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NOTES

Investment Possibilities in the Central American Common Market

I. INTRODUCTION

ECONOMIC INTEGRATION has created new opportunities for investment in Central America, making the Central American region more attractive to foreign capital. Although there are many reasons why companies invest abroad, the more significant ones are the following: a higher rate of return on investment than in the domestic market; protection of the company's world market position; access to cheaper labor; tax and tariff concessions; and nearness to raw materials. Economic integration makes the investment climate more desirable for several reasons. It adds regional planning to the area, which results in the more efficient allocation of resources, the spurring of trade, and the general promotion or development of the economy. Further, it provides access to the entire region.

Economic integration has also created opportunities for the countries in which the investment is made. Usually, the local government or local forces of capital formation lack the capital, expertise in management, and technology to industrialize. Foreign investment may provide all three in varying degrees. Capital from the outside helps the local government's balance of payments as does the export of the final product. Industrialization creates jobs which lead to a trained labor force in the country, and also develops the country's infrastructure through an improved communication and

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1 The members of the Central American Common Market are Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica. With over 14 million people and 170,000 square miles, the region generates a gross regional product of over 4.5 billion dollars. INTERNATIONAL ECONOMIC SURVEY, CENTRAL AMERICAN COMMON MARKET 1 (Chemical Bank New York Trust Company, 1968); OVERSEAS BUSINESS REPORTS, BASIC DATA OF THE CENTRAL AMERICAN COMMON MARKET 1 (U.S. Dep't Commerce Pub. No. 70-43, Sept. 1970).


3 Rubin, MULTINATIONAL ENTERPRISE AND NATIONAL SOVEREIGNTY: A SKEPTIC'S ANALYSIS, 3 LAW & POLICY INT'L BUS. 1, 8 (1971); Chase Manhattan Bank, THE IMPACT ABROAD OF U.S. DIRECT INVESTMENTS, WORLD BUS. Nov. 1966, at 5.

road system. Finally, the foreign government shares indirectly in the profits through taxes or, in the case of a concession or joint venture, directly through participation in the profits.

The Central American Common Market (CACM) has provided another incentive for investment by adopting the Agreement on the System of Central American Integrated Industries.5

Before discussing the Agreement in detail, the form and content of the CACM will be considered to provide a comprehensive understanding of the investment possibilities in Central America. The Agreement will then be analyzed, and finally a form of investment will be suggested that maximizes the benefits both to the investor and the country or region.

II. THE THEORY OF ECONOMIC INTEGRATION

The economic rationale for regional integration varies and is not the same as the free trade rationale that prompted the General Agreement on Tariffs and Trade (GATT). The free trade rationale is premised on the notion that where comparative cost ratios differ among the States, each State will specialize in producing the product in which it has a comparative advantage.6 Since the State with a comparative advantage will specialize, thereby becoming more efficient and able to produce goods at a lower cost, it will export these products. Without protective tariffs, States who receive these goods will find it to their advantage to specialize in another product which they can produce and export more efficiently. By buying those products in which it has a comparative disadvantage from the other States, each State allows for the most efficient allocation of world resources. This follows because each State minimizes the resources it must use to maximize its consumption.7

On the other hand, regionalism,8 where a common external tariff is imposed by all the States within the region upon all those


6 See generally J. PEN, A PRIMER ON INTERNATIONAL TRADE (1967).

7 Id. at 12-20.

8 Regionalism was developed to ease the deteriorating terms of trade, eliminate erratic fluctuations of export income, and stabilize the balance of payments. See Baranson, Industrialization and Regionalism in Central America, 16 INTER-AM. ECON. AFF. 87 (1962).
without, conflicts with the free trade theory since it allows the entire region to produce at a comparative disadvantage and thus inhibits free trade. The economic rationale for regionalism has been articulated by Dr. Raul Prebisch, as being based on the concept of the world being divided into two basic economies; industrialized center economies and nonindustrialized periphery economies. The five periphery economies of Central America are at a distinct disadvantage because they depend upon commodity exports to pay for imported manufactured goods. The problem in Central America is that export prices for agricultural and mining products have declined in relation to the import prices for manufactured and industrial goods. This problem arises because the demand for Central American products is relatively inelastic whereas the demand for manufactured and industrial goods is relatively elastic. Since there is monopoly pricing at the center and competitive pricing by the numerous periphery suppliers, the Central American economies are kept at a perpetual disadvantage.

The Prebisch-ECLA (the United Nations Economic Commission for Latin America) rationale also contends that increases in productivity at the periphery tend to be passed on to the center. Productivity advances in the economies of the Central American export sector increase world supplies. This increase either lowers world prices or forces a reduction in domestic employment. A syndrome is thus created so that when wages in Central America are low in relation to increases in productivity, more labor is drawn into the export sector producing overproduction, low prices, and unemployment again.

To solve this problem, the Prebisch-ECLA group suggests a shift of labor and resources from agriculture and extractive sectors to manufacturing and industry. They contend that industrialization will cure the demand deficiency for Central American exports, increase national income, and stabilize the balance of payments. The policy suggested is industrialization and import substitution — the domestic production of goods formerly imported. Domestic industries will eventually absorb underemployment from the agricultural and extractive sectors causing the aggregate national income

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10 Baranson, supra note 8, at 88.
to increase because of the shift from the less productive agricultural and extractive products to manufactured products. Further industrialization will train an industrialized labor force and bring in more technology from abroad. Finally, industrialization will stabilize further fluctuation and ease the balance of payments since there is less dependence upon the agricultural and extractive sectors.

The foregoing is accomplished primarily by imposing protective tariffs to shield infant industries which are at a disadvantage because of deficiencies in skills and in economies of scale. Industrialization will encourage economic planning for infrastructure development in transportation, power, and human resources. Regional integration will provide the necessary market even though the goods may be produced at a lower cost on the world market.

The critics of the Prebisch-ECLA doctrine argue that the problem is not one of a demand deficiency but rather the inability of lesser developed countries to be flexible and adaptable in their supply.11 The Central American economies cannot shift production as world demand conditions change and, therefore, they cannot reach their export potential. Thus industrialization may lead to a concentration on domestic production while ignoring export opportunities. Furthermore, the critics argue that import substitution does not stabilize the balance of payments since it adds a demand for imported capital goods, raw materials, parts, and fuel.12 According to customs union theorists, economic integration is beneficial when it leads to trade creation and harmful when it leads to trade diversion.13 Trade diversion results when goods formerly imported from countries outside the region are replaced by intraregional trade and the intraregional suppliers are less efficient than the importers. The problem, according to the critics, is how to use the existing productive capacities efficiently, stimulate new investment in industries not viable in a single State, and provide an increasing opportunity for specialization and economies of scale to allow the States to alter their economies in an efficient manner.14

Because the United Nations Economic Commission for Latin America played a leading role in the formation of the CACM, the Prebisch-ECLA theory has been the basis for economic integration

11 R. Hansen, supra note 9, at 19.
12 Id. at 19-23.
14 R. Hansen, supra note 9, at 34.
in Central America. The tendency has been to emphasize industries which will reduce the CACM’s dependence upon using export income to import manufactured products. Import substitution, complementary industrial growth, and infrastructure development have been proposed to accomplish this goal. This economic theory has lead to the adoption of the treaties which are the basis of the CACM.

III. THE LEGAL STRUCTURE OF THE CENTRAL AMERICAN COMMON MARKET

A. The Multilateral Treaty on Free Trade and Central American Economic Integration

The Multilateral Treaty established a “free trade regime” which was to be completely implemented within ten years from the effective date of the treaty. To accomplish this, the States agreed to abolish customs duties and charges among themselves for products

15 Id. at 18.
16 Id. at 18; INTER-AMERICAN DEVELOPMENT BANK, THE IDB AND LATIN AMERICAN INTEGRATION 19-24 (mimeograph, 1970).

The special instruments include the following: The Agreement on the System of Central American Integrated Industries, signed June 10, 1958, id. at 89, and its protocols, id. at 94-116; the Agreement on Fiscal Incentives for Industrial Development, signed July 31, 1962, id. at 117.

In the sphere of monetary policy, the following agreements have allowed Central America to move towards a monetary union in the process of promoting development: the Agreement Establishing the Central American Bank for Economic Integration, signed Dec. 13, 1960, id. at 143: the Agreement Establishing the Central American Clearing House, signed July 28, 1961, id. at 153 (to promote trade and facilitate transactions among members); and the Agreement Establishing a Central American Monetary Union, signed Feb. 25, 1964, id. at 161 (which would create a common accounting unit, the Central American Peso, equal to the U.S. dollar).

Other important documents include: the Central American Uniform Tariff Nomenclature (NAUCA, 1953), which is a uniform system of import commodity classifications upon which the uniform tariff is based; the Basic Agreement on Technical Assistance between the United Nations and the Governments of Costa Rica, Guatemala, Nicaragua, Honduras, and El Salvador, signed Mar. 10, 1954, id. at 195, which established the Central American Advanced School of Public Administration (ESAPAC) which trains public officials, studies administrative problems, and provides a source of public administrators for the region; and the Agreement Establishing the Central American Institute of Research and Industrial Technology (ICAITI), final signature Sept. 27, 1955, id. at 190, which was formed to contribute to the improvement and growth of industry through technical advice and planning.

listed on Schedule A, which was appended to the Multilateral Treaty. This Schedule listed some 200 products which were exempt from import duties, export duties, and taxes levied on imports and exports by all levels of government.\textsuperscript{19} Goods originating in the region and included in the Schedule were to be given "the same treatment as domestic goods" and were to be exempt from quotas.\textsuperscript{20}

The Multilateral Treaty was designed to free trade efficiently within the region without upsetting each State's economy.\textsuperscript{21} Specifically, free trade may result in losses of government revenue due to products of the participating States being brought in duty free. Free trade can also increase competition for the State's domestic industries since industries of the other States participating in the free trade area are allowed to compete with them. Finally, disparities in development among the participants and in their national policies, such as tax and tariff incentives, may widen due to the ability of capital and labor to shift freely. For these reasons, the terms of the Multilateral Treaty were purposely left broad, and the specific means to obtain the objectives were not spelled out. "The free trade zone was to be perfected — in the GATT sense of according national treatment to a substantial fraction of their reciprocal trade — by means of periodic multilateral negotiations designed to incorporate additional products into the original list."\textsuperscript{22} According to one commentator, "the objective of rapid liberalization of trade gave way to the need to minimize disturbances."\textsuperscript{23} This, however, led to a major defect in the Multilateral Treaty — any State could avoid the inclusion of an item in the Schedule by vetoing it in the negotiation.

B. The General Treaty on Central American Economic Integration\textsuperscript{24}

The nucleus of the CACM is the General Treaty, signed in 1960 and finally ratified by all five States three years later. The General Treaty takes precedence over the Multilateral Treaty and any other previous treaties on free trade among the five States but it does not

\textsuperscript{19} Art. I, 454 U.N.T.S. 70, 72.
\textsuperscript{20} Art. II, \textit{id.} at 72.
\textsuperscript{21} C. CASTILLO, GROWTH AND INTEGRATION IN CENTRAL AMERICA 81-83 (1966).
\textsuperscript{22} \textit{Id.} at 82.
\textsuperscript{23} \textit{Id.} at 83.
affect the validity of those agreements. The States must adopt a uniform tariff in accordance with the terms of the Central American Agreement on the Equalization of Import Duties and Charges. The parties endorsed the provisions of the Agreement on the System of Central American Integrated Industries and agreed to establish the Central American Bank for Economic Integration.

"Within the framework of the common import tariff, the General Treaty provides a different solution to the question of intra-regional trade, where the need to minimize disturbance in the existing systems has now given way to rapid progress in the free trade front. The procedure is certainly different from that of the Multilateral Treaty which limited the products receiving preferential treatment to a small schedule. The General Treaty frees all goods produced in Central America from duties, except those on the list of temporary exceptions.

Free trade treatment is granted to all products originating in their respective territories except for goods contained in the special regimes. These special interim regimes exempt specific products from immediate free trade but incorporate them into the free trade area within five years. The origin of the goods is to be determined by bilateral negotiation, or if that fails, then by the intervention of the Executive Council. However, goods simply assembled, wrapped, packed, cut or diluted are not considered to originate in Central America.

The General Treaty also deals with export subsidies and unfair business practices. Each party is forbidden to grant a subsidy to goods exported into the region or to "maintain any system" which allows goods to be sold in the region at a price lower than their domestic market price. Price fixing and price discrimination constitute an indirect export subsidy if the price is lower than that re-

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25 Art. XXVII, id. at 90.
26 Art. II, id. at 70. See note 17 supra.
28 Art. XVIII, id. at 84. Before any country can obtain a loan or guarantee from the Bank it must have signed and ratified the General Treaty, the Multilateral Treaty, the Agreement on Integrated Industries, and the Agreement on the Equalization of Import Duties and Charges. See Agreement Constituting the Central American Bank for Economic Integration, signed Dec. 13, 1960, 455 U.N.T.S. 216.
29 C. CASTILLO, supra note 21, at 87.
30 Id. at 87.
31 Art. III, 455 U.N.T.S. at 70. These special interim regimes are defined in Article IV as exempting products from immediate free trade. Art. IV, id. at 72.
32 Art. V, id. at 72.
33 Arts. IX-XIV, id. at 76-80.
sulting from normal competition. On the other hand, tax refunds of a general nature to encourage the production of a specific good are not considered to be an export subsidy. Similarly, an exemption from external taxes in the exporting State is not an export subsidy nor is the sale of foreign currency on the free market at a higher than official rate.

The General Treaty further provides mechanisms for industrial development. It assures full freedom of transit for goods in vehicles, grants national treatment to enterprises of other signatory States in the construction of economic infrastructure as well as requiring the parties to adopt several other agreements. Finally, the General Treaty requires the States to insure reasonable equalization of the relevant laws and regulations with a view towards establishing uniform tax incentives for industrial development.

The institutional framework which implements the General Treaty is different from that established under the Multilateral Treaty. There are now three institutions to carry out the mandates of the General Treaty. The first, the Economic Council, is comprised of the member States' Ministers of Economic Affairs and has the stated purpose of "integrating the Central American economies and coordinating the economic policy of the Contracting States." The Economic Council is given the authority to examine the work of the Executive Council and has the duty of insuring that resolutions on economic integration are implemented. Thus, the basic duty of the Economic Council is to direct and coordinate economic integration.

The major burden of the application and administration of the General Treaty is put in the hands of the Executive Council. The Executive Council consists of one official and one alternate appointed by each State and can meet as often as required or when it is convened by the Permanent Secretariat. Procedurally, it adopts resolutions by majority vote, however, if there is a deadlock, the Economic Council decides the matter. The power vested in the Executive Council is vague. "The Executive Council shall take such measures as it may deem necessary to ensure fulfillment of the commitment entered into under this Treaty and to settle problems arising from the implementation of its provisions."

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34 See notes 27 & 28 supra.
35 Art. XIX, 455 U.N.T.S. at 84.
36 Art. XX, id. at 86.
37 Art. XXI, id. at 86.
The third, and perhaps the most dynamic, organ is the Permanent Secretariat (SIECA) which was "initiated, as a juridical person, and shall act as such both for the Central American Economic Council and the Executive Council." SIECA can establish the departments and sections necessary to perform its functions which are: to insure that the treaties of economic integration are properly executed; to implement resolutions adopted by the Economic Council and the Executive Council; and to perform the functions assigned to it by the Executive Council.

C. The Central American Agreement on the Equalization of Import Duties and Charges

The purpose of this Agreement was to "establish a common tariff policy and decide to set up a Central American import tariff consistent with the integration and economic development requirements of Central America." Common external tariffs were to be established immediately for items listed on one schedule appended to the Equalization Agreement and tariffs on a second schedule were to be equalized within five years.

The Central American States realized when they signed the Equalization Agreement in 1959 that it was not possible to agree on the same level of tariff commitment. Although it is generally agreed that the larger the scope of trade liberalization the more important uniform external tariffs become, the level of development differs greatly among the five member States, and each State's commitment to tariff equalization varies. On the other hand, a developing pattern of tariffs would benefit the States with lower duties. Therefore, when the Equalization Agreement was signed, the external tariffs were to be established through item-by-item negotiations. The quantative guidelines agreed upon were low for

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38 Art. XXIII-XXIV, id. at 88. See note 67 infra & accompanying text.
40 Art. I, id. at 370.
41 Id. (Article I read in conjunction with Article II). The Equalization Agreement also set forth the following preferences of goods to be added to the schedules: a. Commodities for which trade liberalization is provided under bilateral free trade treaties; b. Good manufactured in Central America; c. Imported goods for which goods produced in central America may be substituted in the short run; d. The raw materials, intermediate products, and containers required for the production and sale of items in a, b, and c; e. Other goods. See Art III, id. at 370.
42 C. CASTILLO, supra note 21, at 83-85.
43 Id. at 83.
capital goods, raw materials, and production goods not produced in Central America; moderate for consumer goods not capable of being regionally produced for several years; and high for those goods produced in Central America or capable of being produced there in the short run. Thus, the Agreement helped to accomplish three goals of regional integration. It provided common external tariff protection which, in turn, facilitated import substitution, and promoted industrial development in the region.

Where the changes in the external tariff involved a substantial alteration from the preexisting national tariff, the Equalization Agreement established an interim system of progressive equalization. The first change in the initial tariff came 12 months after the Equalization Agreement became effective and modifications were made annually until the agreed duty was reached — the total time not to exceed five years. By 1969, a common external tariff had been established on 95.2 percent of the items in the tariff nomenclature. Another .7 percent is scheduled to be equalized by 1972.

D. The Operation of the Central American Common Market

Initially the CACM was very successful. Evidence of the close ties among the five member States includes the fact that trade had increased about 350 percent to a total of $176 million between 1960 and 1966. Intraregional trade in manufacturing had increased over 600 percent to $125 million, and imports originating in the region had risen from 6 percent in 1960 to 18 percent in 1966. By 1970 intraregional trade had reached $286 million. These facts support the conclusion that the elimination of internal trade barriers increased the size of the domestic market and stimulated intraregional trade. Over 98 percent of the items on the tariff schedule were being traded duty free within the region by 1968 and today only a few products are not being traded freely. All five States are

44 Id. at 84.
47 See C. CASTILLO, supra note 21; R. HANSEN, supra note 9; Chase Manhattan Bank, Central American Common Market, WORLD BUS., 1968, at 14-16; Nye, Central American Regional Integration, in INTERNATIONAL REGIONALISM 378 (J. Nye ed. 1968). See also Tables 1 & 2 infra.
48 Chase Manhattan Bank, supra note 47, at 14.
49 See Table 1 infra.
50 OVERSEAS BUSINESS REPORTS, LATIN AMERICAN ECONOMIC INTEGRATION:
offering tax incentives and tariff advantages to encourage new industries that would not compete with those already within the region.

However, the CACM has faced serious difficulties. While all States have gained from integration, El Salvador, Costa Rica, and Guatemala have benefited the most due to their advanced industrial structure. On the other hand, the agricultural exports of Honduras and Nicaragua have made only limited gains, leading to the dissatisfaction of these States. Secondly, American businessmen saw the protective tariff as impairing the quality of industrialization and felt that import substitution had little long-range dynamism in such a small market where income is distributed unevenly.

Faced with the above accomplishments and problems, the task falls on the CACM institutional nexus to provide the initiative to continue the expansion of the Common Market. The impact of the Central American institutions and their ability to implement a functional approach to problem-solving holds the answer to the question of the viability of the Common Market. The functionalist approach in the operation of a common market "seeks out semi-technical tasks with a high degree of political relevance — and establishes supranational bureaucracies to deal with the tasks." Since the ultimate ends are left ambiguous and new tasks are encouraged to "spill-over" into the regional institution, the institutional nexus will become the focal point for decision-making with a minimal amount of political friction.


51 This is reflected in the intraregional trade figures. See Table 1 infra.

52 Chase Manhattan Bank, supra note 47, at 14.

53 One commentator noted that "[t]he basic argument of 'functionalism' as a theory of international organization is for a minimal frontal attack on state sovereignty, which is gradually made irrelevant by a reordering of the world along technical-functional lines." Nye, supra note 47, at 380. Functionalism, relying upon the relationship of the economic and social sectors, and the impetus of technocrats, persuades the individual governments to allow one common task to "spill-over" into another. Thus the regional organization gradually usurps the functions of the governments, and loyalties and expectations are refocused to the developing center (i.e., the regional institutional nexus). See generally E. HAAS, THE UNITING OF EUROPE (1958); Regional Integration: Theory and Research, 24 INT'L ORGANIZATION 607 (1970).

54 Nye, supra note 47, at 380.

55 "Spill-over" refers to the process whereby tasks formerly accomplished by the national governments shift to the regional institutions due to the natural links between the economic and social sectors and the prodding of the technocrats of the regional institutions. Id. The concept of spill-over is further developed in Schmitter, Three Neo-Functional Hypotheses about International Integration, 23 INT'L ORGANIZATION 162 (1969) and Schmitter, A Revised Theory of Regional Integration, 24 INT'L ORGANIZATION 837 (1970). Spill-over is defined as the process whereby the
The actions of the institutions must be sufficiently concentrated to be effective. Similar tasks cannot be allowed to "spill-around," such as being allowed to flow to different institutions each time, with the likely consequence of being duplicated by two institutions. The relationship between State and regional institutions must be such that a consistent policy is achieved — where both are acting in concert with each other. Because Central American regional institutions have already absorbed many of the available trained personnel in Central America, they have the technical know-how and are the best equipped to handle the experimental and operational phases of economic integration.\(^6\) In addition, the maintenance of several Central American institutions (such as the Executive Council, Permanent Secretariat, CABEI, Clearing House, ICAITI, and Monetary Council), with individual staffs and tasks, results in a diffusion of political attention as more than one institution must be focused upon: This has the beneficial effect of lowering the level of politicization of the Common Market as a whole.

Where there are several competent centers formulating and implementing economic integration, the operations must be coordinated. The General Treaty assigned this task to the Economic and Executive Councils.\(^5\) The problem that arises is that the members of these councils are also the ministers of the national governments and consequently they sometimes have conflicting loyalties. As a practical matter then a shifting and strengthening of SIECA and the specialized institutions\(^5\) is necessary to insure further integration.

Internal pressures have recently put considerable stress on the regional institutions. For example, the political turmoil in Guatemala, the seat of SIECA, has adversely affected the integration process.\(^5\) The war between El Salvador and Honduras has affected the Common Market adversely since Honduras refused to take part in the regional meetings and closed the inter-American highway to

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\(^{60}\) C. Castillo, supra note 21, at 122.

\(^{67}\) Arts. XX, XXI, & XXII, 455 U.N.T.S. 86.

\(^{58}\) These include the Clearing House, CABEI, ICAITI, ESPAC, and the Monetary Council.

\(^{59}\) The turmoil is evinced by the following: United States military advisors have been murdered, the Guatemalan Foreign Minister was kidnapped and exchanged for guerilla leaders, and in 1970 the West German ambassador was kidnapped and murdered. See Simmonds, International Economic Organizations in Central and Latin America and the Caribbean: Regionalism and Subregionalism in the Integration Process, 19 INT'L & COMP. L.Q. 376, 377-78 (1970).
Salvadorian goods. This affected the level of intraregional trade in 1969. It has been stated in regard to the war that: "The effect of the conflict upon the potential development of foreign investment in the region should not be underestimated; in the final analysis this may represent a setback from which it will be difficult to recover."

One of the more prominent legal problems facing the CACM is that the States have been reluctant to give the regional institutions any power. The power that the regional institutions currently have has largely been obtained by spill-over. However, this allows the States to preempt institutional powers by the use of diplomatic instruments. The treaties and protocols, which must be negotiated, signed, and ratified by each State, are still the primary means to achieve major policy implementations, even though the process may take months. On the other hand, each State has limited its respective sovereignty by signing independent trade agreements, using tariff mechanisms to solve balance of payment problems and limiting the granting of fiscal incentives to certain industries.

The various treaties and protocols have provided a legal framework for a viable Common Market. In its short existence CACM has stimulated and changed the intraregional trade so that the value of industrial products exceeds that of the agricultural and the extractive sectors. External trade has increased and items that are imported are not principally produced within the region nor are

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60 The war, sometimes called the football war, was started when El Salvador invaded Honduras for alleged attacks by Hondurans on Salvadorian settlers. The hostility followed the competition between the two countries for the World Cup which brought the situation to a head. However, the underlying causes of the hostility lie in the fact that El Salvador has severe demographic problems — a shortage of land and a high birth rate. This has led to the emigration of over three hundred thousand Salvadoreans to Honduras. Honduras, which has not fared as well as the more developed Central American nations under the common market, has consequently encountered a rising rate of unemployment and an adverse balance of payments situation with El Salvador. Cable, supra note 50, at 658.

61 In 1969, Honduran exports to El Salvador dropped from 14.8 million dollars in 1968 to 7.3 million dollars. Honduran imports dropped from 23.2 million dollars in 1968 to 12.4 million in 1969. This accounts for most of the decline in the total amount of Honduran exports from 31.3 to 23.9 million dollars from 1968 to 1969. See SIECA, Information Letters, May & June 1971.


63 See, for example, the designation process for integrated industries discussed in note 83 infra & accompanying text.


65 Simmonds, supra note 59, at 379.
the items essential to industrial development. However, the treaties have not provided effective mechanisms for economic integration in several instances. A regional highway program and telecommunications system have not come about and both are essential to industrial infrastructure development. The Central American Bank for Economic Integration has had less of an impact than expected and the Clearing House and Monetary Council have had difficulty in functioning. In spite of this, SIECA has been able to function fairly efficiently and has provided some much needed leadership and dynamism. One commentator has observed:

The custom union that now exists in the region, with a free internal market and a common external tariff on almost all imports from outside, cannot, however, be transformed into a single integrated economic unit unless some of the regional programmes and the institutions set up to implement them, can be revived and agreement can be reached on a number of matters, such as fiscal reform, the balanced intra-regional allocation of new industries, and the freedom of movement of labor, which have obviously strong political overtones.

The problem has been stated, but it remains to be seen if the institutions can respond in the future. Growing politicization of integration problems is considered a sign of progress towards a true economic union. On the other hand, if politicization occurs at a rate faster than the development of common loyalties to the regional institutions, the result is a spill-back until the institutions and tasks of the regional organization return to a level which the community loyalties and expectations can support.

Regionalism and the CACM have several important supporting factors. The growing number of supranational technocrats and institutions are able to focus their attention on creating a viable Common Market. The fact that economic tasks have in the past remained separated from political tasks, has initially proved to be a stabilizing effect. Spill-over will necessitate more politicization, but

60 Id. at 380.
61 Id. at 380.
62 The growth of SIECA is apparent from the fact that its budget and staff were doubled in the first six years. Also, the departments on trade and taxes have been added to those of infrastructure, agriculture, market, industry, statistics, law, publications, and administration. In practice, tasks have increased and the Secretariat has gained some minor de facto executive powers. See Nye, supra note 47, at 410.
63 Simmonds, supra note 59, at 380.
64 Nye, supra note 47, at 422.
65 Spill-back is a stagnation that leads to a retrogression of loyalties and tasks to the national level.
66 Nye, supra note 47, at 422.
in the short run, political and economic separability will tend to keep the level of politicization low. The increased economic interdependence due to increased regional trade, common industrial policies, minimal infrastructure development, and the monetary union is also a cohesive factor. The past success of the CACM and the cooperation of international agencies in providing a favorable international setting is a positive reinforcement for the continued efforts towards integration.

It is within this framework that the Agreement on the System of Integrated Industries\textsuperscript{72} and the investment opportunities in Central America must be considered. The economic theory, legal apparatus, and institutional structure are oriented towards industrialization. The problem is how to provide a setting that will attract foreign investors while minimizing the cost of their investment.

IV. INTEGRATED INDUSTRIES AND INCREASED INVESTMENT

A. The Agreement on the System of Integrated Industries

In accordance with the Prebisch-ECLA concept of developing Central America, this Agreement has two purposes. The first objective is to promote the rational use of development resources.\textsuperscript{73} The second objective is to encourage the establishment of industries which require free access to the entire region in order to operate under reasonably economic and competitive conditions even at minimum capacity.\textsuperscript{74}

The rational use of development resources is to be accomplished by promoting new industries and specializing and expanding existing industries so that every Central American State may progressively derive economic advantage. This implies that a shortage of resources in capital, skilled labor, and technical knowledge requires a rational priority to avoid several small-scale, high-cost factories that would absorb these valuable resources, and compete with each other within the region. The single industry restriction to meet the entire region's demand results in an economy of scale, namely large-scale, low-cost production. Thus the Agreement on Integrated Industries provides for the rational use of resources by discouraging duplication and competition where the demand for the product is only large enough to support one firm.

\textsuperscript{72}Signed June 10, 1958, INSTRUMENTS, supra note 5, at 89.

\textsuperscript{73}Art. I, id. at 89-90.

\textsuperscript{74}Art. II, id. at 90.
To insure that industrial development is distributed evenly throughout the region, the Agreement on Integrated Industries provides that each State must receive one integrated industry before any can receive a second.\footnote{Transitional Article, id. at 94. See generally Cochrane, Central American Economic Integration: The "Integrated Industries" Scheme, 19 INTER-AM. ECON. AFF. 63 (1965).} However, there is no provision for an equal distribution after each State has received one, save the mention of the development of activities on an "equitable basis." There is a tendency towards uneven distribution because of labor factors, transportation costs, proximity to market, availability of financing, level of existing industrial development, and investment climate. Hence the most the Agreement on Integrated Industries can do is reduce the unevenness. The Agreement cannot prevent uneven distribution because it is applicable to only a particular type of industry (those to be integrated). The establishment of one integrated industry, though, may stimulate the development of supportive industries.

The second objective of the Agreement was intended to be accomplished by permitting the products of the integrated industry to move freely throughout the region, while similar products of non-integrated industries would not enjoy regional free trade for a period of ten years. However, the ten years have passed and this benefit is no longer available because intramarket duties have been almost completely eliminated.

The remaining benefits that can be obtained under the Agreement on Integrated Industries and its protocols\footnote{For Protocols I & II, see INSTRUMENTS, supra note 5, at 94, 109.} are substantial. The integrated industry enjoys external tariff protection while making its products competitive with those of foreign producers. The integrated industry is entitled to duty exemptions on the importation of raw materials and intermediate goods for a ten year period.\footnote{Protocol I, Art. VI, id. at 96.} These industries are also exempt from taxes levied on the production or consumption of such raw materials and intermediate products.\footnote{Id.} The governments of the five States are required to give preference to the products of the integrated industries when they buy,\footnote{Agreement on Integrated Industries, Art. VII, id. at 91.} and the integrated industries are protected against dumping.\footnote{If the foreign exporter dumps in the region (sells his product in Central America (Vol. 4: 37)
If a firm meets certain requirements imposed on price, quality, and capacity, irrespective of whether it is integrated, then duties on competing imports from outside the region may be increased under the Special System for the Promotion of Production.\textsuperscript{81} Similarly, advantages may be obtained under the Central American Agreement on Fiscal Incentives to Industrial Development,\textsuperscript{82} including the total exemption from customs duties in raw materials and intermediate goods, the total exemption from income taxes, and exemption from property and asset taxes.

To become a regionally integrated industry a firm must go through a designation procedure that is both long and uncertain.\textsuperscript{83} This extended process is due to the unwillingness of the individual States to view the integrated industries scheme as regional. The necessity of a separate protocol that must be ratified by each of the States, permits them to be protective of their national interest at the expense of the Agreement.

Since it may take several years to become an integrated industry, the procedure should be streamlined to encourage more industries to apply for this status. The procedure that this writer suggests

\textsuperscript{81} Protocol I, Arts. XXVIII-XXXVII, INSTRUMENTS, \textit{supra} note 5, at 105-07 (which is Chapter IV of the first protocol to the Agreement on Integrated Industries). \textit{See} D. RAMSETT, \textit{REGIONAL INDUSTRIAL DEVELOPMENT IN CENTRAL AMERICA} 38-40 (1969).

\textsuperscript{82} INSTRUMENTS, \textit{supra} note 5, at 117. \textit{See} id. at 135, for the Protocol granting preferential treatment to Honduras. For a complete discussion of the Agreement on Fiscal Incentives to Industrial Development, see Gillim, \textit{The Fiscal Aspects of the Central American Common Market}, in 2 \textit{FISCAL HARMONIZATION IN COMMON MARKETS} 479 (C. Shoup ed. 1967). \textit{See also OVERSEAS BUSINESS REPORTS, supra} note 50, at 10.

\textsuperscript{83} D. RAMSETT, \textit{supra} note 80, at 43. The procedure is as follows: (1) Application to the Secretariat (SIECA), usually by the firm in conjunction with the national government, by a report listing the conditions of demand, probable costs, and amount and sources of capital; (2) With the approval of SIECA, the report is passed on to the Executive Council — two or three months is usually required for their ruling; (3) If the Executive Council approves the application, it asks ICAITI to examine the economic feasibility of the project; (4) ICAITI reports to SIECA; (5) SIECA prepares a report recommending the project if the other reports are favorable; (6) Both the ICAITI and SIEVA reports are given to the Executive Council and it draws up a protocol which is signed by the Executive Council; and (7) Finally, and most importantly, the protocol must be ratified by each State. Three States must ratify it for the firm to begin operations, but it can only operate in those three countries.
is an application to SIECA by a report listing the conditions of demand, probable costs, and amount and sources of capital. If it approves, SIECA would then pass the report to ICAITI to examine the economic feasibility and ICAITI would then pass the report to the Executive Council along with SIECA's recommendations for a final decision. This procedure eliminates the passing of the project back and forth among the regional institutions; with each institution only seeing it once. Secondly, the necessity for each State to ratify the protocol is eliminated. Unfortunately, each State jealously guards its rights to keep the integrated industry from operating within its borders. Each State fears that without its veto there would be an uneven distribution of the new industrial development with it on the short end. Although, each State is represented on the Executive Council, matters are decided by majority vote and it is unlikely that the States will give up the protocol method unless some further guarantee of balanced development is made.

The impact of the Agreement on Integrated Industries so far has been minimal. In 1961, the five members each proposed an industry to be integrated. One of the proposed plants was already in operation on the national level in Guatemala. In 1963, Guatemala's proposal was set back when Costa Rica applied for a second plant to be built by Firestone in the same industry. SIECA replied to Costa Rica by stating that the internal demand in the region was not sufficient to warrant a second plant and denied Costa Rica's application. Nicaragua proposed that a caustic soda plant and an insecticide plant be integrated, even though the Agreement prevented the establishment of two plants until each State had an integrated industry. SIECA decided that the two plants were so closely interconnected that they could be considered as one, since chlorine, a by-product of caustic soda, can be used to make insecticides. Consequently, Nicaragua's application was granted. In 1965, Hon-

84 INTER-AMERICAN DEVELOPMENT BANK, THE IDB AND LATIN AMERICAN INTEGRATION 21 (mimeograph, 1970). See also Cable, supra note 50, at 664.
85 GINSA — Gran Industria de Neumaticos Centro Americanos — Guatemala's tire and tube plant was founded in 1956 and was declared an integrated industry in 1963. See D. RAMSETT, supra note 80, at 90-118.
86 Id. at 47. Costa Rica made this application before ratifying the Agreement.
87 Granting one State two integrated industries would violate the transitional article which requires that "the Contracting States not award a second plant to any one country until all of the Central American countries have each been assigned a plant in conformity with the protocols specified in Article III." INSTRUMENTS, supra note 5, at 94.
88 Protocol I, id. at 94.
duras was granted an integrated industry in the window or plate glass industry.\textsuperscript{89}

During 1966 and 1967, seven applications were submitted, with each State submitting at least one proposal. These applications were competitive and unrealistic.\textsuperscript{90} Furthermore, the transitional article was in the way of developing additional integrated industries until each State had one. To circumvent this problem, the Economic Council reinterpreted the unambiguous transitional article to mean that a second integrated plant cannot be assigned within the "same industry" to any State until a plant in the "same industry" has been assigned to each of the remaining States.\textsuperscript{91} According to one writer, this interpretation has been a factor in spurring new applications for integrated industries.\textsuperscript{92}

To encourage new integrated industries, the Executive Council, SIECA, and ICAITI should initiate plans for a practical and efficient integrated industry in each of the five States. This would ensure that the proposals are economically feasible and realistic, and each State would be assured that it was getting its "fair share" of the new industries.

In summary, the regional institutions have not been able to put the scheme of integrated industries into full operation even though the need for industrialization is imperative. The designation procedure is currently too cumbersome and lengthy to encourage industries to apply for integrated status. The rivalry for integrated industries and industrial investment by the five States has caused the process to bog down.

New commitments by the highest levels of the individual governments are needed. To obtain these commitments, the regional institutions must devise a plan of industrialization and investment for each of the five States and offer it to them as a package. The substantial benefits should then make the scheme attractive to investors.

B. Forms of Investment

Assuming that outside investment can be attracted by the bene-

\textsuperscript{89} Protocol II, \textit{id.} at 109.

\textsuperscript{90} The following applications were made: (1) Guatemala — pulp and paper mill; (2) Honduras — pulp and paper mill; (3) Nicaragua — pulp and paper mill; (4) Guatemala — nylon filaments plant; (5) El Salvador — nylon filaments plant; (6) Costa Rica — steel industry; (7) Honduras — steel industry.

\textsuperscript{91} D. RAMSETT, \textit{supra} note 80, at 64.

\textsuperscript{92} \textit{Id.} at 55.
fits offered in the Agreement on Integrated Industries, the form of that investment is critical. Foreign investment is extremely costly. From the capital importing State's view, the reason for the use of foreign investment is one of necessity due to its inability to raise capital within the State. Also, foreign investment tends to dampen the development of national enterprises. Foreign investors exercise monopoly control and usually do not sell their shares locally. Since many of the companies that invest abroad have a larger dollar value in output than the host State has in gross national product, they can exercise a great deal of pressure on the national government, both internally and externally.

Foreign investors provide three commodities — capital, technology, and management skills — the amounts of which vary with the form of investment. The more of each commodity the foreign investor supplies, the more costly are the concessions that the host government must make. The object is for the foreign investor and the host government to choose a form of organization that meets the needs of both.

Wholly or majority owned foreign subsidiaries are not favored by the host government since the State has relatively little control over the enterprise. While a State may accept this form of organization when capital, technology, and management skills are scarce, it will not when the only need is capital. The establishment of the foreign subsidiary and its operation lessens the scarcity of technology and trains managers, making the amount of outside participation dependent only upon the scarcity of capital. Consequently, this form of organization is self-defeating for the foreign investor in the long run. One possible solution is for the company to keep majority control, but as technology and management skills become more developed in the region, to allow and encourage a greater portion of national participation. From the State's point of view, it could require an agreement calling for diminishing foreign ownership over a period of years.

Host States favor joint ventures rather than investment by means of a subsidiary. While most foreign investors are willing to accept a joint venture where they have majority control, they will not ac-


94 INTER-AMERICAN DEVELOPMENT BANK, supra note 84, at 76.

95 Id. at 75. See generally Gordon, Joint Business Adventures in the Central American Common Market, 21 VAND. L. REV. 315 (1968).
cept the converse. One solution to this problem is to bring international institutions or development banks into the equity picture, giving each of them a substantial interest. Of course, foreign participation cannot be reduced too much or foreign investors will lose interest in maintaining the profitability and efficiency of the enterprise. The problem for the host State is that "local" sources of capital formation must still provide substantial capital and, in many cases, this may be very difficult or impossible to accomplish.

Another form of investment is the management contract where foreigners only provide managerial skills. The problem with a management contract is that the host State receives very little benefit of foreign capital and also very little inflow of technology occurs. Dependence on foreign investment is nil, but this itself may raise the problem of national capital formation. If a State is lacking in technical know-how rather than management skills, then a technical assistance agreement relieves the State from the disadvantages of having foreign capital and management while providing the needed technology. This type of arrangement may be desirable to the host State if it can provide the capital and management.

Still another form of investment that is used is the coproduction agreement where the national company acquires technology from a foreign source and pays for it by exporting its products to the source. This type of agreement gives the national company an assured market. The inflow of capital is low but national control and ownership is maximized.

The international corporation is a form of private foreign investment that deserves special consideration. An international or multinational corporation considers the markets of two or more States within its permanent field of action, and it produces or lends services on the basis of that multinational market. Because its growth and well-being depend on more than one State, its decisionmakers must take into account multinational alternatives.

There are three dangers that exist with an international corporation. The first is the danger of an oligopoly. The international

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98 INTER-AMERICAN DEVELOPMENT BANK, supra note 84, at 77.
98 INTER-AMERICAN DEVELOPMENT BANK, supra note 84, at 201.
corporation normally applies a global strategy to its individual subsidiaries so that it can take advantage of profit opportunities created by its monopoly in technology, its access to additional capital, and its capacity to operate in a way not controlled by market forces. "The existence of oligopoly in an industry implies, among other things, a redistribution of income from consumers to oligopolists. When the owners are (nationals) the redistribution takes place within the (country)."99 Secondly, international corporations do not always maximize the profits of their subsidiaries. "[T]he relevant yield for an international corporation is not the subsidiary's profit: it is the yield to the total network of the investor's interest..."100 Finally, the center of decisionmaking is located abroad. This causes national control to be minimized, especially where the total volume of sales of the international corporation exceeds the gross national product of the host government.

The structure of the multinational corporation creates an important asymmetry in the legal relationship between countries. The government of the parent corporation will normally hold it responsible for the action of its subsidiary; but the government in the receiving country will not normally declare jurisdiction over activities of the parent... The divisions of the multinational corporate family are not equal partners; this is one important reason the term "multinational" is inappropriate; the span of the firm may be multinational but the corporations themselves are national.101

Considering the defects of the preceding forms of investment, a more appropriate form for industrial development would be Central American multinational corporations. They could be public companies with private participation,102 or private companies on the same plane as ADELA.103 These corporations should be regional. To accomplish this, the CACM regional institutions should be given the authority to charter and regulate the corporations. Central

100 R. VERNON, FOREIGN DIRECT INVESTMENT IN THE LDC'S: AN EXPLORATION OF ALTERNATIVE FORMS 5-6 (mimeograph, 1968).
101 S. HYMER, NATIONAL POLICIES TOWARDS MULTINATIONAL CORPORATIONS 35 (mimeograph, 1968).
102 INTER-AMERICAN DEVELOPMENT BANK, supra note 4, at 85.
103 ADELA Investment Company S.A. is a private multinational investment company. Its shareholders include more than 160 industrial companies, banks, and financial institutions. To encourage active interest in ADELA the minimum holding is $100,000 and to assure broad holdings the maximum holding is $500,000 (authorized capital is $50 million). The company derives its profits from interest dividends and capital appreciation on its investments in Latin American private enterprises. ADELA, General Information, Apr., 1968 (pamphlet).
American multinational corporations would change the inability of the individual States to control the parent of an international corporation, and the center of decisionmaking would be located within the region. Even if the corporation did not maximize profits in any one State, it would maximize profits for the region as a whole.

Multinational corporations could become the focal point for Central American entrepreneurship. "Their size and status would enable them to organize consortia of national and foreign investors, to be adequate instruments for implementing inter-industry and complementation agreements and to carry out large projects beyond the capacity of presently existing single institutions, maintaining throughout a '(Central) American presence' in decision making."^104 While the Central American multinational corporation would not instantly replace the international corporation or other forms of investment, its eventual growth would provide an alternative to the present form of private foreign investment.

V. CONCLUSION

While intraregional trade has consistently increased in recent years, the scheme of integrated industries and industrial development has lagged in the Central American Common Market. The CACM has been unable to relieve the unequal levels of industrial development by means of the Agreement on the System of Integrated Industries. It is suggested that the Agreement be revitalized by a new, more rapid designation process as well as new commitments by the five States. When this is combined with a concerted effort of regional planning, in the form of economically feasible projects for all five States, the possibility for industrialization increases. Finally, the form of the industrialization should be through Central American multinational corporations. This would tend to give the region more control over its development and alleviate the problems that arise from private foreign investment.

JEFFREY P. RUDOLPH

^104 INTER-AMERICAN DEVELOPMENT BANK, supra note 84, at 86.
^105 See note 5 supra.
TABLE 1*

INTRAREGIONAL TRADE

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<td>218.0</td>
<td>258.3</td>
<td>252.1</td>
<td>286.3</td>
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1 Exports F.O.B., in millions of U.S. dollars.
2 Preliminary figures — does not include Salvadorian exports to Honduras or Honduran exports to El Salvador.


TABLE 2*

TOTAL TRADE

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Regional Trade Deficit | 98  | 174  | 100  | 89  | —    |

1 F.O.B., Millions of U.S. dollars.
2 C.I.F., Millions of U.S. dollars.