after preferential treatment was granted to the CBI countries, the U.S. balance of trade with the region actually improved: "In 1986, for the first time in a number of years the United States had a small surplus with the Caribbean countries collectively, making the Basin one of the few areas of the world with which the no U.S. trade deficit was recorded." In U.S. International Trade Commission (USITC), *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers*. Second Report, 1986. USITC Publication 2024, September 1987. Under a system of mutual concessions, it would take significant flows of investment spread over a number of years for the CBI group to obtain a significant surplus; while, on the other hand, given the very open structure of CBI economies, increased exports to the United States would be associated with increased imports from the United States in a mutually beneficial trade-creation process.

[20] Porter, Michael E. *The Competitive Advantage of Nations*. New York, Free Press, 1990.

Demand conditions. The nature of home demand for the industry's product or service.

Related and supporting industries. The presence or absence in the nation (or integrated region) of supplier industries, and related industries and services, that are internationally competitive.

Firm strategy, structure, and rivalry. The conditions in the nation governing how companies are created, organized, and managed, and the nature of domestic rivalry or competition.

Applying this vision to the small Central American economies, it becomes clear that the effective exploitation of trade and investment opportunities opened up by greater access to foreign markets requires levels of international competitiveness that are not an automatic by-product of liberalization. In addition to appropriate macroeconomic conditions and clear rules at the national level to improve the investment climate, there are several areas where joint actions can be developed at the regional level in order to remove supply constraints, improve competition, upgrade the quality of factors of production, and develop long-term competitiveness. The private sector of Central America has been insisting on these issues.[21] In particular, in November 1991, FEDEPRICAP submitted a proposal to Ambassador Carla Hills, U.S. Trade Representative, and to Bernard Aronson, Assistant Secretary of State for Inter-American Affairs, to introduce a fourth pillar to the EAI, a science and technology pillar. This would include policies and mechanisms to support competitiveness in small, relatively underdeveloped economies and increase the viability of a FTA that includes large competitive economies and small, relatively underdeveloped ones as members.

The following are examples of joint actions to improve competitiveness, some of which are already being put into practice.

Coordination of export efforts. Coordination in transport, marketing and distribution or the strengthening of enterprises in marketing-exporting (trading companies) can help to generate competitive advantages by improving production-export-marketing chains. For certain products, minimum export volumes can be achieved that are beyond the reach of a single country; in other cases, it could be possible to optimize windows of access to markets as well as transport space and routes. For many products, the size of overseas markets offers Central American entrepreneurs ample opportunities of cooperation instead of competitive behavior.

Investment promotion. A new phase in investment promotion efforts can be started by fostering cooperation among technical agencies such as the Costa Rican Coalition for Development Initiatives and the Salvadoran Foundation for Economic and Social Development, that were established with U.S. Agency for International Development support in the early 1980s. Important savings could be achieved by coordinating efforts and the joint use of external of-

[21] In April 1991, FEDEPRICAP and FECAICA submitted a document to the Central American economic ministers entitled *Central America: Towards a New Model of Economic Integration*, which insists on the need for going beyond purely macroeconomic adjustments and applying specific policies in order to develop long term competitiveness and remove supply constraints. Many of its recommendations were introduced in the *Priority Agenda for the Economic Community of Central America*, which is the basic action plan approved by the Third Meeting of the Economic Cabinets of Central America held in March 1992.

fices and other infrastructure. Harmonization of investment regimes, information systems on joint-venture projects, and aggressive policies to develop local suppliers are some of the new services that can be provided by these agencies.

Subcontracting and development of supplier industries. Liberalization of intraregional trade opens up opportunities for subcontracting at the regional level, both for intraregional sales and for exporting, either through leading enterprises in each country, through subcontracting, exchanges or via joint ventures with foreign capital. Subcontracting schemes have several advantages over export platforms based in duty-free zones: they are less vulnerable to changing costs, open the way to production of technology-intensive exportable goods, and promote flexible specialization in small enterprise networks. [22]

Science and technology policy. This is one of the major areas of regional cooperation that has been identified by governments and the private sector. A Regional Science and Technology Commission was set up that has been working on a project designed to: strengthen the science and technology institutions and responsibilities in each country; improve research and teaching facilities; finance training; create information networks; and develop joint research projects.

Development of capital markets and regional capital mobility. It is necessary to step up banking-reform efforts to improve credit access for small- and medium-size enterprises, including long-term and venture capital. The objective of promoting exports requires the establishment of flexible financing mechanisms for foreign trade. Another action, already being pursued, consists in expanding CABEI's capital by incorporating the United States, European, Latin American, and other countries as Bank members. [23] The process of upgrading capital markets and financing productive modernization must not be limited to payment and credit mechanisms. It is important to promote greater development and integration of the national stock exchanges and new sources of savings and financing by encouraging the development of equity markets. [24]

FINAL OBSERVATIONS

In spite of the economic and social "disintegration" of Central America in the 1980s, and the presence of great political, economic, and military obstacles, the CACM has managed to endure and is on the threshold of an important reactivation.Recently, big steps towards the consolidation of peace and democracy have been taken. However, the situation is still vulnerable, particularly due to extremely deteriorated social conditions in most countries of the

[22] In May 1991, FEDEPRICAP started a project with support from the Spanish Government to develop a subcontracting network at the regional level for several sectors.

[23] For a report of these efforts, see interview with Federico Alvarez, President of CABEI. El BCIE: Un nuevo Banco para el desarrollo de la Region. *Integracion en Marcha*, No.4, FEDEPRICAP, March-April 1992.

[24] FEDEPRICAP has been working on regional capital market development. The analytical base and description of the work advanced so far is contained in FEDEPRICAP. *Los mercados de capitales: un nuevo eje para la integración Centroamericana.* San José, Costa Rica, 1992, forthcoming.

region. Nonetheless, the Central American governments and private sectors are both currently committed to an extraordinary effort to define the areas of cooperation and to move ahead in policy reform and regional economic integration. This means that of the three possible scenarios for the 1990s discussed in this paper—disintegration, growth with limited integration, and accelerated development with integration—favorable conditions for the occurrence of the third are being generated.

However, if the virtuous circle required by this scenario is to be sustained, an improved degree of access to foreign markets and a continuation of international economic and technical cooperation are essential and decisive ingredients.

APPENDIX: ECONOMIC ASSISTANCE STRATEGY FOR CENTRAL AMERICA 1991-2000

Agency for International Development

(January 1991)

CONTENTS

Dramatic political and economic changes in Central America, and in the world, demand a new U.S. economic assistance policy for the region in the 1990s. For the first time in history, all Central American countries have democratically elected governments. The region's presidents have renewed their commitment to peace and mutual interdependence. Also underway in the region is an economic transformation that has the potential to be as profound as the political transition of the 1980s. There is an unprecedented opportunity over the next decade to achieve the political stability, economic prosperity, and social justice that have for so long eluded the people of Central America.

The United States has widened the scope for cooperation with Central America through the Enterprise for the Americas Initiative (EAI) and has called for broad multilateral support for the region through a Partnership for Democracy and Development (PDD). At the same time, U.S. foreign assistance levels for Central America are declining from the historic amounts that were provided during the conflicts and economic crises of the last decade. The challenge for the 1990's is to sustain the positive but still very fragile trends toward political and economic freedom, utilizing diminished resources in a manner that will have the maximum impact.

The new strategy for U.S. economic assistance for Central America in the 1990s will support the broad objectives identified by the Central American Presidents in the Declaration of Antigua, adopted in June 1990, as well as the commitments they made in the Declaration of Puntarenas in December 1990:

- the development of stable, democratic societies;
- the achievement of broad-based, sustainable economic growth; and
- the attainment of effective regional cooperation.

The Agency for International Development will pursue these objectives through its own bilateral and regional programs, and through heightened collaboration with other U.S. Government agencies, multilateral development institutions, and other bilateral donors. As macroeconomic environments improve, A.I.D.'s implementation strategy will emphasize greater concentration of resources on the solution of specific sectoral problems.

To enhance democracy, A.I.D. will increase support for democratic institutions, especially to broaden and deepen participation in democratic processes. Local governments need to be strengthened in order to better deliver services and to broaden citizen participation in government. Judicial, legislative, and electoral systems need to be independent, professional, and effective to consolidate democratic gains. Public finances must be managed with the competence and integrity necessary to merit public confidence. Democratic values need to be promoted to develop stronger, more effective citizen participation.

To stimulate economic growth, A.I.D. will help Central Americans eliminate obstacles to private investment, trade, and employment generation. A.I.D. will encourage the adoption of policies, incentives, regulatory frameworks, and management practices that protect the natural resource base as well as facilitate greater participation in the economy by the disadvantaged. A.I.D. will also assist governments and the private sector to improve the effectiveness, efficiency, financing, and local control of basic social services.

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To foster regional cooperation, A.I.D. will place greater emphasis on implementing initiatives identified by the Central Americans within a regional framework. A.I.D. will encourage policy, legal, and other reforms to further liberalize trade within Central America. A.I.D. will also support key regional institutions while at the same time helping them to achieve greater self sufficiency and reduce their dependence on A.I.D. resources.

Between now and the year 2000, the strategy emphasizes the following goals:

- free and open national and local elections will be the norm; administrative and financial authority of local governments will be strengthened; legislatures will function effectively and cooperate more through a Central American Parliament; judiciaries will increase respect for the rule of law and human rights; the military's role in the political processes will be reduced; civic participation in democratic processes will increase; the press and other media will be freer, more responsible;
- per capita GDP will grow between 2.5% and 3.0% per year; private investment as a percentage of GDP will increase substantially; nontraditional exports will maintain their brisk growth rates; unfettered intraregional trade and capital movements will be the norm; public investment will increase significantly, and will be concentrated in basic infrastructure for economic growth, the development of human resources, and the conservation of the natural resource base.
- infant mortality, malnutrition in children under five, and population growth rates will continue to decline substantially; vaccination coverage and primary school enrollments will increase;
- the annual rate of deforestation will slow substantially.

The new strategy will have implications on management. Increased staff requirements for democracy and environmental programs will be more than offset by staff reductions elsewhere. A.I.D. will need to coordinate its programs more closely with other U.S. Government agencies. Cross-cutting Congressional earmarks and functional accounts that do not reflect the requirements of the new strategy will need to be minimized.

United States foreign assistance resource requirements should decline during the 1990s, as increased trade and investment in Central America are expected to generate more foreign exchange from exports of nontraditional products. Other donor assistance and the return of Central American capital will be equally important. So long as external support is not precipitously withdrawn before the region's own resources can sustain robust growth with broad participation, U.S. objectives in the region can be met with an orderly decline in A.I.D. assistance.

I. INTRODUCTION: A NEW CENTRAL AMERICA AND A NEW CHALLENGE

A. A NEW POLITICAL AND ECONOMIC ENVIRONMENT

Democratically Elected Governments

For the first time in history all the countries of the Central American isthmus, from Guatemala to Panama[1], are led by democratically elected governments committed to market-based economic policies. The realignment of East-West relations and the discrediting of statist and import-substitution economic policies provide a new generation of leaders a unique opportunity to solidify democracy and set a course of dynamic and equitable growth.

Progress toward Peace

The Central Americans are justifiably proud of progress toward peace under the Esquipulas Accords. The democratic transfer of power in Nicaragua, the peace negotiations in El Salvador, and the end to despotic government in Panama provide a basis for renewed regional cooperation and a better environment for all of the peoples of Central America to build a more secure and hopeful future.

A Renewed Commitment to Mutual Interdependence

Central American leaders, building on the success of the Esquipulas peace process begun in 1987, have renewed their efforts to rebuild their economies and integrate Central America into the world economy. In the Declaration of Antigua (June 1990), and reaffirmed in the Declaration of Puntarenas (December 1990), these leaders committed their countries to mutually supportive interdependence and set forth their own vision of Central American cooperation.

B. A SHARED VISION

Peace, Democracy, and Development

Today U.S. and Central American leaders share a common belief, expressed eloquently in the report of the International Commission for Central American Recovery and Development (the Sanford Commission), that "lasting peace, genuine democracy, and equitable development are inextricable. These three objectives are mutually reinforcing. None is sufficient by itself; all are necessary." That report, prepared by a diverse group of Central Americans and individuals from other nations in the Americas and elsewhere, is representative of the growing dialogue between Central Americans and those from outside the region who share a concern for its future.

Supporting the Vision

President Bush, in introducing his Enterprise for the Americas Initiative (EAI), underscored U.S. support for Central American efforts to deepen democracy, foster trade and investment, and promote sustained, broad-based economic growth. "The future of Latin America," the President said, "lies with free governments and free markets." The United States supports the Central Americans' expressed desire for greater political and economic interdependence which we believe will discourage instability and accelerate economic, social, and political progress.

[1]Belize is dealt with by A.I.D. primarily in the context of the Caribbean region. It will be formally involved in the Central American Strategy as the opportunity arises, e.g. its observer role in the Partnership for Democracy and Development.

The EAI is designed to bolster the democratic and market-oriented transition throughout Latin America by focusing on trade, investment, and debt reduction. A companion initiative, the Partnership for Democracy and Development in Central America (PDD), will encourage broad support from the international community for regional democratization and development. The PDD will provide a forum for fostering international support for regional economic policies and integration efforts, strengthened democratic institutions, and a coordinated approach to bilateral and multilateral assistance to the region.

Increased private investment in productive areas is the key to the success of the EAI. Foreign investment is important -- and substantial amounts of it are already flowing. Some of the flight capital that left the region in the early 1980s has begun to return, and continued good policies will result in additional repatriation. Further financial reforms are also needed to increase the level of domestic savings which are critical for greater investment in the region.

With its field missions, the Agency for International Development (A.I.D.) can play a role in achieving the goals of the EAI. A.I.D. support for institutional and policy reforms in the trade and investment area, in addition to macroeconomic policy reform, will lay a basis for sustained growth in investment. In addition, support for increased linkages between the U.S. business community and Central American entrepreneurs will speed up the process of investment and trade. A.I.D. can continue to help Central American countries address their debt problems and take advantage of opportunities under the EAI to reduce debt. Consolidating democracies, addressing the social problems of the disadvantaged and ensuring better management of the environment will require the Central American countries to mobilize increased internal and external resources and use them more efficiently.

C. CENTRAL AMERICA: RECOVERING FROM THE CRISES OF THE 1980s

Crisis Management: The Early 1980s

In the early 1980s, Central American countries faced a profound economic and political crisis. The governments of Guatemala and El Salvador were under virtual siege by leftist insurgents and the extreme right; the Sandinistas were solidifying their power in Nicaragua and menacing El Salvador; Panama was under the increasingly brutal control of General Noriega; Honduras was preparing to end a long period of military rule in the face of a faltering economy. Only Costa Rica had a democratically elected government at the beginning of the decade.

The economies of the region were reeling under the impact of the oil crisis and subsequent recession. It is estimated that at least $1.5 billion in capital left between 1980 and 1982; public and private debt skyrocketed to over $10 billion; and private investment, both domestic and foreign, plummeted. Sharp declines in income (12% region-wide and as much as 20% in El Salvador) exacerbated the political crises. Even stable Costa Rica experienced sharply reduced incomes, high inflation, and rising unemployment. Governments everywhere were losing the capacity to face the economic challenges and to deliver basic social services.

Adopting an Outward Economic Orientation

The crisis of the 1980s made clear to the Central American countries that their economies were ill-equipped for the rapidly changing international economic environment. A regional consensus has emerged that a more outward-oriented economic strategy is essential to sustained, broad-based development. Private sector leaders who once lobbied for the revival of a protected regional market are now turning their energies to exporting new products to new markets outside the region. Governments are lowering tariffs, eliminating restrictions on foreign investment, and taking other important measures to liberalize their economies.

Progress under the Central America Initiative

The Central American Initiative, launched in 1984, was a comprehensive effort by the U.S. Government to help the Central Americans restore long-term political and economic progress. Much has been achieved (Chart I). Democratically elected governments are now in power throughout the region, headed by presidents who achieved national preeminence as political, rather than military, leaders. They are men and women of vision, committed to the democratic process and to improving the well-being of their citizens through sustainable, economic growth.

The economic hemorrhage of the early 1980s has been stemmed and positive economic growth restored. Excluding Panama and Nicaragua, the region has achieved positive real annual per capita growth each year since 1987. Outward-looking economic policies are now in place that promise sustainable growth. The region's entrepreneurs have responded by developing new export products for the United States and Europe. This export growth has created significant new employment and generated growing demand for imports, particularly from the United States.

With substantial aid from the United States and other donors, most countries have been able to improve social indicators. Over 1.8 million more people now have access to potable water. Infant mortality rates have fallen and immunizations and the use of oral rehydration therapy have expanded. An additional 400,000 children are attending primary schools, producing modest gains in primary school coverage and completion rates, despite high birth rates (Chart I).

CHART I: Indicators of Progress During 1984-1990

INDICATOR	1984	1990
Real Per Capita GDP Growth[1]	-0.5%	0.2%
Private Investment (% of GDP)	7%	13%
Nontraditional Exports ($ Billion) to US	0.4	1
Democracy Rating for Political Rights and Civil/Political Liberties (Scale of 1 to 7)[2]	3.6	2.7
Primary School Enrollment Ratio (Gross)[1]	89%	93%
Primary School Completion Rate (Gross)[1]	52%	60%
Infant Mortality (per 1000 births)	58	45
Water Supply Coverage[3]	56%	60%
Sanitation Coverage[4]	48%	59%
Vaccination Coverage[5]	50%	66%
Children under 5 Malnourished[6]	20.4%	17.8%
Annual Rate of Population Increase[7]	2.71%	2.65%
Annual Deforestation Rate[8]	N/A	3%-7%

[1]Excludes Nicaragua.

[2]Freedom House is an independent non-profit organization that has conducted a comparative survey of freedom since 1972. Countries are ranked on a scale of 1 (fully free) to 7 (not free), on the basis of a 36-point checklist of political rights and civil liberties that measures such variables as elections, breadth of political participation, freedom of groups and the press from political terror or intimidation, and individual human rights.

[3]Percentage of Central Americans with access to water within 50 meters.

[4]Percentage of Central Americans with access at least to a latrine.

[5]An estimate of the percentage of living children between the ages of 12 through 23 months who have been vaccinated before their first birthday-three times in the cases of polio and DPT and once for both measles and BCG.

[6]Percentage of children under 5 years of age below 2.0 standard deviations of the WHO/NCHS reference population.

[7]Excludes Nicaragua, El Salvador (due to war).

[8]Under the Regional Environmental Project (RENARM), A.I.D. is developing improved environmental indicators to measure performance and progress in this priority program area.

II. A.I.D.'S STRATEGY AND TARGETS FOR THE 1990s

A. THE FRAGILITY OF PROGRESS TO DATE

Much has been accomplished to achieve peace, democracy, and economic recovery in Central America, but much remains to be done. The foundation for progress must be made permanent. More than anything else, what is needed now is the continued nurturing of the institutions of economic and political freedom to deepen their roots.

Serious challenges remain. Continuing internal strife in El Salvador and Nicaragua is evidence of the fragility of democratic principles. While elections have been held, many democratic institutions are weak, particularly at the local level. Although most countries are managing their economies better, they still need assistance to sustain their adjustment programs. Moreover, continued poor world markets for Central American products, an unresolved external debt problem, high population growth rates, and environmental degradation will complicate the economic management problems of the region's leaders. The majority of Central Americans still live in poverty, many in extreme poverty, and lack the means to alter their situation in the foreseeable future unless national policies and programs reduce the barriers to their participation in democratic political systems, growing economies, and fundamental social services.

B. KEY PREMISES

A.I.D. will build on past successes by consolidating and focusing its programs in the areas of participatory democracy and broadly-based growth. The World Bank's World Development Report for 1990 makes clear that market-based economic growth is essential for rapid and sustained progress in reducing poverty. "Getting prices right" not only provides farmers and urban residents more incentives to increase production; it also removes exchange-rate, credit, fiscal, and other distortions that have made capital arbitrarily cheap. This means that employers will place a higher value on labor, thus creating more jobs and providing the poor more income with which to improve their standards of living. Rapid and sustained economic growth also provides governments more revenue with which to expand primary education, primary health and nutrition programs, family planning programs, and other basic services that constitute the second major element of a successful strategy for reducing poverty. This kind of broad-based, sustainable model of economic growth offers Central American countries the best prospects for strengthening the democratic gains made during the 1980s.

A.I.D.'s strategy for supporting a deepening of democratic processes and the achievement of rapid broad-based, and sustainable economic growth is based on the following key premises:

There is a Shared Vision of the Region's Future

Central Americans have a vision of their future, and one aspect of that vision is that increased regional interdependence can promote common good for the region.

The Central Americans will use the consultative group and PDD mechanisms to mobilize additional external cooperation, trade, investment, debt relief, and democratic development.

Trade, Investment, and Aid are Linked

Over the longer term, increased trade and investment are key to the economic development of Central America, and aid can help lay the basis for this private sector-led growth. A.I.D. will place increased emphasis on trade and investment within its programs and explicitly link them to business outreach activities with and in the United States.

Expansion of trade and investment must be based on comparative advantage, which will require increased productivity, specialization, and aggressive marketing.

Significant policy and regulatory changes encouraging increased private investment and open trade are required to stimulate significant growth.

A reduction of political strife and an improved regional macroeconomic and sector policy environment will encourage substantial renewed private capital flows into the region.

Accelerated economic growth in Central America will create larger markets for U.S. exports, greater opportunities for U.S. investors, and more trade opportunities for Central American countries within the region, with the United States, and in the world economy.

Public and Private Sector Responsibilities Must be Realigned

Centralized government bureaucracies need to be reduced, with productive activities transferred to the private sector and essential government services provided with greater efficiency. The roles of municipalities, the private sector, and non-governmental organizations in development should be increased.

The multilateral banks and the private sector will take the lead in financing the construction and rehabilitation of productive infrastructure in the region.

A.I.D. will maintain and foster sound and focused safety net programs in the context of continued support for the Central Americans' macroeconomic policies and programs.

The U.S. Role and Objectives Will Change

The need for U.S. assistance to Central America will decline as recovery proceeds, as trade and investment flows to the region expand, and as other sources of multilateral and bilateral assistance increase.

In order to obtain the most productive use of more limited resources, Congress will need to agree to eliminate functional accounts and minimize earmarks of U.S. assistance to Central America.

A.I.D. will also streamline the programming process, including new sector assistance approaches.

C. TEN PRINCIPLES OF A.I.D.'S STRATEGY IN THE 1990s

With these premises serving as a framework, ten major principles will guide A.I.D.'s development assistance strategy in Central America during the 1990s:

1. A.I.D. will help Central Americans eliminate impediments to private sector-led trade, investment, and employment generation. The foregoing will require low inflation, macroeconomic stability and the further liberalization of international trade. To the degree that these efforts are successful, A.I.D. will gradually shift its focus from addressing macroeconomic constraints to helping to reduce barriers to growth in specific economic sectors, i.e. industry, agriculture, tourism, energy, and services such as finance.

2. Greater emphasis will go to supporting the development of democratic institutions and particularly to deepening and broadening participation in democratic processes.

3. To consolidate the democratic process, A.I.D. will emphasize programs to strengthen the judicial, legislative, and electoral systems through increased professionalism, heightened accountability, and civilian oversight.

4. Programs will be expanded to promote informed civic participation in public policy issues as a stimulus for open and responsive government.

5. The Central Americans, with A.I.D. assistance, will strengthen democratically-elected local governments through decentralization of real authority and resources.

6. Greater emphasis will be given to encouraging Central Americans to adopt economic policies, incentives, regulatory frameworks, and management practices which promote the protection and sustainable use of the natural resource base.

7. To help assure that a majority of Central Americans share in the benefits of a growing economy, A.I.D. will encourage governments to adopt policies and regulatory frameworks that will facilitate greater participation in the economy by the disadvantaged. A.I.D. will focus especially on policies designed to promote increased employment at the lower end of the economic spectrum where Central America has comparative advantages in labor costs.

8. A.I.D. will help Central American governments and the private sector improve the effectiveness, efficiency, financing, and local control of basic social services, thus increasing access to them and assuring their sustainability. Further improvements in the social service sectors will require increased national financing of public sector programs (in contrast to donor-funded service delivery) and broadening of private sector financing of quality health and other social service delivery wherever feasible.

9. Within the EAI and PDD frameworks, A.I.D. will more closely collaborate with other U.S. Government agencies, multilateral development institutions, and bilateral donors in helping Central Americans meet their political and economic development goals.

10. To reinforce the benefits of increased cooperation among the Central Americans, A.I.D. will support regional initiatives through regional and bilateral efforts to encourage regional dialogue and networking. Working with the Central Americans, A.I.D. will support initiatives such as promoting and strengthening intra-regional dialogue and interchange among Central American legislative representatives, including the possible emergence of a Central American Parliament; promoting liberalization of trade in goods and services within the region; facilitating the free flow of capital both intraregionally and between the region and the rest of the world, and supporting initiatives of special significance to the U.S. Government, e.g. counter-narcotics issues.

D. TARGETS FOR THE YEAR 2000

With adequate international support, Central America by the year 2000 can be a democratic, vibrant, and increasingly prosperous region. Specifically, the following targets appear attainable:

Democracy

- Free and open national and local elections will be the norm.
- Administrative and financial authority of local governments, including the power to generate revenues, will be increased, while that of central bureaucracies will decrease.
- Strengthened judiciaries will increase respect for the rule of law and human rights, and better protect the security of person and property.
- Legislatures will function effectively, and intraregional cooperation will increase through a Central American Parliament.
- The autonomy of the military in political and economic processes will be reduced.
- Civic participation in the democratic process will increase.
- The press and other communications media will be freer and more responsible.

Broad-Based, Sustainable Economic Growth

Central America will be a full participant in the world economy, with market-oriented economic policies that make possible steady increases in employment and productivity based on the region's comparative advantages. Government policies will reinforce a broadening of the economic base by improved access to quality basic education and health care in response to the democratically-expressed will of the people, by market-based policies that nurture entrepreneurs, small businesses, and agricultural producers, and by a legal framework that protects property.

Feasible indicators for measuring progress are shown in Chart I. Specific quantitative goals will be reflected in regional and country strategies and annual action plans, and adjusted as may be necessary in light of evolving circumstances. In this manner, it is feasible to account for and measure progress in each country. This is particularly important due to the diversity that exists in the region in the quality of life, conditions and prospects for economic growth, and the stability and development of democratic institutions.

While it is difficult to project goals ten years in advance, it is estimated that regional economic growth by the end of the decade should increase to 5% per year. Private investment as a percentage of Gross Domestic Product should increase from 13% to 19% region-wide, while nontraditional exports to countries outside the region are expected to increase from a baseline of $1.46 billion in 1990 to over $4.7 billion by the end of the decade. Infant mortality (per 1,000 births) should decrease from a 1990 baseline of 45 to about 37 region-wide. Communicable diseases susceptible to immunization control should be virtually eliminated by the end of the decade. The regional primary school completion rate is expected to rise from a 1990 baseline of 60% to over 70% in the year 2000.

III. STRATEGY OBJECTIVE NUMBER ONE: THE DEVELOPMENT OF STABLE DEMOCRATIC SOCIETIES

Support for and development of stable democratic societies in the countries of Central America constitutes the leading edge of A.I.D.'s strategy for the region. The strategy envisions a significantly expanded role in this area for field missions, including the Regional Office for Central American Programs (ROCAP). Working within the context of the USG country team, A.I.D. will work closely with other USG agencies to support nonpartisan efforts to deepen and consolidate indigenous democratic institutions. A.I.D. will focus on technical assistance and training, investing in human resources and the strengthening of local institutions, and will include democratic initiatives in its policy agenda.

Under the proposed strategy, A.I.D. will increase its financial resources for various democratic initiatives. These resources, particularly for strengthening local government, will need to be complemented by additional flows from other members of the donor community. However, support for democracy is not resource intensive. While external assistance is important, additional resources do not assure greater or more rapid progress. Success ultimately depends upon the political will and popular expectations of Central American societies.[2]

A. CONSTRAINTS

The following are the more salient constraints in varying degrees that restrain the growth of democratic values and institutions:

- Authoritarian history and political structure with tradition of military control and/or influence over government.
- Overly centralized public sector power with weak municipalities as well as weak traditions of support for human and civil rights.
- Lack of support for legislative, judicial, electoral, and political processes.
- Inefficient government institutions and widespread corruption.
- Lack of social, political, and economic pluralism and local participation; weak and unprofessional media.
- Government policies that reinforce the powerful and discriminate against disadvantaged groups.

B. PROGRAM STRATEGY

To address these constraints A.I.D. proposes a ten-point program under two broad areas of focus:

1. Strengthening government institutions to be more responsive to citizens and more democratic in operation.

2. Promoting democratic values among citizens through greater participation and influence of non-governmental and educational institutions and a free and professional media.

[2]See "Strengthening Democracy in Latin America and the Caribbean: U.S.A.I.D.'s Experience to Date and Plans for the Future", a presentation to the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD), Agency for International Development, Bureau for Latin America and the Caribbean, November 1990.

The first area focuses on the need for open, responsible and effective government, at both the national and local levels, to assure full application of the rule of law, the protection of individual rights, the holding of free and fair elections, the effectiveness of the legislative process, and the diminution of inefficiency and corruption.

The second area highlights the need to go beyond public institutions and formal processes to help stimulate pluralism and the growth of democratic values and traditions among the citizens at large. These efforts would build upon A.I.D.'s already extensive working contacts with non-governmental organizations, educational institutions, labor unions, the press, and community organizations to help develop stronger, more effective citizen participation.

1. Improve the administration of justice through increasing the independence, professionalism, and effectiveness of the judiciary and police.

Working through field missions and regional institutions, A.I.D. will support Central American efforts to:

- Upgrade judicial personnel, including judges, prosecutors, public defenders, clerks, and court administrators, through promotion of higher selection standards and the establishment of effective in-service training and continuing education programs for these key legal and management personnel;
- Establish and expand effective public defender systems;
- Modernize court and case management through professionalization of administrators and use of automated case management techniques;
- Establish and expand information systems on legislation in effect, past court decisions, and scholarly writing, including improved law libraries and documentation centers;
- Continue legal education for the private bar, with a particular focus on more active bar association involvement in justice system improvement.

2. Promote the exercise and protection of civil and human rights.

A.I.D. will support the work of the Inter-American Institute of Human Rights (IIHR), in human rights education in schools; rights of women, indigenous peoples, refugees and displaced persons; and training for human rights lawyers and activists. The civic education projects will include components that sensitize students or trainees to the obligations and duties of their governments in this fundamental area of applied democracy. A.I.D. missions will be sensitive to country human rights records when considering development portfolio composition and expansion.

3. Strengthen electoral processes and institutions.

The objective is to support and strengthen national electoral management bodies to assure that they are independent and professional. In the 1990s, A.I.D. will continue to help foster free and open elections through support for Center for Electoral Assistance and Promotion (CAPEL). CAPEL conducts research, widely distributes information about the electoral process, and provides networking activities and technical assistance to electoral courts and other institutions. Missions will seek to assist national electoral management bodies (electoral boards and tribunals). Policy dialogue will focus on the status of each national electoral process and its fair and non-partisan management.

4. ***Strengthen legislative processes and institutions.***

The aim of this program is to foster an open and accessible legislative process, assisted by a trained professional staff. Such elements as specialized standing committees and access to appropriate legal, economic, and technical expertise in the legislative process are to be stressed.

The initial focus will be on strengthening institutional capabilities to draft legislation, improving the analytical and management capacity through training, promoting research, and sustaining dialogue on major policy roles for national and local parliaments. Support will also be provided to activities that increase contact and cooperation among legislators in the region, as well as with their counterparts in the United States and Western Europe. Since an independent, professional legislative auditor general is important to ensuring that legislators can actively monitor government programs, A.I.D. will help train and strengthen the offices of the Comptrollers General in a number of Central American countries.

Finally, regional activities such as the Regional Federation of Central American Legislative Clerks and the proposed Central American Parliament will further establish and reinforce relationships among Central American legislative leaders and with their counterparts in the United States and Western Europe. A.I.D. will expand its support for additional efforts in these areas.

5. ***Strengthen elected local and municipal governments through decentralization of authority and control over financial and human resources.***

Most Central American leaders now realize that centralized national bureaucracies limit the ability to deliver services. There is also a growing recognition that centralized bureaucratic power is often anti-democratic since it limits citizen participation in the development process and encourages paternalism. Central American countries are working to create more responsive locally-elected governments which provide greater opportunities for citizens to participate in and more directly influence the development process.

The program will foster the empowerment of local governments through support for:

- revenue-sharing legislation;
- reform of the electoral processes;
- development of sound, equitable local tax bases and other local revenue sources;
- strengthening local government capacity to respond to local priorities and to deliver basic services; and
- other forms of municipal management training and technical assistance.

A.I.D. will also explore ways to help Central Americans:

- strengthen local government decision-making processes;
- encourage financial and administrative decentralization;
- strengthen local service delivery and maintenance capabilities; and
- enhance local revenue generation and cost recovery capabilities.

In developing these programs, A.I.D. will foster complementary and/or co-financing proposals with the Inter-American Development Bank (IDB) and the World Bank (IBRD) to provide the required capital financing, with A.I.D. financing technical assistance and training.

6. Promote honesty and efficiency in government through transparency of decision-making processes and heightened accountability of civil service structures.

This program will assist cooperating governments to assess their anti-corruption practices and procedures and support the design and implementation of financial management systems which improve the quality, reliability, timeliness, and credibility of financial information in the decision-making process. Working with other donors, A.I.D. will also undertake broader sectoral administrative and policy interventions to help improve host government development administration.

7. Support for civilian control of the police and the military and for demilitarization through encouragement of dialogue between civilian and military leaders, and promotion of civilian oversight of government.

Both the police and the military in most Central American countries have demonstrated a lack of civilian control and professionalism. This lack of civilian control has led to civil strife and human rights abuses. The U.S. country program will help promote greater judiciary-police cooperation through its legal assistance projects and coordinate with international organizations to facilitate multilateral assistance in this area.

Working with representatives of U.S. armed forces in U.S. Embassies in Central America, A.I.D. has a role to play in helping to further the dialogue between military and civilian leaders. A.I.D. will utilize both policy dialogue and project assistance for:

- integration of former military and police force members as productive civilians in the society;
- civilian scholars and policy specialists to acquire credible expertise in military affairs;
- legislatures to develop the institutional capacity to monitor military systems effectively and routinely; and
- civilian leaders to implement strategies to decrease military involvement in conflict resolution and build effective procedures for civilian control of military organizations.

8. Strengthen political parties and the party system.

Working through organizations such as the National Democratic and Republican Institutes and the National Endowment for Democracy (NED), A.I.D. will continue to support the strengthening of local political parties. NED is a private, non-profit organization established and funded by the U.S. Congress to promote democratic values and practices around the world, working with non-government organizations. When appropriate, A.I.D. will provide direct grants to NED for electoral and political party development, while carefully avoiding any involvement in or association with electoral campaigns or other partisan activity.

9. Promote and strengthen pluralism and civic participation through non-governmental organizations and leadership training.

The United States has a long tradition of supporting non-governmental organizations (NGOs) in the region. Support has been provided to technical NGOs working in specific sectors, humanitarian organizations, research institutes, labor unions and employee associations, community and municipal associations, business groups, cooperative organizations, and other groups. The continued sponsorship of a broad range of NGO activities will remain an important area for A.I.D. financing during the 1990s.

Of special note is the need to give attention to those civic groups and institutions working to assure citizen access to electoral, legislative, and judicial systems and helping people to acquire the knowledge, skills, and confidence needed for full participation in the democratic process. Special consideration will be given to financing NGOs active in civic and voter education programs and programs to strengthen judicial systems. The NGO programs will also focus on civic education curricula in the primary schools in order to teach basic citizen participation skills in a democratic context.

In 1985 A.I.D. launched the Caribbean and Latin American Scholarship Program (CLASP) to provide training in the United States to over 12,200 individuals from Central America as well as others from the Caribbean and South America. Most of this training is focused on the disadvantaged who are present or prospective leaders. The support to the CLASP program will continue through 1998. A.I.D. will also offer additional training opportunities for other individuals and leaders not covered by CLASP.

10. Promote alternative information sources, including a free and responsible press, other media, and social/economic research organizations.

In FY 1988 A.I.D. initiated a program to strengthen journalistic professionalism and improve mass media education and research capacities in Central America. This program will be expanded in the 1990s and will focus on training, creation of regional associations of media professionals and owners, strengthened and more appropriate university journalism education programs, and establishment of self-sustaining centers for mass media training in Central and South America, similar to some mass media training activities and programs already under way in A.I.D. population and child survival programs.

The program will continue to finance journalism education, with adaptation of U.S. textbooks to the Central American environment and long-term training in the United States in specially adapted journalism courses.

Through the Regional Technical Activities Center in Mexico, A.I.D. will continue to finance the translation into Spanish, and the sale to university students and the general public, of inexpensive U.S. textbooks in a variety of academic and technical subjects that would otherwise be unavailable. Political science and economics texts will be added to the available subjects.

IV. STRATEGY OBJECTIVE NUMBER TWO: THE ACHIEVEMENT OF BROAD-BASED, SUSTAINABLE ECONOMIC GROWTH

A. RECOGNIZING THE FLAWS IN THE OLD MODEL

The sharp decline in Central America's per capita GDP in the late 1970s and early 1980s was due to a combination of unfavorable external economic events, civil war, and insurgency in several countries, and economic policies that inhibited the ability of market forces to respond to opportunities offered by the world economy. Gradually, the Central American countries have come to realize that the old economic model--a hybrid based on traditional agricultural exports and regional import substitution within the framework of the Central American Common Market--was not sustainable.

The import-substitution model exacerbated already significant income inequalities by rewarding inefficient industries that did little to provide opportunity for growing labor forces. The differential protection of industry also diminished incentives for agricultural production and investment and limited both food production and exports. This fed the political unrest that erupted violently in Nicaragua, El Salvador, and Guatemala. The unrest, combined with poor economic policies, led to substantial capital flight and dramatic declines in private investment. Likewise, the model aggravated the deterioration of the region's natural resource base that was already underway because of population growth and lack of attention to environmental concerns.

B. PROMOTING THE NEW MODEL

There is now a widespread recognition throughout Central America, and in developing countries generally, that small countries especially must adopt more market-oriented, market-directed economic policies if they are to achieve rapid, sustainable economic growth. There is also a greater awareness that accelerated economic growth is essential to poverty alleviation. Economic growth does not guarantee rapid poverty alleviation, nor does it automatically take care of environmental problems. But it makes both of these tasks easier, especially if it places greater reliance on market forces by eliminating subsidies and controls that have benefitted primarily the wealthy, and when policies are adjusted to overcome "market failures" that produce environmental deterioration and thus threaten long-term economic growth.

A more broad-based, sustainable model for economic growth is essential to strengthen the democratic gains made in Central America during the 1980s. Reform of the policy environment, while critical to achieving vigorous private sector-led growth, is not sufficient. Non-policy constraints are also a major hindrance to growth and include: lack of infrastructure, poor market information and linkages, insufficient technology development and transfer, and undeveloped financial markets. During the 1990s, the Central American public and private sectors must improve the efficiency of free market activities and social service delivery systems, create more sustainable and less donor-dependent social programs, and develop domestic funding sources to support and further expand investment, public services and economic infrastructure.

The adoption of economic policies designed to stabilize and diversify the exports of Central American economies provides an opportunity for A.I.D. to build upon previously successful efforts to accelerate private sector-led growth focusing on agriculture, small business, and export industries and improve the delivery of social services that economic growth makes possible. In doing so, A.I.D. will increasingly work with other U.S. Government agencies involved in other aspects of the trade and investment programs under the Enterprise for the Americas Initiative.

C. CONSTRAINTS

Though progress has been made over the past six years, the constraints to economic growth and the widespread benefits that emanate from growth (in some cases excluding Costa Rica) are:

- Tax, foreign trade and credit policies that continue to discourage investment and labor intensive production.
- Macroeconomic policies that result in debilitating inflation and devaluation.
- Policy, legal, regulatory, administrative, and technical barriers to the free flow of goods, services, and investment capital within countries, among the Central American countries themselves, and between the region and the rest of the world.
- Lack of adequate transportation, communications, power, and other infrastructure in support of trade and investment.
- Despite progress in privatization, the continued existence of inefficient state enterprises dependent on government subsidies for survival and large, costly and overly centralized national bureaucracies in charge of social and other public service delivery. .
- Poorly functioning financial markets, inefficient state financial institutions, and inadequate levels of long-term financing for private sector investment.
- Legal and regulatory obstacles to the establishment of small enterprises and protection of property and asset rights of low income groups.
- Rapid population growth.
- Continuing low levels of productivity of land and labor and inadequate and inappropriate technology development and transfer..
- Inequities in access to the factors of production by the agricultural sector as a whole vis a vis the industrial sector as well as within the agricultural sector.
- Poor quality of instruction and lack of textbooks and educational materials and supplies leading to educational inefficiencies.
- Inadequate and inefficient resource mobilization and allocation for social services and infrastructure.
- Lack of appropriate or adequately enforced environmental protection and management policies, laws, and regulations, and lack of awareness of environmental problems and potential solutions.

D. PROGRAM STRATEGY

To address the constraints identified above, A.I.D. proposes a ten-point program under three broad areas of focus:

1. Stimulate private sector trade and investment through regional and bilateral policy reforms efforts and programs.

2. Encourage greater opportunities for increased participation in the economy by the disadvantaged.

3. Encourage policies, incentives, regulatory frameworks and management practices which promote the preservation and sustainable use of the natural resource base.

These three areas of focus underscore the interrelationship of macroeconomic policies, trade and investment initiatives, promotion of access to jobs and social services for the disadvantaged, and conservation and proper management of the environment.

1. *Further liberalize external and intraregional trade in goods and services.*

Central American countries have already reduced maximum import tariffs from the 80-200% range to the 20-40% range. The evident success of these reductions in stimulating trade and employment, and President Bush's encouragement of free trade in the region, should make further progress feasible. A.I.D.'s approach will involve several elements:

- policy dialogue at both the country and regional level, linking U.S. assistance to continued progress;
- support for regional organizations, both private and public, that will further this goal;
- continued macroeconomic and sectoral policy improvement at the country level, particularly for stable market-determined exchange rates and open access to foreign exchange to facilitate movement of capital within Central America; and
- continued effort, through sector- and project-level interventions, to address procedural and regulatory impediments to the free flow of goods, services and capital.

A.I.D efforts to support improved investment policies will enable host countries to gain access to investment and debt relief benefits under the EAI. A.I.D. will complement these efforts by working with the Office of the U.S. Trade Representative (USTR) to help liberalize treatment of products of special interest to Central America.

2. *Strengthen private-sector organizations promoting trade and investment and cooperate with other U.S. Government trade and investment promotion efforts.*

Central American export and investment promotion organizations which A.I.D. has supported have proven to be important both in helping to generate additional foreign investment and exports and in influencing governments to eliminate obstacles to growth in trade and investment. It is anticipated that A.I.D. support for some of the activities of these organizations will continue to be required while they attempt to become as self-sufficient as possible. A.I.D. will continue to provide support for those national export and investment promotion organizations it has helped create within the region and will encourage more host government, other donor and private financing for existing and future institutions.

Both in countries where A.I.D. has traditionally supported national export and investment promotion organizations, and in other countries - especially those where A.I.D. will be initiating new trade and investment programs - A.I.D. will seek opportunities to support local associations, chambers of commerce and other private organizations which represent and serve the interests of local businesses in various sectors of activity (agribusiness, commerce, industry, etc.). Support for specific trade and investment activities of these organizations will help them serve as bridges between their private business membership and U.S. and other foreign businesses interested in trade and investment. Two-way trade and transfer of technology can be facilitated by such organizations when U.S. business representatives, on trips organized by the Departments of Commerce and Agriculture, use these to make contact with local businesses. A.I.D. will also assist such organizations to access market information sources in the U.S. and other markets and to provide other services to their members. A.I.D. cooperation with such organizations for specific activities will also help strengthen their capabilities to promote government policies that improve the business climate.

A.I.D. and local private sector organizations it supports will intensify cooperative efforts with the Department of Commerce, the Overseas Private Investment Corporation (OPIC), the Export-Import Bank (EXIM), and the Department of Agriculture (USDA) to attract U.S. business to the Central America region. These efforts will be complemented by business outreach programs in the United States. The Latin America and Caribbean Business Development Center, created by the Department of Commerce and A.I.D., will be the focal point for these outreach programs.

3. *Reform fiscal systems by improving tax structures and administration, improving efficiency of government service delivery, and privatizing state-owned productive enterprises.*

The public sector must continue to play a key role in development, but structural improvements are needed. Excessive fiscal deficits constitute the major source of inflationary pressure and prevent private sector access to credit. In addition, these deficits contribute to the non-competitive financial markets and related capital flight.

A.I.D.'s strategy is to:

- use technical assistance and policy dialogue (together with the International Financial Institutions (IFIs)) to reduce distortionary tax systems, simplify tax administration, and improve enforcement.
- encourage implementation of tax programs which do not rely on tariffs to fund government budgets.
- use sectoral assistance to help reduce the cost and improve the quality of social services;
- promote reductions in public-sector payrolls through policy dialogue and technical assistance, and where appropriate, support for severance pay.
- continue efforts to privatize government enterprises through policy dialogue and technical assistance, and encourage capital support from the IFIs.

4. *Strengthen the ability of the financial sector to mobilize domestic resources and channel them efficiently to the most productive sectors of the economy, and continue to promote access to outside sources of long-term investment capital.*

Financial sector reform requires greater reliance on market forces in allocating resources, and greater pressure on financial institutions to mobilize domestic savings. In the past A.I.D. has sometimes dealt with these problems through temporary expedients -- directed lines of credit, central bank rediscounting, loans for specific activities, subsidized sources of financing -- that do not resolve the underlying problems.

A.I.D. will concentrate on strengthening domestic financial incentives for attracting and efficiently allocating financial resources. This will require support for privatization of financial intermediaries, decontrol of interest rates, support for establishment of cross-border financial institutions in the region, and promotion of capital markets.

A.I.D. will assist potential investors to gain access to external sources of long-term investment funds, including the IDB Investment Fund to be established under the EAI, Section 936 funds, OPIC financing and guarantees, and A.I.D. guarantees.

5. Stimulate agricultural production and trade through removal of macroeconomic and sectoral policy constraints; promoting technology improvements; reducing tenure insecurity; and promoting agribusiness development and trade linkages with US and neighboring markets.

Misguided macroeconomic policies have a disproportionate effect on incentives for investment in agriculture. These macroeconomic policy constraints are exacerbated by the sectoral policy distortions of pricing and market controls. A major focus of A.I.D.'s policy dialogue and support for policy reform will be to correct these negative policies. These policy reforms will increase demand for improved production and post-harvest technology, increased agribusiness inputs, and a more rational allocation of credit to farmers to acquire these inputs.

This strategy will also support institutional reforms encouraging private sector driven technology generation, adaptation, and transfer, private sector provision of inputs, and reform of the financial sector. It will also focus on upgrading productive market information and linkages between traditional and non-traditional small producers with modern agribusiness processors, exporters, and marketers.

To address tenure insecurity A.I.D. will support both legal reforms and simplification of procedural aspects of land registration.

6. Increase investment in infrastructure, market information systems and networks, education and training, and technology development and dissemination.

As economic recovery proceeds and nontraditional exports expand, bottlenecks in infrastructure, skills and technology will emerge. To deal with these issues A.I.D. will link skills training to requirements by promoting close ties between training institutions and private employers.

Under this strategy, A.I.D. will also seek institutional improvements that better utilize existing infrastructure, such as:

- increasing competition among ports in Central America by easing the difficulties of moving goods intended for trade among countries;
- increasing competition in transport by deregulating trucking and increasing access by additional carriers to airports through "open skies";
- reducing paperwork and procedural requirements for movement of goods and services;
- encouraging demand-driven technology development and dissemination; and
- stimulating sustainable public and private support for improving energy policy, planning, and conservation.

Where appropriate, technical assistance will be provided in the development of viable infrastructure initiatives while seeking capital support from the private sector and the IFIs.

7. *Increase participation in income-generating opportunities by segments of the society previously isolated from the economic system.*

Substantial opportunities for poorer segments of society should result from improved trade and investment policies. The growth in demand for labor resulting from increased use of comparative advantage should particularly favor unskilled workers, gradually eliminating the supply of underemployed workers. Nevertheless, more direct efforts will be undertaken to speed this process. These include:

- support for small and microenterprises through innovative credit and technical assistance activities in both urban and rural areas;
- policy dialogue on impediments to the integration of the informal sector in the economy, with technical assistance from experts in the region; and
- support for diversification by small scale agricultural producers through innovative credit and technical assistance activities.

8. *Increase access to basic education and improve the efficiency of the education system.*

A.I.D. will:

- help countries address education sector constraints through support for review and reform of fiscal and financial allocation policies affecting spending on basic education in both the public and private sectors.
- encourage decentralization, curriculum reform, and other policy and institutional reforms designed to improve both educational content and administrative efficiency.
- encourage increased investment in basic education as a percentage of total government expenditures.
- provide assistance to review legal changes needed to sustain private school systems and to encourage greater private sector support for basic education.
- increase, dramatically, its support for sustainable vocational and management education programs geared to productive employment.

9. *Increase access to basic primary health care, family planning, and nutrition services by the poor and improve the efficiency of those delivery systems.*

A.I.D. will:

- support policy and institutional reforms to help governments and NGOs reduce costs and expand access to basic preventive health and family planning services by improving management and administration and by shifting priority for public financing to cost-effective primary and preventive care.
- help governments, working with the IFIs and other donors, explore ways to mobilize alternative sources of financing through cost recovery, cost sharing, privatization, insurance schemes, and, where appropriate, targeted tax schemes.
- help explore the use of debt swap arrangements to support sustainable provision of family planning services through NGOs.
- look for ways to help remove constraints on resource mobilization and investment by the private sector in commercial provision of health and family planning services.

- continue to support development of private-sector service delivery and education mechanisms such as social marketing, use of the media, HMO models, innovative insurance and group health schemes.
- help governments, working closely with the IDB, encourage increased investments designed to expand water and sanitation coverage.
- emphasize creative sector policy and program approaches to consolidate many of the gains that have been made in the region and to assist governments to develop sustainable, decentralized social service delivery systems. Promote increased use of low cost paramedical personnel to provide basic health services.
- gradually reduce its support for commodity and other resource transfers for direct delivery and focus more on policy and systemic reforms, leading to long term sustainable delivery mechanisms.

10. Promotion of sound environmental laws and regulations which are effectively enforced and rational management of natural resources by the public and private sectors to ensure long-term sustainability and high economic return.

A.I.D. will:

- intensify its efforts to engage indigenous NGOs to work on environmental concerns.
- encourage creative programs such as debt-for-nature swaps to increase the role of the private sector in protecting and maintaining the natural resource base and limit the role of public agencies to policy-making, regulatory functions and support for investments in critical infrastructure and research.
- concentrate its investment in the following technical areas of environmental concern:

a. Sustainable agriculture

A.I.D. will:

- help NGOs and governments develop policies, laws, and programs; particularly those affecting land use, and those required to encourage sustainable agricultural practices including soil and water conservation and adoption of farm based tree crops.
- work with regional- and local-level institutions to develop, disseminate, and encourage the use of conservation technologies and minimize pesticide contamination.
- strengthen public and private institutions working in integrated crop protection methods and pesticide regulation and management, through regional initiatives.

b. Sound forestry management

A.I.D. assistance will:

- focus on policies and mechanisms for control of tropical and pine forest management plans and other policies, e.g., sale and pricing of standing timber.
- assist Central American institutions in the management of selected areas of existing natural forest with high production potential, and in the sustainable production of forest products, water conservation, and other environmental benefits.

c. **Management of wildlands and protection of biological diversity**

A.I.D. will:

- support and strengthen programs to consolidate and manage, on a sustainable basis, legally declared national parks and reserves.
- assist public and private agencies to prepare practical plans for the management of priority wildlands and will help develop facilities and services needed to control visitors' access to wildlands.
- strengthen institutional capacity to plan and manage coastal development.

d. **Management of critical watersheds**

A.I.D. will:

- encourage policy measures that call for users to pay for the costs associated with the management and conservation of water supplies.
- assist landowners, farmers, and community groups to carry out needed conservation practices in priority watersheds, including water storage/distribution structures, land purchase, fencing, and monitoring of water quality and runoff.
- support environmental education to increase public awareness of coastal resources.

e. **Control of urban pollution**

A.I.D. will:

- promote greater private-sector responsibility for resolving problems of solid waste management and water and air pollution through analysis of policy and regulatory reforms, technical assistance, and feasibility studies.
- look to the U.S. private sector to provide technical assistance and training in industrial pollution control and occupational health and safety.
- collaborate and develop pilot projects, working with the World Bank, the Environmental Protection Agency (EPA), and the IDB, to demonstrate cost effective approaches to reduce air and water pollution in urban areas.

V. STRATEGY OBJECTIVE NUMBER THREE: THE ATTAINMENT OF EFFECTIVE REGIONAL COOPERATION

A. REGIONALISM AND MULTILATERALISM

Consistent with the EAI approach and PDD framework, the A.I.D. strategy is a regional one that supports the political and economic interdependence of the Central American countries. A regional strategy implies not only working with regional groups, but also focusing on regional issues and concerns in our bilateral relations to further the shared regional objectives of democracy and growth. Coordination with other donors--Canada, the European Community, Japan, and Latin American countries such as Venezuela and Mexico--will be strengthened through the PDD framework.

The Central American Common Market (CACM) and its associated regional institutions made important contributions to Central American economic growth and development during the 1960s. Over the past two decades, however, the weaknesses of the import substitution model upon which the CACM was based became evident, with lower growth and fewer efficient investment possibilities. Moreover, regional institutions played a progressively less influential role, and regional cooperation likewise became progressively weaker until Central American efforts to achieve a peaceful solution to the region's conflicts reversed this trend toward the end of the 1980s.

The election of a market-oriented government in Nicaragua has led to renewed interest in common solutions to regional economic problems. There is growing interest in accelerating the recent revival of intraregional trade, not as a substitute for exporting to markets outside the region, but as a complement to it. Recent exchange rate and tariff reforms in the individual countries have reduced the obstacles to intraregional trade. In June 1990, at Antigua, Guatemala, the Presidents of the Central American countries--including Panama as an observer--adopted a Central American Economic Action Plan for strengthening intraregional integration and cooperation. This trend was given further impetus by the adoption of a specific work plan and calendar in the December 1990 Declaration of the Central American Presidents following their summit meeting at Puntarenas, Costa Rica.

B. CONSTRAINTS

Despite a revived spirit of intraregional cooperation, and the reversal of a long, sharp decline in intraregional trade, there remain significant constraints to effective regional cooperation:

- Key institutions--notably SIECA (the Common Market Secretariat) and CABEI (the Central American Bank for Economic Integration)--are financially weak because of individual countries' failures to meet their designated financial contributions to these institutions and, in the case of CABEI, member governments' arrears in repaying loans.
- Regional institutions are excessively dependent on external resources, especially from A.I.D., whose levels cannot, and should not, be sustained.
- Managerial and technical capabilities of some regional institutions are weak, partly but not entirely because of their financial problems.
- Honduras and Nicaragua have long felt that the benefits of regional economic integration during its heyday were distributed unequally, and will want to be reassured that any new integration efforts provide for a more equal distribution of benefits. Panamanian participation in selected regional initiatives may also prove problematical.
- Although exchange rate realignments have largely removed a major obstacle to increased intraregional trade, quantitative restrictions remain in the form of customs procedures, transport regulations, and other controls preventing goods and services from moving freely between countries. In addition, some intraregional trade continues to be subject to tariffs.

C. PROGRAM STRATEGY

1. *Forum for Central American regional dialogue.*

The overall theme of this strategy is to support the broad objectives of the Declarations of Antigua and Pantarenas through:

1. development of democratic societies,
2. achievement of broad based economic growth, and
3. the attainment of regional cooperation.

A priority for achieving this third objective is the expansion of regional cooperation relating directly to the first two objectives. A.I.D. will support a series of programs to:

- provide fora for discussion of specific regional cooperation initiatives,
- share information,
- exchange experiences, and
- foster a convergence of policies in the region.

Examples of appropriate themes include:

- the exchange of legislative information among country legislators and other elected representatives,
- municipal development and the deepening of local democratic institutions, and
- mobilization of domestic investment and intraregional financial flows.

2. *Strengthening regional institutions and reducing their dependence on A.I.D. resources.*

A.I.D. recognizes the important role of some regional institutions in addressing a range of regional concerns. Nevertheless, over the period of the strategy, regional institutions will assume greater responsibility for their own core budgets. A.I.D. will assist these institutions to pursue other means of financing including other donor, endowment, and self-financing mechanisms. The strategy anticipates that regional institutions will become independent of U.S. aid.

While reducing its financing of core costs, A.I.D. will work with regional institutions where possible on specific tasks consistent with the Central Americans' development agenda. ROCAP will take the lead in implementing A.I.D.'s strategy to promote sustainable regional institutions that will no longer depend predominantly on A.I.D.'s resources.

3. *Studies and policy dialogue supporting trade liberalization.*

A.I.D., in cooperation with the international financial institutions and other bilateral donors, will encourage additional policy, legal, and other reforms to further liberalize trade within Central America. ROCAP will undertake more economic analyses including trade, market, and financial analyses to assist the countries to increase intraregional trade and financial flows. ROCAP will work with the missions and countries to stimulate the convergence of sound economic policies and promote a future regional free trade zone.

4. *Sectoral programs.*

Sectors in which A.I.D. will seek to strengthen or initiate regional programs include the following:

a. **Trade infrastructure**

A.I.D. will support joint private and public-sector efforts to identify key infrastructure bottlenecks inhibiting investment and trade. Specific needs include improvements in port handling/processing facilities and modernization of key channels leading to ports. While A.I.D. financial and technical resources preclude much in the way of financial support for construction activities, A.I.D. can play an important role by supporting studies, technical assistance, training, and policy dialogue.

b. **Energy**

This is another sector in which resources are appropriately concentrated on efforts other than the financing of physical infrastructure. Issues that will be addressed through other types of assistance include strengthening of regional grid operations; movement toward a common rate structure; privatization; co-generation; expanded use of geothermal and small hydroelectric plants; and expansion of rural coverage.

With rapid economic growth, energy production and distribution will be a significant constraint to further expansion. Working through regional mechanisms, A.I.D. will help the countries through technical assistance, training, intraregional dialogue and information exchange to improve energy policies, planning and conservation, and encourage appropriate intraregional energy sharing and access.

c. **Social sectors**

A.I.D. will also take advantage of opportunities provided by the Central American governments to implement programs in the social sectors within a regional framework. One such opportunity is provided by a new regional initiative, "Health and Peace for Development and Democracy," adopted in 1990 by the Ministers of Health of the Central American countries. A.I.D. will support this regional initiative, thus helping to consolidate progress made during the 1980s in expanding access to basic maternal-child health and nutrition services and child survival interventions. The emphasis will be on mechanisms to assure the sustainability of these programs.

d. **Environment and natural resources**

A.I.D is now supporting regional cooperation in addressing Central America's environmental and natural resource problems under the RENARM project. The new spirit of cooperation in the region, and growing awareness of the importance and interdependent nature of environmental and natural resource problems, will provide additional opportunities for A.I.D. to support regional programs in this area.

VI. MANAGEMENT AND RESOURCES

A. ORGANIZATIONAL RELATIONSHIPS

1. U.S. Government Coordination and Implementation Framework

The A.I.D. strategy is consistent with stated U.S. policy and Central American initiatives. In order for the strategy to work, close coordination with other U.S. Government agencies is required. For example, with respect to the EAI, A.I.D. will work closely with USTR, USDA, and Commerce on trade opportunities (e.g., the Latin American and Caribbean Business Development Center), with Treasury and the IDB on investment and debt reduction, and with State and EPA on programming local currency for environmental activities.

Within the PDD framework, A.I.D. will provide staff support for the consultative process. Close coordination will be maintained with the Peace Corps, USDA, USTR, the Department of Justice, the Department of Defense, the Department of Health and Human Services, and other agencies with which A.I.D. has already established relations in the region.

2. Regional Coordination within A.I.D.

To enhance coordination and more effectively integrate bilateral and regional programming, a new management oversight structure will be established for A.I.D.'s Central American programs. The Assistant Administrator will chair a steering committee to be comprised of the directors of A.I.D. missions, ROCAP, and the office of Central American Affairs, with ROCAP serving as the Executive Secretariat. The Committee will convene semi-annually to review overall priorities, address region-wide issues, and prepare inputs for the PDD and regional Consultative Group processes.

3. Regional Approaches

With its field presence and long experience in the region, ROCAP is in a unique position to assist in fostering regional cooperation in areas of concern to the Central Americans and the United States. ROCAP can provide a regional forum for information dissemination, technical support and program assistance to stimulate a harmonization of policies with respect to major issues such as trade, investment, energy and municipal development.

While ROCAP is only tangentially involved with the present portfolio of democracy strengthening initiatives, under the new strategy it will be assigned three important responsibilities. First, ROCAP--in consultation with bilateral missions and the A.I.D. Latin America and Caribbean Democratic Initiatives Office--will develop terms of reference and retain specialized "requirements" contractors similar to ROCAP's existing contract in the export sector. Where appropriate, technical assistance would be provided for "common theme" programs, such as judicial and legislative reform and development. Such an approach to the provision of technical assistance and information sharing would reduce administrative workload requirements for participating missions. Specialized contractors would be in an excellent position to facilitate communication and networking among country counterpart institutions, and through this process foster the development of shared values and approaches among Central Americans.

Second, ROCAP will be charged with managing a range of "common theme" training programs within the region, in the United States and other countries. ROCAP will contract with firms or institutions specialized in training which would be responsible for curriculum development and participant administration. Missions would use these contracts to access required expertise or training programs according to country priorities. This aspect is important since most Missions will be short on staff to handle the administrative workload implicit in the Democratic Initiatives program.

Finally, ROCAP will coordinate with Central American A.I.D. missions in helping to implement the PDD. This role will be particularly important as donor dialogue intensifies and opportunities for joint or parallel donor activities emerge at the regional or country level.

B. MANAGEMENT CONSIDERATIONS

1. Managing Shifts in Workload

In order to accommodate anticipated declines in funding and staff levels, and in recognition of the expanded role of other donor financing in the region, A.I.D. plans to change its mode of implementing projects and concentrate its programs both in terms of sectors and number of initiatives it manages. While the strategy calls for increased use of non-project assistance in support of economic growth activities, expansion of the democracy and environment programs will partially offset staff savings from a sector approach. Reductions in both technical and administrative functions will be sought through increased use of regional implementation mechanisms.

The strategy's greater emphasis on strengthening democracy will require increased coordination with other U.S. government agencies and some change in the technical orientation of A.I.D. staff. A.I.D. will work closely with the State and Justice Departments in the implementation of the democracy portfolio and will take the initiative, where appropriate, for policy, operational, and accountability functions associated with the program. A.I.D. will intensify and deepen in municipal development under the DI program.

2. Need for Congressional Restraint

More effective program concentration will require greater funding flexibility to respond to the region's expressed needs and more program accountability to demonstrate the impact of the program on these needs. This requires relief from cross-cutting earmarks and functional accounts that do not easily reflect the growth and democracy foci of this strategy. A.I.D. proposes relief from the rigidities of traditional functional accounts to permit the increased allocation of resources based on the objectives of this strategy and the performance of the recipient towards these objectives. With increased programming flexibility, A.I.D. will be better positioned to engage other donors in increasing their financing for complementary programs in the region.

C. RESOURCES

During the 1984-90 period, the Central American countries were heavily dependent upon U.S. economic assistance to pay for imports and to finance investment. The capacity of the Central American countries to meet their own development needs and to obtain external resources from non-U.S. Government sources has increased significantly since 1984, however, and this dependence should continue to decline during the 1990s. In addition, the return of peace to the region should increase the productivity of investment, particularly by eliminating the substantial requirements for replacement of guerrilla-damaged infrastructure. The principal sources of foreign exchange are export earnings, private capital flows and official assistance.

Export Earnings

Though traditional exports from the region continue to stagnate because of low world prices, the rapid growth of nontraditional exports is increasingly providing the foreign exchange needed to meet resource requirements. Nontraditional exports rose from $423 million in 1983 to $1.3 billion in 1990, and have the potential to rise to $4 billion by 1996, if outward-oriented economic policies continue to be implemented. This will reflect a fundamental economic transformation. In 1984, nontraditional products accounted for only 12% of total exports outside Central America. By 1996, they could represent nearly half. This export diversification should improve the stability of export earnings and increase productive employment, as well as provide the basis for greater economic dynamism and production of exports with more favorable world market prospects.

Private Capital

Private capital flows are also likely to be substantially more positive during the 1990s than during the 1980s. The gradual decline in the military conflict in El Salvador, the establishment of democratic governments in Nicaragua and Panama, and the generally improved economic policy frameworks throughout the region can be expected to stimulate larger private capital inflows, both from foreign investment and from return of flight capital from the 1980-84 period.

After substantial net outflows during 1980-84, private capital began flowing into the region in 1985-89, averaging about $300 million per year. Continued sound economic policies could raise this average perhaps to $500 million per year by 1996.

Other Donor Assistance

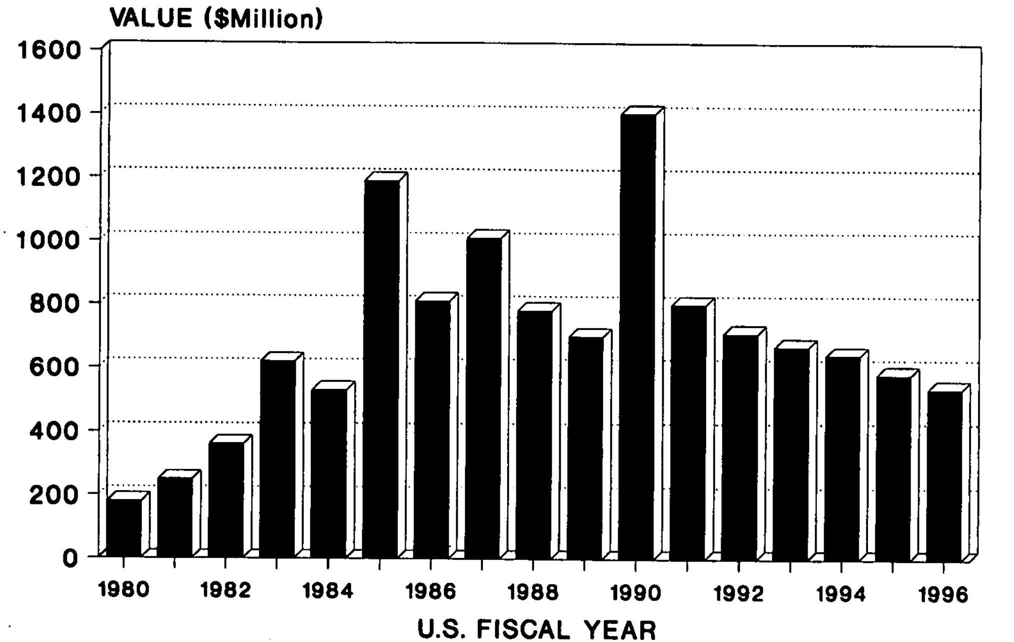
Other donor assistance to Central America, particularly from the multilateral agencies, is expected to be substantially larger during the 1990s than during the 1980s. Net disbursements during 1984-90 from the IMF were negative $400 million, and from the IBRD were only about $200 million. For 1991-96, net flows with the IMF should be about zero, for the region has substantially reduced its indebtedness to the Fund. With continued good policies, gross disbursements of funds from the World Bank and the Inter-American Development Bank should more than double during 1991-96 from the past six years. A modest increase in other bilateral donor flows can also be expected during the 1990s.

U.S. Assistance

The developments discussed above should permit a gradual decline of U.S. assistance to the region, consistent with the goals of rapid economic growth and democracy deepening outlined above. Chart II provides a notional trend for A.I.D. flows over the 1991-1996 period, consistent with continued progress in these areas and expected flows from other sources. A.I.D. assistance would decline from $810 million in 1990 (excluding $420 million in extraordinary assistance to Panama) to $430 million by 1996, for a total of $3.2 billion in 1991-96. This would be a decline from $6.2 billion in 1984-90. Over $1 billion of the this assistance during 1991-96 would be expected to flow to Nicaragua, which was excluded from U.S. assistance during 1984-1989. For the four countries included in the Central American Initiative during 1984-89, the decline would be from $6 billion in 1984-90 to $2 billion during 1991-96.

The projected A.I.D. flows of $3.2 billion, complemented by other projected resource flows, should lead to a growth rate of slightly above 5% by 1996. Because of the numerous assumptions and projections required for such modelling, the results can only be notional. Numerous factors--world coffee prices, trends in the overall world economy, productivity of investment, and economic policy generally--could substantially change the projected resource requirements. With the projected flows to Central America from other sources, the A.I.D. share of total resource availabilities would be expected to steadily decline during the 1990s. From a level of 44% of the total availabilities in 1984, the A.I.D. share would fall to 16% in 1996.

A.I.D. ASSISTANCE TO CENTRAL AMERICA
1980-90 Actual, 1991-96 Projected



Note: A.I.D. assistance was not provided to Panama from 1987 to 1989. A.I.D. assistance was not provided to Nicaragua from 1981 to 1989. These two countries accounted for about one-half of A.I.D. assistance to Central America in 1990 and Nicaragua is expected to be the largest single recipient in 1991 and future years.

III. TRADE AND INVESTMENT IN THE CARIBBEAN AND CENTRAL AMERICA

U.S. FOREIGN TRADE AND INVESTMENT POLICY IN THE CARIBBEAN BASIN REGION

by Vladimir N. Pregelj *

CONTENTS

INTRODUCTION

In most aspects, the U.S. policy on foreign trade with and private investment in the countries of the Caribbean Basin does not differ substantially from comparable policy in effect with the world at large or, in the context of Caribbean Basin countries as less developed countries, with the Third World. That is to say that whatever the policy on the basis of which the United States conducts its foreign trade and investment relations with the nations of the world applies, with a few exceptions, equally to the Caribbean Basin countries. Nevertheless, the geographic proximity of the Basin to the United States and particularly the concerns arising from its lively political and underdeveloped economic conditions have prompted the United States to implement several economic measures which accord preferential treatment to the Caribbean Basin countries, primarily in the area of foreign trade.

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TRADE POLICY

Trade policy of the United States toward the countries of the Caribbean Basin, [1] with one major and several small exceptions, has not differed substantially from the basic manner in which U.S. trade relations have been conducted with the rest of the world. Thus, virtually all Caribbean Basin countries are accorded by the United States most-favored-nation treatment in trade and—being without exception developing countries—are eligible for and most have been designated beneficiaries of the generalized system of preferences (GSP). Virtually all have access to export credits extended or guaranteed by the U.S. Government's export credit agencies. Within the U.S. export control regime, they are part of the country group subject to the least restrictive export control policy. The main—and significant—exception to this general trade policy has consisted of the special tariff treatment accorded to these countries since 1984 under the Caribbean Basin Initiative (CBI) program.

GENERALLY APPLICABLE PROVISIONS [2]

Most-Favored-Nation Treatment

The United States accords most-favored-nation (nondiscriminatory; MFN) treatment in trade to its trading partners in three, often overlapping, ways. One is by means of a bilateral compact (e.g., a "friendship, commerce, and navigation" or similar treaty, or an executive trade agreement) in which MFN status is accorded reciprocally. Another way, somewhat broader in its reach, is through being a party to the General Agreement on Tariffs and Trade (GATT), which, as a rule, carries with it the obligation of according MFN treatment to all other GATT members. The broadest way is the U.S. general statutory policy of extending MFN treatment, with some exceptions, to all trading partners on the basis of U.S. legislation, first enacted in 1934 and now contained in section 126 of the Trade Act of 1974 (19 USC 2136).

Bilateral treaties containing reciprocal MFN clauses are in force with only two Caribbean Basin countries: Costa Rica, and Honduras, respectively, since May 26, 1852, and July 19, 1928. [3] The United States has a GATT-based reciprocal obligation to extend most-favored-nation treatment to and, in turn, receive it from the following independent Caribbean Basin countries, signatories of the GATT: Antigua and Barbuda, Barbados, Belize, Costa Rica, Cuba, [4] Dominican Republic, El Salvador, Guatemala, Guyana, Haiti, [5] Ja-

[1] In the context of this paper, the Caribbean Basin encompasses the Central American states, Guyana, Suriname, and Caribbean islands, whether independent or not, except for U.S. possessions.

[2] It is not the intent of this section to discuss the trade provisions of general applicability in complete detail, but only to the extent that they are particularly relevant to U.S. trade policy toward the Caribbean Basin countries as a whole or individually.

[3] A third treaty, with Nicaragua, which entered in force on May 24, 1958, was terminated effective May 1, 1986, as a part of sanctions imposed on Nicaragua.

[4] United States' obligation under the GATT to accord MFN treatment to Cuba was, however, in effect nullified by the imposition by the United States of a total embargo on trade with Cuba as of February 7, 1962. Cuba's MFN status was, furthermore, specifically suspended by law as of May 24, 1962.

[5] As in the case of Cuba, a U.S. embargo imposed on November 5, 1991, on virtually all imports from Haiti has in effect nullified current application of MFN treatment to Haiti, although

Continued

maica, Nicaragua, Suriname, and Trinidad and Tobago, as well as several former dependencies to which the GATT applies *de facto* on the basis of the accession to the GATT of their former colonial home-country, the United Kingdom, namely: Bahamas, Dominica, Grenada, St. Christopher (Kitts) and Nevis, St. Lucia, and St. Vincent and the Grenadines.

General statutory MFN treatment under section 126 of the Trade Act of 1974 applies to all Caribbean Basin countries (whether CBI beneficiaries or not) except Cuba. Cuba's MFN status was suspended [6] effective May 24, 1962, by section 401, Tariff Classification Act of 1962 (76 Stat. 78), which defined Cuba as a country controlled by international communism and as such subject to the suspension of MFN status required by section 5, Trade Agreements Extension Act of 1951 (65 Stat. 73). The suspension is currently maintained in effect by section 401, Trade Act of 1974 (19 USC 2431), and General note 3(b), Harmonized Tariff Schedule of the United States (HTS) (not codified). Provided the embargo on trade with Cuba is lifted, Cuba can regain its MFN status either under the provisions of Title IV, Trade Act of 1974, upon compliance with the freedom-of-emigration amendments of the Trade Act (19 USC 2432, 2439), conclusion of a bilateral trade agreement (19 USC 2434, 2435) and its approval by the Congress (19 USC 2437), or by specific legislation.

Generalized System of Preferences

The GSP is a system implemented by developed countries in the early 1970s with the intent of fostering export-oriented industrialization and diversification of developing economies by unilaterally extending preferential tariffs to their imports from the latter. The coverage of the products involved, the conditions under which the preferences apply and their extent (elimination or partial reduction of the generally applicable duties) vary from one donor country to another.

In the United States, the establishment and administration of a generalized system of preferences was authorized on January 3, 1975, by Title V of the Trade Act of 1974, subsequently amended several times (19 USC 2461-2465). The system was put into effect on January 1, 1976, to terminate on January 3, 1985, but was later extended through July 4, 1993 (sec. 505(a); [7] 19 USC 1465(a)). The system provides duty-free treatment to a vast array of imports (excepted are products specifically listed as ineligible in the law, or determined by the President as import sensitive) from developing countries designated as "beneficiary developing countries" (BDCs). The eligibility of an article for the preference or of a country for being designated a BDC is subject to specified conditions and limitations. One such limitation is the "competitive need" provision, under which imports of an otherwise eligible article from an individual country lose their duty-free status if the value of such imports exceeds a specified absolute (in terms of dollars) or relative

neither Haiti's MFN status nor the preferences applicable to Haiti have been formally suspended.

[6] Also suspended was preferential trade agreement with Cuba of 1947, and preferential agreements of 1902 and 1934 were terminated.

[7] Unless otherwise specified, statutory provisions referred to in this (GSP) part of the report by section designation are those of the Trade Act of 1974, as amended.

(in terms of total imports of the article) level (sec. 504(c); 19 USC 2464(c)).

Since all Caribbean Basin countries are considered by the United States as developing countries—Haiti even as a least-developed developing country (LDDC)—all of them, whether independent or dependent, except Cuba (as a Communist country subject to strict trade sanctions), were designated initially as BDCs of the U.S. GSP (E.O. 11888, 40 FR 55276). In addition, as of March 31, 1982, the countries of the *Caribbean Common Market* [8] were designated, pursuant to section 502(a)(3) (19 USC 2462(a)(3)), as an association of countries to be treated as one country for the purposes of the GSP (E.O. 12354, 47 FR 13477). Several later changes in the BDC designation of individual countries took place for various reasons. *Haiti* was included in the list of least-developed developing countries, which, since July 4, 1985, have been exempt pursuant to section 504(c)(6) (19 USC 2464(c)(6)), added by the Trade and Tariff Act of 1984, from the "competitive need" limitations on preferential treatment (E.O. 12542, 50 FR 27409). Upon separation from the Netherlands Antilles, *Aruba* was individually designated a BDC effective January 1, 1986 (Proc. 5458, 51 FR 12681). *Nicaragua's* BDC designation was terminated effective March 5, 1987, pursuant to sections 502(b)(7) and 504(a) and (b), because of Nicaragua's failure to afford its workers internationally recognized worker rights (Proc. 5617, 52 FR 7265); denial of BDC status is still in force. [9] GSP preferential treatment was denied, as of April 9, 1988, to *Panama* under section 802(a) (19 USC 2492(a)) [10] because of Panama's failure to cooperate with the United States in preventing international drug traffic and transactions (Proc. 5779, 53 FR 9850); Panama's BDC status was restored on March 17, 1990, after democracy was restored to Panama and the President determined that Panama did adequately cooperate in controlling international drug traffic (Proc. 6103, 55 FR 7685). Consequently, Cuba and Nicaragua are the only Caribbean Basin countries formally excluded altogether from the benefits of the U.S. GSP. In addition, five otherwise GSP-eligible products from three Caribbean Basin countries (Bahamas, Dominican Republic, and Guatemala) are at present ineligible for the preference under the "competitive need" limitation.

Other Relevant Import Provisions

Substantial imports from CBI countries take place under the *"offshore assembly"* provision (subheading 9802.00.80.50) of the HTS (before January 1, 1989, item 807.0050 of the former Tariff Schedules of the United States (TSUS)). Under this provision, imported articles assembled (but not otherwise processed) in any country in whole or in part from U.S.-origin components are exempt from duty on the value of such components. This provision is particularly useful for reducing the duty cost of imports that do

[8] Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Christopher-Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago.

[9] Nicaragua, however, is a designated beneficiary of the Caribbean Basin Economic Recovery Act notwithstanding an identical "worker rights" condition for designation under that law, which was waived.

[10] See: "Other Relevant Import Provisions," below.

not qualify for the GSP or the CBERA preference (e.g., textile apparel).[11]

Similar to but much less used than the "offshore assembly" provision is one (HTS 9802.00.60; formerly TSUS 806.30) under which *articles of base metals*, originating in the United States, *sent abroad* for processing and processed there, and *returned to the United States* for further processing are dutied only on the value of foreign processing.

At the opposite side of the import-policy spectrum are measures adversely affecting U.S. imports. Besides restrictive measures specifically included in preferential programs (GSP and CBI), discussed elsewhere, the generally applicable Section 802 of the Trade Act of 1974 (19 USC 2492), enacted by the Anti-Drug Abuse Act of 1986, can restrict imports by requiring the President to apply *tariff and other economic sanctions* to any major drug-producing or drug-transit country that does not fully cooperate with the United States in controlling production or international traffic in *illicit drugs*. The major of these sanctions—which can be applied in combination with each other—are: denial of any type of preferential tariff treatment (including specifically GSP and CBERA) of imports from such country, substantial increases in regular duty-rates thereon, and suspension of the country's air carriers' authority to engage in transportation to and from the United States.[12]

Export Controls[13]

The restrictiveness of U.S. export controls, reflected in the number of articles whose exportation must be approved by a specific validated license but even more so in the policy and criteria of the Bureau of Export Administration for granting such approval, varies according to the "country group" in which a foreign country is placed by Export Administration Regulations. A large number of commodities may be exported to most countries under various general licenses; excepted are exports to the countries subject to an embargo (Cuba, North Korea, and Vietnam) or to severe export restrictions (Libya, often also South Africa).

Caribbean Basin countries, except Cuba, are placed for export control purposes in a group together with the rest of the Western Hemisphere countries (except Canada, virtually no exports to which are subject to controls). Validated licenses are required for exports to this country group (as well as to the group containing all countries other than members of the former Warsaw Pact, and countries under embargo or severe export restrictions) only with respect to specified, strategic commodities. Since the main purpose of this type of export control is to prevent reexport of strategic goods to countries under more severe restrictions, licenses are as a rule readily approved. The latter may not be the case with regard

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[11] For a special variant of this provision, applicable only to textile apparel manufactured in CBI countries, see: "*Special Access Program*" in the section, "Other Relevant Measures," below.

[12] As noted earlier, this authority was used in 1988 to suspend temporarily Panama's status as a BDC of the GSP.

[13] This section is but a sketchy presentation of the basic elements of the export administration system as it applies to the Caribbean Basin countries. For a detailed description of the entire system, see Export Administration Regulations (15 CFR Parts 768–799), particularly the special country policies and provisions described in Part 785.

to licenses for the same commodities destined to countries in other groups, encompassing Libya and most former Warsaw Pact members, the approval of which is considered on a case-by-case basis. Cuba, subject to a trade embargo, is placed in the same country group with North Korea and Vietnam, where virtually all exports require validated licenses which are, as a matter of policy, usually denied (15 CFR 785.1(a)). Within the export control program, Cuba also shares with North Korea the designation as a country that has repeatedly provided support for acts of international terrorism (15 CFR 785.1(b)) and is subject to export controls applicable specifically to countries of that type.

Export Credit

Export credit facilities of the U.S. Government, essentially the Export-Import Bank of the United States (Eximbank) and the Commodity Credit Corporation, are available for financing exports to any Caribbean Basin country except Cuba. Like the restoration of MFN treatment to Cuba, mentioned earlier, Cuba's access to U.S. Government credit facilities is contingent on Cuba's compliance with the requirements of the freedom-of-emigration amendments of the Trade Act of 1974 (19 USC 2432, 2439) (but not on the restoration of MFN status itself), or to the enactment of specific authorizing legislation. In addition, Cuba is specifically excluded from access to the Eximbank's credits and credit guarantees by section 2(b)(2) of the Export-Import Bank Act of 1945 (12 USC 635(b)(2)), which has, together with similar earlier versions enacted since 1964, prohibited any Eximbank credit operations connected with exports to any Communist (later expanded to "Marxist-Leninist") country, unless the President determines that such action is in the national interest and reports each determination to the Congress. The statute contains a list of countries to which the prohibition specifically applies, among them Cuba. The President also is authorized to determine whether any listed country has ceased to be Marxist-Leninist and thus no longer within the purview of the prohibition, and is required to report each such determination to the Congress.

CARIBBEAN BASIN INITIATIVE AND RELATED MEASURES

In a February 1982 speech before the Organization of American States, President Reagan proposed a comprehensive program "to promote economic revitalization and facilitate expansion of economic opportunity in the Caribbean Basin region." A legislative measure combining a tariff preference system, investment incentives, and enhanced foreign assistance was transmitted to the Congress on March 17, 1982, and eventually enacted in a somewhat reduced scope as the Caribbean Basin Economic Recovery Act (Title II—Caribbean Basin Initiative, P.L. 98-67), Subtitle A of which provided for a system of tariff preferences for most imports from eligible Caribbean Basin countries. Subsequently, other provisions according special benefits to imports from CBI countries were enacted or promulgated by regulation.

Caribbean Basin Economic Recovery Act

The tariff preference authorized by the Caribbean Basin Economic Recovery Act (CBERA) (Title II, secs. 201-218, [14] P.L. 98-67, as amended; 19 USC 2701-2706) is the principal element of the U.S. trade policy that focuses specifically on the Caribbean Basin countries [15] and the centerpiece of the Caribbean Basin Initiative (CBI). Enacted on August 5, 1983, and implemented effective January 1, 1984, by Proc. 5133 (48 FR 54453), the law has been subsequently amended several times, most notably by the Caribbean Basin Economic Recovery Expansion Act of 1990 (popularly referred to as "CBI II")(Title II, Customs and Trade Act of 1990; P.L. 101-382). This amendment added several improvements to the original law and made the program—initially slated to remain in force through September 30, 1995—permanent.

The CBERA authorizes duty-free importation from countries designated as CBERA beneficiaries of any article, except textiles and apparel subject to textile agreements, canned tuna, petroleum and its products, and watches and watch parts containing any material originating in countries without MFN status (sec. 213(b), 19 USC 2703(b)). [16] In addition, the 1990 amendment, with effect on May 21, 1992 (Proc. 6428, 57 FR 19363), authorized a preferential reduction in duty rates (rather than outright duty-free status) for footwear, handbags, luggage, flat goods, work gloves, and leather apparel—articles initially ineligible for the duty-free preference (sec. 213(h); 19 USC 2703(h)). The new preference consists of a 20-percent reduction of the regular (MFN) duty rates in effect on December 31, 1991, staged over 5 years beginning January 1, 1992. The reduction on any item, however, may not exceed 2.5 percent ad valorem, or, for items that would become subject to Uruguay Round reductions, be more than 1 percent ad valorem greater than that reduction.

By declaring that such products may not be treated as foreign articles, or as subject to duty, the 1990 amendment also authorized, in section 222, in effect, duty- and quota-free importation from CBI beneficiaries of any article (except a textile article, apparel article, or petroleum, or petroleum product) that has been assembled or processed entirely from components, or processed entirely of ingredients (other than water), that are a product of the United States (U.S. Note 2(b) to HTS Chapter 98, Subchapter II).

The eligibility for the CBERA benefits has been limited by statute (sec. 212(b); 19 USC 2702(b)) to 27 countries, encompassing all

[14] Unless otherwise specified, statutory provisions referred to in this part of the report by section designation are those of the CBERA, as amended.

[15] Trade benefits very similar to those of the CBERA have been enacted by the Andean Trade Preference Act (Title II, P.L. 102-182, December 4, 1991, 19 USC 3201-3206) for Bolivia, Colombia, Ecuador, and Peru.

[16] Eligible product coverage of the CBERA preference is substantially broader than that of the GSP. They differ mainly in that under the CBERA all products except those specifically excepted by statute are eligible for the preference and have been so designated; under the GSP, on the other hand, eligibility and designation are denied not only to those specific import-sensitive products or broader product categories that are spelled out in the law (several of which are also ineligible under the CBERA) but also to "any other articles which the President determines to be import-sensitive in the context of the Generalized System of Preferences" (19 USC 2463(c)(1)(G)). Another significant difference between the two preferences is the general absence in the CBERA of the "competitive need" provision.

Caribbean Basin countries except Cuba.[17] In order to participate in the program, however, an eligible country must also be designated by the President as a beneficiary on the basis of a set of criteria and conditions. These are very similar to those on which the designation of a country as a BDC of the GSP is based.

At present, 24 countries are designated beneficiaries of the CBERA. Twenty countries (*Antigua and Barbuda, Barbados, Belize, British Virgin Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Panama, St. Christopher and Nevis, St. Lucia, St. Vincent and the Grenadines,* and *Trinidad and Tobago*) were designated at the inception of the program effective January 1, 1984 (Proc. 5133, 48 FR 54453, and Proc. 5142, 49 FR 341), and the *Bahamas* were added to the list on March 14, 1985 (Proc. 5308, 50 FR 10927). As of January 1, 1986, the date of its becoming independent from the Netherlands Antilles, *Aruba* became an individually designated CBERA beneficiary (Proc. 5458, 51 FR 12681), and *Guyana* was added with effect on November 24, 1988 (Proc. 5909, 53 FR 47487). *Nicaragua*, earlier subject to U.S. trade sanctions, was authorized such designation by section 241 of the Customs and Trade Act of 1990 (104 Stat. 665) for the duration of 1990, but was granted permanent designation under the regular designation procedure effective November 13, 1990 (Proc. 6223, 55 FR 47447), after the President waived, on November 29, 1990, in the national security interest of the United States, Nicaragua's ineligibility for CBERA beneficiary status under the "worker rights" exclusion (55 F.R. 49499). Meanwhile, *Panama's* designation as a CBERA beneficiary was withdrawn as of April 9, 1988, at the same time and for the same reason as its designation as a BDC of the GSP (Proc. 5779, 53 FR 9850) and similarly restored as of March 17, 1990 (Proc. 6103, 55 FR 7685) (see section on GSP, above).

Four countries eligible by law (Anguilla, Cayman Islands, Suriname, and Turks and Caicos Islands) have not formally requested CBERA designation and have not been designated as beneficiaries.

The President is authorized to withdraw or suspend the beneficiary status of any country, or withdraw, suspend, or limit the application of the duty-free treatment to any article of any country, if such country is found not to be in compliance with all of the conditions required for designation as a CBERA beneficiary or in violation of some other related provision.[18]

An import qualifies for the preference if it was produced in the CBERA country of exportation and at least 35 percent of its value has originated in that or any other CBERA country (including also value originating in Puerto Rico or the U.S. Virgin Islands), but up to 15 of the 35 percent also may have originated in the United States.

Special rules apply to imports of sugar and beef products. Duty-free treatment of these products is contingent on the beneficiary country's submitting a satisfactory stable food production plan en-

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[17] The separation of Aruba from the Netherlands Antilles as an independent country, in practice, increased the number of eligible countries to 28 as of January 1, 1986.

[18] See, for example, withdrawal of Panama's designation as a CBERA beneficiary described above, and section on "Other Relevant Import Provisions."

suring that the food production and nutritional level of the country will not be adversely affected by increases in the production of sugar and beef products for export in response to CBERA tariff benefits (sec. 213(c), 19 USC 2703(c)).[19]

U.S. imports of sugar, syrups, and molasses from CBERA beneficiaries are, furthermore, subject to other provisions contained in the CBERA as well as to general sugar-import rules.[20]

Qualified imports from Caribbean Basin countries of sugar within the quotas are free of duty.[21] In order to protect the sugar price-support program, they are, however, subject to the same "competitive need" limitation that applies to imports of any article under the GSP; consequently, duty-free status of sugar imported from a CBERA country is suspended if its imports from that country exceed certain relative or absolute ceilings, a contingency, however, not likely to occur. Alternatively, a CBERA country can, upon request, be allocated an absolute but duty-free quota instead of having duty-free status of U.S. imports of its sugar products suspended under the "competitive need" provision. This choice does not apply to three Caribbean Basin countries (Dominican Republic, Guatemala, and Panama) whose exports of sugar to the United States in 1981 exceeded the competitive need limits and which have been allocated specific absolute, duty-free quotas. Any duty-free, absolute quotas may be suspended or increased upon the recommendation of the Secretary of Agriculture.

Since sugar is an important export article for CBI countries, U.S. sugar import policy plays an important role in their trade with the United States. Much to the disadvantage of the CBI countries, therefore, has been the gradual substantial reduction of the overall U.S. sugar import quota. When the quota was still absolute (prior to October 1, 1990), it had already been cut by two-thirds of its 1983–84 level of 3.2 million short tons. Under the tariff-rate quota system, the global quota was set at 1,725,000 metric tons (1,901,500 short tons) for the 1990/1991 crop year; this was reduced to 1,385,000 metric tons (1,526,700 short tons) for the 1991/1992 crop year. Since about 37 percent of the global quota (507,365 metric tons in 1991/1992) is allocated to 14 sugar exporting CBI countries,[22] the cutbacks in the global quota have also adversely affected sugar imports from the CBI beneficiaries.

Attempting to address this situation through a special preference for the CBI countries, one of the improvements proposed in the

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[19] Under this provision, sugar and beef products of Antigua and Barbuda, Montserrat, Netherlands Antilles, St. Lucia, and St. Vincent and the Grenadines are not eligible for CBERA duty-free treatment (General note 3(c)(v)(D)(1), HTS).

[20] Provided in Additional U.S. note 2 to chapter 17 of the HTS and contained in Additional U.S. notes 3 and 4 to that chapter.—The overall sugar import program (regulating U.S. imports of sugars, syrups, and molasses), as revised as of October 1, 1990 (Proc. 6179, 55 FR 38293), consists of tariff-rate quotas, where above-quota imports from any country are subject to duties at full rates 25.6 times the concessional (MFN) rate, making such imports prohibitive and the tariff-rate quota tantamount to an absolute one. These tariff-rate quotas replaced the earlier equivalent absolute-quota system, which was found to be violative of U.S. obligations under the GATT and had to be discontinued.

[21] Imports of quota sugar are duty free also under the GSP.

[22] *Cuba's* quota, once by far the largest of all, was drastically cut back in 1960, and reduced to zero in 1961. On September 26, 1983, *Nicaragua's* annual sugar quota, set at 2.1 percent of the global quota, was reduced from 58,000 short tons to 6,000 short tons (5,443 metric tons); full quota was restored on April 25, 1990. *Panama's* quota (2.9 percent of the total) was suspended by law as of January 1, 1989, but restored as of January 29, 1990.

Caribbean Basin Economic Recovery Expansion Act of 1990 called for a guaranteed aggregate minimum quota allocation for the CBI countries as a group, enhanced by pro-rata allocations of unutilized or suspended country-quota allocations. The provision was subsequently dropped as presumably violative of U.S. obligations under the GATT waiver of the CBERA program.

Special duty-free treatment also applies to *ethyl alcohol (ethanol) and ethanol mixtures used as fuel or in the production of fuel, or suitable for such use.* Imports of such ethanol have been subject since January 1, 1981, and of such ethanol mixtures since January 1, 1987, in addition to their basic duty, to a duty at first set at 10 cents per gallon but after several upward and downward changes now assessed at 14.27 cents per liter (about 54 cents per gallon). This duty is to expire on October 1, 2000. [23]

Under the CBERA (but not under the GSP), nonbeverage ethanol and ethanol mixtures (except gasohol) in general are duty free. Since January 1, 1987, duty-free treatment under the CBERA has also applied under specified conditions to ethanol fuel products subject to the additional duty if they are "indigenous" products of the exporting country. The definition of an "indigenous" product in this context encompasses not only products produced entirely in the exporting country, but also certain quantities of such products dehydrated there from imported hydrous feedstocks if dehydration takes place in facilities of the kinds defined in precise detail in the statute. The first 60 million gallons, or 7 percent of the U.S. domestic market (whichever is greater), of such ethanol product produced in a CBERA country and imported into the United States are treated as an indigenous product even though it contains no local feedstock; the next 35 million gallons qualify if they contain at least 30 percent local feedstock, while imports of anything over 95 million gallons must contain at least 50 percent local feedstock. [24]

Since ethanol is not duty free under the GSP, its exemption from duty under the CBERA, particularly of fuel-grade ethanol under the "indigenous product" provision, represents a real tariff advantage for the CBI countries, which, moreover, provides for an alternative use of sugar cane. The prime beneficiary of this exemption has been Jamaica, which has in recent years been accounting for 80 percent and more of ethanol imports from CBI countries (mostly fuel-grade ethanol dehydrated from imported feedstock); most of the balance of CBI-origin ethanol comes from and is entirely produced in Costa Rica.

Assessment of the CBERA

The broad statutory product coverage of the CBERA (all products except those ineligible by law) is somewhat deceptive as an indication of the program's actual or even potential effectiveness as a stimulant of exports of CBI countries to the United States. This can be attributed mainly to the circumstance that a large array of im-

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[23] Sec. 1161, Omnibus Reconciliation Act of 1980, P.L. 96-499, 94 Stat. 2695; at present, HTS subheading 9901.00.50.

[24] Sec. 423, Tax Reform Act of 1986 (P.L. 99-512), as amended by sec. 1910, Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418); sec. 7, Steel Trade Liberalization Program Implementation Act (P.L. 101-221); and sec. 225, Caribbean Basin Economic Recovery Expansion Act of 1990 (Title II, Customs and Trade Act of 1990; P.L. 101-382); 19 USC 2703 note.

ported products cannot be affected by the CBERA preference, mostly because they already are free of duty under other tariff provisions, but also because of the statutory ineligibility of certain products for the duty-free treatment.

As Table 2 shows, over one-half of the total value of U.S. imports from CBI countries as a group has been exempt from duty either under the regular tariff regime, or under the GSP, or under some special provision, including therein also the duty-free portion of products assembled abroad at least in part from U.S.-origin components ("Item 807" imports), which largely consist of textile apparel, ineligible for CBERA duty-free treatment. Moreover, between 43 and 45 percent of total value of U.S. imports from CBI countries has in recent years been accounted for by products ineligible for the CBERA duty-free preference (mainly, petroleum products, and textile apparel).[25] In any event, these exclusions leave a relatively limited share of U.S. imports from CBI countries amenable exclusively to the benefits of the CBERA.

A further factor to be taken into account in evaluating the net trade effect of the CBERA (i.e., export stimulation attributable solely to the CBERA) is the fact that all CBERA beneficiaries are also GSP beneficiaries and that many imports taking place under the CBERA could also take place under the GSP.[26] The actual imports attributable to CBERA alone, hence, are likely to be significantly lower than imports shown in the statistics as having taken place under the CBERA.

With these qualifications in mind, data in Table 2 suggest that, in CBERA's first year (1984), CBERA duty-free imports represented a genuine increase in imports of CBERA-eligible products as well as accounted for the largest share of the increase in overall duty-free as well as nonpetroleum imports. This increase was brought about by the expansion (compared with the GSP) under the CBERA of the list of eligible products, and by the less restrictive (again compared with the GSP) criteria for individual transactions or country eligibility.

Data in Table 2, however, suggest also that in the years since 1984, particularly in the early part of the period, much of the increase in CBERA imports could be substantially attributed to the shifting of utilization of the respective preference from GSP to CBERA for imports of products eligible under both, since virtually all GSP-eligible products are also CBERA-eligible.

Several statistical data support this view. Substantial cross-utilization of the two preferential systems is suggested, for example, by the fact that the combined duty-free imports under both preferences have remained, with some fluctuations, within the $1.0 to $1.2 billion range until 1988 (with some apparently real increases registering thereafter). Furthermore, substantial changes have occurred in the annual utilization ratios (value of actual imports ±

[25] If the distorting effect of imports of petroleum products (see Footnote 30) on overall trade with the area is disregarded and only nonpetroleum trade is taken into account, the share of CBERA-ineligible imports in total imports is significantly reduced (to about one-third) while non-CBERA duty-free imports account for about two-thirds of the total.

[26] However, articles eligible under either program whose GSP duty-free status has been suspended with respect to individual countries under the "competitive need" provision qualify for such status only under the CBERA.

value of eligible imports x 100) of the GSP program after the implementation of CBERA with clearly complementary changes in the utilization ratios of the CBERA preference. The GSP utilization ratio, 56.3 percent in 1983 (i.e., before CBERA), dropped to 26.9 and 28.4 percent, respectively, by 1989 and 1990, while the CBERA utilization ratio, 35.3 percent in 1984, reached a high of 53.8 percent in 1987 and settled at 47.9 percent in 1990. [27]

According to U.S. International Trade Commission's estimates for the years 1988–1990, a relatively small percentage (respectively, 37.5, 36.5, and 41.3) of imports under CBERA could be attributed exclusively to that preference. [28] Such "net" CBERA imports accounted, respectively, for 4.9, 5.0, and 5.6 percent of total U.S. imports from CBI countries, and for 5.9, 5.9, and 6.8 percent of such nonpetroleum imports.

These facts and observations suggest that, although "the CBERA has proven to be a success in many regards" [29] and significant increases have been registered in some new or nontraditional U.S. imports under the preference (e.g., GSP-ineligible frozen orange juice, and ethanol; GSP-eligible jewelry, and medical instruments) from selected countries, the CBERA and other related provisions have as yet not brought about substantial improvements in the overall export position of CBERA countries vis-a-vis the United States and, indirectly, in the diversification, restructuring, and/or expansion of Caribbean economies as a whole. Nor does it appear that CBERA imports have grown faster than other imports from CBERA countries.

Trade data in Table 2 show, for instance, that the growth of imports under the CBI duty-free provisions (CBERA, including articles eligible also under GSP, and "Super 807"), in absolute terms, has been smaller than that of nonpetroleum [30] CBERA-ineligible imports, the former having increased, between 1983 and 1990, by $1,339 million and the latter by $1,648 million, suggesting that the effectiveness of the CBERA might need some improving. The same need is suggested by Congressional concerns that resulted in the enactment of the Caribbean Basin Economic Recovery Expansion Act of 1990, with some additional trade benefits for the CBI countries and, more importantly, significantly enhanced future value of

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[27] U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: First Report, 1984–1985.* USITC Publication 1897. Washington, September 1986. p. 1-15; *Sixth Report, 1990.* p. 2-13.

[28] U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: Sixth report, 1990.* USITC Publication 2432. Washington, September 1991. p. 3-2. (Hereinafter referred to as: USITC. *Sixth Report*).

[29] U.S. Congress. Senate. Committee on Finance. *An act to make miscellaneous and technical changes to various trade laws; report [to accompany H.R. 1594].* 101st Cong., 2d sess., Senate report 101-252. Washington, U.S. Govt. Print. Off., 1990. p. 41.

[30] Imports of petroleum and its products have been excluded from this comparison mainly because of the peculiarities of world petroleum trade. Demand for petroleum is price-inelastic, its world prices tend to move in unison, much of the trade (particularly U.S. imports from the Caribbean) is of intra-company nature, and, hence, decisions as to sourcing of imports may be influenced by noncommercial considerations and result in substantial fluctuations in the level of imports from any particular source. The almost 75-percent drop in the value of U.S. imports of Caribbean petroleum between 1983 and 1986 and the resulting 30-percent drop in total U.S. imports from the CBI countries (see Table 2), for instance, would result in an exaggerated upward bias in the growth of the share of CBERA imports in total imports from the area and possibly misleadingly attribute to the CBERA an overly great effectiveness. In addition, while petroleum imports account for a large share of U.S. imports from the CBI countries as a group, they originate almost entirely in only three CBI countries: Bahamas, Netherlands Antilles, and Trinidad and Tobago.

the program by making it permanent and thereby creating greater business certainty as a basis for future operations and increased investment.

On the negative side, the effectiveness of the program is being adversely affected by the gradual erosion of the CBERA competitive edge in consequence of several parallel developments. The competitive advantages of the CBERA (and also the GSP) preference will be diminished by the lowering of regular duty rates expected to result from multilateral negotiations of the Uruguay Round, which will reduce the tariff differential that CBERA beneficiaries now enjoy with respect to countries without U.S. trade preferences. The enactment on December 4, 1991, of the Andean Trade Preference Act, providing virtually identical benefits as the CBERA and its implementation with respect to Bolivia and Colombia as of July 22, 1992, with the possibility of being extended to Ecuador and Peru, has all but equalized the competitive ability of those countries with that of the CBERA beneficiaries. The prospective implementation of the North American Free Trade Area will not only eliminate CBERA's competitive edge with respect to Mexico but, particularly in the long term, place the latter in a better competitive position by eventually eliminating all duties. [31]

Other Relevant Measures

After the original CBERA program was implemented, several other trade benefits were extended to the CBI countries through *measures outside the CBERA legislation.*

CBI countries, for instance, are the exclusive beneficiaries of a special variant of the "offshore assembly" provision of the U.S. tariff law. The *Special Access Program* (also dubbed "Super 807" because of its former tariff classification 807.0010, now HTS 9802.00.80.10), implemented on June 11, 1986 by regulation (51 FR 21208), applies, subject to specified conditions, to imports of textile apparel assembled in a CBI beneficiary from fabric *formed as well as cut* in the United States. In addition to benefiting from the special duty treatment for articles assembled offshore, apparel falling under this provision may be imported outside the import quotas applicable to regular apparel imports, up to bilaterally negotiated—and readily renegotiable—guaranteed access levels (GALs). GAL agreements are in effect with Costa Rica, Dominican Republic, Guatemala, Haiti, and Jamaica.

Imports from CBI countries have been exempted from the payment of the *customs user fee*, provided for by section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (19 USC 58c(b)(8)(B)(iii)). The fee is charged at a rate of 0.17 percent ad valorem (with a $21 floor and $400 ceiling for each entry) to compensate for the cost of processing formal entries of imported merchandise by the U.S. Customs Service.

Except for the import-sensitive products ineligible by law for duty-free treatment under the CBERA preference, CBI countries

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[31] The impact of NAFTA on the apparel industry in CBI countries (whose growing exports to the United States accounted in 1990 for almost one-third of total nonpetroleum exports to the United States) is explored in a recent study by the U.S. International Trade Commission:*Potential effects of a North American Free Trade Agreement on apparel investment in CBERA countries.* USITC Publication 2541. Washington, July 1992. 74 + 17 p.

are being accorded (since February 1986 and through September 30, 1995) the benefits of the GATT Agreement on *Government Procurement* although they are not parties to it (51 FR 6964 and 7660). Beneficiaries of this Agreement are entitled to compete for procurement bids valued over 150,000 SDR (approximately $210,000) tendered by U.S. executive agencies (with some exceptions) on equal basis with U.S. firms (i.e., without the Buy American preference being accorded to competing U.S. firms).

The *Caribbean Basin Economic Recovery Expansion Act of 1990* ("CBI II") also enacted several provisions, amending legislation other than the CBERA, but applicable exclusively to CBI countries.

A special *cumulation provision in countervailing and antidumping investigations* of imports from CBI countries (19 USC 1677(7)(C)(iv)(II)) was added to the countervailing and antidumping statutes. In determining injury in such cases, the U.S. International Trade Commission generally must cumulatively assess the volume and effect of imports from two or more countries of like products subject to the investigation if they compete with each other and with the domestic products in the U.S. market. In the cases involving CBI countries, such cumulation is limited only to those products that originate in the CBI countries under investigation and, therefore, is less likely to result in a finding of injury and, hence, in the assessment of the respective compensatory duty.

In the HTS, a new subheading (9804.00.70) was added providing for a more favorable *duty-free allowance for U.S. residents returning from abroad* in the case of returnees from any CBI country. The earlier general allowance of $400 has been increased to $600 for returnees from CBI countries, thus giving the latter a $200 advantage over third countries. The CBI allowance also includes one additional liter of alcoholic beverages duty- and excise tax-free if produced in a CBI country. [32]

INVESTMENT POLICY

While enhanced investment, particularly foreign investment (the main source of which would presumably be the United States), is clearly necessary for the overall economic development of the Caribbean Basin countries and particularly for achieving the stated purposes of the CBI, the CBERA contains no direct incentives for stimulating U.S. private investment in the Basin. An income-tax credit for U.S. direct private investments in the Caribbean Basin contained in the original CBI proposal was dropped during the legislative process. There are, however, two income tax provisions that indirectly and less effectively provide incentives for U.S. investment in the Caribbean Basin. Consequently, the driving forces behind any actual CBI-connected stimulation of private investment in the CBI countries are basically—and indirectly—the perceived prospects for expanded business brought about by the Caribbean Basin tariff preference.

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[32] The provision also increased to $1,200 the earlier $800 allowance for returnees from U.S. possessions, and, hence, increased the advantage of U.S. possessions over CBI countries as well as over non-CBI countries. In either case (CBI or U.S. possession), $400 of the allowance can originate in third countries.

On the other hand, U.S. private investment in the Caribbean Basin countries (whether or not beneficiaries of the CBI) with the exception of Cuba, is eligible for insurance, guaranties, and other support available for "less developed friendly" foreign countries from the U.S. *Overseas Private Investment Corporation (OPIC)*. Since OPIC statutes are part of U.S. foreign assistance legislation, the prohibitions on providing foreign assistance to Cuba, first enacted in 1962, apply also to OPIC operations. Thus, all foreign assistance is denied to "the present [i.e., 1962] government of Cuba;" the denial applies also to any other government of Cuba until steps have been taken to return to U.S. citizens and entities, or to compensate them for, property taken by the Castro regime (22 USC 2370(a)). Cuba is also on the list of Communist countries to which U.S. foreign assistance is denied unless the prohibition is waived by the President under specified conditions (22 USC 2370(f)).

OPIC's investment insurance and guaranties are available only in countries with which the United States has concluded investment guaranties agreements, which provide for eventual compensation by the foreign country of OPIC's payments on claims for covered losses occurring in that country. In the Caribbean Basin, OPIC's programs are available in most CBI designated countries as well as in CBI-eligible but nondesignated Anguilla; they are not available in CBI-designated British Virgin Islands, Haiti, [33] and Montserrat, in CBI-eligible but nondesignated Cayman Islands, Suriname, and Turks and Caicos Islands, nor in CBI-ineligible Cuba.[34]

A specific, if indirect and limited, incentive for investment in CBI countries is provided in *section 936* of the Internal Revenue Code (26 US 936). That statute allows, under specified conditions, a *tax credit* on incomes of U.S. corporations derived from active conduct of business in a U.S. possession. The Tax Reform Act of 1986 expanded the scope of the provision to income derived from investment in a financial institution in Puerto Rico also to the extent that the institution itself invests in active business assets or development projects in a qualified Caribbean Basin country (26 USC 936(d)(4)).

In order to qualify for this type of investment, a country must be a designated CBERA beneficiary and have concluded with the United States a "tax information exchange agreement" (TIEA) providing for "the exchange of such information [with respect to any person] . . . as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings), including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country." (25 USC 2674(6)(C)(i)). Many Caribbean Basin countries, however, have been reluctant to conclude such TIEAs for fear that as a result they might be forced to change their tax laws or disclose sensitive income information. [35]

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[33] OPIC operations in Haiti have been suspended temporarily.

[34] Like availability of U.S. Government export credits, OPIC's underwriting of insurance and guaranties of investment in Cuba is subject also to the requirements of the freedom-of-emigration amendments of the Trade Act of 1974 (19 USC 2432, 2439) (see section on "Export Credit," above).

[35] USITC. *Sixth Report.* p. 1-8, 4-19.

Section 227 of the Caribbean Basin Economic Recovery Expansion Act of 1990 expanded the provision further by requiring the Government of Puerto Rico to take the steps necessary to ensure annual new investment of at least $100 million of Section 936 funds in qualified CBERA beneficiaries (26 USC 936(d)(4)(D)). By mid-1992, $620 million in Section 936 funds has been invested in 33 projects located in nine CBI beneficiary countries,[36] with $267 million more in the pipeline.

Conclusion of a TIEA by a CBERA beneficiary also is a condition related to a tax provision intended directly to promote American tourism in the Caribbean Basin countries, but indirectly and quite remotely providing a possible incentive for investment in that industry. Expenditures for attendance at conventions, seminars, or similar meetings taking place in the "North American area" are allowed as an itemized deductible expense on individual or corporate income tax returns. Section 274(h)(6) of the Internal Revenue Code (26 USC 274(h)(6) [37] adds the CBERA designated beneficiaries and Bermuda to the definition of the "North American area" (including also the United States, its possessions, the Trust Territory of the Pacific Islands, Canada, and Mexico) thereby allowing the same tax treatment for expenditures connected with such gatherings taking place in CBERA beneficiaries that have concluded a TIEA with the United States. The highly remote functional connection with new investment, the dilution of the provision's potential effectiveness as a tax benefit with respect to CBERA countries because of the broad geographical area of applicability, and the restrictive TIEA requirement make the measure a highly unlikely practical incentive for investment in CBERA countries.

The lack of specific, broadly based investment incentives in the CBI has left any CBI-connected stimulation of U.S. investment in the Caribbean Basin countries primarily up to the indirect effects of export stimulation brought about by the CBERA trade preference. The latter, however, does not appear to have constituted an effective stimulus to investment. As evaluated by the U.S. International Trade Commission, [38] "although some of the new investment taking place in specific Caribbean Basin countries ... [has] focused on products eligible for duty-free entry under the CBERA, in general the act has not fueled economic growth and development in the region." The report points out two factors underlying the lack of development-oriented investment in the CBERA countries. One is that, despite notable investment promotion successes in a few individual countries, "the overall level of private sector investment in the region remains relatively low" due to "political instability, insufficient investment incentives, restrictions on foreign exchange and profit repatriation, and inadequate infrastructure." The other factor, specifically tied to the possible stimulative effect of the CBERA preference, is "the limited scope of products produced in the region that are eligible for duty-free entry under the CBERA

[36] Barbados, Costa Rica, Dominica, Dominican Republic, Grenada, Honduras, Jamaica, St. Lucia, and Trinidad and Tobago.

[37] The provision was enacted by sec. 222 of the CBERA, while the originally proposed tax credit for investments in the CBERA beneficiaries was dropped.

[38] USITC. *Sixth Report*, p. 4-1.

and not otherwise eligible for duty-free entry under either MFN or GSP provisions."

Indeed, investment—whether domestic or foreign, U.S. or third country—appears to be gravitating more toward economic activities that are not eligible for CBERA benefits, such as tourism, services, and footwear and textile apparel manufacturing.

TABLE 1. U.S. Total Imports from Countries Designated and Nondesignated under the CBERA, By Major Groups, 1983–1990.

(in thousands of U.S. dollars)

Country	1983	1984	1985	1986	1987	1988	1989	1990
Designated:								
Non-oil-refining								
Central America								
Belize	27,315	42,843	46,951	50,181	42,906	52,049	43,056	43,978
Costa Rica	386,520	468,633	489,294	646,508	670,953	777,797	967,901	1,006,474
El Salvador	358,898	381,391	395,658	371,761	272,881	282,584	243,922	237,538
Guatemala	374,692	446,267	399,617	614,708	487,308	436,979	608,280	790,900
Honduras	364,742	393,769	370,219	430,906	483,096	439,504	456,790	486,330
Nicaragua [a]	NA	NA	NA	NA	NA	NA	NA	15,254
Panama [b]	336,086	311,627	393,605	352,206	342,700	256,046	NA	226,555
Subtotal	1,848,252	2,044,530	2,095,344	2,466,270	2,299,843	2,244,959	2,319,949	2,807,030
Eastern Caribbean								
Antigua	8,809	7,898	24,695	11,849	8,621	6,893	12,274	4,120
Barbados	202,047	252,598	202,194	108,991	59,110	51,413	38,725	30,899
Brit. Virgin Isl.	880	1,335	11,902	5,904	11,162	684	1,112	1,999
Dominica	242	86	14,161	15,185	10,307	8,530	7,664	8,346
Grenada	211	766	1,309	2,987	3,632	7,349	7,862	7,783
Guyana [c]	NA	NA	NA	NA	NA	50,432	55,858	52,261
Montserrat	924	989	3,620	3,472	2,413	2,393	2,285	562
St. Kitts/Nevis [d]	18,758	23,135	16,258	22,278	23,793	20,822	21,447	16,100
St. Lucia	4,700	7,397	13,796	12,269	17,866	26,044	23,985	26,920
St. Vincent	4,276	2,958	9,643	7,836	8,493	13,950	9,244	8,672
Subtotal	240,846	297,161	297,578	190,771	145,397	188,510	180,457	157,660
Central Carribbean								
Dom. Rep.	806,520	994,427	965,847	1,058,927	1,144,211	1,425,371	1,636,931	1,725,430
Haiti	337,483	377,413	386,697	368,369	393,660	382,466	371,875	339,177
Jamaica	262,360	396,949	267,016	297,891	393,912	440,934	526,726	563,723
Subtotal	1,406,364	1,768,790	1,619,560	1,725,186	1,931,783	2,248,771	2,535,532	2,628,329
Total non-oil refining	3,495,462	4,110,481	4,012,482	4,382,226	4,377,024	4,682,240	5,035,938	5,593,019
Oil-refining								
Aruba [e]	NA	NA	NA	1,797	2,452	647	1,156	967
Bahamas	1,676,394	1,154,282	626,084	440,985	377,881	268,328	460,723	506,772
Neth. Antilles [e]	2,274,510	2,024,367	793,162	453,333	478,836	408,100	374,358	421,789
Trinidad and Tobago	1,317,534	1,360,106	1,255,498	786,405	802,838	701,738	765,265	1,002,661
Total oil-refining	5,268,438	4,538,754	2,674,744	1,682,519	1,662,006	1,378,813	1,601,501	1,932,189
Total designated	8,763,900	8,649,235	6,687,226	6,064,745	6,039,030	6,061,054	6,637,440	7,525,208
Nondesignated:								
Anguilla [d]	NA	NA	NA	89	168	497	348	227
Cayman Islands	8,607	6,212	10,950	14,611	27,670	18,195	48,041	21,387
Guyana [c]	67,332	74,417	46,010	62,928	58,828	NA	NA	NA
Nicaragua [a]	99,013	58,064	41,003	1,071	1,231	1,121	31	NA
Panama [b]	NA	NA	NA	NA	NA	NA	258,319	NA
Suriname	63,147	104,636	60,091	38,591	46,445	87,894	73,892	50,901
Turks & Caicos	3,465	3,935	4,649	4,792	4,680	3,517	2,507	3,547
Total nondesignated	242,065	247,264	162,703	122,081	139,022	111,224	383,137	76,063
GRAND TOTAL	9,005,965	8,896,499	6,849,928	6,186,826	6,178,052	6,172,278	7,020,577	7,601,271

Note: Figures may not add to totals shown because of rounding.
NA = Not Applicable.
[a] Nicaragua was designated a beneficiary country effective November 8, 1990.
[b] Panama lost its designated beneficiary status effective April 9, 1988, and was reinstated effective March 17, 1990.
[c] Guyana was designated as a beneficiary effective November 24, 1988.
[d] Anguilla, not designated as a beneficiary, had been included with the data for St. Kitts and Nevis through 1985. For 1986-1990 data for Anguilla are shown separately among the nondesignated countries.
[e] Upon becoming independent of the Netherlands Antilles in April 1986, Aruba was designated separately as a beneficiary effective retroactively to January 1, 1986. Trade data for Aruba, however, were not reported separately until June 1986. The 1986 figure for Aruba represents trade for June–December only.
Source: U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: Third Report, 1987.* USITC Publication 2122. Washington, September 1988. p. 1–2, 1–4; and, *Sixth Report, 1990.* USITC Publication 2432. Washington, September 1991. p. 2–4.

TABLE 2. U.S. Imports from CBERA Countries, 1983–1990
By Type of Tariff Treatment.

(in millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988	1989	1990
Total	8,764	8,649	6,687	6,065	6,039	6,061	6,637	7,525
Duty-Free Value:								
Regular (MFN)	1,750	2,171	2,070	2,340	2,056	1,928	1,854	1,968
Special Rate	254	155	81	49	47	107	270	337
GSP	567	592	533	476	301	353	416	472
CBERA	—	576	493	671	768	791	906	1,021
TSUS 806.30/807.00 [a]	519	588	547	612	756	906	1,090	1,153
of this:"Super 807"	—	—	—	1	58	162	286	318
Subtotal	3,090	4,082	3,275	4,148	3,928	4,085	4,536	4,951
Dutiable Value [b]	5,674	4,567	2,962	1,917	2,111	1,976	2,102	2,574
of this: Petroleum and its Products	5,004	4,215	2,370	1,376	1,377	1,059	1,044	1,340
Memorandum Items:								
Non-petroleum Prod	3,760	4,434	4,317	4,689	4,662	5,002	5,593	6,185
of this: Dutiable [b]	670	352	592	541	734	917	1,057	1,234
CBERA eligible prod. [c]	1,397	1,719	1,560	1,498	1,414	1,529	1,945	2,137
CBERA ineligible prod.	5,437	4,760	3,057	2,227	2,569	2,604	2,876	3,421
Petroleum & products	5,004	4,215	2,370	1,376	1,377	1,059	1,044	1,340
Textiles & apparel [d]	398	512	658	818	1,149	1,499	1,753	2,006
Leather, flat goods, etc.	20	23	20	22	30	31	33	39
Footwear	15	10	9	11	13	16	45	36
Canned tuna	*	*	—	—	*	*	*	*

Note: Figures may not add to total shown because of rounding.
* Less than $500,000.
— Nil.
[a] Duty-free (U.S. origin) value of TSUS 806/807 (HTS 9802.00.60/80) imports.
[b] Includes dutiable (foreign origin) value of TSUS 806/807 imports.
[c] Based on current-year product eligibility, except 1983 and 1984 (based on 1985); excludes products duty-free under MFN and special rates.
[d] Includes total (duty-free and dutiable) value of 806/807 imports.
Source: U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: Third Report, 1987.* USITC Publication 2122. Washington, September 1988. p. 1–8, 1–9, 1–11; *Sixth Report, 1990.* USITC Publication 2432. Washington, September 1991. p. 2–8, 2–13, B–4.

TABLE 3. U.S. Imports under CBERA Provisions, By Designated Country, 1984–1990.

(in thousands of U.S. dollars)

Rank	Country	1984	1985	1986	1987	1988	1989	1990
1	Dominican Republic	222,462	171,566	189,708	178,938	242,549	299,173	311,074
2	Costa Rica	65,756	72,184	112,710	129,577	141,076	190,756	218,380
3	Guatemala	43,442	42,440	54,143	57,621	77,256	112,627	154,205
4	Honduras	60,198	44,620	53,765	53,150	56,181	52,647	67,891
5	Haiti	21,856	46,460	60,463	77,906	83,309	67,548	63,792
6	Jamaica	44,737	40,365	51,017	58,293	42,022	51,542	60,689
7	Trinidad and Tobago	6,422	15,791	26,485	26,044	41,938	32,368	38,274
8	El Salvador	71,986	19,217	12,712	22,135	22,177	27,606	28,313
9	Belize	4,621	8,412	19,200	11,579	18,845	14,028	18,566
10	Barbados	13,376	11,372	10,223	20,223	19,125	14,850	15,198
11	Panama [a]	11,787	6,619	13,775	18,539	9,717	—	12,343
12	St. Kitts and Nevis [b]	6,757	5,503	6,192	9,592	9,417	14,033	10,136
13	Bahamas	—	3,089	53,087	95,488	10,692	9,085	8,578
14	Netherlands Antilles [c]	2,504	2,828	1,874	1,199	2,603	2,529	4,518
15	St. Lucia	1,413	1,556	2,183	2,568	3,007	2,971	3,552
16	Grenada	2	13	39	31	118	2,200	2,808
17	St. Vincent	55	200	2,089	4,583	9,990	5,642	1,516
18	Dominica	9	320	494	626	358	844	1,329
19	Antigua	114	349	533	333	255	2,309	675
20	Guyana [d]	—	—	—	—	131	2,769	521
21	Nicaragua [e]	—	—	—	—	—	—	174
22	British Virgin Islands	207	21	18	28	56	138	157
23	Aruba [c]	—	—	—	14	—	—	4
24	Montserrat	—	98	3	—	118	96	—
	Total	577,704	493,024	670,711	768,467	790,941	905,762	1,020,686

Note: Figures may not add to totals shown because of rounding.

[a] Panama lost its beneficiary status effective April 8, 1988 and was reinstated effective March 17, 1990.

[b] For 1984 and 1985, includes Anguilla, a nondesignated CBERA country.

[c] Upon becoming independent of the Netherlands Antilles in April 1986, Aruba was designated separately as a beneficiary effective retroactively to January 1, 1986. Trade data for Aruba, however, were not reported separately until June 1986. The 1986 figure for Aruba represents trade for June–December only.

[d] Guyana was designated as a beneficiary effective November 24, 1988.

[e] Nicaragua was designated as a beneficiary effective November 8, 1990.

Source: U.S. International Trade Commission. *Annual Report of the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: Third Report, 1987.* USITC Publication 2122. Washington, September 1987. p. 1–13; *Fourth Report, 1988.* USITC Publication 2225. Washington, 1988. p. 1–14; *Sixth Report, 1990.* USITC Publication 2432. Washington, 1990. p. 2–14.

TABLE 4. U.S. Total Imports from Caribbean Basin Nations, 1984–1990.

(in thousands of U.S. dollars)

Country	1984	1985	1986	1987	1988	1989	1990
Anguilla [a]	—	—	89	168	497	348	227
Antigua	7,898	24,695	11,849	8,621	6,893	12,274	4,120
Aruba [b]	—	—	1,797	2,452	647	1,156	967
Bahamas	1,154,282	626,084	440,985	377,881	268,328	460,723	506,772
Barbados	252,598	202,194	108,991	59,110	51,413	38,725	30,899
Belize	42,843	46,951	50,181	42,906	52,049	43,056	43,978
Brit. Virgin Isl.	1,335	11,902	5,904	11,162	684	1,112	1,999
Cayman Islands	6,212	10,950	14,611	27,670	18,195	48,041	21,387
Costa Rica	468,633	489,294	646,508	670,953	777,797	967,901	1,006,474
Dominica	86	14,161	15,185	10,307	8,530	7,664	8,346
Dom. Rep.	994,427	965,847	1,058,927	1,144,211	1,425,371	1,636,931	1,725,430
El Salvador	381,391	395,658	371,761	272,881	282,584	243,922	237,538
Grenada	766	1,309	2,987	3,632	7,349	7,862	7,783
Guatemala	446,267	399,617	614,708	487,308	436,979	608,280	790,900
Guyana	74,417	46,010	62,928	58,828	50,432	55,858	52,261
Haiti	377,413	386,697	368,369	393,660	382,466	371,875	339,177
Honduras	393,769	370,219	430,906	483,096	439,504	456,790	486,330
Jamaica	396,949	267,016	297,891	393,912	440,934	526,726	563,723
Montserrat	989	3,620	3,472	2,413	2,393	2,285	562
Neth. Antilles	2,024,367	793,162	453,333	478,836	408,100	374,358	421,789
Nicaragua	58,064	41,003	1,071	1,231	1,121	31	15,254
Panama	311,627	393,605	352,206	342,700	256,046	258,319	226,555
St. Kitts/Nevis	23,135	16,258	22,278	23,793	20,822	21,447	16,100
St. Lucia	7,397	13,796	12,269	17,866	26,044	23,985	26,920
St. Vincent	2,958	9,643	7,836	8,493	13,950	9,244	8,672
Suriname	104,636	60,091	38,591	46,445	87,894	73,892	50,901
Trinidad and Tobago	1,360,106	1,255,498	786,405	802,838	701,738	765,265	1,002,661
Turks & Caicos	3,935	4,649	4,792	4,680	3,517	2,507	3,547
GRAND TOTAL	8,896,499	6,849,928	6,186,826	6,178,052	6,172,278	7,020,577	7,601,271

Source: U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recover Act on U.S. Industries and Consumers: Third Report, 1987.* USITC Publication 2122. Washington, September 1988. *Sixth Report, 1990.* USITC Publication 2432. Washington, September 1991.

[a] Anguilla data included with data for St. Kitts/Nevis through 1985.

[b] Trade data for Aruba are included in statistics for the Netherlands Antilles for 1984–1985.

TABLE 5. U.S. Total Exports to Countries Designated and Nondesignated under the CBERA, By Major Groups, 1983–1990.

(in millions of U.S. dollars)

Country	1983	1984	1985	1986	1987	1988	1989	1990
Designated:								
Non-oil-refining								
Central America								
Belize	36	53	56	59	72	103	101	105
Costa Rica	382	423	422	483	582	696	882	986
El Salvador	365	426	445	518	390	483	520	554
Guatemala	316	377	405	400	480	590	662	763
Honduras	299	322	308	363	418	476	515	564
Nicaragua [a]	NA	NA	NA	NA	NA	NA	NA	67
Panama [b]	748	757	675	711	742	637	NA	869
Subtotal	2,146	2,358	2,311	2,534	2,684	2,985	2,680	3,908
Eastern Caribbean								
Barbados	195	241	173	147	132	160	180	161
Guyana [c]	NA	NA	NA	NA	NA	67	78	76
Leeward & Windward Islands [d]	166	209	199	225	238	285	355	375
Subtotal	2,146	450	372	372	370	512	613	612
Central Carribbean								
Dominican Republic	632	646	742	921	1,142	1,359	1,645	1,656
Haiti	366	419	396	387	459	475	472	477
Jamaica	452	495	404	457	601	762	1,006	943
Subtotal	1,450	1,560	1,542	1,765	2,202	2,596	3,123	3,076
Total non-oil refining	3,957	4,368	4,225	4,671	5,256	6,093	6,416	7,596
Oil-refining								
Aruba [e]	—	—	—	—	—	99	127	202
Bahamas	452	555	786	761	782	740	772	800
Neth. Antilles [e]	553	648	427	398	507	432	412	543
Trinidad and Tobago	728	601	504	532	361	326	563	428
Total oil-refining	1,733	1,804	1,717	1,691	1,650	1,597	1,874	1,973
Total designated	5,690	6,172	5,942	6,362	6,906	7,690	8,290	9,569
Nondesignated:								
Anguilla [f]	NA	NA	NA	NA	NA	14	17	15
Cayman Islands	67	78	75	83	127	104	204	183
Guyana [c]	36	51	43	47	60	NA	NA	NA
Nicaragua [a]	132	112	42	3	3	6	2	NA
Panama [b]	NA	NA	NA	NA	NA	NA	723	NA
Suriname	117	100	86	84	72	93	140	156
Turks & Caicos	12	16	12	15	15	33	46	39
Total nondesignated	364	357	258	232	277	250	1,132	393
GRAND TOTAL	6,054	6,529	6,200	6,594	7,183	7,940	9,422	9,962

Sources: U.S. Bureau of the Census. *Highlights of U.S. Export and Import Trade.* Report FT900. December 1988 and *U.S. Merchandise Trade: December 1991.* Report FT900 Supplement. (Additional data by fax.); U.S. International Trade Administration. *U.S. Foreign Trade Highlights 1991.* May 1992.

NA = Country's CBERA-beneficiary designation or nondesignation status not applicable throughout the year.

[a] Nicaragua was designated a beneficiary country effective November 8, 1990.

[b] Panama lost its designated beneficiary status effective April 9, 1988, and was reinstated effective March 17, 1990.

[c] Guyana was designated as a beneficiary effective November 24, 1988.

[d] Includes Antigua and Barbuda, the British Virgin Islands, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. Separate export data are not available for individual countries of the Leeward & Windward Islands for the years 1983–1987.

[e] Upon becoming independent of the Netherlands Antilles in April 1986, Aruba was designated separately as a beneficiary effective retroactively to January 1, 1986. Trade data for Aruba for 1983–87 are included in statistics for the Netherlands Antilles.

[f] Anguilla, not designated as a beneficiary, had been included with the data for the Leeward and Windward Islands through 1987. For 1988–1990 data for Anguilla are shown separately among the nondesignated countries.

TABLE 6. U.S. Total Exports to Caribbean Basin Nations, 1984–1990.

(in millions of U.S. dollars)

Country	1984	1985	1986	1987	1988	1989	1990
Anguilla [a]	—	—	—	—	14	17	15
Antigua [a]	—	—	—	—	68	74	69
Aruba [b]	—	—	—	—	99	127	202
Bahamas	555	786	761	782	740	772	800
Barbados	241	173	147	132	160	180	161
Belize	53	56	59	72	103	101	105
British Virgin Islands [a]	—	—	—	—	39	49	60
Cayman Islands	78	75	83	127	104	204	183
Costa Rica	423	422	483	582	696	882	986
Dominica [a]	—	—	—	—	3	33	31
Dominican Republic	646	742	921	1,142	1,359	1,645	1,656
El Salvador	426	445	518	390	483	520	554
Grenada [a]	—	—	—	—	26	28	35
Guatemala	377	405	400	480	590	662	763
Guyana	51	43	47	60	67	78	76
Haiti	419	396	387	459	475	472	477
Honduras	322	308	363	418	476	515	564
Jamaica	495	404	457	601	762	1,006	943
Leeward & Windward Isl. [a]	209	199	225	238	—	—	—
Montserrat [a]	—	—	—	—	6	11	11
Netherlands Antilles	648	427	398	507	432	412	543
Nicaragua	112	42	3	3	6	2	67
Panama	757	675	711	742	637	723	869
St. Kitts and Nevis [a]	—	—	—	—	36	44	52
St. Lucia [a]	—	—	—	—	71	76	82
St. Vincent/Grenadines [a]	—	—	—	—	36	40	35
Suriname	100	86	84	72	93	140	156
Trinidad and Tobago	601	504	532	361	326	563	428
Turks & Caicos Islands	16	12	15	15	33	46	39
GRAND TOTAL	6,529	6,200	6,594	7,183	7,940	9,422	9,962

Sources: U.S. Bureau of the Census. *Highlights of U.S. Export and Import Trade.* Report FT900. December 1988 and *U.S. Merchandise Trade: December 1991.* Report FT900 Supplement. (Additional data by fax.); U.S. International Trade Administration. *U.S. Foreign Trade Highlights 1991.* May 1992.

[a] For 1984 through 1987, trade data for Anguilla, Antigua, the British Virgin Islands, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines are included in statistics for the Leeward and Windward Islands.

[b] Trade data for Aruba are included in statistics for the Netherlands Antilles for 1984 through 1987.

THE INTERNATIONAL ECONOMY AND THE CARIBBEAN: THE 1990s AND BEYOND

by Stephen A. Quick *

CONTENTS

INTRODUCTION

The decade of the 1990s promises to be a difficult period in the economic life of the Caribbean. Sweeping changes in finance, technology, politics, and trade are likely to alter the pattern of global production in ways that will pose new challenges to the small island states of the region. Lacking the population to become major centers of final demand and in competition with other low-wage producers in Africa, Asia, and Latin America, Caribbean nations will find that many of their past economic development strategies no longer are effective. In this new world, all of the states in the region will need to undertake a rigorous reassessment of their resources and their development strategies. They must define a role within the evolving world economy that produces adequate employment growth and rising living standards for their populations. This, in turn, will require a systematic reorientation of economic policy toward exports and international competitiveness, a reorientation that is already under way in most countries, where it is starting to pose severe challenges to domestic political systems.

TRENDS IN THE WORLD ECONOMY

During the 1980s, three global trends converged to bring about a major change in the world economy. First, the capacity of the

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global *communications* system expanded enormously, with such innovations as broadcast satellites, fiber optics, and global computer networks. The communications revolution transformed the marketing of products from a national enterprise to an international one, where firms sought to organize consumer tastes and preferences everywhere on the planet. The communications revolution also transformed the process of controlling production. In the digital era, it became possible for a single headquarters staff to control effectively the production of goods in a dispersed network of factories worldwide.

Second, the 1980s witnessed an enormous increase in the pace of *technological innovation*. Innovation produced a wave of new products and dramatically shortened the useful life of many existing products. Innovation also sharply altered the raw materials requirements of many production processes in ways that reduced the market power of producers of primary products. [1] The significance of labor costs in the production process also was reduced by technological innovation, since profitability was influenced far more by the ability of the firm to respond quickly to customer needs, to have access to good transportation and communications networks, and to mobilize the investment needed to stay at the cutting edge of technology.

Third, the 1980s were characterized by unprecedented *liberalization of financial markets*. In virtually all industrialized countries, money was allowed to flow across national borders with unprecedented ease. In such an environment, firms doing business in one country no longer needed to rely solely on the savings of that country to provide finance for their new investment. Conversely, savers in a given country no longer were restricted to domestic investments as an outlet for their savings. If investment demand and therefore interest rates were higher in one country, savings flowed easily across borders to capture the higher returns.

These three major trends helped create an integrated world economy whose central dynamic is the process of new capital investment. Rapid technological change meant that the successful firm had to step up its rate of investment, both to develop now products and to match the cost-cutting innovations of global rivals. [2] Recovering the costs of such investment within the shortest possible time meant that firms needed to tap the broadest possible market for their products, which put them under enormous pressure to develop marketing networks worldwide. The revolution in communications made it technically possible to organize both production and marketing on a global basis, and financial liberalization provided a mechanism of ready finance for investment virtually anywhere on Earth.

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[1] Japan, for example, now uses less than 60 percent of the raw materials it required in 1973 to produce a unit of output. See Drucker, Peter F. The Changed World Economy. Foreign Affairs, v. 64, Spring 1986. p. 773.

[2] This tendency was first noted by Kenichi Ohmae in *Triad Power: The Coming Shape of Global Competition*. London, Macmillan, 1985. Recently, it has been refined considerably and elaborated by Alfred Chandler in his monumental *Scale and Scope: The Dynamics of Industrial Capitalism*. Cambridge, Mass., Harvard University Press, 1990.

CORPORATIONS AND THE STATE: NEW LIMITS AN ECONOMIC POLICY

This new international environment has profound implications for economic policy. The less integrated, less competitive international economy of the past permitted countries broad latitude in shaping domestic economic activity through fiscal, monetary, and trade policies. In the emerging world economy, however, the ability of governments to pursue independent economic policies has been sharply constrained. Governments previously made extensive use of monetary, fiscal, regulatory, and trade policies to influence the character of economic activity within their borders. National firms were often favored at the expense of multinational companies, and an expansionary bias was built into many macroeconomic policies. In response to rapid market growth and preferences for national firms, multinational enterprises stepped up the pace of cross-border investment, in effect establishing a "national" presence in many countries at once. During the 1980s, direct foreign investment grew nearly four times as fast as gross national product (GNP) in the industrialized world. [3]

Once established in foreign markets, however, multinational enterprises often lobbied for a reduction in trade barriers and regulatory incentives, confident of their ability to compete both domestically and internationally. Much of the movement toward regional free trade agreements in Europe, North America, and Asia has been actively supported by the multinational business firms operating in these regions.

The changing realities of the international economy have substantially increased the leverage of global corporations. With capital and technology mobile, countries find it increasingly difficult to follow policies that differ from those pursued elsewhere in the world economy. Rapid money growth or expanding government deficits, for example, can quickly lead to capital flight, which destabilizes a nation's currency. The result of these trends was noted in the following terms in a recent article in the *Economist*: "Foreign direct investment has already reduced the freedom of governments to determine their own economic policy. If a government tries to push tax rates up, for example, it is increasingly easy for businesses to shift production overseas. Equally, if governments fail to invest in roads, education, and so on, domestic entrepreneurs are likely to migrate. In short, foreign investment is forcing governments, as well as companies, to compete." [4]

THE NEW INTERNATIONAL ECONOMY AND THE PROBLEM OF DEVELOPMENT

This new need for governments to compete has helped transform the debate about development strategy. In the decades after the Second World War, most large developing countries sought growth by exporting primary products and developing domestic substitutes for imported goods behind high external tariff walls. The strategy often worked because the industrial world needed raw materials,

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[3] Julius, DeAnne. *Global Companies and Public Policy.* London, Royal Institute of International Affairs, 1990. p. 6.

[4] *Economist,* June 23, 1990. p. 67.

domestic entrepreneurs were willing to invest on the strength of protection, and multinational firms were sufficiently attracted by large markets that they were willing to accept the regulations and restraints that were part of this development strategy. The oil crises of the 1970s reinforced this strategy. Oil import bills rose dramatically, but so did the prices of other primary commodities. Most large developing countries borrowed to finance huge internal deficits during the 1970s and 1990s rather than take the painful steps needed to bring consumption into line with income.

This entire approach was brought to an abrupt halt by the global recession of the 1980s, which coupled rising interest rates on external debt with falling prices for primary products. [5] The subsequent debt crisis also cut off access to external debt capital for most developing countries. At the same time, changes in communications technology were turning firms with multiple national subsidiaries into truly *global* production entities, which now chafed under the regulatory restraints associated with import substitution. Rapid technological innovation also rendered obsolete (and therefore unmarketable) many of the manufactured goods produced behind protective walls in the developing world.

This new international environment was much more supportive of an alternative development strategy—the export-led growth model of the Newly Industrializing Countries (NICs) of Asia: Taiwan, Korea, Singapore, and Hong Kong. Initially, the NICs also protected domestic industry, but it was a protection designed to encourage investment and exports. The NICs also actively encouraged multinational firms to establish factories in their countries, viewing such competition as healthy for the growth of domestic manufacturing industry.

The NICs provided the rest of the developing world not only an alternative development model but also intense *competition* for capital investment. The attractiveness of the NIC approach to internationally mobile capital quickly became apparent, and this approach to policy became what economist John Williamson called the "Washington Consensus" on "macroeconomic prudence, outward orientation, and domestic liberalization." [6] In practice, the "Washington Consensus" translated into cutting both public deficits and domestic demand, dismantling trade protection, enacting policies to encourage international private investment, and devaluing the currency to produce a competitive exchange rate—in short, emulating the NICs.

The Caribbean and the World Economy

The pattern of economic growth in the small island states of the Caribbean has been shaped by the global trends noted above. All of the Caribbean islands formed their initial links to the international economy as exporters of agricultural commodities, particularly sugar and bananas. Later, some countries developed significant ex-

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[5] According to a recent International Monetary Fund estimate, prices for commodities other than oil in 1990 will be nearly 20 percent below their levels in 1980, compared with an average annual rate of increase of 11.6 percent per year during the 1970s.

[6] Williamson, John. *Latin American Adjustment: How Much Has Happened.* Washington, D.C., Institute for International Economics, 1990. p. 1.

ports of bauxite (Jamaica, Guyana) and oil (Trinidad and Tobago). More recently, tourism has become a major export sector on a number of islands, while manufacturing has become significant in Puerto Rico, Jamaica, Trinidad and Tobago, and the Dominican Republic. Despite considerable sectoral diversification within the region, the exports of most islands remain dominated by a single product.

An important part of the explanation for one-product dominance of island exports is the phenomenon known as "Dutch Disease." When a very small country finds a ready world market for one product, the export boom in that product pulls local resources away from other industries and undermines their competitiveness.

In the first few decades after the Second World War, international markets and trading arrangements encouraged excessive specialization in tropical agriculture. The Commonwealth Sugar Agreement provided a ready U.K. market for the region's principal export during the 1960s, at a time when the U.S. market was also relatively open. Many Caribbean countries were granted preferential access for agricultural products in the European market through both multilateral agreements (the Treaty of Rome Association, the Yaounde Conventions, and most recently, the Lome Convention) and bilateral concessions (particularly the U.K. export subsidy on Caribbean bananas).

The inflation of the early 1970s contributed to this pattern, raising sugar prices and providing a spur to the development of mineral resources such as bauxite and oil. This inflation also, however, provided the first sign of trouble, since the prices of imports to the islands started rising faster than export prices, leading to deterioration in the terms of trade for many islands. This deterioration in the terms of trade accelerated sharply with the first "oil shock" for all of the islands except Trinidad and Tobago, an oil producer, and the oil refiners of the Bahamas and the Netherlands Antilles.

In company with much of the developing world, the nations of the Caribbean sought to cushion the blow of the oil crisis through external finance rather than domestic austerity. Current account deficits swelled enormously, hitting a high of 31 percent of GNP for Guyana in 1976, with Jamaica, Barbados, and Haiti posting deficits in excess of 10 percent of GNP. These deficits were financed with surprising ease through a combination of direct foreign investment (particularly in tourism) and both grants and loans from official creditors. Unlike the larger debtor countries, however, most Caribbean islands received only scant financial assistance from commercial banks during this period. [7]

Statistics on international direct investment in the Caribbean are difficult to obtain, but recent reports suggest a decline in these flows during the 1980s. [8] Equity investment in the extractive indus-

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[7] This aggregate picture of the region's financial balance obscures some important differences among the countries. Jamaica and Guyana were by far the largest borrowers from official creditors, while Grenada received heavy inflows of aid from Cuba during the late 1970s and early 1980s. Trinidad and Tobago borrowed very little initially, owing to strong oil exports, but became a significant borrower in the mid-1980s as oil prices collapsed. Barbados and many of the countries of the Organization of Eastern Caribbean States were generally able to finance their external deficits with modest official borrowing supplemented by private capital flows and managed to avoid serious overindebtedness.

[8] See Hope, Kempe Ronald. Private Direct Investment and Development Policy in the Caribbean. *American Journal of Economics and Sociology*, v. 48, January 1989. p. 69–78.

tries was hit by declining commodity prices and by conflicts between governments and multinational corporations, particularly in Jamaica and Guyana. Such conflicts throughout the developing world in the 1970s caused a number of multinational firms to shift their focus toward expanding resource extraction in more stable countries. [9] Tourism attracted some foreign investment, but the aggregate financial impact was not large, due to the preference of international hotel and resort companies to finance construction locally while retaining a management contract to operate the facility.

Prospects for financial flows to the Caribbean do not appear to be particularly bright, and a recent review by the World Bank concluded that "all but a few of the countries are likely to confront a scarcity of external financing." [10] During 1990, the United States cut aid allocations for the Caribbean substantially, as priorities shifted toward fighting the drug war in the Andean countries, rebuilding Panama and Nicaragua, and supporting the liberalization of Eastern Europe.

Recent developments in debt policy are more encouraging, particularly for those countries with heavy debt burdens to official governments. Canada in 1990 announced a cancellation of debts owed by many Caribbean countries, and the Bush Administration's Enterprise for the Americas initiative supported the concept of debt forgiveness on official bilateral debt. Despite these changes, most Caribbean islands remain in need of substantial external financing if they are to grow fast enough to absorb population increases and manage even a modest rise in per capita consumption levels. Such financing will need to come from private sources, since the recent World Bank survey of the region (cited above) found that only 40 percent of the needed funds were presently available from official sources.

EXTERNAL TRADE AND INVESTMENT IN THE 1980s

The marked deterioration in the region's access to external finance during the 1980s provoked a major shift in emphasis in development strategy: from seeking finance for imports to seeking markets for exports. Caribbean countries had previously sought and won preferential access to the European market through the U.K. banana subsidy and some of the provisions of the Lome Accord, but exports to the United States became the focal point for regional trade policy with the announcement early in President Reagan's first term that the United States would launch a major initiative for the Caribbean Basin.

In its original conception, the Caribbean Basin Initiative (CBI) was to offer both free access to the U.S. market for the region's exports and substantial new investment funds to take advantage of the new market opportunities. As the proposal made its way through Congress, however, the planned investment funds were deleted, and restrictions were added that limited access to the U.S.

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[9] Oneal, John. Foreign Investments in Less Developed Regions. *Political Science Quarterly*, v. 103, Spring 1988. p. 143.

[10] World Bank. *Caribbean Region: Current Economic Situation*. Report No. 8246-CRG. Washington, D.C., February 22, 1990, mimeographed. p. 3.

market for certain key products. When finally passed in 1983, the CBI explicitly excluded textiles, footwear, sugar, oil, leather, luggage, and beef.

These exclusions sharply diminished the potential trade benefits to the region from the CBI. Since many of the region's exports enjoyed duty-free access prior to the CBI, and many others were limited by nontariff barriers untouched by the initiative, only a small minority of the region's exports derived any benefit from the CBI. [11] In fact, total U.S. imports from the Caribbean actually fell substantially following passage of the CBI, as sharp cuts in the region's sugar quota and declining oil imports overwhelmed the expansion in such nontraditional exports as vegetables and fruits, tobacco, industrial chemicals, fish and shellfish, and electronic components and parts. [12] Nontraditional exports from the Caribbean did grow substantially during the 1980s, but a large fraction of the growth owed little to the benefits of the CBI. Exports from the Caribbean under the reassembly provisions of the U.S. Tariff Code (Sections 806 and 807), for example, regularly exceeded the value of imports under preferences granted by the CBI.

Investment also showed no significant change with the CBI. A report by the U.S. International Trade Commission concluded that "overall, levels of new investment in beneficiary countries in the region remain disappointingly low." [13] There were several reasons for the disappointing investment response. First, obviously, was the elimination of public funds to support investment from the original CBI proposal. Of greater significance, however, was the fact that the CBI promised duty-free access to the U.S. market for a period of only twelve years, a period too short to convince private investors to take the risks of Caribbean production. Finally, the exclusion of textiles and apparel from the CBI removed the sector of greatest potential interest to investors.

Prospects for expanded trade and investment under the provisions of the CBI remain uncertain. In 1986 the rules governing financial deposits of Puerto Rican tax-exempt (Section 936) firms were liberalized to permit such funds to be invested elsewhere in the Caribbean. In 1990 the trade provisions of the CBI were made permanent (albeit with largely the same product exemptions as the earlier law). Together, these changes could create both a larger pool of investable funds and a greater desire on the part of entrepreneurs to take the risks of Caribbean production.

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[11] For a quantitative analysis of the benefits of the CBI, see Pelzman, Joseph and Gregory Schoepfle. The Impact of the Caribbean Basin Economic Recovery Act on Caribbean Nations' Exports and Development. *Economic Development and Cultural Change*, v. 36, July 1988. p. 753–796.

[12] Both the United States and the European Community (EC) subsidize sugar production but then permit some imports from the Caribbean into their markets. The EC subsidizes sugar directly, while the United States uses imports as a device for regulating domestic supply and demand conditions so that "the market" sets a high price for sugar without the need of direct government subsidy. As a result, EC sugar quotas for the Caribbean are fixed, while U.S. quotas are variable. Under heavy pressure from subsidized European sugar production, the world sugar price collapsed in the 1980s, forcing the United States to cut back on imports sharply in order to maintain domestic prices. As a result, Caribbean countries saw their sugar quota cut from over 5 million tons in 1981 to less than 1 million in 1987.

[13] U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers*. Publication 2225. Washington, D.C., 1989.

Despite these positive developments, the overall trend in global trade policy does not appear to be particularly supportive of Caribbean trade. Heavy European subsidies continue to depress the world sugar price, and a recent General Agreement on Tariffs and Trade (GATT) decision criticizing the U.S. sugar quota system has met with stiff resistance from the U.S. Congress, which passed a 1990 Farm Bill that continued the old sugar quota system. Changes in global trade policy are also likely to eliminate preferences formerly enjoyed by Caribbean producers. The EC delegation to the Uruguay Round recently tabled a proposal for elimination of all barriers on most tropical agricultural products. This proposal would open up European markets generally, but would also eliminate the advantages granted to Caribbean producers under the Lome Accord.[14] Caribbean banana producers are likely to lose their preferred access to the U.K. market when the single European market is completed in 1992.[15] The U.S. Enterprise for the Americas Initiative is also likely to grant to other nations in Latin America the benefits previously granted only to the Caribbean.

Taken as a whole, these changes mean that Caribbean producers are likely to see a reduction in preferential market access agreements, possibly coupled with a general lowering of external barriers in all major markets. These changes could potentially improve growth prospects for Caribbean exports, but only to the extent that Caribbean producers are low-cost suppliers by world standards. It remains to be seen whether Caribbean producers can be the world's low-cost suppliers of even the most basic goods.[16]

DEVELOPMENT STRATEGIES FOR THE 1990s

In the 1990s, the island nations of the Caribbean must craft new development strategies in the context of a much more competitive international environment. Loans and grants from official sources will not be adequate to meet the region's growth needs; they will need to be supplemented by private capital flows if growth is to be maintained at an adequate level. Private capital will, however, have other markets equally eager to attract it, and the diminished value of Caribbean trade preferences will reduce the attractiveness of the islands if local costs are significantly above those prevailing in other developing countries.

This tough international environment will require difficult policy choices in the islands, where the task of government has always been to achieve a delicate balance between employment growth, consumption growth, and social stability. New employment is needed to accommodate the rapid growth in the labor force, growth

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[14] Of the European Currency Unit (ECU) 10.4 billion of tropical agricultural imports to the EC, some ECU 7.7 billion are now affected by specific trade preferences. The EC offer would eliminate most of these preferences. See *Financial Times*, London, March 20, 1990.

[15] Recent World Bank projections show that an elimination of banana subsidies would result in a 49 percent drop in the prices paid to "protected" exporters in Africa, the Caribbean, and Pacific regions. See World Bank. *World Development Report, 1990*. New York, Oxford University Press, 1990. p. 22.

[16] The case of sugar is particularly interesting. The World Bank is forecasting a generally positive environment for sugar in world markets because of tight world supplies, but in a recent report it noted that Brazil may be a lower-cost sugar producer than most Caribbean islands. Brazil has recently scrapped an ethanol fuel program that absorbed much of its sugar production in the domestic market. If the United States liberalizes sugar imports, Brazil could well displace many Caribbean producers now benefiting from the quota system.

associated with young populations and relatively high birth rates. Consumption growth in needed not only to meet the basic needs of those at the lower end of the income distribution but also to retain the more mobile professional and middle classes. Social stability is particularly important for the plural societies of the Caribbean, where racial, class, and cultural divisions pose special threats to stability.

The old formula for reconciling these objectives relied on primary-product exports to support what Jonathan Hartlyn of the University of North Carolina calls a "massive but irrationally constituted" state apparatus.[17] This apparatus protected an inefficient private sector from international competition while simultaneously using both subsidies and government jobs to distribute income and employment broadly through the society. The importance of the state to the economy tended to push all social conflicts into the government arena, where public spending and subsidies became the easiest solution to every problem. Raising adequate tax revenue to fund the subsidies almost always proved politically impossible, and large public-sector deficits became the inevitable consequence. Similar political pressures also led to a persistent overvaluation of the exchange rate, encouraging consumption and imports at the expense of exports.[18]

For a period of time, this formula worked tolerably well, but in a world of falling commodity prices, the model could be sustained only through external financial flows, and such flows are clearly no longer available at previous levels. Thus far, few countries have coped effectively with the new financial environment, with most simply cutting public spending along the lines of least resistance rather than refocusing public spending on a new strategy of growth.

The new external environment has also not brought about any major change in trade policy. Despite the strong moves toward trade liberalization in Mexico and elsewhere in the hemisphere, most Caribbean governments continue to protect the private sector behind both tariff and nontariff barriers. Even though the Caribbean Community and Common Market (CARICOM) has proposed a relatively high common external tariff (CET), individual countries continue to maintain high and variable local barriers to imports. Duty-free zones established on various islands to avoid the restrictions imposed by protection have been only partially successful.[19]

As a result of excessive protection and ill-considered fiscal retrenchment, few islands have either a public sector or a private sector that is prepared for what appears to be an increasingly competitive struggle for access to world export markets. If the islands are to prosper in the 1990s, this will have to change. Since they can

[17] See chapter 8 of *Democracy in the Caribbean.*

[18] See Fletcher, Richard. Undervaluation, Adjustment, and Growth. In *Debt Disaster? Banks, Governments, and Multilaterals Confront the Crisis.* Weeks, John, ed. New York, New York University Press, 1989.

[19] Recent case studies of firms investing in the free zones found "domestic customs procedures" to be among the most frequently cited impediments to business activity, despite the goal of such zones to eliminate government interference. See Kramer, Susan. *Incentives and Impediments to U.S. Foreign Direct Investment in the Caribbean.* Commission for the Study of International Migration and Cooperative Economic Development, Working Paper, No. 14. Washington, D.C., January 1990.

no longer count on external finance on a large scale, the islands will have to expand exports rapidly in order to pay for the imports they are clearly not prepared to forgo.

Around the world, in industrialized and developing countries alike, there is a growing recognition that maintaining access to world markets will require a substantial commitment to *investment* broadly conceived. Manufacturing firms need to invest to keep up with new technologies, while service firms need investment to maximize productivity growth. Governments need to make new investments in infrastructure and "human capital" to facilitate private-sector activity.

The investment imperative is no less for the Caribbean. Unlike their larger competitors, however, small islands do not have the luxury of diversifying investments broadly across sectors. As the smaller Asian NICs have realized, small economies must make strategic choices among investment alternatives and hope their choices are correct. [20] For the Caribbean, this means, first, deciding in which sectors to concentrate investment, and then, deciding which groups in society should make the needed investments.

Investment in Which Sectors?

The choice of sectoral strategies differs markedly among the islands due to differences in natural and human resource endowments, but several broad generalizations seem to stand out from the available literature. *Primary products* appear to have little fundamental appeal to new investors. The 1990 *World Development Report* projects growth in primary-product prices of only 0.2 percent per year through the 1990s, and this after what it calls "a dip in the short run." [21] Such projections reflect the increased use of synthetics and recycling in the industrialized countries, as well as the reduction in raw material needs as output in the developed world shifts from goods to services.

Agriculture would appear to be a more promising area for many Caribbean islands, as a means to both reduce imports and absorb a share of the growing labor force. Yet despite the economic advantages of diversified agricultural production, few islands have been successful in promoting broad growth in this sector. Some have managed to develop export enclaves in the agricultural sector to export high-value products such as melons, shrimp, and winter vegetables to the U.S. market, but these successes have not translated into improved agricultural self-sufficiency.

There appear to be several reasons for this failure. Generally, Caribbean islands are high-cost producers of many staple agricultural products and are unable to compete against the subsidized agricultural output of the industrialized world. Broad-based agricultural development therefore would require maintaining domestic food prices well above world levels, a practice that few governments with large urban food consumers have been prepared to embrace. Without such protection, the principal opportunities in agri-

[20] Krause, Lawrence. Industrialization of an Advanced Global City. In *The Singapore Economy Reconsidered.* Krause, Lawrence, et al., ed. Singapore, Institute of Southeast Asian Studies, 1987. p. 56.

[21] World Bank. *World Development Report, 1990.* p. 16.

culture appear to lie in the high-value niche markets, which might benefit from the reasonably efficient air transport system linking the islands to U.S. markets.

Manufacturing was the key to the success of the Asian NICs, and many hold out hope of a similar future for the Caribbean economies. Puerto Rico is one of the world's first industrialized tropical islands, and the manufacturing sectors in Barbados, Jamaica, Trinidad and Tobago, and the Dominican Republic have expanded significantly in recent years. Yet a close look at the manufacturing sector in the Caribbean reveals some critical differences with the Asian NICs. Most islands have two quite distinct manufacturing sectors. The first produces goods for local and regional markets on the strength of external protection, goods that cannot meet the tests of cost or quality in world markets. [22] The second consists of labor-intensive assembly operations, producing products destined for the U.S. market, often under the duty-free provisions of Sections 806 and 807 of the U.S. Tariff Code. While such firms generate exports and jobs, they generally pay low wages, have limited linkages with the rest of the economy, and produce little value added or foreign exchange for the rest of the island economy.

For most of the islands, therefore, manufacturing means low-paid assembly work, an industry in which the islands are in competition with producers offering even lower wages. This is a strategy that holds greater promise for the poorer nations, such an Haiti and the Dominican Republic, which can compete with China or Bangladesh on the basis of low wages. Other islands are caught in a kind of limbo, with wage rates too high to compete as low-wage assemblers, but without the technological infrastructure to follow the lead of the Asian NICs and shift toward high-value-added integrated manufacturers. [23]

Services would appear to be a more promising growth area for the islands. The income elasticity of demand for services in the industrialized world is high, and a recent Organization for Economic Cooperation and Development (OECD) report suggests that service promotion may be an effective growth strategy for the developing world. [24] Tourism is, of course, already the largest industry in the islands, and it is an industry that is projected to grow rapidly as long as there is no recession in the United States. Tourism is a "rent-based" service industry, and the plentiful beaches and attractive scenery of the islands give the Caribbean a comparative advan-

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[22] The World Bank notes that while roughly 5–8 percent of total island exports are sold within the CARICOM market, over 50 percent of manufactured exports are sold within the region. (See World Bank. *Caribbean Region.*) An official of the Planning Institute of Jamaica referred to his country as "a nation of samples," where manufacturers produced goods in tiny lots at high cost and low quality. See *Economist.* August 6, 1988.

[23] A recent study discussed the general problem facing developing countries seeking to expand manufacturing in the following terms: "Countries are able to attract industrial investment not so such because of their comparative advantage in labor costs but because of their market potential and their technological capacity. . . . A few countries in the Third World have been able to achieve the required technological capacity after competing in the world economy for at least two decades, mainly on the basis of lower production costs in traditional manufacturing. But the large majority of Third World countries do not have the potential to attain a significant level of technological upgrading by themselves; hence they seen destined to lag increasingly behind the OECD countries." Castells, Manuel and Laura D'Andrea Tyson. High Technology and the hanging International Division of Production. In *The Newly Industrializing Countries in the World Economy.* Purcell, Randall, ed. Boulder, Lynne Rienner, 1989. p. 21.

[24] OECD. *Trade in Services and Developing Countries.* Paris, 1989.

tage in earning rents from the U.S. market. Tourism in not without its problems. Critics point to its high capital intensity and heavy import demands, its weak linkages to the rest of the economy, its seasonality, and its sensitivity to business-cycle fluctuations in the industrialized world. [25] Tourism also imposes environmental burdens, which may set limits to the rate at which this sector can grow. Despite these objections, most observers conclude that tourism offers the most appealing growth prospects of any major industry. [26]

Other service industries also have shown considerable growth potential on several islands. The improvement in regional communications, including the establishment of digital "teleports" such as the one in Montego Bay, Jamaica, make it possible for island firms to compete in the growing international market for data-processing services. International banking and insurance operations have grown rapidly in Puerto Rico, the Cayman Islands, the Bahamas, and the Netherlands Antilles.

In considering sectoral investment options, island governments need to be mindful of the "Dutch Disease" problem endemic to small economies. The successful development of one sector may push up island costs to the point where other industries are rendered uncompetitive. A decision to push ahead with tourist development, for example, could undermine the chances of success in data processing or manufacturing.

Investment by Whom?

The local private sector in the islands thus far has not demonstrated a great enthusiasm for international competition. Most local businesses are focused entirely on the protected domestic market, and much of their business activity is concentrated in real estate, construction, and retail distribution. In Puerto Rico, for example, of the two-hundred largest, island-owned businesses, only three are significant exporters to non-island markets. [27] This reality has generated considerable concern about the ability of the local business class to take the entrepreneurial risks associated with penetrating new export markets. [28] Of particular concern is the willingness of the local big business sector to take such risks. [29]

Risk aversion by local entrepreneurs has led many islands to look to international corporations as the lead investors in their export promotion strategy, particularly in tourism and manufacturing. In comparison with other developing countries in the hemisphere, however, Caribbean islands have had more difficulty in at-

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[25] On the high capital intensity, see Erbes, Robert. *International Tourism and the Economy of Developing Countries*. Paris, OECD, June 1973. On the heavy import demands, see U.N. Economic and Social Council, *Impact of International Tourism on the Economic Development of Developing Countries*. New York, May 1975.

[26] Former Jamaican Prime Minister Michael Manley stated that tourism is "the strategic industry for Jamaica's immediate future and the sector which could improve the island's balance of payments and pull it out of the clutches of the International Monetary Fund." See *Inter Press Service*, February 5, 1990.

[27] The Largest Locally Owned Businesses in Puerto Rico. In *The Caribbean Business Book of Lists, 1990*. San Juan, Caribbean Business Publications, 1990.

[28] Danns, George. The Role of the Entrepreneur in the Development Strategy of the Caribbean. *Caribbean Affairs*, v. 2, July-September 1989. p. 152.

[29] Demas, William. Perspectives on the Future of the Caribbean in the World Economy. *Caribbean Affairs*, v. 1, October-December 1988. p. 9.

tracting global corporate investment. One major reason is that the domestic market is so small that foreign firms must plan to export virtually all of the output, and empirical studies of foreign investment behavior have found a distinct preference for larger domestic markets. [30]

Traditionally, Caribbean nations have pursued both U.S. and European corporations, with attention turning more recently toward Japanese firms. Since such firms tend to be very large and concerned about the scale problem in small islands, Caribbean governments might wish to consider pursuing foreign investors accustomed to operating on a smaller scale. Korea and Taiwan both have firms accustomed to global exports from small facilities, and the decision taken in 1989 by the Taiwanese government to finance an industrial park in Costa Rica may indicate growing interest in the Caribbean region. [31]

The state has been called upon to play an entrepreneurial role in many of the Caribbean islands, but the results have been generally disappointing. Public enterprise was the cornerstone of the early development strategy in Puerto Rico, but losses in these enterprises quickly shifted the focus to attracting industry rather than public entrepreneurship. Elsewhere, public enterprises often picked up the "lemons" discarded by the private sector in an attempt to salvage jobs (sugar refining) or ran prestige projects (airlines) that the local market could not support. As a result, there are almost no success stories of public enterprise in the Caribbean, and little current inclination to expand public entrepreneurship in the face of a worldwide trend toward privatization.

Implications for Policy

If the state cannot be expected to play a role as direct investor, it must find one as facilitator of the new strategy of enhanced export competitiveness. In the words of one Caribbean commentator, "The state must be the jockey, not the horse." Being an effective jockey means creating a climate conducive to rapid expansion of export-oriented investment by both the domestic private sector and international corporations. While this formulation sounds innocuous enough, it amounts to nothing less than a revolution in economic policy in the Caribbean. Moreover, this revolution can potentially undermine the carefully crafted social compromise that underlies the stability and democratic character of most of the islands.

It is helpful to approach the issue of investment climate from the perspective of international investors, who must be attracted to a given location and therefore define the lengths to which the state must go in making a country hospitable to investment. For such investors, the *sine qua non* for local attractiveness is macroeconomic stability. Wild swings in inflation and interest rates, along with abrupt movements in the exchange rate, damage the ability of an international investor to realize and repatriate profits.

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[30] Davidson, William H. The Location of Foreign Direct Investment Activity. *Journal of International Business Studies*, Fall 1980. p. 9–22.

[31] To the extent that trade tensions continue between the United States and the Asian NICs, a strategy of expanding investment inside the U.S. tariff wall may make sense to Asian firms.

Macroeconomic stability in turn requires stability of policy direction in the economy. One recent student of international investment noted that the "fear of policy inconsistency" is now the premier concern of foreign investors. Allaying these fears "requires going beyond the advertising of a good investment climate in the present, to finding a way for host authorities to bind their own hands (and the hands of their successors) as far as six to eight years in the future.[32]

With some notable exceptions, the past history of the Caribbean contains little of this sort of macroeconomic stability or policy consistency.[33] Instead, governments have regularly monetized deficits to maintain expansions, only to face sharp contractions and currency devaluations when the prior strategy proved unsustainable. Such strategies purchased a measure of social peace but at the price of a deterioration in the islands' investment climate.

This history suggests three basic observations about the future of economic policy in the Caribbean:

1. *Monetary autonomy is a major threat to macroeconomic stability.* DeLisle Worrell of the Central Bank of Barbados notes that "central banks were a potential source of economic instability from their inception," largely because they gave governments the opportunity to cover fiscal deficits with money creation.[34] These potential disadvantages were counterbalanced in the past by the ability to use monetary policy to cushion an island economy against shocks, but given the recent trends toward integration of global capital markets, it is appropriate to ask whether these advantages are still worth the potential instability associated with independent national central banks, particularly in light of recent movements elsewhere toward restricting national monetary autonomy.[35]

If it were decided that limiting autonomy made sense for the small nations of the Caribbean, there are two routes the region could pursue. The first would involve following the lead of Puerto Rico and Panama and adopting the U.S. dollar as the national currency. The second would be to follow the lead of the Eastern Caribbean states, which have established a multi-island central bank with strict limits on its ability to finance fiscal deficits in member states. The international stability of the Eastern Caribbean dollar throughout the 1980s puts it in sharp contrast to the national currencies of other, much larger islands in the region.

2. *Fiscal policy must also be reshaped to improve the climate for export-oriented investment.* Internationally mobile capital is notoriously averse to taxation, and the locational disadvantages of devel-

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[32] Moran, Theodore. Shaping a Future for Foreign Direct Investment in the Third World. *Washington Quarterly*, v. 11, Winter 1988. p. 119–130.

[33] The OECS countries have generally had a more stable macroeconomic environment than have other Caribbean countries, owing partly to their decision to adopt an umbrella central bank that separated control of fiscal and monetary policy.

[34] See chapter 10 of *Democracy in the Caribbean.*

[35] Throughout the 1980s, the process of European integration convinced most of the nations of Europe to abandon national monetary autonomy, first by linking their currencies together in the European Monetary System and more recently by endorsing the concept of a European Monetary Union managed by a single "Euro-Fed." They have apparently decided that encouraging investment through regional monetary harmonization was worth the costs of diminished national flexibility in responding to external shocks. Singapore, a highly successful NIC, also abandoned monetary autonomy by electing to set a firm external exchange-rate target and sticking with it despite domestic distress. See Yuan, Lee Tsao. The Government in Macro-economic Management. In Krause, et al. *Singapore Economy Reconsidered.* p. 132.

oping countries strengthen the argument for low taxation of capital income as a device for attracting investment. [36] Yet in the Caribbean, few islands have a fiscal system capable of extracting adequate revenue to fund public services without taxing capital. Individuals either have too little income, are too hard to monitor, or derive too much of their income from the "informal economy" to provide an adequate tax base. Governments have therefore generally struck a deal with local investors to tax capital income directly (in return for import protection) or to tax it indirectly (in the form of duties on imports). Both arrangements serve to entrench external protection and force external investors to seek refuge in duty-free export-processing zones.

Yet changing the tax climate to be more favorable to investors holds enormous potential for social conflict, since such changes require either an overall shrinkage in the activities of the state or a redistribution of the tax burden to noninvestors. Both of these trends can be seen in the tax reform effort in Trinidad and Tobago, where a new value-added tax, combined with a cutback in government services and subsidies, fanned the popular resentment that gave rise to the looting that followed the July 1990 hostage taking.

Improving the investment climate while avoiding a regressive shift in taxing and spending is possible, but only if a government is prepared to confront the power of domestic elites in its search for a more competitive strategy. Most local wealth in the islands is held in the form of real estate, which largely escapes effective taxation. Unlike machinery, real estate is an "immobile" factor of production, whose taxation would not diminish an island's international competitiveness. Yet even the very broad-based "tax reform" effort, recently undertaken in Puerto Rico, completely avoided any reform of the property tax system.

3. *Public spending to promote investment must expand significantly, possibly at the expense of more traditional governmental functions.* One of the paradoxes of the contemporary world is that investors demand services from the state but are unwilling to pay for them through taxes on property income. In the Caribbean, exporters are demanding better roads, ports, electricity, and telecommunications facilities as a precondition for new investment, as well as expanded police protection to lower the costs to exporters associated with the region's drug trade. [37]

At the same time, attracting international investment capital requires a substantial increase in public-spending for education, training, and other "human capital investments." This means not only improvements in basic literacy, which is already high on many islands, but also substantial improvements in secondary and

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[36] A recent article on international taxation observed: "In the world today, some forms of incentives are necessary in order to match those offered by competing host countries in attracting capital investments. In the tax area, such incentives should reduce the level of taxation in the host country to its average level in the home countries of the investors, and preferably across the board as part of a comprehensive tax reform plan available to all taxpayers." See Hadari, Yitzhak. The Role of Tax Incentives in Attracting Foreign Investments in elected Developing Countries. *International Lawyer*, v. 24, Spring 1990. p. 152.

[37] The U.S. policy of "zero tolerance" for drugs on any ship or airline has resulted in heavy fines on shippers operating in the Caribbean. Some shipping lines have withdrawn from direct Caribbean-to-U.S. shipping, raising the specter of rising freight rates and diminished service. Richardson, Helen. Troubled Growth for Caribbean Sourcing. *Transportation and Distribution*, February 18, 1989.

technical education. The lack of managerial and technical expertise in particular appears to be a concern to international firms evaluating Caribbean locations.[38] With island education budgets already strained by efforts to attain universal primary enrollments, it may prove difficult to accommodate these additional demands.

In addition to spending more on infrastructure, most islands need to invest substantial resources in the promotion of local exports in global markets. Ideally, this is a task that could be accomplished on a regionwide scale, through the creation of a Caribbean-based export trading company, since the costs of marketing in global markets are high. Such investments are particularly necessary if the strategic goal is the expansion of exports by locally-owned firms that lack established international marketing networks. In addition to spending on such investment "incentives," governments also find themselves called upon to bear increased fiscal burdens as a result of *successful* attraction of foreign investment. Manufacturing and tourism both create heavy environmental burdens, and remediation of these burdens falls on the public sector.

CONCLUSION

The policies needed to reshape the investment climate in the islands involve fundamental tampering with the social and political contract that has produced social stability and political democracy for most of the postwar period. The state will find fewer resources at its disposal to manage social conflict and may find itself called upon to repress dissent arising from its "development" policies. To the extent that the "Washington Consensus" urges the islands to follow the development model of the Asian NICs, it is important to recall that serious repression of labor demands in pursuit of international competitiveness has been a fundamental part of that strategy.[39]

As pointed out by historian Franklin Knight and political scientist Evelyne Huber, an ability to craft ingenious social compromises has been an essential part of the Caribbean political structure for decades.[40] The best hope for the economic future of the islands is that this capacity will enable them to meet the challenges of a more competitive international environment without sacrificing the open character of their societies.

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[38] See Kramer, Incentives and Impediments.

[39] Huff, W.G. Patterns in the Economic Development of Singapore. *Journal of Developing Areas*, April 21, 1987. p. 311.

[40] See chapters 2 and 5, respectively, of *Democracy in the Caribbean*.

THE CARIBBEAN AND HEMISPHERIC FREE TRADE

by Richard L. Bernal *

CONTENTS

INTRODUCTION

There is now a new phase of globalization of trade, production and finance which is rapidly sweeping away national barriers to the movement of goods, services, capital and finance. Genuine global production cannot be undertaken efficiently if there are national impediments. Global corporate integration is the fundamental economic development behind the dismantling of national barriers (e.g. tariffs, quotas, exchange controls) and the movement to regional groups within which there is a common market for capital and goods. The institutional dimension of this is a resurgence of global corporate integration through mergers which denationalize ownership [1] and which require multi-country market integration. Global corporate integration is one of the driving forces behind regional economic integration because the latter facilitates the minimizing of differences arising from national variations in monetary policy, taxation and regulatory regimes. The process of globalization has impelled a deepening of the integration process in the European Community (EC).

The Uruguay Round of the General Agreement on Tariffs and Trade (GATT), which seeks to further liberalize trade and invest-

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[1] National ownership of major corporations is giving way to globally diffused ownership leading to the "irrelevance of corporate nationality." See Reich, Robert B. *The Work of Nations.* New York, Alfred A. Knopf, 1991. Chapters 11 and 12, particularly.

ment, was a natural extension of globalization. In this scenario, the GATT would be the institutional and regulatory framework for global trade liberalization. The difficulties experienced in the Uruguay Round negotiations indicate that this round could end in a partial resolution. There is the distinct possibility that the disintegration of GATT negotiations could provoke a proliferation of bilateral trade arrangements, and intensify the tendency to form trade blocks [2] and regional trade arrangements which raise protectionist barriers to exports from other groups and countries.

Against this background, the severe economic crisis of Latin America and the Caribbean during the 1980s compelled a re-examination of economic policy. The region responded to the economic stagnation with reorientation of economic policies to focus on economic reform, stabilization, and structural adjustment in an attempt to initiate a private-sector led, market-driven, outward-looking growth strategy. An important aspect of this for most Latin American countries and many Central American and Caribbean countries has been a substantial reduction in tariffs and the removal of quantitative trade restrictions.

In recent years, Latin America and the Caribbean have assumed increased importance as export markets. The region accounts for only 14 percent of U.S. exports, [3] but this is larger than exports to Japan and to the newly industrialized countries (NICs) of East Asia. Latin America has been a market in which there has been steady increase in demand. [4] Exports from the United States increased by 70 percent since 1986 growing from $31 billion in 1987 to over $54 billion in 1990. The U.S. share of the region's imports has grown from 46 percent to almost 55 percent. [5] Some observers believe that Latin American and other developing countries are replacing Europe and Japan as the major source of growth in U.S. exports. [6]

A dramatic process of democratization has also blossomed simultaneously in several countries throughout the region. The United States wants to tangibly support democratization in the region and to rehabilitate economic growth, especially where this is taking the form of private-sector led growth strategies. The United States is anxious to stabilize the region because of concerns about security, drug trafficking and illegal migrants.

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[2] The establishment of a common market in the EC in 1993 will set in motion countervailing responses by the United States and Japan leading to a global economy of "managed trade" and "Quasi trading blocks." See Thurow, Lester. *Head to Head: The Coming Economic Battle Among Japan, Europe and America.* New York, William Morrow and Company, 1992.

[3] In 1987, Latin America and the Caribbean accounted for 14 percent of total U.S. exports and 13.6 percent in 1990. See *U.S. Exports to Latin America and the Caribbean: A State-by-State Overview 1987-1990.* Washington, U.S. Department of Commerce, International Trade Administration, and U.S. Agency for International Development, March 1992. p. 7.

[4] President Bush has stated that a "prosperous Latin America is a natural market for U.S. goods and services. Strengthening our neighbors' economies will result in more exports." See text of Remarks by the President in an address to the Council of Americas Dinner. Washington, Office of the Press Secretary, White House, April 23, 1992. p. 4.

[5] World Bank. *World Development Report 1990.*

[6] Brownstein, Vivian. The Economy Comes Back. *Fortune*, July 13, 1992. p. 60.

Regional Trade Liberalization Initiatives [7]

There has been a resurgence of interest in regional trade liberalization, regional integration, and cooperation. This momentum actually preceded the Enterprise for the Americas Initiative (EAI), although the Enterprise complimented and may have accelerated this process. [8] On March 26, 1991 the presidents of Argentina, Brazil, Paraguay and Uruguay signed the Treaty of Asúncion, which has as its goal the establishment of a Southern Common Market (MERCOSUR) by December 1994. These countries have already reduced tariffs on trade among themselves, and are discussing the establishment of a common external tariff (CET). The Andean Common Market Pact was signed by Bolivia, Columbia, Ecuador, Peru, and Venezuela in May 1991. Subsequently, a number of measures have been taken to eliminate restrictions and to standardize various regulations. Within the framework of the Andean Pact, Columbia and Venezuela signed a partial free trade agreement (FTA) covering 6,000 goods and which came into effect on February 6, 1992. The group has pledged to establish a common agricultural policy and to harmonize exchange and fiscal policies.

Existing regional integration schemes such as the Caribbean Common Market (CARICOM) and the Central American Common Market (CACM) have regained momentum. The CACM was originally established in 1961, and by 1969, nearly 95 percent of trade had been granted duty free status. However, the CACM collapsed during the 1970s because of political and ideological differences among the governments. In July 1991, the CACM countries agreed to reestablish the common market. El Salvador, Guatemala, and Honduras have signed an agreement to establish a free trade zone by January 1993. The CACM plans to negotiate a FTA with Mexico by 1996 and to join a North American Free Trade Agreement (NAFTA) as soon as possible. The CARICOM was established in 1973 as further integration of these economies which had previously traded in the Caribbean Free Trade Association. During the 1980s, intraregional trade declined sharply due to severe economic recession in several member countries and the collapse of the regional payments facility. In 1984, CARICOM members agreed to establish a CET which at present is partially implemented. On July 2, 1991, CARICOM and Venezuela signed a FTA with free entry to the Venezuelan market with reciprocity phased in over five years.

While the new impetus towards regional free trade is a welcomed development, the viability of geographic groupings is threatened by the uneven pace of liberalization among the countries. A recent illustration is Bolivia's contemplation of seeking full membership in MERCOSUR because its tariffs are lower than other Andean Pact member countries. [9] The efficacy of regional arrangements and bi-

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[7] For a recent review of regional trade liberalization schemes in Latin America see: U.S. International Trade Commission. *U.S. Market Access in Latin America: Recent Liberalization Measures and Remaining Barriers*. Washington, June 1992.

[8] Some observers date the liberalization momentum to as early as 1986. See: Organization for Economic Cooperation and Development and Inter-American Development Bank, 1991. Free Trade Areas, the Enterprise for the Americas Initiative and the Multilateral Trading System. In *Strategic Options for Latin America in the 1990s*. Bradford, Colin J. Jr., ed. p. 259.

[9] Kendall, Sarita. Bolivia puts Andean pact in doubt. *Financial Times*, July 7, 1992.

lateral FTAs in promoting the expansion of trade is constrained by the proliferation of agreements. Numerous bilateral agreements have been initiated and are in various stages of negotiation and implementation, e.g., the Colombia/Venezuela FTA and the Mexico/Chile FTA. The overlapping legal frameworks could very well inhibit trade, as they complicate the conduct of trade and confuse traders.

ENTERPRISE FOR THE AMERICAS INITIATIVE AND THE NORTH AMERICAN FREE TRADE AGREEMENT

The U.S. economy has had a persistent trade deficit, and there is a growing perception that protectionism and unfair trade practices by Japan and other trading partners have been a principal contributor. The further integration of the EC in 1992 and its collective intransigence in the GATT negotiation, particularly over agricultural subsidies, has been interpreted by the U.S. government as protectionism to maintain a trade bloc. [10] The difficulties experienced in expanding exports to the Asian NICs has compounded the feeling of being embattled in a world compartmentalized by protectionist trade blocs. In 1987, the United States and Canada concluded a FTA; and, in June 1990, Mexico and the United States announced their intention to negotiate a comprehensive bilateral FTA, which was later expanded into the trilateral NAFTA by the inclusion of Canada. The difficulties experienced in completing the negotiations of the Uruguay Round of GATT have aroused fears that the negotiations could end in disarray or fail to resolve key issues of the agenda. The formation of the NAFTA and the Enterprise for the Americas Initiative (EAI) may serve both trade liberalization [11] and as a negotiating tactic [12] by providing a regional option which the United States will fall back on if it is not able to achieve its objectives within the GATT negotiations. [13]

The EAI, which was launched in June 1990 by President Bush, consists of three components:

1. Trade Liberalization with the aim of creating a Western Hemispheric Free Trade Agreement (WHFTA) through a series of free

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[10] The creation of a common market in the EC in early 1993 is widely felt to be detrimental to U.S. exports. Many estimates suggest a small decline in exports because of trade diversion. See: U.S. Congressional Budget Office. *How the Economic Transformations in Europe Will Affect the United States.* Washington, D.C., December, 1990. p. XV and p. 9–38. It should be noted that one study projected a positive impact because trade creation would exceed trade diversion. See: Hufbauer, Gary C. *Europe 1992: An American Perspective.* Washington, D.C., Brookings Institution, 1990. p. 22–23.

[11] It has been suggested that the United States could use the creation of FTAs with individual countries to press for multilateral free trade. See Dornbusch, Rudiger W. Policy Options for Freer Trade: The Case for Bilateralism. In Lawrence, Robert Z. and Charles L. Schultze, eds. *An American Trade Strategy: Options for the 1990s.* Washington, Brookings Institution, 1990. p. 106–133.

[12] Douglas Seay has argued that regional free-trade agreements could "demonstrate forcefully to the EC and other protectionists that America has the option of establishing its own free-trade system and that countries that pursue protectionist policies risk exclusion from these and other markets." See: A Seven-point Strategy to Push Europe to Free Trade. Heritage Foundation Backgrounder, No. 839, July 8, 1991. p. 13.

[13] The U.S. Government has maintained that the EAI/NAFTA and the GATT are complementary. At a seminar on "The United States and Argentina in Relation to the Enterprise for the Americas Initiative" at The American University on June 12, 1991, Myles Freschette, Assistant U.S. Trade Representative for Latin America, the Caribbean and Africa stated: "Some have interpreted the Enterprise for the Americas Initiative as a U.S. contingency plan for a failure of the (GATT) Round, or as an indicator of a trading system breaking down into blocs. In truth, the opposite is the case: The EAI and the Uruguay Round are complementary."

trade agreements commencing with NAFTA. Succeeding agreements would depend on the readiness of countries. The United States has repeatedly stated that it sees the process of creating hemispheric free trade as taking many years, at least a decade and probably longer, [14] recognizing that trade on a completely reciprocal basis cannot be achieved within a short time-frame. In May 1992, President Bush indicated that an FTA with Chile would follow the completion of NAFTA. [15]

2. Promotion of private investment flows by: a) the creation of an investment sector loan program within the Inter-American Development Bank to provide resources to support privatization efforts and to create an environment which promotes increased entrepreneurship; and b) the creation of a Multilateral Investment Fund of U.S.$1.5 billion to be capitalized between 1992 and 1996. The fund would furnish financial and technical assistance to support privatization, private enterprise development, and business infrastructure.

3. Reduction of the stock of external debt by reducing debt owed to the U.S. Government. This involves two strategies: a) For concessional and P.L. 480, or food aid loans, a portion of the debt stock will be reduced with interest on the remaining portion payable in local currency. Interest payments will fund environmental projects. b) The debt owed to the U.S. Export-Import Bank or to the Commodity Credit Corporation will be reduced through a sale of the debt on the secondary market.

Caribbean Trade

The Caribbean (excluding Cuba) consists of very small economies, many of which are microstates. In fact, even if the entire region is aggregated, it is small, with a total population just over 19 million [16] spread over 197,000 square miles in 16 independent countries. The gross domestic product (GDP) of the region (excluding Cuba) is only $22 billion. [17] The smallest microstate is St. Kitts and Nevis, which has a population of 42,000 in an area of 104 square miles. These economies are so minute that they have to be differentiated from the conventional concept of small economies such as Singapore, which has a GDP of $28 billion, or Hong Kong, with a population of 5.7 million. [18] In these circumstances small size is an additional constraint on development, which is reflected in the size of the market, narrow range of resources, and lack of economies of scale.

The Caribbean's trade and capital flows, both foreign investment and loans (concessional and commercial) are concentrated on the United States. Over 50 percent of the region's trade is with the United States. Caribbean exports to the United States amounted to

[14] Testimony of Ambassador Julius Katz, Deputy U.S. Trade Representative before the Committee on Finance, U.S. Senate, April 24, 1991. p. 6.

[15] The White House. Statement by Press Secretary. May 13, 1992.

[16] World Bank. *World Development Report 1990.*

[17] U.S. Library of Congress, Congressional Research Service. *The Caribbean: A Primer on the Region's Independent Nations.* Washington, CRS Report 90-445F, September 14, 1990. p. 19.

[18] World Bank. *World Development Report 1990.*

$4.8 billion in 1990, having grown by 24 percent since 1987. [19] Exports from the United States to the region grew even more rapidly, by 33 percent between 1987 and 1990, when the total reached $5.6 billion. This level of exports provides an estimated 110,000 trade related jobs in the U.S. economy. [20] This makes the Caribbean one of the few regions where the United States has a favorable trade balance, and one which has grown steadily, as exports have increased. [21] Canada is the region's second most important trade partner; the region imported U.S.$1.9 billion from Canada in 1990 and total exports amounted to U.S.$1.1 billion. [22]

Most of the region's exports enter the United States, Canada, and the EC under the respective preferential arrangements of the Caribbean Basin Initiative (CBI), CARIBCAN, and the Lome Convention. This means that many of the exports from the region have not faced competition in the global market place, and for some leading exports, like sugar, bananas, and garments, prices may be uncompetitive. This is particularly true in the CARICOM countries, which have always exported within preferential trade arrangements, starting during the colonial period when they were confined to the British market by mercantilist restrictions. Upon independence in the 1960s, most exports continued to have preferential access to the British market and to the EC under succeeding Lome Conventions. In 1984, the United States extended preferential market access under the Caribbean Basin Economic Recovery Act (CBERA), the centerpiece of the CBI. This provides duty-free entry into the United States for nearly all products from eligible countries. Several items, however, which account for a significant percentage of U.S. imports from CBERA-eligible countries, are excluded from the program. These items include most textiles and apparel, canned tuna, petroleum and petroleum products, most footwear, handbags, luggage, gloves, leather wearing apparel, and watches and watch parts of Communist country origin. Canada's CARIBCAN and the EC's Lome convention arrangement provide one-way market access for exports from the CARICOM countries.

The adjustment to the removal of preferential treatment for exports would be severe on Caribbean economies, particularly the English-speaking countries which have been the beneficiaries of such arrangements for over three-hundred years. The dislocation would be compounded because free trade would also have a dramatic impact on producers for the national market, especially the manufacturing sector, which developed behind high levels of protectionism. The manufacturing sector has been insulated from exposure to competition from imports as a deliberate strategy of nurturing import-substitution industrialization by protectionism.

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[19] U.S. International Trade Commission. *Annual Report on the Impact of the Caribbean Basin Economic Recovery Act on U.S. Industries and Consumers: Sixth Report 1990.* Washington, September 1991.

[20] Calculations are based on the assumption that every $1 billion of U.S. exports supports 20,000 jobs. Assumption based on testimony of Ambassador Carla A. Hills, United States Trade Representative before the Trade Subcommittee of the Committee on Ways and Means, U.S. House of Representatives, Washington, May 14, 1992. p. 2.

[21] Although small in amount, exports to the Caribbean are important to U.S. economic growth as total U.S. exports are estimated to have accounted for over 40 percent of U.S. economic growth since 1986. See: U.S. Department of Commerce. *North American Free Trade Agreement: Generating Jobs for Americans.* May 1991. p. 3.

[22] Statistics Canada, International Trade Division.

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THE CARIBBEAN'S READINESS FOR FREE TRADE

The Caribbean's movement towards free trade requires a change in the entire historical basis and structure on which production and trade have been conducted. The profound adjustment has two elements: 1) liberalization of the trade regime governing imports; and 2) internal economic reform and structural adjustment to create a genuine market economy. This process has been going on since the late 1970s in countries like Jamaica, Guyana, Trinidad and Tobago, and the Dominican Republic. These countries have implemented a series of International Monetary Fund (IMF) stabilization programs and World Bank adjustment programs to increase growth, reduce the balance of payments deficit, and control inflation. The liberalization of trade regimes has varied throughout the region, but is well-advanced in Jamaica, the Dominican Republic, and Costa Rica. But the imminence of the NAFTA and the concomitant erosion of benefits of the CBI confront the Caribbean with the need to accelerate the completion of the adjustment process in preparation for competition in the global marketplace without the advantages of preferential treatment for their exports.

The question which immediately confronts the Caribbean countries is whether they want to move quickly towards free trade by participating in the NAFTA, or whether they will wage a rear-guard action to preserve preferential trade arrangements. They must decide quickly whether they want to meet the criteria to qualify for participation in NAFTA and the EAI. There has to be a detailed process, weighing the costs and benefits, to determine whether more costs are associated with participating than with staying outside of the process. Given that the EAI encompasses trade in services, investment, and intellectual property rights, meeting the eligibility criteria implies a particular growth strategy which not all governments in the region are at the moment inclined to pursue. This strategy is an outward-looking, private-sector led, market-driven growth strategy which involves privatization and liberalization. Governments should pursue this type of growth strategy only out of conviction not out of expediency.

Can Caribbean economies meet the eligibility criteria in their entirety in the foreseeable future? This will be especially difficult question for the micro-states of the Eastern Caribbean to resolve, and may require a much more extended adjustment period than the more developed economies of the region.

To be considered an acceptable partner for the negotiation of a free-trade agreement with the United States, the following criteria have been outlined by the Bush Administration: [23]

1) elimination of tariffs on substantially all the trade between the parties to the agreement. (This would include trade from all other countries already included in the customs union.); 2) phase-out of non-tariff barriers; 3) inclusion of services in the agreement; 4) provision for standards for the treatment of investments, guaranteeing the principle of national treatment of investors. (There should be no inclusion of "trade-distorting performance require-

[23] Katz, Julius. p. 7; and U.S. House of Representatives, Washington, *Enterprise for the Americas Initiative Act of 1991.*, H.R. 964, 102nd Cong., 1st Sess., February 19, 1991.

ments" on the part of investors.); 5) inclusion of a dispute settlement mechanism; 6) assurance of the protection of intellectual property rights; 7) inclusion of special provisions, if necessary, to handle trade in and access to natural resources and natural resource-based products; 8) inclusion of a variety of operational, technical, and security provisions such as rules of origin and public health safety exceptions and safeguards; 9) monitoring of government actions that could undermine the basis of the agreement, such as provisions covering subsidies, state trading, trade restraints justified on balance-of-payment grounds, and the use of foreign exchange restrictions and controls; 10) a stable macroeconomic environment and market-oriented policies as certified by the IMF, World Bank, and Inter-American Development Bank; 11) displayed commitment by these countries to a multilateral trading system, assessed by the extent to which their positions concur with those of the United States in the GATT Round of Negotiations.

Whether the Caribbean economies are able to take advantage of access to the larger hemispheric market to expand exports depends not only on the policies of governments, but on the readiness and ability of the private sector to compete effectively. Even where Caribbean economies have a comparative advantage it could, as in the past, be offset by the lack of a competitive advantage by locally owned firms. The expansion of exports will depend on a combination of both comparative and competitive advantages. The state of preparedness varies considerably, reflecting economic and psychological factors. In the larger, more advanced economies, e.g. the Dominican Republic, Jamaica, Trinidad, and to a lesser extent Barbados, some firms and financial institutions have become Caribbean multinationals or are branching into the United States, Britain, and Cuba; and there are entrepreneurs whose horizons are hemispheric and even global. In fact, it is the outgrowth of the national market and the process of corporate integration which, like in the EC, is driving the resurgence of regional trade liberalization, including that of CARICOM. In the micro-economies, the private-sector firms are economic minutiae, family-owned and managed, and almost wholly and profitably confined to commerce rather than production, except in the traditional agricultural exports such as bananas. Even a trans-island merger movement would not make them viable, but there is no reason why they cannot be worthwhile joint-venture partners with foreign investors. Apart from infrastructure, all other inputs including technology can be purchased. The difficulties are not insurmountable, but there must be both a recognition and a willingness to compete. Like every process of adjustment, this begins with a change of mind, outlook, and attitude.

THE COMPATIBILITY OF OVERLAPPING TRADE ARRANGEMENTS

The movement toward free trade in the hemisphere raises numerous questions concerning the compatibility of overlapping trade arrangements:

1) What is the compatibility of NAFTA and the EAI with existing trade arrangements such as the Lome Convention and CARIBCAN? For example, in accordance with Article 174 [2(a)] of the Lome Convention, "African, Caribbean and Pacific (ACP) States ...

shall grant to the [European] Community treatment no less favorable than most-favored-nation treatment." [24] This means that any trade concession extended to the United States by CARICOM must also be extended to the EC.

2) What is the compatibility of NAFTA and the EAI with CARICOM? Does CARICOM's CET conflict with the requirements of the EAI? CARICOM's CET has been perceived by some in the U.S. government as protectionist and not compatible with hemispheric-trade liberalization. [25] Similar questions also would confront the Central American Common Market.

3) What is the future of the CBI? Is it to be superseded by NAFTA and eventually the EAI? Will it be upgraded to give similar provisions or will it remain as is? Within the long-term vision of a hemispheric free-trade area, CBI benefits will naturally be lost. In the short-term, it is still to be determined how the CBI will operate alongside the EAI.

Implications of Delayed Entry to NAFTA/WHFTA

It is unclear what the sequencing will be in the creation of a hemispheric free trade area. There are two alternative scenarios. One scenario is the creation of NAFTA first, with countries later negotiating free trade agreements with the NAFTA countries. However, there are no clear criteria indicating the sequence of steps, the ordering of countries, or the schedule. There is a growing worry that securing a free trade agreement with, or joining NAFTA, is going to be difficult because the "Big Three" may lose interest in further expansion, or may want to wait for a period in order to evaluate NAFTA's progress. [26] Moreover, expansion may face political obstacles; since existing U.S. trade law prevents the extension of FTA benefits to third countries, it will be necessary for the U.S. Congress to renew "fast track" authority for agreements subsequent to the NAFTA. [27] This uncertainty has spawned a "hub and spoke" development, with Mexico as the central node of catenation. Consequently, there is now a diplomatic stampede to negotiate, even in principle, a FTA with Mexico to get into NAFTA through the "back door." This jockeying could become unsavory and might be detrimental to the spirit of regional cooperation intended by the EAI.

A second scenario, one frequently mooted, is that NAFTA would constitute the core of the EAI with expansion by "docking" or "accession" by additional countries. Any "associate status" or accession would have to be included as a clause in the NAFTA agree-

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[24] Fourth ACP-EEC Convention signed in Rome on December 15, 1989. *The Courier*, No. 120, March-April 1990. p. 166.

[25] Malpass, David, U.S. Department of State, Statement before the Joint Economic Committee, Congress of the United States, April 2, 1992. It should be noted that no CARICOM country is regarded by the USTR as having barriers to U.S. exports. See: U.S. Trade Representative. 1991 National Trade Estimate on Foreign Barriers. Washington, March 1991.

[26] Ambassador Carla Hills has warned that "The U.S. Congress will want to see the positive results of the North American Free Trade Agreement before authorizing the Administration to launch new free trade agreements with other trading partners in the region." *Trade, the Americas, and the World.* Address by Ambassador Carla H. Hills, U.S. Trade Representative before the Organization of American States Conference of Trade Ministers. Washington, October 29, 1991. p. 4.

[27] Hufbauer, Gary Clyde and Jeffrey J. Schott. *North American Free Trade: Issues and Recommendations.* Washington, Institute for International Economics, 1992. p. 41.

ment before it is submitted for fast-track approval, otherwise, each application for accession would have to be submitted to the process of congressional approval. For the sake of order and equity, it would be necessary to establish and enunciate a clear set of criteria for eligibility into NAFTA.

It has been suggested that the United States should not wait until the NAFTA has been ratified by Congress before starting negotiations with the other countries which are ready. [28] The United States has stated that it simply does not have the resources to negotiate simultaneously with all or several countries. This is difficult to understand given the size of the bureaucracy and the large fiscal budget. In fact, it might be relatively easy to negotiate free trade with CBI countries since the program already embodies substantial unrestricted entry to the U.S. market.

While the question of when to participate depends on the United States and the outcome of the NAFTA negotiations, Caribbean governments must decide whether to seek to participate immediately or whether to delay participation until later. If they wait, there are costs involved. For example, if there is a lag in creating a "level playing field," like Mexico getting free entry for certain products that are now restricted under CBI II, then there will be: a) *trade diversion*, reduced CBI exports to the United States because of relatively higher tariffs or barriers than Mexican exports; b) *diversion of investment and associated technology* from the Caribbean to Mexico as investors opt to install new productive capacity in Mexico and existing industries in the Caribbean, like the garment industry, seek to relocate.

Should the Caribbean proceed as individual countries, or should there be collective participation? If collective participation is available and feasible given the differences in readiness, what collection of countries should proceed? Should this be CARICOM or some wider version of the Caribbean? Collective participation may prove difficult because it involves measures which deal with national policy regimes, e.g., investment codes and intellectual property rights.

DIFFERENT LEVELS OF DEVELOPMENT

How is the treatment of different levels of economic development to be accommodated within FTAs? Indeed, are they going to be accommodated? In fact, this was one of the most contentious issues in negotiating the framework agreements even though they are nonbinding, and only commit the signatories to further dialogue. In negotiating the U.S.-CARICOM framework agreement, the United States was not prepared to accommodate any reference to different levels of development, and the whole agreement could have foundered. The difference was resolved by using the term "undiversified economies," which deals with the fact that Caribbean economies have a structural vulnerability to external events and are in urgent need of structural adjustment because of their very narrow range of production and exports. Since then, the United States has

[28] *Miami Report III.* Recommendations for a North American Free Trade Agreement and for Future Hemispheric Trade. Miami, University of Miami, North South Center, 1992. p. 14.

continued to maintain that there can be no accommodation of different levels of development in a "mature relationship." Some flexibility will be necessary since any regional arrangement aimed at integration and/or trade liberalization must accommodate development heterogeneity, at least initially, including different levels of development, coexistence of a variety of growth strategies, and structural adjustment at varying stages of completion. Indeed, this development heterogeneity is recognized and reflected in CARICOM and the EC, and was conceded by the United States when it granted developing-country status to Israel in the U.S.-Israel FTA.

If the NAFTA and the EAI are to be consistent with the GATT, as several senior officials of the Bush Administration have stated, then the principle of "differential and more favorable treatment for developing countries" will have to be explicitly recognized as it is in the GATT. [29] Article VI notes the special characteristics and importance of trade of developing countries and the need to promote growth and facilitate diversification; paragraph 8 states: "The developed contracting parties (countries) do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less developed contracting parties (countries)." [30]

Reciprocity can have a range of connotations that cannot be reduced to equivalence, but which can consist of conditional or modified "most favored nation" treatment. Asymmetrical adjustment is one way to recognize and compensate for differences in the levels of development. The notion of differential treatment is deeply entrenched in the smaller, less developed countries which receive longer adjustment periods even within CARICOM. It will be difficult to disabuse these countries of this tenet of their philosophy of development, but there can be little opposition to the concept of phasing out differences in obligations over a long period, perhaps 20 years. Clearly, it would be difficult at the outset of an FTA to enshrine special and differential treatment in perpetuity. Instead, there should be specific criteria for graduation to nondiscriminatory status. In practice, the United States has espoused "graduation" by disqualifying certain advanced developing countries from the Generalized System of Preferences. [31]

Should reciprocity be complete and asymmetrical or partial and relative, and should it commence immediately or be phased in over a period of years? The Caribbean's apprehension of immediate and complete reciprocity derives less from the inability to undertake policy measures and institutional changes than from the social and economic costs of structural adjustment. This is a valid concern because in these economies, structural adjustment implies both resource allocation, from extinct to emerging or growing sectors, and resource creation, for the installation of new or upgraded produc-

[29] Yusuf, Abdulqawi A. Differential and More Favorable Treatment: The ATT Enabling Clause. *Journal of World Trade Law*, v. 14, no. 3, 1980. p. 488–507.

[30] However, in Article XXXVII the developed countries only committed to implement Article XXXVI to the fullest extent possible and to accord high priority. See: Dam, Kenneth W. *The GATT: Law and the International Economic Organization*, Chicago, University of Chicago Press, 1970. p. 443–446.

[31] Jackson, John H. *The World Trading Systems Law and Policy of International Economic Relations*. Cambridge, Mass., MIT Press, 1989. p. 278.

tive capacity. There are risks and difficulties involved in improving quality, quantity, and price in order to survive and compete in the vast hemispheric market, with a range of competitors including some of the giant, multi-national corporations, whose assets and sales dwarf the GDP of the combined Caribbean countries. Daunting as this appears, it can be accomplished because the fragmentation of the production process into smaller, discrete processes provides opportunities, and there are specialized niches in the international division of labor which can be filled by relatively small-scale operations.

ADJUSTMENT PERIOD

The period of adjustment is critical and can be general, sectional, or product specific. Product or sector specific adjustment periods, if sufficiently long, would allow these small, "undiversified" economies to implement orderly economic reorganization. Caribbean fears may be exaggerated, since in some areas in the U.S.-Canada FTA, the phase-in period is as long as 10 years. In addition, only a limited number of products would require prolonged adjustment periods or exemptions because production is concentrated on a narrow range of goods and services, and exports consist in many cases of a few primary products. Sensitive products could be handled by "snapback provisions," similar to Article 702 of the U.S.-Canada FTA [32] which permits, under specified conditions, the imposition of a temporary duty on fresh fruits and vegetables. There could also be safeguards such as Article 1101 of the U.S.-Canada FTA, [33] which allows that during the transition period (which ends December 31, 1998), either country may respond to serious injury to domestic producers resulting from the reduction of duties under the FTA by restoring tariffs for a period of no longer than three years. Such action may be taken only once in each industry, and the exporting country is entitled to compensation. An FTA does not have to preclude the invoking of Article XIX of the GATT. The United States and Canada continue their rights under the GATT provision; [34] however, in taking global actions, they agree to exempt each other except in cases where imports from the other country "are substantial and are contributing importantly to serious injury or threat thereof . . ." [35] To meet this condition, imports from the United States or Canada must be at least five to ten percent of total imports and an important, though not necessarily the most important, source of injury.

LAGS IN CREATING A LEVEL PLAYING FIELD

The time lag between when NAFTA would go into operation and when other countries follow or attain similar access is important

[32] Office of the U.S. Trade Representative. *The United States-Canada Free Trade Agreement.* Washington, January 1991.

[33] Ibid.

[34] Morici, Peter. *Transition Mechanisms and Safeguards in a North American Free Trade Agreement.* Paper presented at a conference on North American Free Trade: Economic and Political Implications, Washington, D.C., June 27-28, 1991; Richardson, J. David. Adjustments and Safeguards. In Peter Morici, ed., *Making Free Trade Work: The Canada/U.S. Agreement.* New York, Council on Foreign Relations Press, 1990. p. 68-69.

[35] Ibid.

because it could lead to economic dislocation. Reduced exports and relocation of new and existing productive capacity could result, as well as a diversion of investment away from the Caribbean. Some decisions on investment in the Caribbean have been on "hold" since NAFTA negotiations commenced. [36] Investment diversion is a real danger because Mexico already has certain competitive advantages: a) lower transportation costs; b) lower wages than most Caribbean countries; c) cheap energy; and d) a market size which can yield economies of scale that Caribbean economies would find difficult to realize. Location would give Mexico an advantage in the Western and Southwestern United States, while the Caribbean should be able to compete in the South and the east coast of the United States where, in fact, most of the nation's population centers are located.

Approximately 33 percent of trade with CBI countries enters the United States duty free under normal tariff rates and will not be affected by NAFTA. [37] The U.S. Trade Representative's Office has estimated that based on the initial U.S.-tariff offer in NAFTA negotiations, $4.5 billion, or 60 percent of U.S. imports from CBI countries in 1990, would be put at a competitive trade disadvantage as soon as NAFTA begins to be implemented. In addition, a further $.5 billion, or 7 percent of dutiable CBI imports, would be subject to declining preferential margins over NAFTA. [38] According to a recent study by the Association of American Chambers of Commerce in Latin America (AACCLA), at least 37 percent of Jamaica's exports to the United States are not covered by either the CBI or the Generalized System of Preferences (GSP). Nearly all of this represents textiles and textile products which would be threatened if import barriers on Mexican goods are lowered. In addition, a further 10 percent of Jamaica's exports to the United States enjoy a tariff advantage over Mexico, [39] which could be lost. The products which would be adversely affected are rum, other alcoholic beverages, and orange juice. The AACCLA estimates that about 34 percent of the exports of the Dominican Republic could be vulnerable to Mexican competition. [40]

The NAFTA may provide entry of products excluded under the CBI (textiles, sugar, leather goods, and garments) and put the entry on a much more secure footing because NAFTA would be a contractual agreement in the form of a treaty. The CBI, on the other hand, is not a treaty and, therefore, is subject to unilateral dispensation or withdrawal of benefits, and provides a much less secure basis of market access and, as a result, a more insecure investment environment.

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[36] Thurston, Charles W. Japanese Investors Looking at Mexico. *Journal of Commerce*, April 30, 1992.

[37] *Impact on Other Latin American Economies of a Mexico-U.S. Free Trade Pact: A Preliminary Analysis*. Association of American Chambers of Commerce in Latin America, Washington, October 1991. p. 8.

[38] Ibid.

[39] Ibid.

[40] Ibid. p. 7.

Investment for Export Expansion

Increased debt relief will be necessary if trade is to be stimulated. Commercial bank debt, which is obviously a major concern for the region, has not been addressed in a new or substantive way. Passing reference is made to encouraging the application of the Brady guidelines and is a reflection that U.S. banks are not as exposed to Latin American debt as they were a few years ago.

Some form of aid will be necessary to strengthen physical and social infrastructure that would allow these countries to support and harness private sector entrepreneurial energy and to take advantage of whatever export opportunities might open up. Trade liberalization and debt relief are not substitutes for development assistance, but are complementary because an efficient and expanding private sector requires a competent public sector. Extra demands will be placed on the public sector due to resource reallocation that is inherent in a process of adjustment. To effectively support the revamping and improvement in private sector activity, the public sector will have to be transformed and reoriented. This will necessitate additional resources at the very time when liberalization of the trade regime may engender short-term dislocation in revenue-raising capacity. This is a particular anxiety in the microeconomies of the Eastern Caribbean where fiscal revenue is based largely on import duties. Reduced tariffs and import duties would cause the expenditure capacity of the government to be truncated by the erosion of the traditional tax base, and this would require an overhaul of tax administration.

Development capital (venture capital, equity investment funds, Section 936 funds) is needed to create new productive capacity and export production. There is now a paucity of private-capital inflows to the Caribbean associated with the reconstruction of East Germany and Kuwait, the use of significant resources to assist the Soviet Union and Eastern Europe, and the United States having its own economic difficulties. In this sort of capital shortage, where savings as a proportion of GNP decreased in both the industrialized and developing countries during the 1980s, there is a need to create a component which provides venture capital, equity investment, and development bank financing. One possibility is the restoration of Overseas Private Investment Corporation (OPIC) guarantees for projects funded by Section 936 funds. This question is critical because the problem is not just resource allocation for efficiency, but the need to create new economic capacity and therefore a need for resource creation to enable these countries to take advantage of the trade opportunities.

Since 1984, 789 companies have invested $2.2 billion in CBI designated countries employing 142,016 full-time jobs and generating $1.3 billion annually in foreign exchange earnings.[41] Costa Rica, Guatemala, Panama, El Salvador, and the Dominican Republic attracted two-thirds of the companies and accounted for 92 percent of foreign-exchange earnings, 87 percent of full-time employment, and

[41] U.S. Department of Commerce, Latin America/Caribbean Business Development Center, Caribbean Basin Division. *1990 Caribbean Basin Investment Survey*. Washington, February 1991. p. 7.

78 percent of the assets.[42] For these countries, the main reasons for investing were access to the U.S. market under the CBI, host country investment incentives, and the cost of labor. There is a need for the United States to establish investment incentives that would enhance the region's ability to attract more private capital, even if Caribbean economies succeed in establishing the macroeconomic climate to maximize domestic investment and recapture capital flight. The need to assist the market-induced investment flows derives from the trend towards increasing concentration of foreign investment among the industrialized countries and the paucity of foreign investment in the Caribbean. The U.S. economic recession, following the adverse impact of the Gulf War on tourism, has been a further dampener to the region's economy. The need for investment incentives is urgent to encourage greater use of loans from the Section 936 funds.[43]

ACTION AGENDA

Whether the world economy moves towards the liberalization of trade or the formation of trading blocs, the Caribbean cannot count on the continuation of existing preferential trade arrangements. The Caribbean must recognize that the developed countries no longer feel obliged to provide preferential trade arrangements and aid to a region of economies with minute markets, no indispensable raw materials, and limited strategic importance. The region must be prepared to adapt to the elimination or erosion of preferential trade regimes (e.g., the extension of CBI-type trade benefits to the Andean countries with the passage of the Andean Trade Preference Act approved on November 26, 1991, and the proposed extension of benefits of the Lome Convention to Central America and perhaps to the rest of the developing world). The Caribbean must prepare a strategy for its survival and development in the new world economic and political context. Therefore the Caribbean must:

1) Formulate a growth-promoting adjustment strategy to enable Caribbean economies to survive in a global economy which is undergoing rapid and profound changes, including those represented by the EAI.

2) Undertake an economic evaluation of the costs and benefits of participation in, or omission from, hemispheric free trade. The complete and careful analysis of all aspects of the EAI, the terms and conditions of participation, and its implications for the immediate and long-run future, is a prerequisite for arriving at decisions of such paramount importance and the establishment of objectives.

3) If the decision is to participate, then the Caribbean must decide what kind of EAI it wants or needs and ensure, as far as possible, that the EAI is compatible with existing trade agreements such as CARICOM, the Lome Convention, and CARIBCAN.

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[42] Ibid.

[43] Flax-Davidson, Ron H. Tax-Exempt Investment for the Caribbean Basin Initiative Region. *The International Lawyer*, v. 25, no. 4, Winter 1991, p. 1021-1029; U.S. Library of Congress, Congressional Research Service. *The Possession Tax Credit (IRC Section 936): Background and Issues* by David L. Brumbaugh. CRS Report 88200E. Washington, March 11, 1988.

The Caribbean must not be a passive participant but must be active in shaping the EAI. The Caribbean must seize the opportunity afforded by the unique nature of the U.S. political process and the consultative institutional mechanism of the trade and investment framework agreement with the United States to shape the EAI before it is written on tablets of stone. It is incumbent on Caribbean governments to become active participants in the political process of shaping the EAI by their lobbying efforts and diplomatic initiatives in the United States to help shape the outcome of the Enterprise. This could most effectively be done by collective action on the basis of the wider Caribbean, that is, the traditional Caribbean together with Central America. It is possible for small, vulnerable economies, which are a particular genre of economy with their own peculiar constraints and specific development problems, to argue successfully to receive special consideration and even priority treatment. Time is short; the Caribbean must act now to convert the Enterprise *for* the Americas Initiative, into an Enterprise *of* the Americas Initiative.

CENTRAL AMERICA IN THE 1990s: THE CHALLENGE OF TRADE LIBERALIZATION

by Sylvia Saborio *

CONTENTS

INTRODUCTION

Thirty years ago, the five countries of Central America decided to join forces in an attempt to overcome the disadvantages posed by their small size: thus emerged the Central American Common Market (CACM). The experiment prospered in the 1960s, languished in the 1970s, and nearly collapsed in the 1980s, on account of the financial and political crises that enveloped the region in those years.

Today, with the struggle behind them and a great deal of catching up to do, countries in the region are assessing their options in facing the challenges and opportunities of the 1990s. Specifically, they are searching for ways to integrate more fully into the international economy that will accelerate their development without exacerbating their vulnerability.

This paper examines the evolution of regional trade policy in recent years, summarizes the region's trade profile, and analyzes the implications of trade liberalization for these countries. The paper concludes with a number of considerations concerning the possible impact of the Enterprise for the Americas Initiative (EAI) on the region.

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TRADE AND PAYMENTS POLICIES IN THE 1980S

The payments crisis that struck the region in the early 1980s not only influenced the use of trade and exchange controls in the region. It also prompted a reassessment of the role of international trade in the region's development strategy and the role of the CACM within that strategy. During the initial years of the crisis, the central concern was to reduce external imbalances through import compression; later on, the emphasis shifted to finding ways of expanding exports, so as to more fully integrate these economies into the international economic system at large. The main trends in the evolution of trade and exchange policy over the past decade are summarized below.

PAYMENTS POLICY

For years, the countries of Central America managed to maintain stable nominal exchange rates vis-a-vis the dollar, thanks to relatively low inflation rates, easy access to external credit, and occasional windfall gains linked to surges in export prices. Even though this picture changed radically in the late 1970s, when the payments crisis struck, most countries resisted adjusting the exchange rate, resorting instead to a series of trade and exchange controls. In retrospect, it is clear that these measures were counterproductive: they fueled speculation and capital flight, greatly increased transaction costs, and caused exchange imbalances to spill over onto other markets. It took the better part of a decade to restore normalcy to the operation of exchange markets in these countries.

Costa Rica was the only country in the region to realign its currency early on and adopt a flexible exchange rate regime, which allowed it to maintain a relatively stable effective real exchange rate along a declining trend. (See Table 1.) Guatemala and El Salvador maintained multiple exchange rates until 1989, when they decided to unify their exchange markets and float their currencies. However, while Guatemala was able to depreciate its currency in real terms since 1984, El Salvador's effective real exchange rate remained well above its 1980 level until late in the decade.

Honduras maintained a fixed nominal exchange rate and hence experienced a significant real appreciation of the currency until early 1990, when the lempira was devalued by 50 percent and a flexible exchange rate regime was put in place. Finally, in Nicaragua, hyperinflation led to the adoption not only of multiple exchange rates but of multiple currencies as well. In 1986, the Nuevo Córdoba replaced the old Córdoba at the rate of 1 per 1,000; five years later, the Nuevo Córdoba was replaced by the Cordoba Oro at a rate of 5,000,000 to 1!

Real exchange rate volatility and the extensive use of exchange controls to ration scarce dollar reserves dealt a severe blow to intraregional trade flows. Since foreign exchange was allocated so as to favor essential imports—which most regional products decidedly were not—those imports ended up bearing the brunt of the restric-

TABLE 1. Central America: Basic Macroeconomic Indicators.

	1979–83	1984–88	1989–90
Gross Domestic Product (average annual rate of change)			
Costa Rica	−0.2	4.6	4.6
El Salvador	−4.8	1.7	1.8
Guatemala	0.6	1.4	4.0
Honduras	1.0	3.9	1.2
Nicaragua	−2.5	−3.1	−4.0
Public Sector Deficit (% of GDP) (average of annual figures)			
Costa Rica	12.4	5.4	5.9
El Salvador	7.7	4.2	5.3
Guatemala	4.3	4.0	4.4 [a]
Honduras	9.4	7.9	8.1
Nicaragua	18.0	42.3	31.4 [a]
Current Account Balance of Payments (% of GDP) (average of annual figures)			
Costa Rica	−12.7	−4.3	−7.5
El Salvador	−1.7	1.2	−2.6
Guatemala	−3.8	−4.5	−6.2
Honduras	−9.6	−5.3	−7.3
Nicaragua	−15.5	−19.1	...
Consumer Prices (average annual rate of change)			
Costa Rica	37.4	15.3	17.5
El Salvador	13.8	22.1	20.1
Guatemala	9.0	16.6	25.7
Honduras	11.4	3.9	16.2
Nicaragua	32.7	3,232.9	6,850.0
Real Effective Exchange Rate (average of annual figures, index 1979=100)			
Costa Rica	85.9	81.8	86.0
El Salvador	120.7	151.3	155.0
Guatemala	106.1	82.8	62.7 [a]
Honduras	112.2	121.2	72.6
Nicaragua	135.5	356.4	236.2 [a]
Terms of Trade (average of annual figures, index 1979=100)			
Costa Rica	93.3	113.6	102.5
El Salvador	80.6	82.3	71.6 [a]
Guatemala	93.0	93.6	80.2 [a]
Honduras	95.0	96.0	89.3
Nicaragua	97.5	100.0	101.1 [a]

[a] 1989.
Source: International Monetary Fund.

tions. [1] The bias against intraregional trade was exacerbated by the breakdown and eventual collapse of the regional payments clearing arrangement. The cumulation of large imbalances, primarily by Nicaragua, undermined the multilateral clearing mechanism, which required that uncompensated bilateral balances in

[1] One of the peculiarities of the Central American tariff schedule is that it placed the highest tariffs on the most superfluous goods so as to discourage their use. As a result, it was the local production of these types of products (perfumes, cosmetics) that received the greatest incentives.

local currency be paid in dollars. As a result, creditor countries limited commercial transactions to cash or barter exchanges. The atrophy of the payments clearinghouse thus eliminated an important source of potential economic activity in the region, and precipitated a decline in the share of intraregional trade to levels similar to those prevailing prior to the formation of the CACM. [2]

IMPORT REGIME

Since the establishment of the CACM, the common external tariff and the regional system of fiscal incentives were the cornerstones of import and industrial policy in the region. [3] In the early 1980s, under pressure from mounting external and fiscal imbalances and unable to launch concerted actions in view of the political crisis also enveloping the region in those years, countries resorted to unilateral measures that undermined the spirit—if not the letter—of the regional treaty. Thus, exchange controls and other non-tariff measures came to replace tariffs as the main instrument to control the flow and composition of imports to the region.

The use of import surcharges, for instance, became widespread, with a view both to curbing imports and shoring up fiscal revenues. Even though from an economic perspective surcharges are mere tariffs in disguise, they do provide certain advantages in terms of flexibility: they do not violate outright the common external tariff and, at least in the case of Costa Rica, they are the only form of taxation that does not require a lengthy and controversial process of congressional ratification.

Prior-import deposits, likewise, became prevalent, with the double purpose of restraining imports and contracting internal liquidity. Consumption taxes on non-regionally produced goods, which had an effect analogous to that of tariffs, were also widely used. Finally, extensive use was made of quantitative restrictions, [4] particularly import licensing, though in many cases these were used not so much as import barriers per se, but as a means to allocate scarce foreign exchange reserves among alternative uses.

In 1984, as part of its structural adjustment program, Costa Rica initiated a series of reforms aimed at redressing the anti-export bias of its trade regime. Internally, it adopted a policy of mini-devaluations to gradually reduce the real exchange rate, and established a generous system of incentives for non-traditional exports. At the regional level, it launched a campaign to revamp the region's tariff regime that culminated with the first comprehensive reform of the common external tariff since 1969.

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[2] The share of intraregional exports in the region's export total rose from 6.8 percent in 1960 to 25.4 percent in 1980, dropping to a low of 10.7 percent in 1986. Despite some recovery in recent years, the volume of intraregional trade remains lower than it was in 1980. (See Table 4.)

[3] The first established free trade in regionally-produced goods, set tariffs and other duties on extraregional imports, and specified the exclusions from the common treaty (i.e. basic grains, essential imports). The second established the incentives that could be provided under "Industrial Contracts."

[4] Traditionally, Central America has shunned quantitative restrictions except to maintain support prices for certain agricultural products. In a region that suffers chronic deficits—both fiscal and commercial—quantitative restrictions are considered an inferior form of protection, since they restrict imports but do not generate fiscal revenues.

The reform, which took effect on January 1, 1986, repealed the regional system of fiscal incentives; eliminated all specific import duties and other levies, replacing them with ad valorem rates in the common tariff schedule; and reduced the level and the dispersion of nominal tariff rates. As a result, the average nominal tariff declined by about 50 percent relative to the ad valorem tariff equivalent existing prior to the reform. (See Table 2.) The impact on effective rates of protection is more difficult to ascertain, given the large number of exemptions, exceptions and surcharges to which imports were subjected prior to the reform. However, several studies reveal that the reform merely eliminated the "water" from the tariff schedule, so that the level of effective protection did not change very much in most cases. They also confirm that the structure of protection continued to favor industry over agriculture, and final products over intermediate and capital goods. [5]

TABLE 2. Central America: External Legal Tariff.

(percentages)

	Pre-reform Average Tariff *	Average Legal Tariff, 1987	1991 Range	1993 Range	1995 Range
Costa Rica	52	26 [a]	10-50 [b]	5-30	5-20
El Salvador	48	23	5-35	5-25	5-20
Guatemala	50	25	5-37 [c]	5-20	5-20
Honduras	41	20	4-35 [d]	5-20	5-20
Nicaragua	54	21	5-20 [e]	5-20	5-20

Sources: "Politicas Industriales en Centroamerica y Panama", ECLAC, LC/MEX/R.310, August 5, 1991; World Bank, Trade Liberalization and Economic Integration in Central America, Report No. 7625-CAM, 1990, p. 29 and 32; Ministry of Economy, Industry and Commerce, Costa Rica.

* Ad valorem equivalent of the average external tariff before the reform.

[a] Includes surcharges.

[b] Excludes a temporary surcharge of 2% and a levy of 1% on extra-regional imports. The Central Bank of Costa Rica also requires prior import deposits, currently 30% of the CIF value of the imports.

[c] Excludes a surcharge of 3% on extra-regional imports.

[d] Excludes a general surcharge of 5% and an additional 10% on final products. The surcharges cover all imports, but Central America will be exempt as of 1992.

[e] Excludes a stamp tax of 3% and selective consumption taxes of up to 75% that act as import tariffs. Such taxes will be reduced gradually to 15%.

Since then, unable to agree on a common calendar for future liberalization, countries have followed separate paths to trade reform under structural adjustment programs with the World Bank and their process of accession to the General Agreement on Tariffs and Trade (GATT), invoking escape clause provisions in the regional accord. [6] Currently, tariffs and other import duties range from a

[5] See World Bank: *Trade Liberalization and Economic Integration in Central America.* Report No. 7625-CAM, February 1990; Taylor-Dormond, Marvin: *Estructura de la Proteccion al Sector Industrial en Costa Rica.* San Jose, Costa Rica, PRODESSARROLLO, 1984; and Herrera Amiguetti, Carlos. "El programa de ajuste estructural y la politica comercial de Costa Rica durante las decadas del setenta y del ochenta y perspectivas para la decada del noventa." Comentarios sobre Asuntos Economicos series, No. 93, Central Bank of Costa Rica, 1991.

[6] Costa Rica joined GATT in 1990, El Salvador and Guatemala did so in 1991, and Honduras accession is underway. Nicaragua has been a member of GATT since 1950.

narrow band of 5 percent–35 percent in El Salvador to a wide margin of 5 percent–95 percent in Nicaragua, but there is a commitment to revert to a common external tariff schedule with a floor of 5 percent and a ceiling of 20 percent by the end of 1992, with a few exceptions to be phased out by 1994. (See Table 2.)

EXPORT REGIME

To a large extent, the measures to liberalize import and exchange controls and realign the exchange rate noted above were taken in order to reduce the anti-export bias of the regional economies. At the same time, and for the same purpose, a number of measures were adopted to promote nontraditional exports to markets outside the CACM.

Currently, there co-exist three basic export promotion programs with slight variations among countries. One is the *free zone regime*, under which firms located in designated industrial parks operate under a free trade regime, i.e. they are exempt from import duties and income taxes and are not subject to foreign exchange restrictions. The second is a program for *drawback industries*, which allows firms, regardless of their location, duty-free import of raw materials and intermediate inputs for further processing and re-export, and exempts them from income taxes. Finally, a program of *fiscal incentives for nontraditional exports*, provides import-duty and income-tax exemptions, and in the case of Costa Rica, El Salvador and Nicaragua, includes additional fiscal incentives linked to the value of exports. These programs do not discriminate between local and foreign firms and are thus open to all qualifying investors, regardless of nationality. [7]

In the case of Costa Rica, the response of nontraditional exports to changes in trade policy (including the management of the exchange rate) has been very positive. The average annual rate of growth of such exports over the last seven years has been on the order of 27 percent, and in 1989 for the first time, nontraditional exports as a whole, exceeded traditional ones. Nevertheless, certain flaws in the export promotion program have become increasingly apparent and need to be corrected. The cost of the scheme has become a large and growing burden on the national budget, currently absorbing around 7 percent of government expenditures. There is evidence that the incentives often exceed the margin required to make exports profitable, thus resulting in unwarranted fiscal rents. Finally, there is the risk that such incentives will become a permanent transfer mechanism for exporters, instead of a temporary measure to compensate for the anti-export bias in the economy.

In light of these concerns, and taking into account the experience with export promotion elsewhere, [8] an overhaul of the export promotion programs is in order. In the future, less emphasis should be placed on fiscal incentives per se, and more on measures that contribute more directly to international competitiveness, such as im-

[7] For a discussion of foreign investment regimes in Central Americã, see CEPAL: Politicas industriales de Centroamerica y Panama. LC/MEX/R.310. Mexico, August 5, 1991.

[8] See, for example, Thomas, Vinod and John Nash. Reform of Trade Policy: Recent Evidence from Theory and Practice. *The World Bank Research Observer*, v. 6, no. 2, July 1991. p. 219–240.

provements in infrastructure and transportation, customs administration, quality control, the cutting of red tape, and export credit.

FUTURE COURSE OF REGIONAL INTEGRATION

During the San Salvador summit in July 1991, the Central American presidents undertook a series of important commitments regarding the future course of regional trade policy. [9] Among them:

- the elimination of obstacles to intraregional trade in manufactures as soon as possible;
- complete liberalization of intraregional trade in agricultural products under a common system of price bands by mid-1992;
- reversion to a common external tariff schedule consisting of four basic rates within a range of 5 percent to 20 percent beginning December 31, 1992, with a few exceptions to be phased out by December 31, 1994;
- the reinstatement of Honduras to the Central American Economic Integration Treaty, from which it had withdrawn in 1969; [10] and
- the initiation of a process for the eventual incorporation of Panama into the Central American Economic Integration Treaty.

The presidents also agreed to: proceed with negotiations with Mexico within the Economic Complementarity Agreement (Acuerdo de Tuxtla Gutierrez) for the creation of a free trade area between Mexico and Central America; to ratify the Framework Agreement on Trade and Investment between Central America and Venezuela, which would also be open to accession to Panama; and to step up the pace of negotiations with the United States within the framework of the Enterprise for the Americas Initiative (EAI).

THE CHALLENGE OF TRADE LIBERALIZATION

Notwithstanding the unmistakable tone of the presidential directive, the process of trade liberalization in Central America will not be easy or painless. Not only is there a well-entrenched clientele for protection and privilege among both old industrialists and new age entrepreneurs, but politicians and bureaucrats will, likewise, resent having less leeway to dispense favors to their constituents. On the other hand, the awareness that sweeping changes are occurring in the international arena and elsewhere in Latin America, and that Central America cannot afford to remain at the margin of those events, is a powerful stimulus to action.

The shift from an inward-looking to an outward-oriented strategy poses challenges at the national and regional levels, and raises important questions about Central America's extraregional economic relations. Before addressing these issues, however, it is useful to have a sense of the structure and trends in Central America's trade patterns. (See Tables 3–5.)

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[9] See: *Declaracion de San Salvador*, July 17, 1991.

[10] Honduras formally withdrew from the common market after the "soccer war" in 1969, and subsequently entered into bilateral agreements with the other countries in the region.

TABLE 3. Export Promotion Schemes.

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua
			FREE TRADE ZONES		
Tax exemptions					
Machinery and intermediate imports.	100% [a]	100%	100%	100%	
Profits	100% 8 years 50% 4 years	100% 10 years extendible	100% 12 years	100%	
Local market sales	Up to 40% subject to approval	No limit subject to approval	Up to 20% subject to approval	No limit "when there is not national production of the same," subject to approval	
			DRAWBACK INDUSTRIES		
Tax Exemptions					
Machinery and intermediate imports.	100%	100%	100%	100%	
Profits	100% [b]	100% 10 years	100% 10 years	100% 10 years	
Local market sales	no	No limit	No limit subject to approval	No limit with payment of corresponding taxes	no
Export Incentives	no	Bonus of 8% of value-added	no	no	
			NON-TRADITIONAL EXPORT INCENTIVES		
Tax exemptions					
Machinery and intermediate imports.	100%	—	100%	100%	100%
Profits	100% [b]	—	100% 10 years	100% 10 years	80%
Export taxes	—	—	2%	1%	—
Tax Rebates	Up to 12% of the FOB value [c]	—	—	—	15% of the FOB value [d]
Cash Bonus	—	8% of the FOB value	—	—	—
Requirements	35% minimum national value-added	—	—	Generate at least 25 direct jobs	Export at least 25% of production

Source: "Politicas Industriales de Centroamerica y Panama," ECLAC, LC/MEX/R.310, August 5, 1991.

[a] Normally there are no retrictions for imports to the zone, but raw materials or intermediate imports may be restricted if the Ministry of Industry determines that local products can meet the price, quality and delivery conditions required by the import firms.

[b] In the case of registered foreign investments, a tax of 15% is charged when repatriating the profits.

[c] Declines each year and disappears in 1997.

[d] Declines to 10% in 1993, 5% in 1995 and disappears in 1997.

Note: The figures for Nicaragua are from the proposed "Ley de Promocion de Exportaciones" which has not yet been approved.

CENTRAL AMERICA'S TRADE PATTERNS

The United States is Central America's main trading partner. It is the dominant export market for all categories of exports from the region, with the exception of manufactures (other than textiles and apparel), which are directed primarily at other countries in the region (60 percent) and elsewhere in Latin America (20 percent). The United States is also Central America's dominant supplier of all categories of imports except fuels, where Venezuela (50 percent) and Mexico (20 percent) dominate, and motor vehicles, which come mainly from Japan (44 percent).

TABLE 4. Central America's Exports by Major Partner Regions.

		North America			Other America		Rest of the World			
Year	World (1,000 US$)	USA	Canada	Mexico	Central America	Other Latin America & Caribbean	EC 9	Japan	Other Developed	Other
1980	4,464,982	35.7%	0.4%	0.6%	25.4%	3.4%	23.0%	3.1%	3.3%	5.1%
1985	3,500,527	37.5	1.3	0.6	15.5	4.6	21.6	5.2	4.0	9.6
1986	3,873,284	43.9	1.4	0.4	10.7	4.8	25.3	5.1	4.0	4.4
1987	3,669,902	42.1	1.6	0.4	14.1	4.6	23.7	3.6	4.6	5.3
1988 [1]	3,902,420	37.3	3.3	0.9	14.1	4.2	23.5	4.1	5.4	7.3
1989 [1]	4,429,069	41.0	3.9	1.2	14.8	4.7	20.6	3.8	4.8	5.3
1990 [1]	4,555,327	43.0	3.4	1.4	14.6	4.5	21.5	3.2	4.1	4.4

Source: Comtrade data base, United Nations data, International Computing Center, Geneva. 1987 and 1988 data are based on SITC, revision 2.
[1] Direction of Trade Statistics, IMF.

The importance of the United States as the region's main trading partner is on the rise: between 1980 and 1990 the share of the region's exports absorbed by the United States rose from 36 percent to 43 percent, while the share of imports supplied by the United States increased from 33 percent to 42 percent of the total. Meanwhile, the relative importance of the European Community (EC) as a trading partner has remained largely unchanged: the EC absorbs some 20 percent of the region's exports (mainly coffee and bananas) and supplies around 11 percent of the region's import needs (mostly chemicals, machinery and transport equipment). Two-way trade with Japan and other industrial countries is relatively small; altogether, it amounts to only about 10 percent of the total.

Trade with the rest of Latin America, including Mexico, is quite asymmetrical, largely because of fuel imports. Currently, Latin America absorbs about 6 percent of the region's exports and supplies around 19 percent of its imports. While the share of imports from Latin America has declined since 1980, this is entirely due to the fall in oil prices; the share of non-oil imports supplied by Latin America has nearly doubled over the decade.

The most dramatic shift in trade patterns has occurred within the region itself. The severe payments crisis that rocked the region in the early 1980s, along with disruptions caused by civil unrest, lead to a veritable implosion of trade among regional partners. Be-

TABLE 5. Central America's Imports by Major Partner Regions.

Year	World (1,000 US$)	North America			Other America		Rest of the World			
		USA	Canada	Mexico	Central America	Other Latin America & Caribbean	EC 9	Japan	Other Devel-oped	Other
1980	6,021,981	33.0%	1.6%	3.7%	18.3%	20.0%	10.7%	7.8%	3.0%	1.9%
1985	5,439,554	27.0	1.1	13.0	10.6	17.3	11.3	5.3	4.0	10.4
1986	4,634,877	31.7	1.5	6.6	10.0	14.0	13.3	6.4	4.9	11.7
1987	5,598,351	31.2	1.7	6.7	11.1	12.7	16.8	7.0	5.8	7.0
1988 [1]	5,551,505	36.8	1.6	6.5	10.2	12.5	13.9	6.0	4.2	8.3
1989 [1]	6,324,269	38.4	1.3	6.6	10.4	12.9	12.6	6.2	4.5	6.9
1990 [1]	6,786,141	42.0	1.2	5.9	10.5	12.6	11.4	5.9	3.5	7.2

Source: Comtrade data base, United Nations data, International Computing Center, Geneva. 1987 data is based on SITC, revision 2.
[1] Direction of Trade Statistics, IMF.

tween 1980 and 1986, intraregional exports fell from 25 percent to only 10 percent of the total; this amounted to a drop of 63 percent in the dollar value of exports! Since then, the share of intraregional exports has risen to around 15 percent of the total; in value terms, though, they are still some 40 percent below their 1980 level. Meanwhile, the share of intraregional imports also fell from about 18 percent in 1980 to only 10 percent. Unlike exports, however, the shift in procurement patterns (towards suppliers in the United States and Latin America) appears to be more permanent, as the share of intraregional imports has remained virtually unchanged since 1985. In 1990, the dollar value of intraregional imports was still 35 percent lower than in 1980.

Two important conclusions can be drawn from this analysis. The first is that despite efforts to promote and diversify exports, throughout the 1980s Central America's exports declined both in volume and in value, and became increasingly concentrated along traditional lines, largely because the collapse of the regional market wiped out a great deal of trade in manufactures.[11] The second is the importance for the countries of Central America of their trade links with other countries in the hemisphere: there they sell two-thirds of their exports and purchase three-fourths of their imports. This generalization, of course, belies crucial differences in the relative importance of various trading partners in the

[11] There are important country differences within this regional picture. Costa Rica, for instance, less oriented to the regional market, with a more diversified export structure and a more aggressive export policy, managed to increase the value of its exports by 40 percent during this period. Honduras, whose exports consist basically of coffee and bananas to the U.S. and European markets and virtually does no trade with the rest of Central America, also managed to increase its exports by 18 percent during the decade. Guatemala, on the other hand, despite a successful drive to increase its nontraditional exports to the U.S. market, did not manage to compensate for the loss in regional sales, and saw its exports decline by 13 percent over the decade. El Salvador experienced a decline of 20 percent in exports on account of the war and the collapse of the regional market where it previously made 40 percent of its sales. Finally, in Nicaragua, as a result of the war, the crisis, and the U.S. trade embargo, exports fell by 40 percent during the decade.

area. Nevertheless, it is clear that anything that affects hemispheric trade relations will have a profound impact on Central America.

TRADE LIBERALIZATION AND INTERNAL ADJUSTMENT

In a way, "openness" is nothing new to Central America. These economies have been extremely "open" in the sense that a large part of their economic activity has always been linked to international trade. While the ratio of trade to gross domestic product (GDP) for Latin American Integration Association countries is currently around 32 percent, in Central America, it ranges from a low of 44 percent in Guatemala to a high of 90 percent in Costa Rica, with the ratios for El Salvador, Honduras and Nicaragua clustering around the regional average of 60 percent. Nonetheless, pockets of activity—notably in industry and basic grain production—have been sheltered from international competition by wide margins of protection in the domestic and regional markets.

Import liberalization will increase competitive pressures within these economies and in the regional market. As a result, some displacement of existing activity is unavoidable. Considering the shocks these economies went through over the last decade, however, it seems reasonable to assume that the most vulnerable firms will have succumbed already and that most of those which survived the debacle are probably capable of withstanding some competition within a generally more favorable economic environment. Anecdotal evidence suggests that many firms have not only managed to cope with the rigors of greater competition in the domestic market, but have become successful exporters as well. Still, competitive pressures will mount as trade barriers continue to decline, and unemployment is bound to rise, unless new job opportunities are created—presumably in export-oriented activities—to pick up the slack.

Export expansion is essential not only on employment grounds. In the face of continuing external financial constraints—due both to credit scarcity and their own limited capacity to assume further debts—these countries' access to imports will increasingly depend on their ability to generate export earnings. In turn, the constraint on external borrowing implies that in order to expand export capacity, these countries must redouble their efforts to increase domestic savings (both public and private) and to attract foreign direct investment in export-related activities. Evidently, success in this endeavor will depend not only on the ability of entrepreneurs to adapt to the new rules of the game, but also on the capacity of governments to support this effort by removing structural bottlenecks that constrain export development and by providing a healthy and stable macroeconomic environment.

Trade reform will require great discipline in the management of monetary and credit policies. Relinquishing the use of direct import and exchange controls implies that external imbalances will need to be addressed through adjustments in the exchange rate and in the level of domestic economic activity. Without strict control of the money supply, currency devaluation would result in severe inflationary pressures in these economies. Moreover, in the context of a large external debt overhang, such as exists in most of these countries, currency devaluations would exacerbate fiscal imbalances insofar as they would increase the local currency cost of servicing such debt.

Indeed, one of the most daunting tasks for these countries will be to grapple with the fiscal implications of trade reform. Currently, import duties alone represent between 20 and 40 percent of total tax revenues in these countries. Deep tariff cuts would, therefore, have a potentially devastating impact on public finances. True, lower tariffs (if uncompensated by devaluation) would expand the import base and potential contraband might come in legitimately instead; in addition, the elimination of some duty exemptions could likewise generate some additional revenues. On the whole, though, these effects are unlikely to prevent a sharp decline in fiscal revenues and on the tax burden, because in the face of external constraints, imports could not expand enough to make up for the reduction in tariff rates. In order to be sustainable, therefore, trade liberalization will require a comprehensive tax reform to shift the tax burden on to some other activity, or else, a downsizing of the state.[12]

In sum, the liberalization of the trade regime in these countries would have important repercussions not only on the allocation of resources between tradables and nontradables—which is what is being explicitly sought—but also on macroeconomic management and even on the role and prerogatives of the state.

TRADE LIBERALIZATION AND REGIONAL INTEGRATION

The lowering of political tensions and the convergence of views regarding the regions's economic future have produced a remarkable integrationist revival in Central America. Honduras' decision to rejoin the common market and Panama's interest in joining as well are clear expressions of the new spirit sweeping the region. So is the pledge made by the five Central American presidents at their summit meeting in Antigua (June 1990), to establish a true "economic community" in the isthmus.[13]

The practical difficulties of such an endeavor must not be underestimated, however. Two hundred years of history prove that it is not easy to forge a "Central American nation" and there exist today, as in the past, severe political and bureaucratic constraints to common action. But even if the integration effort falls short politically, it should be possible for these countries to cooperate economically. The role of regional integration in the context of trade liberalization is somewhat ambiguous, however, and needs to be sharply defined.

There is no inherent contradiction between an outward-oriented strategy and an attempt to reactivate intraregional trade by removing some of the obstacles that contributed to its collapse in the 1980s. In fact, actions or commitments toward this end have already been undertaken, in particular: 1) the elimination of tariffs,

[12] See: Farhadian-Lorie, Ziba y Menachem Katz. Fiscal Dimensions of Trade Policy. IMF Working Paper WP/88/43. International Monetary Fund, May 18, 1988; and Blejer, Mario I., and Adrienne Cheasty. Fiscal Implications of Trade Liberalization. In *Fiscal Policy in Open Developing Economies*. Tanzi, Vito, ed. International Monetary Fund, 1990.

[13] See: *Declaracion de Antigua*. Guatemala, June 1990.

non-tariff barriers, and exchange restrictions on regionally produced goods; 2) restoring the multilateral payments clearing mechanism with the necessary safeguards to avoid the build-up of bilateral imbalances that could once again throw it off kilter; 3) finding an equitable solution to Nicaragua's bilateral debt problem; 4) maintaining a flexible exchange rate policy to avoid real exchange rate volatility among regional currencies; and 5) restoring the infrastructure and improving transport services within the region.

The choice between deepening the process of regional integration or opening up the economy comes up when defining the trade stance vis-a-vis the rest of the world, be it multilaterally or in the context of preferential arrangements. In this regard, the joint decision to reduce tariffs to a maximum rate of 20 percent by 1993, effectively marks the end of the traditional import-substitution integration scheme.

That need not mean the end of regional cooperation, however. In fact, countries in the region could usefully undertake joint actions to improve their competitiveness vis-a-vis the rest of the world, in areas where economies of scale would lower the costs all around. For instance, setting up joint commercial offices, issuing common visas, establishing joint information and marketing systems and inspection and quality control centers. Beyond that, they could move on to more ambitious undertakings, such as consolidating the region's financial markets to improve the quality and lower the cost of financial intermediation, establishing a regional securities exchange, consolidating the national airlines into a regional carrier, and pooling resources to strengthen the region's technological base in order to eventually develop a competitive edge in areas other than low-wage, labor-intensive activities. [14]

Furthermore, in the process of liberalizing their trade regimes, countries will need to make adjustments in other areas, such as taxes, investment, intellectual property protection, and export incentives. While these reforms could be undertaken separately, it would be far more efficient to harmonize them so as to avoid unnecessary (and unintended) distortions within the region. While the track record on regional coordination is not impressive, the hope is that this time around the market will enforce more policy convergence than ministers were able to negotiate in the past.

For the time being, what these countries urgently need to agree on are the basic parameters of trade reform beyond 1992: the pace and depth of import liberalization, and also whether it will be done multilaterally or in the context of preferential trade arrangements.

Central America and the Enterprise for the Americas Initiative

Central America's attitude to the EAI must be seen in the light of two basic facts: 1) the United States is by far the largest and most dynamic market for the region's exports—particularly nontraditional exports; and 2) Central America (along with other small countries in the Caribbean) already enjoys unilateral and exclusive

[14] See: Buitelaar, Rudolf and Juan Alberto Fuentes. The Competitiveness of the Small Economies of the Region. *CEPAL Review*, no. 43, April 1991.

preferences in the U.S. market under the Caribbean Basin Initiative (CBI).

It is true enough that the margin of preference offered by the CBI is small and that certain items of export interest to the region are explicitly excluded from preferential treatment (notably textiles and clothing, footwear, leather goods and canned tuna), while others are restricted (sugar, beef, veal and ethanol). On the other hand, some products such as clothing assembled in the area enjoy certain preferences in terms of duty assessment and guaranteed access levels to the U.S. market under production-sharing schemes. Such advantages in terms of preferential and presumably secure access to the U.S. market—however small—appear to have helped attract investment to the region at a time when the economic and political climate was quite inhospitable, to say the least.

Regardless of the specific merits of the CBI, the point is that being accustomed to having a "special" relationship with the United States based on unilateral and exclusive trade preferences, the region feels somewhat intimidated by the transition to a reciprocal arrangement open to the whole continent. [15]

The most immediate threat is posed by the North America Free Trade Agreement (NAFTA), which would grant Mexican products duty free access to the U.S. and Canadian markets. That would not only erode Central America's trade preferences in the U.S. market, but is likely to divert actual or potential investment from the region to Mexico. Since Mexico is a strong competitor of Central America in virtually all export products to the U.S. market, the mere leveling of access conditions to the U.S. market would pose a threat. If Mexico were to obtain access conditions more favorable than those offered by the CBI, for instance in textiles and clothing and certain agricultural products, the region (along with everyone else) would then face *negative* preferences on those products in the U.S. market. Indeed, preliminary estimates indicate that, next to Brazil, Central America would experience the largest amount of trade diversion—some 20 percent of the total for the entire hemisphere. [16] Even though the sums involved are currently small, they would tend to grow over time, as investment patterns got diverted as well.

Investment diversion is, in fact, the most serious concern. Before the NAFTA deal is even signed, anecdotal evidence is beginning to accumulate of investors shelving plans to invest in Central America and going to Mexico instead, and of others, already established, reconsidering expansion plans or relocation of their plants. Indeed, it will be extremely difficult for Central America to compete successfully in terms of investment attraction with a country of 88 million people, adjacent to the United States, with a more devel-

[15] The siege mentality has been exacerbated by: the U.S. decision to extend essentially the same CBI benefits to the Andean countries; the European Community's decision to grant tariff preferences to the Andean countries on certain products that place Central American exporters at a serious competitive disadvantage in that market (these preferences were extended to Central America beginning January 1, 1992); and the fear that as a result of the single European market, banana sales to Europe will be even more restricted.

[16] See: Erzan, Refik, and Alexander Yeats. U.S.-Latin America Free Trade Agreements: Some Empirical Evidence. In *The Premise and the Promise: Free Trade in the Americas*. Saborio, Sylvia, ed. New Brunswick, N.J., Transactions Publishers in cooperation with the Overseas Development Council, 1992.

oped and diversified productive structure and contractually guaranteed access to the U.S. and Canadian markets.

For all these reasons, Central America's interest in a free trade agreement (FTA) with the United States is primarily of a defensive nature. In fact, in terms of *expanded access*—the principal motivation behind FTAs—Central America would have relatively little to gain, since the barriers it currently faces in the U.S. market are not very high. Around 80 percent of U.S. imports from the region already enter the United States duty free, either on a most-favored-nation (MFN) basis, or under the Generalized System of Preferences (GSP) or CBI programs. Duties on the remaining 20 percent of imports are generally low, except in the case of textiles and apparel and certain agricultural products. Imports of these products are also constrained by quantitative restrictions and other non-tariff barriers. In all, some 15 percent of total regional exports face some sort of non-tariff barrier in the United States, the incidence of such barriers being highest in the case of apparel and foodstuffs. (See Table 6.)

TABLE 6. Access Barriers to the US Market.

	Tariffs		Non-Tariff Barriers		
	Average	(Manufact)	Average	(Textiles)	(Food)
Costa Rica	3.9	(11.5)	26.2	(52.7)	(78.2)
El Salvador	0.8	(5.5)	7.0	(40.8)	(67.5)
Guatemala	0.6	(9.5)	11.4	(8.9)	(64.9)
Honduras	1.2	(9.4)	11.6	(0.0)	(59.8)
Nicaragua	6.7	(5.7)	2.4	(0.0)	(10.6)
Central America	1.8	(10.0)	15.0	(38.0)	(69.2)

Source: International Trade Division, World Bank.
Note: 1986 trade weights applied to 1989 tariff and NTB data. Data for Nicaragua distorted by the US trade embargo.

On this basis, it is clear that benefits in terms of expanded access to the U.S. market would be minimal, unless the United States were prepared to remove tariffs and non-tariff barriers on textiles and apparel and relax a number of quantitative restrictions and other provisions (phytosanitary restrictions, for instance) that affect a large share of agricultural exports. What is unclear is whether the United States will be prepared to make major concessions in these highly protected and sensitive areas. Even if the United States eliminated all tariffs and relaxed non-tariff barriers so as to allow the full effect of the tariff removal to play out, a recent study estimates that Central American exports to the United States would rise by only around 7.6 percent (16.5 percent in the case of Costa Rica, whose exports currently face by far the largest amount of access barriers to the U.S. market). [17]

Another reason often cited for seeking a FTA with the United States is to attain not so much enlarged, as *secure* access to the U.S. market in the future. Specifically, what is usually sought is

[17] Ibid.

protection from the arbitrary use of trade remedies (anti-dumping and countervailing duty actions) on the part of the United States. In the case of Central America, this argument is not very compelling either. In truth, these countries are too small and their exports too marginal to invite such actions. The few cases that have occurred (i.e. cut flowers from Costa Rica) were actually spillovers from unfair trade allegations and investigations made against larger exporters. In any case, in order to avoid such problems, CBI legislation (as amended in 1990) now contains separate cumulation rules and injury test provisions for CBI beneficiaries, which take into account the relatively insignificant size of these exporters. It is true that these provisions could be unilaterally changed by the United States at any time, but for such action to be warranted, these countries must have succeeded as exporters!

Evidently, a FTA with the United States would also have dynamic effects. Given that market access conditions to the United States are not likely to improve markedly for these countries, the main benefits would be those attributed to improvements in the domestic policy environment, coupled with the boost in confidence that locking-in those reforms contractually might have in attracting investment, both domestic and foreign. Conversely, a FTA with the United States would imply significant adjustment costs for these countries. Moreover, in order to take advantage of enhanced market opportunities, they would need to take steps to boost their external competitiveness, since mere trade liberalization will not automatically bring this about, and they will need to undertake reforms in other areas, such as taxation, investment, services, and intellectual property protection. [18]

CONCLUSIONS

The Enterprise for the Americas Initiative presents Central America with several dilemmas. The first is that while the trade gains of entering into a FTA with the United States might be limited, the costs of not doing so would be high. In fact, countries that remain outside the free trade area would lose twice: they would face a competitive disadvantage against member countries in the U.S. market, and they would face a competitive disadvantage vis-a-vis the United States in member countries' markets as well. The cost of exclusion from the FTA would thus be high and rise over time, as more and more countries joined the FTA.

The second dilemma is that if Central America is to join the free trade area, it should do so as soon as possible in order to minimize the cost of exclusion and prevent a temporary competitive disadvantage from becoming a permanent investment loss. The problem is that while the threat of investment diversion is imminent—indeed, it is already happening *in anticipation* of a successful NAFTA—the United States is unwilling, and Central America is unable, to seriously contemplate engaging in FTA negotiations at this time. The United States has indicated that it will not proceed with further FTA negotiations until the NAFTA has been conclud-

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[18] See: Hills, Carla A. Toward a Dynamic New Era of Growth. Speech presented at the Conference on Trade and Investment, San Jose, Costa Rica, August 12, 1991.

ed and assessed. For its part, Central America must undertake a series of reforms before it is in a position to enter into a reciprocal FTA with the United States.

A way to bridge this time gap would be for the United States to extend to Central America (and the Caribbean) on a unilateral, but time-limited basis, whatever preferences it grants other countries under the EAI through, for example, 1995. In turn, the countries of Central America would commit themselves to continue the process of domestic and trade reforms according to existing timetables under agreements with the International Monetary Fund, World Bank, Inter-Amercan Development Bank, GATT and the U.S. Agency for International Development. Monitoring of the compliance with such agreements could be done in the context of the framework trade and investment agreement that the United States already has in place with each of these countries. By 1995, both sides would agree to negotiate in good faith towards a full-fledged reciprocal agreement. The cost of such a concession to the United States would be minimal, as exports from the region account for only around 1 percent of U.S. total imports, and 80 percent of those are already duty-free. On the other hand, such a provision could have a significant impact on Central America's ability to expand exports and attract investment.

Meanwhile, Central America should proceed to liberalize trade both unilaterally and in the context of preferential arrangements based on "relative reciprocity" with Mexico, Venezuela, Colombia and perhaps others in the hemisphere. The amounts of trade involved are small, so that the benefits of such agreements are likely to be modest at best, and they do carry some risk of trade diversion. Nonetheless, as intermediate steps in a broader process of trade liberalization, they would have the advantage of exposing these countries gradually to growing levels of foreign competition. Moreover, if mutually consistent, these agreements would result in a sort of Grand Caribbean Basin region, which might facilitate the eventual establishment of a FTA between this group of countries and the United States.

These attempts to negotiate enlarged and secure access to foreign markets are fine, but they should not distract attention from one basic fact: that the main constraints on Central America's export growth are on the *supply*, not the demand, side. In order to export more, these countries will need to improve their infrastructure and transport systems, financial intermediation, market information and distribution systems, quality control, and customs administration—in addition to removing certain distortions that favor domestic activity over exports. In fact, development of an export culture will require adjustments in the *modus operandi* of both government and business. The former will need to exercise more discipline in the management of public resources, set up an appropriate regulatory framework and provide incentives that are efficient, fair and fiscally sound. The latter will have to learn to put a premium on efficiency and competitiveness rather than on the pursuit of privileges and fiscal rents.

In the end, the most important legacy of the EAI may not be to provide marginally enlarged access to the U.S. market, but to push forward this process of internal transformation in Central America.

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