Pergamon

World Development, Vol. 23, No. 12, pp. 2067–2077, 1995

0305–750X/95 $9.50 + 0.00

0305–750X(95)00101–8

Adjustment Toward Peace: An Introduction

JAMES K. BOYCE*
University of Massachusetts, Amherst, U.S.A.

Summary. — The recent experience of El Salvador offers valuable lessons for economic policy in postconflictual transitions. In the wake of a negotiated settlement to a civil war, economic policy must support the adjustment toward peace. In the short run, policy must promote not only macroeconomic stabilization but also political stabilization. This requires the mobilization of resources and the maintenance of political will for implementation of immediate peace-related needs such as the reintegration of excombatants into civil society and the strengthening of democratic institutions. Long-run policy objectives must encompass not only the attainment of macroeconomic balances, but also equity, that is, balance in the distribution of income and wealth; balanced investment in human, natural, and physical capital; and democratization in the broad sense of a more balanced distribution of power. In the end, policies which fail to build on the crucial complementarities between peace and development are unlikely to achieve either goal.

1. INTRODUCTION

The transition from civil war to peace poses formidable challenges for economic policy. During the postconflictual transition the goals of economic policy cannot be limited to macroeconomic stabilization and conventional structural adjustment. Economic policy must also promote the adjustment toward peace. In a world where civil conflict is tragically widespread, the postwar experience of El Salvador offers valuable lessons.

The interdependence of peace and development in El Salvador is widely recognized. A failure to achieve broad improvements in living standards would fuel social tensions and heighten the risk of renewed war. In addition, a return to war would shatter hopes for economic revival. Yet there has been little systematic discussion of how economic policy should be reshaped in the special circumstances of a country emerging from civil war. In El Salvador the government and the international financial institutions (IFIs) have pursued essentially the same macroeconomic stabilization and structural adjustment policies they would have followed had the country never been at war. Recognition of the interdependence between peace and development has been translated into the questionable precept that if the peace process were allowed to interfere with economic policy, both would fail. The articles in this special section are based on the contrary premise that *unless* the peace process is allowed to reshape economic policy, both will fail.

Two broad sets of economic issues arise in the adjustment toward peace. The first concerns the problem of financing the immediate costs of peace, including the establishment of new democratic institutions, the reintegration of excombatants into civilian life, and the repair of physical infrastructure. The mobilization of resources for the peace process is a political problem as well as a financial problem. External assistance actors must deploy appropriate conditionalities if their aid is to support the momentum of the peace process and "crowd in" domestic resources for peace-related needs.

The second set of issues concerns the longer term interrelationships among economic growth, income distribution, and the consolidation of peace. Income inequalities can jeopardize both peace and growth.

*The author served as coordinator of the Adjustment Toward Peace project commissioned by the United Nations Development Programme in El Salvador, from which the articles in this special section are drawn. I have learned much from my colleagues on the research team: Carlos Acevedo, Deborah Barry, Michael E. Conroy, Colin Danby, Manuel Pastor, Jr., Eva Paus, Herman Rosa, Alexander Segovia, and Elisabeth J. Wood. In addition, we benefited greatly from the suggestions of the project advisory board comprised of Michael E. Conroy (chair), Victor Bulmer-Thomas, Hector Dada, Keith Griffin, Gabriel Siri, and Lance Taylor. On behalf of the entire team, I also wish to thank the staff of the San Salvador mission of the United Nations Development Programme, and in particular Anders Kompass and Francesca Jessup, for their support and assistance. Responsibility for the views expressed here rests with the authors alone, and should not be attributed to the United Nations or any of its member agencies.

Investments in human capital and natural capital are as critical as investment in physical capital. Democratization — in the broad sense of movement toward a more equitable distribution of power — can improve the functioning of both the state and the market. These issues are not unique to countries emerging from civil war. But the postconflictual setting presents them in exceptionally stark relief.

Section 2 of this introductory essay discusses the short-run issues of financing the costs of peace. Section 3 considers the longer term policy issues. Finally, Section 4 provides a brief overview of El Salvador's recent history as background for the articles which follow.

2. ECONOMIC POLICY AND EL SALVADOR'S POSTCONFLICTUAL TRANSITION

The war in El Salvador had many losers, but no clear victors. The Peace Accords brokered by the United Nations and signed at Chapultepec, Mexico, in January 1992 were born of a military stalemate. The 12-year civil war, which claimed some 75,000 lives, had brought neither the government nor the guerrillas of the Farabundo Martí Front for National Liberation (FMLN) the prospect of a decisive victory. Both sides agreed to major concessions to be implemented in phased steps in the ensuing months. The government agreed to recognize the FMLN as a legitimate political party, to disband its paramilitary police forces and replace them with a new, politically neutral police force, to purge the armed forces of those responsible for human rights abuses, to reform the judiciary and establish new democratic institutions, and to transfer land to excombatants and supporters of the FMLN. In return, the guerrillas agreed to lay down their arms and contend for power via free elections.

The far-reaching reforms embodied in the Chapultepec Accords were hailed as a "negotiated revolution" by Alvaro de Soto, who mediated the peace talks on behalf of the Secretary-General of the United Nations (Golden, 1992; Karl, 1992). Neither the negotiation nor the revolution ended, however, with the signing of the Accords. The peace agreement stopped the shooting, but the conflicts which rent El Salvador's social fabric continue to be fought by other means. The policies of external actors can strengthen, or weaken, the political resolve of both sides to implement the accords and consolidate the peace.

Economists and the international financial institutions which they staff are generally ill-prepared to operate in such a context. Contemporary economic theory typically takes for granted, as exogenously given, basic underpinnings of the economy which are far from settled in a country torn by civil conflict. These include a well-defined and socially accepted distribution of property or "initial endowments," a legal system to enforce property rights and contracts, and a state able to perform necessary economic tasks not fulfilled by markets, such as the provision of public goods. All of these preconditions are compromised or shattered by civil war, if indeed they existed before it. Moreover, they do not spring forth spontaneously upon the signing of a peace agreement. Rather they must be built gradually in a process regarded as legitimate by all parties to the conflict. Economic theory has little to say about how this crucial process of institutional change is to be accomplished. Indeed, many economists seem oblivious to the need to modify their policy prescriptions in the absence of these fundamentals.

International financial institutions such as the World Bank, the International Monetary Fund (IMF), and the Inter-American Development Bank (IDB), cannot so readily ignore these core issues of political economy. Yet these agencies historically have sought to distance themselves from such "political" issues, straying as little as possible from the familiar economic terrain in which they can claim technocratic expertise. In recent years, the IFIs have widened their self-proclaimed mandate to encompass such previously off-limits topics as military expenditure and "governance." But while these concerns now feature in the IFIs' public pronouncements and public relations, they remain poorly integrated at the operational level of their country programs. In El Salvador they have been notable by their absence.

This lacuna has contributed to a lamentable lack of coordination between economic policy and the peace process. Institutionally, this has been manifested in the division of labor between the Bretton Woods institutions (the World Bank and the IMF) and the United Nations: economic policy has been the province of the former, the peace process the province of the latter. Writing in the March 1994 issue of *Foreign Policy*, Alvaro de Soto and Graciana del Castillo depict the resulting situation by means of a metaphor: El Salvador is a patient on the operating table "with the left and right sides of his body separated by a curtain and unrelated surgery being performed on each side." Like most metaphors this image is inexact (see Segovia and Wood, 1995), but it dramatizes a critical issue raised by the Salvadoran experience.[1]

Contemporary macroeconomic policy distinguishes between short-run stabilization and medium-to long-run adjustment. Stabilization involves primarily fiscal and monetary policy; in the division of labor among the IFIs, this is mainly the province of the IMF. Adjustment refers to policies designed to alter the structure of the economy, including the relative sizes of the public and private sectors and of the tradable and non-tradable sectors; this is mainly the province of the World Bank and the regional development banks.

The dominant strand of policy making at the IFIs maintains that sound economic medicine is basically invariant with respect to time and place. Government budget deficits are assumed to be the root cause of inflation; hence these deficits must be curtailed, regardless of local circumstances such as the need to fund peace programs. Liberalization of trade and of the financial sector invariably promotes efficiency and growth. Structural adjustment is the key to long-run growth, the benefits of which will sooner or later percolate to the poor. If, in the meantime, reforms impose short-run costs on the poor, they should be cushioned by temporary schemes. Land reform is missing from the policy makers' tool-kit, as asset redistribution would transgress the minimal role accorded to the state.

The special features of the postconflictual transition do not imply that sound economic policies are unnecessary, nor that they should be sacrificed to political expediency. But in the aftermath of a civil war, the "soundness" of policies can be ascertained only in light of the political economy of the peace process.

In the short run, economic policy during the postconflictual transition must support political as well as economic stabilization. Political stabilization requires the successful implementation of the measures negotiated in the peace accords. This in turn requires adequate funding for programs mandated by the accords, and a continuing commitment by both sides to the ongoing peace process. Neither is an axiomatic feature of "sound economic policy" prescribed without reference to the peace process.

In some cases it could be necessary to ease macroeconomic stabilization targets so as to permit funding of peace programs through deficit finance. In the case of El Salvador, however, considerably greater domestic resources could be mobilized for the peace process by shifting government expenditure from other uses, notably military spending, and by raising the country's extremely low tax coefficient. The IMF reports that "in the Western Hemisphere, El Salvador allocated the largest share of total [government] spending for defense (16 percent) in 1992, and the smallest share for social security and welfare (3 percent)" (Abdallah, 1995, p. 77). The World Bank (1994, p. 182) reports that total government revenue in 1992 was less than 10% of GNP, the lowest of any middle-income country in the world. In recent years IFI-backed policies in El Salvador have contributed to some progress in raising tax revenues, though there remains much room for improvement. The IFIs have however, largely neglected military expenditure.

The failure of the IFIs to promote vigorously a greater reallocation of domestic resources to peace programs has been compounded by their failure to incorporate the maintenance of the political will behind the peace process as a policy objective. Yet large-scale infusions of external assistance, and the conditions attached — or not attached — to them, can significantly affect the priorities of political actors and the balance of power among them. A key lesson of El Salvador is the need for "peace conditionality" as an element of stabilization policies during postconflictual transitions (Boyce, 1995).

3. GROWTH, DISTRIBUTION, AND THE CONSOLIDATION OF PEACE

In the long run, economic policy after a civil war must promote not only economic adjustment but also a process of political adjustment: the consolidation of peace. In such a context distributional equity cannot be relegated to a lower priority than economic growth. Rather it must be a policy objective of the first order. To promote both equity and growth, economic policy should aim not only to stimulate overall investment, but also to achieve an appropriate balance among investments in human, natural, and physical capital. Rather than focusing narrowly on demarcation of the respective roles of the market and the state, economic policy during postconflictual transitions must also promote an equitable distribution of power, without which neither the market nor the state is likely to advance successfully the goals of efficiency, economic equity, and growth.

(a) *Growth and equity revisited*

Recent years have seen a quiet revolution in economists' understanding of the relationship between growth and equity. For many years the dominant view was that there was a "great tradeoff" between these objectives: policies to improve distributional equity would exact a price via lower growth. A revisionist view popularized in the 1970s by World Bank President Robert McNamara, among others, held that "growth with equity" was possible if the income increments from growth could be directed disproportionately to the poor. In the 1990s, fresh empirical and theoretical work has advanced a third and strikingly different proposition: equity not only is compatible with growth, but positively promotes it.

On the basis of a cross-sectional study of more than 40 countries over the quarter century from 1960 to 1985, Rodrik (1994) concludes that the countries with more equal distributions of land and income experienced more rapid growth. Primary school enrollment — a rough indicator of equity in the allocation of human capital investment — also had strong positive effects on growth. One avenue by which equity appears to have fostered growth was by encouraging investment in physical capital: land distribution and primary school enrollment both were statistically significant determinants of the investment/GDP ratio.

In an analysis with clear relevance to El Salvador, Alesina and Perotti (1993) test the proposition that a key link in the causal chain from equity to growth is political stability. They first test whether income inequality increases political instability, then whether political instability reduces investment. To both questions the answer is "yes," a result they term "not only statistically significant, but also economically significant."

A third econometric study, by Birdsall and Sabot (1994), likewise finds that countries with lower income inequality tend to have higher growth. These authors suggest that an important equity-to-growth link is investment in basic education. High income inequality reduces both the demand for primary education and its supply. Demand is limited as poor families cannot afford to send their children to school, and supply is limited as the rich resist paying taxes to subsidize education for the poor. Again, the analysis is quite relevant to El Salvador. Whereas public expenditure on education in "medium human development" countries rose from 2.5% of GNP in 1960 to 4.7% in 1990, in El Salvador it declined over the same period from 2.3% of GNP to 1.8% (UNDP, 1994, p. 158).[2]

Writing in the *American Economic Review*, Persson and Tabellini (1994) pose the question "Is Inequality Harmful for Growth?" They too answer in the affirmative. They present empirical evidence from a long-run historical panel of nine industrialized countries and from a postwar cross-section of 56 countries; in both, econometric analysis indicates that income inequality significantly lowers growth. Investment is again an important mediating variable: higher inequality leads to lower investment and hence to lower growth.[3]

In an historical study of the Americas since the European conquest, Engerman and Sokoloff (1994) similarly conclude that differences in "the degree of inequality in wealth, human capital, and political power" account for the enormous long-run variation in the economic performance. Their analysis highlights the historical link between extreme inequality and the cultivation of certain export crops, including sugar and coffee, a relationship which has featured prominently in El Salvador's history.

A further strand in the recent literature focuses on how inequality can impede growth in the presence of financial market imperfections. In these theoretical models, the poor are blocked from undertaking high-growth activities by their inability to afford the initial set-up costs, and owing to imperfect financial markets they are unable to borrow for this purpose. Plausible examples include not only investment in physical capital but also investment in education. Hence policies to redistribute income and wealth, as well as policies to reduce imperfections in credit markets, can enhance growth.[4]

It is still early to speak of a new consensus on growth and equity in development economics. But signs of an impending shift are evident. In *The East Asian Miracle*, the World Bank's (1993) widely publicized study of the economic performance of the "high-performing Asian economies," great importance is attached to the role of widespread primary education in laying the foundation for growth. Other dimensions of distributional equity also feature in the analysis. Equity is recognized as a source of political legitimacy (p. 158); land reform in Taiwan is held to have advanced both land productivity and political stability (p. 161); successful land reform in China, Japan, Korea and Taiwan "helped to lay the foundation for rapid, shared growth" (p. 169); and the failure of the Philippines to share this success is attributed to the fact that "Philippine policy making has historically been captive to vested interests that have shaped economic policy to protect and enhance their privileged position, often to the detriment of national well-being" (p. 169). Despite these insights, however, *The East Asian Miracle* for the most part echoes the McNamara-era view that growth with equity is merely possible, stopping short of the recognition that equity actually promotes growth. Indeed, the legacy of the old tradeoff mentality is still apparent in that the successful combination of rapid growth with equity is regarded as "the essence of the miracle,"[5] rather than as the logical, unmiraculous result of causal links from equity to growth.

In November 1994 a delegation from the Government of El Salvador visited the World Bank and IMF in Washington, lunched with the principal author of *The East Asian Miracle*, and carried multiple copies of the book back to El Salvador. It remains to be seen whether Salvadoran policy makers will build on the vital lessons of the east Asian experience regarding the importance of equity — notably in land distribution and education — for economic growth.

(b) *Investment in natural, human, and physical capital*

Investment in physical capital — the plant and equipment with which labor transforms raw materials — has long been recognized as a basic precondition for economic growth. Investment in human capital — the health and education of the labor force — is now widely agreed to be of comparable or perhaps even greater importance.[6] In El Salvador there is considerable scope for greater public and private investment in both physical and human capital. As a share of GDP, El Salvador's gross domestic investment is among the lowest in Latin America.[7] It also has the lowest primary school enrollment ratio of any country in the Western Hemisphere with the exception of Haiti.[8]

Investment in natural capital — that is, sources of raw materials, and sinks for the disposal of by-products of economic activity — has yet to receive comparable attention from policy makers, despite much recent talk of "sustainable development." In part this is because some regard natural capital as a fixed endowment, something which cannot be augmented by human activity, while others regard physical and human capital as perfect substitutes for natural capital. The first view gives rise to Malthusian pessimism: humanity is on a one-way road to depletion of its natural capital, and the only question is how quickly we travel it. The second gives rise to Panglossian optimism: as natural capital is depleted, price signals will induce smooth factor substitution and technological change, ensuring that we continue to inhabit the best of all possible worlds. Neither view recognizes the basic fact that humans can invest in natural capital, as well as deplete it.

For example, soil erosion and the depletion and degradation of water supplies are today critical environmental problems in many countries. El Salvador faces them in extreme forms (Acevedo, Barry and Rosa, 1995). Yet appropriate human interventions can slow and even reverse these processes. Soil conservation measures, including terracing, afforestation, and the cultivation of cover crops and green manures, can restore soils and improve water retention. Integrated pest management can, over time, allow ecosystems to recover from the toxic legacy of indiscriminate pesticide use. Similarly, pollution control can allow water quality to recover from contamination by industrial and domestic wastes.

The problem is that many of the returns to such investments in natural capital are external, accruing to others in society, rather than internal to the investor. For example, the *campesino* who protects soil and water may derive some personal benefit from doing so, but much of the social benefit will be reaped by others. No market mechanism exists by which those others can pay the *campesino* to invest the "right" amount of time and money in natural capital. In the absence of social mechanisms to correct this market failure, there will be systematic underinvestment in soil conservation, water quality protection, and other types of natural capital. The possible corrective mechanisms include state regulation, taxes and subsidies, community management, and informal norms and sanctions, alone or in combination.

Investments in natural, human, and physical capital are highly complementary; that is, one type of investment can enhance the scale and productivity of the others. For example, investment in the human capital of the poor can lead to greater investment in natural capital by several routes: by reducing their need to degrade the environment for immediate survival; by improving their ability to combat environmental degradation of which they are victims, not perpetrators; and by diffusing knowledge of the relationships between economic activity and the environment (Segura and Boyce, 1994).

Investment in physical and human capital form critical links in the newly recognized causal chain from distributional equity to growth, as noted above. Investment in natural capital constitutes a further link. Greater equality of wealth and power can be expected to result in lower rates of environmental degradation, by lowering the discount rates of the poor, and by enhancing the ability of the less powerful to resist the imposition of external costs on them by the more powerful (Boyce, 1994). El Salvador offers striking examples of the effects of political and economic inequalities on natural capital, ranging from the environmental damages inflicted by the war itself to the current threat to San Salvador's aquifer from attempts to urbanize disputed lands at the adjacent El Espino coffee cooperative (Barraza, 1994).

(c) *Democratization: Beyond the market and the state*

In El Salvador, as elsewhere, a central element of the structural adjustment programs backed by the IFIs has been the "modernization" of the state. In practice this has primarily meant efforts to trim the size of the state by privatizing state-owned enterprises and eliminating certain agencies and functions, coupled with attempts to increase the efficiency of what remains. Such efforts are often well justified in terms of both growth and equity. What has been generally missing from IFI prescriptions, however, has been democratization, both in the broad sense of promoting a more equitable distribution of power, and in the narrow sense of strengthening democratic institutions such as free elections, the protection of human rights, and the administration of justice.

This reflects the widespread tendency among economic theorists and policy makers alike to concentrate on defining the appropriate roles of the market and the state, while abstracting from the political economies within which both are embedded. When the problems posed by the distribution of power are broached at all, the favored solution is "technocratic insulation" — defined in *The East Asian Miracle* as the ability to formulate and implement policy "with a minimum of lobbying for special favors from politicians and interest groups" (World Bank, 1993, p. 167).

Successful economic policy in El Salvador will require critical state interventions which have been underemphasized in the adjustment programs implemented to date. These include interventions to promote a more equitable distribution of income, to correct financial market imperfections, to redress environmental externalities, to implement agrarian reforms, and to promote competitive industries in the tradable-goods sector. But, these interventions — or, for that matter, any other program of state modernization, whatever its mix of market and state — are unlikely to succeed in the absence of political reforms which establish checks on the use and abuse of power.

Democratization, not only in the narrow electoral sense but also in the broad sense of establishing an equitable distribution of power, is crucial because it provides the only secure foundation for accountability. Democratic accountability is more desirable than "technocratic insulation" not only because it is a virtue in itself, but also because in its absence there can be no guarantee that technocrats will in fact pursue the public interest.[9] In El Salvador it is also more viable, since technocratic insulation is quite difficult to achieve in the wake of a negotiated settlement to a civil war, the essence of which is the creation of checks and balances on the exercise of power.[10]

Democratic accountability thus can better serve the function ascribed to "technocratic insulation" in *The East Asian Miracle:* it can foster the formulation and implementation of policies which advance the long-term interests of the society as a whole rather than the short-term interests of a powerful few. Democracy in the broad sense provides the necessary political leverage:

- to protect basic human rights;
- to safeguard the property rights of the poor;
- to foster the political stability needed to encourage private investment;
- to orient public investment toward advancement of the public interest;
- to combat corruption;
- to prevent the socially injurious exercise of market power, that is, monopolistic or oligopolistic control over input and output markets;
- to secure government action to redress environmental externalities, such as industrial pollution and watershed degradation;
- to minimize the extent to which selective government interventions, such as subsidized credit or export incentives, are captured by unproductive rent-seekers instead of being effectively tied to economic performance; and
- to implement redistributive policies in pursuit of inclusive economic growth.

In sum, medium and long-term adjustment toward peace requires more than achieving macroeconomic balances between exports and imports, saving and investment, and government revenue and expenditure. It also requires equity, that is, balance in the distribution of income and wealth; balanced investment in human, natural, and physical capital; and democratization to achieve balance in the distribution of power. Economic policy during the postconflictual transition therefore must aim to secure not only stabilization and growth but also equity and the consolidation of peace. Policies which fail to build on the powerful complementarities among these objectives will ultimately fail to achieve any of them.

4. WAR AND PEACE: LEARNING FROM EL SALVADOR

El Salvador's civil war provides a dramatic illustration of the potentially debilitating economic impact of great inequalities of wealth and power. The economic, political, and social changes wrought by war have created the opportunity to at last redress these inequalities and thereby lay the foundation for a more stable and prosperous future.

(a) *Inequality and organized violence*

The roots of war in El Salvador can be traced to the latter half of the 19th century, when the country became a major producer and exporter of coffee. The volcanic slopes of central and western El Salvador are admirably suited for growing coffee. Most of these lands were held by indigenous communities in the mid-19th century as communal property. In response to the opportunities presented by coffee, communal property was abolished by state decree in 1882. By the turn of the century the indigenous communities had been forcibly evicted, and the country's best coffee lands converted into *latifundia*, large estates owned by the "Fourteen Families" who formed the core of the ruling oligarchy.[11] The result was among the most inequitable patterns of land distribution in the world.

There is no inherent technological reason why coffee must be grown on large estates; in some countries, including Costa Rica and Colombia, coffee is widely grown on small family farms. There was a strong political logic, however, behind the large-estate mode of coffee cultivation which emerged in El Salvador. The advent of the international coffee market presented lucrative opportunities for profit, and these opportunities — and the land to realize them — were seized by those with the political and economic power to do so.

The expropriation and concentration of landholdings "freed" labor to work on the coffee estates. But much of this labor was required only for the harvest. For the remainder of the year, the seasonal laborers survived on *minifundia*, very small holdings where they grew subsistence crops such as maize and beans. A central aim of the coffee oligarchy was to keep this labor available and cheap. The deployment of military forces to maintain rural law and order and suppress intermittent peasant revolts contributed to this end.

El Salvador's agrarian structure thus was forged by a process which bears little resemblance to the stylized theories of social interaction found in neoclassical economics textbooks. It did not emerge from free exchanges among optimizing individuals, in which the more efficient producers bought land at the prevailing market price from others, who then merrily reinvested their capital in alternative lines of production in which they could better compete. Rather the country's agrarian structure arose through intimidation, bloodshed, and hatred, the scars of which remain visible to this day.

Organized violence was necessary not only to create El Salvador's oligarchical agro-export structure, but also to maintain it. The Great Depression and the attendant slump in world coffee prices hit the Salvadoran economy hard. Coffee growers responded by slashing wages and employment. Discontent mounted, and a peasant revolt broke out in 1932. The Salvadoran Communist Party, founded three years earlier and led by Farabundo Martí, helped to lead the uprising, but it was not a carefully organized affair. The military quickly crushed the revolt, and government forces killed 10,000–30,000 people in *la matanza*, the slaughter, an event indelibly imprinted on the country's historical memory.

Fifty years later El Salvador was engulfed in a civil war in which the government confronted the Farabundo Martí National Liberation Front (FMLN), named after the communist leader executed during *la matanza*.[12] No single event marks the beginning of the war; rather it gathered force in a rising tide of violence. The October 1979 coup by young army officers brought to power a *junta* which combined reformist policies with severe repression. In January 1980 the largest demonstration in El Salvador's history — one aim of which was "to pay homage to the *compañeros* who had died in the 1932 uprising" — was fired on by paramilitary forces, killing scores and wounding hundreds (Montgomery, 1995, pp. 108–109). In March 1980 the government promulgated an agrarian reform, nationalizing large estates. That same month Archbishop Oscar Romero was assassinated during a mass; a few days later the thousands of people who gathered in central San Salvador for his funeral were attacked with bombs and machine guns by military forces, leaving scores dead. By the end of the year, virtually all avenues for peaceful opposition to the government had been closed.

The *junta* and its successors, including the government of José Napoleon Duarte which was elected in 1984, received strong backing from the US government, which in a 1981 white paper characterized the Salvadoran conflict as "a textbook case of armed aggression by communist powers."[13] The global rivalry between the United States and the Soviet Union, which was being waged in earnest in the 1980s, helped to fuel the civil conflict in El Salvador. But superpower contention was not a sufficient condition for civil war. The central role of economic and political inequalities in the origins of the war was implicitly recognized in the US-sponsored doctrine of low-intensity conflict, which coupled military force with economic and political reforms designed to win the "hearts and minds" of the populace.

The combination of repression and reform both reflected and reinforced divisions among political actors in El Salvador and the United States. In the United States, reformist measures were necessary for the Reagan administration to win support in the opposition-controlled Congress for stepped-up economic and military aid. In El Salvador, the political opening fostered by reforms permitted some open criticism of government policies. Such criticism in turn was often met by further acts of repression.[14]

Alfredo Cristiani of the rightist ARENA party was elected president in March 1989. Cristiani represented what has been variously described as the "agro-industrial," "modern," or "more moderate" wing of El Salvador's ruling elite, and his ascendancy to the presidency marked a shift in the balance of power within the ARENA party.[15] While embarking on a new economic agenda of neoliberal reforms, the Cristiani government continued the low-intensity conflict strategy and the intermittent peace talks with the FMLN begun under Duarte's government.

Two dramatic events in November 1989 intensified the search for peace. The first was an FMLN offensive which brought the war to the capital and dispelled illusions that either side could soon win the war. The second was the murder of six Jesuit priests at the University of Central America in San Salvador.[16] These events helped to precipitate a shift in US policy in favor of a negotiated settlement. By the end of 1990 the United States had cut military aid to El Salvador and imposed conditions whereby military aid would be eliminated altogether if the government failed to negotiate in good faith, and restored to previous levels if the FMLN did not do the same (Whitfield, 1994, p. 188).

In a sense, the peace agreement which followed was born of the excesses of violence which preceded it. de Soto (1994, pp. xiii–xiv) expressed this paradox as follows: "The Jesuits had to lose their lives to provide the moral outrage that kept the Salvadoran armed forces on the defensive and forced the concessions at the negotiating table, without which a durable peace could not possibly have been built."

(b) *El Salvador's negotiated revolution*

The Salvadoran Peace Accords, signed in Chapultepec, Mexico in January 1992, aimed not only to end the civil war but also to resolve the underlying causes of the conflict. The potential for organized violence was to be reduced through demobilization of armed combatants, a purge of military officers guilty of human rights abuses, the disbanding of paramilitary forces, and the creation of a neutral police force, the National Civilian Police (PNC). A more equitable distribution of power was to be achieved through the strengthening of democratic institutions, including reform of the judiciary, free elections open to participation by all parties, and the creation of a permanent Human Rights Ombudsman's office. Moreover, the most pressing of economic inequalities were to be redressed through land transfers to excombatants and FMLN supporters, microenterprise and housing assistance for excombatants, and expanded poverty alleviation programs.

Under the timetable established in the Accords, each side agreed to implement a series of measures tied to complementary actions by the other. The implementation process was beset by a number of delays, however. These were sometimes blamed on financial constraints, but the basic reasons for the delays were generally political: the process of negotiation did not end with the signing of the Accords. For example, the purge of the army officer corps occurred only after substantial delays and required strong international pressure. A particularly serious threat to the peace process came in October 1992, when the FMLN halted its phased disarmament in response to lack of progress in the land transfer program; this dispute culminated in a further UN-brokered agreement designed to expedite the transfer of lands. The establishment of the PNC was also subject to numerous delays. The dismantling of the National Police, originally slated for the end of 1993, in the end was not completed until January 1995.

The March 1994 elections represented a landmark in the implementation of the Peace Accords. The ARENA party won the presidency, the largest share of seats in the Legislative Assembly, and the vast majority of municipal elections, while the FMLN, participating in elections for the first time, finished second in the presidential race and won a number of Assembly seats. While marred by incomplete voter registration and polling irregularities, the elections were peaceful and the outcome was regarded as reasonably fair by most observers.[17]

The land transfer program established by the Accords and the October 1992 supplemental agreement provided for voluntary land transfers to excombatants on both sides and to peasant supporters of the FMLN in the former conflictive zones. Landowners who agreed to give up their lands were to be compensated at "market prices." The program was described by many as a land-for-arms exchange. de Soto and del Castillo (1994b, p. 11) observe:

> The land transfer program was certainly not an attempt at land reform or a mechanism for income redistribution as such, but rather the main venue in the Agreement through which ex-combatants and supports of the FMLN would be reintegrated into the productive life of the country.

The fulfillment of even this limited aim has proven problematic, however: the transfer program is now far behind schedule; agricultural credit and technical assistance have not been readily available; the current macroeconomic environment is very unfavorable to agriculture; and the recipients are saddled with debts for land acquisition which they are unlikely to be able to repay.

Failures to fulfill the expectations of demobilized excombatants have had serious implications for public security. Excombatants are widely cited as a factor in the country's recent crime wave. Moreover, protests by excombatants periodically threaten to rekindle organized violence. In January 1995, for example, exsoldiers occupied the Legislative Assembly and other government buildings in San Salvador for two days, taking hundreds of hostages and blocking key highways. The weekly journal *Proceso* commented: "The actions taken by the demobilized soldiers demonstrate the extremes to which desperate people, without jobs or a future, can resort" (Center for Information, Documentation and Research Support, 1995).

The Chapultepec Accords represent only initial steps toward peace in El Salvador. Further progress will require a deepening of economic reforms to achieve a more equitable distribution of wealth and income, and continued strengthening of democratic institutions to ensure the rule of law. In their absence, the roots of organized violence in El Salvador will remain intact. Notwithstanding the historic achievements since the signing of the Accords, de Soto and del Castillo (1994b, p. 16) observe, "it would be premature to label El Salvador a success story."

(c) *Generalizing from the Salvadoran experience*

El Salvador's peace process has been facilitated by two favorable circumstances: the end of the Cold War and an abundance of foreign exchange thanks to external assistance and remittances from Salvadorans overseas.

The superpower rivalry between the United States and the Soviet Union was not the prime mover of the Salvadoran conflict. As President Alfredo Cristiani remarked at the signing of the Peace Accords, the war in El Salvador had "profound social, political, economic and cultural roots . . . in synthesis, the absence of a truly democratic form of life" (quoted by Whitfield, 1994, p. 380). But as noted above, the US-Soviet conflict added fuel to the fire. The end of the Cold War unquestionably created an external environment more conducive to peace in El Salvador.

Remittances and external assistance have cushioned the country's postconflictual transition in three ways. First, ample foreign exchange has prevented shortages of imports.[18] Second, the erosion of the living standards of the poor has been moderated, and for some reversed, by transfers from relatives abroad. Third, external resources have provided a "cushion of governability," easing political pressures and conflicts. While the volume of these inflows in El Salvador is remarkable, the phenomenon is not exceptional in postconflictual settings: the end of a war often triggers both substantial aid and an influx of private capital.[19]

Apart from these somewhat special circumstances, many aspects of the Salvadoran experience are of general relevance to the formulation of economic policy in postconflictual transitions. A negotiated conclusion to a civil war inevitably poses the short-run problems of securing the financial and political preconditions for implementation of the peace accords. In such a context there is a critical need for "peace conditionality" in the policies of the major external assistance actors, including the international financial institutions. Over the long run, the consolidation of peace in countries emerging from civil war often hinges, as in El Salvador, on the forging of a more equitable distribution of wealth and power. If El Salvador succeeds in its adjustment toward peace, and if the international community absorbs the lessons of that experience, then the terrible war will not have been entirely in vain.

NOTES

1. For a more general analysis of coordination problems between the United Nations and Bretton Woods institutions, see Childers and Urquhart (1994, pp. 77–87).

2. The composition of public expenditure on education is also important. Birdsall and Sabot (1994, p. 4) observe that in Latin America as a whole, the ratio of total public expenditure on education to GDP has been similar to that in East Asia, but that the share allocated to basic (as opposed to higher) education has been notably lower. They attribute this to pressure from high-income families "to channel subsidies to higher education where their children will be the beneficiaries."

3. Persson and Tabellini's theoretical analysis hypothesizes that the reason why greater inequality leads to lower investment is that in democracies the distributional conflicts generated by inequality lead to redistributive policies which tax or otherwise deter investment. They find empirical support for this in the history of OECD countries; their postwar cross-sectional analysis also indicates that the negative relation between inequality and growth holds only in democracies. This hypothesis can be questioned. Much of the new growth and equity literature (including Persson and Tabellini's own main empirical results) suggest the opposite conclusion: that redistributive policies can enhance growth. For evidence of a positive association between democracy and private investment in Latin America, see Pastor and Hilt (1993).

4. See, for example, Galor and Zeira (1993). Danby (1995) discusses credit market imperfections in El Salvador.

5. World Bank (1993, p. 8). "The striking characteristics of the East Asian miracle are rapid and persistent growth in a context of high income equality," the volume's principal author remarked at an IMF Economic Forum. "This unusual combination indeed suggests a miracle" (*IMF Survey*, 1995, p. 78).

6. *The East Asian Miracle* (World Bank 1993, p. 52), for example, concludes that "primary education is by far the largest single contributor to the HPAEs' [high-performing Asian economies'] predicted growth rates." See also Rodrik (1994, pp. 15–22).

7. In 1992, according to the World Bank (1994, pp. 178) gross domestic investment in El Salvador stood at 16% of GDP; the only country in Latin America for which a lower ratio was reported was Argentina, at 15%.

8. The ratio for El Salvador, according to the UNDP's (1994, pp. 156–157) *Human Development Report*, was 71% in 1990. For comparison, in Nicaragua the reported ratio was 76%, in Honduras it was 93%, and in Mexico it was 100%.

9. One can contrast the voluntarism of *The East Asian Miracle* — in which economic technocrats left to their own devices choose to advance the public interest — to Amsden's (1989) characterization of the South Korean model as one in which the government disciplined the capitalists, and the student movement in turn "disciplined" the government.

10. This can be contrasted to the situation facing an occupation government installed by external powers after an international conflict, as in postwar Korea and Japan.

11. As Bulmer-Thomas (1987, p. 340) notes, in fact some 60 families, rather than 14, came to dominate the country's economic, social, and political life.

12. The FMLN was formed in 1980 by an alliance of five parties; for details, see Montgomery (1995, Chapter 4).

13. Cited by Whitfield (1994, p. 405).

14. "Between 1983 and 1986," Whitfield (1994, pp. 242–243) remarks, "unions, popular organizations, and social forces tentatively re-emerged from the silence and fear of the early years of the war and first filled and then pushed beyond the narrow margin of legality granted them by a U.S.-driven policy committed to 'democratization' in the midst of war."

15. For discussion, see Wolf (1992), Paige (1993), and Johnson (1993).

16. The six priests, and a housekeeper and her daughter, were slain on the night of November 15, 1989. Suspicions immediately focused on the military. After the war these suspicions were confirmed by the findings of the Truth Commission for El Salvador (1993). For a thorough account, see Whitfield (1994).

17. The Secretary-General of the United Nations reported that "the elections were held under generally acceptable conditions, without any major acts of violence, although serious flaws regarding organization and transparency were detected." (United Nations Security Council, 1994, pp. 2–3.)

18. This has not been an unmixed blessing: inflows of external resources have propelled exchange rate overvaluation, with adverse effects on producers of tradable goods.

19. Within three years of its 1971 independence war, for example, Bangladesh received more external assistance than its previous 24 years as East Pakistan (Hartmann and Boyce, 1983, p. 268).

REFERENCES

Abdallah, K. W., "GFS Yearbook highlights trends in fiscal balance, military spending," *IMF Survey*, Vol. 24, No. 5 (March 6, 1995), pp. 76–77.

Acevedo, C., D. Barry and H. Rosa, "El Salvador's agricultural sector: Macroeconomic policy, agrarian change, and the environment," *World Development*, Vol. 23, (1995), pp. 2153–2172.

Alesina, A. and R. Perotti, "Income distribution, political instability, and investment," Working Paper No. 4486 (Cambridge, MA: National Bureau of Economic Research, October 1993).

Amsden, A. H., *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989).

Barraza, B., "El conflicto por El Espino: dónde está el estado?," *Prisma Boletín*, No. 7 (1994), pp. 7–10.

Birdsall, N. and R. Sabot, "Inequality as a constraint on growth in Latin America", *Development Policy: Newsletter on Policy Research* (Washington, DC: Inter-American Development Bank, Office of the Chief Economist, September 1994), pp. 1–5.

Boyce, J. K., "Inequality as a cause of environmental degradation," *Ecological Economics*, Vol. 11 (1994), pp. 169–178.

Boyce, J. K., "External assistance and the peace process in El Salvador," *World Development*, Vol. 23, (1995), pp. 2101–2116.

Bulmer-Thomas, V., *The Political Economy of Central America since 1920* (Cambridge: Cambridge University Press, 1987).

Center for Information, Documentation and Research Support (CIDAI), "Editorial: Demobilized soldiers mobilize," *Proceso*, No. 647 (February 1, 1995).

Childers, E. and B. Urquhart, *Renewing the United Nations System* (Uppsala: Dag Hammarskjold Foundation; New York: Ford Foundation, 1994).

Danby, C., "Challenges and opportunities in El Salvador's financial sector," *World Development*, Vol. 23, (1995), pp. 2133–2152.

De Soto, A. "Foreword," in T. Whitfield, *Paying the Price: Ignacio Ellacuría and the Murdered Jesuits of El Salvador* (Philadelphia, PA: Temple University Press, 1994), pp. xi–xiv.

De Soto, A. and G. del Castillo, "Obstacles to peacebuilding," *Foreign Policy*, Vol. 94 (Spring 1994a), pp. 69–83.

De Soto, A. and G. del Castillo, "El Salvador: Still not a success study," Mimeo (New York: Office of the Secretary-General of the United Nations, June 1994b).

Engerman, S., L. and K. L. Sokoloff, "Factor endowments, institutions, and differential paths of growth among New World economies: a view from economic historians of the United States," Historical Paper No. 66 (Cambridge, MA: National Bureau of Economic Research, December 1994).

Galor, O. and J. Zeira, "Income distribution and macroeconomics," *Review of Economic Studies*, Vol. 60 (1993), pp. 35–52.

Golden, T., "The Salvadorans make peace in a 'negotiated revolution'," *The New York Times* (January 5, 1992), p. E3.

Hartmann, B. and J. K. Boyce, *A Quiet Violence* (London: Zed Books, 1983).

IMF Survey, "East Asian Economic miracle," Vol. 24, No. 5 (1995), pp. 65, 78–80.

Johnson, K., "Between revolution and democracy: Business elites and the state in El Salvador during the 1980s," Ph.D. dissertation (New Orleans: Tulane University, 1993).

Karl, T. L., "El Salvador's negotiated revolution," *Foreign Affairs*, Vol. 71, No. 2 (1992), pp. 147–164.

Montgomery, T. S., *Revolution in El Salvador: From Civil Strife to Civil Peace*, Second edition (Boulder, CO: Westview, 1995).

Paige, J. M., "Coffee and power in El Salvador," *Latin American Research Review*, Vol. 28, No. 3 (1993), pp. 7–40.

Pastor, M. and E. Hilt, "Private investment and democracy in Latin America," *World Development*, Vol. 21, No. 4 (1993), pp. 489–507.

Persson, T. and G. Tabellini, "Is inequality harmful for growth?," *American Economic Review*, Vol. 84, No. 3 (1994), pp. 600–621.

Rodrik, D., "King Kong meets Godzilla: The World Bank and *The East Asian Miracle*," in A. Fishlow *et al.*, *Miracle or Design: Lessons from the East Asian Experience* (Washington, DC: Overseas Development Council, 1994), pp. 13–53.

Segura, O. and J. K. Boyce, "Investing in natural and human capital in developing countries," in A. Jansson *et al.* (Eds.), *Investing in Natural Capital: The Ecological Economics Approach to Sustainability* (Washington, DC: Island Press, 1994), pp. 470–489.

Truth Commission for El Salvador, *From Madness to Hope:*

The Twelve-Year War in El Salvador (New York and San Salvador: United Nations, 1993).

United Nations Development Programme (UNDP), *Human Development Report 1994* (New York: Oxford University Press, 1994).

United Nations Security Council, "Report of the Secretary-General on the United Nations Observer Mission in El Salvador" (New York: United Nations, S/1994/561, May 11, 1994).

Whitfield, T., *Paying the Price: Ignacio Ellacuría and the Murdered Jesuits of El Salvador* (Philadelphia, PA: Temple University Press, 1994).

Wolf, D. H., "ARENA in the Arena: Factors in the Accommodation of the Salvadoran Right to Pluralism and the Broadening of the Political System," Paper presented to the United Nations Observers Mission in El Salvador (ONUSAL) (La Jolla, CA: University of California, San Diego, Department of Political Science, January 20, 1992).

Wood, E. and A. Segovia, "Macro-economic Policy and the Salvadoran Peace Accords," *World Development*, Vol. 23, (1995), pp. 2079–2099.

World Bank, *World Development Report 1994* (New York: Oxford University Press, 1994).

World Bank, *The East Asian Miracle* (Washington, DC: The World Bank, 1993).