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NATIONAL SECURITY COUNCIL

December 22, 1988

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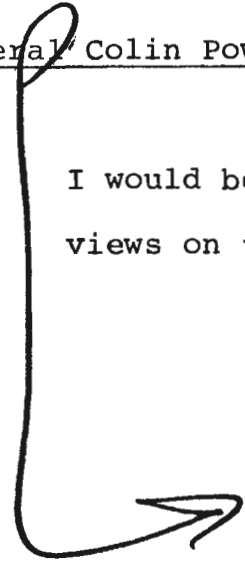
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Arthur Levitt, Jr.

General Colin Powell

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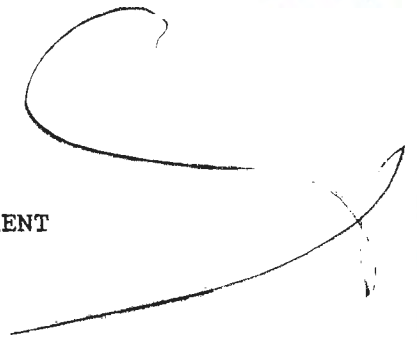
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CENTRAL AMERICAN RECOVERY AND DEVELOPMENT

Draft Report
of the
International Commission for
Central American Recovery and Development

December 14, 1988

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INTRODUCTION

In the 1980s, Central America has become synonymous with bloodshed, inequality, and poverty. Few economies on earth have gone so quickly from rapid growth to rapid decline, and the human and social costs have been enormous. Although the five countries have diverse histories, economic systems and methods of governance, all have suffered.

Yet recent historic breakthroughs, both in Central America and in global affairs, create solid grounds for hope. To build on this progress in a spirit of realistic optimism, this Commission sets forth far-reaching, inter-related recommendations to foster peace, democracy, and economic development throughout Central America.

The Impact of the Crisis

There can be no doubt that a full decade of civil conflict and economic decline has caused tremendous human hardship in Central America. After nearly three decades of high but unevenly shared economic growth, Central America since 1978 has gone backwards by every measure of social well-being, including income, education, life expectancy, and health.

* Violence has uprooted between 2 and 3 million Central Americans -- up to 15% (check) of the total population -- from their homes and communities, leaving most as refugees without jobs, income, or health services.

* More than 160,000 Central Americans have died in wars or civil violence -- 26,000 in Nicaragua, 62,000 in El Salvador, and 75,000 in Guatemala.

* Notwithstanding massive external economic assistance, the living standards of the average person has actually declined by 25%. Not even pacific and relatively prosperous Costa Rica has been able to escape the aftershocks of the crisis.

Conditions of life, already substandard for many Central Americans, have grown much worse. Today, three out of five Central Americans live in poverty, and two in five cannot afford their basic food needs. Three out of 10 Central Americans can neither read nor write.

Throughout the decade, governments of the region grew more distrustful of each other, and built security forces far larger than the region had ever known. Governments questioned each other's legitimacy and threatened each other's existence. As a result, regional insecurity increased.

Compounding the problem, external powers have fueled local tensions by emphasizing military solutions to economic and political problems. Conflict within Central America poses the danger of further involvement of external powers.

Grounds for Hope

In the face of this deteriorating situation, Central Americans recently took decisive steps forward. In an impressive display of political cooperation that few in or outside the region expected, the five presidents met at the request of Guatemalan President Vinicio Cerezo to discuss ways of ending the wars and building peace.

After more than a year of intense discussions, the presidents signed the Esquipulas peace accords in August, 1987. In recognition of this achievement, the Nobel committee conferred its Peace Prize upon the chief architect of the historic accords, Costa Rican President Oscar Arias.

The Esquipulas accords affirmed certain principals that are critical for the establishment of a secure region -- the recognition of the legitimacy of each nation's governments, a halt to the use of any nation's territory for hostile actions against another, and an end to external military support for irregular forces.

But the Esquipulas accords went beyond relations among nations. They affirmed that permanent peace was impossible without democracy. Therefore the vision of Equipulas calls for genuine, popular democratic processes and institutions in each country, and the resolution of domestic differences through dialogue, negotiation and the ballot box.

Equipulas has important economic implications as well. The five presidents foresaw not only an end to the bloodshed and the expansion and strengthening of democracy, but the development of the region's human and economic potential.

In addition to regional progress, shifts in the relations between the superpowers have enhanced the possibilities of peace in the region. Central Americans are heartened by progress toward the peaceful settlement of regional conflicts in Afghanistan, Southeast Asia, southern Africa, and the Persian Gulf. Just as East-West rivalry has made such resolutions difficult in the past, cooperation among the superpowers can encourage peaceful settlements of Third World conflicts today.

The growing interest in Central America of the European Economic Communities and the Nordic countries, Japan, Canada, and others further enhances the climate for progress towards peace.

Origins of the Commission

The Esquipulas accords properly focus first on the responsibilities and rights of Central Americans. At the same time, the accords explicitly call on the international community to assist the region in achieving the mutual objectives of political peace and economic development:

"We have Central American avenues for peace and development, but we need help to make them effective. We ask for an international treatment that will ensure development so the peace we seek will be lasting. We firmly reiterate that peace and development are inseparable."

Inspired by this call to international action, United States Senator Terry Sanford proposed the formation of an international commission to put forth recommendations for regional reconstruction.

The resulting International Commission for Central American Recovery and Development includes 47 members from across the political spectrum and from 20 nations in Central and South America, Europe, Japan, and North America. To guarantee its autonomy and integrity, the Commission is a non-partisan, pluralistic entity independent of any government. Philanthropic foundations and development agencies fund the Commission's work. While maintaining its independence, the Commission cooperates closely

with governments and private organizations throughout the world. It has working relationships with national, regional and international organizations that work on issues ranging from trade and agriculture to education, finance and human rights.

This Commission's propose is to put forward a comprehensive strategy for economic, social and political recovery and development in Central America. Its mission is to promote democratic development, and to end the paralyzing terror of recurring social strife. The Commission seeks to strengthen the peace where it exists, spur efforts to end the fighting where it continues, and to encourage governments inside and outside the region to unite for democratic development.

Peace, Democracy, and Development

The Commission's report is based on the fundamental premise that in Central America, durable peace, genuine democracy, and equitable development are indivisible. None is sufficient by itself -- each is necessary for the attainment of the other. Without peace, there can be no development. But without equitable development, democracy cannot be sustained. And without democracy, there will be no lasting peace.

Further, the Commission believes that these three objectives are dynamically intertwined -- that progress in one promotes progress in the others. The comprehensive development plan we propose is intended to promote the peace process by healing the wounds of war, helping to invest in reconstruction, enhancing incentives for democracy, and building a strong regional and international framework.

Progress in Central America has too often been halted by debate over which steps should precede others. The Commission believes that all fronts should move forward together. Since the proposed development is designed to cement the future gains of the peace process, its initiation should not await peace but be pursued as an integral component of the struggle for peace.

The Commission seeks a Central America in which individuals feel secure in their own homes, families feel secure that their basic needs can be met, businesses feel secure from arbitrary interventions, and governments feel secure from internal or external violence. Such a secure Central America is the best guarantee of the legitimate security interests of external powers.

The Commission is fully aware of the obstacles which lie between present facts and the fulfillment of its objectives. While Esquipulas accords created much hope and some concrete progress; many of its promises remain unfulfilled and the progress that has occurred is fragile. Nevertheless, the Commission believes that through history and circumstance, diligence and courage, a rare moment of international opportunity has arrived. It must be seized.

The Contents of the Report

The report is organized in six chapters -- from the origins of the crisis through immediate needs and an economic development strategy, to strengthening internal democracy, regional integration and international cooperation.

Chapter 1 -- The Recurring Causes of Crisis. The Commission has devoted much attention to the social and economic dimensions of Central America's crisis. It has done so because it believes that economic welfare is an essential component of human dignity, but also because it is convinced that a properly crafted strategy for economic reconstruction and development can help alleviate today's political tensions, and can contribute significantly to the fundamental objectives of genuine democracy and sustainable peace. This is what the history of Central America -- good and bad -- demonstrates.

Chapter 2 -- Immediate Needs. Given limited financial resources and institutional capacities, the Commission chose to target those most destitute, but fully recognizes that this immediate action plan does not solve the region's poverty. Only a broad and sustainable development strategy can alleviate the poverty that oppresses many millions of other Central Americans. However, the guiding principles of the immediate action plan -- its economic incentives and political organization -- are fully consistent with the Commission's proposed development strategy.

The first priority of development in Central America must be the satisfaction of basic needs. Growth and equity are both indispensable. Only by increasing the region's total wealth can the needs of the poor be met. But only concerted, affirmative action can guarantee that the poor are given priority -- so that the cycle of uneven wealth leading to social unrest is not repeated.

Chapter 3 -- Sustained Development. The Commission proposes a strategy for sustained development that is based on four pillars: export promotion, regional integration, food security, and human resource

development. To earn foreign exchange and generate employment, Central America should expand and diversify its export products and markets. Disincentives to trade should be removed, and governments should reduce distortions that prevent the efficient allocation of investment. However, basic grains -- so critical in the diets of the poor -- warrant exceptional promotion measures.

To foster both productivity and equity, the Commission calls for a concentrated effort to reform the region's educational systems, and to increase spending on primary education. Efficiency and equality can also be enhanced by indepth reforms of tax systems, the liberalization of financial policies, and the reduction of governmental inefficiency and overreach. Since over the long run development and poverty alleviation both depend on a sustainable resource base, it is also vital that Central America design an integrated environmental protection plan.

A strengthened Central American private sector can provide a powerful engine of growth. Governments must provide entrepreneurs a stable macroeconomic climate for investment, and offer competitive reward-risk ratios. At the same time, businessmen should serve the public welfare by providing jobs through investment at home and by paying taxes as required by law.

Chapter 4 -- Political and Economic Democracy. The root cause of strife and poverty in Central America is the exclusion of much of the population from political life and the fruits of economic growth. Therefore, the Commission proposes a model of political and economic development that is inclusive and participatory.

In reaction to the region's past political failures, the Commission has adopted an expansive definition of democracy. It affirms that democracy has several essential aspects: the participation of the entire population in institutions that represent their interests; the peaceful resolution of disputes through legal channels that facilitate dialogue, mediation, and peace; full observance of the rights of citizens; political succession by free elections; and social and economic justice. This report includes recommendations regarding specific institutions, laws, and processes to facilitate participatory democracy, and to build attitudes of tolerance and mutual respect upon which democracy is based.

The Commission identifies the role of the armed forces as protecting the security of each Central American nation, and affirms the principle of civilian governance and the withdrawal of the military from politics. Moreover, once hostilities abate, military budgets should be reduced and funds should be diverted into education, infrastructure, and other development projects.

Chapter 5 -- Regional Integration. The Commission finds that a revitalization of regional integration can contribute significantly to the strategic objectives of peace, democracy, and development.

The Central American Common Market should be revived, and made compatible with an export promotion strategy by progressively and deliberately reducing the external tariff. But a new integration scheme should go beyond trade to encompass macroeconomic policies. Central American nations should gradually increase the coordination of their fiscal and monetary policies, as well as interest-rate, exchange-rate, and capital-market policies. Ultimately, the region should seek to establish a single

currency and a regional central bank. Such comprehensive integration of each Central American nation into the regional community would require conformity to the norms of democratic politics and efficient economics. Comprehensive interdependence would reduce regional tensions and contribute to regional peace.

Furthermore, the Commission believes that the new integration scheme should seek to involve a broad range of political and social organizations, including business, labor, and grassroots movements. To further these objectives, the Commission endorses the creation of several multi-sectoral regional political institutions -- a Central American Parliament, a Central American Economic and Social Council, a Central American Educational and Cultural Council, and a Central American Court of Justice.

Chapter 6 -- The International Contribution. The most urgent priority demanding the attention of the international community is the promotion of peace. Peace should be pursued directly, by helping to negotiate ceasefires and negotiations among warring parties, as well as by immediately beginning to implement reconstruction programs which reduce political tensions and create incentives for democratic practices.

The Commission estimates that the immediate action plan targetted toward refugees and displaced persons will cost about \$2.5 billion over three years. Apart from this, the Commission's macroeconomic projections of the region's external financing needs suggests a total annual external financial flow of \$2 billion. Currently, net external financial flows into Central America exceed \$1.5 billion annually, so the Commission is recommending only a modest increase. This assumes that the region's debt is

restructured in order to make debt service obligations consistent with the stipulated growth path.

External assistance should, however, be fundamentally reorganized with regard to sources, channelling, and purposes. The Commission calls upon the United States to maintain its current assistance levels, but does not seek significant additional resources from the United States because it recognizes that global welfare will be served by a reduction in the U.S. fiscal deficit. Therefore, the Commission urges that the required increase in assistance come from a diversity of sources, including the multilateral lending agencies and bilateral donors in Latin America, Europe, and Asia, particularly from the capital-surplus nations.

Foreign assistance should be channeled through mechanisms which insure adequate coordination among donors and strong participation in decisionmaking by Central Americans. The Commission recommends the creation of a Central American Development Coordinating Commission (CADCC) where donor and recipient nations can discuss aid policies and programs.

Much of the external assistance reaching Central America today is spent on security forces, and on repairing war damage and keeping war-torn economies afloat. As conflicts subside and nations feel more secure, it will be possible to allocate a rising share of external resources for productive enterprises.

While the ultimate objective of the proposed development strategy is for Central America to become financially self-sustaining, it is vital that assistance funds and foreign commitment not dissipate prematurely; in the past, foreign assistance programs have dried up once perceived security threats disappeared.

Economic assistance is an instrument for peace. Donors should condition their assistance on compliance with the Esquipulas accords as judged by an effective and agreeable multilateral verification mechanism. It would be a violation of the peace process to exclude on political grounds nations that are judged to be in compliance. Furthermore, the Commission urges the international community to base its economic conditionality on the economic policies outlined in this report. Donors should provide renewed impetus to countries making significant progress toward implementing this report's recommendations.

External capital can help launch Central America on a path of renewed growth, but growth will be sustained only if the region can earn foreign exchange through trade. Eventually, Central America should finance itself through export growth and non-concessional credits and private investments. Therefore the Commission urges Central America's trading partners -- the United States, Europe, Japan, and other Latin American nations -- to sharply reduce their barriers to the region's exports and where quotas determine trade flows to grant preferential treatment to Central American products.

Learning from the Past

There have been several major development proposals for Central America over the years. The Commission has attempted to build on the experience of these previous efforts. The Alliance for Progress is memorable for its dedication to equitable development and social justice, even if much of its development strategy was more appropriate to that era than to today's more global economy.

The National Bipartisan Commission on Central America (the "Kissinger Commission") wisely advocated the elimination of trade barriers through the Caribbean Basin Initiative, while also correctly drawing attention to some of the linkages between democracy and development.

More currently, in 1988 the United Nations Development Programme (UNDP) and the U.N. Economic Commission for Latin America and the Caribbean developed the "Special Plan of Economic Cooperation for Central America" which identifies specific development projects that can contribute to strengthening regional ties while providing production and employment in the immediate recovery period. The U.N. Special Plan, overwhelmingly approved by the U.N. General Assembly, provides lessons in its emphasis on Central America's own initiatives in the formulation of development plans.

The Commission recognizes that previous efforts to tackle Central America's difficult political and economic problems have fallen short. However, the time for concerted action is far more propitious today than before. Within the region, economic reforms have begun in several nations, political structures and attitudes have shifted markedly, and elected leaders have themselves sketched a new vision for the attainment of peace and democracy.

This Commission is unique in that 20 of its 47 members are Central American. A Central American co-chairs the Commission and each of its five working groups. The Commission's recommendations are not a plan imposed from outside the region, but are the result of deliberations by an international body benefiting from strong Central American participation and leadership. The very process whereby the Commission completed its work is encouraging: that 47 individuals representing a wide diversity of opinion and

nationalities could reach such a high degree of consensus on broad objectives and specific recommendations.

Chapter 1

ROOTS OF THE CRISIS

The recommendations of this Commission seek to promote peace, democracy and development by addressing the root problems of the current crisis. Three major factors in Central America's complex history must be understood to put the Commission's strategy in proper context: the failure of political institutions to mature during the period of economic expansion from 1950 to 1978; the inability of Central American economic structures to ensure sustainable, equitable development; and the added complications arising from the military involvement of governments outside of Central America.

Exclusionary Politics

Throughout most of Central American history, political structures have not shown the ability to modernize and accommodate the interests of all members of society. In the 1970s, all Central American nations except Costa Rica lacked the key attributes of democracy: full participation, peaceful and tolerant means of conflict resolution, observance of civil and human rights, civilian governance through free elections, and social and economic justice.

Across the region, Central American elites utilized exclusive economic, social and political systems to forward their own interests. The military formed alliances with the traditional elite and played a fundamental role in enforcing the closed political system. Thus the military assumed a crucial role in the management of governmental affairs.

In order to ensure its own privileged position, the military also prevented the development of political institutions and mechanisms that could have served not only to establish civilian control over the military itself, but also to allow less privileged groups to organize and to advance their interests.

As 1950-1978 economic growth failed to translate into political and economic decision-making power for the majority, the political repression which predominated in most countries of the region sparked vigorous, widespread public frustration. Though economic expansion helped many poor Central Americans raise their standards of living, neither existing nor emerging social groups were permitted to participate democratically. Elections, when held, were frequently marred by fraud and the marginalization of many political groups. Through campaign restrictions, limited media access and even threats of violence, political parties were excluded from genuinely competing for power. Repression by authoritarian regimes in all countries of the region except Costa Rica further damaged social attitudes toward participatory democracy, and undermined the public legitimacy of national leaders.

Along with the absence of genuine democracy in Central America, government instability since World War II stymied peace and development. In Guatemala since 1950, chief executive power changed hands three times through coups, twice through elections widely viewed as fraudulent, once through assassination, and once through U.S. intervention. Of the fifteen Salvadoran administrations since 1950, three came to power through coups; only two government changes followed reasonably free, open elections. In Honduras, there have been five coups since 1950. Although in the 1980s

efforts to overcome political instability and install lasting, democratic governments have made solid progress, gains toward true democracy remain fragile.

Historically, the active military involvement of foreign interests and powers in the affairs of the Central American states has too often exacerbated civil unrest and government instability in the region. This has occurred at various times since World War II. As local discontent grew, so did repression and political instability; as unrest grew into armed conflict, both governments and local insurgencies found support from countries outside the region. Although guerrilla groups had been active in the region for more than a decade, the late 1970s saw the greatest increase in armed conflict. Civil wars erupted in El Salvador and Nicaragua, and the widespread guerrilla insurgency intensified in Guatemala. To varying degrees, civilian opposition to counterinsurgency programs provided additional support to guerrilla groups.

From Growth to Crisis

Equally important to understanding the causes of the Central American crisis is that despite periods of strong economic growth the gains from that growth were distributed far too inequitably.

Central American economies expanded rapidly over the post-World War II period through export-led growth based on agroindustiral activities, accompanied by some import substitution. This growth was characterized by stable terms of trade and high investment rates. During this period of growth, Central America expanded trade with the international community and

among the five nations themselves, and the region began to modernize and diversify its narrow economic base.

While aggregate measures of economic health improved, however, mechanisms for distributing the fruits of expansion to the majority of the population were absent or inadequate. Moreover, due to the increasing use of labor-saving technologies, the creation of new jobs did not keep pace with a growing labor force, and real wages began to fall throughout the region in the 1970s. Thus, while many people struggled out of poverty over the course of these three decades, rapid population growth actually increased the numbers living in extreme poverty.

At the end of the 1970s, growing social unrest alarmed local business communities throughout the region, resulting in a drastic reduction in private investment and substantial capital flight. With conflicts in three countries and guerrilla warfare directed against the infrastructure -- particularly in Nicaragua and El Salvador -- businesses stopped investing altogether. By ceasing to invest and grow, business no longer created jobs, thus exacerbating one of the root causes of the crisis and fueling the political instability.

In the early 1980s, just as the violence was increasing, Central America's international terms of trade suffered the sharpest downturn in 40 years, as prices for Central American's four primary exports -- bananas, sugar, coffee and cotton -- fell sharply and remained depressed throughout the decade. Faced with these trade deficits and growing external debts, the governments of the region began to face foreign exchange constraints and adopted diverse measures to ameliorate their respective balances. Efforts to curtail imports resulted in progressive restrictions on regional trade.

The Central American Common Market virtually collapsed after 1980, adding to the region's growing trade gap, depressing industrial activity while pushing Central American governments further into debt. The growing tensions in three of the five countries during this period both reflected and reinforced the structural weaknesses of the Central American economies.

Economic Strengths

The unprecedented period of economic growth, averaging 6 percent annually from 1950-78, demonstrated some strengths of the Central American economies. One was a competitive class of innovative entrepreneurs capable of adapting modern technologies and ideas to export production. Growth in exports came principally from three new areas of post-war expansion -- cotton, sugar and beef. During this period, the nominal value of Central American exports of goods and services to countries outside the region increased thirteen-fold, rising from \$250 million to \$3.2 billion.

The small size of domestic markets and the proximity to major export markets were other regional strengths, which helped to create a willingness to adopt new forms of economic cooperation to take advantage of economies of scale. Just two years after six West European countries organized the European Economic Community, the five Central American states in 1960 established the Central American Common Market (CACM), primarily to facilitate trade in non-agricultural goods. Industrialization followed a policy of import-substitution and was stimulated in particular by the creation of the Central American Common Market and by protective tariffs.¹

Exports expanded despite counterproductive policy measures, such as export taxes, overvalued exchange rates and import tariffs. Further

export expansion was often blocked by closed or restricted markets in North America and Western Europe, even as industrialized countries grew at a cumulative rate of 5 percent per year during the post WWII period, and volume of world trade expanded at an annual rate of 9 percent.

Flawed Economic Structures

The economic growth that characterized the three decades up to 1987 rested heavily on the historic roots of the five Central American economies. Almost since their independence from Spain in 1821, the nations of Central America have had a history of uneven and unequal economic development. By centering their economies on a few agricultural exports -- primarily bananas and coffee -- they entered the world economy in the late 19th century vulnerable to international cycles of boom and recession. The benefits of growth had gone to a small elite and left out the mass of the population, including peasant farmers and indigenous peoples.

The Central American economies remain dependent on the production of a handful of agricultural goods for export. In the 1920's, coffee and bananas accounted for more than 70 percent of export earnings in all five republics, and more than 90 percent in Costa Rica, El Salvador and Guatemala. Although the region diversified into cotton, cattle and sugar in the 1960s, five agricultural commodities still accounted for more than 70 percent of Central America's total exports, or more than one third of the region's total gross domestic product in 1980.

Landlessness caused by the agricultural booms was an important factor contributing to social unrest or civil war. El Salvador's high population density and scarcity of land provided the most dramatic examples

of the impact of the new commodity production. In 1971, an estimated 29 per cent of Salvador peasants had no land, a figure which increased to 65 per cent by 1980. Many Salvadoran peasants migrated to Honduras, but were expelled in 1969 after the so-called "soccer war."

During the period of the post-war expansion (1950-78), there were modest improvements in the sharing of benefits in Guatemala and Honduras, with a serious deterioration in El Salvador and little change in Nicaragua and Costa Rica.²

Population Pressures. But because of rapid population growth, the numbers of people trying to eke out livings on tiny plots, or living marginal lives of unemployment or underemployment in over-crowded cities, increased dramatically in all countries of Central America. Unemployment for the region as a whole rose to 12 percent, leaving idle between four and five million Central Americans.

The region's population grew from 1950 to 1980 by 3 per cent annually, the highest rate in Latin America. In just three decades, the population of Central America increased by two and a half times -- from 9 to 22.5 million people. Although economic growth outpaced the rise in population, growth was insufficient to alleviate poverty, largely because its benefits were concentrated in the hands of the few. Thus, more people were living in poverty in 1980 than in the period immediately following the Second World War.³ Large segments of the burgeoning population could not find access to land or other employment opportunities. Population growth has severely exacerbated competition for land, particularly in light of the land requirements of cattle and cotton production.⁴

Policy failures. During the 1950-78 years of growth, the Central American governments adopted policies that reinforced severe inefficiencies and inequities in their economic structures. Although many developing economies have overcome such difficulties, Central America failed to enact necessary reforms and allowed policy errors to become deeply entrenched.

Fiscal policies adopted during this period were often overly complex, distorting and ineffective. On one hand, governments of the region failed to collect enough revenues to finance adequate programs to improve the human capital of the poorest social groups. And on the other hand, expensive subsidy schemes and artificially-supported exchange rates reduced the prices of food, thereby hurting small-scale farmers.

Economic Decline

The crisis of the 1980s has had a devastating impact on intra-regional trade. Instead of serving as a buffer against worsening external conditions, intra-regional trade has fallen drastically, from about \$1 billion in 1979 to approximately \$300 million by 1987. In the midst of severe balance of payments constraints and national political tensions, countries have increasingly gone their own way in devising responses to the crisis. In place of fixed exchange rates, low inflation and free intra-regional exchange, there are now multiple national protective systems, adopted primarily to cope with the adverse world economy.

The effect on the region's economies can be measured by the fall in exports -- to both regional and international markets -- from \$4.6 billion in 1979 to \$3.8 billion in 1987. Intra-regional trade declined during the economic downturn of the past decade. Other problems --

including political disputes and the disparity of development among the countries -- were also to blame for regional disunity. In addition, economic relations within the region changed dramatically following the Nicaraguan revolution, creating another challenge to economic reintegration.

External Economic Setbacks

While the violence and political upheavals of the late 1970s clearly disrupted growth, external factors further contributed to the economic decline. The drop in world prices for agricultural commodities, coupled with the oil shocks, reversed the terms of trade for Central America's non-oil-exporting economies.⁵ The growth in world trade in agricultural products slowed to 1.3 per cent a year between 1979 and 1986, compared with 4 per cent in the 1960s and 1970s. The prices of Latin America's 15 major export products dropped between 25 and 60 per cent from 1981 to 1986. Central America's 1984 exports bought 30 per cent less than they did five years earlier.

The second setback to growth was the drying up of credit. To adjust to the worsened terms of trade in the late 1970s, several countries tried to expand their production and exports rapidly, using foreign financing. In the early to mid-1980s, credit could no longer be obtained cheaply from abroad. World interest rates rose dramatically, prompted by the anti-inflation policy and enormous borrowing of the U.S. government to meet record U.S. budget deficits.

When it became impossible to finance fiscal deficits externally, Central American governments began borrowing heavily in domestic markets.

From 1976 to 1985, the share of domestic credit taken up by the public sector and thus unavailable to the private sector increased in every country from an average of 20 per cent to an average of 47 per cent.⁶ This led to domestic inflation, devaluation, and economic decline. Indebtedness for Central America grew dramatically. Costa Rica's external debt grew to 102 per cent of gross domestic product in 1985. From 1975 to 1986, Nicaragua's debt went up sixfold; Guatemala's and Honduras' fivefold, Costa Rica's and El Salvador's fourfold. Nicaragua's debt totaled 6.7 million dollars at the end of 1986, or more than three times its gross national product. In Costa Rica, the cost of servicing the country's debt reached a peak of almost 60 percent of exports of goods and services in 1985.

Indirectly, civil violence caused further damage by adding enormous defense budgets to the resource-strapped governments in the region and by scaring off investment capital. By 1984, approximately \$2.5 billion owned by Central Americans was on deposit in U.S. banks. The total amount of Central American deposits held abroad was certainly much greater.

War and severe economic recession induced by the world economic downturn have created a cascade of problems. In addition to their costs in lives and human suffering, the wars have added heavy financial costs, including losses in the productive use of human capital. While the level of open conflict between insurgents and the armed forces in Guatemala has subsided since 1983, violence and casualties -- both civilian and military -- continued to mount in Guatemala, El Salvador and Nicaragua.

Instability and national insurgencies have led to huge increases in Central America's armed forces, diverting growing numbers of citizens from productive activities. Military personnel have increased for the

region as a whole from about 48,000 in 1977 to over 207,000 in 1985. These comparisons are most dramatic in Nicaragua, where military personnel grew from 7,100 in 1977 to almost 77,000 in 1986. Even in the case of Costa Rica, there have been sharp increases in the civilian police force.

In terms of direct economic losses, El Salvador estimates that during the most intense period of the conflict, between 1979 and 1982, the country lost over 450 million dollars in agricultural production and damage to infrastructure. It is that estimated damages and production losses from the Nicaraguan civil war have exceeded \$700 million over the last seven years. Total spending on defense budgets for the region as a whole, meanwhile, jumped from 140 million dollars in 1977 to 600 million in 1986.

In addition to these enormous war-related costs, Central America must cope with between 1.8 and 2.8 million refugees and other persons displaced by the wars. The more than 160,000 war-related deaths and at least as many war casualties have left tens of thousands of families headed by widows.⁷ Nature has also contributed to the human misery, inflicting severe earthquake, drought and hurricane damage upon the region.

The Commission concludes that economic weakness, political failure, and relentless violence are interrelated causes of the present crisis. Peace, democracy, and development can only progress together. The process must begin immediately, with support for the most pressing human needs.

Chapter 2

A PLAN FOR IMMEDIATE ACTION

Central America's decade of crisis has most severely hurt the people least able to endure worsened conditions -- the poor. Over the last ten years, not only have the numbers of impoverished Central Americans increased, but their living conditions have further deteriorated. Civil strife has uprooted millions of people from their homes, jobs and means of subsistence. As the direct victims of the crisis, refugees and displaced persons are among the most vulnerable of the many millions of Central Americans living in extreme poverty.

The Commission firmly supports the five presidents' call for "urgent relief to the flows of refugees or displaced persons that the regional crisis has caused" as the most urgent challenge facing the region's post-war recovery and development.⁸ Clearly, the issue of refugees and displaced persons is one of the most volatile political problems facing the Central American leaders.

This chapter proposes a comprehensive set of immediate actions in order to attend to the most pressing basic needs of Central Americans who face life-threatening conditions of poverty. These immediate actions, however, are designed to do more than to feed the hungry. They offer pragmatic suggestions for reintegration of the displaced and refugee population, they will create employment, establish an infrastructure to ensure adequate food supplies and set up and maintain health facilities for the poor.

We also believe the actions called for in this chapter will serve as a strong push to the consolidation of peace. If basic conditions of living dramatically improve and the prospects for political participation are enhanced for the majority of the population that lives in abject poverty, this will encourage both guerrilla fighters and those civilians who have supported them to see the possibility of rebuilding their lives in a society at peace.

In assessing where the crisis has had the most severe impact, this report provides a framework for immediate needs assistance, and estimates the magnitude of resources required to serve targeted groups. We estimate that it will cost \$2.55 billion over three years to resettle refugees and displaced persons. We recognize that this will alleviate conditions for only a part of those now living in extreme poverty. Thus, we stress that the eradication of extreme poverty must be the primary focus not only of immediate actions, but also of medium and long-term development.

The recommendations that follow are intended as a framework which the Central American countries can adapt in consultation with bilateral and multilateral development agencies.

The Social Impact of the Crisis

Ten years of global and regional crisis have multiplied the problems of the poorest people in Central America. The region is currently suffering from the most acute food supply shortage in decades. The world recession, structural adjustment policies, droughts, increased unemployment and armed conflicts have disrupted both the production and the distribution of food. With the rise in production of foods for export, and consequently

the declining production of basic grains, as much as 40 percent of the region's yearly food needs have been met with imported food.⁹ Not surprisingly, prices of basic foods have risen, further straining pocketbooks as the poor struggle against falling opportunities for employment and declining real incomes.

The economic crisis and armed conflicts of the 1980s have also forced reductions in spending on health care and other essential social services. Large-scale migration to urban centers -- an additional consequence of the wars -- has sharply increased demands on social services. The numbers of trained medical personnel are inadequate, and governments lack the funding and administrative expertise necessary to implement effective, broad-based health programs.

As a result, fewer than half of all Central Americans now have access to basic health care. At the same time, key indices of health, such as nutrition and daily caloric intake, have declined. Particularly for the most vulnerable members of the population, including infants and young children of poor families, this combination has contributed to alarming declines in health. Throughout the region, over one child in every ten dies before reaching the age of five. Of those children who survive, two thirds suffer from some degree of malnutrition. In El Salvador, Guatemala and Honduras, four of five children are malnourished or at risk of malnutrition.¹⁰

Other fundamentals of health and sanitation are equally inadequate. Some 10 million Central Americans do not have access to safe drinking water; in rural areas, these numbers represent sixty percent of the

population. Drainage, trash disposal and sewage systems are even scarcer.¹¹

Education, which has never been broadly available except in Costa Rica, has also declined. Although elementary school enrollment and literacy rates significantly improved in the 1970's, in the past 10 years there have been dramatic setbacks. Many schools have been either closed or destroyed in the countries suffering from armed conflicts, and illiteracy now stands at 40 to 50 percent of the economically active population. For those who have been able to continue their studies, cuts in education budgets have contributed to a decline in quality. In fact, many displaced take into consideration the lack of educational facilities and opportunities for their children as a factor to decide returning where this is now possible.¹²

The physical destruction of communication and transportation systems in poor communities has hindered efforts at alleviating crisis conditions. Particularly in El Salvador, war has severely damaged the physical infrastructure. Rural war zones, where poverty is greatest, have been hardest hit. Guerrilla activity has destroyed roads, bridges, power plants and electrical systems. Schools and health clinics have been abandoned due to military activity. Governments have not been able to replace or repair much of the wartime damage due to the high priority given to defense and/or strapped by the economic recession.

The violence of civil strife has also damaged a large percentage of homes. Many of the Central Americans who return to their communities in war-torn regions will find that their houses have been destroyed or damaged. In El Salvador, recent returnees found that about 40% of their homes were completely destroyed, with another 25% requiring major repairs.¹³

The Imperative of Satisfying Basic Needs

Immediate steps must be taken to assist those who now live in the conditions outlined above. Yet the huge number of those living in poverty and extreme poverty compel us to make difficult choices of priority.

Widespread poverty, the most serious affliction of Central America when the decade of crisis began, has gotten worse. In 1980 the poverty level, defined as the level of income insufficient to cover one's basic needs, took in over 13 million Central Americans (or over 60 percent of the region's population). Those living in "extreme poverty" -- unable to cover the value of the minimum shopping basket of food considered necessary to meet their nutritional needs -- totaled 8.5 million people.¹⁴ By 1985, those numbers had risen even further, according to the United Nations, with 65 percent of the population living in poverty, and those living in extreme poverty totalling 10 million people.¹⁵

In short, the dimensions of the problem of poverty require identifying the highest priority groups within the impoverished populace. We identify refugees and displaced persons as the highest priority group because the conditions they face are the most severe. Targeting immediate assistance to one group, however, does not diminish the importance of addressing the needs of all impoverished people.

The goal of assisting all Central Americans in extreme poverty to break out of their circumstance is not simply a compelling humanitarian challenge; it is a fundamental element of long-term development. Most important, in the long run it is feasible. But our report highlights the most vulnerable of all poor Central Americans and calculates the cost of

their basic needs with the realization that this larger goal -- eliminating extreme poverty in Central America -- can only be the fruit of long-term development policies which emphasize equity and the needs of the poor.

The Targeted Population

We support the Central American presidents in recognizing the plight of displaced persons and refugees as the number one challenge to recovery and development. They have left their communities, homes, jobs, income, reliable sources of food, and (though these never existed for many) access to health care and other social services. Moreover, refugees and displaced persons often are denied the fundamental legal rights of other citizens. The extremely difficult conditions facing those who have fled homes and communities therefore not only imperil their lives, but also place in jeopardy efforts to attain social stability, national reconciliation and longer-term development.

We identify four groups who should be the focus of an immediate action program. This targeted population totals 2,271,000 people.

The first group is drawn from all persons who are either displaced within their countries, or are refugees in another country, who are likely to return to their homes in Central America. Because the region's civil conflicts have taken place largely in rural areas, we assume that almost all displaced persons are of rural origin, and that returnees will go back to their original rural communities.¹⁶ In addition, we assume that they have no resources for resettling, and that resettlement will mean an improvement in their living standards (even if they are still living in extreme

poverty). There are a total of 618,000 Central Americans identified in group (1).¹⁷

The second group consists of people living in extreme poverty in the rural communities receiving the displaced persons and refugees. We assume this group faces conditions of indigence similar to those confronting refugees and displaced persons. There are a total of 483,000 people in this second group.¹⁸

The third group includes the displaced persons who are already integrated -- or may integrate -- into communities other than their places of origin, and are not likely to return to their home communities. They include both those internally displaced within their native countries and those who have left their native countries but remain within the borders of Central America. We have assumed that most in this group left rural communities and resettled in urban centers. The total number of these refugees and displaced persons within their countries and Central American region is 680,000.¹⁹

The fourth group includes those people who are living in extreme poverty in the urban communities where the displaced persons and refugees of group (3) have resettled. The estimates for the size of this group are based on the same data utilized for estimating the size of group (2).²⁰ This group totals 510,000 people. All four priority groups are summarized in Table 2 at the end of this chapter.

Women, Children and the Elderly

Within the above population, we also identify a smaller group that requires special care and specific programs -- children under four years

old, pregnant or nursing women, and elderly over 60 years of age. We single out these "biologically vulnerable" people because they require significantly different treatment, are particularly susceptible to disease and illness, and cannot satisfy all of their basic needs by themselves. The total number of Central Americans who fit the above criteria for biological vulnerability is approximately 48 percent. Thus within the total target population, there are 1,090,320 biologically vulnerable people.²¹

A Plan for Immediate Action

The immediate actions recommended in this report are not intended to be relief efforts like those that follow a natural disaster. Instead, this plan is intended to be the first step of a long-term effort to make structural changes that will enable Central Americans to benefit from the recovery and development of their region.

Programs described here should be based on comprehensive, multi-sectoral programs. As the larger goals of the programs are not simply to provide assistance but also to enable the target population to assist themselves, programs should be limited in duration and should be tied to the organized participation and work of those who benefit.

A critical factor of all programs should be employment and income generation. Job programs should revolve around the construction of infrastructure for the protection, renovation and conservation of critical natural resources, the provision of social services, and the rebuilding of the physical infrastructure. Productive employment, even if it is short term, will help strengthen the basic skills of those who participate.

Though programs should be carefully coordinated and supported, they should also be decentralized in order to further promote participation, organization and community self-sufficiency. Furthermore, efforts should be made to increase the management skills within the community as well as those of individuals and organizations working in immediate action programs in order to absorb effectively the flows of foreign aid and other resources devoted to such programs.²² Hence, those participating in immediate actions should also utilize the local resources and the first-hand expertise and comparative advantages of non-governmental organizations. To facilitate the work of these non-governmental organizations, governments should recognize their valuable contributions and provide the support their assistance requires.

Immediate Actions and Cost Estimates

We recommend immediate actions to assist the target population in seven principal areas: food security, health and nutrition, basic education, safe drinking water and sanitation, temporary housing, infrastructure and fundamental rights. These areas are essential to meet basic needs, consistent with regional priorities as set forth by the Central American presidents, and complementary to other efforts by the international community.²³

The following proposed immediate actions are based on careful cost estimates which we detail in Appendix 1 at the end of this report. The specific programs and their accompanying price tags, however, are intended to serve as a model which each country can elaborate and adapt in accordance with local conditions and development priorities.

For the minimum group targeted for immediate actions, total costs over a three-year period are US \$2.55 billion. Our proposed immediate actions, however, could be extended to cover more Central Americans who cannot satisfy their basic needs. Yet, there are clearly political and technical limitations to the amount of aid that the five nations can use effectively.

As we explain in Chapter 6, the Central American economies can only effectively utilize about \$2 billion per year over the next five years without creating serious economic distortions. Thus although we can calculate the costs of extending the full benefits of the immediate action plan to all Central Americans in extreme poverty, the costs of these benefits -- which would include food provision as well as employment opportunities -- would bring the cumulative aid total to \$11.3 billion over three years. Given the current economic situation in the region, this money could not be absorbed effectively.

The programs of immediate actions for this group are outlined below.

1. Food supply security:

The key considerations in maintaining an adequate food supply are overall supply, local access and price. Central America has both an absolute scarcity of basic foods and problems of access, particularly for displaced persons and for those who cannot afford the rising prices of the basic food basket. Immediate actions should focus on providing food assistance, strengthening the production of food, and improving access to food staples (including both the prices and distribution of basic foods).

Total costs of programs aimed at securing food supplies for the target population have been estimated at \$1.5 billion. This figure includes food, logistical and technical support, and administrative costs. Although the costs of assuring food security represent nearly sixty percent of the entire immediate assistance effort, less than a third of the funds are devoted to providing food. The major element is compensation for employment in community development, rebuilding the agricultural infrastructure, and improving food production. The essence of the strategy is to employ the targeted population as quickly and thoroughly as possible.

We recommend the following immediate actions:

(a) Direct provision of food to the target populations in rural and urban communities.²⁴

(b) Provision of financial resources required to initiate production.

Revolving funds and/or community banks should be made available for the production of basic grains and other food staples. Interest rates on the loans provided through these funds should reach market prices within 3 to 5 years.

(c) Food should be distributed in conjunction with work programs that generate income for participants. The income generated through the programs would serve to complement participating families' food requirements and other essential needs. These work programs should focus on community-based development projects.²⁵

(d) Income generating programs which accompany food programs should stress soil conservation and the protection of other natural resources, reforestation, and the construction of basic infrastructure for irrigation and water conservation.

(e) In urban communities, programs should be developed to create public food outlets and/or food cooperatives that could help guarantee adequate prices.

2. Health and nutrition:

Immediate actions should focus on a primary health care strategy, providing the target population with better access to all health services, controlling contagious diseases prevalent throughout the region, extending immunization and oral rehydration coverage, strengthening the management of health services, and improving the nutritional levels of those at greatest risk. Too little attention has been devoted to preventive health services.²⁶ Basic public health measures aimed at controlling intestinal disorders through assuring safe drinking water, for example, must be instituted.

The estimated cost for all of the above actions related to health and nutrition, including infrastructure, is \$263.7 million. These monies are to complement and/or supplement on-going initiatives at both regional and national levels. Proposals for immediate action include:

- (a) To increase the target population's access to health services, health posts should be constructed or rebuilt in rural communities, and clinics should be constructed in urban areas.²⁷ Labor for the construction and rehabilitation of these units would be provided by the income generating programs mentioned above.
- (b) Medical supplies and services should be provided to the target population, with special attention to those who are biologically vulnerable.²⁸

- (c) Oral rehydration campaigns should be carried out together with campaigns to eliminate intestinal parasites. Both campaigns should include attention at health posts and units as well as efforts at public health education to minimize the risk of their recurrence.
- (d) There should be special campaigns for the control of tropical diseases, particularly malaria, in rural areas.
- (e) Current vaccination campaigns should continue and expand their coverage, paying particular attention to returnees under 5 years old and infants in resettled communities.
- (f) Additional food should be provided to supplement pregnant and nursing mothers' daily intake, as well as for children under 5 years old.
- (g) In both urban and rural settings, health units and posts should provide rehabilitation services for those maimed and wounded in armed conflicts. Psychological treatment should be provided for both communities and individuals.
- (h) Medical training should be provided to community volunteers and paramedic personnel in order to carry out the above actions with a certain level of community autonomy.

3. Drinking water and waste disposal

Programs in this area should strive to secure access to drinking water and basic sanitation measures for the target population. It is estimated that the immediate actions required to cover at least minimal conditions would cost approximately \$178 million. Yet provisions should be made for medium and long range plans that will require substantial investment in infrastructure.

The following immediate actions are recommended:

- (a) Emergency water supplies should be provided until safe drinking water services are re-established or introduced in communities of the target population.²⁹
- (b) For urban centers, the numbers of community faucets should be increased so that there are no more than 50 families per faucet. Rural drinking water systems should be repaired or constructed.
- (c) Programs to build latrines in the resettled communities should receive high priority. Where sewage systems already exist, these systems should be fully restored, connecting home latrines to main sanitary collectors. In urban centers, appropriate basic sanitation measures such as covering water waste disposal should be implemented. In both urban and rural settings, programs for proper garbage disposal should strive to improve municipal garbage collection services, incineration, and dump sites.

4. Temporary Housing

As refugees and displaced persons return to their places of origin, the first housing priority should be to provide building materials for temporary shelter for those whose homes were totally destroyed (an estimated 40% of returnees homes have been destroyed). Simultaneously, building materials should be provided for repairing the homes damaged or partially destroyed (some 60% of homes require minor or substantial repair). Returnees should conduct these repairs themselves, but technical training and supervision should be provided to make better use of the materials.

Technical assistance, building materials and their transport to rural and urban communities is estimated at approximately \$117 million.

5. Education

Immediate actions should focus on rebuilding formal educational services, including adult education and literacy programs, and should provide basic training in order to increase production and productivity. Total estimated costs on immediate actions revolving around education are \$236.4 million.

The following actions are recommended:

- (a) Schools should be repaired and constructed where needed. Labor for repair and construction should come from the income generating programs mentioned above.
- (b) Teachers should be hired so that there are more teachers per student. Each school should be provided with at least the minimum equipment and materials necessary for instruction.
- (c) Massive adult literacy programs should be carried out, insuring the participation of women.
- (d) Literacy programs should be implemented along with technical training programs in order to increase agricultural production as well as to protect and conserve soil and water.

6. Fundamental rights

Immediate actions must be taken to protect basic individual rights of all citizens -- but particularly for displaced persons and refugees. Guaranteeing these rights is essential to the target population's ability to

actively participate in organized, effective ways in permanently satisfying their own basic needs. Programs should focus primarily on securing all legal documentation granted to other citizens in each country, and on supporting local efforts at organization.

The cost for these minimal actions is estimated at \$48.2 million, but provisions should be made to bolster and upgrade the juridical system. Respect for human rights, however, will require much more than capital investments. It will require the organization of the population to defend those rights; the political will of governments and armed forces; and the support of the international community. We recommend:

- (a) Those who have been displaced from their original communities should be provided with the necessary personal identity documents so that there is no distinction between them and the rest of the population.
- (b) Population displacements have caused a great deal of difficulty over land titling and titles for other properties. Final and definitive titles should be provided to solve these problems.
- (c) In urban communities, legal security of living quarters should be provided to those who live under permanent threat of being evicted from the land or buildings they occupy.
- (d) Programs should be developed to organize and educate communities to enable the target population to participate actively in its own economic recovery. They should not be passive recipients of assistance, but rather active participants in the defense of their interests.

7. Physical infrastructure

Immediate action should focus on repairing and rebuilding important municipal buildings and principal roadways to resettled communities. Immediate action should also be taken to provide emergency power supplies, and to rebuild power and communications systems where they have been destroyed. In brief, the physical infrastructure must be in adequate condition to support sustainable food production and sound health; without programs to accomplish this goal, many key areas requiring immediate action would be placed in jeopardy.

We estimate that \$216.6 million will be required to restore this basic infrastructure. The following actions are recommended:

- (a) Markets, town halls, cemeteries, and other basic municipal services should be rebuilt or repaired. In urban communities, projects should be carried out to protect communities from rain damage, erosion and landslides. Labor for these projects can be provided by the income generating programs discussed above.
- (b) Access to resettled communities must be improved; it is essential not only to provide immediate assistance, but also to facilitate longer-term economic recovery.
- (c) Emergency power sources should be provided to communities receiving returnees in order to ease and assist the process of resettlement.
- (d) Where they existed, telephone and telegraph systems should be restored in order to improve communications between resettled communities and the rest of the country.
- (e) Provisions should be made for medium and long-term programs that would restore the social infrastructure. This should also hold for high schools, vocational schools and specialized health services.

Conclusions

Though this set of recommendations for immediate action represents an extremely important step toward Central American recovery and development, it is not an attempt to solve the problem of Central American poverty. Solutions to the region's poverty go beyond the reaches of an aid package, no matter how great its magnitude; they cut to the roots of structures of development, and demand both reform and a reordering of priorities. Long term programs should seek to overcome the structural causes that underlie the conflict and restore and advance the levels of coverage of basic services that existed before the crisis, increase access to land and permanent shelter and broaden the space for political participation and organization of the population.

Regardless of the quantity of funds obtained from external financial aid, each government must also make contributions. For each program, for instance, governments should cover the administrative, logistical and technical support through matching funds. But as we have stressed, governments must also enact rigorous structural reforms and make the alleviation of poverty a primary goal of medium and long-term development. In this regard, foreign assistance can play an extremely important role.³⁰ Foreign aid will not only encourage the region's governments to make the satisfaction of their people's basic needs the highest development priority, but it will also help make such critical goals possible.

Chapter 3

A STRATEGY FOR SUSTAINED DEVELOPMENT

The first priority in Central American development must be the satisfaction of the population's basic social and economic needs. While this is the most urgent priority, only through growth will Central America generate and sustain the additional resources needed to provide better benefits for the poor and, ultimately, to improve the living standards of all. But if this growth is not accompanied by greater political access and economic equity, then peace -- and therefore sustained development -- will not be possible.

The greatest challenge for Central America is to address the immediate needs of reconstruction and recovery, and at the same time create the conditions for sustained development. Economic revival could get its impetus from the immediate action plan and the restoration of physical equipment and facilities that have been deteriorating over the past decade. These activities of reconstruction, combined with the revival of intra-regional trade and the assurance of adequate inflows of external capital, could lead to a phase of recovery that would take advantage of the idle industrial and agricultural capacity.

But consolidating long-term development requires more fundamental changes. It rests on basic changes in attitudes of all sectors of society: confidence, mutual trust, and a commitment to cooperation, efficiency and equity. The Central American governments must reformulate their policies

and promote changes in institutions to foster these attitudes so that recovery can dovetail smoothly into sustained development.

A well-balanced development strategy must have three primary objectives: growth, increased employment, and improved distribution of the benefits of growth. These objectives can be achieved through three inter-linked sets of policies: stimulating productivity and investment, developing human resources, and reforming fiscal and monetary policies. In addition, to sustain development based on these policies, Central America's fragile ecology must be protected and its natural resources conserved and renovated.

The stimulation of productivity and investment must focus on domestic, regional and international markets. Production and investment for the domestic market should concentrate on rapidly increasing the supply of basic foodstuffs for the Central American populations. In addition to taking advantage of the idle capacity in the industrial sector, reviving the regional market can be oriented to develop the competitiveness of Central American industry in the world markets. The recovery and expansion of diversified production for the international market is essential because the small Central American economies cannot grow on the strength of their domestic markets alone.

This multi-level revival involves removing the obstacles that impede exports to regional and international markets, while avoiding discrimination against production for domestic markets. The removal of barriers to trade, in fact, can contribute to domestic expansion.³¹

The second complementary set of policies is the development of the region's human resources. Building a healthy, educated workforce will

promote both growth and equity in the long run, although it requires some short-run sacrifices. A strong human-resource development strategy is a prerequisite for increased productivity for export promotion and a means to share its benefits more widely.

Third, a prerequisite for successful export promotion and broader, more intensive human-resource development is fiscal and monetary reform. Once Central America's domestic-oriented and export-oriented production has revived to the point where it generates sustainable surpluses, an even-handed and economically-neutral tax structure must be devised to channel a larger portion of the surplus into government spending on social services. Monetary and fiscal discipline is necessary to guarantee price stability and improved balance of payments that will restore and strengthen the climate for investment.

Promoting equity will also require specific and courageous efforts to mobilize and channel resources to the poorest, often excluded segments of the population. Agrarian policy must ensure more realistic agricultural prices and more productive access to land for the poor (especially where cultivable land is idle), which would also promote food security. Concerning the urban poor, the "informal sector" presents a strong but as yet untapped potential for increased production, employment and equity through micro-enterprise development.

Economic Revival: Productivity and Production

The first key to economic revival is the cessation of armed conflict. An end to civil violence would help restore investor confidence and, if accompanied by guarantees against confiscation, would unleash some entrepreneurial activity. Assuming that the external financial flows

outlined in this report are forthcoming, this economic activity could rapidly fill the domestic-market vacuum created over the last ten years.

If Central America is to sustain increases in production beyond the immediate future, however, the five countries will have to expand and diversify the region's productive capacity. This capacity should be oriented toward domestic, regional and international markets, and should be based on improved allocation of resources (to reduce uneconomical activities), increased productivity and efficiency in the production of goods and services, and aggressive export diversification in areas in which the region has comparative advantages.

Advances toward these goals will help unleash Central America's export potential. Past agricultural and industrial development has been geared toward exports, creating the expertise and the structure that could make another export take-off possible.

In recommending an export revival, the Commission recognizes that the region's dependence on a narrow base of primary-product exports exacerbated social and economic inequities and left Central American economies vulnerable to sharp changes in international prices. To reduce its vulnerability, Central America should aggressively diversify its export products as well as its markets. For now, traditional exports -- both agricultural and manufactured -- provide the greatest potential for growth. At the same time, Central America should develop new manufactured and non-traditional agricultural exports to provide a cushion against drops in world prices for coffee, bananas, cotton, beef and sugar.

International cooperation can contribute to this export effort by supporting infrastructure construction, short-term export financing,

technology transfer, joint ventures, technical assistance and marketing. International lenders and donors can also reward sound economic policy through the volume and terms of their loans and grants. But of greatest importance is preferential access to extra-regional markets.

Currently, over half of Central America's exports go to the United States. Central America should develop other markets, with special attention to its regional market. Reviving intra-regional trade -- which has fallen from 28 percent to 7 percent of the five countries' trade -- is an essential component of growth. Just to regain the volume of intra-regional trade reached in 1980 would fully utilize now-idle installed capacity, and contribute to lower prices. As detailed in Chapter 5, the regional common market is also important as a platform for launching new industries to be competitive in international markets, but requires declining protection, progressive and deliberate reduction of discrimination against exports, and closer coordination of monetary and exchange rate policy among the countries of the region.

The reduction of the discrimination against exports would not jeopardize the robust opportunities for domestic-oriented production. After a decade of war and the collapse of intra-regional trade, there is ample room for revitalizing production for the domestic and regional markets. Reduction of export discrimination would, however, better utilize scarce resources by steering investment out of highly inefficient domestic-market production.

Assuring the Creation of Employment

In the wake of economic collapse and rapid population growth, roughly 45% of Central America's workforce is now unemployed or underemployed. Employment creation should be a central concern in the minds of planners as they seek to stimulate production for domestic, regional and international markets.

The expansion of employment must come from:

1. economic recovery, insofar as it re-employs workers to operate already installed capacity;
2. an emphasis on labor-intensive production, particularly through micro-enterprise finance and in export-related production that takes advantage of Central America's abundant labor and relatively low wages;
3. the elimination of subsidized credit for large-scale enterprises that have been substituting artificially cheap capital for labor; and,
4. education, vocational training, and other human-resource investments necessary to make the workforce employable as production opportunities arise.

Developing Human Resources

The development strategy of economic revival and greater equity rests heavily on better educated, better trained, healthier Central American people. In a region where capital is scarce, labor is crucial to production. For Central America, labor constitutes a large, under-utilized potential. The greatest long-term growth can be achieved through investing in this abundant but poorly developed resource.

Developing human resources will also help alleviate poverty and promote equity. In a region where three out of five citizens live in poverty, income-generating employment will help meet basic human needs and encourage social stability. This requires policies to raise the incomes of the poor, to improve basic education and health care, and to expand access to credit for male and female small farmers, self-employed laborers and tradespeople.

Experience in other parts of the world affirms the value of investing in people. In both Japan and Western Europe, economies destroyed in World War II were transformed into "miracles" in less than 20 years with the help of sizable U.S. aid. The economies that advanced the fastest were precisely those which put enormous resources into education, health services and generation of employment for the displaced and the poor. The greatest success of human resource development has clearly been Japan, where investments in education and health have been tailored to Japan's outward-looking development strategy. The Japanese example also shows that an export orientation and rapid growth can be consistent with democracy.

A Focus on Education. Education is a fundamental element of human resource development. Education not only increases productivity and incomes, but also encourages social mobility and integration, and helps to impart values of justice, democracy and respect for human rights.

Throughout Central America, the quality and accessibility of education are deficient. Although primary school enrollment and literacy improved in the 1970s, these educational advances have suffered reversals during the crisis of the 1980s. Today, three in ten Salvadoran children do not attend elementary school. Many elementary-school teachers have only a

high school education. And in the coming years, population growth will put additional strains on the region's already burdened educational systems. With more than 30 percent of the region's population under 10 years old, 4.7 million children will reach school age between 1996 and the year 2000.³²

The Commission recommends increased investment in education, particularly in literacy and primary education. This must include greater expenditures for improving instruction materials and facilities as well as for better training primary-school instructors. Because the economic returns from investment in primary education are remarkably high, educational investment is extremely effective in promoting productivity and efficiency. Averaging 26 per cent throughout Latin America, returns are highest for investments in teachers, other personnel and general curricula.³³

Without doubt, every level of education in Central America could benefit from increased funding. With limited resources, however, literacy and primary education should receive higher priority than secondary and higher education. Basic education provides the greatest and broadest benefits at the lowest cost; it gives people the basic tools to participate in society, and it provides the foundation on which all advanced educational achievements must be built.

Even without increased funding in the near future, secondary and higher education can be restructured to be made more relevant. Secondary education should have a stronger technical and vocational orientation. Regarding higher education, governments should consider the possible trade-offs between open admissions and standards of quality and how to reconcile the growing number of entrants with the limited number of instructors.

Given scarce resources, Central American universities should institute regional programs for specialized curricula.

The private sector can play an important role in improving the quality and relevance of education and may be able fill the gap of limited public funds available for secondary and higher education. Key steps to raise technological expertise, increase productivity, and improve private and public management include cooperation between educational institutions and business (through company-sponsored training programs and school construction), volunteer teaching by well-educated private-sector employees, and privately-financed scholarships.

The private sector, regional governments and the international community should cooperate to provide loans and scholarships for Central American students. The opening of a Regional Student Bank, for example, could be organized within the structure of the Central American Bank for Economic Integration. The international community can contribute to the development of managerial and technical expertise by supporting the Central American Institute of Business Administration (INCAE), which provides such training on the broadest regional basis. The Commission also recommends that the international community complement improved education in the region with technical and professional training programs in countries outside the region.

Health Care and Family Planning. Adequate health care is also critical for the success of human resources development, in affecting performance in the workplace, the classroom and relations with the rest of society. Yet half of all Central Americans lack access to basic health care, safe drinking water, and sewage or waste disposal services. The

immediate action plan, discussed in Chapter 2, addresses these needs for the region's most vulnerable populations. Extending basic health, sanitation and nutritional services to the entire population should be a priority for the Central American governments and for international donors.

Health ministry budgets average under 3% of the national budgets and health expenditures are under \$10 per person in several countries. Compared to an average of 40 to 80 times that amount in developed countries, these levels of spending on health resources are dangerously low.³⁴

Not only is greater spending on health care necessary, but a fundamental transformation of national health systems is also required. Scarce resources are still concentrated in the major urban centers, in hospitals rather than health clinics and in curative rather than preventive services. Local health services should be the core of a transformed system, offering every citizen access to basic services and providing the entry point to more complex secondary and tertiary levels of care. The bulk of new resources must be targeted at community-based health centers with greater capacities to serve marginal groups and to promote prevention and control of infectious diseases.

In order to reform national health systems, three basic changes in the health infrastructure and policies must be made:

- First, the walls separating the health ministries and the social security institutions should be broken down to ensure the most efficient use of scarce resources;
- Second, the supply and training of health personnel, including community health workers, technicians, nurses,

sanitation specialists and doctors, should be increased to improve the extremely low ratios of health workers to population.³⁵

-- Third, region-wide primary health care strategies should be implemented through the decentralization and strengthening of local health services and the incorporation of community participation.

The first priority of this revised national health system ought to be to lower the rate of infant mortality. Many of these deaths are easily preventable with inexpensive, available measures. Many of the deaths of young children are attributable to malnutrition of mother and child. Improved nutrition would have an enormous impact on reducing infant mortality, especially if accompanied by immunization, oral rehydration, and treatment of acute respiratory infections. Without these improvements, high infant mortality rates fuel higher birth rates; where a child's prospects for survival are lowest, women have the greatest number of births.

Central America has the highest birthrates in Latin America,³⁶ posing serious problems for the children, their mothers, and society. Many children are endangered by closely-spaced births that result in premature deliveries and weak and underdeveloped infants. Women suffer from pregnancy-related illnesses and increased maternal mortality. Induced abortions account for the highest proportion of maternal deaths in all five Central American countries, and are the most frequent cause of hospital admissions among women. Societies suffer as overpopulation puts pressures on land, labor markets and government services. Therefore the Commission strongly recommends developing and expanding programs of sex education and

family planning, especially in the rural areas, where birth rates are highest.

Including the Previously Excluded. The human resource development strategy must seek to make all citizens productive participants in the democratic development of the region. For those who have traditionally been excluded from development, extra efforts must be made to bring them into the economic mainstream. In the context of the Commission's development strategy, this means extending to these people access to education, training, credit, health care and family planning. Women, indigenous groups and workers are illustrative of social groups that have been ignored or excluded. Special efforts must be made to include them in the process of Central American growth and development.

-- Women. Women are currently denied the opportunity to make their full contribution to the reconstruction and development of the region. Women grow 30 to 40 per cent of the food crops, but their rights to own land are restricted for legal and cultural reasons. Women are also denied adequate assistance from agricultural extension services for their productive activities. Women's illiteracy is higher than men's, and they have less access to education and to formal-sector jobs.³⁷ Since women are more likely to be under-educated and underemployed, even modest education yields significant returns, both to the women and to their societies. In fact, investment in women's education yields returns nearly a third higher than investment in men's education.³⁸

Women also constitute a majority of the so-called informal sector -- the vendors, artisans and other entrepreneurs who operate without formal employers or legal protection and whose income goes unreported. Sixty-five

per cent of the smallest concerns are owned and managed by women.³⁹ For many of these women, family responsibilities and lack of education prevent their entry into formal-sector professions.

Therefore the Commission recommends that women receive equal access to credit, land, education and extension services. Laws that discriminate against women should be revised, and laws that provide equity should be enforced. During the period of reconstruction, priority access to services and productive resources should be given to widows with small children and displaced female heads of households who have been displaced by the wars.

-- Indigenous populations. Native Americans are among the poorest of the poor in Central America, and have consistently been denied access to economic resources and political participation. They represent another untapped human resource. To develop their productive potential, indigenous peoples must be encouraged to join the economic and political mainstream. Governments must recognize their political and legal rights of the indigenous populations, their cultural and religious diversity, and their right to make decisions on the conditions that affect their daily lives.

-- Workers. The best response to the social and economic problems that affect each country can only be formulated through consultation among government, management and labor. When workers participate in economic decision-making, they have a greater stake in the success of an enterprise. Wages throughout the region are low enough to be competitive in the international market; in the traditional sector, they are especially depressed. As productivity increases, so should wages. Labor-intensive

techniques and strategies are important for employment generation, especially in the near future.

Workers and their representatives must have the opportunity to express their concerns about wages and working conditions. The Commission recommends the creation of opportunities for workers' participation in ownership and profits. Central American governments must assure the safety of labor leaders and members, and should enforce International Labor Organization codes.

The Potential of Micro-enterprises. Assisting very small businesses or "micro-enterprises" is another very effective action the Central American governments can take to develop human resources. Micro-enterprises -- defined by the World Bank as firms with fewer than 10 workers and less than \$10,000 capital -- already represent a large share of the region's economies. Some 48 per cent of the employed population now works in micro-enterprises. In El Salvador, micro-enterprises represent 94 per cent of all enterprises or 39 per cent of the non-agricultural jobs; in Honduras, 95 per cent of enterprises are micro-enterprises.

Making small amounts of credit available to male and female farmers, fishermen, artisans, self-employed workers and tradesmen is an efficient means to promote both productivity and equity; a relatively small amount of credit can generate a very large return. The Inter-American Development Bank reports that the average cost of generating a job and a business is \$1000, and the average loan by non-profit lenders is \$682. But these small loans produce dramatic income growth, and have surprisingly high repayment rates.⁴⁰

The absorptive capacity of micro-enterprises is impressive. The resources that micro-entrepreneurs throughout the region could quickly and productively use range from \$180 million to \$250 million. Yet in spite of exemplary repayment rates, banks are reluctant to make such small loans, in part because servicing them involves higher administrative costs. Most micro-enterprises borrow from informal sources, sometimes paying 10 times the bank rate of interest. In Costa Rica, fewer than one percent of commercial bank loans go to micro-enterprises.⁴¹

The Commission recommends earmarking more credit for the micro-enterprises.⁴² These loans could be handled more efficiently and effectively by local development organizations, credit unions or cooperatives. Foreign assistance agencies and central or commercial banks could lend larger sums to these organizations, which are often better equipped to process small loans.

However, for credit to micro-enterprise to be effective, it must be accompanied by a package of technical assistance in manufacturing, marketing and administration. Government and the international community should also support cooperative arrangements among micro-enterprises to purchase inputs, establish creditworthiness, share equipment and market their products. Finally, governments are urged to reduce the costs and complexity of official transactions that micro-enterprises must undertake.

Agrarian Reform and Food Security. The agrarian situation is a very serious problem in Central America; the poor conditions of agrarian workers has contributed to the instability of the past ten years. It is imperative to improve the living conditions of agricultural workers and help them become land owners. In doing so, it is necessary to strive for peace

among the groups involved, and to preserve productivity and efficiency while promoting equity.

In light of the diverse agrarian conditions in Central America, different approaches ought to be taken. Where land is abundant, idle land should be purchased with due compensation to its owners, and distributed to create new farming enterprises. Where land is scarce, greater investments and re-orientation of land use (for example, through expanded irrigation to increase the number of growing seasons) is essential for increasing the availability of steady employment.

Central American governments should assist small farmers with credit and technical advice so that they can become viable businesses and should work to provide alternative non-farm employment to landless peasants. Rural non-farm employment, especially in agriculture-related industries, provides the key to rural employment and to integrating rural and urban development.

The strategic importance of national food security, and of rural employment and subsistence, justify special measures. The Commission recommends tariff protection for three essential food grains -- rice, corn and beans. Food production should also be promoted through the elimination of over-valued exchange rates and a package of credit, technical assistance and infrastructure support for small farmers. The financial resources for this assistance can be recaptured from existing price supports; these subsidies have induced larger land-owners to move into producing basic foodstuffs, thereby displacing some of the small farmers.⁴³ Direct assistance to small farmers therefore represents better-targeted financial support.

Fiscal and Monetary Reform

The distortions in Central American monetary, credit and fiscal systems are serious obstacles to advancing beyond short-term economic recovery. The same policy reforms required to revitalize production for the domestic and regional markets are essential for unleashing Central America's export potential.

The Commission strongly recommends a stable and realistic exchange rate policy. The aim is a unified rate corresponding to market conditions. This is as important for achieving the monetary compatibility needed for regional integration as it is for removing the obvious disincentive that overvalued exchange rates pose for export in general.

The Commission also strongly urges a common tariff structure that progressively reduces protection of domestic industry. Commercial policy should aim for modest levels of protection of no more than 30% in five to seven years, via regular and predictable reductions. There should be only limited variation in effective protection across sectors. Here, too, regional integration will be best served by non-protectionist policies that will avoid recurrence of intra-regional debts (discussed at length in Chapter 5). By the same token, the revival of regional integration can contribute to the pressure to eliminate domestic protectionism that arose to serve special interests or to meet past emergencies.

These two central pillars of trade policy should be carried out as an integral part of the medium-term transition while adequate external resources are assured. Tariff rationalization must be accompanied by availability of credit for modernization and investment by domestic firms.

With secure capital inflows (see Chapter 6), central banks could use reserves to reduce speculation and gain credibility for the new policies.

Successful trade policy also depends on adequate infrastructure (including roads, ports, airports, communications and transport facilities); adequate finance and insurance systems; trading companies; technical assistance; and human resource development at all levels of export-production skills, including improvements in business and managerial skills.

Investment and the Financial System. Medium- and long-term development in Central America requires significantly higher levels of domestic savings and investment. Foreign investment and other external financial flows ought to be welcome and encouraged, but even a generous external effort cannot substitute for higher domestic investment. To provide the infrastructure to support the rise in savings and investment, national financial systems require extensive reform. Within a framework of gradual structural adjustment, financial liberalization can make a positive contribution. Clearly, a central objective must be moderately positive real rates of return on domestic deposits in the financial system. Although improved political conditions could remove one impediment to the return of capital flight, realistic domestic returns are also necessary. This can be attained only if central bank regulation focuses on consistent implementation of monetary and credit policy and effective bank supervision, rather than regulating interest rate limits and providing liquidity to problem institutions through rediscounts.

But financial liberalization must be conceived in the context of a broad array of supporting policies, including significant reduction of fiscal deficits and improvement in the trade accounts, as well as an

effective supervisory framework. A next stage should see the development of a broader market for public securities, to provide more credit to the private sector and a broader range of assets for savers.

Growth With Equity: The Importance of Tax Reform. As export growth and domestic-market revival produce increased income, these earnings must finance human resource investment. It is essential to obtain more predictable, broader-based and more equitable taxes to finance essential public functions like education, health, and physical infrastructure investment. For progress toward economic and political democracy to be sustained, tax revenues will have to increase, and tax administration and collection must be improved.

With their dependence upon primary exports, Central American countries have relied heavily on export taxes. Given the fluctuations in international prices, these capture some of the windfall gains of suddenly-improved commodity prices. But for that very reason, their collection is unstable. Due to exemptions and special incentives that complicate administration and divert revenues, direct taxes have suffered from declining yields. The impact of indirect taxes has been weakened by long lists of exemptions. Discriminatory taxes on foreign enterprises either discourage investment or lead to arrangements that deprive governments of legitimate revenues.

Increasing the importance of a single-rate value-added tax within each country would improve the soundness and equity of the tax systems, which suffer from large-scale avoidance and evasion of direct taxes. The value-added tax would also avoid distortions in relative prices resulting from different tax rules, substitute for many specific excise taxes and ease

administration. Furthermore, a value-added tax would facilitate international and intra-regional trade by allowing the full indirect tax content in exports to be removed at the time of export.

Insofar as direct taxes remain a part of Central American tax systems, simplification and the elimination of special treatments is also the best approach. World experience has shown that extremely high marginal rates do not yield high revenues, especially where tax administration is weak.⁴⁴ A far better approach is to broaden the tax base, provide greater horizontal equity across sectors (rather than taxing export and domestic-oriented enterprises differently), and eliminate exemptions designed to steer investment. These steps would increase the effectiveness of the tax system while reducing the distorting impact of differential treatments.

The timing of tax reform is crucial. There can be a lag of several years before reforms are implemented, with implementation tied to resumption of growth, but the planning should begin right away. Planning a fundamental tax reform must be based on consultations with all groups, and must recognize that simplicity is essential to ease administration and to eliminate the abuse of loopholes.

Fiscal management requires discipline on the part of the Central American governments. Since successful exporting appears to generate "easy surpluses", there is always a temptation to intervene directly into the exporting transaction to extract gains through overvalued exchange rates that redeem hard currency with less local currency, or through export taxes and "windfall profits" taxes. Export earnings should be taxed, but only as other earnings are taxed, so as not to depress the "after-tax returns" on export activities artificially. If export is profitable, then effectively-

administered uniform direct or indirect taxes on individual incomes or consumption will yield revenues without discouraging export activities or inducing exporters to evade taxation. This is especially important as exporters are in an excellent position to remove their capital from the domestic economy.

Streamlining Government Budgets. The increased competitiveness necessary for this development strategy depends in part on actions by the public sector. Wasteful central government expenditures must be reduced. Although reductions in the intensity of regional conflicts offer the promise of smaller defense budgets, military expenditures are likely to decline only gradually. Governments should focus efforts on tightening public spending and reducing bureaucratic inefficiency. Clearly, large fiscal deficits must be brought under control, and inefficient government programs should be reformed. While the provision of social services could be better managed and more carefully targeted, overall services are already tragically low and should not be cut further.

State enterprises are candidates for close scrutiny. Governments should choose between public and private operations on the basis of economic efficiency and sound economics, examining each state enterprise on a case-by-case basis rather than through an ideological predisposition either to maintain public management or to privatize.

The seemingly poor performance of state enterprises is often due to policies beyond their control -- such as maintaining unrealistically low output prices, extending high subsidies, or burdening state enterprises with excessive debt. Therefore, reforming the policy environment for public enterprises is equally important. As much as possible, public sector

enterprises ought to face the same competitive, market-regulated conditions as the private sector. They should not enjoy special privileges on input prices, tax treatment, tariff protection and access to credit; nor should they be subject to the burdens of price controls and indebtedness. Public enterprises should operate within a decentralized government structure, and should not be linked to central government budgets.

Conserving Natural Resources

Sustainable development, especially if one of its major components is the export of agricultural products, requires much more care of Central America's natural resource endowment than it has been receiving. Deforestation and soil erosion have become serious threats to resource-based sustainable development, and therefore must be addressed by government policy as part of the economic strategy.

With the partial exception of Costa Rica, responsible natural resource use has been badly neglected:

- half of Central America's farms use land very inefficiently
- the vast majority of pasture land is completely unmanaged
- fragile marginal lands are being added rapidly into production despite under-utilization of better lands
- pesticides are often abused
- soil erosion is undermining hydroelectric dams, port facilities, and river ecosystems
- overfishing has depleted near-shore species while potentially lucrative off-shore fishing has been neglected.⁴⁵

Strengthening and enforcing environmental regulation must be combined with resolve on the part of Central American governments to withhold support or approval for ventures that are productive only at the cost of depleting the resource base and damaging the environment. While Central American entrepreneurs should not be discouraged from pursuing the region's comparative advantages in exports, the costs of depleting or damaging the natural resource endowment must be taken into account.

The Commission recommends the suspension of colonization programs designed to grant virgin land in environmentally fragile areas to small farmers. While such programs have permitted modest increases in production, they have had negative effects on forests and rivers. Moreover, the newly-acquired land has been frequently consolidated into large farms, further contributing to land concentration without addressing the fragmentation of small property. In light of the potential for increasing agricultural productivity on existing farmland through better policy and more intensive management, further colonization into lands of uncertain long-term productivity is ill-advised.

Similarly, the misuse of pesticides and fertilizers, even if motivated to produce greater agricultural yields, should be regulated more carefully by Central American governments. Technical assistance for monitoring chemical pollution would be an important contribution to this end.

The Commission underscores the importance of poverty alleviation as an instrument of environmental protection. Employment that alleviates the necessity for poor people to establish small farms on hilltops, forest land, or other marginal areas contributes directly to conservation.

There must be greater recognition of the regional nature of Central America's environmental problems. These include watershed management, the conservation of shared river basins, regional energy systems (such as electricity grids) and preservation of coastal areas.

Therefore the Commission recommends an integrated, regional environmental plan to address these and other environmental concerns. Without a comprehensive plan that seeks to promote the rational use of land, water, and renewable and non-renewable resources, the costs of acceding to requests for bending the environmental rules are difficult to judge, and the discipline of complying with a multilateral agreement would be lacking. An integrated plan should be devised through the cooperation of governments, non-governmental organizations, universities, research centers and the private sector. This same multi-sectoral structure should be involved in implementation.

Part of the technical preparation of a regional environmental plan must be a far more intensive inventory of Central America's natural resource endowment. More knowledge of the region's water, land, flora and fauna will facilitate the estimation of the environmental costs of specific projects. It would also permit an "environmental accounting" system that could indicate when apparent economic advances are coming at the expense of environmental and resource losses that jeopardize future development.

The protection of fragile ecosystems is difficult during a period of economic crisis. The international community can help by engaging in "debt for environment swaps" through which foreign debt is redeemed in local currency to purchase virgin lands of low agricultural potential. In the

long run, Central America will face the need to renovate the areas that have suffered from environmental damage during this period of crisis.

Sequencing the Components of the Development Strategy

The appropriation of hard-earned profits from export growth and domestic recovery to finance human-resource development must be gradual and deliberate, with great care taken to avoid leaving the economies starved for capital or vulnerable to renewed capital flight. Fiscal policy must be formulated in recognition of the fact that attractive real returns are necessary for investment. Redistribution in times of depression or even fragile recovery is neither politically nor economically feasible. In the meantime, tighter targeting of governmental human-resource investments toward the poor and greater efficiency in providing human resource services will have to suffice as far as the domestic effort is concerned, until a more robust Central American economy begins to generate significant surpluses. Thus external assistance takes on a crucial role in nourishing a human resources strategy until the domestic effort can get underway on a sustainable basis.



Chapter 4

BUILDING DEMOCRACY

The difficult history of democratic governments in Central America demonstrates again that peace, democracy and development are inseparable in this region. As the previous chapter points out, despite the strong economic growth from 1950 to 1978, a lack of democracy in all but Costa Rica contributed greatly to the civil wars of the past ten years.

Similarly, as economic stagnation of the past decade has followed in the wake of physical destruction, the collapse of regional trade, and massive capital flight, it has become clear that peace is a prerequisite for long-term development. And while not all situations of poverty and inequality lead to disruption, the Guatemalan, Salvadoran and Nicaraguan insurrections can easily be traced to a combination of inequality and highly-mobilized opposition.

It is also a basic belief of the Commission that democracy reinforces equitable development and promotes peace. The model of Costa Rican democracy, uninterrupted since 1948, shows that political pressures can induce governments to assist lower-income groups, thus improving human resources to promote development. The Costa Rican example also demonstrates that democratic practices can be preserved in an economy oriented to export-driven growth, and that democracy and equity do not have to undercut economic responsiveness to new productive opportunities.⁴⁶

Despite the wars and economic crises, some progress in the mechanisms that encourage democratic participation has taken place in the

last few years. Numerous political parties have become active. More credible and legitimate electoral processes have emerged, supported by large voter turn-outs even when voting entails personal risk. There have been some changes in economic structure, such as increased benefits for workers and reforms in land titling and ownership. Labor unions and pressure groups have re-emerged, and the number of grass-roots groups and local development organizations has increased tremendously.

Although fragile, these developments are a start. In order for democracy to sustain peace as well as equitable development, the governments and citizens of Central America must make strong and sustained progress toward the essential elements of democracy:

- the participation of the previously excluded in institutions that represent their interests;
- tolerance of conflicting views;
- the peaceful resolution of internal and external conflict;
- civilian rule and respect for civilian institutions and constitutional guidelines;
- social and economic justice;
- full observance of the rights and freedoms of citizens;
- political competition and succession of government through free elections, with the peaceful passage of power by one administration to another it may not trust.

These elements of democracy are all essential; many of them cannot be attained unless they all exist. A government that allows certain formal

democratic practices without permitting the full scope of democracy runs the severe risk of losing its legitimacy.

Broadening Participation

An essential element of the democratic vision of the "Procedures" of Esquipulas is the broadening of participation. Three main obstacles stand in the way of those who have previously been excluded. The first obstacle is the perception by those who hold power that broader participation is a threat to their interests and, hence, to stability. Second, the fragility of emerging institutions representing the interests of those who have so long been excluded is also an obstacle. Finally, the fact that the excluded are often the poorest in society, and therefore the least capable of mobilizing as a political force, stands as another major obstacle.

The international community can be extremely helpful in supporting broader political participation of domestic groups. Because democracy is a key objective of Esquipulas II, there is a legitimate and compelling basis for pressuring Central American governments to adhere to democratic principles. The requirements (or "conditionality") imposed on loans, other financial arrangements, or even political and diplomatic interaction with the Central American governments, can address the observance of democratic practice without overstepping the bounds of non-interference. Since extra-regional powers currently hold the key to financing Central America's economic recovery, we discuss economic conditionality at length in our chapter on international cooperation.

As long as international assistance is in keeping with the non-interference stipulations of the Esquipulas II accord, Central American

governments should recognize the right of non-governmental groups to seek support of the broader regional and international communities.

International funding and training can help to overcome the disparities in resources and skills that put groups representing the poor at a disadvantage. Affiliation with regional or international movements can help insulate local groups from political exclusion or repression. Because regional and international connections enhance a local group's ability to communicate its situation to the outside world, civil rights violations are more likely to be visible internationally, and to bring censure upon the violators.

Democracy can also be broadened within government through decentralization. Local government is the training ground for national participation. A local government with real authority over development decisions, as long as it is not dominated by local elites, can bring democracy home to previously non-participating or excluded people. Even the poorest populations can become directly involved in local development issues. Thus financial decentralization, which is often advisable out of considerations of administrative efficiency, deepens democracy.

Tolerance: Human and Civil Rights

Nothing is more fundamental to democracy than respect for human rights. At the same time, few challenges are more difficult for democratic development than enforcing human rights laws and prosecuting human rights violations. Improved training and discipline within the armed forces can help uphold professional military standards and curb human rights abuses by

the military. For democracy to prevail, military and civilian courts must expand the prosecution of human rights violations.

Governments must also assure the independence and physical security of judicial personnel -- especially for judges and lawyers. The autonomy of the judiciary means that its members must be free to reach decisions independently, without being influenced by other branches of government or the military. For this to be possible, the judicial branch requires control over the financial resources necessary to carry out its functions, and control over its own personnel. Through both training and financial support to strengthen legal systems, international aid can again be extremely helpful.

The regional and international communities can also promote the work of human rights organizations, church-supported human rights groups, and local and national programs offering legal services. The Central American Court of Justice, a new judicial body described in Chapter 5, could help resolve disputes that arise between the Central American nations or between regional institutions.

International institutions have played crucial roles in supporting human rights groups. Domestic groups operating under the protection of Catholic and Protestant churches have played a critical role in monitoring human rights abuses in the region. They have provided legal and humanitarian services to political prisoners and their families and to the families of the disappeared. They also raise the visibility of human rights violations nationally and internationally.

Tolerance: Instilling Values of Democracy and Peace

After decades of mutual suspicion and open conflict, Central Americans have little basis for mutual trust or for confidence in democracy. Democratic norms have to be cultivated. This is one of the virtues of the Central American Parliament, discussed in the chapter on regional cooperation.

To directly instill democratic values in all Central Americans, the Commission proposes the creation of a Cultural and Educational Council. This body would be dedicated to the exchange of information, knowledge and technology on the development of human resources among the five Central American countries in support of the principles of democracy, peace and development. Because the tradition of peace and democracy has been absent in Central America outside of Costa Rica, instilling commitment to these principles must go beyond formal practices and the absence of armed conflict. The aspiration in the region for peace, democracy and development stems in part from a frustration with the sacrifices of war, and does not yet rest on deeply-rooted cultural values of respect for democracy and the love of peace. Without developing such values, no new development strategy or structure will function well in the long run.

To this end, the Cultural and Educational Council would organize seminars, produce publications and create education programs, but also serve as a mechanism for ensuring that the process of human-resources development truly reinforces peace, democracy and development. The Council would evaluate human-resource development programs, projects and educational efforts, and would verify that they are properly targeted and effective.

The Cultural and Educational Council would also provide a window to absorb new financial and technical assistance from the international

community for the explicit purpose of human resources development in support of peace and democracy.

The key to structuring the Cultural and Educational Council is to integrate national, regional and international interactions. On the national levels, the participation of government, labor, cooperatives, the private sector, non-governmental organizations and other organized groups would demonstrate that democracy and tolerance are not mere slogans. On the regional level, as with the Central American Parliament, democratic practices of one country can reinforce those of the others. Internationally, the recognition of the Cultural and Educational Council would signal an endorsement of the practical utility of peaceful cooperation.

Civilian Rule and Civil-Military Relations

Central American governments must engage the armed forces in the movement toward democracy. The armed forces have an essential and legitimate role in protecting the security of each Central American nation. But security is not achieved by repression and military dominance of government. Continued withdrawal of the military from the political scene, their training in democratic political values, the rejection of authoritarian doctrines of national security, and the development of effective mechanisms of civilian political control are indispensable elements for achieving the de-militarization of Central American societies.

Nevertheless, in light of the military's heavy current involvement in governance as well as security, we recommend that the civilian and military leaders engage in an institutional dialogue on the issue of reforming civil-

military relations. The emphasis of these discussions must be on cooperation -- rather than open confrontation -- between civilians and the armed forces. Civilian leaders and the armed forces must jointly define a democratic concept of security, military professionalism and international military cooperation, to assure that the armed forces contribute to the consolidation and protection of democracy, peace and development.

Disengagement. The fact that all five Central American nations have civilian presidents indicates that the armed forces have made at least a provisional commitment to the process of democratization. Their willingness to consolidate democracy in the form of civilian control depends, of course, on the extent of the security concerns they face. Concerted action toward peace is the best way to reduce the armed forces' reluctance to disengage politically. But if the militaries are to be expected to risk further withdrawal from political control, it is essential for extra-regional and intra-regional support of insurgencies to end.

Dealing with Civilian Governments on Security Issues. Civilian control over relationships with extra-regional security forces is also essential. Extra-regional powers have sometimes by-passed civilian authorities to deal directly with the Central American armed forces, because of the attraction of engaging the institution with the highest presumed commitment to security and counter-insurgency.

If extra-regional governments deal with the Central American armed forces as professional institutions subordinate to civilian control, then the civilian authorities would be in a better position to assert responsible control. Ironically, the massive flows of military assistance coming into Central America give the extra-regional powers enormous potential to induce

the Central American armed forces to adhere to democratic principles and play a professionalized, non-political role.

Nurturing the Professionalism of the Military. The movement to democracy does not signify the demise of the armed forces in Central America, but rather the opportunity for the institutional recovery of the armed forces. Despite the leadership and sacrifices that some military personnel have shown over the past decades, the armed forces have been drawn into political entanglements and corruption that have diverted them from achieving the professional status for which military officers are trained and to which many aspire. Democratic development that is not seen as a threat to the military's institutional survival can carry the armed forces toward the status of the respected and professionalized militaries of North America and Western Europe. Several South American militaries have moved successfully in this direction.

Ultimately, the reduction of arms will enable the channeling of resources away from military programs and into economic and social development. But the reduction of military budgets has to be paced so that the security risks do not increase significantly, and it must be sensitive to the importance of adequate military salaries for encouraging and maintaining a professional orientation within the armed forces. Low salaries, as much as lack of professionalism, have induced the forays of military officers into private business affairs and to the use of political power for personal gain.

Economic and Social Justice

Bringing Central Americans now living in poverty into the economic mainstream is just as important as engaging the military in the movement toward political freedom and democracy. In the short run, this means nurturing a wide range of institutions that foster broad-based social and economic participation. Over the long run, institutions such as political parties, unions, cooperatives, non-governmental organizations and church groups help increase the capacities of currently marginal groups to participate more fully.

As stressed in the third chapter of this report, a human resources strategy is essential to promote wider and more active participation of the entire population. Among the groups who have traditionally been excluded from social and economic justice are women, indigenous groups, workers, and the rural and urban poor. In our human resources strategy, we emphasize the importance of investing in basic needs as well as reforming policy to equalize access to credit and employment for these Central Americans. Wider opportunities for literacy and primary education, in particular, will promote both economic and political development.

Strengthening political parties throughout Central America is another important method for widening social participation. One serious weakness of the region's political parties is their tendency to split into factions, divided by ideology, personality and mutual intolerance. This factionalization of parties and movements damages the effectiveness of their programs and organizations.

The international community can promote democratic development by supporting institutions that foster economic and social justice. Growing worldwide involvement through international non-governmental organizations