



**Universidad del Salvador  
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**Colegio Interamericano de Defensa  
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**ECONOMIC GLOBALIZATION and GOVERNANCE  
in  
EL SALVADOR AND HONDURAS**

**By  
HECTOR A. SALINAS**

**MASTER EN DEFENSA Y SEGURIDAD HEMISFERICA  
Tutor: LIC Eduardo Murillo (CFO Grupo Creet, El Salvador)  
Academic Advisor: Lieutenant General (Ret) Evergisto de Vergara, MS  
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## INTRODUCTION

### 1. Problem statement and Research Questions:

Many argue that globalization can be traced to the exploration and colonization era, or perhaps even farther in history. The current cycle has had the greatest impact on our society. It started only twenty-five years ago with the arrival of the World Wide Web. Globalization, fuel by an exponential growth in technology, can mean many things. On this paper, I plan to focus on the economic aspect of globalization and its effect on governability and poverty in the countries of El Salvador and Honduras. Thus, citing Jagdish Bhagwati's term, I will refer to it as "*economic globalization*".<sup>1</sup>

Economic globalization is generally associated with the elimination of trade barriers and governmental regulations, thus leading to an increase of international and transnational exchanges. The flow of goods, services, capital and people increases inter-dependability between states and regions and creates opportunities for development that otherwise would not exist. Thomas Friedman argued in "The World is Flat", that globalization increased the opportunities for economic growth, reduced poverty, and empowered individuals. Empowering individuals means strengthening individual liberties and consequently democracy. Friedman also addresses globalization's drawbacks and warns us about erosion of governments, environmental degradation, and social impact.

Economic globalization created a set of benefits as well as costs for developing countries. The political-economic policies associated with the "Washington consensus" were translated into a set of very specific policies by international financial institutions (IFIs) such as the World Bank and the Inter American Development Bank that in turn were enacted by Latin American governments. These policies, designed to liberalize trade, set the stage for a sea change in political and economic philosophy. They spur a radical economic opening, reduced government regulation and instituted fiscal discipline.

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<sup>1</sup> Bhagwati, Jagdish, *In Defense of Globalization*, Oxford University Press, NY 2004

Critics argued that the economic opening favored developed nations but not developing ones, largely because of their comparative economic disadvantage. They point out that economic globalization has had a negative effect on wages, labor movements, social wellbeing, economic mobility, health, environment and democratic institutions.

Certainly, in the Central American countries of El Salvador and Honduras, the social and political costs have been high. Government cut back social spending in order to build the infrastructure required to be competitive in the global market. Trade did create jobs but not in sufficient numbers and did not reduce poverty and extreme poverty significantly.

Critics argued that governments hastily adopted market economies, deregulated, privatized and reformed, but in doing so, neglected to provide prosperity and wellbeing to their constituencies. The population, specially the poor, disillusionment with the failure of democratic governments and institutions to provide for their basic needs created a climate of crime, corruption and ungovernability.

El Salvador's and Honduras' economic perspective has improved somewhat, however, the benefits have not been enjoyed equally across the economic spectrum.

Macroeconomic figures point to sustained economic growth but it has not translated to individual prosperity across the social spectrum. A large amount of the population still lives on less than a dollar a day. Income distribution is not equitable and the income gap has widened.

An overarching analysis on the issue of globalization and poverty in El Salvador and Honduras raises the following questions:

1. Is economic globalization eroding nation-states ability to govern? i.e. ability to fulfill its contract obligation with its population?
2. Is free trade (economic globalization) the solution to poverty in El Salvador and Honduras?
3. If globalization is eroding governments and failing to reduce poverty levels, what are the economic alternatives?

## **2. General Objective:**

Suggest how El Salvador and Honduras (CENTAM) may enact policies that would maximize the advantages of economic globalization (free trade) while minimizing the costs to their constituencies.

## **3. Specific Objectives:**

- Analyze globalization policies and their implementation from a historical perspective.
- Analyze external and internal pressures that led to the implementation of free trade policies.
- Analyze the benefits and costs of free trade policies.
- Determine the relationship between globalization and governability.

## **4. Central Hypothesis:**

Free trade (economic globalization) in El Salvador and Honduras cannot be stopped or substituted, but certainly, it can be managed in such a way that it becomes an instrument, perhaps the most important tool, that will help reduce poverty.

## **5. Derived Hypothesis:**

- Even though free trade generates economic growth, it is not by itself the solution to poverty. Macroeconomic figures suggest sustained economic growth and a segment of the population is improving their economic status. However, poverty and extreme poverty remain at high levels.
- Governments responded to external and internal pressures and enacted macroeconomic policies aimed at creating an investor friendly environment. The results have translated into sustained economic growth. Despite the economic bonanza that these policies generated, governments failed to reduce poverty and the income gap burdens a large segment of its population.
- Globalization, due to its basic fabric of trade barrier elimination and ferocious economic competition, is in fact eroding the nation-states ability to govern.

- However, free trade generates benefits that far outweigh costs and nation-states should maximize the benefits and invest in social and infrastructure projects. Investment in these areas could ensure an improved comparative advantage for future generations.

## **6. Methodology and Investigative Techniques:**

The methodology used during the research consists of analyzing the economic globalization policies, the external and internal pressures that led to their implementation, and the benefits and costs associated with them. The final phase of the methodology will consist in determining the relationship between economic globalization and governability.

The foundations of the scientific reasoning of this paper mainly includes the use formal logics (inductive and deductive reasoning); applied logics by using statistics, and critical logics when interpreting figures and tables data.

## **7. Limitations:**

The issue is very wide, and has several implications on each Central American country. An additional limitation is that accurate statistics and tables are scarce. Furthermore, they are suspect of data manipulation for political purposes. This is the reason why I chose to focus on El Salvador and Honduras, in order to avoid time constraints in generalizing the data.

It is also difficult the access to subject matter experts. In fact, if the so called “experts” are found, they may be ideological tainted or bias. Therefore, those “experts” are bias and often bend their technical judgment, or purposely arrive at wrong conclusions.

This is the reason why this paper is limited to providing a broad set of policies or courses of action that those nation-states could pursue in order to utilize fully globalization's potential in combating poverty.

The general outline of this thesis is as follows: an introduction, which states the theoretical framework of the paper. Chapter 1 discusses globalization policies, their implementation and CENTAM's economic outlook. Chapter 2 addresses the benefits and costs associated with economic globalization. Chapter 3 discusses the globalization's effects on governability. Chapter 4 suggests perspectives for CENTAM. Finally, Chapter 5 deals with the General Conclusions of this study.

## **CHAPTER 1: GLOBALIZATION POLICIES AND IMPLEMENTATION/ ECONOMIC BACKGROUND**

**Historical Perspective:** From the early 60s and thru the early 90s, internal conflicts plagued CENTAM. Social, political and economic dissatisfaction evolved into insurgent movements that attempted to change a society characterized by political oppression and social inequality. During the 80s, full-scale civil war engulfed the region as cold war superpowers played cold war politics. Collapsed of the agro-export economies, the debt crisis of the 80s, and civil strife were contributing factors to what is called “the lost decade.” The 90s ushered an end to the conflicts, pacification, demilitarization and transition to democracy. Economic stabilization became a priority under a new model that advocated growth thru free trade and a lesser amount of government intervention. Peaceful democratic transition became the norm and with it, neoliberal economic policies replaced the protectionist, inward oriented and interventionist economic model.

Many scholars agree that the treaties of Westphalia gave birth to the modern nation state system and the concept of sovereignty. The principles of territoriality and non-intervention defined sovereignty. The system of nation states generated national political structures, production systems, and trade. Market economies evolved thru the interaction of these systems, passing thru many stages, and during each stage becoming increasingly intertwined and mutually dependent system. The system progressively eroded boundaries, autonomy and governability.

Economic globalization is closely associated with neoliberalism. Defined as a political-economic movement dating back to the 70s, it advocates less government and greater freedom to trade. It calls for the elimination of trade barriers and regulations in order to facilitate the flow of capital, goods and services. Theoretically, the resulting political-economic model would promote sustained development; strengthen democratic institutions and further political liberties. Fiscal discipline, reduction of government bureaucracy, non-intervention in the economic cycle, and privatization of state run monopolies are key elements. The assumption being that trade will lead to economic

growth. Economic growth increases state revenue that governments could invest in social programs - education, health, and social welfare -.

Two distinctive features of globalization are the increase of transnational capital flows and the erosion of states as the basic production system.<sup>2</sup> The technological advances in information management, i.e. telecommunications, hardware and software coupled with innovative management and production techniques transformed the national production system into a transnational one. Thus, transnationalization gave rise to “economic globalization”.<sup>3</sup>

Deregulation and reduction of trade barriers allow transnational capital and corporations to move freely from country to country or region to region. Transnational actors replaced international ones. They seek investor friendly environments that permit investments and maximization of profits. Governments, especially in underdeveloped countries, faced the choice of maintaining an obsolete economic model or transform their system to a market economy. Transformation implies that the governments had to make unpopular political-economic decisions in order to remake the welfare oriented and interventionist state into an outward oriented and less regulated one. In essence, governments would open their economies to the world.

- **Transnationalization of Production:** Industrial societies fragmented their national production processes by moving segments to different countries or regions where the comparative advantage of those states would lower production costs and maximize profits.<sup>4</sup> Economic factors such as cheap labor, productivity, and fiscal incentives motivate a particular factory to relocate. Another factor that caused production relocation was the imposition by a state of tariffs and quotas on goods and services.

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<sup>2</sup> ROBINSON, William I., *Transnational Conflicts, Central America, Social Change and Globalization*, Verso, NY, 2003, p.12

<sup>3</sup> Id.

<sup>4</sup> ROBINSON, op.cit. p 14-17

The US imposed tariffs and quotas on Japanese cars in order to protect the national automobile industry. The Japanese response was to relocate several of its plants to the US and elsewhere. Thus, the Japanese national production system became “globalized”. Obviously, the fragmentation of the production process led to an increase in trade and economic integration.

Between the 50s and 70s, the “Dependency” theory, championed by the Argentinean Raul Prebisch, and its import substitution industrialization (ISI) corollary, guided economic policy. Prebisch argued that the economic system had a center or core formed by wealthy states who extracted the natural resources from the “periphery states”. The poor states constituted the periphery. These states became “dependent” on the manufactured goods produced by the core states. Prebisch argued that “all developed countries had industrialized behind high protective tariffs and it was only after a country had developed a more mature industrial structure, that it could become involved in the freer trading of goods”.<sup>5</sup>

Most Latin American countries to include CENTAM adopted ISI and protectionism as their economic model. Governments enacted policies that protected their small economies with trade barriers while fomenting the national industry in an attempt to substitute imports. Governments assumed an active role in the economy, not only regulating it, but also by actively participating in it. They became the owners of basic services companies, finance institutions, and other productive sectors.

Unfortunately, small states did not develop an industrial base because industrialized nations “exported” their manufacturing plants in a strategy design to bypass the

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<sup>5</sup> THOMAS, Linus J. *Neoclassical development theory and the Prebisch doctrine*, American Economist, Los Angeles, Spring 1994. Vol. 38, Iss. 1; p. 75 “The core issue Prebisch addressed was the decline in the terms of trade (TO) between industrialized and non-industrialized countries, which meant peripheral nations had to export more to get the same value of industrial exports. Through this system - he said -, all of the benefits of technology and international trade would accrue to the centre”.

In international economics and international trade, terms of trade or TOT is the relative prices of a country’s export to import. An improvement in a nation’s terms of trade is good for that country in the sense that it has to pay less for the products it imports, that is, it has to give up fewer exports for the imports it receives. Prebisch’s proposed solution for this was the ISI initiative.

protectionist measures, retain the industrial base and continue to profit. A secondary effect of ISI was that due to the relatively small demand for manufactured goods and the saturation of the markets, states were forced to seek market expansion. Their actions precipitated the establishment of the Central American Common Market (CACM)

### **1.2 External Pressures:**

- **Global:** As developed states' economic policy shifted towards free trade, they enticed other states to do the same. Free trade and foreign direct investment became two of the pillars of sustained economic growth in the globalized world. States created investor friendly environments and adopted policies designed to attract foreign direct investment, a key element of globalization.<sup>6</sup>

Another aspect of globalization is the free trade agreements (FTA). They facilitate trade by eliminating tariffs, eradicating unfair trade practices and facilitating investment. Economic blocks created thru FTAs are in a better position to compete for markets and resources. States decided that it was in their best economic interest to negotiate and enter into these agreements resulting in the worldwide proliferation of FTAs in the past few years.

### **Regional:**

-**Washington Consensus:** The "Washington Consensus" was a term coined in 1989 by John Williamson. It refers to a set of economic policy recommendations whose objective was to reform the economies, especially those of Latin America, that were suffering from a prolonged economic crisis. Critics argue that the consensus was a set of policies, designed by international financial institutions (IFI) based in Washington DC, whose objective was to further the capitalist system principally benefiting TNCs. The policy's ultimate objective was to create an environment that supported transnational corporations' interests, facilitated the exploitation of underdeveloped countries, and maximized profits. In Latin America's case, reforms would open economies to foreign

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<sup>6</sup> MOGUILLANSKY, Graciela, *Innovation, the Missing Link in Latina American Countries*, Journal of Economic Issues. Lincoln: June 2006, Vol. 40, Iss. 2 p.343-357.

investment and trade, and exploitation of labor. Trade liberalization expanded the role of market forces while substantially diminishing the role of government.

Political-economic reforms were derived from the consensus recommendations.

Governments should adopt the reforms in order to reverse the economic quagmire of the 80s and achieve sustained economic growth. The reforms are based on three ideological ideas on political-economic policy:

- Opening markets to trade liberalization and foreign direct investment.
- Reducing government intervention in the economy: privatization, fiscal discipline, tax reform and increase of “technocrats” role
- Making the private sector the main instrument of economic growth – creating investor friendly conditions.

The Washington Consensus is closely associated with neoliberal policies, some of which imply limiting the state’s ability to enact social programs such as health, education and making income distribution more equitable. However, Williamson did not intend that his guidelines became “mandated external policy” nor he intended that the policies be considered the cure-all solution to economic problems at the expense of social welfare. Rather, they were a set of guidelines from which governments could adapt them according to their national realities and enact at the speed that they consider convenient. For example, one of the pillars of the consensus was fiscal discipline. However, it also called for “reordering public expenditure priorities.”<sup>7</sup> This suggested redirecting expenditures to education, health and infrastructure rather than increasing the size of the bureaucracy and increasing subsidies. As the case studies suggest, El Salvador and Honduras neglected to invest in social programs and instead invested in infrastructure and other sectors that were considered indispensable to attract foreign investment.

Economic stagnation, the debt crisis of the 70s and the political and social instability of the 80s were the precursors in CENTAM’s economic transformation. The chaotic

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<sup>7</sup> WILLIAMSON, John, *Did the Washington Consensus Failed*, Speech at the Center for Strategic and International Studies, Peterson Institute, Washington DC, Nov 2002

situation coupled with US influence became the catalysts for the adoption of a new economic model based on neoliberal policies. El Salvador reformed its economy in 1989 and Honduras in 1990.<sup>8</sup>

**-Central American Common Market (CACM):** It is a trade organization established during the export boom of the 60s by Guatemala, El Salvador, Honduras, and Nicaragua. Costa Rica became a member in 1963. The organization collapsed in 1969, due to a war between El Salvador and Honduras. The political upheaval of the 70s and 80s prevented its reestablishment. It revived in the 90s only after the civil conflicts had ended.

CENTAM's economic model was based on Prebisch's ISI theory and the Economic Commission's for Latin America and the Caribbean (ECLAC) guidelines. It emphasized public and private investment in the manufacturing of primary commodities in order to substitute imports. Prebisch recognized the inherent limitations that small markets would have on his model. Therefore, he proposed, "to expand local market by means of common markets among like groups of countries (regions) with a common external tariff that would protect national industries".<sup>9</sup>

CENTAM recognized its national market limitations and created the CACM.

Among its early successes were an increase in trade, due to the removal of duties on a variety of goods and the unification of external tariffs. Revived in the 90s, the CACM currently constitutes the second largest market of CENTAM after the United States. The trade between member nations represents 27% of exports and 12.6% of imports.<sup>10</sup>

CACM success encouraged member countries to continue with their economic transformation.

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<sup>8</sup> INTER-AMERICAN DEVELOPMENT BANK, Remittances to Central America to rise to \$12.1 billion in 2007, <http://www.iadb.org/>

<sup>9</sup> LIBRARY OF CONGRESS, Federal research Division, Country Studies, Honduras, Appendix B, [http://www.country-data.com/frd/cs/honduras/hn\\_appnb.html](http://www.country-data.com/frd/cs/honduras/hn_appnb.html)

<sup>10</sup> SECRETARIA DE INTEGRACION CENTRO AMERICANA, SICA, <http://www.sica.int/>

- **SICA:** The Integration System of Central America (SICA) consists of seven Central American States and Dominican Republic as an “associate state”. It was established in 1991, evolving from the Organization of Central American States (ODECA) that had been constituted in 1962. Its primary purposes are the strengthening of democracy, developing a regional security model, assisting in the development and integration of economic and financial systems, and promoting sustained economic growth. SICA’s organization includes a Central American Parliament, whose members are elected in each of the countries and a CENTAM Court of Justice whose judges are appointed by each of the member states. The Secretaria de Integracion Economica Centroamericana (SIECA) is SICA’s economic organ. Its function is to provide technical and administrative assistance to Central America’s economic integration process. Both the SICA and CACM promote regional political-economic integration and therefore exert pressure to diminish or erode national governance and boundaries. Member State’s policies yield to regional policies.

### **1.3 Internal Pressures – Transition to an economic globalized model:**

Economic elites realized that the states needed to incorporate themselves into the globalized world. They pressured governments to enact neoliberal policies, as they stood poised to take advantage of the new economic model. As governments deregulated and privatized, the domestic economic elites gained tremendous financial and political power. Numerous times, they were able to manipulate the government in order to pursue their own interests, sometimes at the cost of the population’s wellbeing. In the next sections, I will examine El Salvador and Honduras economic transition.

**EL SALVADOR:** El Salvador set the basis for its transition into a global economy during the 1980s. At the time, El Salvador’s government was engaged in a civil war in which the Frente Farabundo Marti para la Liberacion Nacional (FMLN) almost gained control of the country. The US provided huge amounts of economic and military aid that prevented the insurgent movement from taking control of the government. The US tied its economic assistance to structural reforms such as trade liberalization, deregulation,

sound fiscal and monetary policy and the creation of an investor friendly environment. U.S. military assistance amounted to equipment, training and advice.

The Salvadoran government sought to defeat the insurgency politically rather than military, making the social, economic and political programs the center of its counterinsurgency strategy.

Between 1981 and 1992, the U.S. provided around 6 billion in military and economic assistance.<sup>11</sup> Roughly, a third went to military assistance for training, equipment and operations. The rest was economic aid in the form of economic support funds (ESF), foodstuff donations and loans from international financial institutions.

During the early to middle 80s, Napoleon Duarte's government enacted a series of economic reforms that included market regulation, nationalization of certain financial sectors and an agrarian reform program. The agrarian reform expropriated large estates and transformed them into cooperatives. These cooperatives were the subject of much economic and technical assistance until the late 80s, when the government's policy shifted from cooperative to individual ownership. The agrarian reform was especially important because it diluted the economic elite's power base. Additionally, the reform helped stave off what seemed an imminent guerrilla take over in a similar scenario to that of Nicaragua, where the Sandinista popular uprising took power in 1979.

By early 90s, the reforms had achieved what they were intended to – prevent the FMLN from taking control of the government. The strategy consisted first in preventing the insurgency from taking control and then transforming the country politically and economically. "USAID began from 1985 and on to withdraw its support for the earlier reforms and to push privatizations, lifting state price controls, fiscal austerity, raised

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<sup>11</sup> SCHWARZ, Benjamín C. Schwarz, *American Counterinsurgency Doctrine and El Salvador*, Santa Monica, CA: RAND, 1991 p. 26

tariffs and so on”.<sup>12</sup> In the late 80s and early 90s the state banking system was re-privatized and the Central Bank given autonomy. The Duarte regime pursued deep social and economic reforms, in an effort to stave off an insurgent takeover.

In 1981, Roberto D’Aubuisson, a former military officer, created the Alianza Republicana Nacionalista (ARENA), a right wing party. Its principal objective was to oppose the transitional junta that had replaced the military dictatorship and later the democratically elected leftist Duarte government. During most of the 80s, the U.S. spent considerable efforts stemming D’Aubuisson’s (and ARENA’s) popularity and keeping him from winning the presidency. However, by the late 80s ARENA began to embrace economic liberalization and moved towards the political center. Proactive young professionals and members of the business sector created the Fundacion Salvadorena para el Desarrollo Economico (FUSADES). The US immediately embraced it. In 1983, FUSADES obtained a grant from USAID in order to promote the Caribbean Base Initiative. Over the next 10 years, it would receive over 150 million dollars, thus becoming USAID’s principal recipient of US funding in El Salvador’s civil sector programs.<sup>13</sup>

FUSADES became Salvador’s most influential think tank. Its department of Economic and Social studies drafted the economic program that was adopted in 1989 by Alfredo Cristiani, the incoming president from the ARENA party. The program was the result of USAID and FUSADES contracting a team of international advisors that included a member of the original “Chicago Boys” from the University of Chicago. The Chicago Boys were a group of free market economist who created the basis for neo-liberal policies in the 1970s. The program liberalized trade, devaluated the currency, privatized state own enterprises, lifted subsidies, and expanded free trade zones and *maquiladora* activities.<sup>14</sup>

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<sup>12</sup> CUENCA, Breny, *El Poder Intangible: La AID y el Estado Salvadoreno en los Anos Ochenta*, San Salvador. CRIES. 1993, p. 132

<sup>13</sup> ROSA, Herman, *El Papel de la Asistencia de AID en el Fortalecimiento de Nuevas Instituciones: El Caso FUSADES*; XVII Congress of Latin American Studies Association, Los Angeles, September 1992.

<sup>14</sup> Id.

Calderon Sol, also from the ARENA party, followed Cristiani. His program advanced the economic reforms started by Cristiani. Calderon's ultimate aim was to incorporate El Salvador into the "global production chain and thus the global economy".<sup>15</sup>

Francisco Flores, also an "Arenero" followed Calderon Sol. Flores dolarized the economy and pushed further liberalization. High economic growth rates, reduction of poverty, and large investment in infrastructure projects – roads, electricity- water – characterized his presidency.

**HONDURAS:** Unlike El Salvador, Honduras did not suffer from a bloody civil war during the 80s. There was no internal armed struggle nor was Honduras engaged in war with its neighbors. However, because of external pressures, Honduras experienced similar military, political and economic pressures as its neighbors did. For all practical purposes, it served as a base from where the U.S. would support the civil war in El Salvador and the counter-revolutionary efforts in Nicaragua. The US poured military and economic aid and became a very powerful and influential force.

Following the 1969 "soccer war" with El Salvador, the military led by Oswaldo Lopez Arellano came into power. Described as a "progressive young officer", Lopez Arellano embarked the country in a reformist path. He enacted labor laws such as minimum wage, instituted an agrarian reform, and promoted industrialization.<sup>16</sup> (Robinson) Despite his efforts, the economy was rapidly deteriorating by the end of the 70s. ISI had run its course, domestic markets shrunk, and the CACM ceased to exist.

In 1979 the Frente Sandinista para la Liberacion Nacional (FSLN) defeated Nicaragua's dictator Anastasio Somoza. The Sandinistas promptly declare their allegiance to the soviet camp. This made Honduras a strategic country for US policy and its importance increase within the overall cold war superpower conflict. The US stepped in with a massive infusion of military and economic aid. Its strategy was to make of Honduras a command, control and logistics center that would serve as a platform from where to counter the insurgent movements of its neighbors. US developed a three-prong strategy

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<sup>15</sup> ROBINSON, op.cit, ver nota 1, p.62

<sup>16</sup> ROBINSON, op.cit, ver nota 1. p. 118

for Honduras. It consisted of 1) military buildup, 2) promotion of democracy and 3) economic reforms.

The transition from military to civilian rule started in 1980 when Honduras elected a constituent assembly that formulated a new constitution that was approved in 1982. The first election was held in 1981 under US tutelage. Hondurans have been electing presidents every four years since. Thus, the limited reforms of the 70s, the return to democracy in the 80s and the massive US aid kept Honduras from enduring a popular uprising.

For the purpose of this study, the focus will be on the economic strategy rather than the political one. US aid was used to stimulate the economic reformist movement, pursuing a similar path as the Salvadoran one. Under USAID'S auspices and funding, the foundation for Honduran economic transformation was set. "The US Agency for International development has attained a central position in the Honduran society and economy".<sup>17</sup> AID sponsored a number of private sector organizations. The Foundation for Investment and Development of Exports (FIDE), founded in 1984, was a private, non-profit organization whose objective was to promote the creation of industry and exports. FIDE actively supported the industrial, natural resources, financial, infrastructure and energy sectors.<sup>18</sup> It played a similar role as that of FUSADES in El Salvador. US economic assistance between 1980 and 1990 was approximately 1.7 Billion, of which 711 million was in the form of Economic Support Program (ESP) funds going directly to the private sector.<sup>19</sup> FIDE, supported by USAID, developed the foundation for Honduras' export oriented and investor friendly transformation. It became the "neoliberal" think tank that competed with the traditional economic elite for influence and national power.

Despite FIDE'S and USAID'S pressure to enact economic reforms, Honduras traditional elites resisted them. They prevented the country from moving towards economic liberalization until the late 80s. In 1989, Rafael Callejas won the presidency and with

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<sup>17</sup> NORSWORTHY, Kent, Tom Barry, *Inside Honduras*, 2<sup>nd</sup> edition, September 1994, Interhemispheric Resource Center, NM,

<sup>18</sup> The Washington Times, *Honduras*, A Special International Report, March 2000, <http://www.washingtontimes.com/>

<sup>19</sup> ROBINSON, op.cit, ver nota 1, p. 123

him, the FIDE group came into power. Shortly afterwards, Callejas launched his “*paquetazo*”, a term given to a series of economic reforms that included privatization of a several of state-owned enterprises, devaluation of the “lempira”, imposition of fiscal discipline and tax reform, elimination of price controls and in general, the creation of a friendlier investment climate.<sup>20</sup> The *paquetazo* gave new life to the tax-exempt free zones that had been created in the mid 70s and attracted foreign investment. Honduras created duty free zones in the mid 1970s, but they had remained practically useless until the early 1990s.

The immediate effect of the free zones’ reactivation of the Honduran economy was an overnight explosion of the *maquila* industry and the creation of thousand of jobs. *Maquila: refers to the type of foreign-owned assembly plants set up in low-wage third world countries that puts together products, mostly clothing, from imported materials and then re-export them for sale to other countries like the United States. The individual assembly plants are called maquiladoras.* By the mid 90s, the *maquiladora* industry was employing close to 75,000 workers and had become Honduras third source of income, after coffee and bananas.<sup>21</sup> By the end of the 90s, the *maquila* industry was employing over 110,000 in approximately 250 factories. Exports climbed to over 1.8 billion USD. Factory ownership reflected 41% US owned, 32% Honduran, 14 Korean, and 13% other.<sup>22</sup>

Callejas *paquetazo* was the first of three. It was followed by Carlos Roberto Reina’s (President 94-98) and a third one by Carlos Flores (President 99-03). Reina’s “*paquetazo*” deepened neo-liberal reforms substantially. The great project called for “further and deeper Honduran insertion into the global economy over the following decade through the promotion of non traditional exports and tourism, the creation of a super free trade zone in major stretches of the country, and vast infrastructural and energy

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<sup>20</sup> POSAS, Mario, *El Nuevo Rostro del Paquetazo Rojo*, Revista Envio, Universidad Centroamericana UCA, #155, December 1994

<sup>21</sup> POSAS, Mario, *El Nuevo Rostro del Paquetazo Rojo*, Revista Envio, Universidad Centroamericana UCA, #155, December 1994

<sup>22</sup> ARMBRUSTER-SANDOVAL, Ralph, *Globalization and Cross-Border labor Solidarity in the Americas*; Business and Economics, 2005, NY, p 224

projects that would make every corner of the country accessible to transnational investors”.<sup>23</sup>

#### 1.4 Country Outlook:

**EL SALVADOR:** El Salvador’s GDP has grown from 24 billion USD in 2000 to 33.2 billion USD in 2006. Real GDP growth rate went from a 2.8% in 2006 to a 4.2% in 2007. The current government (Saca-ARENA) is committed to free market and fiscal discipline, hardly deviating from the original Cristiani-FUSADES policies of the 90s. The economy has been growing at a small but steady pace since the peace accords were signed in 1992. The chart depicts real GDP growth adjusted for inflation.

Year	GDP - real growth rate	Rank	Percent Change	Date of Information
2003	1.90 %	137		2002 est.
2004	1.40 %	162	-26.32 %	2003 est.
2005	1.80 %	174	28.57 %	2004 est.
2006	2.80 %	149	55.56 %	2005 est.
2007	4.20 %	126	50.00 %	2006 est.

CIA World Fact book 2007 April 2007

Salvador’s most impressive accomplishment is the reduction of poverty from 66% in 1991 to 30.7% in 2006.<sup>24</sup> Many scholars agree that the Salvadoran economic improvement is the result of privatization of a number of state-owned or regulated enterprises such as the banking system, electricity, water and telecommunications. Additionally, the government fostered an investor friendly environment. During the Flores administration in 2001, the dollar supplanted the Colon and now the Salvadoran economy is fully dolarized. The government’s principal revenue comes from the value added tax (IVA) which is 13%. Other taxes include an income tax at 20% and import duties.

<sup>23</sup> ROBINSON,op.cit, ver nota 1, p. 135

<sup>24</sup> US DEPARTMENT OF STATE, Country Profiles/El Salvador, <http://www.state.gov/r/pa/ei/bgn/2033.htm>

The *maquila* industry, concentrated mainly in the apparel sector, provides over 70,000 jobs. Several free trade zones have been established in order to attract this type of investment. Additionally, El Salvador attracted foreign companies in the financial, retail and services sectors leading to the creation of more than 18,000 jobs. New banks and telephone call centers stand out as a prime example of this type of investment.

“Labor export” or migration, mainly to the US has generated a wealth in remittances. In 2006, remittances were estimated at 3.3 billion USD. They supported an estimated 22% of Salvadoran families and accounted for an estimated 17% to 20% of the GDP.<sup>25</sup> Spent largely on consumer goods and consumption, their effect on economic growth although significant, does not constitute an investment.

In November 2006, El Salvador and the US signed a \$461 million economic development agreement under the Millennium Challenge Account (MCA) program. Its purpose is to provide a quick infusion of funds for infrastructure projects aimed at the short and long-term alleviation of poverty. Salvador’s MCA is a five-year project, targeting an area of about 850,000 people, 50% of which live at the poverty level. The funding will be spent in education, public services, agro-export production, and the “Northern Transnational Highway” system that will facilitate significantly intra-and inter-state transportation.<sup>26</sup>

Pursuing a greater integration into the global economy, El Salvador’s government is committed to free trade agreements. Besides being a member of the CACM, it has also negotiated treaties with Chile, Mexico, Panama, Taiwan, Colombia and the Dominican Republic. As part of SICA, it is currently negotiating a treaty with the European Union, Canada and the CARICOM. The most beneficial trade agreement is the U.S.-Central America-Dominican Republic Free Trade Agreement (CAFTA-DR). Similar to other

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<sup>25</sup> UNITED NATIONS DEVELOPMENT PROGRAMME, 2007 Development report, <http://www.undp.org/> Jan 2008

<sup>26</sup> MILLENNIUM CHALLENGE CORPORATION, *El Salvador and the Millennium Challenge Corporation Sign \$461 Million Agreement*, <http://www.mcc.gov/>

free trade agreements, CAFTA DR creates a free zone much like the one created by the North American Free Trade Agreement (NAFTA).

The Central American nations and the Dominican Republic were enjoying preferential trade treatment, i.e. duty free for a variety of exports to the United States, thru the Caribbean Basin Initiative (CBI). El Salvador's apparel, shoes, processed foods and manufactured goods had preferential access to U.S. markets. CAFTA-DR improves on the CBI by reducing tariffs and taxes for almost all exports to the US and vice versa. Additionally, it ensures that investment and trade are not affected by other treaties and protects CENTAM from non-FTA signatories.<sup>27</sup> The member countries will enjoy greater market access to consumer, industrial and agricultural products. The consumers will be favored by lower prices.

According to the Commerce Department, the agreement creates the second largest export market in Latin America with approximately 19.6 billion USD of goods exported in 2006. *The agreement also addresses government transparency and corruption, workers rights, protection of the environment, trade capacity building and dispute settlement.*<sup>28</sup>

Although most sectors of the economy will benefit from the free trade agreements, unfortunately others will not. The agricultural sector is one of them. Provisions were taken, i.e. up to 15 years to phase-in agricultural products in order to minimize negative effects. The phased implementation provides the Salvadorans time to develop competitive non-traditional agro-exports and increase productivity. The Salvadoran government must wisely administer funds and programs and focus its strategy into two vital areas: infrastructure development and education. This will improve competitiveness. As Jane Armitage, (World Bank Director for Central America) stated *“DR-CAFTA is not a silver-bullet, but it offers significant opportunities to increase growth and reduce poverty”*.<sup>29</sup>

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<sup>27</sup> US Department of Commerce, Free Trade Agreements, US-CAFTA-DR Free Trade Agreement, <http://www.export.gov/Feb> 2008

<sup>28</sup> US DEPARTMENT OF COMMERCE, op.cit., see note 25

<sup>29</sup> WORLD BANK, The World Bank and the DR - Central America Free Trade Agreement (DR-CAFTA), <http://www.bancomundial.org/> Feb 2008

Privatization of the electrical and telecommunications companies opened opportunities for foreign direct investment. Since privatization took place, the US Commerce department claims that more than 300 U.S. companies have established either a permanent or a representative presence in El Salvador. This has generated a boom in employment in these sectors as evidence by the explosion of call centers.

Despite the free trade initiatives and an export-oriented economy, El Salvador imports more than it exports. In 2006, exports grew 3.7% while imports grew 11.6%.<sup>30</sup> Imports continued growth is mainly a reflection of the remittances that are for the most part spent in consumption.

## **OUTLOOK FOR 08-09**

- **Internal:** Governability should be good until mid 08 when the Presidential campaign for 09 will be in full swing. Currently the opposition party's (FMLN) has surged in popularity and appears more palatable to the constituency than previous ex-guerilla commanders turned candidates. Regardless, should the opposition win in the 09 elections; no significant shifts from the current economic policies are expected. The government will not deviate from the macroeconomic policies instituted during the past decade. Strong fiscal discipline will be maintained while further reforms focusing on improving investor friendly climate will continue. The current administration is challenge by a large public debt of approximately 38 percent of GDP and the low taxation of approximately 13 percent of the GDP.<sup>31</sup> The current administration will continue to pay more attention to social programs than previous ones.

**External:** El Salvador remains one of the strongest US allies, certainly the strongest in the Western Hemisphere. The relationship between the United States and El Salvador goes back many decades and was only briefly interrupted by a dictator named Maximiliano Hernandez Martinez when he made public overtures to the Germans during World War II. It is the only country in the Western Hemisphere that is still supplying

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<sup>30</sup> US DEPARTMENT OF STATE, op.cit. see note 22

<sup>31</sup> EIU Views Wire, *El Salvador Economy: GDP remains firm*, NY Oct 3 2007

troops to the Coalition in the Iraq war. It has allowed the United States to establish a cooperative support location in one of its airbases from where the US supports its war on drugs. Its economy has been dolarized and many US firms are conducting business in El Salvador. As a democracy pursuing economic globalization, it shares similar national interests and objectives as the US. More recently, a demographic dimension was added to the political and economic ties. It is estimated that more than 3 million Salvadorans live in the US.

Because of these ties, El Salvador is expected to receive benefits such as the extension of the Temporary Protection Status (TPS) program that allows about 225,000 Salvadorans to remain working in the US. The US will support Salvadoran efforts to control organized crime manifested in the “Mara” (gang) phenomena. As part of the “Merida Initiative”, El Salvador, Honduras and Guatemala will receive substantial US funding for anti-crime purposes. The initiative is a new security cooperation program between the US, Mexico and Central America in order to combat drug trafficking, transnational organized crime, and terrorism.<sup>32</sup> Integration will receive special attention, especially with Guatemala, Honduras and Nicaragua.

**Economic:** The economy will continue to grow, although at a much slower pace due to external pressures such as the US economic recession and high energy prices. Additionally, the slowing of the US economy may have a negative impact on remittances. In 2007, El Salvador grew at about 4.5 percent and it is expected that for 08-09 timeframe, the growth will be significantly lower. The Economist Intelligence Unit estimates the range from 2.5 percent to 3.2 percent. The FTAs could provide growth opportunities that may offset the slowing of the US economy. Compounding the economic problems is the continuous increase in oil and foodstuff prices. These factors have contributed to an increase in inflation that ended with a 6.5% for 2007. EIU estimates that inflation will remain above 5 percent for the 08-09 period. The MCA

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<sup>32</sup> US DEPARTMENT OF STATE. Op.cit. ver nota 22

infusion of funds may help offset the possible lost of jobs due to the slowing of the US economy.<sup>33</sup>

**-HONDURAS:** Even though Honduras has enjoyed sustained economic growth during the last 4 years, it remains one of the poorest countries in the Western Hemisphere. Honduras hopes that the CAFTA DR and other FTAs will usher a period of sustained economic growth.

The Heavily Indebted Poor Countries (HIPC) program benefited Honduras. Industrialized countries create the “HIPC” initiative in 1996. The World Bank and International Monetary Fund lead it. Its goal is to provide a comprehensive approach, i.e. economic reforms and fiscal discipline, which countries may take in order to obtain debt relief. By granting debt relief, the HIPC initiative hopes to “reduce the constraints on economic growth, reduce poverty, and allow countries to pay future interest payments without needing further debt relief”.<sup>34</sup>

Even though donor-countries pardoned portions of Honduras external debt thru the HIPC initiative, almost 4 billion USD since 2005, with the understanding that the Honduran payments would go to poverty alleviation, they have not. Instead, the government spent the funds in fuel subsidies and raised salaries of government employees.

Although Honduras went thru the privatization stage in the early 90s, it did not privatize the communications and electric company. Both of these companies constitute a financial drain to the government’s coffers. “The state electric company, ENEE, is losing an estimated 300 million a year, primarily because rates do not cover the production costs”.<sup>35</sup> Honduras desperately wants to obtain some relief in the energy sector and for that reason joined the Venezuelan PetroCaribe initiative in December 2007.

Honduran economy depends heavily on agricultural and *maquila* exports. *Maquila* exports are mainly in the apparel sector, although recently it has diversified into

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<sup>33</sup> EIU Views Wire, op.cit, note 31

<sup>34</sup> WORLD BANK, op.cit, ver nota 27

<sup>35</sup> US DEPARTMENT OF STATE, op.cit., ver nota 22

automobile wiring harnesses and other products. *Maquiladora* industry is responsible for approximately 130,000 jobs (est. 2007). A large segment of the population remains engaged in subsistence agriculture. Additionally, Honduras possesses forest, mineral and marine resources that it continues to exploit.

Remittances for 2.7 Billion USD represented approximately 27% of the GDP and equals approximately 75% of Honduran exports. They became, since 2005, the largest source of foreign exchange surpassing the strong *maquila* and tourism sectors.<sup>36</sup> Ten years ago, Honduran remittances totaled 160 million USD. In 2007 Honduras received 2,675 millions USD.

Several organizations to include the UNDP and IADB as well as national organizations are studying the remittances phenomena. Even though available data is inconclusive, most agree that remittances are alleviating poverty and extreme poverty in Honduras. Researchers believe that most of the remittances go to consumption of goods rather than investment in durable goods. Another potential problem with remittances dependency is that they are vulnerable to social and economic variations. During 2007, the growth of remittances to both Honduras and El Salvador suffered their first decrease after years of continuous growth. The decrease may be due to the slowing of the US economy or perhaps of a more lasting impact, 2<sup>nd</sup> and 3<sup>rd</sup> generation immigrants do not feel compel to send money back to the country of origin.

<b>Año</b>	<b>Producto Interno Bruto (PIB) - Tasa de Crecimiento Real</b>	<b>Posición</b>	<b>Cambio Porcentual</b>	<b>Fecha de la Información</b>
2003	2,00 %	131		2002 est.
2004	3,00 %	114	50,00 %	2003 est.
2005	4,20 %	101	40,00 %	2004 est.
2006	4,20 %	110	0,00 %	2005 est.
2007	6,00 %	72	42,86 %	2006 est.

<sup>36</sup> INTER-AMERICAN DEVELOPMENT BANK, Remittances to Central America to rise to \$12.1 billion in 2007, <http://www.iadb.org/> Fe b 2008

High oil prices and the increase in grain prices have also affected the Honduran economy. Inflation rate has increase to over 8%.

Honduran trade policy will continue to focus on entering FTAs and attempting to make the established ones work for the benefit of its economy. The Taiwanese FTA with took effect 1 January 2008. The FTA will allow for a considerable amount of items to enter tariff-free into Taiwan with a similar reciprocity for Taiwanese items. Colombia will enter into a FTA with Honduras, El Salvador and Guatemala effective 2<sup>nd</sup> semester of 2008. As part of the CACM, Honduras is also negotiating an FTA between the EU and Central America. However, *the EU will only negotiate the treaty as a block and not individual countries*. Disappointingly, after more than a year into the CAFTA-DR, Honduran exports to the United States have not increase significantly.<sup>37</sup>

## **OUTLOOK FOR 08-09**

- **Internal:** The current government's ability to govern and enact policies is handicapped by the lack of clear majority in the congress and aggravated by the public discontent created by the increase in oil and food prices. Some analysts considered Zelaya a "lame duck" even though he is only halfway thru his term. His government has failed to reduce poverty, and counter crime effectively. His government is expected to stay the course as far as macroeconomic policies are concern, however as the election year approaches (2009), it is expected that the Zelaya government will turn towards populist policies in an effort to gain votes.<sup>38</sup>

In February 2008, Zelaya's government reached a basic agreement with the IMF in order to replace the three-year poverty reduction and growth facility (PRGF). *The PRGF is the IMF's low-interest lending facility for low-income countries. Its programs are conditioned by country poverty reduction strategies*. Analysts agree that the Honduran

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<sup>37</sup> US Census Bureau Trade Data, <http://www.census.gov/foreign-trade/reference/codes/csc.html>, Dec 2007

<sup>38</sup> EIU Views Wire, Honduras Economy, *Politics, Mixed Report for Zelaya*, May 10 2007

government will seek a policy support instrument in lieu of a PRGF because it gives the Government greater flexibility in managing its economic policy.<sup>39</sup>

Zelaya's government is aiming at developing or modifying macroeconomic policies, to include external policy in order to address imbalances, maintain growth, reduce inflation and prevent escalation of the energy crisis. It appears that his government will not maintain fiscal discipline. Funds earmarked for social spending are used to increase government salaries and not to address structural shortcomings.

- **External:** The slowdown in the US economy will certainly have a negative impact on Honduras exports and remittances. Coffee, one of Honduras principal exports will continue to have reasonable good and stable prices. On the other hand, the bananas exports to the EU may suffer as a new tariff is imposed. Central America expects to solve some of the problems with the EU by actively pursuing a FTA.

Relations with the US are strained due to US concerns that Zelaya is warming up to Venezuela's Hugo Chavez.<sup>40</sup> (US Embassy Honduras) Nevertheless, the US remains Honduras principal trade partner. In 2007, the US extended the Temporary Protected Status (TPS) for Honduran citizens residing and working in the US from July 07 thru Jan 09.

Honduras was a recipient of a MCA 215 million USD grant in 2005. It is aimed at stimulating growth and reducing poverty by fomenting rural development and investing in infrastructure projects. The rural development effort consists of four Farmer Training and Developmental Programs that are expected to be concluded by 2009. They include education, production, marketing and financing. The infrastructure effort consists in building or improving a series of secondary roads and the main highway between the capital city Tegucigalpa and the industrial northern city of San Pedro Sula. Road

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<sup>39</sup> Inter-American Development Bank, Remittances to Central America to rise to \$12.1 billion in 2007, <http://www.iadb.org/Jan> 2008

<sup>40</sup> US Department of States, Country Profiles/El Salvador, <http://www.state.gov/r/pa/ei/bgn/2033.htm>

improvement objective is to facilitate transportation between production and consumer/export areas.

- **Economic:** Honduras economy should continue to grow at about 6% in 2008-2009. Annual inflation should remain two to three percentage points higher than what the Banco Central Honduras forecasted (approximately 8%). As previously discussed, inflationary pressures should not decrease, thus inflation should remain relatively high. Oil and grain prices coupled with demand for goods and services caused by the remittances are factors that aggravate inflation.

According to the EIU, the trade deficit (excluding *maquila*) widened to US\$3.7bn in January-October 2007 from US\$2.8bn in the same period of 2006. It will continue to widen in 2008-2009. This is caused primarily by continued spending on consumer goods as most of the remittances are spent in this area. Even though there was an increase in exports in 2007 of approximately 10.5%, there was an increase of 24% in import spending.<sup>41</sup>

The *maquila* industry will continue to be an important element of the Honduran economy. Currently employing over 130,000 workers, it is expected to grow, despite the US economic slowdown and Asian competition.

Growth is expected to be stimulated by the several FTAs Honduras is entering into. Remittances should remain at the current level (2.8 Billion USD), making up almost 27% of the GDP. Infrastructure projects, government or MCA, will stimulate the local economy by providing jobs and generating secondary chains of production. The government is unwilling to reform the telecommunications and energy sector but should it be reformed, an increase in FDI would surely follow.

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<sup>41</sup>EIU Views Wire, Honduras Economy, *Fiscal Position Deteriorates*, NY Oct 5, 2007

Remittances growth comparison – 2006-2007:

<i>Country</i>	<i>2007 Remittances in millions of US\$</i>	<i>2006 Remittances in millions of US\$</i>
<b>Guatemala</b>	4,055	3,610
<b>El Salvador</b>	3,530	3,316
<b>Honduras</b>	2,675	2,359
<b>Nicaragua</b>	990	950
<b>Costa Rica</b>	590	520
<b>Panamá</b>	320	292
<b>Total</b>	<b>12,160</b>	<b>11,047</b>

Inter-American Defense Bank, Remittances to Central America Feb 2008

## CHAPTER 2: BENEFITS AND COSTS

The information, communication, transportation, management, and marketing revolution made the economic globalization possible. The world economy gave way to a global production process. The difference between a world economy and a global economy is that in a world economy the national production process was contained within a nation and in the global economy, the process was fragmented and integrated into a global production process.<sup>42</sup> For example, the production of Brazilian Embraer aircraft is dispersed among 14 other nations. Thus, state economies became interconnected, mutually dependent and highly competitive. The global production system also created benefits and costs. The next sections will examine them from state's factors of power perspective.

CENTAM experienced a substantial and sustained economic growth in the last six years. Economists agree that the GDP will maintain an average growth of between 4 to 5 percent for the next 3-4 years despite negative external economic pressures in 2008, resulting from the mortgage crisis in the United States. The forecast was based on the assumption that the macroeconomic conditions such as prudent fiscal policies, investor friendly environment and political stability will be maintained. Yet, despite the optimistic economic and political forecasts, reduction of poverty and extreme poverty is not as fast as desired. The United Nations Development Programme estimates that about 40 percent of Salvadorans and 36 percent of Hondurans lived with less than \$2 USD per day. (Estimates based on 2005 data) Thus reducing poverty continues to be the biggest challenge for governments in the twenty-first century.

**2. 1. BENEFITS:** A new type of economic and political leadership emerged in CENTAM during the late 80s and early 90s. Influenced by the internal social conflict, they decided to break away from the traditional elitist groups that had dominated the political and economic scene of the past, and attempted to charter a new way into the

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<sup>42</sup> ROBINSON, op.cit., ver nota 1, p. 20

future. These new breed of leaders, for the most part in the United States and Europe, were instrumental in transforming the economic policy of El Salvador and Honduras and ushering these countries into market-democracies. Sponsored by progressive elite elements and supported by external governments, they were responsible for translating external ideas and pressures, i.e. the Washington Consensus and IFI's advice, into political-economic policies. Branded as "technocrats", they were able to transform CENTAM's economies because of their connection with the private sector and placement in government or the political parties that came into power. The US sponsored economic "think tanks" (FUSADES in El Salvador and FIDE in Honduras) served as an incubator for the political-economic policies that would guide CENTAM. The technocrats positioning was key in the designing and implementing the economic agendas during the Cristiani era in El Salvador and the Callejas era in Honduras.

Because of the relation between their highly developed technocratic skills, and political orientation and leadership, Jorge Dominguez named them "technopols".<sup>43</sup> According to Dominguez, technopols are "political leaders at or near the top of their country's government or political life (including opposition parties); who go beyond their specialized expertise to draw on various different streams of knowledge, and who vigorously participate in the nation's political life for the purpose of affecting politics".<sup>44</sup> The concept of technopols, although developed based on South American experience, is applicable to CENTAM. They represented, in the case of El Salvador and Honduras, young, well-educated and transnational oriented professionals, who were sponsored and nurtured by external governmental agencies. They formed "think tanks or blocs" which were responsible for devising national economic and political strategies aimed at ushering CENTAM into the globalized economic world. They also formed a new "middle to upper socioeconomic class" that significantly strengthened the democratic process.<sup>45</sup>

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<sup>43</sup> DOMINGUEZ, Jorge I., ed., *Technopol: Freeing Politics and Markets in Latin America in the 1990s*, University Park, 1997, p.215

<sup>44</sup> Id

<sup>45</sup> ROBINSON, op.cit., see note 1, p. 213-215

The next sections will discuss the political, economic and social benefits that resulted from the economic changes brought on by the technopols' policies.

**2. A.1 POLITICAL:** There are three points of views on economic globalization and its effects on democratic governance: one point argues that economic globalization strengthens democracy; a second point of view argues the complete opposite; and a third one argues that its effects on governance are minimal if any at all. Let us examine the first one:

- **Strengthens Democracy:** The promotion of democracy became a priority as the threat of communism faded. The economic web created by the global production system forced states to charter a political and economic course in which external and internal actors exert great pressures on the governments.

Transnational corporations (TNCs), International Finance Institutions (IFIs), and foreign direct investments represent external actors. These external actors will not invest or will move their investment if the government does not provide certain guarantees. Among these guarantees are property rights, institutional order and governance. Thus, the external actors exert great pressure and supervision of a country's governance, liberties and rule of law. If a government should deviate from the minimum acceptable standard of behavior, it may cause the external actors to pack up and go, leaving the country in a very difficult economic and political situation.

Economic globalization encourages economic development. Economic growth, specially sustained economic growth, has the immediate effect of increasing the size of the middle class as well as the "trickle down effect" that improves some of the conditions of the poor and reduces poverty.

Historically, the middle class of a nation is closely associated with strong democratic values and principles. Thus, it becomes the strongest internal actor exerting pressure on the government to maintain a democratic system.

Economic competition amongst states will lead to improve education as governments realized that education is fundamental in order to raise competitiveness. Better-educated middle class constituencies will strengthen the nucleus of a democratic society in which economic growth and political maturation go hand in hand.

As economic globalization advances as the only viable economic developmental model, authoritarian regimes are opening their economies. The opening increases their constituencies' interaction thru information flow and contacts with the outside world. Information spreads ideas contrary to authoritarianism (less or no liberties) and in favor of democratic values (more liberties). "Nations face greater pressures from external actors to increase their economic and political liberalization."<sup>46</sup> To a certain extent, we are seeing this phenomenon in China and in Cuba. Many analysts believe that the Chinese government's main concern is to remain in power as they face increased pressure from its population to reform the system.

Recently, Cuba began to relax its restrictive policies on some sectors of its economy to include the computer and internet sector. Computers are now available for purchase by ordinary citizens and the internet access is being relaxed.

An additional benefit created by democracy (market democracies) is that it prevents conflict. Democratic states rarely fight each other, in great part because commercial interests only flourish in a peaceful and political stable environment.<sup>47</sup>

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<sup>46</sup> QUAN, Li, REUVENY Rafael, *Economic Globalization and Democracy: An Empirical Analysis*, British Journal of Political Science; Jan 2003; Research Library p 29.

<sup>47</sup> Id.

**- Strengthens Institutions:** FDI will arrive to a country but as soon as confidence is shaken, it will leave. This forces the preservation of a stable political climate, regardless of a power or political ideologies shift. Should that climate be shattered, the investment will move to other states.

Economic globalization requires political stability, sound economic policies and rule of law. It also requires development of infrastructure and improved education. States do not have a choice but to invest in governmental institutions such as the judicial system, economic management, infrastructure development, and education just to name a few areas. It also requires rule of law, i.e. security and property rights, prompting the judicial system and the state security apparatus to become more efficient.

As an added benefit, the constituencies demand government transparency and accountability, thus curbing or making governmental corruption more difficult.

## **2. A. 2 ECONOMIC:**

**Economic growth:** Sound macroeconomic policies and opening of the economies to trade and investment are key factors but cannot by themselves achieve and sustain economic growth. Therefore, governments have to develop a variety of complementing economic growth strategies and foment governmental institutions that support market economies. Free trade should be seen as a tool to achieve growth but it is not an end in itself.<sup>48</sup>

CENTAM has enjoyed sustained economic growth for the past decade as a direct result of the economic globalization and the policies associated with this economic model. El Salvador's GDP growth rate shows a steady increase since 2003 from less than 2 percent to over 4 percent in 2007. Honduras GDP growth

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<sup>48</sup> RODRIK, Dani. *One economics, many recipes: globalization, institutions, and economic growth*. Princeton, 2007. p 44

is even more dramatic, showing an increase from a 3.4 percent in 2003 to a 6.4 percent in 2007.<sup>49</sup>

The *maquila* industry and remittances from abroad are mayor contributors to the economic growth. *Maquilas* represent foreign investments and remittances are the product of emigration, both factors of globalization.

Investment in infrastructure development has also increased tremendously. Three key development projects in El Salvador are worth mentioning: Salvador's international airport is considered the most modern in Central America. It serves as a hub to Transportes Aereos del Continente Americano (TACA), a Salvadoran air transport company whose original scope was to compete with other CENTAM companies but grew into a continental reaching company. The construction of the seaport at La Union started in 2007. Its construction is being made possible by strong foreign investment. The cross-country road system is continually being improved and much of the country is now covered by four-lane highways.

Honduras infrastructure development, according to Canfield from the Public Private Infrastructure Advisory Facility of the World Bank, results revealed mixed outcomes.<sup>50</sup> According to Canfield, the predominant provider of infrastructure services (roads, ports, telecommunications, electricity and water/sanitation) has been the state. The private sector takes over only when the public sector is not able to meet the public demand, i.e. water tankers provide water when needed instead of the private sector taking over the water distribution system. However, during the past decade, the Honduran government has allowed, although at a very slow and deliberate institutional pace, the participation of the private sector in service areas where the public sector, thru government run enterprises, has been the only actor.

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<sup>49</sup> EIU Viewswire, Country Outlooks, *Economic Structure*, NY, Feb 20 2008

<sup>50</sup> CANFIELD, Dorothy Fisher, Public-Private Infrastructure Advisory Facility, *Private Solutions for Infrastructure in Honduras*, World Bank Publications, 2003, p. 160

In the transportation sector, maintenance contracts have been awarded to private contractors. The country's four international airports were awarded to concessionaires thru contracts during the early 2000s. Also in 2000, the municipal government of San Pedro Sula (Honduras principal industrial city) awarded a water and sewage concession contract to an Italian company. In the electric sector, power purchase agreements (PPAs) significantly expanded the energy supply. The PPAs, account for almost 37% of the total electric generation. They were instituted by the government after an energy crisis in 93-94, account for almost 37% of total generation. Additionally, the billing process has been outsourced. In the telecommunications service, private companies provide the cellular, cable and internet services.<sup>51</sup>

#### **Free Trade Agreements:**

- CAFTA-DR will enhance growth and have a positive impact on the reduction of poverty. However, analysts agree that the impact will much smaller than originally expected unless the governments actively promote the trade benefits and increase the investing in infrastructure and education. CAFTA-DR created an investor friendly environment, betting that the inducements would increase the inflow of FDI. The expected surge in foreign investment will benefit ultimately, both urban skilled and rural unskilled population by creating more jobs and improving wages. According to Morley, Nakasone and Pineiro, the benefits of CAFTA-DR are currently small but positive, but they have the potential for growth. However, it requires that the governments take a more active role in managing this sector of the economy.

- European Union (EU) and Central American Bi-Regional Association Treaty: This treaty is currently under negotiation. Its 2nd round of discussions took place in Brussels, Feb 2008. The negotiations cover

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<sup>51</sup> CANFIELD, Dorothy Fisher, Public-Private Infrastructure Advisory Facility, *Private Solutions for Infrastructure in Honduras*, World Bank Publications, 2003, p. 160

three areas: Political dialogue, Cooperation and Trade. Central American exports to the EU are about 15 percent of their total exports and the EU exports to Central America are about 11 percent. Once this treaty is implemented, it will create additional economic and political benefits for Central America.

Morley concluded that growth could be increase in three ways: already employed resources can be moved to a sector where they are more productive; second, the structure of demand can be change in order to increase the demand for unskilled labor which is what the *maquila* does; and third it will increase investment and consequently supply of capital.<sup>52</sup>

**FDI attraction:** The openings of economies continue to attract foreign direct investment. According to the Economic Commission for Latin America and the Caribbean (ECLAC), CENTAM experienced a significant FDI growth as their governments pursued market democracies. The figures also appear to suggest that the investments' peaks and valleys are directly correlated to industry privatization and *maquila* investment.

El Salvador experienced a boom in FDI largely due to the privatization of public held industries and banks. Private enterprise investments in the *maquila* industry and other service sector businesses ventures such as call centers account for a considerable amount of DFI also.<sup>53</sup>

Honduras has experience a significant progressive FDI increase between 2000 and 2006 due mainly because of positive macroeconomic policy and legislation designed to improve the investment climate. Out of the total foreign investment in 2006, almost 38 percent was invested in the *maquila* industry with the remaining in other sectors such as transportation, communication (cellular) and consumer

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<sup>52</sup> MORLEY, Samuel, *The Impacto f CAFTA on Poverty, Distribution and Growth in El Salvador*, Dec 2007, <http://www.ifpri.org/pubs/dp/ifpridp00743.asp#dl>, Feb 2008

<sup>53</sup> Banco Central de Reserva El Salvador, Statistics, <http://www.bcr.gob.sv/index.html>, Feb 2008

goods. If further liberalization and deregulation are achieved, depending on the governments' political ability to continue reforms, the telecommunication and energy sector may attract a substantial increase of FDI.<sup>54</sup>

<b>FDI FLOWS INTO LATIN AMERICA AND THE CARIBBEAN, BY COUNTRY, 1990-2004</b>								
<i>(US\$ million)</i>								
	<b>1990-1995 b</b>	<b>1996-2000 b</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>El Salvador</b>	<b>19.4</b>	<b>309.5</b>	<b>278.9</b>	<b>470.0</b>	<b>3.275.4</b>	<b>3,655.5</b>	<b>4,260.</b>	<b>4,448.</b>
<b>Honduras</b>	<b>42.5</b>	<b>166.1</b>	<b>304.2</b>	<b>275.2</b>	<b>402.8</b>	<b>546.7</b>	<b>599.5</b>	<b>674.1</b>

Source: Banco Central de Reserva El Salvador y Banco Central de Honduras

**Employment:** The tremendous increase in the *maquila* industry generated over 210,000 direct hire jobs in El Salvador and over 125,000 in Honduras.

Additionally, estimates place over a million indirect jobs in both countries as a direct result of the direct hire jobs. Although the value added is relatively small, the industry does provide income to thousands of families that would otherwise have no job or in the majority of the cases, live in rural areas in poverty or extreme poverty.

El Salvador's *maquilas* are shifting away from traditional low-wage, garment-assembly operations toward the delivery of value-added, high-end apparel and other non-textile products. According to Ricardo Sagrera, president of the textile group Hilasal, enhanced two-way trade is helping El Salvador capitalize on its comparative advantages -- notably its legendary work force and its proximity to the U.S. -- making it more competitive with China.<sup>55</sup>

<sup>54</sup> Banco Central de Honduras, Flujos de inversion Extranjera, <http://www.bch.hn/index.php>, Feb 2008

<sup>55</sup> Banco Central de Reserva de El Salvador, op.cit. ver nota 46

In Honduras, some of the textile *maquilas* are being replaced by other production activities such as car parts, furniture, electronic components and food processing.<sup>56</sup>

Honduras and El Salvador can optimize their comparative advantage that includes closeness to the US, large labor pool, and FTAs, in order to improve their competitiveness for the US and other overseas markets.

### 2. A.3 Social

**Poverty Reduction:** The jobs created by the opening of the economic system have benefited a substantial amount of the citizenry but certainly have not alleviated poverty as expected. Although, the effects of the FTAs and overall FDI on poverty reduction and growth rate are positive, they are not enough to reduce poverty substantially, unless the government and private enterprises' investment grow significantly.

**Labor wages:** Economic globalization continues to provide jobs and economic growth. It has improved to a certain extent, the worker's condition. First, it has provided sources of employment, even though the pay may not be up to developed nation's standard, it provides a paying job that they might otherwise not have. Second, the increased demand in labor has a secondary effect of raising the wages in other sectors of the economy. Unskilled labor is attracted to the *maquila* industry because the wages are much better than those paid in other sectors of the economy, i.e. the agricultural sector. Third, provisions in many FTAs include a workers compensation packet that benefits labor. These provisions are included in order to avoid legislative resistance during the political approval process or consumer anti-sweatshop indignation.

**Education:** Strides have been taken in order to improve the level of education, however, despite of the efforts, education is still falling short of what is required.

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<sup>56</sup> Banco Central de Honduras, op.cit., ver nota 47

An example of these efforts occurred in El Salvador during 2007. The government, private enterprise and in conjunction with North Carolina State University, developed a plan to establish a textile-production and management school in El Salvador. The purpose was to train personnel, including managers, which could meet the full service (package) challenge. Full package production system ranges from costing the product, producing it and shipping it directly to the retailer. 100 or so *maquilas* have been closed since the multi fiber agreement ended in 2005. The MFA imposed quotas for over 30 years on apparel exports for the US and EU. As the demand from the US for full service increased, El Salvador began looking at how to convert to full package *maquila*. At the time only about 10% had adopted a full package production system. The rest are cut, make and trim (CMT) operations.

## **2. B. COSTS:**

Costs, more than benefits, were evident when CENTAM instituted the economic reforms. Some of these costs associated with economic globalization included erosion of sovereignty and governance, weakening of labor unions and workers rights, and reduction of public investment in social programs. Additionally, increase poverty, unequal distribution of income and a rise in the informal economic sector has resulted. Technocrats argue that the negative social impacts reflect a short-term adjustment to new conditions and will be soon turned around. However, after over a decade of globalization, the problems persist and a solution does not appear to be. Increase poverty, unequal distribution of income and a rise in the informal economic sector has resulted.

Following the advice based from the “Washington Consensus”, state owned enterprises were sold at bargain prices. The expectation was that once they were privatized, the constituencies would receive better service at lesser costs. What constituencies got was completely the opposite – poorer service at increased cost. Although theoretically it

privatization was a sensible idea, the way that the governments went about privatizing was flawed and corrupted. The process lacked government oversight and regulation.

Globalization erodes the state's autonomy to legislate and regulate. Governments are pressured to enact policies in order to attract foreign investment. These policies may negatively impact large segments of the citizenry in the short term. In CENTAM, they were referred to as "shock therapy" or the "paquetazo" in Honduras. The terms given reflect what the common people endured when the system went from paternalistic subsidies to open markets, competition and efficiency. Additionally, social spending was reduced in order to improve the infrastructure needed to make the state more attractive to FDI.

Labor unions and labor rights were weakened also. Due to the temporary nature of the TNCs' investment in the *maquila* sector, labor felt in constant fear of losing their jobs. Unions lost membership. Governments were reluctant to intervene in their favor because they too feared that capital would leave at the first sign of labor unrest and with it the jobs that had been created.

Additionally, a more dangerous cost is the potentiality for an economic crisis. Globalization enables the fast movement of money between countries that may result in economic crises and unstable domestic economic performance.<sup>57</sup>

According to Bhagwati, economic globalized states, must confront fears that although economic globalization is benign in the sense that it increases trade and production, it is socially malign, because of its inherent characteristics, i.e. income distribution gap, erosion of labor rights, and environmental damage among others.<sup>58</sup>

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<sup>57</sup> QUAN, REUVENY, *op.cit.*, see note 40, p. 53

<sup>58</sup> BHAGWATI, *In Defense of Globalization*, Oxford University Press, NY 2004, p. 30

**2. B.1 POLITICAL COSTS:** “Economic globalization promotes democracy but at the same time constrains it”.<sup>59</sup> This statement seems to hold its ground, directly and indirectly, internally and externally and in both democratic and authoritarian states.

Democracy is constrained because governments have to yield to external and internal actors’ pressure to create investor friendly environments and to stay within the free markets boundaries. Wages cannot be raised beyond a certain level because raises may cause *maquilas* to move to other states where the profit margin may be greater. Open trade dynamics imply that states may lose some of its ability to govern. The weaker the state the more sovereignty it may lose in order to comply with the demands that other more developed states place upon the system.

Social programs may suffer because of budget constraints or budget diversions. With limited amount of resources, legislatures may focus their priorities at funding infrastructure projects, roads, energy, water, air and seaports at the expense of health, education, or security. Effectively, external and internal pressures can force government’s officials to enact unpopular legislation in the short term, thus creating public discontent.

**Erosion of sovereignty:** States entering economic globalization and opening their economies to outside influence in the form of direct investment must first create an environment that satisfies the prerequisites of the companies looking to do business within that country. These companies are not bound to any particular country but are loyal only to profit margin. Therefore, a state must accommodate its legislation, provide infrastructure and other fiscal incentives in order to remain competitive and attract FDI. In essence, the state may be caving in to outside pressures, at times, disregarding its own constituency.

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<sup>59</sup> Id, p.92

Salvadoran and Honduran governments face the dilemma of what is the better of two evils --- jobs at a social, political and economic cost or no jobs at all.

**Populism: Movement to the left:** As governments that adopted free market policies failed to deliver on their economic promises, some states shifted to populist, center left leaders. This is the case of Chile, Brazil, Nicaragua and others.

In Brazil, Lula, a populist and left leaning politician, upon assuming power, embraced tough macroeconomic policies and reversed his anti trade position. His economic policies brought economic well-being to Brazil and won him a second term in office.

In El Salvador, it is possible that the opposition party's candidate wins the 2009 presidential election. If it wins, many analysts will consider the opposition party's victory, as a sign of frustration with the current economic model failing to deliver overnight an economic bonanza for everybody. However, the last four FMLN's candidates strong anti economic globalization, anti dollarization and populist rhetoric in general failed to win the popular vote and failed in their presidential quest. The current opposition candidate, a "technopol" himself, is distancing himself from the old party guard and is considered to be more political centrist. Although he brandishes the populist rhetoric, many analysts believe that even if he should win the presidency, the economic policy will not suffer a substantial deviation from that of the current and past administrations.

By contrast in Honduras, the two main political parties have shared the presidency in Honduras since the current economic policies were enacted under president Callejas. The Partido Nacionalista Hondureno (PNH), a conservative center right party, has been in power twice and the Partido

Liberal Hondureno (PLC), the liberal party, has been in power three times. Both parties have enacted economic reforms and their macroeconomic policies have not deviated from the chartered course set in the early 90s.

**Small Nation Independence:** This concept is argued by Spolaore and Wacziarg.<sup>60</sup> They argue that economic globalization constrains smaller nation's sovereignty and forced them to merge into larger blocs or unions in order to be able to compete in an interdependent world. In essence, they subordinate their preferences and choice under the larger whole.

This concept may be supported by the explosion of free trade agreements, some of which are made between blocs of small countries with a larger more powerful country. In the case of CENTAM, CAFTA-DR is an example where several countries collectively bargain with one. The same model is being pursued with the European Union, where the Central American Common Market countries are bargaining a free trade agreement with the European Union.<sup>61</sup> What this implies is a political cost as well as an erosion of sovereignty.

## **2. B.2 ECONOMIC COSTS:**

**Income gap:** Latin America reflects the highest level of wealth inequality in the world. This is an irrefutable statement made by just about every organization and analyst in the world.<sup>62</sup> Despite statistics reflecting sustained economic growth, a small reduction of poverty levels and a growing middle class, income inequality and income gap has not diminished. On the contrary, most analysts' projections and statistics not

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<sup>60</sup> ALESINA, Alberto; SPOLAORE, Enrico, WACZIARG, Romain, *Economic Integration and political disintegration*, The American Economic Review, Nashville, Dec 2000, Vol. 90, Iss 5; p.1276, pgs. 26

<sup>61</sup> SICA, *Acuerdo de Asociacion Union Europea y Centroamérica*, <http://www.sica.int/sgsica/>, Mar 2008

<sup>62</sup> FRECHETTE, Myles, *Rethinking Latin America: A new Approach in the US Foreign Policy*, Harvard International Review. Cambridge: Summer 2006. Vol. 28, Iss. 2, p. 28-31

only suggest that it has grown but that it reflects the greatest inequality in the world.

Additionally, the achievement of the first Millennium Development Goal (MDG), which is the reduction by half of the population living in extreme poverty, is unlikely to be met by the year 2015. Critics blame governments' weak institutions and rampant corruption, as responsible for failing to achieve this goal and ensuring a more equitable distribution of wealth.

### **2. B.3 SOCIAL COSTS:**

**Erosion of social programs:** As governments try to make their countries more attractive to foreign capital, they have to invest in the country's infrastructure, i.e. roads, electricity, water, telecommunications, ports and airports. Limited resources and budgets forced them to reduce funding for sectors such as defense and social programs in order to be able to invest in the infrastructure. Foreign investment, concessions to private enterprises and other forms of financing infrastructure projects are available but in the end, some governmental sector's funding have to be reduced or the projects not executed. Investment in education in El Salvador and Honduras averaged about 2.5 percent of the GDP between 2002 and 2005. By comparison, Mexico' and Brazil's is about 5.5 percent of their GDP during the same period.<sup>63</sup> This indicator may reflect the government's lack of commitment to education and points out a government's fallacy because education is intricately related to the success of a state in a global economy.

- Costa Rica and Intel's investment: "Costa Rica initially won Intel over with its highly educated workforce. But now we see a healthy

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<sup>63</sup> UNITED NATIONS DEVELOPMENT PROGRAMME, 2007 Development report, <http://www.undp.org/>, Feb 2008

follow-on effect, in which young students are encouraged in their studies by the prospect of a job at a gleaming multinational. Intel's investment and presence have had an overwhelmingly positive impact on Costa Rica, generating both direct and multiplier effects on the country's economy, industry, educational institutions and business culture. Intel's requirements served as an important motive for the country to immediately upgrade its infrastructure and enhance the investment climate to the benefit of all investors. The process of attracting Intel to Costa Rica helped shape the country's investment promotion strategy".<sup>64</sup>

**Poverty and Income gap:** Statistics differ somewhat, but 2005 estimates indicated that the poverty index is quite high - about 50 percent in Honduras, and 37 percent in El Salvador.<sup>65</sup> Although governments have managed to reduce poverty somewhat, it remains the biggest challenge. This seem to confirm what many analysts proclaim – that free trade or the global economy – is a tool, probably the best tool that governments have, to combat poverty but by itself it is not the cure or solution for eradicating poverty.

Additionally, sustained GDP growth statistics do not reflect the widening of the economic gap or the unequal distribution of wealth. Top 10 percent of the population amasses 50 percent of the wealth and 50 percent less than 10 percent of the wealth.<sup>66</sup>

Theoretically, economic globalization would help reduce income inequality by generating jobs and increasing citizen's economic opportunities, however in Latin America, quite the opposite is true.

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<sup>64</sup> WORLD BANK, The Impact of Intel in Costa Rica, <http://www.bancomundial.org/> Oct 2007

<sup>65</sup> UNITED NATIONS DEVELOPMENT PROGRAMME, 2007 Development report, <http://www.undp.org/>, Feb 2008

<sup>66</sup> Id.

**Erosion of workers rights:** Competition for foreign investment may pressure governments to provide as much fiscal and monetary incentives as they can in order to make the country more attractive. These incentives may affect workers' rights, like association, compensation, benefits and monetary incentives. Workers unions' and labor movements' bargaining power have been substantially diminished. In part, this is the result of a global economy where TNCs will establish their production units wherever the cost of production is the cheapest.

The *maquila* industry in CENTAM is part of the globalized production system. *Maquilas* employ relatively unskilled labor. For example, it is relatively easy to set up a textile *maquila* and is just as easy to pack up and leave. Thus, workers employed by the *maquilas* are afraid of losing their jobs if labor unions confront management seeking better working conditions and benefits. Governments may opt to ignore violation of workers rights because they rather have employment, even if it pays minimum wages, than not having employment at all.

***Case Study: "El Salvador's Just Garments"***

Just Garments traces its roots to a *maquila* union organizing campaign at a Taiwanese *maquila*, Tainan Enterprises, in El Salvador during 2001. The union, the Sindicato de Trabajadores de Industrias Textiles (STIT), won legal recognition in July 2001 but faced typical anti-union reaction by the company's management, including the firing of union leaders and other workers. STIT was supported internationally by the International Textile, Garment, and Leather Workers Federation (ITGLWF), the AFL-CIO, and USLEAP, as well as by other Salvadoran NGOs.

Tainan's US clients included Kohls, Target, and Gap. While Kohl's and Target proved unresponsive to requests for intervention, Gap engaged Tainan once it was requested by the union and its allies. While Gap accounted for a small part of Tainan's production in

El Salvador, it was one of Tainan's biggest customers globally. Tainan was eventually persuaded to reinstate the fired union leaders in late 2001 and agreed to meet with a "labor committee" to resolve problems.

In 2002, the union asked for contract negotiations. A week later, Tainan shut down its Salvadoran operations, prompting a vigorous international campaign against them. The campaign was characterized by close and an unusual tri-national coordination between Salvador (STIT and CEAL), the Taiwanese NGO Focus on Globalization, and groups in the U.S. (USLEAP).

The campaign forced Tainan to a second round of negotiations, leading to a resolution in late 2002. The resolution marked a significant labor victory. For the first time, Central American workers won the reestablishment of a *maquila* factory that had been shut down in the face of union organizing. Tainan agreed to the establishment of a new company, with a board of directors comprised of one representative from Tainan and one from the worker side. Tainan also agreed to provide machinery and initial capital to get the unionized factory off the ground and to provide technical support. In April 2003, the new venture was launched as Just Garments.

Just Garments was hailed as a major victory by the labor movement, especially important in El Salvador where independent unions had until then been unable to win a collective bargaining agreement despite numerous efforts.

However, Just Garments was plagued by mismanagement, lack of capital and inability to compete. Finally in May 2007 Just Garments was closed. The closing of Just Garments marks a sad end to a valiant effort to establish a unionized *maquila*. Despite efforts by the workers and the plant's administration, Just Garments was not able to overcome the opposition of local forces, the cut-throat nature of the apparel industry, the lack of

development of the sweat-free market in the North, and its unique approach of essentially operating as a unionized cooperative.<sup>67</sup>

The above case study is an example of the erosion of workers rights caused by economic globalization. Their highly competitive nature coupled with the TNCs desire for profit makes fighting for workers rights extremely difficult, especially if the enterprises are employing semi-skilled labor.

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<sup>67</sup> US Labor Education in the Americas Project; *Just Garments Closes; Forced to End Effort as Sweat-free Producer*; <http://usleap.org/node/394>, Mar 2008

### CHAPTER III ECONOMIC GLOBALIZATION AND GOVERNANCE

**Governability:** During the past ten years, countries embarked in an economic reformist path that led to trade liberalization and export-led growth Democracy has taken root in the region. The civil armed conflict that characterized the region for more than two decades ended and the scars have all but healed. Yet, discontent, frustration and dissatisfaction with the current political economic system permeated society. Elected governments have failed to meet societies' expectations. They have failed to fulfill their contractual obligation – provide life, liberty and the pursuit of happiness – translated into security, strong democratic institutions and governance and social wellbeing - to their societies. Historically, these have been the causes of civil unrest. “The perception that democracy has still not responded to the aspirations of the region’s poor brings home to us the need to make the fight against poverty and extreme social inequality a regional priority”.<sup>68</sup>.

Although economic globalization has strengthened democracy in Central America, it has also eroded it. Erosion occurs when states modified their obligations and enact policies in order to comply with external demands or when seeking foreign investment and new economic opportunities from abroad. Entering a globalized world at a shock pace is a no win proposition and many states have paid the economic price for doing so. So perhaps what Honduras has done, entering in a managed and methodical manner, is the best course of action. For one, it serves to protect the constituencies from economic shocks similar to what happened in Argentina and Russia.

The state has a role in protecting individuals from economic adversities. Economic globalization is not a perfect system and institutions should take preventive measures to protect its society. It is up to the state to manage the pace in which the state enters a globalized economy and to protect its society from adversity. “But the way globalization

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<sup>68</sup> BAN KI-MOON, *Crime and Inequality still holding Central America Back*, UN News Centre, <http://www.un.org/apps/news/story.asp?NewsID=22897&Cr=central&Cr1=america> June 2007

has been managed has eroded the ability of the state to play its proper role; and the root of this problem lies in the global political system- if such can be called".<sup>69</sup>

However, El Salvador's and Honduras' are in a position to seize and capitalize on the opportunities that are presenting themselves. In order to do so, the government must invest on its institutions and enact good policies in order to ensure that the benefits are shared throughout the economic spectrum.

**Strengthening of Democracy:** Radical shifts towards an undemocratic system are highly unlikely to take place within the economic globalization context. If a government chooses to change, the immediate effect would be capital flight, reduction or complete retraction of foreign investment and emigration. The effect on the economy would be disastrous. Thus, Economic globalization does strengthen democracies mainly because the economic downfall of an alternative is too negative to contemplate.

**Effects on Institutions:** El Salvador and Honduras have enjoyed an unprecedented era of democracy and sustained economic growth. The future, with the exception of the current real state crisis in the United States, looks bright. The countries embarked in a series of free trade agreements that should improve their economic lot. They continue to maintain the economic political course chartered over fifteen years ago with minor modifications. So what is the problem? Citizens in both countries are plagued by uncertainties, discontent with the current state of the nation and frustration with the current system. Many ask: when will the poor start enjoying the benefits of the current economic bonanza? When is society going to safe and secure? The answer clearly lies with the strengthening of the institutions and the exercise of good governance.

It is undisputable that private investment is crucial to sustained economic growth but by itself, it is not enough to reduce poverty. Institutions must design a more equitable distribution of wealth, and provide basic services to the constituencies. Therefore, the

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<sup>69</sup> STIGLITZ, Joseph the social costs of globalization, financial times, London edition 1, p.19  
[http://www2.gsb.columbia.edu/faculty/jstiglitz/download/opeds/Social\\_Costs.pdf](http://www2.gsb.columbia.edu/faculty/jstiglitz/download/opeds/Social_Costs.pdf) Feb 2005

problem per se is not the economic system failing to reduce poverty, but the problem lies with governments not exercising good governance. Democracy is not only about electing a public official to office, but is the complete participation of society in the different governmental sectors. It is about transparency, accountability, and balancing economic policies with social ones. It is about having the opportunities to be educated and successful in life. According to the UNDP, human development must orbit around three capabilities: people must live long and healthy lives; they must have access to education and knowledge; and they must have a decent standard of living.

If the system is not working as desired or it has not met society's expectancies, then the answer is not to radically change the system but to strengthen the institutions that can modify system. It is about making the government accountable and transparent and thus eliminating the pervasive corruption that plagues all levels of society and government. "In a sense, our countries have to use all of the instruments at their disposal...in order to guarantee greater security to all of our citizens".<sup>70</sup>

Countries cannot copy institutions or management styles from one another because there are no blueprints that would fit every country. Differences in societies, environment and idiosyncrasies will dictate how are institutions developed and operated. Thus, even though there is not set of institutional blueprints or how to develop and strengthen them, "empirical evidence points to a clear link between the quality of institutions and economic growth".<sup>71</sup>

## **POVERTY:**

Despite the positive indicators and outlook, poverty remains quite high and income inequality in Latin America is the highest in the world. However, positive indicators failed to tell the whole story. The government and its institutions have to make a concerted effort to target reforms and assistance packages to help the poor benefit from

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<sup>70</sup> INSULZA, Jose Miguel *El Potencial de America Istina en los Proximos cinco anos*, Foreign Affairs en Espanol, <http://www.foreignaffairs-esp.org>, Oct 2007

<sup>71</sup> KOHLER, Horst, *Seizing the Opportunities of Globalization in Central America*, IMF, <http://www.imf.org/external/np/speeches/2003/072103.htm>, Mar 2008

the economic boom. Special emphasis should be place in education and other types of social nets in order to ensure that the self-fulfilling cycle of poverty.

### **INTEGRATION:**

Regional integration must continue in order to ensure continued economic growth. . SICA and the CACM are examples of how regional cooperation enhances growth. CENTAM stands to reap more benefits from its association with larger countries if they bargain, produce and trade as a bloc. Their economies are small, thus they need to explore and develop other markets. However, cooperation and integration should be taken one-step further. CENTAM should increase its efforts to continue developing cross border infrastructure projects. The electric grid is a good example of how this cooperation leads to economic growth that translates into prosperity. Perhaps another area for integration could be the banking system and the creation of a common currency.

## CHAPTER IV: PERSPECTIVE

El Salvador and Honduras political and economic perspective is positive. They have achieved political stability, i.e. democracy has taken root, and analysts predict sustained economic growth for the next 3 to 4 years. However, reduction of poverty and extreme poverty remains an elusive proposition and their societies are being threatened by crime and insecurity.

Economic globalization eroded democracy to a certain degree. It has created more benefits than costs. It is the government's most important system to bring prosperity to their societies and to preserve and strengthen democracy and institutions. However, globalization by itself will not eliminate poverty. Good governance, rule of law, and social investment are other factors that have to contribute to social development.

CENTAM should concentrate on five key points in order to consolidate their economic and political gains. These are economic and political integration, social investment, institutional strengthening, economic proofing, and seeking alternative growth strategies and developing a CENTAM economic model.

Most importantly, CENTAM's main effort should be to develop an alternative or modify the current developmental model in order to address social problems effectively.

**Integration:** The benefits of integration, especially for countries with small markets and economies, are positive. CENTAM should continue its efforts to integrate politically and economically. The Central American Common Market (CACM), the Sistema de Integracion de Centro Americana (SICA) and the Conferencia de Fuerzas Armadas (CFAC) are leading the integration effort. As a block, CENTAM successfully negotiated a free trade agreement with the United States and is currently seeking to enter into one with the European Union.

**Social investment:** A basic requirement for successful globalization is that governments have to invest in education. For CENTAM, the most important resource is its people. An

educated labor force can transform the textile *maquila* industry into high-end service and production centers as with the case of Intel in Costa Rica.

**Institutional strengthening:** CENTAM's institutions must strengthen if governments expect to reduce poverty and insecurity. Educating civil servants and the bureaucracy, increasing their productivity, making them accountable and demanding transparency of their institutions and officials are some of the actions that government could take in order to breathe new life to their institutions.

**Prevent economic crisis:** Governments should develop strategies in order to prevent or lessen the impact that an economic crisis may have on the state. Some of these strategies may include diminishing the impact of natural disasters, emergency economic relief funds and developing an improved social welfare network.

**Alternative growth producing strategies:** These may include the merging of similar oriented enterprises like in the case of Transportes Aereos del Continente Americano (TACA). TACA is a Salvadoran company that during the early 90s was joined by other Central American aviation companies. TACA's management convinced the other airlines that if they did not consolidate their operations they would not survive in globalized world. TACA grew substantially and now operates throughout the hemisphere.

Another strategy may be "export flagships". They refer to the creation of a country brand and use it to export products. "Country branding, defined as the development of a strong, and unique international brand identity, is playing an increasingly significant role on the global economic stage"<sup>72</sup> "Export flagships" is a strategically selected product or service that represents the country of origin; the product is unmistakably associated with that country, i.e. Juan Valdez coffee beans – Colombia, and the product has to be competitive in the global market.

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<sup>72</sup> FLOREK, Magdalena, CONEJO, Francisco, Export flagships in branding small developing countries: The cases of Costa Rica and Moldova", Place Branding and Public Diplomacy, Vol.3, No. 1, Mar 2007

CENTAM has the natural and cultural wealth that should be exploited thru the development of a world-class tourist-service industry.

**Central American Development Model:** Not too long ago, the Economic Commission for Latin America and the Caribbean (ECLAC) under the leadership of Raul Prebisch developed Latin America's structuralist theory, commonly referred to as the centre-periphery paradigm. The theory grew out of the critique of existing economic theories. Perhaps it is time for another Prebisch to develop an alternative theory or at least modify the current ones in order to deal more effectively with the social injustice that millions of Latinos live today.

## CHAPTER V CONCLUSION

The problem with economic globalization is one of governance, policy implementation and dividend reinvestment. Good governance implies fulfilling the social contract that elected governments have with its citizens, while at the same time, its citizens fulfilling theirs, by actively participating in the local and national decisions. Although it is impossible to stop or change economic globalization, governments can certainly manage the speed, breath and depth of the system's gradual implementation and thus reducing its negative impact on society. At the same time, governments need to maximize the utilization of the economic dividends by reinvesting in its society and infrastructure.

Governments have a choice to make: they either reinvest their earnings in governance, education and infrastructure or they use them to continue with the failed policies of the past – subsidizing social, economic and partisan blocks for political gains.

Good participative governance will ensure transparency in government and thus containing Latin America's endemic corruption in every level of society; it will strengthen the institutions responsible for the rule of law and thus ensure a safe and attractive investment climate; and it will mandate and obligate the government to invest in social programs and truly required infrastructure projects. In the social investment area, education is the key because there is proven direct link between level of education and economic development – if Costa Rica had not educated its workforce, Microsoft would not have built its plant there.

The lack of citizen participation and apathy in the democratic system reduced the confidence in the system. Yet it is not the system that has failed, but rather its citizens have. The problem *per se* is not that economic globalization failed to reduce poverty, but that governments and the electorate have not exercise good governance.

Democracy is not only about electing a public official to office, but is the complete participation of society in the decision making process at the different governmental

levels. It is about transparency, accountability, and the balancing of economic policies with social ones. It is about having the opportunities to be educated and successful in life.

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## TERMS

- **ADDED VALUE:** The difference between the cost of materials purchased by a firm and the price for which it sells goods produced using those materials. The parts of the process that add worth from the perspective of the external customer. The notion of additional benefit being provided by some activity or service.

- **BALANCE OF PAYMENTS:** the total of all the money coming into a country from abroad less all of the money going out of the country during the same period. This is usually broken down into the current account and the capital account. The current account includes:

\*VISIBLE TRADE (known as merchandise trade in the United States), which is the value of EXPORTS and IMPORTS of physical goods;

\*INVISIBLE TRADE, which is receipts and payments for services, such as banking or advertising, and other intangible goods, such as copyrights, as well as cross-border DIVIDEND and INTEREST payments;

\*private transfers, such as money sent home by expatriate workers;

\*official transfers, such as INTERNATIONAL AID.

The capital account includes:

\*long-term capital flows, such as money invested in foreign firms, and profits made by selling those investments and bringing the money home;

\*short-term capital flows, such as money invested in foreign currencies by international speculators, and funds moved around the world for business purposes by multinational companies. These short-term flows can lead to sharp movements in EXCHANGE RATES, which bear little relation to what currencies should be worth judging by fundamental measures of value such as PURCHASING POWER PARITY.

- **BALANCED BUDGET:** when total public-sector spending equals total government income during the same period from taxes and charges for public services. This is usually broken down into the current account and the capital account. The current account includes:

\*VISIBLE TRADE (known as merchandise trade in the United States), which is the value of EXPORTS and IMPORTS of physical goods;

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- **BARREL:** In the oil industry, a barrel is 42 US gallons, approximately equal to 159 liters.

- **CURRENT ACCOUNT BALANCE:** The current account balance is the difference between a country's savings and its investment. "[If the current account balance is] positive, it measures the portion of a country's saving invested abroad; if negative, the portion of domestic investment financed by foreigners' savings."  
The current account balance is defined by the sum of the value of imports of goods and services plus net returns on investments abroad, minus the value of exports of goods and services, where all these elements are measured in the domestic currency.

- **DEREGULATION:** cutting red tape. The process of removing legal or quasi-legal restrictions on the amount of competition, the sorts of business done, or the prices charged within a particular industry. During the last two decades of the 20th century, many governments committed to the free market pursued policies of liberalization based on substantial amounts of deregulation hand-in-hand with the privatization of industries owned by the state. The aim was to decrease the role of government in the economy and to increase competition.

- **ECONOMIC INTEGRATION (stages):**

- **FTA:** The first level of formal economic integration is the establishment of free trade agreements (FTAs) or preferential trade agreements (PTAs). FTAs eliminate import tariffs as well as import quotas between signatory countries. These agreements can be limited to a few sectors or can encompass all aspects of international trade. FTAs can also include formal mechanisms to resolve trade disputes. The North American Free Trade Agreement (NAFTA) is an example of such an arrangement.

- **CUSTOMS UNION:** A customs union (CU) builds on a free trade area by, in addition to removing internal barriers to trade, also requiring participating nations to harmonize their external trade policy. This includes establishing a common external

tariff (CET) and import quotas on products entering the region from third-party countries, as well as possibly establishing common trade remedy policies such as anti-dumping and countervail measures. A customs union may also preclude the use of trade remedy mechanisms within the union. Members of a CU also typically negotiate any multilateral trade initiative (such as at the World Trade Organization) as a single bloc. Countries with an established customs union no longer require rules of origin, since any product entering the CU area would be subject to the same tariff rates and/or import quotas regardless of the point of entry.

- **COMMON MARKET:** A common market represents a major step towards significant economic integration. In addition to containing the provisions of a customs union, a common market (CM) removes all barriers to the mobility of people, capital and other resources within the area in question, as well as eliminating non-tariff barriers to trade, such as the regulatory treatment of product standards.

- **ECONOMIC UNION:** The deepest form of economic integration, an economic union adds to a common market the need to harmonize a number of key policy areas. Most notably, economic unions require formally coordinated monetary and fiscal policies as well as labor market, regional development, transportation and industrial policies. Since all countries would essentially share the same economic space, it would be counter-productive to operate divergent policies in those areas.

- **ECONOMIES OF SCALE:** Reduction in cost per unit resulting from increased production, realized through operational efficiencies. Economies of scale can be accomplished because as production increases, the cost of producing each additional unit falls.

- **ECONOMIC SUPPORT PROGRAM (fund):** The Economic Support Fund programs of the Department of State in the Western Hemisphere region work to strengthen democratic institutions, civil society, and trade capacity building, to aid in the resolution of regional conflicts, and to assist nations faced with difficult economic and political crises.

- **FISCAL POLICY:** One of the two instruments of MACROECONOMIC POLICY; Policy's side-kick. It comprises PUBLIC SPENDING and TAXATION, and any other GOVERNMENT income or assistance to the private sector (such as tax breaks). It can be used to influence the level of demand in the economy, usually with the twin goals of getting UNEMPLOYMENT as low as possible without triggering excessive INFLATION. At times it has been deployed to manage short-term demand through FINE TUNING, although since the end of the KEYNESIAN era it has more often been targeted on long-term goals, with monetary policy more often used for shorter-term adjustments.

- **FOB, Free On Board:** is a transportation term that indicates that the price for goods includes delivery at the seller's expense to a specified point and no further. The FOB term is used with an identified physical location to determine 1) the responsibility and basis for payment of freight charges, and 2) the point at which title for the shipment passes from seller to buyer.

The FOB location terms, Origin and Destination, may be qualified by modifiers. The modifier determines the payment of the transportation charges. Modifiers denote nothing about the title of the goods or filing of claims. The most three common modifiers are: Collect, Prepaid & Add, and Prepaid & Allow.

- **GINI COEFFICIENT:** is a measure of statistical dispersion most prominently used as a measure of inequality of income distribution or inequality of wealth distribution. It is defined as a ratio with values between 0 and 1: the numerator is the area between the Lorenz curve of the distribution and the uniform distribution line; the denominator is the area under the uniform distribution line. Thus, a low Gini coefficient indicates more equal income or wealth distribution, while a high Gini coefficient indicates more unequal distribution

- **HUMAN DEVELOPMENT INDEX (HDI):** is the normalized measure of life expectancy, literacy, education, standard of living, and GDP per capita for countries worldwide. It is a standard means of measuring well-being, especially child welfare. It is used to determine and indicate whether a country is a developed, developing, or underdeveloped country. It is also used to measure the impact of economic policies on quality of life.

- **INTERNATIONAL OR INTERNATIONALLY:** most often describes interaction between nations or encompassing two or more nations, constituting a group or association having members in two or more nations, or generally reaching beyond national boundaries.

- **LIBERALISATION:** a policy of promoting liberal economics by limiting the role of government to the things it can do to help the market economy work efficiently. This can include privatization and deregulation.

macroeconomic policy

**MACROECONOMIC POLICY:** top-down policy by government and central banks, usually intended to maximize growth while keeping down inflation and unemployment. the main instruments of macroeconomic policy are changes in the rate of interest and money supply, known as monetary policy, and changes in taxation and public spending, known as fiscal policy. The fact that unemployment and inflation often rise sharply, and that growth often slows or GDP falls, may be evidence of poorly executed macroeconomic policy. However, business cycles may simply be an unavoidable fact of economic life that macroeconomic policy, however well conducted, can never be sure of conquering.

**PROFIT MARGIN, NET MARGIN OR NET PROFIT RATIO:** all refer to a measure of profitability. It is calculated using a formula and written as a percentage or a number. Profit margin = Net income/ Net sales revenue

**PURCHASING POWER PARITIES (PPP):** are currency conversion rates that both convert to a common currency and equalize the purchasing power of different currencies. In other words, they eliminate the differences in price levels between countries in the process of conversion.

**TAZA DE POLITICA MONETARIA:** La tasa de política monetaria (TPM), es la tasa de interés objetivo para las operaciones interbancarias que el Banco Central procura lograr mediante sus instrumentos de política monetaria: operaciones de mercado abierto, facilidades de crédito y depósito.

- **TERMS OF TRADE (TOT):** In international economics and international trade, terms of trade or TOT is the relative prices of a country's export to import. An improvement in a nation's terms of trade is good for that country in the sense that it has to pay less for the products it imports, that is, it has to give up fewer exports for the imports it receives.