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# THE 'FOOTBALL WAR' AND THE CENTRAL AMERICAN COMMON MARKET

*Vincent Cable*

OVERSEAS reactions to the July hostilities between El Salvador and Honduras varied between indifference and amusement. Indeed, a war between the original 'banana republic', Honduras, and what looked like another obscure Central American military dictatorship, over issues that could not be easily labelled as racial, religious, ideological, linguistic or anticolonial and which had their immediate origin in a soccer match, appeared to deserve this lack of interest. However, quite apart from the serious matter of the 1,000 or more dead and up to 100,000 refugees,<sup>1</sup> the war has broader implications of considerable importance. First, it has put to test the peace-keeping machinery of the Americas in what could be the forerunner of more serious disputes between Latin American states. Second, the Central American area is one of considerable importance to the United States, both commercially and politically, as evidenced by its past intervention in the affairs of Panama, Nicaragua and, more recently, Guatemala. Third, the two protagonists are participants in one of the very few examples of successful economic integration amongst developing countries, which as such, has been held up as a prototype of the kind of arrangement which could well be emulated by the large and growing number of very small states. It is the effect of the war on this Central American Common Market (consisting of Guatemala, El Salvador, Honduras, Nicaragua and Costa Rica) which is of particular interest here.

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Ironically the origins of the war can be dated back to a phenomenon which in a common market of advanced market economies, such as the EEC, would be regarded as generally beneficial—the mobility of labour between partner states. For almost half a century, overcrowded El Salvador (3 million people on 21,393 square kilometres—all of it utilised) has been exporting labour to Honduras (2½ million people

<sup>1</sup> Estimates vary but the range 1,000–2,000 dead is supported by several sources. The refugees consist of 75,000 approximately displaced by the war and about 25,000 preceding it. For corroboration of details of the events of the war the author has drawn on field reports of *The Economist* (Latin American Edition), *Le Monde*, and the Economist Intelligence Unit (*Central American Review*, No. 3, 1969).

on 112,000 square kilometres, much of it uncultivated), though attempts have been made to control the intake in recent years. Three hundred thousand have settled there—over 12½ per cent. of the total population of Honduras. While Salvadorian immigrants may have had a beneficial effect in a macro-economic sense, providing cheap, hard-working labourers for the banana plantations, and a general infusion of skill, business acumen and manpower, their presence has aroused resentment amongst the Hondurans who have faced competition on their own labour market.

Animosity between El Salvador and Honduras is longstanding and certainly predates the formation of the Common Market in 1958. Several factors have recently combined to make it worse. First, Honduras has begun to experience unemployment, mainly amongst the semi-educated school leavers and urban dwellers looking for employment in the manufacturing sector and the service industry: in 1964 the officially registered rate of unemployment in Honduras had risen to 7 per cent.<sup>2</sup> and the urban population is increasing at well over twice the rate of the labour force (6 per cent. v. 2.5 per cent.). The plantation sector has stagnated, and because of disease affecting the banana in Honduras the major banana companies (Standard and United Fruit) have turned their attention to Ecuador. The Salvadorians in Honduras are consequently held responsible for depressing the wage level and limiting opportunities for employment—grievances voiced by the powerful trade unions. Second, land hunger and the frightening 3.8 per cent. birth rate in Salvador have caused growing numbers to cross the border illegally and squat on unoccupied land in the isolated frontier regions of Honduras. Their periodic discovery has given rise to angry outbursts from the Honduras authorities. Third, the Honduran Government has been forced to accept land reform by pressure from the peasants, most of whom are outside the money economy and are overcrowding certain areas while others are under-utilised. The Agrarian Reform Law, however, pointedly excludes Salvadorians, and any squatters have been evicted from the areas selected for colonisation. Tensions in the countryside have thus been aggravated.

In addition to these economic and demographic factors, both governments have, in their different ways, done little to help. The Salvadorian Government has been criticised for exporting its social problems rather than solving them, and Honduran propagandists have drawn attention, for propaganda purposes, to a feudal oligarchy of 'fourteen families' who supposedly own most private property in El Salvador. These accusations do have an element of truth, and certainly the contrast between the living conditions of the small élite and the

<sup>2</sup> Development Plan—Honduras 1964-69.

labouring masses in El Salvador is as jarring as anywhere in the region, which is saying a great deal. Distribution of land ownership is highly uneven. Five per cent. of farms occupy 70 per cent. of the cultivated land.<sup>3</sup> Almost 80 per cent. of landholdings are under 3 acres: 200,000 peasants are estimated to be landless. Studies of rural incomes have shown how 75 per cent. of rural families live on under £2 a week. Wage levels are about one-third of Costa Rica's and substantially less than elsewhere. Nevertheless, the Salvadorian Government has made some efforts at land reform, though the 'willing seller-willing buyer' principle blunts its effectiveness in a situation which calls for confiscation or at least compulsory purchase. The Salvadorian élite is also by now quite broadly based economically; its members are certainly not all upper-class absentee landlords; many of them are noted for dynamism and a successful entrepreneurship which (together with the availability of cheap labour) have helped to build up a relatively powerful manufacturing sector under local control, especially in the textile industry.

The Honduran tradition is rather different: one in which the large concentration of wealth has been in foreign hands—notably the U.S. banana producers—rather than in those of a local élite, a situation perhaps less conducive to social divisiveness but more favourable to the development of nationalism. El Salvador has complained about the manner in which this nationalistic fervour was whipped up, especially after the June 15 soccer match, by official speeches and by the press and radio which closely reflected the Honduran Government's views. It has been argued that this fervour was carefully encouraged to help the Government overcome its immediate political problems—a strike of teachers, labour troubles generally and student disorders (Honduras faced a riot during the Rockefeller visit when a student died). Certainly the highly intemperate language used immediately after the first rumours trickled in from El Salvador of the defeat of Honduras on the football field was directly responsible for the anti-Salvadorian riots (or 'masacre' depending on one's point of view) which were the main pretext for the invasion by El Salvador.

There are two other factors which may have aggravated relations between the two countries. First, Honduras runs a consistent and relatively large payments deficit with El Salvador. Salvador's exports are largely manufactured goods, while Honduras exports mostly agricultural products. As is shown below in the discussion on 'unbalanced growth', Honduras derives some benefit from the Central American Common Market, but there are some who find it easy to justify the description of the relationship as 'unfair' or 'colonial'. Second, there was a serious incident two years ago which has not been forgotten.

<sup>3</sup> Details are taken from the Salvadorian Development Plan 1964-69 and the evaluation of the Plan by the Pan-American Union.

A contingent of Salvadorian troops was caught in Honduras allegedly coming to support an abortive coup against President Lopez Arellano. El Salvador claimed that they had lost their way and eventually the matter was officially settled, though the incident probably left a residue of bitterness especially as the Salvadorian President Hernandez was closely involved in it.

However, manifestations of local nationalism are inadequately explained by passing problems. The long history of bad communications, illiteracy (now 60 to 70 per cent. of adults), unimaginative politicians and economic development tied to interests and exports outside the region have all played their part in developing mistrust and parochialism. At various times over the last one hundred and fifty years men of vision have seen the futility of it all and have tried to unite Central America, and at no time was their influence stronger than in the nineteen fifties and sixties when many businessmen, through their Chambers of Commerce, the growing numbers of overseas-trained technical specialists and economists, influential overseas investors in industries seeking regional outlets, local officials of the United States and the United Nations Economic Commission for Latin America were all pressing the Central American governments towards economic unity. While no serious encroachment on the national power base of their leaders was involved the governments were happy to be associated with a going international concern which brought industrial development in its wake. Nevertheless, it cannot be said that the mass of the people of the region have shared in this movement and national consciousness still runs very deep. For example, very few Central Americans except sportsmen, businessmen and senior officials ever travel intra-regionally. It is not all that surprising, therefore, that sooner or later governments would seek to forge internal unity and bolster their sagging popularity by appealing to aggressive nationalism. In both El Salvador and Honduras the government is essentially military and cannot be described as reforming or popular, and the decision in both cases to allow nationalistic feelings to build up offered a line of least resistance.

There is another, conspiratorial theory that the whole affair was carefully calculated by El Salvador which had a long premeditated plan for the invasion.<sup>4</sup> There is some evidence to suggest that the Salvadorian Army was surprisingly well armed and well supplied for a more or less spontaneous attack. The troops were equipped with modern American rifles from Vietnam (how did they get there?) and supply bases were conveniently available. The motives ascribed to El Salvador are the after effects of the abortive 'invasion' of two years ago and the need to acquire '*lebensraum*'. However, this theory seems somewhat

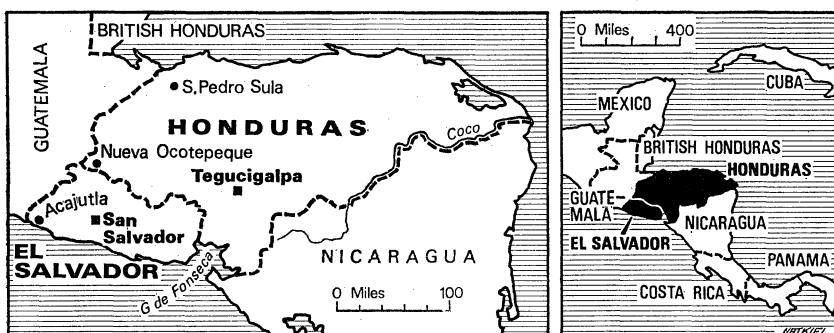
<sup>4</sup> This theory was set out in the E.I.U. Review (see footnote 1).

unlikely. It is difficult to believe that the Salvadorian generals could have overlooked the probability of outside intervention, from the OAS or the United States, the damage to their economy which depends so much upon the Common Market and the likelihood of an invasion having serious repercussions on their 'hostage' minority in Honduras. It is more probable that the Army prepared for war very rapidly after the June 15 'massacre' without, in the emotional climate of the period, thinking deeply about its political repercussions.

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The catalyst which helped to ignite an already inflammable situation was a series of football matches. This is less trivial than one might imagine. A set of surprise results in the qualifying rounds of the World Cup had left a situation in which the winner of the Honduras/El Salvador tie would need only to defeat Haiti to qualify for the finals—and a great opportunity for national self-advertisement. On June 8 Honduras defeated El Salvador at home. There were reports of hostility amongst the rival supporters. On June 15, on the return tie in El Salvador, Honduras lost after their team had been allegedly disturbed from their sleep by festive Salvadorian fans, their women defiled, their menfolk assaulted and the national flag desecrated. The incidents were immediately denounced as an outrage, and riots followed in the main Honduran towns. An unspecified number of Salvadorian settlers were killed and many fled the country. El Salvador condemned these occurrences as 'genocide' and demanded 'reparations'. Reservists were mobilised and El Salvador broke off diplomatic and economic relations.

Face could possibly have been saved had the Hondurans as the initially 'aggrieved' party won the play-off in Mexico City on June 22. They lost 4–3. In the event military preparations proceeded rapidly, and against a background of border incidents, the Salvadorian Army invaded Honduras after an initial air-raid by the small Salvadorian air force (8 Second World War Mustangs). The Salvadorians, more numerous and better armed, clearly hoped to seize a large area of land either for resettlement or to enable them to bargain from strength with Honduras over their compatriots' rights in Honduras. They attempted to divide Honduras by advancing in two directions—northwards to the prosperous banana growing northern Sula valley and eastwards along the Central America Highway to the Nicaraguan border and to Tegucigalpa, the capital of Honduras. They gained an important border town, Nueva Ocotepeque, on the northern advance, and then began to encounter stiff resistance. The Honduran air force (of a similar vintage) proved superior, inflicting losses on the enemy fighters and putting part of the Salvadorian oil refinery at the port of Acajutla out of action. The OAS eventually prevailed upon El Salvador to withdraw under the threat of



economic and other sanctions with a loose guarantee being given by Honduras regarding the safety of its Salvadorian minority.

What immediate effects has the war had? The situation is in many ways more unstable than ever. On the one hand the original justification for El Salvador's aggression, to stabilise the position of the immigrants in Honduras has not been achieved, and there is talk of increasing discriminatory measures against them despite official assurances. On the other hand, the Salvadorian Government has now compounded rather than solved its domestic problems. The military 'hawks' feel that they were cheated and wish to return to the fray. There is also increasing criticism from the opposition. The influx of refugees from Honduras presents the Government with a tremendous problem of resettlement and an additional need to alleviate agrarian discontent in general. At the moment the military are being appeased with victory parades, rearmament and promises of a return to war; the peasants by promises of land reform which will be financed from the proceeds of a large bond issue. In Honduras, too, there is a continuation of vigorous propaganda, which is helped by El Salvador's alleged sacking of occupied towns and by reports of atrocities during the advance. Rearmament is proceeding with the aid of 'defence bonds'. As both are military governments whose credibility rests ultimately on military competence and which both lack genuine popularity, the chances of them seeking a renewal of armed conflict are quite high. Nevertheless, there are some encouraging signs—prisoners are being exchanged, the border has been opened to 'third country' traffic; and El Salvador is attempting to get to the root of the problem by land reform measures.

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What effect has the war had on the Central American Common Market and on the economies of the belligerents? The Common Market,

which was formed as a result of a series of treaties over the 1958–62 period, was the answer by the five small Central American countries to their besetting difficulties of small size and an over-concentration on agricultural commodities (coffee in Salvador and Guatemala; bananas in Honduras; bananas and coffee in Costa Rica; cotton in Nicaragua) which had fashioned them into classic ‘dual economies’ typified by technologically advanced and largely foreign owned plantations and a backward, poor subsistence sector in which the bulk of the population live, and little industry. Unifying their economies would have the effect of enlarging the market for local industrial products, particularly for industries enjoying ‘economies of scale’.

The Common Market had various elements :

(a) First, it was a ‘customs union’—a free trade area with a common external tariff. This aspect has been very successful. Intra-regional trade had risen to over \$260 million in 1968 from \$21 million in 1958, having the effect of reviving traditional industries by using their idle capacity as well as encouraging new investments in more ‘advanced’ products (fertilisers, chemicals, etc.) which had the attraction of a regional market. Only a few products (such as petroleum products) are not traded freely.

(b) Second, there have been a whole set of successful multinational economic projects, notably the Integration Bank which has financed major infrastructural projects (there are now paved roads, of a sort, all the way from Guatemala to San José) and has concentrated its efforts on the ‘less developed’ countries, Honduras and Nicaragua. Central America has evolved a regional payments system (or clearing house), regional telecommunications systems, has joint air navigation services, and institutions catering for industrial technology (ICAITI) and training in public administration (ESAPAC). It is significant that the regional foreign policy body—ODECA—is virtually defunct while the Common Market organisation (SIECA) is much more effective—though all important changes in tariffs have to be specially approved nationally. Integration has taken place mostly in non-political spheres.

(c) Third, and more ambitiously, the Central Americans have tried to introduce a form of regional allocation of those large plants which can only operate on a monopoly basis in the small regional market—caustic soda, tyres, pulp and paper, etc. It was planned to allocate these industries amongst the countries on an equitable basis. Under the Integration of Industry protocols the establishment of several plants was approved but the scheme did not develop, due mainly to the complexities of the approval procedure, and the opposition of the U.S. agencies on the spot. As a result, industries like plastics, pulp and paper and iron and steel are now being planned nationally in a thoroughly anarchic manner. Petroleum refining has already developed on an autarkic basis thus robbing the region of the possibility of a major petrochemical complex



in the near future. Basically the scheme for industrial integration was faced by a fundamental contradiction: it was an attempt to indulge in intra-regional planning, even if of a crude horse-trading type, against a background in which there was no tradition of effective planning, in which effective investment decisions were taken by (overseas) private investors, and in which there was basically no commitment to day-to-day supranational decision-making on matters of national importance.

The Common Market thus flourished in those sectors where it did not provoke a conflict between national and multinational authority. But even then, by mid-1969 it was in serious difficulty. Nicaragua had virtually withdrawn from the Common Market in March—as part of a series of measures to protect its balance of payments it had imposed the pre-Common Market tariffs on goods of regional origin and was only with difficulty prevailed upon to remove them. The Common Market was also seriously strained by disputes over the rice trade, a reminder that the region had no agreed agricultural policy. Finally, the last twelve months have been marked by attempts to protect the serious balance of payments position of all the countries in a 'co-ordinated' manner. The instrument for this purpose, the 1968 'San José Protocol', is open to very serious criticism as a piece of economic policy and Costa Rica's parliament refused to accept it. The details are discussed below; the important factor here is to point to the disunifying effect of the Protocol, which has reflected important differences in economic and political approach.

The immediate effect of the war has been to disrupt trade. This is particularly serious as Honduras constitutes the neck of the Common Market connecting Guatemala and El Salvador with the south. Fortunately the resumption of third country trade by the two belligerents should minimise the worst effects of the war, though considerable doubt will have been sown in the minds of potential investors as to the security of their original export outlets. Salvador and Honduras are still at 'economic war' between themselves and in Tegucigalpa there are car stickers and notices advising the population to be patriotic and not to buy Salvadorian goods.

Provided that war is not resumed, it is unlikely that this posture will be maintained, and trade should be flowing long before the political problems are resolved. Both sides have a strong incentive to restore the free trading situation. El Salvador's whole industrial base depends on exports to the Common Market, and she runs a good surplus with Honduras, especially in manufactured goods. Honduras relies for many of her overseas imports on the Gulf of Fonseca and on the use of a Salvadorian port. Honduras exports important quantities of maize and other raw materials to Salvador. In addition, she takes a good deal of her petroleum from Salvador: her own refinery supplies only the North,

due to bad communications. Honduras is also preparing major projects in the field of pulp paper and iron and steel which could transform her economy. Since both depend on the regional market, the closure of the Salvadorian market would seriously jeopardise them, and they already face the threat of competition from alternative projects in Costa Rica and Guatemala. Honduras is also moving into a more satisfactory position *vis-à-vis* her partners now that her road communications have improved, and now that she has obtained special provision to grant more favourable fiscal incentives. Of the regional institutions Honduras derives particular benefit from the Integration Bank.

More dangerously, the war could have the effect of opening up the other latent disputes in the region. The main concern is over Costa Rica which joined the Common Market only in 1963 and has never concealed her concern over her politically primitive northern neighbours. Costa Rica has a free press, an active parliament which opposes the present President, a high level of literacy and an ambitious welfare state. Costa Rica has kept open the option of links with Panama, though Panama is now politically unstable and guerrillas are operating on the Costa Rican border—with the result that Costa Rica, latterly without one, has now expressed her intention to form an army. Costa Rica also continues to refuse to adhere to the San José Protocol. Nicaragua has occasionally disrupted the CACM, as has already been mentioned. However, the basic strength of the CACM has in the past lain in its pragmatic apolitical role, thus avoiding a direct confrontation between El Salvador and Honduras, and between Nicaragua and Costa Rica, and there is no overwhelming reason why it should not continue on this basis. In 1963 diplomatic relations had been broken between three of the five countries, all of which continued to participate actively in the Common Market.

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If the Common Market is to develop further, however, it must solve some of the very serious economic problems which face it and which have been aggravated by the war. First, all the five countries have serious trading deficits which render them hypersensitive to any bilateral imbalances with their neighbours. The war, and reconstruction and rearmament of the two countries will make their problems considerably worse. Second, all five countries have serious fiscal problems, partly due to their growing commitment to expenditure on education and development generally, and to difficulties in shifting from sources of revenue based on imports which are increasingly entering duty free from Common Market partners. The effects of the war, rearmament, and, in El Salvador, substantial agricultural expenditure, must be to put greater strain on the budgets which cannot be alleviated entirely by emergency

taxes and non-inflationary borrowing. Third, the question of 'im-balance' in the distribution of benefits remains a point of dispute within the Common Market, and a strengthening of the Integration of Industries scheme may be a precondition for reviving Honduras' interest in the CACM. Fourth, there is the need to continue to extend the modest range of integrated economic functions in Central America, notably to some degree of agreement over factor (especially labour) mobility, the basic source of friction between El Salvador and Honduras, but one in which the other three countries could assist.

The seriousness of the deficits on current account in the balance of payments can be assessed from the fact that in 1967 Honduras, Guatemala and Nicaragua registered record postwar deficits of U.S. \$40 million, U.S. \$80 million and U.S. \$50 million (approximate) respectively, while Costa Rica and El Salvador were recovering from record deficits sustained in 1965 and 1966. The cumulative current account deficit of the region with the outside world approached U.S. \$300 million in 1967, having climbed steadily from a position of near balance in 1961. Provisional figures for 1968 do indicate, however, that emergency measures were beginning to bite.

In any case, this situation might not have mattered unduly if there had been a favourable trend on capital account. However, this has not been adequate, and the unfavourable outlook for loans, aid and investment gives additional cause for concern.

The main factors making for a growth in the deficit are:

(a) the terms of trade for the primary products on which Central America largely depends have generally deteriorated (though this applies less to bananas than to coffee and cotton). Long-term prospects, especially in coffee and cotton, look very dismal, and there has so far been only slow progress in developing export lines with better prospects, such as fish or meat products and tourism.

(b) Despite a vigorous industrial import-substitution policy, imports from outside Central America have risen from about 18 per cent. of the total regional g.d.p. in 1961 to 21 per cent. in 1967. The totals included surprising increases, such as in foodstuffs, of which imports almost doubled over this period. Much of the increase in consumer demand attracted imports from outside the region. Imports of durable consumer goods are becoming more important, and it is difficult to manufacture these products locally with significant local value added. There have been increased imports of higher-grade textiles and artificial fabrics, replacing locally-produced cheap cottons to some extent.

(c) Only very recently has the CACM moved into its 'second stage' of local production of intermediate products, though some chemicals and fertilisers have already become important. Imports of these products from outside the region had also continued to rise rapidly and the further

import substitution proceeds the greater is the derived demand for chemical and fuel imports, which is only satisfied after a lag—if at all.

(d) Similar considerations apply to imported capital goods. And for those industries that package, mix or assemble imported ingredients or components, the cost to the balance of payments of the imported components and machinery may be almost as much as the exchange saved on importing the final product. This problem, especially in the proliferation of assembly plants, can be expected to intensify as there is nothing remotely like an indigenous machine-tool industry in Central America for standardised machinery.

There are thus several factors at work. Some of them, such as the growing demand for fuels and capital goods, and some intermediate goods, are predictable and unavoidable concomitants of industrial growth. Imports of certain consumer goods have also risen due to the boom in the region. On the other side the lag in traditional exports can only be met by greater diversification, which is a difficult long-term prospect. The only real freedom for manoeuvre in the short run is to take the policy of import substitution within the Common Market to a higher stage.

The budgetary problems of the Central American countries can be put down quite simply to the ideologically motivated unwillingness of the Central American governments to consider shifting their sources of revenue from indirect taxes on imports to direct taxation of income, profits or capital assets. In 1965, 33 per cent. of current revenue in Central America was derived from import duties, 4 per cent. from other indirect sources and 14 per cent. from the taxation of incomes. However, by the diversion of trade to non-duty paying sources, Central America has created a serious problem. The difficulty is made worse by a rather reckless attitude towards the tax concessions given to overseas investors; they have been made needlessly expensive by competition in generosity between the five countries.

An attempt to resolve these problems was the San José Protocol of June 1968, which imposed a 30 per cent. surcharge on the common external tariff for non-essential imports and allowed individual countries to impose consumption taxes on a wide range of goods produced within the region: 10 per cent. on non-essentials and 20 per cent. on luxuries. The San José Protocol, however, is not adequate. It might help to solve the revenue problem, which could be solved more easily by raising income tax, tightening up on concessions, introducing property taxes, or levying export taxes on surplus commodities. The revenue yield of the San José import-duty surcharge is uncertain; it will only be really effective if the impact on the volume of imports remains large, which makes little sense from a balance of payments point of view. In increased direct taxation there is no such conflict of interest. There is also now

an additional incentive to produce, very uneconomically, various luxury consumer goods. Finally, consumption taxes can be used to discriminate against products from other CACM countries, thus hampering regional trade. Nicaragua has done just that. The increase in the common external tariff provided for in the San José Protocol makes Central America an even more heavily protected area than before, hindering future links with the Latin American Free Trade Area, and especially with Colombia and Mexico. It may also hinder new investment, and raise the cost of present plants, unless remission for imports necessary for industry is speedily and extensively obtained. Finally, the San José taxes may have inflationary effects if prices are given a permanent upward twist, though presumably it is intended that the measures should have the opposite effect, of reducing real incomes and therefore expenditure. So, as a revenue measure the Protocol is almost certainly tending in the wrong direction—away from direct taxation, while the improvement to the overall balance of payments is unpredictable and may be achieved at high cost to the economies. Deflationary direct tax increases, co-ordinated money supply restrictions and consumer credit restrictions would probably have been better. Eventually there will have to be a move in that direction.

The question of unbalanced growth is a complex one, but it can be summarised here very briefly. Honduras is the poorest member of the group (GNP *per capita* \$225 in 1965—regional average \$305). She is particularly weak in the industrial sector, and has (or had) very poor communications outside the north coast region. New Central American industrial investment has been attracted to the traditional industrial areas (San Salvador, San José, Guatemala City, etc.) which have roads, water supplies, trained labour and a large nearby market. A boom in investment tends to reduce the initial and operating costs of other investors, and a tortuous circle sets in until congestion or high rents reduce the benefits. Indeed, with one or two exceptions (a modern textile factory in Honduras—the caustic soda complex in Nicaragua) most new investment has been attracted to the already more industrialised areas. This also applies to the plants of traditional industries like textiles which have either been driven out due to competition from Salvadorian exports or have not been founded when perhaps they could have survived in a national market. The effect of this can be seen in the commodity composition of regional trade. Honduras exports largely agricultural products and timber (plus, admittedly, some chemicals and cement) which do not depend particularly on the Common Market and are slow growing. El Salvador, by contrast, dominates the fast-growing trade in chemical products, textiles and manufactured goods generally, and Honduras feels that the relationship is unsatisfactory. Honduras has, partly as a result, tended to slide into increasing deficits with her partners. As a disproportionate regional

importer of manufactures Honduras also feels that she suffers excessively from trade 'diversion' (buying her partners' products—often of low quality—at above the import parity for overseas goods) and from the loss of customs revenue.

It cannot be said, however, that the CACM has entirely overlooked the question of 'balanced growth', though it has never been clear whether active redistribution to the less-developed members was intended, or merely action to limit widening divergencies—perhaps more the latter. It was accepted in principle in 1958 that a completely free market choice of investment location would lead to a widening of inequality, and both the Central American Bank (BCIE) and the Integration of Industries agreements were examples of an interventionist approach.

By the end of 1968, the BCIE had disbursed U.S. \$145 million. Nicaragua and Honduras have been the two largest recipients, and the Bank's long-term importance perhaps lies in the provision of infrastructure, especially in Honduras. But the importance of the Bank can be exaggerated; most of its funds are provided by international and U.S. organisations, which would in any case have offered aid. Also, it is difficult to identify cases that the Bank actively promoted, or where it made the difference between a project starting or not. It should also be stressed that in Honduras, at least, the bottleneck is only partially financial; it is also one of skilled manpower.

The Integration of Industries Agreement (1958) and the subsequent Special Industries Agreement (1963) giving concessions and what amounted to a monopoly position to important growth industries have had a very marginal effect. Under the first agreement the only industries to be classified have been a plate glass industry for Honduras (not yet established), the caustic soda complex in Nicaragua and the tyre and tube factories in Guatemala and Costa Rica.

The conclusion cannot be escaped that, despite their expressed concern, the five countries have not wholly accepted the principle of limiting, in the interest of greater balance, their freedom of choice in industrial policy. They have competed vigorously for investment by means of generous tax concessions, until the entry into force in March 1969 of the Central American Industrial Incentives Agreement and its protocol granting Honduras preferential treatment, and no sanctions, such as comprehensive licensing, have been instituted to control location in the region. As a result, most new industries have been attracted to Guatemala, El Salvador or Costa Rica; the Honduran projects—pulp and paper, plate glass and an integrated iron and steel plant—remain in the discussion stage while plans are being prepared elsewhere for competing installations. The best way of satisfying Honduras would be to ensure, by reactivation of the Integration of Industries scheme, that its pulp

and paper plant, at least, is given a monopoly position in Central America. Honduras is also pressing for the allocation of an ammonia plant, and this too would require El Salvador's sanction. However, the war may have hindered such ambitious ideas for integrated industrial planning which requires a level of trust far greater than is needed for mere free trading.

Finally, the countries could co-operate regionally to deal with the problem of El Salvador's surplus population by resettlement. Costa Rica also claims difficulty on this score, and the question would mainly concern Guatemala and Nicaragua which both have empty spaces but also many unemployed and high birth rates. This is a task which calls for political courage and considerable finance, and it would have to be underwritten by the United States. Nevertheless, the Guatemalans have declared a basic willingness to help and this could be a means of involving Panama—not so far a member of the CACM—which could utilise surplus Salvadorian labour.

To summarise, there is more reason for optimism over the immediate future of the Common Market than over the resolution of political differences which have been deepened by the war. Both countries involved have a vested interest in preserving the Common Market at least at its present level of evolution. On the other hand, the political situation is so serious that great efforts will be needed to prevent a renewed outbreak of war. If the Central American 'integrationists' are to steer the Common Market through its present difficulties they will need to keep economics and politics apart as they have done successfully before.

Nevertheless, they should keep in mind that if the Common Market is to develop further in the longer term, they will need to tackle thorny problems such as migration policy, industrial allocation and fiscal reform which have important political implications. The war has set back their prospects, but eventually sheer necessity should force the belligerents to co-operate and there is no reason yet to write off the Central American Common Market.

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