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The Dynamics of Sectoral Growth in Central America: Recent Trends and Prospects for 2020

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Executive Summary

The Central American countries entered into a severe and prolonged economic depression in the early 1980s. Per capita GDP for the five countries of the Central American Common Market (CACM) fell by a weighted average 18% between 1979 and 1986. In most countries, recovery was barely perceptible until the 1990s, when gross domestic product (GDP) for the region, including Belize and Panama, grew at a weighted average annual rate of 4.3%, or 1.8% per capita, through 1997. This pattern of moderate recovery, facilitated by the adoption of significant economic policy reforms and a strong U.S. economy, was temporarily disrupted by Hurricane Mitch, which devastated Central America in October 1998, with particularly severe effects in Honduras and Nicaragua.

At the end of the 1970s, agriculture was clearly the region's dominant sector. It fared better than the economy as a whole between 1978-80 and 1987-89 but underperformed it between 1987-89 and 1995-97. Agriculture's share of 1997 GDP in current prices was 18%.

The manufacturing sector, according to the national accounts, underperformed aggregate GDP in both periods. However, a significant proportion of *maquila* (assembly) production, whose value added in the region grew explosively from about $165 million in 1990 to about $1.180 million in 1997, is not recorded in the national accounts. Manufacturing's reported 16% share of regional GDP in 1997 thus understates its contribution.

During the 1980s, Central American countries paid little attention to external advice to shrink the size of their public sectors, whose shares of real GDP rose everywhere but Costa Rica. In the 1990s, by contrast, the state shrunk absolutely in real terms in Honduras, Nicaragua, and Panama, and declined relatively everywhere else but Guatemala, where most observers would say a relative increase was desirable to remedy that country's very low spending on social services. Public administration and defense accounted for 9% of 1997 regional GDP in current prices.

The private services sectors contributed 50% of regional GDP in 1997. Commerce, by far the largest of these sectors, declined in relative

importance in the 1980s and only partially recovered its pre-crisis share during the 1990s. Two other sectors - transport, storage, and communications, and finance, insurance, and business services - outperformed aggregate GDP in both periods.

Another notable development was the rapid expansion of mining between 1987-89 and 1995-97, with annual growth rates ranging from 6% to 12% in all countries. However, mining contributes more than 1% of GDP only in Honduras, where the figure is close to 2%.

Central America's economic growth potential in the next two decades lies primarily in the services sectors, and secondarily in manufacturing, including maquila operations. In agriculture, traditional exports will continue to decline relatively and sometimes absolutely. Agriculture's overall performance will depend on countries' abilities to (1) continue diversifying their exports and (2) reduce poverty and narrow income inequality, thus increasing effective demand for domestic foodstuffs. Changes in the structure of production will depend on how well the region adapts its policies and institutions to exploit sectoral growth opportunities, especially in the services sectors.

Overall economic performance will depend not only on national economic policies and entrepreneurial dynamism, but also on world demand for the region's potential exports. The degree to which intraregional (CACM) and hemispheric (FTAA) integration advances will also influence GDP growth, although to a lesser degree.

Key developments in the global economy that will strongly influence Central America's aggregate economic performance and sectoral patterns of growth between 1997 and 2020 include (1) economic growth performance in the industrial and newly industrialized countries; (2) the extent to which world trade is liberalized, particularly for agricultural products and services; (3) the continued globalization of financial markets; and (4) technological progress, especially in telecommunications and information technology, biotechnology, energy, and transport. Sectors or subsectors for which Central America has particularly good prospects include maquila operations and other labor-intensive manufacturing; horticultural products and other non-traditional agricultural exports; telecommunications and information technology; financial services; and tourism.

Three scenarios (base, high, low) are developed for aggregate and sectoral growth to 2020 in the region as a whole, as time and space considerations preclude calculations for each country. Actual growth, of course, will vary by country. Since skilled human resources are a major determinant of long-term economic growth, Costa Rica and Panama are currently best able to exploit growth opportunities, other things being equal, while Guatemala, Honduras, and Nicaragua are the most disadvantaged.

The base scenario assumes that aggregate GDP grows by 4.5% a year. Continued but modest reforms in macroeconomic and microeconomic policies, and in institutional structures, allow countries to take advantage of opportunities in manufacturing and, especially, private services. The share of private services in GDP rises from 50% in 1997 to 55% in 2020; manufacturing's share remains at 16%, while agriculture's falls from 18% to 14%.

Under the high-growth scenario, stronger policy reforms and a dynamic world economy allow aggregate GDP to expand by 6.0% annually. Growth is led by private services, whose share of GDP reaches 58% in 2020. Manufacturing's share of GDP holds steady at 16%, while agriculture's drops to 12%.

The low-growth scenario, based on little progress in policy and institutional reforms and a weak world economy, produces little change in the structure of production. Manufacturing's share of GDP rises from 16% to 18% on the strength of maquila exports, while agriculture's falls from 18% to 16% and the share of private services remains at 50%.

Per capita GDP in the region rises from $1.630 in 1997 to $2.000 under the low-growth scenario, $2.790 under the base scenario, and $3.870 under the high-growth scenario.

Successful, sustainable responses to the challenges of globalization require national strategies with an integrated focus on four interrelated goals: (1) economic growth, (2) poverty reduction, (3) environmental protection, and (4) participatory democracy. Deeper and broader regional integration would strengthen Central America's participation in the world economy.

Key national policy actions that, together with a favorable global economy, could make the high-growth scenario feasible include maintenance of macroeconomic stability; stronger supervision and prudential regulation of financial institutions; pension reform, including the establishment of private schemes; modernization and rationalization of the state, including a reduction of high transaction costs that inhibit private investment; major educational reforms to improve the quantity and quality of skilled human resources; elimination of most remaining price distortions in agriculture (including forestry); adoption of a long-term strategy to convert maquila operations into true manufacturing activities; and effective cooperation between the public and private sectors to promote tourism.

At the regional level, more effective economic integration requires additional measures to liberalize trade, especially in agriculture and services, and eventual adoption of a common currency (perhaps the U.S. dollar). These measures, together with strong macroeconomic policies, would almost automatically create strong regional financial institutions and capital markets.

International donors could more effectively support Central American economic growth by reorienting their support for social investment funds, away from a primary focus on temporary job creation to one centered on directly productive activities; permitting more flexibility in fiscal adjustments to external and internal shocks; supporting consensus-building mechanisms involving governments, business groups, and civil society; strengthening programs that deepen understanding of economic and social policy issues; and improving the quality and timeliness of economic and social data, thus providing better inputs for policy analysis.

Resumen Ejecutivo

A principios de los años 80 los países de América Central entraron en una seria y prolongada depresión económica. Entre 1979 y 1986, el PIB per cápita de los cinco países miembros del Mercado Común Centroamericano cayó en un promedio ponderado del 18%. En la mayoría de los países la recuperación fue casi imperceptible hasta entrados los 90, desde el momento en que el PIB de la región - incluyendo a Belice y Panamá- empezó a crecer a un promedio anual ponderado del 4.3%, equivalente al 1.8% per cápita, fenómeno que se prolongó hasta 1997. Este proceso de recuperación moderada, facilitado por la adopción de importantes reformas económicas y por la fortaleza de la economía norteamericana, se vio temporalmente interrumpido por la destrucción causada en Octubre de 1998 por el huracán Mitch en toda Centroamérica, especialmente en Honduras y Nicaragua.

Hacia fines de 1970 la agricultura dominaba claramente la actividad económica en toda la región. Entre 1978-80 y 1987-89 el sector creció más rápido que el resto de la economía, pero decayó notablemente entre 1987-89 y 1995-97. En precios actuales, en 1997 la participación del sector agrícola en el PIB era del 18%.

Según cuentas nacionales, el sector manufacturero se mantuvo por debajo del PIB acumulado para ambos períodos. Estas cifras, sin embargo, no dan cuenta de gran parte de la producción de las maquiladoras, cuyo valor agregado tuvo un enorme crecimiento en toda la región, pasando de unos US$165 millones en 1990 a cerca de US$1.180 millones en 1997. Así, la participación del 16% en el PIB regional que tiene el sector manufacturero según estas cuentas, en realidad subestima su verdadero aporte.

Durante los años 80 los países de América Central prestaron poca atención a las recomendaciones externas en el sentido de reducir el tamaño del sector público, cuya participación en el PIB real aumentó en todos los países a excepción de Costa Rica. En contraste con lo anterior, durante los 90 el tamaño del aparato estatal se redujo absolutamente en términos reales en Honduras, Nicaragua y Panamá y disminuyó en términos relativos en todos los países salvo Guatemala, donde la mayor parte de los observadores señalan que un aumento relativo era necesario para remediar en parte el extremadamente bajo gasto social. En precios actuales, hacia 1997 la participación en el PIB regional de la administración pública y la defensa alcanzaba al 9%.

En el mismo año los sectores de servicios privados aportaban el 50% del PIB regional. El comercio, lejos el más importante de estos sectores, decayó en términos relativos en los años 80, recuperando durante los 90 tan sólo una parte de su participación previa a la crisis. Dos otros sectores -transporte, bodegaje y comunicaciones y servicios financieros, comerciales y de seguros- mostraron mejores resultados que el PIB acumulado para ambos períodos.

Otro acontecimiento notable lo constituyó la expansión de la minería entre 1987-89 y 1995-97, con tasas de crecimiento anual que fluctuaron entre el 6% y el 12% en todos los países. Sin embargo, sólo en Honduras - donde la cifra es cercana al 2% - la minería aporta más del 1% del PIB.

El mayor potencial de crecimiento para los siguientes veinte años se observa en los sectores de servicios, y en segundo lugar en el sector manufacturero, en especial las operaciones de maquila. En cuanto respecta a la agricultura, las exportaciones tradicionales seguirán decayendo en términos relativos, y en ocasiones en términos absolutos. Los resultados generales en el sector agrícola dependerán de la capacidad de los países para 1) Seguir diversificando sus exportaciones, y 2) Combatir la pobreza y la mala distribución del ingreso, aumentando de paso la demanda interna por productos agrícolas. Los cambios en la estructura productiva dependerán del grado en que la región sea capaz de adaptar sus políticas e instituciones a fin de aprovechar las oportunidades de crecimiento sectorial, especialmente servicios.

Los resultados económicos generales, por su parte, dependerán no sólo de las políticas económicas nacionales y del dinamismo empresarial, sino además de la demanda mundial por las exportaciones que ofrece la región. Si bien en menor grado, el grado de avance de la integración regional (Mercado Común Centroamericano) y hemisférica (Área de Libre Comercio de las Américas) también afectará el crecimiento del PIB.

Entre los acontecimientos de la economía global que afectarán fuertemente los resultados económicos generales y los patrones de crecimiento sectorial en América Central entre 1997 y el 2020 se cuentan: 1) El crecimiento económico en los países industrializados; 2) El grado de apertura de los mercados mundiales, especialmente para los bienes y servicios agrícolas; 3) La globalización sostenida de los mercados financieros, y 4) El avance tecnológico, especialmente en el terreno de las telecomunicaciones, la informática, la biotecnología, la energía y el transporte. Entre los sectores o subsectores centroamericanos con muy buenas perspectivas se cuentan las maquiladoras y otras actividades manufactureras intensivas en uso de mano de obra; los productos hortofrutícolas y las exportaciones agrícolas no tradicionales; las telecomunicaciones y la informática; los servicios financieros y el sector turismo.

Dado que el tiempo y el espacio disponibles impiden realizar cálculos por país, para estimar el crecimiento acumulado y sectorial hasta el año 2020 hemos elaborado tres posibles escenarios – base, alto y bajo – para el conjunto de la región. El crecimiento real, por cierto, variará de país en país. Dado que los recursos humanos son una determinante fundamental del crecimiento económico a largo plazo, y considerando todos los demás factores, Costa Rica y Panamá muestran mejores condiciones para aprovechar las oportunidades de crecimiento, mientras que Guatemala, Honduras y Nicaragua presentan las mayores desventajas.

El escenario base supone un crecimiento acumulado del PIB del 4.5% anual. La realización de algunas reformas modestas pero estables en la política macro y microeconómica y en las estructuras institucionales permitirá a los países aprovechar las oportunidades que se abran en el sector manufacturero, especialmente en los servicios privados. La participación de los servicios privados en el PIB aumenta del 50% en 1997 al 55% en el 2020; la participación del sector manufacturero se mantiene en el 16%, en tanto que el sector agrícola cae del 18% al 14%.

Bajo el escenario de alto crecimiento, un proceso de fuertes reformas y una economía mundial dinámica permiten un crecimiento del PIB acumulado a razón de un 6.0% anual. Este crecimiento está impulsado por los servicios privados, cuya participación en el PIB alcanza al 58%

hacia el año 2020. La participación del sector manufacturero en el PIB se mantiene sin variación en un 16%, mientras que el sector agrícola cae al 12%.

El escenario de bajo crecimiento, que supone escasos avances en materia de reforma institucional y una economía mundial debilitada, produce pocas variaciones en la estructura productiva. La participación del sector manufacturero en el PIB sube del 16% al 18% en base a las exportaciones de la maquila, el sector agrícola cae del 18% al 16% y los servicios privados se mantienen en el 50%.

El PIB per cápita en la región crece de US$1.630 en 1997 a US$2.000 en el escenario de bajo crecimiento, a US$2.790 en el escenario base, y a US$3.870 en el escenario de alto crecimiento.

La elaboración de respuestas fructíferas y sustentables a los desafíos que presenta la globalización necesita de estrategias nacionales con un enfoque integral sobre cuatro objetivos estrechamente ligados entre sí: 1) Crecimiento económico; 2) Combate a la pobreza; 3) Protección ambiental; y 4) Democracia participativa. Además, la profundización y ampliación de los procesos de integración regional fortalecería la participación de Centroamérica en la economía mundial.

Entre las medidas nacionales que en conjunto con una economía global favorable podrían hacer realidad el escenario de alto crecimiento se cuentan la mantención de la estabilidad macroeconómica; una mayor fiscalización y prudente regulación de las instituciones financieras; una reforma previsional que entre otras cosas permita el ingreso del sector privado; una modernización y racionalización del estado que contemple la reducción de los altos costos por transacción que inhiben la inversión privada; una reforma educacional amplia que mejore la calidad y cantidad de los recursos humanos calificados; la eliminación de la mayor parte de las distorsiones de precios en el sector agrícola (incluyendo la explotación forestal); la adopción de una estrategia de largo plazo para convertir a las maquiladoras en verdaderas plantas manufactureras, y una cooperación eficaz entre los sectores público y privado para promover el turismo.

A nivel regional, una integración económica más eficaz necesita de medidas amplias destinadas a promover la apertura comercial, especialmente en los sectores agrícola y de servicios, y la eventual adopción de una moneda común (que podría ser el dólar). Estas medidas, en conjunto con una sólida reforma macroeconómica, crearían de forma casi automática instituciones financieras y mercados de capitales fuertes en toda la región.

Los países donantes pueden aportar de forma más eficaz al crecimiento económico en América Central a través de la reorientación de los fondos para la inversión social, actualmente centrados en la creación de empleos temporales, hacia objetivos vinculados directamente con actividades productivas; permitiendo una mayor flexibilidad en los ajustes fiscales que se deban hacer para enfrentar los impactos internos y externos; apoyando la conformación de mecanismos de búsqueda de consenso con participación del estado, empresariado y sociedad civil; fortaleciendo programas que profundicen la comprensión de la problemática económica y social, y elevando la calidad y oportunidad de la información económica y social para mejorar los elementos de juicio disponibles para el estudio y diagnóstico de las políticas públicas.

1. Introduction[1]

In the early 1980s, the Central American economies were all affected adversely by a world recession, a hemisphere-wide debt crisis, and internal political upheavals. Large-scale U.S. economic assistance to some countries helped halt their economic declines and initiate a modest recovery, although sometimes with significant social and political costs. In Costa Rica this assistance contributed positively to economic stabilization and structural adjustment (Newton et al. 1988); but in El Salvador and Honduras it allowed these reforms to be delayed until 1989 and 1990, respectively.

The 1990s were a decade of generally moderate economic recovery, aided by policy reforms within the Central American countries and a strong U.S. economy. Still, the region remains vulnerable to sharp fluctuations, and probably a secular decline, in primary-export prices. Moreover, economic expansion in the 1990s appears to have reduced poverty only modestly in most countries, especially in rural areas. Income distribution trends are not as clear because these data are even less reliable than the flawed poverty statistics[2]. The favorable experience of Costa Rica (Morley 1995: 134-150) is unlikely to be typical of the region.

After summarizing recent economic performance in Central America in the second section of this essay, I focus in the third section on sectoral trends in output over the last two decades. Twenty years ago, the five Central American Common Market (CACM) countries were still more agricultural than industrial, at least in current prices[3], even after two

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[1] The author has benefited from comments by members of the CA 2020 steering committee and participants in a project workshop held in Antigua, Guatemala, 7-9 July 1999. Thanks are due also to the many persons in Central America who provided data on macroeconomic and sectoral trends. None of these individuals bears any responsibility for the views expressed in this essay, which are those of the author alone.

[2] Only Costa Rica has reasonably good poverty and income distribution data.

[3] In constant prices, value added in manufacturing exceeded that in agriculture in Costa Rica and El Salvador. However, the base years for calculating constant-price data differ significantly in these two countries (1966 and 1990, respectively).

decades of import-substituting industrialization[4]. The same structure was evident in Belize[5]. while in Panama both agriculture (8% of 1980 GDP in 1982 prices) and manufacturing (10%) were dwarfed by services (73%).

The structure of production has changed significantly in some Central American countries but not in others. The relative importance of any sector (notably agriculture) is sensitive to the base year in which the data are expressed in constant prices. Where base years are several decades old, differences between constant-price and current-price shares can be large.

In the fourth section of this paper I examine the outlook for the world, hemispheric, and regional economies in the next two decades, and how these developments might affect the structure of production in Central America. The fifth section then presents three alternative visions of the size and structure of the Central American economies in 2020, based on different sets of assumptions about global, hemispheric, regional, and national conditions. The concluding section offers policy recommendations, for both the Central American countries and the international community, to help make the high-growth scenario feasible.

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[4] Victor Bulmer-Thomas (1987: 185) has argued persuasively that the CACM was simply grafted onto the traditional model of agricultural export-led development to form a "hybrid" model of industrialization. Agriculture's share of GDP in 1980 (in 1970 prices at factor cost) exceeded that of manufacturing in all five CACM countries, by an average margin of 8 percentage points (Bulmer-Thomas 1987: Appendix Tables A.1, A.4, and A.8, pp. 309, 315, and 323). Agriculture's share of employment exceeded that of manufacturing by much wider margins, reflecting the large average productivity differentials between the two sectors.

[5] Agriculture outranked manufacturing in current prices but not in constant (1984) prices.

2. Macroeconomic Performance since 1980: A Brief Review[6]

Macroeconomic performance in Central America since 1980 can be divided into three distinct phases. The dates apply roughly to the region but vary somewhat by country. Table 1 presents key macroeconomic indicators for selected years.

2.1. 1980-83: Multiple Shocks, Major Depression

Factors contributing to a major economic depression in the CACM countries in the early and mid 1980s include soaring petroleum import costs; falling non-petroleum commodity prices during the worldwide recession triggered by the second oil price shock; debt problems (Zuvekas 1993a); armed internal conflicts, especially in El Salvador and Nicaragua[7]; and capital flight.

For the CACM as a whole, the decline in per capita GDP began as early as 1979 and continued through 1986. The weighted-average per capita GDP fell over this period by 18% (Zuvekas 1997: 1, n. 2). For the individual countries, including Belize and Panama, the declines from pre-crisis peak to crisis trough were as follows:

Belize	(1980-83)	-9%
Costa Rica	(1979-83)	-17%
El Salvador	(1978-82)	-28%
Guatemala	(1980-86)	-20%
Honduras	(1979-83)	-11%
Nicaragua[8]	(1977-93)	-62%
Panama	(1982-84)	-4%

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6 This section draws heavily on Zuvekas (1997) and the sources listed in Table 1.

7 The Guatemalan conflict was longer, but on a smaller scale and with only modest economic effects.

8 This decline is exaggerated because of data problems.

The economic downturn is clearly reflected in investment and savings rates. The unweighted average gross domestic investment (GDI) rate for the seven countries fell from 21.1% of GDP in 1980 to 17.8% in 1983[9]. Gross national savings (GNS) also fell, from an unweighted average of 12.8% to 11.8%. The large gap between GDI and GNS illustrates the region's dependence at that time on external savings.

Falling prices for traditional primary products (64% of total exports in 1980) led to a 15% drop in earnings from these exports between 1980 and 1983. Intra-CACM trade (24%) declined by 33%, and nontraditional exports outside the region (12%) fell by 36%. Total CACM earnings from merchandise exports fell by 22%, from $4.9 billion to $3.8 billion. Belize also suffered a sharp drop in merchandise exports (-20%), while Panama had a small increase (4%).

The Central American countries initially cushioned the effects of the second oil price shock by additional borrowing abroad. The region's public external debt rose from $7.7 billion in 1980 to $14.2 billion in 1983. However, the ability of governments to borrow from private lenders was restricted severely after Costa Rica stopped payments to commercial-bank creditors in July 1981.

Fiscal deficits (consolidated nonfinancial public sector, except for Belize) tended to worsen between 1980 and 1983, reflecting declining tax revenues and a reluctance to cut expenditures, which sometimes increased because of external borrowing. The major exception was Costa Rica, the first country in the region to initiate major economic reforms (late 1982), where the deficit fell from 13% of GDP in 1980-81 to 3.1% in 1983.

Interestingly, annual inflation rates were lower in 1983 than in 1980 everywhere but Costa Rica, where inflation peaked at 90% in 1982 before falling to 33% in 1983. Significant external financing of fiscal

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9 The weighted average figures for both years would be lower because the two largest economies (Guatemala and El Salvador) had investment rates well below the unweighted averages, having suffered significant declines between 1978 and 1980: from 21.6% to 15.9% in Guatemala and from 24.5% to 13.3% in El Salvador.

deficits, and in some cases overvalued exchange rates, helped keep inflation in check or at least repressed.

2.2. 1983-1990: Uneven Progress toward Policy Reform

Regional per capita GDP continued to decline between 1983 and 1986. Costa Rica was the major exception to this trend, with per capita GDP rising by a cumulative 5.6%. Belize, Panama, and Honduras also had positive growth, but barely so. After 1986, economic recovery was more widespread, if generally slow. However, per capita GDP continued to fall in Nicaragua through 1993, and in Panama the U.S. embargo and invasion contributed to a drop of 18% between 1986 and 1989. Belize was the star performer in 1986-90, with per capita GDP rising by 36% in response to major policy reforms begun in 1984. Except for Belize, per capita GDP in 1990 remained below its pre-crisis level. No other country recovered this level until Panama did so in 1993 and Costa Rica in 1994.

Gross domestic investment rates rose between 1983 and 1990 everywhere but Nicaragua and Panama. The unweighted regional average rose from 17.8% to 19.9%, but Guatemala and El Salvador were below 14%. Gross national savings rose from 11.8% to 14.9%.

Exports contributed less to economic recovery than U.S. grant assistance and remittances. Total CACM merchandise exports in 1990 were only 12% higher than in 1983; most of the increase occurred in 1989-90. Disaggregating these figures, however, one sees evidence of policy and institutional reforms that helped diversify exports:

	US$ Million		Percent	
Export Category	1983	1990	1983	1990
Traditional	2.648	2.491	69.6	58.6
Nontraditional-CACM	779	664	20.5	15.6
Nontraditional-Other	376	1.097	9.9	25.8
Total	3.803	4.252	100.0	100.0

Nontraditional exports to extraregional destinations rose from 10% of total exports in 1983 to 26% in 1990. Costa Rica accounted for 53% of these exports in 1990, and 63% of their growth between 1983 and 1990, reflecting both policy reforms and export subsidies that were phased out in the 1990s. Another 20% of the growth was in Guatemala, where significant policy reforms were begun in 1986. Meanwhile, traditional exports declined, reflecting depressed commodity prices as well as the continuing wars in El Salvador and Nicaragua. Intra-CACM trade first continued to contract, falling to $409 million in 1986 - 65% below the 1980 peak in nominal terms and 69% below in real terms - before initiating a recovery that would accelerate in the 1990s.

The export figures above exclude value added from maquila (assembly) operations, reported as an export of services until new national accounts norms adopted in 1993 treated the gross value of maquiladora exports and imports as merchandise[10]. Maquila exports differ qualitatively from standard merchandise exports in that their value added in Central America generally accounts for only 20-25% of the value of the final product. Thus, including their full value with merchandise exports, as some countries began to do in the 1990s, creates a significant upward bias in export growth rates. Value added from maquila operations rose from about $45 million (1% of merchandise exports) in 1983 to about $165 million (4%) in 1990, more than half of which were accounted for by Costa Rica, with Guatemala again in second place (see Table 3).

Fiscal deficits in Central America generally were lower in the mid and late 1980s than in the early part of the decade, sometimes significantly so. Except for Nicaragua (17.8%) and Honduras (6.6%), fiscal deficits in 1984-89 averaged less than 5% of GDP.

Consumer-price increases during 1984-90 ranged from annual averages of 0.7% in Panama, 2.6% in Belize, and 3.7% in Honduras (1984-88) to a four-figure average in Nicaragua, where inflation exceeded 14,000% in 1988. Inflation rates rose between 1980-83 and 1984-90 in Guatemala and El Salvador but fell in Costa Rica.

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[10] Inter-Secretariat Working Group on National Accounts (1993:327-328). Most Central American countries have adopted the new methodology, at least in part; but not all of them clearly isolate maquila operations, as recommended.

2.3. 1990-1997: Moderate Recovery[11]

Central America experienced moderate economic growth in the 1990s, aided by further advances in policy reform; the strong economic performance of the United States, the region's major trading partner; and a lowering of tariffs and other trade barriers within the CACM. El Salvador joined the ranks of the reformers in 1989, Honduras in 1990, and Nicaragua in 1991. Panama, whose modest reforms in the mid 1980s were unsustained, began a major reform process only in 1994. A sharp decline in U.S. assistance to the region was offset by more foreign direct investment, higher remittance inflows, and further debt renegotiation and forgiveness.

Regional GDP increased by a weighted annual average rate of 4.3% during 1991-97 (inclusive), while per capita GDP grew by 1.8% a year[12]. Country growth rates were as follows (in percent):

	GDP	Per Capita GDP[13]
Belize	3.6	0.9
Costa Rica	3.8	1.0
El Salvador	5.3	3.6
Guatemala	4.1	1.1
Honduras	3.8	0.9
Nicaragua	2.5	-0.6
Panama	5.0	3.2

These figures probably underestimate GDP growth in some countries.

The regional gross domestic investment rate rose from an unweighted average of 19.9% in 1990 to 22.8% in 1997. Although the quality of the investment data is poor in a number of countries, the efficiency of

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[11] Most of the discussion in this section ends with 1997 to avoid distortions caused by Hurricane Mitch in October 1998.

[12] Based on 1995-97 GDP weights in U.S. dollars: Belize 0.012; Costa Rica 0.183; El Salvador 0.203; Guatemala 0.316; Honduras 0.084; Nicaragua 0.039; and Panama 0.163.

[13] Actual per capita GDP growth in Guatemala and Nicaragua was probably higher, as population growth likely is overstated.

investment appears to be greatest (by far) in El Salvador and Guatemala.

A significant expansion and diversification of exports contributed to economic growth in the 1990s. Intra-CACM trade more than doubled between 1990 and 1995, from $0.7 billion to $1.5 billion (21% of total merchandise exports), while extraregional NTEs rose from $1.1 billion to $2.0 billion (28%). These two categories of exports continued to grow over the next two years, while traditional exports were affected by commodity price volatility. Total merchandise exports by the CACM countries rose from $5.0 billion in 1990 to $9.8 billion in 1997[14]. Hurricane Mitch, however, disrupted export growth in 1998 and 1999.

Merchandise exports in Belize and Panama grew less rapidly than in the CACM. Between 1990 and 1997, they rose from $129 million to $179 million in Belize and from $460 million to $659 million in Panama.

Value added by maquila exports grew especially rapidly in the 1990s, rising from $165 million in 1990 to nearly $1.2 billion in 1997 and at least $1.4 billion in 1998 (almost all in the CACM), as Hurricane Mitch had only minor effects on these operations.

Central America's long-term public external debt declined from $23.3 billion in 1990 to $22.1 billion in 1997, partly because of debt forgiveness and partly because Honduras and Nicaragua had little capacity to acquire new non-concessional debt.

Fiscal deficits during the 1990s have on the whole been relatively modest. Nicaragua's has remained high (an average of 10.3% during 1990-97), but the bulk is financed externally.

Consumer price increases accelerated in all countries in the region in 1990, partly because of the one-time effects of exchange rate adjustments in several countries. During the rest of the decade, however, inflationary pressures eased. El Salvador reached international inflation levels in 1998, joining Belize and Panama, which have long been there.

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[14] I was unable to obtain, for all CACM countries, a breakdown of merchandise exports by major category for the years after 1995.

Panama, in fact, has achieved a significant real effective exchange rate depreciation, even though its currency is the U.S. dollar, because price increases there have lagged behind those in the United States since the early to mid 1980s.

3. Sectoral Growth Trends since 1978

3.1. Data Sources and Issues

This section summarizes sectoral growth patterns over two periods, 1978-80 to 1987-89, and 1987-89 to 1995-97 (except as noted below). Real annual growth rates (compounded) are based on three-year averages to reduce distortions caused by sharp annual fluctuations in sectors such as agriculture and construction.

The initial years exclude most of the "debt-crisis" effects of the 1980s. An earlier starting point of 1976-78 was chosen for El Salvador and Nicaragua to minimize the effects of those countries' civil wars. In Nicaragua, only current-price data are available for 1976-78, and growth rates for the first period are annual averages for 1980-90 (IDB 1995); the second period is 1990-92 to 1995-97. In Belize and Panama, because of data limitations, the starting point is the single year 1980. For all countries, the final three years are 1995-97 rather than 1996-98 to avoid the distorting effects of Hurricane Mitch, particularly on agriculture.

The existence of widely differing base years for the national accounts data limits the value of any comparative discussion of trends in sectoral shares of GDP. It is more useful instead to look at trends in real sectoral growth rates (Table 2)[15].

The quality of the national accounts data varies among countries, and is highest in Costa Rica. Some base years are quite old (1958 in the case of Guatemala), a situation that over time increasingly distorts reported trends in overall real GDP growth, as sectoral weights become outdated. The use of old base years tends mainly to exaggerate the relative importance of agriculture.

It is important also to examine two "sectors" not identified as such in the national accounts: maquila operations (mainly for apparel) and

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[15] An Annex, available from the author, or on the CA 2020 Web Page (http://ca2020.fiu.edu/), examines the data on a country-by-country basis and presents sectoral shares in both current and constant prices.

tourism. Data for these activities (Tables 3 and 4) come from the balance of payments, although in El Salvador maquila operations are now shown as a branch of manufacturing. The recent dynamism of these sectors should continue for the next two decades.

Another "sector" that might be considered is the "informal sector." However, this concept, which is not defined in a consistent manner (see Zuvekas 1993b), is of limited analytical utility, and for purposes of this paper it stretches the definition of "sector" beyond the boundaries I consider appropriate.

3.2. Sectoral Growth Patterns

3.2.1. Aggregate GDP. Table 2 shows that all Central American economies experienced slow or negative growth during the first period, generally from 1978-80 to 1987-89. Per capita GDP declined everywhere but Belize. During the second period, usually 1987-89 to 1995-97, all countries recorded positive GDP growth, with the four largest economies each expanding at annual rates of 4.0%-4.1%. Belize performed even better, at 5.6%, while Honduras (3.3%) and Nicaragua (2.5%) were below-average performers. Per capita GDP increased in all countries except Nicaragua.

3.2.2. Agriculture. At the end of the 1970s agriculture was clearly the dominant sector of the region, leading all others with between 19% (Costa Rica) and 40% (El Salvador) of GDP in current prices, except in Panama. Agriculture contributed even more to employment and foreign-exchange earnings.

During the first period, agriculture grew slowly or declined (and per capita sectoral product fell) everywhere but Panama, which had annual growth of 3.3% despite (although to some extent because of) high levels of protection and costly subsidies. Still, agriculture outperformed the rest of the regional economy, with the minor exception of Belize, where it lagged aggregate GDP only slightly. Agriculture's share of GDP in constant prices thus increased, although its share in current prices generally declined because of falling relative prices.

In the second period, Panama dropped toward the bottom of the list and agricultural performance improved everywhere else. Belize (6.7%) and Nicaragua (5.2%) recorded especially high growth rates, reflecting improved macroeconomic and microeconomic policies. Still, in all other countries agriculture grew more slowly than aggregate GDP, although per capita agricultural product fell only in El Salvador and Panama. Agriculture's sluggish performance in El Salvador, despite price and marketing reforms since 1989, is due partly to a significant appreciation of the real effective exchange rate, explained mainly by large remittance inflows. At the end of the period, agriculture's share of GDP in current prices ranged from 14% (El Salvador) to 34% (Nicaragua), again with the exception of Panama (7%).

3.2.3. Mining. The mining sector accounts for no more than 1% of GDP except in Honduras, where the figure is close to 2%. In the first period, it generally fared less well than aggregate GDP, except in Belize. The second period, on the other hand, was one of rapid expansion in all countries, with annual growth rates of 6%-12%. Mining in Central America is unlikely ever to acquire the importance it has in Peru or Bolivia; but its potential for continued rapid growth is good if countries do more to address legal and institutional obstacles to exploration and exploitation, while also providing adequate environmental safeguards.

3.2.4. Manufacturing. After growing relatively rapidly during most of the 1970s, manufacturing activity in Central America as a whole lagged overall GDP performance between 1978-80 and 1987-89. Only in Honduras did it grow faster (barely so), while in Costa Rica the sectoral and aggregate growth rates were equal. Contributing to the sector's woes was the sharp drop in intra-CACM trade, due both to the economic depression per se and to trade barriers erected by the CACM countries against each other.

At least according to published figures, the 1990s were a period of moderate expansion; but once again manufacturing grew slower than GDP in most countries (the exceptions were Honduras and Panama), and its share of regional GDP continued to decline. In current prices, manufacturing's share of GDP in 1995-97 ranged from 22% in El Salvador to less than 9% in Panama[16].

Some manufacturing activity in the 1990s clearly was hurt by competition from extraregional imports, as tariff barriers were reduced significantly throughout the region[17]. However, the published figures for manufacturing output do not fully cover maquila operations, and in some cases may not include them at all. For example, the national accounts figure for value added in Honduras's apparel industry is far below the respective balance-of-payments figure, even though this industry's growth rate for 1987-89 to 1995-97 is reported to be 14.9%. If maquila operations were fully incorporated into the national accounts, manufacturing's performance during the 1990s might have exceeded that of aggregate GDP, whose growth itself would thus be higher than reported.

3.2.5. Electricity, Gas, and Water. The utilities sector is small in Central America, sometimes suspiciously so. In El Salvador, value added by utilities in 1995-97 was reported to be only 1.6% of current-price GDP and 0.6% of constant price GDP. The utilities share of GDP exceeds 3.3% only in Panama (in both current and constant prices in 1987-89 and 1995-97) and in Honduras (5.7% in current prices during 1995-97). Differences between current-price and constant-price shares are often difficult to explain, and cannot always be accounted for by changes in pricing policies.

Value added by utilities grew relatively rapidly during the 1980s for the region as a whole. Their share of GDP thus increased significantly, albeit from a small base. The completion of several large hydroelectric

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16 Current-price data were not available for Belize, where the share in constant (1984) prices was 16%. Guatemala, the region's largest economy, does not even produce current-price GDP figures by sector; manufacturing's share in constant (1958) prices was 14%.

17 Panama caught up with the rest of the region dramatically on January 1, 1998 when it reduced all tariffs to no more than 15%, with exceptions only for rice, dairy products, and automobiles. The average tariff fell to less than 9%. The new government, however, has begun to reverse these actions.

projects helps explain this rapid growth in the midst of an economic depression.

Growth of the utilities sector was also relatively rapid in the 1990s, exceeding GDP growth everywhere but in El Salvador and Panama. The reported real growth rate of -3.4% in El Salvador is difficult to reconcile with that country's overall GDP growth rate of 4.1%; it is attributable largely to an implausible decline of 71% in the electricity subsector between 1990 and 1991.

3.2.6. Construction. Between 1978-80 and 1987-89, construction activity contracted everywhere except Belize and Honduras. In most cases its share of GDP declined. In current prices, construction's share of GDP ranged from 2% in Guatemala and Panama to 6% in Belize[18]. Public capital expenditures fell especially rapidly after the early 1980s, as debt problems restricted most countries' abilities to borrow abroad.

Construction activity grew in the 1990s by more than 10% annually in Nicaragua and Panama, and at low to moderate rates elsewhere. For the region as a whole, its share of GDP may have increased slightly.

3.2.7. Trade, Restaurants, and Hotels. Commerce is by far the largest service sector in all Central American countries, and in Guatemala and Panama (and in Costa Rica in current prices) it is larger than any other sector. Its contribution to GDP in 1995-97 generally ranged from 16% to 24%, except in Honduras, where the 12% figure is probably explained mostly by statistical problems.

During the 1980s, commercial activity lagged GDP performance in every country. In most cases its share of aggregate GDP fell by 3-4 percentage points in constant prices. This situation was partially reversed in the 1990s, as commercial activity expanded at rates nearly equal to or greater than aggregate GDP everywhere but Honduras, where again the reported growth rate of only 2.5% may reflect statisti-

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18 In Guatemala the figure is in constant prices. The low figure in Panama was a temporary phenomenon associated with the political turmoil surrounding Gen. Noriega's ouster.

cal problems. Still, only in El Salvador did the constant-price share of GDP in 1995-97 exceed its late-1970s level.

3.2.8. Transport, Storage, and Communications. This sector has gained relative importance in most Central American countries over the last two decades. It is largest in Panama, where Canal-related services and the transshipment activities of the Colón Free Zone have long been major components of the economy. Nevertheless, recent growth in Panama has been slow, and the sector's share of GDP in constant prices slipped from 13.1% in 1980 to 12.3% in 1995-97; in current prices the 1995-97 share was 14.0%.

Elsewhere, the transport sector outperformed the rest of the economy in both periods in all countries except Nicaragua. Its share of 1995-97 GDP in current prices varied widely, from 3.4% in Nicaragua to about 13% in Belize, where growth has been rapid for two decades. The Honduran figures for 1987-89 to 1995-97 are puzzling in that the constant-price share rose from 8.3% to 8.6%, while the current-price share dropped from 6.9% to 4.6%.

3.2.9. Finance, Insurance, and Business Services. During the 1980s, the financial sector outpaced overall GDP in most countries. The major exception was Panama, where financial institutions are by far the most advanced in the region and contribute the most to GDP (more than 10%). After growing by 50% between 1980 and 1985, Panama's financial sector was devastated by subsequent political events, and real value added fell by 61% between 1985 and 1989. Despite rebounding by 7.0% annually between 1987-89 and 1995-97, the financial sector was smaller in 1998 than in 1982-85.

Costa Rica, El Salvador, Guatemala, and Honduras all experienced financial sector growth rates of between 6.2% and 8.3%, substantially above their GDP growth rates (3.3%-4.1%). In Belize, the growth rate was a respectable 4.9%, but below the aggregate GDP growth rate of 5.6%. Nicaragua was still struggling, not with much success, to rebuild a financial sector that was seriously weakened in the 1980s; sectoral growth was only 1.3% a year between 1990-92 and 1995-97.

3.2.10. Real Estate. This sector largely represents the imputed rental value of owner-occupied housing. It held up well during the troubled 1980s, but in the 1990s its growth lagged that of aggregate GDP everywhere but Honduras. In evaluating Central America's prospects over the next two decades in the context of increased globalization, this almost-pure domestic sector is of little interest. In most countries its constant-price share of GDP is around 5%-6%; the figure is lower in Nicaragua (4%) and much higher in El Salvador (10%) and Panama (14%).

3.2.11. Public Administration and Defense. During the 1980s, Central American countries paid little heed to external advice to shrink the size of their states, relatively if not absolutely. For the region as a whole, the public sector grew in real terms by a weighted average close to 4%. Its GDP share rose everywhere but in Costa Rica.

In the 1990s, by contrast, the state has shrunk absolutely in Honduras, Nicaragua, and Panama, and declined relatively everywhere else but Guatemala, where most observers would say a relative increase was desirable to remedy that country's very low spending on social services. In current prices, the sector's share of GDP during 1995-97 ranged from 6%-7% in El Salvador, Honduras, Nicaragua, and Guatemala[19], to 12%-14% in Costa Rica and Panama, with Belize occupying an intermediate position.

3.2.12. Other Services. Community, social, personal, and domestic services account for between 5% and 10% of GDP. Like real estate, they are of little interest in the context of globalization. Sectoral growth rates in both the 1980s and 1990s have differed little from those for aggregate GDP.

3.2.13. Maquila Operations. After allowing for missing data and underestimates in Honduras before 1993, value added by maquila operations in Central America was probably about $45 million in 1983 and about $165 million in 1990. As late as 1990, Costa Rica still accounted for about 53% of the regional total (see Table 3).

Maquila expansion was dramatic in the 1990s, at least in Costa Rica, El Salvador, Guatemala, and Honduras. By 1997 regional value added

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[19] Guatemala, as noted above, does not produce sectoral GDP data in current prices; but the state clearly is small there.

totaled perhaps $1.180 million, with the four big producers each accounting for 18% to 27% of the total.

Relative to the size of the economy, maquila operations are most important in Honduras, where they now directly employ about 5% of the labor force. Value added in 1998 ($398 million) represented 7.4% of reported Honduran GDP in that year, although aggregate GDP is probably underestimated, partly because maquila operations are not fully recorded in the national accounts.

3.2.14. Tourism. Regional foreign-exchange earnings from tourism in the first half of the 1980s rose only from $379 million in 1980 to $429 million in 1985 (see Table 4). Panama was the leader in 1985 with 48% of the regional total, followed by Costa Rica with 29%. By 1990, however, Costa Rica had vaulted into first place with 39% of the total, both because of its own strong promotional efforts, especially in ecotourism, and because tourism in Panama was set back by political events. Guatemala experienced a resurgence of tourism after 1985, following a dramatic plunge earlier in the decade because of civil conflict, human rights abuses, and an upsurge in criminal activity. Regional foreign exchange earnings from tourism in 1990 totaled $730 million.

Tourism expanded rapidly in the 1990s, with all countries except El Salvador at least doubling their foreign exchange earnings between 1990 and 1997. The regional total reached $1,801 million in 1997. Costa Rica strengthened its hold on first place, with its regional share rising to 41%. Panama was second with 21%, and Guatemala third with 15%. Honduras was next with 8%, followed by El Salvador with 6%, Belize with 5%, and Nicaragua with 4%.

4. Anticipated Global, Hemispheric, and Regional Economic Trends and their Potential Effects on the Structure of Production in Central america

4.1. Overview

The small, open economies of Central America are highly sensitive to external events. Globally, they are affected by volatile prices for their major commodity exports and for one major commodity import, petroleum[20]. Moreover, the decline in relative prices of primary products since 1980 may continue well into the 21st century (OECD 1997: 78; Reinhart and Wickham 1994), although its extent will depend on the performance of the global economy. Within the Western Hemisphere, the Central American countries' high dependence on exports to the U.S. market makes them vulnerable to trends in that large economy. Also, as intra-CACM trade has expanded significantly since 1986, the countries of the region are increasingly affected by each other's economic performance.

Despite this vulnerability to external events, the economic depression experienced by the Central American countries in the 1980s led to a widespread consensus on the desirability of economic openness to external trade in the face of a radically changed international economic environment (see Zuvekas 1992: 137-142).

This section seeks to identify some of the major changes likely to occur in the global, hemispheric, and regional economic environments over the next two decades, and to consider how these trends might affect the structure of production in Central America. The region has basically accepted the challenges of globalization, but not all countries are well prepared to meet these challenges.

[20] Guatemala, the only petroleum producer in the region, depends on imports for most of its requirements.

4.2. The Global Economy

4.2.1. Aggregate GDP. One can conceive a rosy scenario for the next two decades, based on rapid technological progress (e.g. in telecommunications, biotechnology, environmentally friendly energy, and transport); favorable economic policies in most of the world; and only minor disruptions from events such as civil wars, localized cross-border conflicts, AIDS, and occasional financial crises. One such picture is the OECD's high-growth scenario (1997: 92), which envisions average annual world economic growth of 5.0% in the first decade of the new century and 4.9% in the second.

On the other hand, one could paint a grim picture in which the world is dominated by protectionism; other backsliding on economic policy; major regional or global financial crises; the revival of armed conflict in areas where peace has been achieved; and social and political unrest, emanating from increased income inequality and decreased personal security, that could reverse recent democratic gains.

An intermediate position is the OECD's (1997: 92) low-growth scenario, which envisions world GDP growing at an average annual rate of 3.1% in 2001-2010 and 2.8% during 2011-2020.

This paper leans toward a favorable outcome for the world economy, reflecting the author's optimistic long-run worldview, however much he might be concerned about short-term events. Still, it is important to bear in mind that the scenarios presented in Section 5 are closer to speculations than projections.

4.2.2. Trade. The OECD's high-growth scenario envisions world trade as rising considerably faster than global output, thus increasing its share of global GDP from 30% in 1995 to 45% in 2020. This scenario assumes elimination of all tariffs and tariff equivalents, and of all export taxes and subsidies, by 2020 (OECD 1997: 63, 71). Complete free trade by 2020 is unlikely, but further liberalization of world trade is a reasonable assumption.

Many policy makers and other interested parties had hoped that a new round of trade negotiations would be launched at the World Trade Organization (WTO) meetings in Seattle in November-December 1999. However, these hopes were dashed, largely by strong resistance to further trade liberalization by groups ranging from those with environmental and equity concerns to those with narrow protectionist agendas. Weak U.S. government support for a new round of talks - due more to electoral politics than to a lack of commitment to trade liberalization - also contributed to the meeting's failure.

Nevertheless, new talks are likely to be launched formally sometime in the first half of the 2000s. John Croome (1998), the World Bank's Permanent Observer to the WTO, believes that any such talks are unlikely to rival the Uruguay Round in scope or duration. Only agriculture and services are certain to be covered; near-certain areas are tariff reductions and government procurement. Agriculture remains Central America's dominant sector, while the region's success in exploiting service sector opportunities will be a major factor in determining its overall economic performance in the next two decades.

Within the services sectors, an agreement to liberalize professional services would benefit countries such as Panama that significantly restrict employment of foreign professionals. Such restrictions, unless eased, could severely hamper the effectiveness of Panama's City of Knowledge (Ciudad del Saber), an R&D and educational complex planned for the site of the former Ft. Clayton.

Ernest Preeg (1998: 1-4), a former U.S. trade negotiator and ambassador, argues that the current "third wave" of globalization differs qualitatively from the previous two (1870-1914 and 1950-70). Preeg maintains that three mutually reinforcing stimuli - (1) the triumph of economic liberalism, (2) the information-technology revolution, and (3) the internationalism of private enterprise - enhance the benefits of globalization and make it more inexorable.

Greater openness may produce faster economic growth over the long run, but recent experience in Central America and the rest of the hemisphere makes clear that trade and financial liberalization also increases short-run economic and human vulnerability to both internal and external events (Emmerij 1997: 27-31). The costs of inappropriate economic policies or lack of export diversification would thus increase if globalization proceeds as Preeg envisions. Emmerij and Fishlow

(1997) rightly call for specific actions to reverse the growing inequality that has usually (but not always) accompanied economic liberalization[21]. It is worth remembering, too, that the rapid expansion of Central America's trade between 1950 and 1980 did little to reduce poverty and sometimes aggravated income inequalities (Bulmer-Thomas 1987).

4.2.3. Financial Flows. The increased availability of private capital flows to Latin America generally, and Central America specifically, has been a mixed blessing. As world financial markets continue to become more globalized, the potential availability of private external financing over the next two decades is not an issue, although the OECD (1997: 86) does not envision a dramatic rise in net capital flows to developing countries by the year 2020. Rather, it expects that the close correspondence between domestic savings and investment in developing countries, on average, will continue to prevail.

Both foreign direct investment (FDI) and portfolio investment in developing countries by the OECD countries will likely increase. Transfers of OECD pension assets to emerging markets could be $20 billion in 2000 and $35 million in 2020 (OECD 1997: 87-88).

Central America is better prepared to take advantage of FDI than of portfolio investment. Financial markets are weak, except in Panama, and they are insufficiently regulated and supervised. Moreover, some countries have yet to achieve the requisite macroeconomic stability for attracting significant pension assets and other portfolio flows from abroad. Even in Panama, many observers believe the financial sector will not greatly expand its existing range of services, thus remaining a banking center and not offering the broad array of financial services that Singapore provides for much of Asia. Indeed, if the rest of Latin America were to become dollarized, Panama would be less attractive even as a banking center, except for countries with relatively rigid banking rules.

4.2.4. Technological Progress. Central America will meet its new technological challenges well only if it significantly improves both the

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[21] Costa Rica is an important exception to this pattern (Morley 1995: 134-150).

quantity and quality of its educational and training programs, so that its labor force can move into new jobs requiring computer skills, critical thinking and problem-solving abilities, and an understanding of economic globalization processes. Costa Rica is making good progress toward putting computers in every classroom, but the rest of the region is well behind in applying new technology to the educational system.

The following paragraphs look briefly at the implications of technological progress in four key areas: telecommunications and information technology, biotechnology, energy, and transport.

4.2.4.1. Telecommunications and Information Technology. Many observers believe that the speed, size, and cost of computers will continue to improve over the next 20 years at the same rate as in the recent past (Miller, Michalski, and Stevens 1998: 9). These improvements will lower costs of information gathering and production processes. One observer believes that "[f]ibre optics will in many parts of the world drop the cost of telecommunications so low that it will be virtually free" (Coates 1998: 42).

In most of Central America, the new telecommunications and information technology will likely widen disparities in income and living standards for much of the next two decades. Large producers - farmers, manufacturers, and service providers - who continually take advantage of new technologies to obtain better market information and reduce production costs, will increase their cost advantages over smaller producers. At least in urban areas, small producers above a minimum educational threshold should be able to purchase customized market information at low cost from specialized firms with access to the Internet. However, most will likely find it hard to finance cost-cutting capital investments without significant financial deepening in the region, something that may not occur until the second decade of the new century.

Still, the effects of advances in telecommunications and information technology on poverty may on balance be positive, at least in urban areas. Production costs for some goods and services will be reduced, and competition from imports - in an environment of liberalized trade - will ensure that some of these cost reductions will be passed on to consumers.

4.2.4.2. Biotechnology. Perhaps the greatest advances in biotechnology will be in the field of human health (Miller, Michalski, and Stevens 1998: 11-14). Where these advances have public health implications, Central American populations as a whole will benefit. In other cases, the benefits will be concentrated among those who can pay for specialized medications and treatments.

Significant technological advances are also expected in plant agriculture and animal husbandry. Genetically modified (GM) seeds, already available, have improved plant quality (e.g. by prolonging shelf life before spoilage); increased resistance to weed killers and pests; and in some cases permitted cultivation on poorer-quality land. Arber and Brauchbar (1998: 88) report that "[t]he agro-food industry forecasts annual growth rates in the next few years of 40 per cent in the sale of genetically modified seed."

Such a rapid expansion now seems unlikely, at least in the short and medium run, as many consumers fear GM foods will have adverse health and environmental effects. Particularly in Europe, sales of GM crops, as well as hormone-treated beef, are restricted by both legal means and by lack of acceptance in the marketplace. If research shows that health and environmental risks are minor, resistance to GM products will likely fade, especially in the second decade of the new century.

If consumers in the developed countries eventually relax their resistance to hormone-treated beef, Central America's beef exports, long in decline from their heyday, could suffer further as yields increase in beef-importing countries. Large yield increases in developed countries from genetically modified basic grains would also hurt Central American producers, especially small farmers, who would be slower to learn about the new seeds and financially less able to acquire them. Some local production, especially with freer trade, would be displaced by imports, and the resulting rural-urban migration would tend to depress real wages for unskilled labor in the short and medium run. A positive element is that Central American consumers would benefit from the price reduction effects of yield increases.

4.2.4.3. Energy. The emphasis of applied energy research over the next 20 years will depend largely on whether the global-warming controversy is resolved (Coates 1998: 39-40). If no clear answer emerges, research will likely be diffused among efforts to improve noncarbon fuel technologies (hydroelectric, nuclear, wind, solar, and geothermal) and those to make exploration and exploitation more efficient for petroleum, natural gas, and coal. If global warming came to be widely accepted as a real threat, research would likely shift toward energy conservation measures. Even so, many observers expect that most vehicles in 2020 will still be powered by internal combustion engines.

The OECD projects world energy demand between 1995 and 2020 to grow by 3.1% annually under a high-growth scenario and 2.1% a year under a low-growth scenario, slower than the respective GDP growth rates in these periods (4.8% and 3.1.%) because of assumed increases in energy efficiency[22]. Still, real oil prices are assumed to rise under the high-growth scenario by 2% annually between 1995 and 2010, and by 1% a year during 2010-2020; under the low-growth scenario, the assumed increases are 1.5% and 0.8%, respectively (OECD 1997: 63, 79-81). Since Central America imports almost all its oil, the cumulative balance-of-payments effects of such increases in real oil prices would be significant.

Central America's most abundant energy resource is hydroelectric power. The large investments in generating capacity needed over the next two decades will be difficult to finance without private sector participation in electricity generation.

4.2.4.4. Transport. A major obstacle to Central America's ability to expand and diversify its exports more rapidly is the generally high cost of international transport. Air and sea transport rates are high partly because of low volumes and lack of competition. Air transport rates (and passenger fares, which affect tourism earnings) should fall as the countries of the region continue to move toward adoption of open-skies policies. Low volume makes ocean-transport rates so high that goods can often cross the Pacific Ocean more cheaply than the Gulf of Mexico. High port charges, due partly to obsolete cargo-handling tech-

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[22] Energy efficiency is assumed to increase by 1% annually in the OECD countries and 2% elsewhere in the high-growth scenario, and by 0.8% and 1.5%, respectively in the low-growth scenario.

nology, add to overall transport costs. Construction or modernization of container-handling facilities can help reduce those costs, and the passage of time will solve some low-volume problems as export levels increase. Still, many Central American ports are now unable to handle larger vessels. The development of even larger cargo ships, further reducing unit transport costs, would make some low-volume problems longer-lasting and aggravate the region's comparative disadvantage. Central American countries would find it even harder to fill ships that higher-volume Asian producers could easily supply on a regular basis.

Panama, which does handle large ocean-transport volumes, much of it for transshipment, has responded well to changes in maritime transport technology and is converting the Canal area into an integrated, multi-modal transport system. Two major ports have been privatized, and private investment has financed two new container ports on the Caribbean, putting Panama in a position to become Latin America's leading container transshipment center. In 2000 Panama may handle one million containers (Panama/ARI 1998: 5).

Planned improvements to the Canal include continued widening of the Gaillard Cut and construction of a third set of locks (Ardito-Barletta 1998: 9). A trans-isthmian railroad, now being built, will be ready for cargo in 2001, and a parallel freeway will facilitate trans-isthmian shipments by truck. Thus even ships too large to go through the Canal will find it increasingly cost-effective to bring cargo to one end of the Canal for transshipment by other modes to the other end.

These developments suggest that Panama's location continues to give it significant advantages over its neighbors as a center of maritime transport. The new investments put it in a good position to respond to further changes in maritime transport technology, which probably will not be radical over the next 20 years[23]. The construction of a competing Canal elsewhere in Central America seems increasingly unlikely, as does development of another transshipment center similar to Panama's Colón Free Zone.

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[23] The OECD's (1997: 63) high-growth scenario assumes that trade and transport margins will decline by 1% a year between 1995 and 2020; the decline is 0.8% annually under the low-growth scenario.

4.3. Global Prospects at the Sectoral Level and Implications for Central America's Exports

4.3.1. Agricultural Products. With world population growth expected to slow from 1.38% per year during 1996-2000 to 1.08% annually during 2011-2020 (OECD 1997: 92), pressures to meet demand for food will ease. The OECD's high-growth scenario envisions effective demand for agricultural products as growing by 2.5% per year between 1995 and 2020, almost identical to actual growth during 1972-92, with about 80% of incremental demand coming from developing countries. As world incomes rise, demand patterns will shift toward high-value foods and nonfood products (OECD 1997: 77). Aggregate supply should not be a major problem, especially if barriers to agricultural trade continue to come down, in which case agricultural trade would grow rapidly[24].

The Uruguay Round of trade negotiations, completed in 1994, significantly liberalized world trade in agricultural products. Nevertheless, many tariff and nontariff barriers to free trade remain. For Latin America as a whole, a major concern is the persistence of export subsidies in both Europe and the United States (Díaz-Bonilla and Reca 1999: 1). Central America has also strongly objected to the (tariff-rate) quota imposed by the European Union (EU) in the early 1990s on bananas, although Costa Rica has worked out an accommodation to the EU's position.[25]

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24 Under the OECD's high-growth scenario, with its assumption of complete free trade, import penetration of agricultural products and processed food into the OECD countries would jump from 7% in 1995 to 20% in 2020; in non-OECD countries, it would more than double from its 1995 level of 8%. Even under the low-growth scenario - which assumes that tariffs, tariff-equivalents, export taxes, and export subsidies fall by 50% from their 1992 level - import penetration would reach 13% in both groups of countries. Import penetration is defined as imports as a share of apparent consumption (i.e., production - exports + imports) (OECD 1997: 75).

25 Although the WTO has ruled against the EU's banana-import regime, the EU has been dragging its heels in liberalizing banana imports to meet WTO standards.

The price and demand outlook for bananas over the next 20 years is probably more favorable than that for most of Central America's other traditional agricultural exports, such as coffee and sugar. Even more favorable are the prospects for exports of fruits and vegetables that only recently have become important in the region, such as melons, pineapple, broccoli, and snow peas, and for nonfood products such as cut flowers and ornamental plants, for which the income-elasticity of demand is high. Cultivated shrimp, another important new export, also has good potential for further expansion. While some observers have strongly criticized nontraditional agricultural exports (NTAEs) because of environmental, health, and other concerns, their benefits have been considerable, and many of the problems are amenable to solutions[26].

An increase in global demand for beef of 50% is anticipated between 1995 and 2020, mostly in developing countries (Pinstrup-Andersen, Pandya-Lorch, and Rosegrant 1999: 11). However, as noted above, prospects for Central America's beef exports are not good.

World agricultural trade will likely become more liberalized over the next 20 years through periodic WTO negotiations. Article 20 of the Uruguay Round Agreement on Agriculture called for new negotiations on agriculture to begin by 31 December 1999. The initial pace of liberalization will probably be slow.

Croome (1998: 7) believes the next round of negotiations will focus on lowering tariff ceilings and further restricting subsidies, rather than on fundamentally altering the existing framework. The major uncertainty is the EU's willingness to reduce domestic and export subsidies under its costly Common Agricultural Policy (CAP), whose structure needs to be reconsidered in the light of the planned accession to the EU of Eastern European countries much more dependent on agriculture than current EU members.

In the new WTO negotiations, Latin American countries will seek lower tariffs on the fruits, vegetables, sugar, meat, and dairy products they export (Díaz-Bonilla and Reca 1999: 1). Central American countries will

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[26] Thrupp (1995) provides an excellent, balanced review of these issues.

also be looking for a quick resolution of their banana dispute with the EU. Central America would benefit from these liberalization measures; but it may suffer from freer trade in basic grains, whose long-term price trend is likely to continue downward (Pinstrup-Andersen, Pandya-Lorch, and Rosegrant 1999: 17). Over the long run, small farmers forced by economic pressures to abandon agriculture and migrate to urban areas will be absorbed into manufacturing and services, where their productivity on average will be higher. In the short run, however, their incomes are likely to fall - a pattern that is the norm in response to structural economic change (Adelman and Morris 1977).

4.3.2. Manufactured Goods. World trade in consumer goods, especially textiles and apparel, is expected to grow rapidly in the next 20 years (OECD 1997: 73)[27]. This is good news for Central America's maquila operations, as well as its manufacturing industries with much higher value added. This rosy picture, however, and the successes achieved to date, can easily breed complacency. If maquila operations continue to concentrate on simple apparel items, real wages will tend not to rise; if they did, wage levels would diverge from productivity and these footloose activities would migrate to lower-wage countries. Productivity (and real-wage) increases can be achieved if the region makes the investments in human capital needed to shift into assembly operations or other manufacturing activities requiring higher skill levels, such as electronics. Even within the apparel industry, a more skilled labor force would permit a shift to higher-value, customized products for niche markets.

Sourcing of components abroad by firms in the industrial countries is likely to continue its rapid growth, facilitated by greater use of the Internet. By the early 1990s, about one-third of world trade in manufactures, or some $800 billion, was in parts and components (World Bank 1999: 33). This trend will create opportunities for traditional manufacturing activities as well as maquila operations.

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[27] Import penetration for consumer goods in the OECD countries rises from just over 15% in 1995 to almost 25% in 2020 under the OECD's high-growth scenario, and to almost 20% under the low-growth scenario (OECD 1997: 75).

4.3.3. Tourism. Tourism is highly competitive worldwide, but prospects for continued growth of world demand mean that even less competitive countries have some scope for expanding tourism services. For sun-and-sand tourism, Central American countries have a higher local value-added content than many of their Caribbean competitors because they can provide more locally produced foodstuffs, construction materials, and other inputs. But this type of tourism is not the most dynamic segment of the market. Ecotourism, ethnotourism, adventure tourism, and other such segments, although constituting only about 5% of the market, have been growing by 25%-30% a year, compared to 4% for sun-and-sand tourism (INCAE/CLACDS and HIID 1999: 79).

The World Tourism Organization (1994) has projected a slowing in the growth of worldwide tourist arrivals, from 3.8% annually during 1990-2000 to 3.55% during 2000-2010. The study does not provide projections specifically for Central America, virtually ignoring this region while viewing favorably the prospects of other Latin American countries. One is left with the impression that Central America must be an uninteresting place for tourists[28].

As noted in section 3, however, tourism in Central America has grown faster than many observers expected. Overnight visitors rose from 1.876.000 in 1990 to 2.565.000 in 1995[29], a healthy annual growth of 6.5% (WTO, Compendium, various issues). Excluding Costa Rica, the growth rate was a more moderate 4.3%. Costa Rica has successfully stimulated ecotourism, mainly because it has taken environmental preservation seriously, effectively packaged tours to protected areas, made supporting investments in infrastructure, and improved the overall environment for private investment.

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28 Central America's share of world tourist arrivals in 1998 was only 0.56%, and its share of tourism earnings, 0.49% (INCAE/CLACDS and HIID 1999: 36).

29 Since no figure was available for Honduras in 1995, I have estimated the number of overnight tourist arrivals in that year to be 225.000, compared to 198.000 in 1994 and 222.000 in 1993. These figures, which exclude day travelers and cruise-ship passengers, probably underestimate the number of overnight visitors.

The Central American tourist industry has adopted an ambitious set of goals: (1) to covert tourism into the region's largest source of foreign exchange earnings; (2) to attract 8 million visitors, spending US$4 billion, by 2005; and (3) to achieve world-class standards of service. Given an estimated 3.544.000 visitors in 1998, spending $2.185 billion, the implied annual growth rates between 1998 and 2005 are 12.3% for numbers of tourists and 9.0% for nominal tourism earnings (INCAE/CLACDS and HIID 1999: 37). The experience of the 1990s suggests that these targets are feasible (see Table 4); but they will not be achieved easily, partly because tourism growth in Costa Rica has slowed, as high rates from a relatively low base could not be sustained indefinitely.

The expansion of Central American tourism could be slowed or even temporarily halted if a regime change were to occur in Cuba. Although tourism in Cuba has already reached significant proportions[30], considerable potential exists for attracting visitors from the United States who at present can go there only with some difficulty and added expenses. A new Cuban regime would have a strong incentive to promote additional tourism, since this sector is better prepared than most others in that economy to create jobs and foreign exchange earnings in the short and medium term. A diversion of U.S. tourists to Cuba would probably affect Central America less than the Caribbean; any efforts to measure the extent and duration of those effects would be speculative.

4.3.4. Other Services. World trade in services grew by 8.7% annually between 1980 and 1995, nearly double the 4.5% annual growth rate for merchandise trade (OECD 1997: 37). The volume of services trade is significantly underestimated: "current balance-of-payments statistics … fail to reflect transactions like cross-border intra-firm exchange of technology and financial advice, remote data processing and transmission, and the revenue from services offered in the host country by foreign affiliates of multinationals" (OECD 1997: 37).

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[30] Cuba's gross foreign exchange earnings from tourism were approximately $1.8 billion in 1998, but the local content (value added) was only around 30%, lower than in Central America.

The OECD (1997: 38) estimates that it is technically feasible to shift abroad 12%-16% of service jobs in the G7 countries. If it were economically attractive for 10% of such jobs to move overseas, "as of 1990 the potential additional exports from developing countries to the G7 was estimated at around $40 billion (or 6 per cent of non-OECD countries' total exports)."

Within Central America only Costa Rica and, in the financial sector, Panama have begun to tap significantly into this potential. In June 1999 Proctor and Gamble announced it would invest $60 million to build a Global Business Services center in Costa Rica, employing some 1.500 persons in finance and accounting, customer orders, payroll, travel management, purchasing, and information technology[31]. A significant improvement in the numbers and quality of skilled human resources will be necessary for other Central American countries to begin attracting such investments.

Panama has great potential for developing or expanding various maritime services, which the Autoridad de la Región Interoaceánica (ARI) is actively promoting (Ardito-Barletta 1998: 18).

4.4. Toward a Free Trade Area of the Americas

The ambitious goals of the FTAA go beyond the areas currently covered by the WTO to include a common investment regime, government procurement (which the WTO may deal with in its next round of negotiations), and competition policy[32]. Whether the negotiations will in fact be completed by 2005 is unclear. Both the United States and Brazil could be major stumbling blocks.

Just how the FTAA might be established, if at all, is something of a mystery. A few years ago, it seemed possible that the CACM would join NAFTA as a single unit before 2005[33]. Central America's early

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[31] Reported in Honduras This Week (June 19, 1999), p. 4.

[32] See the FTAA Web site (www.ftaa-alca.org).

[33] The United States government made clear to the region's leaders, early in the process, that it did not want to negotiate NAFTA accession individually with each Central American country.

accession to NAFTA now seems unlikely, both because of opposition in the United States to the expansion of NAFTA and because the requisite Central American unity is lacking.

Even if negotiations were to be completed by 2005, the FTAA would not likely become operational until about 2007, and its tariff-reduction provisions would be phased in gradually over perhaps 10-15 years. Its impact on Central America between now and 2020 would thus be modest. Moreover, Central America already enjoys duty-free access to the U.S. market for the great majority of its exports. Approval by the U.S. Congress and president of "NAFTA parity" legislation, which seems likely but not certain, would benefit Central America by extending duty-free access, particularly to textiles and apparel. Still, NAFTA's negative effects on Central America's maquila operations have been exaggerated.

Perhaps the greatest potential effect of NAFTA and the FTAA on Central America is one that is difficult to measure: the stimulus it is providing governments to improve their economic policies, thus enabling the region to take better advantage of opportunities for expansion in all economic sectors.

4.5. Strengthening Central American Economic Integration

The strong recovery of intra-CACM trade since 1986 has been facilitated both by the region's economic recovery and by the tariff reductions, agreed to earlier in the 1990s, whose gradual implementation will be completed in 2000. Further progress in economic integration has stalled, however, for reasons discussed in the essay by Luis Guillermo Solís. Moreover, it seems unlikely in the near future that either Belize or Panama would wish to join the CACM, or that the CACM countries would welcome them. More closely integrated economies within Central America would especially benefit agriculture, finance, and transport.

Panama currently has only modest economic relationships with the CACM countries. Only 6% of its imports in 1998 came from its northern neighbors, with Costa Rica providing about half this amount. Panamanian banks and commercial and industrial enterprises have made few investments in the CACM countries. Panamanians tend to view the CACM, despite its aggregate GDP of more than $50 billion, as an uninteresting market with currency and other risks that are not present, or are less serious, in Panama. Some observers believe closer financial links between Panama and the CACM could develop through Panama's *bolsa de valores* (securities exchange), which is closely linked to its banks.

5. Alternative Visions of Central America's Economic Structure in 2020

Central America's economic-growth potential in the next two decades lies primarily in the services sectors, and secondarily in manufacturing, including maquila operations. In agriculture, traditional exports will continue to decline relatively and sometimes absolutely. Agriculture's overall growth will depend on countries' abilities to (1) continue diversifying their exports; and (2) reduce poverty and narrow income inequality, thus increasing effective demand for domestic foodstuffs. Changes in the structure of production will depend on how well the region exploits sectoral growth opportunities.

Overall economic performance will depend not only on national economic policies and entrepreneurial dynamism, but also on world demand for the region's potential exports. The degree to which intraregional (CACM) and hemispheric (FTAA) integration advances will also influence GDP growth, although to a lesser degree.

Given these multiple forces affecting Central America's economic growth potential, one could develop many alternative scenarios for the trajectory of GDP and its sectoral composition. However, three scenarios (base, high-growth, and low-growth), summarized in Table 5, should suffice to illustrate different possible outcomes.

The scenarios are developed for the region as a whole, as time and space considerations preclude aggregate and sectoral growth calculations for each country. Actual growth, of course, will vary by country. Since skilled human resources are a major determinant of long-term economic growth, Costa Rica and Panama are currently best able to exploit growth opportunities, other things being equal, while Guatemala, Honduras, and Nicaragua are the most disadvantaged.

5.1. Base Scenario

The base scenario, or one of reasonably competent "muddling through," assumes that Central America will achieve a (compound) annual growth rate of 4.5%, or 2.4% per capita[34]. The region's real per capita GDP in 1997 prices would rise from $1.630 in 1997 to $2.790 in 2020, an increase of 71%. This scenario assumes that most or all of following conditions will prevail:

- moderate world economic growth (somewhat better than the OECD's low-growth scenario), with periodic disruptions by financial and political crises of more than localized impact;
- additional debt relief, especially for Honduras and Nicaragua;
- relatively slow progress in further trade liberalization (global, hemispheric, and intraregional), but with no worsening of average protectionism;
- continued but slow progress in Central American macroeconomic and microeconomic policies and modernization of the state;
- a relatively modest pace of social and human-resource development in Central America, which at best only preserves existing gaps between the region and the rest of the world;
- modest improvements in environmental protection, through reduction or elimination of harmful subsidies and better protection of national parks; and
- continued advances in democratic development, but few major breakthroughs in decentralizing public-sector functions, strengthening civil society, improving personal security, reducing discrimination against women and minority groups, and strengthening the rule of law.

The major shifts in the structure of production would be away from agriculture (17.9% to 13.7% of GDP) and public administration (9.1% to

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[34] All three scenarios are based on a single set of population projections by the Centro Latinoamericano de Demografía (CELADE). However, population growth would likely be somewhat slower under the high-growth scenario, and per capita GDP growth higher, because of greater urbanization, more educational opportunities for women, and other factors that tend to reduce fertility rates.

7.3%) and toward the private services sectors (50.0% to 55.2%). Manufacturing would retain its share at 16.0%, as continued rapid growth in maquila exports, although at a less heady pace than in the 1990s, would offset sluggish production for domestic and regional markets in the face of strong competition from imports[35]. The presumed 3.3% growth rate for agriculture (1.2% per capita) is respectable if one takes into account the relatively poor outlook for traditional exports.

The assumption of public sector growth hides different trends in the various countries. For example, significantly increased spending on education and health would be required for Guatemala and El Salvador to approach the shares of GDP accounted for by these sectors elsewhere in Central America. On the other hand, all countries have considerable scope for improving the efficiency of public expenditures by reducing total employment while decompressing salary scales to relate pay more closely to productivity. The scope for further reducing military spending is limited because significant reductions have already taken place.

The relatively high growth rate of 5.0% for mining, utilities, and construction (combined in Table 5) reflects in part an assumption that the recent rapid growth of mining will continue. Also likely is substantial infrastructure construction, with the private sector playing an increasingly important role.

Among private services, which account for half the region's GDP in current prices in 1997[36], the sectors assumed to have above-average growth rates for the group as a whole are trade, restaurants, and hotels (which includes most of the tourism industry); transport, storage, and communications; and finance, insurance, and business services. Real estate and other services are assumed to grow at below-average rates.

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[35] Manufacturing's share is probably underestimated, as a great deal of maquila activity in the region seems not to be captured in the national accounts.

[36] This figure is probably an overestimate, since output in the manufacturing and utilities sectors seems underestimated.

5.2. High-Growth Scenario

The high-growth scenario envisions an annual GDP growth rate of 6%, less than the very ambitious rate of approximately 7.2% implied by the INCAE-HIID Agenda (1999: 119, 134)[37]. Per capita GDP in 2020 would be 137% higher than in 1997, rising to $3.870 in 1997 dollars. A 6% rate of growth is desirable and feasible, but it would require an especially favorable set of circumstances, including most of the following:

- rapid world economic growth, close to the OECD's high-growth scenario;
- additional debt relief, especially for Honduras and Nicaragua;
- a successful outcome to the new WTO negotiations, including agreements on further liberalization of trade in agriculture and services, as well as additional trade liberalization under subsequent WTO negotiating rounds;
- establishment of the Free Trade Area of the Americas;
- deeper and broader economic integration within Central America, converting the current scheme into one that begins to look like a true common market and includes, sometime before 2020, the adoption of a common currency;
- significant investments to improve the quality of human capital, and effectively targeted programs to provide poor households better access to other factors of production;
- accelerated privatization of government enterprises and infrastructure, and other mechanisms to permit greater private investment in, and management of, infrastructure projects;
- maintenance of sound macroeconomic policies, more rapid implementation of microeconomic-policy and structural reforms,

[37] The INCAE-HIID figure is expressed in terms of per capita GDP growth of 5% annually.

and accelerated efforts to improve the efficiency of government operations;

- aggressive implementation of pricing policies, enforcement actions, educational campaigns, and other measures to limit or reverse processes of environmental deterioration; and
- a significant strengthening of the various elements of democratic development identified in the base scenario.

The high-growth scenario would produce greater changes in the structure of production than the base scenario. Agriculture, despite growing more rapidly (4.2% annually) than under the base scenario (3.3%), would see its share of GDP drop by almost a third, from 17.9% in 1997 to 12.1% in 2020. Public administration would grow by 4.5% a year, but its share would decline sharply from 9.1% to 6.5%. Manufacturing's share would remain at 16.0%. Its 6.0% growth rate would reflect (1) countries' success in moving away from low-skill maquila operations toward more skill-intensive export production making greater use of local raw materials, and (2) greater economies of scale in production for domestic and regional markets as a result of more complete regional integration. Mining, utilities, and construction together are again assumed to grow more rapidly than aggregate GDP.

The private services sectors are projected to grow at an annual rate of 6.7%. This strong performance assumes that effective public-private partnerships, national and regional, will create a dynamic tourism industry. It also assumes that intra- and extraregional trade will increase notably as a percentage of GDP, thus stimulating commercial activities as well as the transport, storage, and communications sector. Finally, this scenario envisions the modernization and rapid expansion of finance, insurance, and business services, reflecting the establishment of private pension systems; stronger, better supervised and regulated financial institutions offering a wider range of services to their customers and providing loans at lower real interest rates; the establishment of significant regional financial institutions and capital markets; a large increase in demand for various types of insurance; and an explosion in the application of modern information technology.

5.3. Low-Growth Scenario

The low-growth scenario assumes annual GDP growth of 3%, resulting in a cumulative increase in per capita GDP of only 23% between 1997 and 2020. An even worse outcome is possible, but given recent policy reforms in the region, as well as a reduction in debt burdens, the probability of an outcome similar to the "lost decade" of the 1980s seems relatively low.

The low-growth scenario would result from most or all of the following circumstances:

- slow growth of the world economy, at or below the growth rate assumed in the OECD's low-growth scenario;
- relatively little additional debt relief, either because of lack of agreement among donor countries and international agencies, or because of policy backsliding in Central America;
- little progress in trade liberalization under WTO agreements, and perhaps more protectionist policies in the OECD countries;
- continued failure by most Central American countries to adopt policy and institutional reforms needed to achieve significant improvements in educational systems and training programs;
- slow progress in privatization and other arrangements necessary to stimulate more private sector involvement in the construction, operation, and maintenance of infrastructure;
- frequent backsliding on economic policy reforms, resulting in failure to consolidate a key element of a favorable investment climate;
- slow progress in improving property rights; lowering the transaction costs of customs procedures, transport, business registry, and other government operations; and eliminating price distortions that misallocate resources;
- lack of attention to policies, programs, and projects that protect the environment; and
- relatively slow progress in the various aspects of democratic development.

The low-growth scenario would result in little change in the structure of production. Agriculture's share of GDP would fall only from 17.9% to 16.0%, as its growth rate would be closer to that of aggregate GDP than under the other scenarios. World demand for traditional agricultural exports would be weak, but the region could still have much success with nontraditional exports. Production for the domestic (and Central American) market would not grow rapidly because a 3.0% growth rate in aggregate GDP would limit the effective demand for food.

Manufacturing would grow somewhat faster (3.5%) than aggregate GDP, mainly because of the performance of maquila production, although these activities would lose some dynamism because of the slow growth of world demand as well as insufficient attention to productivity growth and skills upgrading. Manufacturing's share of GDP would rise to 17.9% by 2020.

Mining, construction, and utilities are assumed to grow jointly by 3.5%, with mining growing faster than construction and utilities. The combined share of these sectors would rise from 7.0% of GDP to 7.8%.

Public administration is assumed to grow by only 2.5%, as sluggish revenue collection, combined with strong internal and external pressure to contain fiscal deficits, would limit desirable growth in social spending. The share of public administration in GDP would fall from 9.1% to 8.1%.

The slow (3.0%) growth of private services reflects, among other factors, disappointing growth in tourism (due to both slow world economic growth and to ineffective promotional efforts), and inadequate financial modernization. The share of private services in GDP thus remains virtually the same at about 50%.

Both the external environment and domestic (and regional) policy choices by the Central American countries will determine which scenario will most closely approximate the course of the region's development over the next two decades. While the Central American countries can do little to affect their external environment, their small influence would be enhanced by negotiating in the WTO, FTAA, and other international fora as a single unit.

That single unit, for now, would seem to exclude Belize and Panama, although their eventual incorporation into a true Central American common market seems feasible by 2020. An expanded CACM would be facilitated by further trade liberalization; strengthening and maintenance of sound macroeconomic policies; adoption of a single currency by the five current CACM members; and demographic and other changes that are converting Belize from a predominantly Caribbean country to one culturally and economically more rooted in Central America.

6. Conclusions and Policy Recommendations

6.1. Overview

The process of economic development is too complex for economists to tackle alone. The widening inequalities associated with Latin American countries' recovery from the debt crisis of the 1980s (Berry 1997; Bulmer-Thomas 1996) make clear that blind faith in markets is misplaced. Successful, sustainable responses to the challenges of globalization require national strategies with an integrated focus on four goals: (1) economic growth; (2) poverty reduction; (3) environmental protection; and (4) participatory democracy. In addition, deeper and broader regional integration can enhance the Central American countries' participation in the world economy.

This section focuses mainly on economy-wide and sectoral reforms that would facilitate economic growth. The other three elements of the strategy outlined above, as well as regional integration, receive only brief attention, as they are covered in detail in other essays. Finally, I offer recommendations to the international community for making development assistance to Central America more effective.

6.2. Economic Growth: Economy-Wide Measures

6.2.1. Introduction. Economic growth is the most important means for reducing poverty over the long run. It also facilitates (but does not guarantee) the solution of some environmental problems and the strengthening of democratic participation.

A key determinant of economic growth is the amount and productivity of investment, especially private investment. While governments still have a key role to play in providing basic infrastructure, private investors are generally more efficient than bureaucrats as enterprise managers. Further privatizations of directly productive activities would both improve efficiency and strengthen the public finances.

The case for privatization extends to infrastructure, the expansion of which will require both higher public savings rates and more private investment. This is especially the case for heavily indebted Honduras and Nicaragua, whose public sectors have little capacity to finance new investment because of insufficient domestic resources and an inability to contract non-concessional external loans[38].

6.2.2. Macroeconomic Policy. An essential requirement for stimulating private investment - and both private and public savings - is to keep fiscal and external deficits low, not for just a few years, but reasonably consistently over time to establish credibility. Macroeconomic stability minimizes domestic inflationary pressures and exchange rate fluctuations, thus reducing risks and uncertainties faced by private investors. Controlling inflationary pressures particularly benefits the poor.

All Central American countries have made great strides toward fiscal stability, but backsliding episodes (e.g., Honduras in 1992-93, Costa Rica on several occasions) still occur. Further progress toward fiscal stability does not always mean cutting expenditures. In El Salvador and especially Guatemala, the need for higher levels of social spending means that revenue increases deserve priority.

Keeping external deficits low will require vigilant monetary policy to control import demand, as well as actions to ensure that exports remain competitive.

6.2.3. Reform of the State[39]. The ideological debate over state vs. market in Latin America, as elsewhere, has given way to a more balanced dialogue recognizing that streamlining, strengthening, and transforming the state are more important than dismantling it. All Central American countries have made progress in public sector reform during the 1990s, but all have much to do to create modern and efficient states that can strongly support their private sectors, stimulate new private investment, and meet the other challenges of the 21st century.

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[38] Honduras and Nicaragua, which expect to gain access to debt relief under the Highly Indebted Poor Countries (HIPC) initiative, would be ineligible if they contracted non-concessional debt.

[39] Carlos Sojo's CA 2020 essay provides another perspective on this topic.

Key reforms needed are those to (a) privatize most remaining state enterprises and improve the efficiency of the others; (b) eliminate arbitrary regulations that impose high transaction costs on private businesses; (c) strengthen supervision and regulation of the financial sector, private monopolies and oligopolies; (d) rationalize and decentralize overstaffed central bureaucracies, especially in the social sectors, that are out of touch with local concerns; (e) decompress public sector salary structures that inhibit the hiring and retention of highly capable managers, administrators, and professional and technical specialists; (f) modernize and professionalize legal and judicial structures that inadequately protect private property (physical and intellectual); and (g) adopt or strengthen integrated financial management systems that permit better detection of tax evasion, expenditure misallocations, and corrupt practices in general.

6.3. Economic Growth: Sectoral Policies

Sectoral policies should be guided by a long-run vision recognizing that economic growth will depend increasingly on the expansion of private services and the performance of manufacturing and maquila operations. However, for a number of years agriculture will continue to be the primary source of employment and net foreign exchange earnings, except in Panama, and its performance thus remains important to aggregate economic growth.

6.3.1. Financial Sector Reforms. Recent financial crises in Latin America and Asia illustrate the importance of a strong financial sector to sustainable economic growth. Full financial liberalization in countries with weak banking systems is especially risky. Kaminsky and Reinhart (1999) find that currency crises typically have been preceded by banking crises, which in turn are often preceded by capital inflows, credit expansion, and an overvalued currency in the wake of financial liberalization. The clear lesson is that regulatory and supervisory reforms, much needed in Central America, deserve a high priority[40].

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[40] See World Bank (1999: 75-79) for a discussion of specific banking and financial reforms that would be desirable.

Except for Panama, with its dollarized economy, competitive financial services sector, and (since 1998) strong supervisory and regulatory framework, banking operations in Central America are inefficient, as reflected in high intermediation margins[41]. As interest rates are deregulated throughout the region, these large spreads translate into high real interest rates to borrowers, thus discouraging some potential productive investments.

The minimal presence of foreign banks, except in Panama, means that an important stimulus to improved banking efficiency is missing (World Bank 1999: 78-79). A true common market, especially with a common currency, would make Central America much more attractive to foreign banks.

Public pay-as-you-go pension systems in Central America are inefficient, inequitable, and either technically insolvent or heading there. They should be replaced or reformed and supplemented with private, individually financed schemes such as those in El Salvador and Panama, which became operational in 1998.

Private pension schemes should strongly stimulate savings and the development of national capital markets. Movement toward a regional capital market, at least among the five CACM countries, already is incipient. Stronger linkages to Panama's capital market also appear likely. Belize's participation in a regional capital market seems more distant.

A key issue being widely debated now is dollarization. Panama adopted the U.S. dollar as its currency early in the 20th century. The CACM countries had all maintained fixed exchange rates with the dollar for long periods until the 1980s. As their currencies depreciated, and then were formally devalued, the dollar was increasingly adopted as a parallel currency, and most dollar transactions eventually were legal-

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[41] Recent spreads have ranged from 8 (Costa Rica) to 18 (Honduras) percentage points (p.p.) (BCIE, Comportamiento económico de Centroamérica durante el primer trimestre de 1999 y perspectivas a corto plazo [Tegucigalpa, 13 May 1999]). In Panama, by contrast, spreads for local banking operations are generally 5-6 p.p.

ized. The potential benefits of dollarization seem clear, but a major risk is that it restricts economic adjustment options. Moreover, the U.S. Treasury or Federal Reserve System would not likely serve as lender of last resort or cooperate in supervision.

Neither regionwide (CACM) dollarization nor the adoption of a single currency seems feasible in the short or medium term. The requisite macroeconomic stability and harmonization of policies have not been established. Only El Salvador has the combination of sound policies, high foreign exchange reserves, and international levels of inflation needed to make dollarization a viable option in the near term[42]. The long period required for the European Union (EU) to adopt a common currency, which some EU countries still have not accepted, should make clear how difficult this step is. Nevertheless, a fully dollarized Central America, or the adoption of a common CACM currency, is a reasonable policy target by 2020.

6.3.2. Tourism. To achieve their ambitious goals for tourism development, Central American countries will need to improve their promotional efforts; increase investment in infrastructure; promote more competition in international air travel to reduce relatively high fare structures; and take stronger actions to address personal security and environmental concerns[43]. Promotional activities should be increased in Europe, as 83% of tourist arrivals in 1995 came from the Western Hemisphere[44].

At the regional level, Central American tourism ministers, acting through the Consejo Centroamericano de Turismo (CCT), approved in July 1999 the establishment of an Organización Centroamericano de Turismo (OCAT) as a mixed entity with both public and private sector

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42 Even in El Salvador, the IMF (1999: 3) argues that conditions are still not propitious for the adoption of a currency board, which the government has been considering. It recommends further fiscal and financial reforms, and even higher reserves, before taking such action.

43 INCAE/CLACDS and HIID (1999: 36-38, 79-83) provide a detailed discussion of tourism obstacles and policies.

44 Calculated from data in WTO, Compendium 1991-1995 (1997).

representation[45]. Meanwhile, the Government of Taiwan (China) has provided grants totaling $1 million to the Secretaría de Integración Centroamericana (SICA) and the Secretaría de Integración Turística Centroamericana (SITCA)[46]. This apparent fragmentation of the institutional structure may limit the effectiveness of regional promotional efforts. These efforts will also founder if public sector institutions are unable to work effectively with the private sector, as is supposed to occur, appropriately, under OCAT.

The difficulties of effective regional cooperation are illustrated by the slow progress in implementing the "Mundo Maya" project, which seeks to promote multi-country tourism to Mayan sites in southeastern Mexico, Belize, Guatemala, and Honduras. Stronger national efforts, with the collaborative involvement of the public and private sectors, are probably a prerequisite to effective regional cooperation.

6.3.3. Informatics Services. Demand for informatics services is expected to grow rapidly in the first two decades of the 21st century. However, Central America will be poorly placed to exploit these opportunities without improvements in the quality of education and training programs, including basic and specialized computer skills. Costa Rica is well ahead of its neighbors in taking actions to develop informatics exports. Panama could strengthen its ability to compete in this area by relaxing its tight restrictions on employing foreign professionals.

6.3.4. International Transportation Services. Panama not only has a strong lead over the other countries of the region, but also is moving faster to expand and diversify these services. Privatization has stimulated new construction and significantly reduced shipping costs. Elsewhere in Central America, new investments in port services, and in road access to ports, are needed to improve export competitiveness. Most will have to be made by the private sector, given limited public resources and increased internal and external pressures on governments to expand and improve social services.

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45 El Tiempo (San Pedro Sula), 5 July 1999, Internet version.

46 La Prensa (San Pedro Sula), 14 July 1999, Internet version.

6.3.5. Manufacturing. Many Central Americans have embraced the "competitiveness" theories of Michael Porter and his colleagues at Harvard, who together with collaborators at the Instituto Centroamericano de Administración de Empresas (INCAE) have identified "clusters" of manufacturing and service activities with potential for significant expansion in the 21st century, based on innovation and productivity growth (INCAE/CLACDS and HIID 1999). The manufacturing clusters regarded as having the greatest potential are agribusiness and textiles and apparel. The other clusters are tourism and electronics and software services.

Although the focus on clusters represents a type of "industrial-programming" policy whose record in Asia has been mixed, the most important policy recommendations focus on the economy-wide actions and financial sector reforms discussed earlier in this section and investment in human capital. The industrial programming aspects include targeting public infrastructure investments to enhance economies of scale and scope in clusters of related enterprises; close collaboration between the public and private sectors to identify specific obstacles in various branches of manufacturing; and promotional activities to lure specific foreign investors. The rationale is that markets do not work by themselves: government action can both improve their functioning and guide investors in the most productive directions.

"Free-market" extremists might criticize the clusters strategy as an ill-fated attempt to "pick winners". However, the clusters chosen are already demonstrated winners in Central America. The strategy appropriately seeks to strengthen their competitive advantage in a dynamic, not just static context.

For the Central American countries to take good advantage of opportunities provided by the trend toward increased outsourcing of components, particularly important requirements are measures to liberalize and strengthen their telecommunications and transportation sectors (World Bank 1999: 65).

6.3.6. Maquila Operations. Policies related to maquila operations require a longer-run vision than exists now in the region, except perhaps in Costa Rica. One recognized element of a long-run vision is that NAFTA poses a challenge to Central American maquila exports. Other things equal, lower U.S. tariffs on Mexican goods make Central American products less competitive. Thus Central American officials and business leaders have lobbied hard in the United States for "NAFTA parity" legislation that would eliminate Mexico's current advantage. To date, however, NAFTA has affected Central American exports less than is widely believed[47].

A problem with the fixation on NAFTA parity - whose enactment, although increasingly likely, is still not certain - is that it diverts attention from the "other things equal". In other words, Central American countries need to be thinking more about actions they themselves can undertake to maintain and enhance competitiveness. Especially important for the long term is a vision for transforming maquila operations into more of a true manufacturing activity by enhancing the skilled-labor and other domestic input content of textile, electronics, and other assembly production, as many Asian countries have done. Public investments in education and technical training are a key component of this vision. Also, further trade liberalization within Central America, to widen the market and stimulate more intra-industry specialization, would enhance the competitiveness of locally produced inputs other than labor.

6.3.7. Agriculture. Central American countries, mainly because of fiscal pressures, have eliminated most domestic price controls, many other subsidies, and nearly all export taxes. Many import tariffs have also been reduced. Additional price reforms would further improve resource allocation and efficiency, although some producers would be affected adversely. Other important measures would be improved land tenure security and, in Honduras, reform of the ineffective timber auction system and other aspects of forestry policy that discourage production and inadequately protect the environment.

Considerable scope exists for liberalizing intraregional trade in agricultural products, which has not proceeded as far as free trade in manufactured goods. The CACM countries continue to impose arbitrary

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[47] Value added by *maquila* operations in Mexico rose from about $3.5 million in 1990 to $6.0 billion in 1994 and $10.6 billion in 1998 (Vargas 1999, Part I:3). Value added increased even more rapidly in Central America during this period (see Table 3).

tariff and nontariff measures against each other, in response to pressures from national interest groups.

6.3.8. Mining. Institutional weaknesses and legal and judicial issues have limited new mining investments throughout the region. Honduras, which has perhaps the best potential for minerals development, has just adopted a new mining law, but it is too early to tell how much it has relieved investors' worries about secure property rights and other aspects of the rule of law.

6.4. Equity

Poverty and income distribution issues are discussed in detail in Juan Pablo Pérez Sáinz's contribution to the CA 2020 study. Still, it is worth emphasizing here both the consistency between equity and economic growth goals and the importance of the former to the latter. Poor households can do more to escape poverty and contribute to national economic growth on their own if they have more education and training and better access to other factors of production, especially land and credit.

Governments can promote greater equity by reducing costly and highly inequitable subsidies such as that for higher education, and by better targeting other subsidies. Equitable growth can also be fostered by reallocating expenditures, e.g. from university to primary education, from hospitals to primary-care centers, and from primary- and secondary-road systems to farm-to-market roads in poor areas with underdeveloped agricultural potential.

6.5. Environmental Sustainability

Despite more attention to environmental issues in public statements and documents throughout Central America, progress in slowing, halting, or reversing environmental deterioration has been slow. Environmental damage influences competitiveness through such effects as lower crop yields, higher energy costs, and deteriorating workers' health. Neglecting environmental problems may benefit specific economic activities in the short run, but environmental costs are passed on to society at large.

One might question the appropriateness of attaching environmental conditions to free trade agreements, which can be a convenient vehicle for protectionism; but membership in the proposed FTAA likely will be conditioned on the adoption of major programs to reduce environmental damage.

6.6. Participatory Democracy

The voluminous literature on the relationship between political democracy and economic growth has produced findings that often are inconclusive or at least complex. Clearly, political democracy, especially in the narrow sense of electoral processes, does not automatically produce faster economic growth. However, Remmer's (1993: 393) quantitative analysis of eight Latin American countries concludes that "competitive elections have enhanced, rather than undermined, the capacity of political leaders to address outstanding problems of macroeconomic management."

Apart from electoral reforms, economic growth can be strengthened by:

- legal reforms and an improved administration of justice, which strengthen property rights, lower the costs of dispute settlement, and reduce the likelihood of arbitrary applications of the law;
- measures to reduce criminal activity, which causes businesses to make significant investments in security systems and services and to raise risk premiums required as part of profit margins;
- decentralization of some government programs, ideally by transferring financial as well as administrative authority:
- greater scope for non-governmental organizations (NGOs) to administer social service and environmental programs, and for other civil society groups that can play important watchdog roles;
- more rapid movement toward both legal and especially de facto equality of opportunity for women and minority groups; and

- greater freedom of association, to allow various groups a reasonably equal opportunity to negotiate for economic, social, and cultural objectives in the political arena and the workplace.

6.7. Regional Economic Integration

Intraregional agricultural trade still faces significant barriers. Removing them would help Central American basic grains producers survive in freer world markets for these commodities. Key complementary measures include improving the intraregional road network and reducing the transaction costs of border crossings.

Strong regional financial institutions and capital markets would accelerate the expansion of intraregional financial flows that already is taking place, but the development of such institutions depends in part on stronger supervision and regulation of banks and other financial institutions at the national level. Greater exchange rate and macroeconomic policy stability would strengthen the climate for the development of regional financial institutions and capital markets, as would adoption of a common currency. A dollar-based CACM economy would strengthen the currently weak links between the CACM and Panama and facilitate access by private businesses to long-term finance at interest rates lower than those now available. It might also stimulate stronger links between the CACM and Belize.

Removing barriers to the cross-border provision of transport, storage, and communications services would lower transaction costs for intraregional trade in goods. Both goods and services sectors would benefit from freer movement of professionals within the region.

6.8. More Effective Development Assistance

Structural adjustment experiences in Latin America, and more recently in Asia, have made clear the need to better address issues of poverty, income distribution, and even the hardships suffered by middle-class segments of society. Strong IFI support for social investment funds in Latin America and elsewhere reflects increased donor sensitivity to these issues. The next step is to reorient the primary focus of these funds away from temporary job creation (poverty alleviation) and more toward directly productive activities that help reduce poverty permanently by improving poor households' access to productive assets.

In some (but not all) circumstances, IFIs should allow more time for deficits caused by internal or external shocks to be reduced, and provide adequate and timely resources in the interim to dampen pressures for inflationary domestic financing. At the same time, they need to make clear their readiness to withhold disbursements in the event of policy lapses, thus bolstering investors' confidence that needed fiscal adjustments will be made.

Donor financing of various fora can strengthen the role of civil society in planning, programming, and monitoring development assistance in a climate that emphasizes cooperation, a focus on technical analysis instead of polemics, and a spirit of compromise.

Donors can promote cooperative approaches to economic and social reform by providing more support for activities that deepen understanding of economic and social policy issues by government policy makers, business leaders, civil society representatives, the media, and the public at large. These include:

- periodic conferences and public debates on key policy issues, with presentations by representatives of a wide range of public and private sector groups, and formal comments by independent discussants to put pressure on all participants to emphasize argumentation supported by evidence rather than polemics;
- support for research and publications by local universities, think tanks, business organizations, and other groups representing a wide range of political and social viewpoints, to stimulate competition among them that improves the quality of their analysis and the subsequent public debate;
- short courses on economic and social policy topics for professionals, administrators, and managers from a wide range of public and private sector groups (both separately and jointly), including representatives of the media;
- visits by mixed groups (including civil society and media representatives) to observe successful policies, programs, and projects in other Latin American countries; and

- long-term training abroad (or within Central America, in institutions such as INCAE) in economics, business and public administration, policy analysis, and related topics.

None of these activities will have major immediate impacts. But my observations in Costa Rica and El Salvador over the last two decades convince me that their combined, cumulative effects over the long run can be powerful. The most important need now is to incorporate equity issues more fully, and analytically, into the policy debate.

Finally, and again with a long-run perspective, donors should increase support for collection and analysis of better and more timely economic and social data. This essay has shown that weak national accounts data in all Central American countries impede a clear understanding of sectoral trends. Similarly, the lack of good data on poverty and income distribution, except in Costa Rica, distorts the debate on these issues in the directions of rhetoric and polemics. Donors will need to find creative ways to convince governments that good data are important for sound policy analysis.

Table 1
Central America: Macroeconomic Indicators, Selected Years, 1978-1998

	1978	1980	1983	1990	1997	1998
REAL GROSS DOMESTIC PRODUCT (GDP)						
(Index, 1980 = 100)						
Belize	90.8	100.0	98.9	162.5	207.1	214.2
Costa Rica	94.6	100.0	93.2	126.9	164.0	174.2
El Salvador	118.3	100.0	85.2	96.2	137.6	142.0
Guatemala	92.1	100.0	94.6	109.1	144.4	151.5
Honduras	94.9	100.0	100.2	127.1	164.7	169.7
Nicaragua a/	130.0	100.0	109.3	87.2	103.3	107.5
Panama b/	98.7	100.0	109.7	114.5	161.1	167.4
REAL PER CAPITA GDP						
(Index, 1980 = 100)						
Belize	94.6	100.0	91.5	125.5	133.4	134.3
Costa Rica	100.4	100.0	85.4	94.9	101.5	105.3
El Salvador	122.6	100.0	86.2	86.9	111.0	112.8
Guatemala	97.5	100.0	86.9	81.9	88.7	90.5
Honduras	100.7	100.0	91.6	94.9	101.0	101.4
Nicaragua	138.3	100.0	99.7	64.2	61.3	61.9
Panama	94.1	100.0	101.3	93.1	115.5	118.1
GROSS DOMESTIC INVESTMENT (GDI)						
(% of GDP) c/						
Belize d/	n.a.	24.1	20.2	27.9	23.7	n.a.
Costa Rica	23.5	26.6	24.2	27.3	26.5	27.2
El Salvador e/	19.6	13.3	12.1	13.9	15.0	n.a.
Guatemala	21.6	15.9	11.1	13.6	12.6	14.9
Honduras f/	24.2	24.5	16.7	20.2	25.5	23.0
Nicaragua e/	17.3	15.4	22.5	19.3	30.9	n.a.
Panama	24.9	28.1	17.9	16.8	25.4	n.a.
GROSS NATIONAL SAVINGS (GNS)						
(% of GDP) c/						
Belize d/	n.a.	16.5	13.6	26.2	18.0	n.a.
Costa Rica	13.2	11.8	13.5	18.2	24.9	23.3
El Salvador e/	19.3	13.3	6.7	9.5	15.4	n.a.
Guatemala	17.3	13.6	8.0	10.1	9.9	9.4
Honduras	16.1	12.2	9.6	18.4	21.5	20.0
Nicaragua e/	15.2	-5.2	-0.8	-1.9	5.8	n.a.
Panama	16.4	27.6	31.7	23.7	22.4	n.a.

Table 1 (continued)

	1978	1980	1983	1990	1997	1998
MERCHANDISE EXPORTS g/						
(millions of US$)						
Belize	80	111	77	129	193	186
Costa Rica	864	1.001	852	1.354	2.954	n.a.
El Salvador	802	1.075	758	582	1.359	1.257
Guatemala	1.092	1.520	1.092	1.212	2.391	2.562
Honduras	631	860	707	887	1.536	1.605
Nicaragua	646	450	452	331	704	573
Panama h/	386	379	392	460	659	n.a.
PUBLIC EXTERNAL DEBT i/						
(millions of US$)						
Belize	27	47	75	136	199	n.a.
Costa Rica	951	1.700	3.146	3.063	2.840	n.a.
El Salvador	333	499	1.390	1.912	2.427	n.a.
Guatemala	304	563	1.410	2.478	2.834	n.a.
Honduras	595	976	1.629	3.426	3.910	n.a.
Nicaragua	984	1.668	3.404	8.281	4.819	n.a.
Panama	1.880	2.270	3.145	3.988	5.074	n.a.
FISCAL BALANCE j/						
(% of GDP)						
Belize d/	n.a.	-5.4	-10.7	-0.9	-2.0	-3.1
Costa Rica	-9.0	-11.8	-3.1	-2.9	-1.4	-1.3
El Salvador	-1.5	-9.6	-13.8	-2.8	-2.0	-2.0
Guatemala	-0.8	-4.4	-3.3	-2.1	-0.4	0.6
Honduras	-6.2	-9.0	-12.0	-5.9	-1.0	-2.7
Nicaragua	n.a.	-5.9	-25.7	-20.3	-7.1	-2.2
Panama	n.a.	-4.6	-5.0	-2.5	-2.2	n.a.
CONSUMER PRICES						
(annual % change)						
Belize k/	n.a.	7.1	4.9	3.0	1.0	-0.7
Costa Rica	6.0	18.1	33.0	19.0	13.2	11.7
El Salvador	16.0	17.3	13.1	24.0	4.5	2.6
Guatemala	7.9	10.6	4.6	41.2	9.2	7.5
Honduras	5.7	18.2	8.0	23.3	20.2	13.7
Nicaragua	4.6	35.3	31.0	7,485.0	9.2	13.1
Panama	4.2	13.8	2.1	0.8	1.0	0.6

Sources: IDB/ESDB; IMF, Balance of Payments Yearbook, International Financial Statistics and public country documents; USAID (1998 and prior years): USAID's data electronic base for Latin America and the Caribbean (www.info.usaid.gov/regions/lac/sesd/index.html); World Bank, World Debt Tables; and Zuvekas (1997).

a/ Nicaragua's GDP index in 1977 was 141.1, and its per capita GDP index, 154.7.

b/ The 1978 GDP and per capita GDP figures for Panama were adjusted upward to account for economic activities in the former Canal Zone, which were not incorporated into the national accounts until 1980.

c/ Savings and investment rates are in current prices.

d/ Belize's GDP estimates for 1978 were adjusted upward significantly a number of years later. It is not clear how this adjustment affected savings and investment rates (relatively high before the adjustment) and the fiscal deficit (relatively low).

e/ Figure for 1978 is from 1976.

f/ The net investment data for Honduras are for gross fixed investment only; the figures for net changes in inventory are not reliable and indeed have been dropped in most official reporting.

g/ Excludes maquila (assembly) operations, except in Nicaragua (since 1992), where the gross value of maquila exports is included in total merchandise exports and cannot always be readily distinguished. Relatively small amounts of maquila and export-processing activities also seem to be included in Panama's merchandise exports (since 1996).

h/ Excludes operations of the Colón Free Zone and other such re-export activities.

i/ Disbursed and outstanding amounts.

j/ Surplus or deficit of the consolidated nonfinancial public sector, except in Belize, where the balance is for the central government.

k/ Price indices were not calculated in Belize in 1978.

Table 2
Central America: Aggregate and Sectoral gdp Trends,
1978-80 to 1995-97 a/
(annual real percentage growth rates)

	1978-80 to 1987-89	1987-89 to 1985-97		1978-80 to 1987-89	1987-89 to 1995-97
AGGREGATE GDP			**Trade, Restaurants & Hotels**		
Belize	2.6	5.6	Belize	1.1	5.5
Costa Rica	2.0	4.0	Costa Rica	0.8	4.3
El Salvador	-1.9	4.1	El Salvador	-4.0	8.6
Guatemala	0.6	4.0	Guatemala	-0.6	4.1
Honduras	2.5	3.3	Honduras	-0.5	2.5
Nicaragua	-1.4	2.5	Nicaragua	-2.3	2.4
Panama	1.5	4.0	Panama	-1.2	6.5
Agriculture, Forestry & Fishing			**Transport, Storage & Communications**		
Belize	2.5	6.7	Belize	11.3	9.2
Costa Rica	2.5	3.5	Costa Rica	4.2	7.7
El Salvador	-1.2	1.7	El Salvador	-1.1	5.4
Guatemala	0.8	3.1	Guatemala	1.7	6.1
Honduras	2.5	3.7	Honduras	5.0	3.7
Nicaragua	-0.7	5.2	Nicaragua	-3.0	1.5
Panama	3.3	1.9	Panama	2.4	2.2
Mining			**Finance, Insurance & Business Services**		
Belize	13.5	10.9	Belize	2.2	4.9
Costa Rica	b/	b/	Costa Rica	4.9	6.2
El Salvador	1.9	6.4	El Salvador	c/	8.2d/
Guatemala	-0.9	10.9	Guatemala	2.4	7.3
Honduras	-1.0	5.6	Honduras	4.0	8.3
Nicaragua	-3.7	11.8	Nicaragua	-0.9	1.3
Panama	-6.9	11.8	Panama	-2.9	7.0
Manufacturing			**Real Estate**		
Belize	0.8	4.9	Belize	e/	e/
Costa Rica	2.0	3.8	Costa Rica	1.9	2.1
El Salvador	-4.7	3.9	El Salvador	c/	1.6d/
Guatemala	-0.1	2.7	Guatemala	2.3	2.7
Honduras	2.6	3.4	Honduras	4.3	3.7
Nicaragua	-2.8	1.0	Nicaragua	e/	1.7
Panama	0.4	4.5	Panama	7.2	3.9

Table 2 (continued)

Electricity, Gas & Water			**Public Administration and Defense**		
Belize	7.0	9.0	Belize	5.5	2.4
Costa Rica	5.8	5.1	Costa Rica	1.1	1.6
El Salvador	2.9	-3.4	El Salvador	4.2	1.2
Guatemala	4.1	8.0	Guatemala	4.3	4.8
Honduras	9.4	6.0	Honduras	3.4	-2.2
Nicaragua	2.0	3.7	Nicaragua	2.5	-3.7
Panama	7.7	3.3	Panama	4.5	-0.2
Construction			**Other Services**		
Belize	5.3	4.7	Belize	2.7	2.7
Costa Rica	-2.1	1.5	Costa Rica	1.8	4.2
El Salvador	-2.7	3.9	El Salvador	-0.2	4.1d/
Guatemala	-3.8	4.6	Guatemala	0.9	3.2
Honduras	1.1	1.8	Honduras	2.4	1.4
Nicaragua	-0.9	10.6	Nicaragua	-2.9	2.4
Panama	-10.9	13.0	Panama	2.5	3.3

Sources: Table A.1 sources (in the Annex to this paper, available from the author as a separate document), except for the first period in Nicaragua, where the source is IDB (1995:263-272).

a/ Years differ for some countries:
Belize: 1980 instead of 1978-80.
El Salvador: 1976-78 instead of 1978-80; 1990-92 to 1995-97 instead of 1987-89 to 1995-97 for some sectors.
Nicaragua: Annual average 1980-90 instead of annual growth 1978-80 to 1987-89; 1990-92 to 1995-97 instead of 1987-89 to 1995-97.
Panama: 1980 instead of 1978-80.

b/ Included with manufacturing, and well below 1% of GDP.

c/ Included in other services, 1976-78 to 1987-89.

d/ 1990-92 to 1995-97 instead of 1987-89 to 1995-97.

e/ Included with finance, insurance, and business services.

Table 3
Central America: Value Added by Maquila Firms, 1980-1998
(US$ million)

Year	Belize a/	Costa Rica	El Salvador	Guatemala b/	Honduras c/	Nicaragua	Panama a/
1980		2.0			4.7		
1981		1.0			5.2		
1982		1.3			5.8		
1983		19.2			6.2		
1984		26.1	5.9		7.0		
1985		34.5	5.9		9.4		
1986		34.8	6.1		11.4		
1987		44.2	13.1		12.6		
1988		60.6	15.7		15.0		
1989		74.9	15.0		16.5		
1990		86.9	18.0	36.1	9.7		
1991		102.5	24.9	68.4	24.4		
1992		119.3	42.1	96.2	40.3	0.7	
1993	4.7	129.9	70.1	105.5	90.4		
1994	4.2	210.4	108.7	136.4	124.8	11.9	
1995	3.4	269.9	173.6	166.5	162.7	28.2	
1996	4.1	270.0	213.5	175.6	203.7		3.6
1997	4.3	322.0	291.1	212.2	304.6		2.7
1998			343.2 d/	284.9	397.6		1.5

Sources: Belize: Central Statistical Office; Costa Rica: Banco Central de Costa Rica; El Salvador: Banco Central de Reserva; Guatemala: Banco de Guatemala; Honduras: Banco Central de Honduras; Nicaragua: Banco Central de Nicaragua; Panama: Author's adjustments of data from the Contraloría General de la República for assembly firms; does not include value added in export processing zones. Data are not available for earlier years, for which the amounts are believed to be small.

a/ All exports of garments are assumed to be produced by maquiladoras, and value added is assumed to be 23% of the total value of exports.

b/ Rough estimates; some maquila production in Guatemala is not exported.

c/ Data prior to 1993 are not consistent with those since that year. The figures for earlier years underrecorded value added.

d/ Projection based on 9-months' data.

Note: Regional totals have not been calculated because data for some countries are not available for all years, while in other cases some of the available figures underestimate value added.

Table 4
Central America: Tourism Receipts, 1980-1997
(US$ million)

Year	Belize	Costa Rica	El Salvador	Guatemala	Honduras a/	Nicaragua	Panama	TOTAL
1980	9.7	83.2	13.1	60.3	24.0	21.1	167.7	379.2
1985	10.7	122.5	43.3	13.3	24.5	7.2	207.9	429.4
1990	38.2	285.0	76.0	117.9	29.0	12.2	171.8	730.1
1991	45.4	340.4	70.9	145.2	30.6	16.7	203.4	852.6
1992	60.1	440.0	73.4	186.0	31.8	23.3	214.9	1.029.5
1993	69.4	487.6	78.5	204.5	60.0	41.1	225.6	1.266.7
1994	71.4	633.8	85.5	205.0	72.0	40.2	261.6	1.369.5
1995	77.6	670.6	85.4	212.5	80.0	50.8	310.4	1.487.3
1996	93.1	695.1	86.5	216.3	115.0	56.1	343.1	1.605.2
1997	95.1	741.2	101.8	266.1	145.6	76.8	374.2	1.800.8

Source: IMF, Balance of Payments Yearbook, various issues.

a/ Beginning in 1993, the Honduran data provide a more complete coverage of tourism expenditures.

Note: Data include business travel, which is not available in most recent Yearbooks as a separate category, except in Panama, where its share of visitors' expenditures fell from 25% in 1990 to 18% in 1996. In Guatemala, business travel accounted for 19% of visitors' expenditures in 1990, compared to 4% in 1980.

Table 5
Alternative Scenarios for Central America, 1997-2020:
Economic Growth, Structure of Production, and Per Capita gdp

A. ANNUAL ECONOMIC GROWTH RATES, 1997-2020 (%)

	1997-2020 Scenarios		
	Low	Base	High
Aggregate GDP	3.0	4.5	6.0
Agriculture	2.5	3.3	4.2
Manufacturing	3.5	4.5	6.0
Mining/Utilities/Construction	3.5	5.0	6.0
Public Administration & Defense	2.5	3.5	4.5
Private Services	3.0	4.9	6.7

B. STRUCTURE OF PRODUCTION, 1997 AND 2020 (% of GDP) a/

		2020 Scenarios		
	1997	Low	Base	High
Aggregate GDP	100.0	100.0	100.0	100.0
Agriculture	17.9	16.0	13.7	12.1
Manufacturing	16.0	17.9	16.0	16.0
Mining/Utilities/Construction	7.0	7.8	7.8	7.0
Public Administration & Defense	9.1	8.1	7.3	6.5
Private Services	50.0	50.2	55.2	58.4

C. PER CAPITA GDP, 1997 AND 2020 (1997 U.S. dollars) b/

		2020 Scenarios		
	1997	Low	Base	High
Belize	2.720	3.350	4.680	6.490
Costa Rica	2.600	3.200	4.470	6.200
El Salvador	1.900	2.340	3.270	4.520
Guatemala	1.690	2.080	2.910	4.030
Honduras	790	970	1.360	1.880
Nicaragua	430	530	740	1.030
Panama	3.230	3.980	5.540	7.690
Central America c/	1.630	2.000	2.790	3.870

Source: Country national accounts data and author's calculations.

a/ Aggregate and sectoral GDP shares are based on the sums, in 1997 prices, of output in each country, converted to U.S. dollars at the average exchange rate for 1997 as reported in the International Monetary Fund's International Financial Statistics. (Constant-price percentage shares were used to determine sectoral output in Belize and Guatemala.)

b/ Based on population data from the Centro Latinoamericano de Demografía (CELADE), except for Belize; these figures sometimes differ from those used for Table 1. Assumes identical per capita GDP growth rates in each country. Aggregate GDP growth for the individual countries would thus range from slightly below to slightly above the three scenario averages. Per capita GDP figures are rounded to the nearest 10 U.S. dollars.

c/ Total GDP in 1997 U.S. dollars divided by total population.

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Central America 2020

Background

During the 1990s Central America went through processes of profound change on the political scene, with democratic governments being set up in all states in the region. However, the political changes were not accompanied to a sufficient extent by parallel economic and social transformations, so Central America continues to be the continent's poorest region. At the same time the armed conflicts of the previous decade led to greater backwardness in the region in terms of social development (education, health and life expectancy of its population).

This situation has led to increasing awareness in the Central American countries of the importance of implementing profound changes, and the need to establish a regional development model for all the states in the area has grown increasingly apparent. So various actions have been initiated with the goal of achieving regional economic integration, thus reactivating the common internal market.

However, these forces of integration have often found themselves impeded by the lack of an adequate institutional framework capable of meeting the challenges that the future will pose. This is precisely where the international community could support the regional development process in the area in the long term, and the present project *Central America 2020* is in keeping with this.

Project objectives

The aim of *Central America 2020* is to promote sustainable development in the region, starting from a concept of development as a dynamic, multidimensional process consisting of:

- sustained economic growth
- improvement in social well-being
- guarantees of citizenship for all social, gender and ethnic categories.

This definition of development is sound and was devised before Hurricane Mitch struck the region in October-November 1998, with devastating effects. It is not that the definition now lacks relevance, but Mitch served to remind us of the region's vulnerability to natural disasters and of the state's meagre capacity to respond in an effective way. In this context, sustainability acquires a special significance in Central America: natural disasters are inevitable, but they must not be made worse by human action, nor must their consequences be aggravated by the incapacity or incompetence of the state and its institutions.

One of the chief objectives of the *Central America 2020* project is to contribute toward the Central American states' regional integration process, taking stock of the results achieved so far and examining the current difficulties and those which are likely to emerge in the medium term in the politico-institutional field.

The specific objectives are:

1. To mount a comprehensive regional survey of contemporary development issues. The questions asked must take into account three intersecting issues:
    - relations between the state, the market and civil society
    - options at the local, national and regional level
    - the viability of sustainable development in Central America
2. To ensure the participation and contribution of a wide range of key regional players in the course of research.
3. To provide governments and other sectors in the region with various policy options and recommendations
4. To promote regional identity among the public and private players involved in development
5. To extend the project results to the international players that are most active in the region's development dynamics, including multilateral organisations and NGOs
6. To make policy recommendations to the United States and the European Union for more effective aid programmes.

The project's findings will be presented at a major international conference to be held in Central America during 2000 and at seminars in Washington, D.C., and Brussels. They will also be distributed in a series of working papers, monographs and books published in English and Spanish and also available on the Internet, the Spanish and German versions at http://www.rrz.uni-hamburg.de/IIK/za2020 and the English version at http://ca2020.fiu.edu.

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