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ECONOMIC CRISIS AND RECOVERY IN EL SALVADOR, 1978-1992

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INTRODUCTION

El Salvador's economy experienced moderately rapid economic growth during most of the 1970s. Real aggregate GDP rose at an average annual rate of 5.1% between 1969 and 1978, while real per capita GDP grew by 2.5% a year, roughly equal to the Central American average (2.6%) in the pre-crisis decade or so.[1] Per capita consumption, fueled toward the end of the period by a boom in coffee prices, rose by 3.5% a year (Zuvekas and Nassif 1992:5). Meanwhile, political and social conditions in the country were deteriorating. The outbreak of civil war in the late 1970s triggered a sharp economic decline that began in 1979 and was aggravated by the world recession of 1980-82.

This paper begins by briefly tracing the dimensions of El Salvador's economic crisis; discussing the domestic and external factors that made the decline in per capita GDP the second most severe in the region (after Nicaragua's); and examining the policy measures adopted by Salvadoran governments in the early 1980s to overcome the crisis. A similar exercise is then carried out for the period of very slow economic recovery (virtual stagnation in real per capita GDP) between 1983 and 1989, and for the more rapid (but still moderate) recovery since then.

Finally, concluding observations provide some comparisons between El Salvador and Nicaragua and highlight major obstacles to sustained economic recovery and social peace during the remainder of the 1990s. The paper argues that better economic policies since 1990 explain part but by no means all of the improvement in economic performance beginning in that year. It also maintains that El Salvador's economy emerged from civil war in a much healthier condition than that of Nicaragua, which suffered from an internal conflict of comparable destructiveness while receiving a similar amount of external economic assistance.

THE ECONOMIC CRISIS (1978-83)

El Salvador's real per capita GDP peaked in 1978 at about $705 at the price level and exchange rate (2.5 colones to the dollar) then prevailing. Over the next four years it fell by a cumulative 26.4%, and there was virtually no growth in 1983.[2] Per capita private consumption, in some ways a better indicator of living standards, fell by 36.5% between 1978 and 1983.[3] Most of the fall in output occurred in 1980, 1981, and 1982, although the sharpest drop in consumption was in 1979.

Much but by no means all of the economic decline between 1978 and 1983 was caused by the armed internal conflict that began to develop after the traditional elite successfully resisted an attempt by President Arturo Molina and reformist elements in his government to implement a modest agrarian reform program in 1975-76.[4] In 1977 General Carlos H. Romero assumed the presidency through a fraudulent election, ushering in a period of repressive military rule and growing armed resistance to that rule. By 1979 the conflict had been transformed into a civil war that ultimately claimed perhaps 75,000 lives.

In October 1979 a reformist segment of the military overthrew President Romero. But soon thereafter the reformers in the new civilian-military junta were squeezed out, losing power to more conservative groups. The civil war raged on, with the insurgents disrupting agricultural production and marketing, interrupting the transmission of electric power, destroying bridges, burning trucks and buses, kidnapping business leaders, and otherwise contributing to losses in economic output and wealth.[5] On the other side, brutal retaliatory measures by the military and by extreme-right paramilitary groups caused hundreds of thousands of Salvadorans to flee abroad[6] or to become displaced persons within their own country.[7] Capital flight is widely acknowledged to have been substantial over these years, although it is difficult to estimate the magnitude of these outflows.[8]

Unfavorable trends in the world economy were also major contributing factors in El Salvador's economic crisis. The familiar litany of events includes increased prices for imported oil after the second oil price shock in 1979-80; higher world interest rates, requiring greater external debt-service payments;[9] the world recession of 1980-82; and the accompanying sharp decline in the prices of primary export products. Particularly harmful to El Salvador's economy was the drop in the price of coffee, which accounted for 56% of the country's total commodity export earnings during 1976-80. Coffee export earnings fell from an annual average of $533 million during these years (peaking at $675 million in 1979) to $419 million during 1981-83. While some of this decline reflects reduced volume, in part because of the internal conflict, lower prices played more of a role.[10] A sharp drop in exports to El Salvador's partners in the Central American Common Market (CACM), from $296 million in 1980 to $165 million in 1983), further aggravated the economic decline.

In early 1980 the new junta adopted three major programs: (1) a significant agrarian reform, ultimately affecting about 22% of El Salvador's agricultural land (Diskin 1988:443); (2) nationalization of private banks; and (3) nationalization of coffee and sugar marketing. These measures reflected a recognition that the roots of El Salvador's troubles lay in a highly inequitable socioeconomic structure, and that the government needed to correct these inequities to avoid the more radical kind of socioeconomic restructuring advocated by the insurgents of the Farabundo Martí Front for National Liberation (FMLN). The positive impacts of the reforms were expected to be medium- and long-term more than short-term. Indeed, short-term economic disruptions would have occurred even in a peaceful setting.

There is little doubt that the nationalized banking and marketing systems were less efficient than the private services they replaced. In the case of the banks, however, the deterioration in managerial performance was relatively modest because most of the former management was retained. On the other hand, negative real interest rates and directed credit programs (including those for the agrarian reform cooperatives) misallocated resource use, discouraged savings mobilization, and contributed to capital flight. Problems with the nationalized marketing system included the disincentive effects of monopsony buying power and long delays in payments to producers, both of which discouraged maintenance, rehabilitation, and new investment.

It would be a mistake, however, to exaggerate the negative effects of the nationalizations. Real interest rates might have turned negative and directed credit programs implemented even under private bank ownership. Incentives to maintain or increase coffee and sugar productivity were weak in any event because of depressed international prices, the civil war, and an increasingly overvalued exchange rate.[11] Moreover, private coffee marketing before 1980 was hardly a model of competitive efficiency, and it also served as a channel for capital flight.[12]

The effects of the agrarian reform program are more difficult to evaluate, particularly for Phase I, the creation of cooperative farms on lands expropriated from the largest landholders.[13] The fundamental problem in evaluating the performance of these cooperatives is the absence of good data on production and yields <u>on these specific lands</u> prior to the reform. Thus, even though yields on the Phase I lands were above the national average for most crops in the post-reform years (Strasma 1988:417), it is not clear whether this represented an absolute improvement or deterioration over pre-reform years. Also, to the extent that production and/or yields may have declined after the reform, it may be inappropriate to attribute such changes to the agrarian reform. The real explanations may lie more with the civil war, depressed commodity prices, disease (in the case of coffee), internal price and marketing controls, and an overvalued exchange rate. For Phase III—the "land-to-the-tiller" program transferring ownership of small parcels to individual producers who had been renting—the effects on production and income seem more clearly positive.[14]

El Salvador's balance of payments was affected in a number of ways by the political and economic events of the late 1970s and early 1980s. As Table 1 shows, the overall balance-of-payments position shifted from a surplus of $37 million in 1978 to an average annual deficit of $156 million during 1979-81. The deterioration in 1979 occurred despite an increase of $330 million in export earnings. The major factor weakening the external accounts was a negative swing of $381 million in private capital flows (from a surplus of $196 million to a deficit of $185 million) between 1978 and 1979. Net private capital outflows were even greater in 1980, reaching $431 million. These net outflows were held to $125 million in 1981, but export earnings in that year plummeted by $277 million, or 26%.

The overall balance of payments position returned to a surplus in 1982 and 1983. Although exports continued their downward trend, imports likewise fell and the net capital outflow was modest. Also, remittance income[15] and official transfers (mainly grant assistance from the U.S. government) increased significantly, and net official lending remained high despite being lower than in 1981.

The economic crisis in El Salvador also had negative effects on the public finances. Revenues fell absolutely, as well as relative to GDP, because of the declines in output and foreign trade. Current expenditures rose as a percentage of (a falling) GDP, from 11.8% in 1979 to 16.9% in 1981-83. Higher military expenditures accounted for much of this increase, but the government was also trying to assist a large number of persons displaced from their homes by the conflict. Capital expenditures likewise rose relative to GDP, partly to replace damaged or destroyed infrastructure. The effect of these changes was to raise the deficit of the consolidated nonfinancial public sector (CNFPS) from 1.5% to GDP in 1978-79 to 10.2% during 1981-83.[16]

These large deficits had relatively little effect on consumer-price inflation, which after reaching 17.4% in 1980 began to decelerate, averaging 13.2% over the next three years. This somewhat surprising relationship can be explained by at least three factors: (1) the drawing down of foreign exchange reserves to satisfy the demand for imports, which actually rose in 1979 and fell over the next two years by less than GDP;[17] (2) external rather than internal financing of most of the fiscal deficit, except in 1980-81; and (3) fairly extensive price controls on goods and services (and on the exchange rate), which repressed and disguised inflationary pressures.[18]

Government economic policy during the crisis years can be described as concentrating on short-term damage limitation, with no medium- or long-run horizon. Moreover, the interim governments of Presidents Napoleón Duarte (1980-82) and Álvaro Magaña (1982-84) subordinated economic policy reforms to objectives in the political arena, including the holding of free elections and the strengthening of other democratic institutions.

Only modest steps were taken during the crisis years to improve resource allocation, stimulate investment, and reduce capital flight (through incentives rather than direct controls), for fear of unduly offending one or another interest group.[19] The exchange-rate issue was partially addressed through the creation of a dual market in December 1981-January 1982 in which "essential" imports and most export transactions were retained at the official exchange rate of 2.5 colones to the dollar, while "nonessential" imports, invisibles, and nontraditional exports to destinations outside Central America were moved to a depreciated parallel rate.[20] A phased liberalization of trade controls was begun in 1982, along with measures to reduce interest-rate distortions.[21] The impact of these measures was small in the face of the ongoing civil war, and private investment—which had been further discouraged under the Duarte administration by that government's negative attitude toward the elite segment of the business community—responded only modestly.[22]

The March 1982 elections brought to office a new government under the more conservative but politically independent Alvaro Magaña. While it may be something of an exaggeration to say that "representatives of big business took control of all state entities charged with the conduct of economic policy" (Ruiz and Molina 1988:342; my translation), the process of agrarian reform was significantly slowed (but not completely halted) and sufficient "neoliberal" adjustments were made to secure an IMF stand-by arrangement of SDR 43 million ($47 million at the time) in July 1982.[23] The government's program for 1982 included fiscal and credit restraint, a reduction in external payments arrears, and further trade and payments liberalization.[24] Performance under the stand-by was generally satisfactory, and the government was able to draw down the full programmed amount.

The modest policy reforms undertaken to obtain the IMF agreement were oriented toward stabilization rather than economic reactivation, which given the civil war would have been difficult even with the best of economic policies. The fiscal deficits of 1982-83 were two percentage points below that of 1981, but at 9.5% of GDP they were still high. On the positive side, domestic financing of the deficit in 1982-83 averaged only 1.8% of GDP, as most of the financing came from foreign loans and (increasingly) grants from the U.S. government. Indeed, these inflows,[25] along with the growing volume of (recorded and unrecorded) remittances, were mainly responsible for the modest rise in aggregate GDP beginning in 1983 and in per capita GDP beginning the following year.[26] Policy improvements, however, probably made a small contribution to the recovery.

AN ANEMIC RECOVERY (1983-89)

Real per capita GDP bottomed out in 1982-83, then experienced small ups and downs over the next six years, with a net gain over this period of only 1.5%.[27] This qualifies as a recovery only under a generous definition of the term. Key balance-of-payments trends over the period include a continued sharp decline in export earnings;[28] an increase in recorded private transfers (mainly remittances) from $107 million to $237 million;[29] and large official transfers (again, mainly from the U.S. government) averaging $259 million a year during 1984-89.

The trend in real per capita total consumption was similar to that of real per capita GDP, with a net gain over the period of only 0.4%. Real per capita private consumption fell by 0.9%, while real per capita government consumption increased by 8.8% (Zuvekas and Nassif 1992:43-44). The share of the social sectors in total consolidated central government expenditure averaged 29% during 1984-89, with only a slight upward trend despite large amounts of external assistance targeted to these sectors. Defense spending, meanwhile, rose from an average of 11% of the total in the crisis years to 26% during 1984-89.[30]

A reduction of the fiscal deficit by 6.1 percentage points (p.p.) between 1983 and 1985 was accomplished mainly by reducing capital expenditures (by 2.9 p.p.) and net lending (1.6 p.p.). Current revenue actually fell as a percentage of GDP,[31] although this was more than offset by relative declines in spending for interest payments and other items.

Notwithstanding these budgetary trends, the apparent decline in health and educational services in the early 1980s,[32] and a significant increase in the incidence of poverty,[33] some social indicators improved during the course of the decade, although the picture as a whole was mixed. USAID (FY1990:70) reports that "infant mortality declined from 51 per 1,000 live births in 1985 to 43 in 1988. Rural water supply coverage declined, but urban water supply increased from 67% of the population in 1980 to 76% in 1986. The incidence of malaria was cut by 40% between 1979 and 1985."[34] Webb et al. (1988:24-26, 82) find that the infant mortality rate had also declined significantly in the early 1980s, from an average of 71 during 1980-84 to 51 in 1985, probably because of vaccination campaigns undertaken by the Ministry of Health beginning in 1980.[35] They also report "signs of slight recuperation since 1985" in education indicators (p. 29). Data on nutrition "suggest the quality of the diet and quantity of nutrients available have decreased since 1979 at the national level" (p. 27).

The poor performance of exports during the mid and late 1980s is explained to a large extent by factors other than economic policy, although an overvalued exchange rate was an important negative influence. Coffee prices remained low in real terms, except during 1986, and the climate for new investment to improve yields was poor because of the civil war and uncertainties regarding additional agrarian reform measures.[36] Sugar was affected by low prices, the reduction of the U.S. quota, and to a modest extent by the civil war. Cotton prices were likewise low, and cotton production and marketing were especially hard hit by wartime disruptions. Intraregional trade continued to decline, with El Salvador's exports to the rest of Central America falling from $165 million in 1983 to $91 million in 1986 before turning upward again.[37]

The only bright spot in the export picture was a doubling of nontraditional exports to markets outside Central America, from a low of $43 million in 1983 to $89 million by 1987 (Zuvekas 1989:Table 3). The transfer of these exports to the parallel foreign-exchange market at the end of 1981 contributed to this expansion, while traditional exports suffered until the official rate was devalued in January 1986 (although by mid-1985 cotton and shrimp had been transferred to a more favorable rate).

The January 1986 devaluation and unification of the exchange rate at 5 <u>colones</u> to the dollar was part of a package of economic measures that also included import restrictions; steps to reduce the fiscal deficit, including a temporary tax on windfall coffee profits resulting from the devaluation; a tighter credit policy, including higher interest rates (which remained, however, negative in real terms);[38] wage increases; a freeze on prices of most items in the <u>canasta básica</u>; and upward adjustments in the prices of petroleum products.[39]

Agreement on these measures ended a long dispute over economic policy reforms between the second Duarte administration (1984-89) and the U.S. Government (see Rosa 1992:7-8 and 1993:64-74). Disbursement of ESF funds had been held up for a number of months, and the resulting compromise permitting their release represented a significant dilution of the original package proposed by the U.S. Government. Major areas of disagreement included the exchange rate, the fiscal deficit, and the relative shares of credit going to the public and private sectors.[40] Again, President Duarte subordinated economic policy reforms to his vision of what was needed to strengthen democratic institutions and processes and achieve other political objectives. Some U.S. policymakers, on the other hand, regarded continued economic stagnation as a major threat to the consolidation of democratic objectives.

The reform package ended up pleasing no one. As Ruiz and Molina (1988:351) state: "Given the form in which [it] was approved (pressures from AID, counter-pressures from the business community, etc.), the measures encompassed contradictory sectoral objectives from the beginning and therefore were rejected by all sectors of the country" (my translation). Moreover, the benefits of the devaluation were quickly eroded by inflation. Some upward pressures on the price level were expected because of the devaluation, the increase in petroleum prices, and the wage increases. But the acceleration of inflation from 22% in 1985 to 32% in 1986 may seem surprising given the reduction of the fiscal deficit from 3.3% of GDP in 1985 to 2.1% in 1986, caused by a large (but temporary) increase in coffee export taxes. The explanation appears to be, first, that the economic program was correct in assuming the need for even greater fiscal restraint in the face of the devaluation and, second, that inflationary expectations increased because of lack of confidence in the government's economic management. Monetary expansion was more rapid in 1986 than in 1985, but only modestly so, and credit actually increased much more slowly in 1986 than in 1985.[41]

Another major event in 1986 was a severe earthquake that struck the capital city in October 1986, killing about 1,000 people, leaving perhaps 300,000 homeless, and causing an estimated $1 billion in damage (USAID FY1989:88). Foreign donors committed approximately $400 million to the earthquake reconstruction effort; but much of this amount never materialized, due in part to absorptive capacity problems on the part of the Salvadoran government.

The second Duarte administration, like the first, was often hostile toward the business elite and at odds with this powerful group on economic policy issues. However, it actively promoted small- and medium-scale enterprise. Still, even in this respect it promoted divisions in society by encouraging the development of new organizations (linked to Duarte's Christian Democratic party) to represent these interest groups, whose traditional associations were regarded as being too closely aligned with the elites. Duarte's populist strategy also sought to gain the support of small- and medium-scale farmers, especially in the reform sector; but since he was perceived as unable to improve their situation, they came to oppose him openly (Ruiz and Molina 1988:344-345).

To be even-handed, one should point out that President Duarte's stubbornness on economic policy was matched by that of the business elite. Although the positions of some of this group could be characterized as crude rent-seeking, more sophisticated policies, sounder from an economy-wide standpoint, were being formulated by enlightened members of the elite, who with assistance from USAID established in 1983 the Fundación para el Desarrollo Económico y Social (FUSADES), a private-sector think tank that also took on investment- and export-promotion functions as well as banking activities.[42] But the FUSADES agenda did not advance far, as both the rent-seeking and enlightened segments of the business elite, along with the Duarte administration, had locked themselves into positions with little flexibility.

Among the modest reform measures the government did adopt in the mid and late 1980s were the passage of an export promotion law (1986, although implementing regulations were delayed for several years); the creation of a war-risk insurance program to insure domestic investors against damage caused by the insurgents (1986); a reduction in the number of controlled prices (1986-87); modest increases in water, electricity, and port charges (1987); a reduction in the number of prohibited imports from 170 items to 28 and in prior import deposits from 100% to 25% (1988); and elimination of remaining external payments arrears (1988).

The overall pace of policy reform, however, was slow, and the exchange rate became increasingly overvalued. With coffee prices again declining, total exports fell from $755 million in 1986 to an average of $600 million in 1987-88 and only $497 million in 1989. Real GDP growth was 2.7% (1.1% per capita) in 1987 but then fell to an average of only 1.3% (-0.5% per capita) in 1988-89. The fiscal deficit rose over this same period from 2.8% of GDP in 1987 to 5.8% in 1989.

USAID, by far the country's largest provider of external resources (see Table 2), began to express its frustrations openly in its <u>Congressional Presentation</u> for Fiscal Year (FY) 1989, submitted in early 1988:

> Without realistic economic policies to enhance production, investment, and employment, substantial economic and social progress will not be possible in El Salvador. A.I.D. continues to press the GOES [Government of El Salvador] to enact policies that promote a productive economy (p. 85). . . .
>
> Without peace and more coherent economic policies, El Salvador will continue to be heavily reliant on U.S. assistance. . . . [T]he GOES must adopt sensible economic policies and seek assistance from other donors (p. 86). . . .
>
> . . . A.I.D. will try in policy negotiations to encourage the GOES to put in place those structural adjustments most important for long-term growth (p. 86). . . .
>
> . . . A.I.D. is urging the GOES to reduce public spending, increase credit to the private sector, and carry out structural adjustments needed to sustain economic growth. For example, A.I.D. believes that the Government should pass an investment law, expand the mini-parallel foreign exchange market, complete the implementing regulations for the Export Law, and reduce price subsidies for agricultural commodities . . . (pp. 88-89).

> . . . A.I.D. will encourage the GOES to . . . undertake a review of the interest rate regime and . . . privatiz[e] state-owned enterprises (p. 89).

One of A.I.D.'s major concerns was that the lack of appropriate policy measures was both limiting the amount of El Salvador's own resources available for development and cutting the country off from access to the resources of the international financial institutions (IFIs).[43] This put more pressure on the U.S. Government to maintain or increase its resource transfers, given U.S. objectives in the country. But continued assistance at this level seemed unlikely.[44] Moreover, there was concern that poor economic performance would undermine Duarte's own objectives of strengthening democracy and relieving poverty.[45] Duarte "would not regain the confidence of A.I.D. with respect to the conduct of economic policy during the remainder of his period [in office]" (Rosa 1992:9 and 1993:72; my translation).

MAJOR POLICY REFORM, PEACE, AND ACCELERATING GROWTH (1989-1992)

The inauguration in June 1989 of Alfredo Cristiani, candidate of the right-of-center ARENA party, founded in 1981, constituted a sharp break with the economic policies of the Duarte administration. President Cristiani and his economic team moved quickly on a broad front to implement policy reforms that loosened price controls and made El Salvador more open to the world economy. Basically, these reforms constituted the FUSADES agenda, updated in an Economic and Social Program in 1988.[46]

Most key members of the new economic team, in fact, had been associated with FUSADES, including Cristiani himself, who was one of the organization's founders and a member of its original board of directors.[47] Others included Roberto Orellana Milla (President of the Central Bank), Mirna Liévano de Marques (Minister of Planning), Oscar Alfredo Santamaría (Minister of the Presidency), and Antonio Cabrales (Minister of Agriculture). Numerous other FUSADES members served in subministerial and advisory positions. Roberto Murray Meza, a prominent business leader who was the first head of FUSADES's board of directors, is now president of El Salvador's Fondo de Inversión Social Salvadoreño (FISS), a social safety-net program established in October 1990 and the recipient of substantial external funding.[48]

The Cristiani government's view of the relationship between economic policy reform, on the one hand, and social and political peace, on the other, differed considerably from that of its predecessor. As Murray Meza (1992:109) has put it:

> It can be argued that improved economic prospects might facilitate reaching a peace agreement. It is easier to lay

> down a rifle and pick up a shovel in a growing economy than in a stagnant one. A healthy economy would also ease the transition of large numbers of the military back to civilian life. Therefore the Cristiani government moved to reform and stimulate the economy. . . . It was confident that under more liberal market conditions the private sector could stimulate improved conditions on both economic and social fronts and that such improvements would be dispersed throughout the country to benefit the majority of Salvadorans.

The key policy reforms undertaken by the Cristiani administration through the end of 1990 included:

- Progressive transfer of more foreign-exchange transactions to the free market, and adoption by June 1990 of a unified exchange rate;[49]

- A lowering of tariffs and a narrowing of the range of nominal tariff dispersion (with relatively few exceptions) to 5%-35%, thus reducing effective protection;[50]

- Elimination of price controls on 230 items, and their retention for only a modest number of items in the consumer's market basket;

- Elimination of the monopoly marketing powers of the parastatals for coffee, sugar, and basic grains;

- A reduction in export taxes on coffee and the elimination of export taxes on sugar and shrimp;

- Simplification and reform of the tax structure in late 1989, including the adoption of a uniform 5% stamp tax and elimination of most exemptions, and a reduction in the maximum marginal income tax rates for individuals and corporations;[51]

- An upward adjustment of interest rates in late 1990, with rates becoming market-determined within a band established by the Central Bank;

- Financial reform legislation in November 1990 to permit reprivatization of banks and savings and loan associations, clean up and strengthen their portfolios, and improve banking supervision; and

- Successful completion in December 1990 of negotiations providing for El Salvador's accession to the General Agreement on Tariffs and Trade (GATT).

The economy responded well to the new economic environment—and to the improved outlook for peace. Real GDP, after rising by only 1.0% in 1989 (slowed by a sharp drop in coffee prices[52] and the FMLN offensive of November 1989), expanded by 3.4% in 1990. The agricultural sector grew by a strong 7.4%, aided by good weather as well as more favorable price and marketing policies that stimulated a 4.5% increase in the production of basic grains, grown mainly by small farmers, to a record 19.2 million quintals (cwt.) (Murray Meza 1992:115). Coffee production also expanded, as a more favorable exchange rate and lower export taxes offset the effects of lower world prices.[53] Exports in 1990 rose by 17% to $582 million, and imports by 9% to $1,263 million. Despite a slight deterioration in the trade balance, the current account deficit declined from $466 million in 1989 to $359 million in 1990, as remittances and other private transfers significantly increased.[54]

Inflation eased, with prices rising by 19.3% from December 1989 to December 1990,[55] down from 23.5% over the previous 12 months despite a substantial increase in credit in early 1990 to counter the effects of the FMLN offensive, and a sharp rise in petroleum prices in late 1990 because of events in the Persian Gulf area. The fiscal deficit fell from 5.8% of GDP in 1989 to 2.5% in 1990, as revenues rose by 0.8 percentage points (p.p.) of GDP while capital expenditures and net lending fell by 2.0 p.p. On the other hand, private investment, which had risen from 9.7% of GDP in 1988 to 12.7% in 1989, fell back to 9.5% in 1990.[56]

Improved economic policies enabled El Salvador to obtain in August 1990 a 12-month stand-by arrangement from the IMF for SDR 35.6 million (about $50 million).[57] This paved the way for a rescheduling the following month of $138 million in official debt to Paris Club creditors. In December 1990 the Inter-American Development Bank (IDB) approved a multisectoral credit loan for $60 million, and in February 1991 the World Bank approved a structural adjustment loan for $75 million.

The process of policy reform continued in 1991 and 1992. Among the more important measures in these years were:

- Further interest-rate liberalization, to the point that both loan and deposit rates became significantly positive in real terms, and removal in January 1992 of all controls on commercial bank interest rates;

- Reprivatization of the two largest commercial banks in late 1991 and early 1992, liquidation of three state-owned banks, and recapitalization of the others;

- Reduction of the maximum import tariff from 35% to 30% for all but a few products (some of which—such as textiles, apparel, and certain vehicles—were major items);

- Introduction of voluntary separation and accelerated retirement programs to reduce the number of public sector employees;

- Establishment of a Land Bank in March 1991 to facilitate voluntary land sales to small farmers;

- Approval in April 1991 of a law allowing Phase I agrarian reform cooperatives to convert their lands to individually-owned plots or any other form of tenure they might choose;[58]

- Closure in September 1991 of IRA, the basic grains marketing parastatal;

- Passage of an income tax reform law in December 1991;

- Approval in January 1992 of a new stand-by arrangement with the IMF for SDR 41.5 million (about $59 million); and

- Approval in July 1992 of a value-added tax (VAT), collections from which have thus far exceeded expectations.[59]

The economy continued its improved overall performance during 1991 and 1992. GDP grew by 3.5% during 1991, despite a poor performance by the agricultural sector (-0.3%) that was due mainly to unfavorable weather conditions. Manufacturing output, on the other hand, grew by 4.9% and construction by 10.1%. In 1992 the GDP growth rate rose to 4.6%, bolstered by strong performances in agriculture (6.7%) and manufacturing (6.0%). Year-to-year inflation fell to 14.4% in 1991 and 11.2% in 1992.[60] Private investment rose to 11.3% of GDP in 1991 and 11.7% in 1992. The fiscal deficit, however, widened to 4.4% of GDP in 1991 and 5.6% in 1992, as increases in both current and capital expenditures more than offset a modest increase in central government tax revenues relative to GDP (from 8.5% to 8.7%).[61]

In the balance of payments, exports were virtually stagnant in 1991 and 1992, due largely to continued declines in coffee prices.[62] Nontraditional export earnings, however, rose by 13% in 1991 and by 18% in 1992.[63] Imports, meanwhile, jumped from $1,263 million in 1990 to $1,724 million in 1992. About 77% of this increase was offset in the current account by a sharp rise in recorded private transfers, from $345 million to $702 million. A merchandise trade deficit of more than $1.1 billion and rising, however, is unlikely to be sustainable. Some long-run balance-of-payments relief was provided in December 1992 when the U.S. government, under the Enterprise for the Americas Initiative (EAI), reduced El Salvador's PL 480 (food aid) and USAID debt from a total of $615 million to $151 million.[64] But this was a palliative rather than a solution to a structural problem.

The signing of the Peace Accords on January 16, 1992 led the government to begin implementing a multi-year National Reconstruction Plan, under which expenditures totalling more than $1 billion—mostly from external sources—would be made through the mid 1990s.[65] A program of this magnitude will severely strain the country's absorptive capacity, and it is still not clear how much it will require recurrent expenditures that need to be financed with domestic resources.

Data on recent trends in social indicators are spotty. Household labor force surveys that had been suspended after the 1980 survey were revived in 1985, but the data are of only limited usefulness because of a variety of technical problems.[66] Although the survey results show an increase in urban employment from 790,000 to 890,000 between 1989 and 1991—an impressive 13% gain over a two-year period—there is reason to believe that the actual increase was no more than half this amount. The open urban unemployment rate is reported to have declined from 8.4% in 1989 to 7.5% in 1991, the two years for which the most reliable comparisons can be made.

The household labor force surveys also collect data on earnings—not total income—but even what they purport to measure seems incomplete. There is no basis for any reliable judgment about what has happened to income distribution over time.

It is likely, however, that both the relative and absolute status of at least one major group of poor people, small-farm households, has improved since 1990. Price liberalization has significantly raised the farm-gate prices of corn, beans, and rice. This policy reform (and good weather) contributed to an exceptionally good year for basic-grains producers (mainly small farmers) in 1990; and although harvests were affected adversely by weather in 1991, the area planted to basic grains in 1992 set another record. Good quantitative evidence on small farmers' income, however, is not yet available.

Health indicators show that the infant mortality rate fell from 50 per 1,000 in 1990 to 48 in 1992, and that the vaccination rate for children under two rose from 66% to 74% over the same period. In the field of education, some 300 schools were reopened in 1992.

CONCLUDING OBSERVATIONS

El Salvador's economy survived more than a decade of civil war in better shape than that of its neighbor, Nicaragua, which suffered through a comparable period of internal conflict at the same time. Both countries received large-scale economic assistance during this period. But El Salvador did not suffer as did Nicaragua from lack of access to the U.S. market during most of the 1980s, and a higher proportion of the external assistance it received was in the form of grants rather than loans.[67] Moreover, emigrants' remittances were much higher in El Salvador than in Nicaragua.

There is another major reason, however, for the differential performance of the two economies during the 1980s. Economic policy, while seriously deficient in El Salvador for most of the 1980s, was considerably better than Nicaragua's, which produced extreme price distortions, hyperinflation, disincentives to production, and the most severe decline in per capita GDP in the region.[68] Since a review of Nicaragua's economic policy is beyond the scope of this paper, a quotation from an economist sympathetic to the goals of the Sandinista revolution will have to suffice. Stefan de Vylder (1988:200), while recognizing that Nicaragua's economy was severely damaged by war, draws attention to the powerful negative effects of price distortions, which reflect "a fundamental lack of understanding of economic principles on the part of the revolutionary government." Among those distortions, Nicaragua's exchange rate was far more overvalued than El Salvador's, and its fiscal deficits and inflation rates were much higher.

Good economic policy by itself, however, does not guarantee a strong economic performance for a small, open economy. A generally favorable international economic setting is also helpful. But the domestic social, political, and institutional environment is important, too. The Chamorro government, which came into office in Nicaragua in April 1990, failed to develop a coherent economic policy in its first year; but in March 1991 it adopted a solid policy reform package that stopped hyperinflation in its tracks.

Despite these reform measures, the Nicaraguan economy refused to grow in 1991 and 1992.[69] This was due in part to still-unresolved political problems, including stalemates with elements of the Sandinistas who remained in key parts of the government, and the lack of unity within President Chamorro's own coalition. Continuing uncertainties over private property rights, as well as concerns about a possible Sandinista comeback (even through a free election), have been major obstacles to private investment. In addition, Nicaragua has had to rebuild some key economic institutions, especially in the financial sector, that were virtually destroyed during the 1980s.[70] It has also had to overcome the losses through emigration of a greater percentage of the entrepreneurial, managerial, and technical elements of its labor force than did El Salvador.

The domestic postwar setting for economic recovery was more favorable in El Salvador than in Nicaragua. Well before the Peace Accords of January 1992, most people on both sides of the conflict, as well as those in the middle, seemed desirous of moving toward a negotiated peace. Much of the Salvadoran business community was optimistic about the outlook for such a peace before the FMLN offensive of November 1989, and even more so after the failure of that offensive became evident. El Salvador's prices were less distorted than Nicaragua's, and its nationalized banks operated more like banks. The Cristiani government had won a decisive electoral victory, and ARENA was much more unified as a political force than the highly fragmented opposition—quite the opposite from the situation in Nicaragua. El Salvador has faced its own property rights problems (including delays in implementing the provision of land to ex-combatants on both sides), but these have been much less of a hindrance to private investment than in Nicaragua.

El Salvador's economy is projected to grow by 4.5-5.0% in 1993. Private investment is expected to reach 12.5% of GDP, up from 11.5% in 1991-92 and an average of 9.7% during 1984-90. Public investment—now reflecting some reconstruction activity—is expected to remain at the 1992 level of 3.4% of GDP, compared with a very low 2.4% in 1990-91. Exports, stagnant between 1990 and 1992, are projected to rise by more than $100 million to $695 million. Imports are anticipated to grow at a slower rate than exports, but by a greater absolute dollar value. Increases in private and official transfers, and in net official borrowing from abroad, are nevertheless expected to produce a fifth consecutive surplus in the balance of payments. Another stand-by arrangement with the IMF, for $49 million, was approved in May 1993.

The sustainability of the recovery, however, is not yet assured. Both the fiscal and balance-of-payments accounts remain heavily dependent on external grants and loans. The fiscal situation is especially troublesome, given the sharp decline in revenues relative to GDP in the late 1980s and their relatively slow recovery since then.[71] Government investment as a percentage of GDP, despite an increase in 1992, remains well below what it was in the late 1970s and early 1980s. The National Reconstruction Plan (NRP), meanwhile, contemplates expenditures equivalent to about 2.5% of GDP in its peak years. While most of these expenditures would be externally financed, the NRP would raise recurrent costs in health, education, and other services that the government would be expected to assume.

The maintenance of social peace would seem to argue for significant increases as well in non-NRP investments in both physical capital and human resources. Gallagher (1992) has demonstrated, by statistically analyzing data for 47 developing countries, that public spending on education in El Salvador has been far below what would be expected given its level of GDP. Moreover, the public educational system is quite inefficient, as evidenced by high repetition and dropout rates. The sustainability of rapid economic growth over the long run will require significantly increased investments in education.

To finance increased expenditures in education and other areas, it would be unrealistic to count on current levels of external grants to last indefinitely. In addition, the "peace dividend" resulting from the termination of hostilities will be less than some observers might expect, especially in the short run when the government must meet severance pay and other obligations associated with the 50% reduction in the size of the military forces scheduled to occur over a 22-month period.[72] These considerations suggest that a significant increase in tax revenues as a percentage of GDP might be advisable, although this is not the place to debate the speed at which such increases might take place or the particular taxes to be increased.

In the balance of payments, the large and widening trade deficit, as noted earlier, is unlikely to be sustainable. The growth of private transfers will probably slow considerably. Official transfers, notwithstanding their upward turn in 1992 (and probably 1993), are likely to resume the downward trend evident between 1987 and 1991. Net official capital inflows, which jumped from virtually zero in 1990 to $90 million in 1992, and are projected to exceed $200 million in 1993, may not be much higher than this latter figure. On the other hand, there is scope for increased private capital flows, including direct investment, if the 1994 elections produce results that inspire confidence in the continuation of sound economic policies.

If the economy is to continue growing at its present rate of 4.5%-5.0%, import growth of at least this amount (in real terms) will probably be required. Given the likely limitations on the inflows of transfers and capital-account items, described above, a rapid and sustained growth of exports is needed. The near-term outlook for export growth, however, is mixed. Prices of coffee and other traditional exports are forecast to remain relatively low over the medium term. Nontraditional exports have grown rapidly in recent years, but they are still a relatively small percentage of total exports, so that even a high growth rate will have only a modest impact on the total economy until the mid 1990s. Over the long term, El Salvador also needs to exploit opportunities for expanding foreign exchange earnings from tourism,[73] data processing, and other services.

In early 1992 some observers were concerned that the combination of large private and official transfers had produced a "Dutch disease" effect on the exchange rate that was eroding the competitiveness of exports. Such concerns were eased in the second half of the year as the colón depreciated by just over 10%. If combined transfer flows do indeed grow much more slowly or even level off, this particular infirmity may be avoided.

ENDNOTES

1. See Bulmer-Thomas (1987) and Zuvekas (1988) for discussions of the factors contributing to the region-wide crisis, which saw per capita GDP fall sharply in all five Central American countries. If (following Zuvekas and Nassif 1992) we date the onset of the crisis as the beginning of a prolonged decline in per capita GDP, Nicaragua was the first economy in Central America to turn downward (1978), followed by El Salvador (1979), Costa Rica and Honduras (1980) and Guatemala (1981). Since the base year for the analysis in the Zuvekas-Nassif study is 1969, the length of the pre-crisis period as defined therein varies from 8 to 11 years among the five countries.

2. Data for GDP and other economic indicators for 1978-92 are found in Table 1. Newly revised population data show that per capita GDP stopped declining in 1982 and grew by 0.1% in 1983. The data had previously shown a very slight decline in 1983, which we shall continue to regard as the trough, partly because per capita consumption hit bottom in that year.

3. See Zuvekas and Nassif (1992:43), which uses data from the World Bank's <u>World Tables</u>. The major data problem is that the private consumption figures include statistical discrepancies. Per capita total consumption fell by 33.6% during this period.

4. For a useful discussion of agrarian problems at this time, see Lassen (1980). Lassen cites a 1975 study reporting that "67 percent of the campesinos in El Salvador do not own their own land and 80 percent are either landless laborers or work farms of less than two hectares" (p. 133). She also notes that a well-meaning rent reform law in 1974 may have had the perverse effect of reducing the amount of land available for rent (p. 140). For an account of the aborted agrarian reform effort of 1975-76, see Baloyra (1983:111-114).

5. The cost of repairing or replacing damaged and destroyed infrastructure has been estimated at $1.1 billion over the period 1979-90 (Murray Meza 1992:107).

6. Estimates of external migration are as high as 1,000,000 (see Murray Meza 1992:107). A study by the Government of El Salvador and the United Nations Population Fund estimated that net external migration during 1980-85 was 382,000; additional net outmigration during 1985-90 was projected to be 212,000 (El Salvador and FNUAP 1986:13).

7. Estimates of displaced persons vary. USAID (FY1986:64) cites a figure as high as 550,000 (as of September 30, 1984), but this seems to be an overestimate. Two years later, USAID (FY1988:81)

reported that "the number of persons displaced by the conflict rose from 25,000 in 1980 to more than 400,000 in 1985. Webb et al. (1988:19-20) cite a figure of 500,000 in a Baseline Survey of Displaced Population (financed by USAID). But they argue that this figure includes migrants who relocated voluntarily for economic or educational reasons, and believe that a more reasonable estimate of displaced persons would have been in the 250,000-290,000 range. After 1984 or 1985, the number of displaced persons began to decline.

8. A partial measure of capital flight is the increase in deposits by Salvadorans in U.S. banks. These rose by $271 million between June 1979 and June 1984, although part of this increase represents interest earned on these deposits (UN-ECLAC 1986:28). Data are not available for changes in deposits in other countries, or investments in real estate and securities. More comprehensive measures of capital flight are employed by Glower (1986). These calculations show that capital flight from El Salvador may have been as much as $1,119 million from 1977 through 1984.

9. El Salvador's debt burden in 1980, however, was not as high as that of most of its Central American neighbors. The debt-service/export ratio was a modest 7.5%, the lowest in the region, and the debt stock/GDP ratio was 25.9%, higher only than Guatemala's. By 1983 these figures had risen to 19.7% and 48.5%, respectively; in both cases only Guatemala had lower ratios (see Zuvekas 1993:213-214).

10. Export volume and unit value indices for 1976-83 (1980 = 100) were as follows (IMF, International Financial Statistics, Yearbook 1991, pp. 352-353):

Year	Volume	Unit Value
1976	87	76
1977	72	137
1978	60	105
1979	114	96
1980	100	100
1981	91	82
1982	78	85
1983	95	70

11. El Salvador's real effective exchange rate (REER) had been appreciating steadily since 1973. From an index of 1.17 in that year (1978 = 1.00), the REER fell to 0.90 by 1980 and 0.65 by 1984 (Loehr 1987:97). (In Loehr's formulation of the index, a decline indicates an appreciation of the currency.) The black-market exchange rate had reached about 3.9 colones to the dollar by September 1982, compared with an official rate of 2.5 colones, and it weakened further to nearly 5 colones in August 1983 before

falling to an average of about 4.1 colones during 1984 (Cáceres and Núñez 1992:251, Graph 1).

12. For a balanced assessment of the experience through 1985 with nationalized coffee marketing, see López (1986); the arguments used to justify the nationalization are summarized on pp. 4-6. López stresses that factors other than nationalization per se explain most of the problems in the coffee sector.

13. For contrasting views of the agrarian reform program, see Diskin (1988), who has on balance a negative view of the effects of the reform, and Strasma (1988), whose assessment is more positive but still critical in some respects. Another informative perspective is that of Wise (1986), an advisor with USAID/El Salvador.

14. Strasma (1988:427, fn. 5) cites sample surveys in 1982 and 1984 showing that "family income from Phase III parcels rose from $303 to $417 (in U.S. dollars), outrunning inflation by 9 percent. Off-farm income rose even more sharply, perhaps because the former tenants now had a secure base. . . . Total average family income . . . rose from $371 in 1982 to $732 in 1984." A planned Phase II program, which was to affect properties between 100 and 500 hectares, is discussed below.

15. It is widely believed that official statistics significantly understate the magnitude of remittance flows (which account for most of the private transfers account) in the 1980s. The figures for more recent years probably capture a much higher percentage of these flows, which are thought to have reached about $700 million in 1992. Montes Mozo and García Vásquez (1988:36), on the basis of survey research carried out both in El Salvador and among Salvadorans who emigrated to the United States, calculated annual remittances (apparently for 1987) at $1.3 billion, at a time when the balance of payments showed about $200 million and most other observers put the figure in the $400-$500 million range. However, their methodology is flawed, and the resulting figure seems much too high. The vast majority of Salvadoran emigrants probably have come from families in the third through seventh income deciles, who thus are the major beneficiaries of remittances (Webb et al. 1988:11).

16. Unless otherwise specified, all fiscal deficit figures below refer to the CNFPS.

17. Imports fell more sharply (by 13%) in 1982 but thereafter began to rise, facilitated by increased inflows of remittances and official loans and grants, while exports continued to show a downward trend.

18. The most significant control was the fixed, overvalued exchange rate. Controls on the prices of consumer goods were not always enforceable, and on the whole they were probably less distorting than the subsidized rates for public utilities. Producer price controls, however, significantly discouraged agricultural production.

19. For example, the effects on labor of a prolonged freeze in minimum wages and in public sector wages and salaries, in the face of double-digit inflation, were offset in part by a public-works employment program and the provision of basic foodstuffs at subsidized prices through the Instituto Regulador de Abastecimientos (IRA)—both of which increased the fiscal deficit. Measures such as food-price liberalization and exchange-rate devaluation were resisted because of their presumed negative short-run effects on (urban) labor.

20. The parallel rate averaged 3.90 in 1982, 4.00 in 1983, 4.05 in 1984, and 4.53 in 1985. The (illegal) free-market rates in these years were 4.27, 3.70, 4.38, and 5.90, respectively (Brock and Meléndez 1989:321).

21. Interest rates were increased in February 1982, and some lending rates became positive in real terms; but the controlled rates were still lower than what a market rate would have been.

22. Private investment had fallen from 17.6% of GDP in 1978 to an average of only 6.5% in 1980-81. The average during 1982-84 was 7.6%. For a discussion of the relationship between the Duarte administration of 1980-82 (and that of 1984-89) and dominant private-sector interests, see Ruiz and Molina (1988).

23. El Salvador also received (and fully utilized) IMF compensatory financing of SDR 32.25 million ($36 million) in July 1981 and SDR 32.25 million ($35 million) in July 1982. Compensatory financing is available from the IMF almost automatically to offset significant declines in export earnings.

24. In August 1982 commercial banks were permitted to buy and sell foreign exchange in the parallel market. Previously, parallel-market activity had been limited to transactions between holders of dollar accounts. As of November, however, only commercial banks could carry out parallel-market transactions. Holders of dollar accounts either had to convert them to colones or use them to make export-related payments abroad. In October exports to Panama and additional invisibles (including tourism) were shifted to the parallel market.

25. Official transfers (mainly Economic Support Fund [ESF] grants from the U.S. government) amounted to 3.2% of GDP in 1982 and 4.0% in 1983 at the official exchange rate of 2.5 colones to the dollar, and even more at realistic exchange rates.

26. As discussed in footnote 2, the revised, very slight increase in real per capita GDP of 0.1% in 1983 is not considered to be part of the recovery period.

27. Real per capita GDP rose in 1984, 1985, and 1987 and fell in 1986, 1988, and 1989. Real aggregate GDP, however, increased in each of these years.

28. Exports fell from $758 million in 1983 to $497 million in 1989. The only interruption in the downward trend occurred in 1986, when temporarily high coffee prices resulted in total exports of $755 million.

29. Actual inflows were probably about twice as high, or perhaps even higher.

30. Zuvekas and Nassif (1992:25). Real per capita spending on for the social sectors fell by an annual average of 1.4% during 1984-89 (p. 26), compared with an average annual decline of 6.3% during 1979-83 (p. 19). The data on consolidated central government spending are from the IMF's <u>Government Finance Statistics</u>. The social sectors are defined as comprising health, education, social security and welfare, and housing and community amenities.

31. Tax revenues of the central government, however, rose from 10.6% of GDP to 12.5%.

32. In early 1985 USAID (FY1986:66-67) reported that "only about 60% of the school-age population is being served by a continuously deteriorating educational system. . . . There has been a marked deterioration of . . . health status in recent years. . . . Basic health services have been seriously disrupted in at least six of the nation's fourteen departments." One year later USAID (FY1987:89) noted that "1,000 schools have been abandoned, the number of teachers has declined, and over 650,000 children in grades 1-6 are not in school."

33. A comparative study of the Central American countries shows that the incidence of poverty in El Salvador rose from 68% of the population in 1980 to 87% in 1985, although the incidence of extreme poverty was unchanged at 51% (Menjívar and Trejos 1990:76). The 1985 poverty figure was the highest in the region, but extreme poverty was greater in both Guatemala and Honduras.

34. The decline in infant mortality apparently was overstated; USAID now reports a figure of 50 per 1,000 in 1990.

35. Non-governmental health services provided to residents of areas controlled by the insurgents may also have helped contribute to the decline in infant mortality.

36. A Phase II program, affecting properties between 100 and 500 hectares not covered by the Phase I expropriations, had been contemplated from the beginning but continued to be postponed in the face of effective opposition by those potentially affected. About 31% of El Salvador's coffee was grown on these farms (Diskin 1988:436). The 1983 Constitution raised the upper limit for landholdings from 100-150 hectares to 245 hectares and gave landowners until December 1986 to make voluntary land sales to bring their holdings down to the 245-hectare limit. The Constitution prohibited sales to other family members (though some such sales are believed to have occurred). Toward the end of 1986 only 17,000 hectares out of an original 343,000 were still available for distribution under an eventual Phase II law (Diskin 1988:443-444; Strasma 1988:409-410). Such a law was never passed.

37. Total intraregional exports by all five Central American countries fell from a peak of $1,166 million in 1980 to a low of $409 million in 1986 (Zuvekas 1989:Table 3).

38. Deposit rates were raised by 2.0-2.5 percentage points (p.p.) to a range of 11.5%-15.5% (depending on the term), while lending rates were increased by 2-4 p.p. to a range of 15%-21%, excluding some activities for which even lower rates applied. Inflation rates, however, were 22% in 1985 and 32% in 1986.

39. A useful summary of the January 1986 measures in provided in Ruiz and Molina (1988:367-369).

40. USAID had recommended a unification of the exchange rate at 6 <u>colones</u> to the dollar, but the compromise agreement established a rate of 5 <u>colones</u>. Demand for foreign exchange soon exceeded supply, leading the Duarte administration to impose tighter import controls (Rosa 1992:8).

41. The broad money supply (money plus quasi-money) increased by 28.5% from the end of 1985 to the end of 1986, compared with an increase of 26.9% over the previous 12-month period. Domestic credit expanded by 7.0% in 1986, compared with 19.7% in 1985 (IMF, <u>International Financial Statistics</u>, January 1992).

42. For a detailed account of the establishment of FUSADES and its efforts to promote orthodox, market-oriented policy reforms—highly successful after 1989, as discussed below—see Rosa (1992 and 1993). Ruiz and Molina (1988:364-365) summarize the FUSADES agenda as of late 1985 and also present the very different socioeconomic agendas of the "popular movement" in 1985 and 1986 (pp. 370-373). For a more detailed exposition of FUSADES's strategy, whose central focus was an expansion of exports to markets outside Central America, see FUSADES (1985). The studies by Rosa (1992 and 1993) are also informative, notably on the relationships between FUSADES and USAID and on the key

role of FUSADES members in the Cristiani government, which came into office in 1989.

43. In Latin America, these include the Inter-American Development Bank (IDB) as well as the World Bank and the International Monetary Fund (IMF).

44. Commitments of U.S. assistance averaged $365 million from FY 1985 through FY 1989 (see Table 2).

45. In its Congressional Presentation for FY 1991 (submitted in early 1990), USAID commented that the new Cristiani government taking office in mid 1989 "has been faced with the results of self-defeating attempts in recent years to protect social stability" (p. 118). Elsewhere, while recognizing that the Duarte government's political and social objectives were "legitimate priorities," USAID noted that the results of Duarte's policies were "a stagnant economy" (as quoted in Rosa 1992:17; my translation).

46. FUSADES's 1988 program was put together by a team of Salvadoran, Chilean, Argentine, U.S. and other advisors who drew on guidance provided by Prof. Arnold Harberger of the University of Chicago and UCLA (Larmer 1989; Rosa 1992:16). Thus when Cristiani and his FUSADES colleagues came into office, they came to be known as another group of "Chicago boys." The economic planks of ARENA's campaign platform bore a close resemblance to FUSADES's program (Rosa 1992:16).

47. FUSADES was established as an independent organization, and its 240 founding members included several prominent Christian Democrats. Over time, it came to be closely associated with ARENA, and its effectiveness in articulating an alternative economic agenda helped moderate elements within that party hold in check the hardliners who had been associated with right-wing violence during the civil war. USAID's substantial support for FUSADES, as one reporter has put it, was due not only to its "frustrations with . . . Duarte's bull-headed policies . . . [but] also reflected a desire to moderate the far right, known as much for its rapacious capitalism as its reputed death squads" (Larmer 1989).

48. Projects financed by the FISS are implemented by private nonprofit organizations and municipalities. Some observers have criticized the FISS, however, for a "top-down" approach that does not truly involve nongovernmental organizations (NGOs), community groups, and organizations of poor people at the project identification and design stages (see Sollis 1993). The FISS received a $33 million loan from the Inter-American Development Bank (IDB) in 1991.

49. The exchange rate was 7.66 colones to the dollar at the end of June and 8.03 at the end of the year. It was relatively stable during 1991, ending the year with a depreciation of less than 1% to 8.08 (IMF, International Financial Statistics, February 1993).

50. The combined effect of tariff reductions and a lowering of quantitative restrictions on imports was a decline in the average effective rate of tariff protection from 47% to 33% (Murray Meza 1992:110). No data are readily available on the dispersion of effective rates of protection, but as with nominal rates it is believed to have narrowed.

51. For more details on the tax package, see Murray Meza (1992:122, fn. 2).

52. Coffee prices plummeted after the International Coffee Agreement collapsed in June 1989. The price of other milds on the New York market fell from $1.39 per pound in May 1989 to $0.77 by August and an average of only $0.70 in the fourth quarter. Average yearly prices fell from $1.35 in 1988 to $1.07 in 1989 (International Financial Statistics, various issues).

53. Average coffee prices fell from $1.07 per pound in 1989 to $0.89 in 1990.

54. The balance-of-payments data probably overstate the actual increase in private transfers and reflect to a large extent a better recording of remittances. It is also possible that the remittance figures in the last few years include inflows more appropriately classified as short-term capital movements.

55. The December-December change in consumer prices is more revealing than the annual average inflation rate, which rose from 17.6% in 1989 to 24.0% in 1990, partly because of the initial impact of the Cristiani government's price liberalization measures.

56. The improvement in 1989 was due in part to growing expectations that a negotiated settlement to the civil war would be reached relatively soon. The November 1989 FMLN offensive, however, temporarily dampened the optimism of potential investors. The fall in coffee prices beginning in mid-1989 also affected private savings and investment adversely.

57. Despite complying with the terms of its agreement with the IMF (except for a technicality resulting from a delay in negotiations with the World Bank for a structural adjustment loan), El Salvador did not make any drawings under the stand-by because its foreign-exchange reserves were adequate, once the government secured World Bank and IDB loans and rescheduled its Paris Club debt.

58. USAID had spent a number of years, unsuccessfully, trying to convince the Duarte administration that such a law was in the interests of the members of the Phase I cooperatives.

59. The VAT was initially proposed at a 15% rate; but this drew strong opposition in the legislature, even among ARENA legislators. A 10% VAT was ultimately approved.

60. The December-to-December inflation rate, however, rose from 9.8% to 20.0%, largely because of the introduction of the 10% VAT as well as significant increases in electricity rates and public transport fares in the second half of 1992. Inflation has been more moderate thus far in 1993; the cumulative rise in the consumer price index over the first four months of the year was 3.1%.

61. Expenditures under the National Reconstruction Plan (NRP)—see below—accounted for nearly 1% of GDP in 1992.

62. Prices of other milds (New York) fell from an average of $0.89 per pound in 1990 to $0.85 in 1991 and $0.64 in 1992 (IMF, International Financial Statistics, June 1993).

63. Another indication of nontraditional export growth is provided by U.S. Department of Commerce data that show U.S. imports of Salvadoran manufactures, after exhibiting a downward trend for most of the 1980s, rising from $97 million in 1989 to an estimated $228 million in 1992 (based on 9-month data). These figures are not comparable to El Salvador's commodity export data because they reflect the full value of goods assembled in El Salvador from U.S. parts (value added from which is shown in the Salvadoran accounts as a services export). But while the dollar value of Salvadoran manufactured exports is thus exaggerated, their rapid rate of growth since 1989 is a notable development.

64. PL 480 debt was reduced by 80% and USAID debt by 70%. See the U.S. Treasury's press release, "Enterprise for the Americas Debt Reduction Agreements Signed," December 15, 1992. El Salvador became eligible for EAI debt reduction by obtaining and satisfactorily performing under an IMF stand-by, a World Bank structural adjustment loan, and an IDB investment sector loan—which together involved substantial policy conditionality—and by being current in payments to its external commercial-bank creditors and therefore not requiring a debt rescheduling agreement with them.

65. The size of the NRP has since grown to $1.4 billion.

66. One problem is lack of comparability in coverage: the severely flawed 1985 data are national in scope; the 1986 survey covers the metropolitan area only; and the (roughly annual) surveys beginning in 1988 cover all urban areas. Another problem

is that the surveys were carried out at different times of the year, and seasonal factors such as the coffee harvest, school vacations, and the Christmas shopping season have significant effects on labor supply and demand. For all the surveys, there are doubts about how the sample was expanded, and therefore about absolute numbers. The 1990 survey results, like those of 1985, are of especially questionable reliability. The 1980 survey had been conducted with a different methodology, so it is not possible to say anything meaningful about longer-term trends.

67. By the end of 1990 Nicaragua's external debt, including payments arrears, had reached $10.5 billion, by far the highest in the Central American isthmus both in total amount and relative to GDP, and almost as much as Panama—a much more developed economy—in per capita terms ($2,710 versus $2,760). El Salvador, on the other hand, had an external debt of a relatively modest $2.1 billion, 40% of GDP and just $410 per capita (Zuvekas 1993:208-209, 213-214).

68. Between 1977 and 1989 per capita GDP in Nicaragua fell by a recorded 57.5%, and per capita consumption by 56.5% (Zuvekas and Nassif 1992:13). There has been a further decline of about 10% since then. It should be noted, however, that these figures exaggerate the extent of the decline because they overstate population growth and fail to fully account for what is generally acknowledged to have been a significant increase in informal (legal and underground) economic activity.

69. Real GDP growth rates were -0.2% in 1991 and 0.4% in 1992.

70. The oft-heard remark that Nicaragua's banking institutions were converted into welfare agencies during the 1980s is not much of an exaggeration. Loan delinquency rates were very high, and even full repayments were token in real terms because of high inflation and strongly negative real interest rates. A great deal of banking expertise was lost during this period.

71. Trends in total public sector current revenues (excluding grants), and in the tax revenues of the central government, were as follows between 1986 and 1992 (percent of GDP):

	Total Current Revenues (CNFPS)	Tax Revenues (Central Government)
1986	16.8	12.8
1987	14.8	11.3
1988	12.8	9.4
1989	10.3	7.6
1990	11.1	8.1
1991	11.6	8.5
1992	11.8	8.7

72. The 50% reduction was actually achieved in about half this time. Over the long run, however, total military expenditures will decline by significantly less than 50%, since national defense involves a certain amount of fixed costs. Also, the establishment of a new civil national police force will partially offset the savings from the reduction in military forces.

73. El Salvador's earnings from tourism in 1990 were only $18 million, or 3% of merchandise exports, compared with $185 million (15%) in Guatemala and $275 million (20%) in Costa Rica (Melhado 1992:6). Melhado discusses the obstacles that must be overcome for tourism to become a major source of foreign exchange earnings.

TABLE 1
EL SALVADOR: SELECTED ECONOMIC DATA

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	Prel. 1992
POPULATION															
Thousands	4323	4450	4525	4578	4616	4648	4688	4739	4809	4888	4976	5071	5172	5279	5395
Growth Rate (%)	2.1	1.9	1.7	1.2	0.8	0.7	0.8	1.3	1.5	1.6	1.8	1.9	2.0	2.1	2.2
NATIONAL ACCOUNTS															
GDP, curr. prices (m. colones)	7692	8619	8917	8647	8966	10152	11657	14331	19763	23141	27366	32230	41057	47792	54493
GDP, 1962 prices (m. colones)	3664	3602	3289	3017	2848	2870	2936	2994	3012	3094	3144	3177	3286	3401	3558
Real GDP Growth Rate (%)	6.4	−1.7	−8.7	−8.3	−5.6	0.8	2.3	2.0	0.6	2.7	1.6	1.0	3.4	3.5	4.6
Real Per Cap. GDP (1962 col.)	839	809	726.9	659.0	617.0	617.5	626.5	631.8	626.3	633.0	631.8	626.5	635.2	644.3	659.5
Real P. C. GDP Growth Rate (%)	4.2	−3.5	−10.2	−9.3	−6.4	0.1	1.5	0.6	−0.9	1.1	−0.2	−0.8	1.4	1.4	2.4
Gross Dom. Investment/GDP (%)	24.5	18.1	13.3	13.1	13.2	12.1	12.0	10.8	13.3	12.4	12.6	16.2	11.8	13.8	15.1
Private	17.6	12.0	6.1	6.9	7.1	7.5	8.1	7.5	10.7	9.5	9.7	12.7	9.5	11.3	11.7
Public	6.9	6.1	7.2	6.2	6.1	4.6	3.9	3.3	2.5	2.9	3.1	3.5	2.3	2.5	3.4
Gross National Savings/GDP (%)	15.5	18.6	13.3	6.4	6.5	6.7	6.1	4.4	10.7	7.0	8.2	3.8	5.1	8.9	9.2
Private	9.9	12.6	12.8	3.7	6.7	7.8	7.6	4.3	9.3	7.1	7.9	6.4	5.4	9.6	9.2
Public	5.6	6.0	0.5	−0.3	−0.2	−1.1	−1.5	0.1	1.4	−0.1	0.3	−1.6	−0.3	−0.7	0.0
Foreign Savings/GDP (%)	9.0	−0.5	0.0	6.7	6.7	5.4	5.9	6.4	2.6	5.4	4.6	9.4	6.7	4.9	5.9
PRICES															
GDP Price Deflator (1962=100)	209.9	239.3	271.1	286.6	314.8	353.7	397.0	478.7	656.1	747.9	870.4	1014.5	1249.8	1405.7	1531.7
Annual Change (%)	0.9	14.0	13.3	5.7	9.8	12.4	12.2	20.6	37.1	14.0	16.4	15.6	23.2	12.5	9.0
Consumer Prices (Dec. 78=100)	98.1	108.7	127.6	146.4	163.6	185.1	206.7	252.9	333.6	416.6	498.9	586.9	727.8	832.6	926.0
Annual Change (%) [a]	16.0	13.1	17.4	14.7	11.7	13.1	11.7	22.4	31.9	24.9	19.8	17.6	24.0	14.4	11.2
BALANCE OF PAYMENTS ($ m.)															
Current Account Balance	−292	16	−2	−230	−233	−197	−230	−263	−107	−238	−235	−466	−359	−296	−422
Exports, FOB	802	1132	1075	798	700	758	726	695	755	591	609	497	582	588	587
Imports, CIF	1029	1041	962	965	857	893	978	961	935	994	1007	1161	1263	1406	1724
Trade Balance	−227	91	113	−167	−157	−135	−252	−266	180	−403	−390	−664	−681	−816	−1137
Services, net	−113	−121	−132	−109	−170	−189	−116	−110	−87	−30	−58	−39	−23	−21	13
Private Transfers, net	45	48	17	66	94	107	136	113	160	195	221	237	345	543	702
Capital Account Balance	329	−124	−241	114	306	267	236	274	152	324	112	503	476	336	477
Official Transfers, net	6	5	32	15	113	164	177	206	224	378	287	282	223	179	227
Direct Investment, net			5	−6	−2	0		12							
Private, M-T & L-T, net	198	−185	−11	−13	−15	−12	−15	−5	−51	−24	−163	−66	186	125	84
Private, Short-Term, net			−415	−106	12	−41		50							
Official, net		19	77	176	163	149	92	91	51	40	66	150	1	25	90
Fin. Intermediaries, net	126	37	71	46	37	25	−18	−78	−73	−70	−78	67	38	−65	−2
Other, net [c]	1	0	0	0	0	2	0	−4	1	0	0	70	26	94	78
Overall Balance, net	37	−108	−243	−116	75	90	8	11	45	86	−123	37	117	42	56
EXTERNAL PUBLIC DEBT															
Debt Outstdg.,12/31 ($ m.) [b]	517	591	946	1271	1501	1712	1769	1867	1808	1716	1761	2089	2130	2101	2337
Debt Outstanding/GDP (%) [b]	18.2	17.1	26.5	36.7	43.3	47.5	46.0	46.0	43.5	40.6	39.6	42.5	42.7	38.9	36.2
Debt Service/Exports (%)	4.7	4.0	5.0	14.4	21.1	26.7	29.3	32.3	35.9	36.7	36.4	31.6	27.1	63.3	53.1
FISCAL ACCOUNTS (% OF GDP) [d]															
Current Revenue		17.7	15.2	16.6	16.7	16.2	16.0	15.9	16.8	14.8	12.8	10.3	11.1	11.6	12.2
Current Expenditure		11.6	14.7	16.8	16.9	16.9	17.5	15.8	14.1	13.6	12.5	11.8	11.4	12.3	12.0
Current Surplus/Deficit	5.6	6.0	0.5	−0.3	−0.2	0.7	−1.5	0.1	2.6	1.1	0.3	−1.6	−0.3	−0.7	0.2
Capital Revenue	0.1	0.1	0.1	0.1	0.1	0.1	0.6	1.0	0.0	0.1	0.0	0.1	0.0	0.0	0.2
Capital Expenditure	7.4	7.6	5.9	9.5	8.4	7.2	4.8	4.3	4.3	4.0	3.5	4.0	2.4	3.6	5.5
Net Lending	−0.1	0.0	1.5	1.8	1.1	1.6	0.3	0.0	0.4	0.1	0.2	0.3	−0.1	0.0	0.6
Overall Surplus/Deficit	−1.5	−1.5	−7.9	−11.5	−9.6	−9.4	−5.6	−3.3	−2.1	−2.8	−3.4	−5.6	−2.5	−4.4	−5.6

[a] 1978–79 percentage changes are based on an old price index
[b] Includes short-term, debt service also includes IMF
[c] Includes debt servicing and changes in arrears
[d] Consolidated nonfinancial public sector

TABLE 2

U.S. ECONOMIC ASSISTANCE TO EL SALVADOR, FISCAL YEARS 1980-1992
(millions of dollars)

Fiscal Year	Development Assistance	Economic Support Fund	PL 480 Titles I/III	PL 480 Title II	Total
1980	43.2	9.1	3.0	2.5	57.8
1981	33.4	44.9	26.2	9.1	113.6
1982	39.6	115.0	19.9	7.7	182.2
1983	58.8	140.0	39.0	7.8	245.6
1984	41.2	120.2	49.0	5.5	215.9
1985	87.8	285.0	49.0	3.6	425.4
1986	83.9	177.0	44.0	5.9	310.8
1987	133.0	281.5	42.0	6.4	462.9
1988	70.7	195.0	35.5	12.9	314.1
1989	63.4	206.6	40.0	3.1	313.1
1990	61.8	136.4	40.2	6.8	245.2
1991	55.0	128.0	35.0	5.0	223.0
1992	57.8	187.5	29.4	4.7	279.4

Source: U.S. Agency for International Development.

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