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Post-Conflict Reconstruction and the Challenge to International Organizations: The Case of El Salvador

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Summary. — Countries in post-conflict transitions have to reconcile the development challenge with the additional burden of reconstruction and national reconciliation. This paper first describes the peculiarities of these countries which make them clearly different from those pursuing normal development. Second is a discussion of the challenges that these transitions pose on the countries involved and on the international organizations that support them. Third, the paper illustrates through a discussion of El Salvador—by all standards a success story—how the International Monetary Fund and the United Nations had to adapt to meet the challenges of post-conflict reconstruction. The paper concludes with some policy recommendations. © 2001 Published by Elsevier Science Ltd.

Key words — Latin America, El Salvador, political economy, post-conflict reconstruction, international organizations, development assistance

1. INTRODUCTION

A large number of countries have emerged from civil war or other forms of internal conflict. A few have managed to construct a fragile peace and embark on what is often a complex triple transition: from conflict to peace; from a nonparticipatory, militarized society to a system based on democratic principles and the rule of law; and from statist policies and macroeconomic mismanagement to stabilization and economic reform. Post-conflict transitions put a heavy burden not only on the countries themselves, but on the international organizations that are called upon to play a critical role in facilitating and financing them.

Our analysis focuses on the issue of economic reconstruction. [1] In post-conflict transitions, policymakers need to deal early on with serious macroeconomic imbalances and monetary and fiscal management issues in the midst of political, social and institutional vulnerabilities that are the legacy of conflict. Economies coming out of internal strife or conditions of extreme socio-political upheaval have, as a general rule, devastated or at least severely distorted economies. Both human capital and physical infrastructure are often in shambles, existing national institutions are inadequate or lacking, and major macroeconomic disequilibria may require tough stabilization policies.

Thus, countries emerging from protracted civil wars have to confront the normal challenge of socioeconomic development while accommodating, at the same time, the additional burden of reconstruction and peace consolidation, so that they can in the future address their grievances through institutional and peaceful means. This is particularly arduous since, after years of political polarization and ideological confrontations, the lack of consensus on macroeconomic management and structural reform is often acute. Putting the economy back in a path of stabilization and growth, however, becomes imperative, if a large number of former combatants of both sides and other conflict-affected groups, including returnees, internally displaced persons, and the resident population in former zones of conflict, are to be reinserted effectively and permanently into the productive life of the country.

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Development organizations, including the World Bank, the United Nations Development Programme (UNDP) and the regional development banks, particularly the Inter-American Development Bank, play an important role in the economic reconstruction. One of the most daunting challenges in carrying out post-conflict transitions, however, is to design and implement an economic program for the economic reconstruction of the country—usually sponsored by the International Monetary Fund (IMF or Fund)—within the constraints and financial requirements of national reconciliation efforts resulting from the political agreement for peace—usually brokered by the United Nations (UN).

Because of the critical role of the UN and the Fund in post-conflict transitions, this paper will focus on these two institutions to the exclusion of the many others that are also involved. [2] In these transitions the UN often plays the critical role of good offices and verification of peace agreements and of facilitator of their operational implementation. The Fund continues to assist countries in restoring macroeconomic balance, strengthening the external position, and improving the institutional framework. More importantly, an IMF-supported economic program is a *de facto* if not *de jure* requirement for assistance from the World Bank, the Inter-American Development Bank and often from bilateral donors.

Given the peculiarities of countries in post-conflict transitions, assistance to these countries—in (former IMF Managing Director) Michel Camdessus' words—has had to be reinvented (Camdessus, 1996). This has required the rethinking of analytical and operational issues so that they can be framed in a multidisciplinary strategy in which first-best policies based on purely economic profit-maximizing criteria are often not appropriate or even recommended.

Post-conflict reconstruction and the practical and institutional challenges to the UN and the Fund are illustrated with the case of El Salvador. After a decade-long war, 75,000 estimated dead, and serious damage to human capital and physical infrastructure, overambitious expectations were created by a peace agreement—signed in 1992 between the government of El Salvador and the Frente Farabundo Martí para la Liberación Nacional (FMLN). Despite the fact that El Salvador is, by any standard, considered one of the most successful UN peace-keeping operations, the implementation of the peace process in the country was plagued with difficulties and complex challenges from the start. Now that the transition is over, it is a good time to evaluate its strengths and weaknesses, both to facilitate future experiences and to avoid repeating the mistakes of the past.

The performance of the economy and the structural reforms adopted during the National Reconstruction Plan (NRP) were impressive. Five years after the peace agreement was signed, El Salvador was rated only a notch below investment grade (BB+) by Standard and Poor's (which only gives investment grade to Chile and Uruguay) and *investment grade* from Moody's. Real GDP growth averaged about 6% during 1992–97 and the rate of inflation fell to 10%. There was a marked strengthening of the balance of payments which permitted the accumulation of reserves equivalent to six months of imports. The improvement in economic performance reflected a major reorientation of economic policy, including a greater reliance on market forces and a major reform of the exchange and trade systems. By 1997, the commitments of the peace agreements had been mostly complied with, and the expenditure associated with the required institutional reforms had been incorporated into the consolidated budget.

The impressive achievements in the economic performance and in the implementation of the peace process did not come before valuable lessons were learned. The Fund involvement in the economic program while the war raged and the UN involvement in ending the conflict called for careful planning and collaboration between the two organizations. Nevertheless, the adjustment program with the Fund and the peace process under the UN umbrella were created separately with little collaboration. [3]

As the incongruities and inefficiencies of these separate paths became evident, the need for a cooperative and integrated approach where both institutions would inform each other of their respective activities and would show flexibility within their own mandates to achieve common and interrelated goals, became evident. The UN came to acknowledge that peace required macroeconomic stability. Correspondingly, the Fund recognized explicitly the need for increased flexibility in setting economic objectives to allow for divergent demands, thereby taking into account the need for peace-related expenditure, including through access to some domestic financing, despite its inflationary impact. Both institutions agreed that actions should be initiated in a coordinated manner.

Our analysis shows that expenditures linked to the initiation of programs in compliance with the peace agreements exerted pressure on fiscal objectives in the 1992 economic program, and put the authorities in the difficult dilemma between compliance with the provisions of the peace agreements and compliance with the stabilization program. Understandably, the government did not want to undermine the macroeconomic gains made since 1990, but delays in the initiation of peace-related programs, due to a large extent to financial difficulties, put the peace accord at peril only few months after its signature. This experience is indicative of the danger of inadequate financing for peace-related projects, particularly in the early stages. Peace agreements build up expectations that if they are not promptly fulfilled may lead former combatants to stop complying with the agreements. This was the case in October 1992 when the FMLN stopped demobilization because of delays in starting the arms-for-land program.

Contradicting other analysts who argued that the austerity imposed by the IMF-sponsored program impeded the timely implementation of the agreements in subsequent years, [4] our analysis shows that the Fund made the fiscal targets for 1993–94 (and later years) more flexible so as to incorporate the financial needs of the NRP. Moreover, we show that expenditure in those years was significantly below what was permitted in the program and, as a result, fiscal and other targets in the program were often achieved with a margin.

From this analysis we conclude: despite the critical delays at the early stage of the process which could have derailed the process altogether, problems with the full and timely implementation of peace-related programs later on were not due to financing constraints imposed by the stabilization program. The slow pace of capital expenditure (including under the NRP), may be attributed, in part, to lack of political will—particularly at lower levels of the civil service—and to various implementation problems, including administrative, operational, technical, legal, and logistical. [5] In addition, the lack of appropriate technical expertise at the UN Observer Mission in ElSalvador (ONUSAL), particularly in the economic and financial areas, made UN support in overcoming these difficulties inadequate. The cautiousness of the government with regard to expenditures was another factor delaying the process. This may have been induced by uncertainties with respect to external financing arising from fiscal consolidation in donors' countries as well as donors' fatigue in light of new demands in the hemisphere (Haiti, Guatemala) and in the rest of the world (Rwanda, Bosnia, Gaza and the West Bank).

2. PECULIARITIES OF POST-CONFLICT TRANSITIONS

We define post-conflict transitions as those facing countries that have suffered the trauma of civil war or other internal conflict and have to embark on economic reconstruction and on political and social reform to provide the underpinnings of peace and promote democratization and national healing. As former President Clinton stated in Sarajevo in 2000, "It is not enough to end a war; we must build the peace."

In building the peace, it is important to keep in mind that countries in post-conflict transitions often share a number of characteristics with countries in the normal process of development.

First, countries in post-conflict transitions have, as a general rule, devastated or at least severely distorted economies. Both human capital and physical infrastructure are often in shambles. Statist and populist policies of the past have led to major macroeconomic disequilibria that often require tough stabilization policies and structural reform.

Second, countries in post-conflict transitions have flawed or weak national civil institutions (lack of transparency, poor governance, corrupt legal and judicial systems, absence of property rights, lack of independent central banks, weak tax and customs administration and public expenditure management, etc.).

Third, countries in post-conflict transitions are highly dependent on official aid flows, mostly in the form of grants. This dependency is particularly strong right after the solution of the conflict and at the early stages of what often proves to be a long and difficult transition.

Fourth, countries in post-conflict transitions often have protracted arrears on payment of foreign debt. Thus, the provision of financial aid is constrained by the need to clear those arrears and to normalize relations with creditors, particularly with the international financial institutions that have restrictions to assist countries in arrears. In addition, post-conflict countries usually require debt relief on unsustainable external debt burdens.

These similarities are, however, misleading. It may not be possible to build the peace unless it is acknowledged that countries in post-conflict transitions are clearly different and have different needs from those pursuing normal development activities or even from those coming out of economic chaos for three main reasons.

First, countries in post-conflict transitions face a higher risk of returning to civil unrest. To avoid this, these countries need to confront the normal challenge of socioeconomic development in such a way that it allows them to accommodate the additional burden of economic reconstruction and national reconciliation. Critical activities that often need to be carried out in this respect include the delivery of emergency aid to the former conflict zones; the demobilization of former combatants and their reintegration into productive sectors of the economy; the reform of the armed forces and the creation of national civilian police forces; the economic rehabilitation and reconstruction of human capital and physical infrastructure and of basic services damaged or interrupted as a result of conflict; and the clearance of mines. Because of the need to carry out these activities, fiscal and monetary targets of IMF-sponsored economic programs in these countries may have to be made more flexible to facilitate financing.

Second, former adversaries should be encouraged to live with each other, and, to succeed, they will have to overcome the often sharp political polarization and ideological, ethnic, or religious confrontation that fuelled the conflict and are the legacy of war. Only through the establishment of an adequate institutional framework to foster national reconciliation will former adversaries be able in the future to address their grievances through peaceful means. A lack of reconciliation may doom reconstruction efforts to failure.

Third, after years of sharp polarization on economic and social issues, the lack of consensus on macroeconomic management and structural reform is often acute. This makes the transition particularly difficult since putting the house back in order and finding a consensus to implement economic reconstruction is almost a precondition for sustained international assistance.

Due to these peculiarities of post-conflict transitions, policy-making in such situations cannot be *business as usual*. It should be guided by the following principles: First, in carrying out post-conflict activities, economic priorities should be guided by political considerations since it involves addressing problems which, if left unresolved, may lead to a return of fighting. Second, the equity principle that prevails in normal development activities will be overshadowed by the ethics of peace-keeping: it is often imperative to give preferential treatment and address the legitimate grievances of those groups most involved in, or most affected, by the conflict, to discourage them from going back to arms, as well as to redress hardship or repression suffered during the conflict. [6] Third, given the primordial role conferred to the political criterion, the temporary relegation of the equity principle, and the many financial and technical constraints faced by countries in post-conflict transitions, it would be unreasonable to expect the policy design or the allocation of resources to be optimal from a purely economic point of view. [7]

3. POST-CONFLICT CHALLENGES TO COUNTRIES AND TO INTERNATIONAL ORGANIZATIONS

Given these peculiarities, the needs of countries in post-conflict transitions are qualitatively different. This undoubtedly creates a number of unique challenges for the countries concerned, as well as for the international organizations that support them. The primordial challenge of the post-conflict transition is to *prevent the recurrence of hostilities*, that is, to make the transition irreversible. This entails the complex political task of *addressing the root causes of the conflict*. Such a task has very little chance of success unless the economy is quickly stabilized and brought back into a path of investment and high-quality, employment-generating growth with low inflation. Creating opportunities for employment is critical since it will facilitate the complex, long, and expensive process of reintegrating former combatants, returnees, and displaced persons into society and into productive activities. Reintegration is a condition *sine qua non* for the consolidation of peace.

The peculiarities of countries in post-conflict transitions, in conjunction with the absence and/or the weakness of political and legal institutions and the inadequacy of manpower, makes the formulation of economic policy particularly challenging. Although conditions vary widely from country to country, the common requirement for the implementation of effective and sustainable economic policies is the return of peace and of the rule of law and the acceptance by the population of the new government and the legislative bodies that are going to manage the economy.

International organizations become involved in the challenge of post-conflict reconstruction in different ways and at different stages. Many assist countries in normal times and, in some cases, even during the conflict. This is normally the case of the Fund which supports countries in their efforts to stabilize their economies and carry out structural reform. In post-conflict transitions, the Fund continues to assist countries in restoring macroeconomic balance, strengthening their external position, and improving their institutional framework. Countries in such transition, however, are often not able to meet the criteria for borrowing from the Fund, and are unlikely to afford its normal lending terms.

At the same time, the role of the Fund in post-conflict situations becomes even more critical since, for the reasons discussed earlier, external assistance and the reactivation of growth are decisive in the transition process, and donors are not likely to be generous with countries that are not putting their economies in order and doing their best to help themselves. Thus, Fund blessing through a formal or informal program has proved to be a requirement for external assistance in post-conflict transitions. To support such programs financially, the Fund and the World Bank play an important role in catalyzing external financing from other donors, including other international and regional organizations and official bilateral donors, for example, through the Paris Club, donors' support groups and consultative group meetings. [8]

In general, UN involvement in a given post-conflict transition may follow a peace-making role either as facilitator or mediator, and/or a peace-keeping operation which involves overseeing the cease-fire and the disarmament arrangements through the deployment of blue-helmets forces that help keep former belligerents apart. In post-conflict transitions, the UN often plays the critical role of good offices and verification of peace agreements and of facilitator of their operational implementation. In this capacity, the UN addresses mainly political and security, but also legal, institutional, and judicial issues and may play a crucial role in demobilization and reintegration programs. More recently in Kosovo and East Timor, as to some extent previously in Cambodia, the UN has a more intrusive role by performing civil administration functions that are normally the prerogative of sovereign governments.

4. EL SALVADOR: AN ILLUSTRATIVE CASE

The root causes to the decade-long civil war in El Salvador go back more than a century. It is no exaggeration to say that the problem of land tenure [9] was as much a root cause of the conflict that raged throughout the 1980s as was the overbearing power of the armed forces. The two problems were not unrelated: scholars of El Salvador pointed to the armed forces as an instrument created and nurtured by the landed class to protect and preserve its position (de Soto & del Castillo, 1995).

Despite the political tensions and socioeconomic injustice, El Salvador experienced significant economic progress in the 1960s and 1970s. Real GDP grew at an annual rate of close to 6% in the 1970s, reflecting a stable macroeconomic environment, an improvement in the terms of trade and an expansion of the regional market for manufactured products, which followed the creation of the Central American Common Market (CACM). Domestic investment increased from 13% of GDP in 1967–69 to 22% of GDP in 1977–79. This was financed mostly out of national savings which reached 18% of GDP in 1977–79. [10] Social progress lagged, although some gains were achieved in increasing life expectancy and in improving literacy rates and primary education enrollment. Notwithstanding these limited improvements, by the time civil war erupted, life expectancy continued to be below 60 years old, infant mortality rates continued to be high, only 20% of the school-age population attended secondary education, illiteracy was as high as 45% of the population (age 15+), and per capita GDP remained low at slightly over US$600. [11]

(a) *The economic consequences of civil war*

The civil war in El Salvador diverted public resources from investment and the social sectors to military expenditure. While military expenditure averaged over 4% of GDP in 1988–90 and represented 20% of central government expenditure, the highest level in Latin America with the exception of Nicaragua, central government expenditure in education as a share of GDP dropped from 4% in 1980 to less than 2% in 1990 (as compared to an average of over 4% for Latin America in both years). By 1990, total health expenditure had fallen to less than 1% of GDP (from 2% in 1980), which, in per capita terms, represented less than a third of the average for Latin America. At the same time, inappropriate economic policies and a deteriorating external environment due to falling terms of trade, high real rates of interest, and world recession, worsened public finances. As a result, government revenue fell sharply in relation to GDP. In addition, the *colón* remained overvalued. The external deficit on goods, services and rent (that is, the current account excluding transfers) [12] increased from less than 4% of GDP in 1977–79 to over 12% in 1987–89. By 1989, domestic investment and national savings were down to 15% and 6% of GDP, from the high pre-war levels reported above. Net international reserves had declined to the equivalent of three months of imports; and sizable external payments arrears had accumulated. The situation deteriorated further at the turn of the decade as a result of the intensification of the armed conflict, a devastating earthquake, a severe drought, and the weaker economic situation in other Central American countries. As a result of these developments, domestic investment and national savings bottomed out in 1990 at 12% and 5%, respectively (see Table 1).

Damage to the country's infrastructure as a result of the civil war was estimated at over US$1.5 billion (over 30% of 1990 GDP). War destruction and grinding poverty caused serious environmental problems as well. Real GDP declined by 12% during the 1980s and real per capita income dropped by 25%, with 56% of the population falling below the poverty level. In a country known for its price stability, inflation reached 24% at the end of the decade. Although there was some improvement in social indicators, by 1990 El Salvador was in 110th place in the UNDP's human development rank (out of 173 countries), and just below Nicaragua, with an income per capita of just one-fourth of that of El Salvador. Infant mortality remained high at 56 per thousand (compared with an average for Latin America of 44 per thousand); the daily calorie intake per capita of 2,155 was about four-fifths of the average for Latin America; adult illiteracy of 27% was almost twice the average for Latin America, and 4 years of schooling on average remained extremely low by Latin American standards.

One factor that fostered the economy of El Salvador during the war years and helped contain the spread of poverty was the remittances of migrant workers abroad, particularly from the close to one million Salvadorans living in the United States. At the end of the 1980s remittances represented 5% of GDP and grew rapidly in coming years.

(b) *IMF and UN involvement in El Salvador*

Upon taking office in June 1989, President Cristiani set three main goals for his Administration (1989–94): (i) to negotiate an end to the civil war and initiate a national reconstruction and reconciliation effort; (ii) to carry out macroeconomic stabilization and structural reform so as to put the economy back in a path of sustainable growth and development; and (iii) to reduce poverty.

Negotiations with the Fund on an economic program to be supported by a 12-month stand-by arrangement began in November 1989, but were interrupted by an outbreak of warfare in San Salvador. In addition, the financial situation had been aggravated by a series of external shocks—particularly the dramatic drop in the price of coffee after the breakdown of the International Coffee Agreement in June 1989. Notwithstanding those adverse factors, President Cristiani's economic program was finally adopted in 1990 at the peak of the armed conflict. [13] At that time economic activity was disrupted by civil war which included acts of sabotage of electric power and other infrastructure, and disruption of harvests. During this period, official transfers (grants) started to decline (from close to 6% in 1989 to 3% in 1991), but at the same time private transfers (remittances) increased (from about 5% of GDP in 1987–89 to over 7% in 1990–91) (see Table 2).

While the Fund supported stabilization in a civil war economy (1989–92), the UN negotiated a Peace Accord (1990–92). The November 1989 FMLN offensive was the largest of the civil war, for the first time affecting large parts of the capital city of San Salvador. A few days later, six Jesuit priests were assassinated, and the killers were widely believed to be closely associated to the military. Domestic and inter-

Table 1. *El Salvador: basic economic indicators*

	1989	1990	1991	1992	1993	1994	1995	1996	1997
	(Annual percentage change except otherwise indicated)								
GDP (in millions of colones)	32,224	36,488	42,594	49,839	60,359	70,748	83,130	90,63	97,929
Nominal GDP	17.8	27.4	16.8	17.0	21.4	17.2	17.6	9.0	6.0
Real GDP (1990 prices)	35,288	36,488	37,792	40,644	43,639	46,279	49,239	50,139	52,141
Real GDP	1.1	3.4	3.6	7.5	7.4	6.0	6.4	1.8	4.0
Consumer prices (end of period)	23.5	19.3	9.9	19.9	12.2	8.8	11.4	7.2	2.2
Consumer prices (average)	17.6	24.0	14.4	11.2	18.6	10.5	10.0	9.8	4.4
Real wages (private sector)	−3.8	−8.4	−7.5	−1.0	−2.3	1.7	1.3	0.8	2.1
Real wages (public sector)	−2.2	−12.3	−9.7	−3.2	−4.6	16.5	3.1	4.5	3.3
Participation rate[a]	29.7	31.7	34.0	35.9	35.4	38.1	37.7	38.5	38.0
Unemployment rate[b]	13.0	12.0	11.1	9.8	9.9	7.7	7.7	7.7	7.8
Exchange rate (end of year; Colones per US$)	5.0	8.0	8.1	9.2	8.7	8.8	8.8	8.8	8.8
Exchange rate (average; Colones per US$)	5.6	7.6	8.0	8.4	8.7	8.7	8.8	8.8	8.8
Real effective exchange rate (positive numbers indicate appreciation)	−1.6	−18.8	6.7	8.2	12.4	2.2	8.2	4.7	4.8
	(In percentage of GDP)								
Savings and investment									
Gross domestic investment	15.3	11.8	14.8	18.0	18.5	19.7	20.0	14.8	14.9
Public sector	3.9	2.3	2.8	4.0	4.0	3.7	3.5	3.7	3.3
Private sector	11.4	9.5	12.0	14.0	14.5	16.0	16.5	11.1	11.6
National savings	5.9	5.2	10.2	12.4	14.1	16.0	15.2	12.6	14.5
Public sector	−1.6	5.5	10.4	0.2	0.8	2.0	3.2	1.9	1.9
Private sector	7.5	−0.3	−0.2	12.2	13.3	14.0	12.0	10.7	12.6
External savings[c]	9.4	6.6	4.6	5.6	4.4	3.7	4.8	2.2	0.4
Non-financial public sector									
Overall balance (before grants)	−5.7	−2.5	−5.1	−6.5	−3.6	−2.0	−0.9	−2.7	−2.0
Overall balance (after grants)	−4.0	−0.4	−3.2	−4.6	−1.6	−0.6	−0.1	−2.5	−1.8
Savings NFPS	−1.5	−0.3	−0.6	−0.6	0.7	2.0	3.2	1.8	1.6
External financing	1.6	−0.1	2.5	3.9	2.0	2.0	1.3	2.7	2.0
Domestic financing	2.5	0.5	0.7	0.6	−0.3	−1.4	−1.2	−0.2	−0.2
Central Bank profits	–	–	–	−0.8	−0.2	−0.2	0.2	0.3	0.3

Sources: Central Reserve Bank, Ministry of Finance, and IMF.

[a] Economic active population as a percentage of the total population.

[b] Unemployed as a percentage of total labor force.

[c] External savings equals the current account deficit with an opposite sign.

Table 2. *El Salvador: central government consolidated operations (in percentage of GDP)*

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Current revenue and grants	9.7	10.7	10.3	12.9	13.2	13.5	13.7	13.5	12.5
Current revenue	8.1	8.6	8.5	10.8	10.8	11.6	12.7	13.3	12.2
Tax revenue	7.6	8.1	8.5	9.6	10.3	10.9	12.0	11.2	11.0
Official grants	1.6	2.1	1.8	1.9	2.0	1.4	0.8	0.2	0.2
Capital revenue and current transfers from public enterprises	0.2	0.1	0.6	0.2	0.4	0.4	0.3	0.4	0.6
Expenditure and net lending	13.0	11.9	13.8	16.2	14.6	14.2	14.3	15.5	13.6
Current expenditure	10.5	10.1	10.8	11.6	11.2	11.5	11.1	12.4	11.2
Capital expenditure	2.5	1.8	3.0	4.6	3.1	2.6	3.0	3.2	2.6
Overall balance (before grants)	−4.9	−3.3	−5.3	−5.2	−3.4	−2.1	−1.4	−2.2	−1.3
Overall balance (after grants)	−3.3	−1.2	−3.5	−3.3	−1.4	−0.7	−0.6	−2.0	−1.1
Financing	3.3	1.2	3.5	3.3	1.4	0.7	0.6	2.0	1.1
External financing	0.6	−0.3	1.8	2.6	1.7	1.8	1.2	2.2	1.7
Domestic financing	2.7	1.5	1.7	0.7	−0.3	−1.1	−0.6	−0.2	−0.6
Memorandum items									
Military expenditure[a]	4.0	3.1	2.7	2.3	1.9	1.4	2.1	2.5	2.3
(In millions of colones)	1,282	1,118	1,157	1,146	1,154	1,001	1,782	2,235	2,244
Defense (military proper)	3.3	2.4	2.2	1.8	1.5	1.2	1.0	1.0	0.9
(In millions of colones)	1055	872	926	917	920	837	859	886	886
Police (public security)	0.7	0.7	0.5	0.5	0.4	0.2	1.1	1.5	1.4
(In millions of colones)	227	246	231	230	234	163	924	1350	1358
Expenditure and net lending	13.9	11.9	13.8	16.2	14.6	14.4	14.2	14.8	13.4
Military expenditure[b]	4.0	3.1	2.7	2.3	1.5	1.2	1.0	1.0	0.9
Non-military expenditure	9.9	8.8	11.1	13.9	13.1	13.2	13.2	13.8	12.5
National civilian police				0.5	0.4	0.2	1.1	1.5	1.4
Social expenditure	5.3	5.0	4.4	4.4	4.6	4.9	5.0	5.4	5.8

Sources: Central Reserve Bank, Ministry of Finance, and IMF.

[a] Banco Central de Reserva, based on Ley de Presupuesto e Informes, and as reported by the IMF.

[b] Data adjusted to reflect the fact that up to 1992 the police was militarized and was rightly included as "military expenditure." After 1993, expenditure for the National Civilian Police and Police Academy, both institutions created under the peace agreements has been taken from "military expenditure" and included in "nonmilitary expenditure."

national pressure on the two belligerent parties to end their hostilities grew. The violence of 1989 not only claimed hundreds of lives and severe physical damage; it also demonstrated the impossibility of military victory by either side, and set the stage for a negotiated solution. By early 1990, the FMLN and the Government of President Cristiani had separately requested the Secretary-General of the UN to help them negotiate a solution to the military conflict. The agenda agreed for the negotiations made clear that in order to end the conflict its root causes would need to be addressed. After two years of long, complex and painstaking negotiations, and a series of partial agreements, the formal signing of the El Salvador Peace Accord took place on January 16, 1992 in the Chapultepec Castle in Mexico City. The Chapultepec agreement was the beginning of the long, ambitious and arduous post-conflict transition in El Salvador. For the UN—which mediated the agreement and became involved in its first post-conflict transition with the creation of ONUSAL—successful implementation of the Salvadoran peace agreement carried far-reaching implications, not only because of its investment in time and resources, but also because of the implications for future challenges of the kind.

(i) *Economic consequences of peace: 1992–97*

Civil war in El Salvador was costly but the economic consequences of peace were also of significance. This situation was aggravated by the fact that foreign financing dried up after the end of the cold war conflict and there was hardly any *peace dividend* in the fiscal sense. At the same time, peace could only be achieved at a relatively high cost. Reconstructing damaged infrastructure, restoring basic social services, reintegrating former combatants, and reactivating growth entailed financial costs that well exceeded the resource capability of the country and required generous assistance from the international community. As part of the peace negotiations, a number of programs were to be implemented in the framework of the National Reconstruction Plan (NRP) for 1992–97, at an estimated cost of about US$2 billion. The financial implications of the NRP had to be incorporated into and reconciled with the fiscal restrictions imposed by the economic stabilization program.

The main objective of the NRP was the satisfaction of the most immediate needs of the population hardest hit by the conflict, the reconstruction of damaged infrastructure, and the development of the former zones of conflict. Among all programs designed in relation to the peace agreement, two merit special attention: the creation of a national civil police, separate and distinct from the armed forces, and the transfer of land to former combatants of both sides and to supporters of the FMLN who had occupied land during the war years. Given that land had been a main root cause of the conflict, the land program was the main vehicle for reintegrating those most closely involved with the conflict into the productive life of the country; it represented in fact an arms-for-land exchange; credit was to be provided to demobilizing combatants to provide them with a viable livelihood and a stake, however tiny, in the country's wealth (del Castillo, 1997).

Other peace-related programs included the resettlement of displaced persons; reintegration through micro-enterprise development; the reduction of the armed forces; the creation of a policy academy to train the new civilian police; the strengthening of the country's democratic institutions (including the judiciary and the electoral system); and the rebuilding of social and physical infrastructure. The NRP was to be carried out through consensus building among the government, the FMLN and other sectors of the country, with the idea that this would facilitate the allocation of resources and the implementation of peace-related programs.

With the signing of the peace agreement, the challenge of attending to the unsatisfied demands of the participants in the conflict, and the fulfillment of basic needs for large segments of the population that had suffered significant declines in their living standards, required the resumption of stability and economic growth. The government was committed to ensure that reconstruction efforts be conducted in a framework of macroeconomic stability. Underlying the government's actions was the belief that stability and economic growth could not be sustainable without a lasting peace and that peace would not be durable without high-quality growth.

Stabilization efforts led to a reduction in the rate of inflation, recovery in economic activity, and a stronger balance of payments. The improved economic performance reflected a strengthening of the public finances and was facilitated by the implementation of structural reforms that increased market allocation of resources, laying the basis for sustained growth and medium-term balance of payments viability. By mid-1990, the government had unified the exchange rate and had introduced a flexible exchange rate system. The value of the *colón* depreciated in real effective terms by 20% that year. A more realistic exchange rate, in conjunction with some return of investors' confidence due to economic reform, caused an inflow of private capital, which together with official transfers and debt rescheduling with bilateral creditors, including the Paris Club, allowed for a decrease in external debt arrears.

On January 6, 1992, the Fund's Executive Board concluded the 1991 Article IV consultations and approved a 14-month stand-by arrangement (SDR 42 million). The arrangement called for a midterm review, to be completed by August 31, 1992, to provide the opportunity for the incorporation in the program of the financial requirements of the NRP. The Salvadoran authorities expected that the Peace Accord would allow for a reduction in military outlays and make room for an increase in social expenditure. To be able to keep the program on track, however, there was an understanding with the Fund that peace-related expenditure would have to be financed by additional public savings, reallocation of other public expenditure, or external resources.

Management of the economy in 1992 was complicated by a severe slump in international coffee prices, a drought, and the large financial requirements of the NRP. While real GDP grew by close to 8%, there was a considerable deterioration in the overall deficit of the nonfinancial public sector or NFPS (of over two percentage points of GDP), in the current account, and in the rate of inflation. At the same time, the accumulation of reserves was lower than contemplated in the program. The review of the program called for under the stand-by arrangement was not completed because an agreement could not be reached on policies to return the program to an appropriate path. It was the view of the Fund at the time that, in light of the shortfalls in external assistance in 1992, the government should take additional fiscal measures or postpone some of the peace-related expenditure, should shortfalls in external assistance recur in 1993 (IMF, various years).

With the achievement of peace, remittances from Salvadoran workers abroad continued on a large scale (averaging over 12% of GDP in 1992–95) and complemented the financial support from the international community to economic reconstruction of the country. In addition, the Government requested US$2 billion for its peace-related programs during 1992–97, mainly in the form of external grants and long-term concessional loans from bilateral and multilateral creditors. Grants averaged over 3% in 1992–95, mostly pledged at four consultative groups (CG) meetings held in May 1991, March 1992, April 1993, and June 1995 (Republic of El Salvador, 1995; FMLN, 1995). Although donors were supportive of El Salvador's peace efforts, they showed a clear preference for financing specific projects, mostly in infrastructure and the environment. Thus, quick-disbursing external financing for peace-related expenditure such as the reintegration of ex-combatants, the creation of the national civilian police, and the promotion of democratic institutions was in short supply.

The performance of the economy during the NRP was impressive. Real GDP growth averaged over 6% during 1992–97. The rate of inflation, which averaged 24% in 1986–91, fell to less that 10% on average. There was a marked strengthening of the balance of payments from a deficit of 0.4% of GDP in 1989–92 to a surplus of over 2% in 1993–97. This permitted the elimination of external payments arrears, the re-establishment of relations with external creditors, and even high sovereign credit ratings from the top international rating agencies by 1997, allowing the government to borrow internationally at a relatively low cost. Gross international reserves, which had declined to dangerously low levels by the end of the 1980s (slightly over three months of imports), reached six months of imports in 1997. There was, however, continued pressure on the *colón* to appreciate due to large financial inflows resulting from remittances, grants and other foreign assistance.

The improvement in economic performance reflected a major re-orientation of economic policy, including a greater reliance on market forces and a major reform of the exchange and trade system. The multiple exchange rate regime was replaced by a unified market-determined exchange rate system, import tariffs were reduced and unified, and exchange restrictions eliminated. Price controls were reduced and state monopolies in the marketing of agricultural commodities were eliminated. The strengthening of fiscal policy was based on a major tax reform (including the introduction of a value added tax (VAT)). Greater flexibility in adjusting public sector prices, and improvements in the operating efficiency of state enterprises were also adopted. Credit policy was tightened in the context of a dismantling of the complex system of credit allocations and a movement toward market-determined interest rates. Despite tremendous difficulties, by end-1997, the government had achieved (i) the simplification of the tax structure to a system based on a few broad-based taxes; (ii) the restructuring and re-privatization of the financial system, including the liberalization of interest rates, the elimination of credit controls and the revision of the legal framework encompassing new laws for the central bank, banks and financial institutions, and the creation of a new charter for the superintendency of financial institutions; (iii) the acceleration of trade reform including the simplification and sharp reduction of tariff levels and the elimination of nontariff barriers; and (iv) significant advances in the modernization of the public sector.

The medium-term adjustment strategy included a social sector program aimed at reducing poverty and raising the standards of living, education and health of the population through investment in social infrastructure. The strategy also provided for temporary employment, income, and food supplements, and expansion of social services. The government developed a social safety net through the development of community projects, supported by the Social Investment Fund, designed to channel donors' financing to poverty alleviation projects. Efforts were also made to improve the effectiveness of social expenditure, with health and community school programs designed to expand coverage and quality of health and pre-primary and primary education in the poorest areas through community participation. Despite government efforts, remittances from Salvadorans abroad remained, however, a critical factor in poverty alleviation.

International assistance to El Salvador was strengthened by the government's own effort at increasing domestic savings. The NFPS savings rose from average dissavings of 0.8% of GDP in 1989–93 to savings of 2.0% of GDP by 1994–97. At the same time, the deficit of the NFPS (excluding grants)—which reflects the borrowing requirements of the government—was reduced from 5.0% to 2.0% of GDP in comparable periods. The improvement was due to an increase in current revenue that resulted from the introduction of VAT at a rate of 10% in late 1992, the approval in early 1993 of the law of Fiscal Crime to reduce tax evasion, and the introduction of a fiscal package yielding revenue equivalent to 2% of GDP. This increase in revenues was accompanied by a shortfall in capital expenditure (including under the NRP) due to implementation problems (see Table 3).

Because social progress lagged and the poverty situation remained dismal, there was no room for complacency. Social development and poverty alleviation were, however, to be tackled on a longer-term basis. Putting the economy on a sound footing on the fiscal side was a must in this endeavor. In this regard, by the end of 1997, the performance of the Salvadoran economy had been quite remarkable: the UN had certified compliance with

Table 3. *El Salvador: Consolidated operations of the nonfinancial public sector*

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Current revenue and grants	12.0	13.3	13.3	15.5	16.0	17.0	17.4	17.2	15.4
Current revenue	10.3	11.1	11.5	13.6	14.0	15.6	16.6	17.0	15.2
Tax revenue	7.6	8.1	8.5	9.6	10.3	10.9	12.0	11.2	11.0
Official grants	1.7	2.2	1.8	1.9	2.0	1.4	0.8	0.2	0.2
Expenditure and net lending	16.0	13.6	15.8	20.1	17.8	17.9	17.6	19.7	17.2
Current expenditure	11.8	11.4	12.1	14.2	13.3	13.6	13.4	15.1	13.3
Capital expenditure	4.0	2.4	3.6	5.7	4.6	4.1	4.2	4.5	4.0
Overall fiscal balance (before grants)	−5.7	−2.5	−4.3	−6.5	−3.8	−2.3	−1.0	−2.7	−2.0
Overall fiscal balance (after grants)	−4.0	−0.3	−2.5	−4.6	−1.8	−0.9	−0.2	−2.5	−1.8
Savings NFPS	−1.5	−0.3	−0.6	−0.6	0.7	2.0	3.2	1.8	1.6
Financing									
External financing	1.6	−0.1	2.2	3.9	2.0	2.0	1.3	2.3	2.1
Domestic financing	2.5	0.5	0.3	0.6	−0.4	−1.4	−1.2	0.1	−0.3

Sources: Central Reserve Bank, Ministry of Finance, and IMF.

most commitments of the peace agreements, [14] and the expenditure associated with the required institutional reforms had been incorporated into the consolidated government budget.

(ii) *Business as usual*

As discussed above, the government of El Salvador had been implementing an IMF-supported economic program since 1990. The signing of the UN-brokered Peace Accord in early 1992 paved the way for accelerated economic development and improved social welfare for the entire population. Despite the UN involvement in the search for peace and in the design and implementation of the NRP, the economic program was formulated and implemented without the UN being informed about either its progress or its constraints.

Similarly, the UN did not inform the Bretton Woods Institutions about progress in the negotiating process nor did it consult them on the financial implications of the NRP and other programs under negotiation. Notoriously absent were these institutions during the negotiation of the economic and social portion of the peace accord in December 1991 and during the negotiations that led to a revised agreement on the land program in October 1992. Some indirect early collaboration, however, took place in catalyzing foreign assistance. The Fund and the Bank lent full support in the CG meeting held in Washington in March 1992 to efforts to secure external assistance to cover outlays under the NRP.

The *business-as-usual* approach led to misunderstandings and confrontations as the separate economic and peace processes moved forward. In a speech in Bangkok in April 1993, Secretary-General Boutros Ghali expressed strong concern about the UN system where the Fund and the UN did not seem to work on a fully coordinated and transparent basis toward the overriding goal of consolidating peace. Implementation of the agreements should not, in his view, be conditioned on the availability of foreign financing, as the Fund insisted. The Secretary-General argued that it was the government's responsibility, both as signatory to the peace accords and as the government of El Salvador, to define fiscal policies and public expenditure priorities that would enable it to fulfill its commitment to full implementation of the accords. [15] Similarly, the Fund has also acknowledged the *business-as-usual* approach by recognizing that, while cooperation between the UN, the Fund, and the Bank had been instrumental in drawing up the technical assistance and the macroeconomic framework in the case of Rwanda, such coordination had initially not taken place with regard to the preparation of El Salvador's NRP. As a result, the fiscal impact of the NRP had not been fully assessed when the Peace Accord was drawn up (IMF, 1995a).

(iii) *Increased cooperation and flexibility within a more integrated approach*

As pointed out earlier, the Fund's initial reaction to the NRP financial needs had been that, to keep the 1992 program on track, peace-related expenditure would have to be financed by additional public savings, reallocation of expenditure, or external resources. After early 1993, however, the fund worked closely with the government to develop an economic program that would allow for NPR expenditure of \$250 million a year in 1993–94 (representing over 3% of GDP a year), to cover the indemnization payments related to the demobilization of the military, the establishment of a new police force, the setting up of health and education facilities in the former conflict areas, and the acquisition of land for ex-combatants. Thus, a compromise scenario was incorporated in the 1993 economic program; by cutting certain expenditure categories and reallocating others, room was made for a significant increase in peace-related expenditure. [16]

As discussions between the Fund and the UN began on a regular basis and a more cooperative and integrated approach was developed, ways were explored to support the government to finance the increased peace-related expenditure required under the NRP, from a mix of more external resources, higher domestic revenue, expenditure switching, and increased bond financing and money creation. [17] Despite an uneven pattern in the availability of grants and net external financing (foreign financing), the central government was able to increase nonmilitary expenditure by over three percentage points of GDP in 1992–97 as compared to 1989–91. This can be explained by a decrease in military expenditure (of two percentage points of GDP) [18] and an increase in tax revenue (of 2.5 percentage points of GDP) which allowed for a reduction in the central government fiscal deficit from close to 5% of GDP to below 3% between these periods.

(iv) *On being more royalist than the king*

The performance of the Salvadoran government in managing the economy under a succession of IMF-supported programs and in carrying out peace-related expenditure during 1989–97 was remarkable. The Salvadoran government, however, spent less on peace-related programs than what was allowed under its 1993 and 1994 programs with the Fund. As a result it achieved fiscal and other targets often with a margin. This means that there was room under fiscal and domestic financing ceilings to spend more, especially on capital expenditure (including under the NRP). By spending less than what the program allowed, it could be argued that the Salvadoran authorities "were more royalist than the king" although, as we explained earlier, there were valid reasons for this.

The situation in 1992, however, had been different. Because the expenditure requirements of NRP had not been incorporated into the 1992 program (they were unknown at the time the program was designed), the NFPS deficit was much higher than programmed (close to 7% of GDP compared with the 2% required by the program).

In 1993, with the incorporation of the NRP into the program, the deficit of the public sector deficit was programmed to reach 6% of GDP. This deficit, however, was less than 4% in 1993, significantly lower than programmed, reflecting a shortfall in capital expenditure of the central government (including under the NRP), and a somewhat better than expected performance of current revenue. Furthermore, despite a sizable shortfall in programmed net external financing, the net indebtedness of the NFPS was unchanged in 1993, compared with a program limit of close to 1% of GDP.

At the same time, current expenditure of the central government was higher than programmed, with lower expenditure on goods and services more than offset by higher than anticipated transfers to local governments for expenditure on health, education, and the reintegration of ex-combatants. But, capital expenditure was about 3% of GDP compared with over 4% of GDP in the program. Capital expenditure in 1994 was also lower than programmed (less than 3% as compared to over 4% in the program) (see Table 4).

Table 4. *El Salvador: Summary balance of payments (in percentage of GDP)*

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Current account	−9.2	−6.6	−4.6	−5.6	−4.4	−3.7	−4.8	−2.2	−0.4
Trade balance	−13.1	−12.6	−13.4	−18.5	−17.0	−17.7	−19.5	−15.9	−14.4
Services	−2.4	−2.3	−2.1	2.7	2.5	2.3	3.1	3.1	3.4
Rent	1.6	1.9	1.8	−1.7	−1.7	−0.7	−1.0	−0.9	−0.8
Current transfers[a]	4.7	6.4	9.1	11.9	11.8	12.4	12.6	11.5	11.4
Capital and financial account	7.3	8.2	4.1	4.9	6.6	5.5	6.3	3.8	2.6
Capital account[b]	5.7	4.1	3.0	3.8	3.2	3.5	2.0	0.6	0.2
Financial account	1.6	4.1	1.1	1.1	3.4	2.0	4.3	3.2	2.4
Nonfinancial public sector	3.0	0.0	0.0	1.5	2.0	2.2	1.3	2.1	1.0
Central Bank	1.1	0.0	−1.4	−0.6	−0.7	−1.4	0.8	0.5	0.3
Private sector (incl. errors and omissions)	−2.6	4.1	2.1	0.1	2.1	1.2	2.2	0.6	1.1
Overall balance	−1.9	1.6	−0.5	−0.7	2.2	1.8	1.5	1.6	2.2
Memorandum items									
GDP (in millions of US$)	4,986	5,414	5,970	5,955	6,957	8,086	9,508	10,359	11,192
Gross international reserves (in millions US$)	500	571	567	563	675	788	935	1,099	1,461
Gross international reserves (months of imports)	3.3	3.8	4.4	4.0	4.2	4.2	3.9	4.9	5.9
Public external debt ratio (in percent of GDP)	42.5	39.4	37.2	38.4	27.4	25.6	23.6	24.3	23.9
Debt service ratio (percent of exports of goods and services)	24.4	18.2	26.2	35.4	24.7	25.7	15.4	16.8	13.0

Sources: Central Reserve Bank, Ministry of Finance, and IMF.

[a] Mostly remittances of workers abroad.

[b] Mostly official transfers.

5. POLICY RECOMMENDATIONS

The experience of El Salvador reviewed above, and that of many other countries in post-conflict transitions in which the international community has been actively involved, allow us to formulate some policy recommendations, not only for the countries involved in such transitions, but also for the international organizations that facilitate and finance them.

Initial conditions in the respective countries and access to external financing will determine the appropriate reconstruction strategy and policy mix required for the reestablishment of production and trade. Appropriate policies are important not only in terms of macroeconomic management but also to create the right framework for international assistance.

The formulation of economic policy needs to include a viable economic reconstruction strategy, a legal, institutional, and regulatory framework that will guarantee the proper operation of property rights and private markets, and a coordinating mechanism to ensure the effective access and utilization of foreign assistance and technical advice from bilateral and multilateral sources, as well as from nongovermental organizations (NGOs).

A key aspect of a post-conflict transition strategy is that countries must not only own their reconstruction programs in the sense that it is up to them to set up the priorities, but they must build a national consensus for economic and institutional reforms. In this regard, governments, both national and local, should work closely with civil society and with NGOs in developing the reconstruction strategy and programs.

Careful planning and adequate financing are important at an early stage. Before the combatants are disarmed and demobilized, a reintegration strategy needs to be in place, well funded and ready for implementation in step with demobilization. Unless this is successfully done, common crime will increase, the security situation will deteriorate, and the peace process may be endangered. This is clearly what happened in El Salvador and the lesson is particularly relevant to cases such as Kosovo where reintegration was a sham and the consequences are being felt, not only in Kosovo itself, but in Macedonia and Serbia.

Aid assistance is essential to countries in post-conflict transition. These countries have hardly any capacity to raise their own revenue, at least in the early stages of the transition. For this reason, countries need to present to potential donors a well structured and comprehensive rehabilitation, reconstruction, and development plan at consultative groups or other such donors meetings, so that donors can pledge their assistance with full knowledge and understanding of the needs and vulnerabilities of the countries concerned.

External technical and financial assistance needs to be properly coordinated and channeled to high-priority projects. In this regard, the international community should establish a focal point to bring together the various donors and to make sure that they all work together in a prompt and effective way and to ensure that commitments for assistance are actually disbursed. Given the very different circumstances of countries coming out of conflict, there should be no single institutional formula to deal with coordination. It is preferable that the coordinating agency be created on an *ad hoc* basis. It is imperative, however, that this should not become a matter of controversy and turf battles between agencies and thus delay the provision of external assistance.

Efforts at improving macroeconomic management are a must for economic reconstruction. Macroeconomic policies should be designed with special care to address the main problems of the particular country. Because of the need for national reconciliation, it is particularly important that countries in post-conflict transitions pursue high-quality growth. This means growth that is sustainable, creates employment, and brings poverty alleviation, growth that promotes greater equality of income through greater opportunity and human development, and growth that respects both human freedom and the environment.

An improvement in economic performance often requires a major re-orientation of economic policy, a greater reliance on market forces, and a major reform of the exchange and trade system. The latter generally includes a removal of price controls, the establishment of a market-determined exchange rate system, reduced and unified tariffs, and the elimination of exchange and trade restrictions.

Efforts at improving social conditions should aim at reducing poverty and raising the standards of living, education, and health of the population through investment in social infrastructure. To develop the necessary infrastructure may take time and measures will have to be adopted to provide temporary employment, income, food, and basic services in the early stages of the transition.

In the fiscal area, strengthening public finance management is an important prerequisite for economic reconstruction and the resumption of growth. Depending on the deterioration of public finances, the diminished planning and execution capacity, and the break in institutional memory, a transitional budget (for two to three months) may be necessary. Issues relating to tax policy and tax and customs administration are also critical and might require temporary action until a more permanent solution can be found. Efforts at revenue collection are fundamental since donors are reluctant to finance current expenditure (salaries and pensions) (see Tanzi, 1997, for more details on fiscal issues).

In the monetary area, a system for exchange, internal and external payments, and the provision of credit needs to be restored. This may also take some time and a temporary solution may have to be adopted to deal with urgent payment needs. Inflation has to be checked, since rapid inflation creates uncertainty and discourages savings and investment, promotes capital flight, distorts market signals and imperils growth. Inflation also brings about arbitrary changes in income distribution that mostly hurt the poor sectors of the population.

Fiscal and monetary discipline assures public savings and contributes to investment. A house in order makes it more desirable to come back to and promotes repatriation of private sector capital. A developing and well-nurtured private sector contributes to investment and government taxation. Good macro-management, a transparent institutional framework, and a clear understanding of government policies encourage international assistance: donors are more willing to help countries that help themselves. The reactivation of the economy with low inflation is vital to the effective reintegration of former combatants and their supporters into productive activities.

At the same time, expenditures linked to the financing of peace-related programs are likely to exert pressure on fiscal objectives and put the national authorities in the difficult dilemma between compliance with the provisions of peace agreements and compliance with the economic program. Fiscal targets in IMF-sponsored programs will have to be flexible enough so as to incorporate the financial needs of reconstruction. We argue, thus, that the Fund, working closely with the UN, should set realistic economic conditionality that would allow for implementation of peace agreements. But the Fund should not become a political forum to advance human rights and other political goals or set political conditionality; it does not have a comparative advantage and it may even jeopardize its mandate. [19]

With more multidisciplinary international teams and more flexible institutional mandates international organizations would be better prepared to help countries reconcile the often conflicting objectives of economic reconstruction and the reactivation of growth, on the one hand, and national reconciliation and peace consolidation, on the other. Under such conditions international organizations could better help countries design post-conflict activities in accordance with a master plan whose main theme and goal could be to assure that the preservation of peace prevails above all other considerations. To be sure, an integrated approach to human security—important as a general rule—becomes imperative in post-conflict transitions. Multifaceted and complex post-conflict transitions require diverse and specialized expertise, not easily available in a single international institution.

6. CONCLUDING REMARKS

The peace process in El Salvador involved the complex challenge of designing and implementing programs, on the basis of a national consensus, for the reconstruction and reconciliation of a country polarized by years of civil war. This process was facilitated by macroeconomic adjustment and structural reforms that allowed for a rapid recovery of high-quality growth, as well as by generous financial, technical assistance, and policy advice from the international community. The government eventually succeeded in implementing the NRP within the framework of a sound macroeconomic plan consistent with the maintenance of price and external stability.

In view of the large number of countries recovering from conflict situations or in transition to new political and economic systems amidst considerable turmoil, the intervention of both the UN and the Fund will be increasingly needed. In El Salvador, these organizations have built a body of evidence and experience, both in designing programs, policies, and strategies that have worked, and in avoiding counterproductive situations and even confrontations that make the transition more difficult and less effective.

The UN and the Fund, in conjunction with other national and international actors, will have to work closely together to provide an integrated approach (as opposed to a merely coordinated one) to matters of peace and economic stability. The experience of El Salvador demonstrates the importance of ensuring that: (a) the UN designs peace accords that are in line with the financial and technical capacity of the country to implement them; (b) the programs critical to the successful implementation of the peace process are adequately financed early on in the process (delays in implementing key programs may endanger peace); and (c) the government does not use conditions imposed in the IMF-sponsored economic program as an excuse to avoid making difficult political decisions that are essential to a successful transition. Each organization should obviously use its own comparative advantage while taking into consideration and contemplating the needs of the other. By doing so, many mistakes that led to parallel but largely unconnected and sometimes conflicting operations in the early stages of the Salvadoran transition, as well as to *unfinished business* in the implementation of many of its programs, could well have been avoided.

NOTES

1. The term economic reconstruction is used in a broad sense to include, not only the reconstruction itself, but all the policy measures, including stabilization and structural reform, necessary to reactivate the economy and bring it into a sustainable development path.

2. For a detailed analysis of the role of the UN programs (UNDP, UNICEF) and specialized agencies of the UN system (FAO, ILO, UNESCO, UNIDO, UNHCR, UNRISD, WHO), see United Nations (1995b). For a detailed analysis of the World Bank activities, see World Bank (1998a,b, 1997) and IMF and World Bank (1998).

3. As de Soto and del Castillo (1994) have pointed out, the IMF-supported stabilization program and the UN-brokered peace negotiations "were born and reared as if they were children of different families. They lived under separate roofs. They had little in common other than belonging roughly to the same generation... The IMF and the World Bank did not consult with the UN in the elaboration and subsequent implementation of the economic program... When the UN engaged in peace negotiations early in 1990, it did not think to consult the IMF or the Bank, notwithstanding the serious financial implications of postwar rehabilitation."

4. Wood and Segovia (1995) conclude that "The macroeconomic policy environment of austerity," impeded the timely implementation of the peace agreements. In their view, "A greater interest on the part of the international financial institutions in the implementation of the Peace Accords rather than a dominant emphasis on economic reform might have contributed to the reconciliation of the apparently conflicting priorities of macroeconomic stabilization and peace-building." See also Boyce *et al.* (1995).

5. These problems are well detailed in the reports of the Secretary-General on ONUSAL (United Nations, various issues). See also del Castillo (1997).

6. In El Salvador, for example, 300,000 peasants with no land were excluded from the land program, which benefited only former combatants and their supporters.

7. For example, the success of the arms-for-land program should not be measured by purely economic or financial criteria used in normal land reform programs (e.g., production per acre, debt repayment, etc.). It should be judged by whether it contributed to national reconciliation and allowed beneficiaries to find a productive activity that would permit them to make a decent living without resorting to arms.

8. To strengthen its capacity to assist countries as they embark on post-conflict transitions, in 1995 the Fund expanded its guidelines on emergency assistance to include such situations. The countries that pose the greatest problem for Fund assistance are those with large arrears to the Fund and the Bank.

9. For an analysis of the very complex land tenure problems in El Salvador see del Castillo (1997). During the war, land tenure problems worsened; many rural properties were abandoned. It was estimated that about half a million persons were displaced, approximately 45,000 became refugees, and more than one million (close to 20% of the population) emigrated, mostly to the United States. Many of the displaced persons were

settled in communities, some of them on abandoned lands. Thus, property rights became a serious issue in the post-conflict transition.

10. National savings have been measured as the difference between domestic investment and the current account deficit (as a proxy for foreign savings).

11. Economic data were taken from the Government of El Salvador and the IMF. Social data are from published sources from the World Bank, various years, UNDP, several years, Inter-American Development Bank, and CEPAL (Spanish acronism for the UN Economic Commission for Latin America and the Caribbean).

12. Current transfers are mostly private transfers from remittances of workers abroad. The current account excluding transfers, thus, shows the external position of Salvadorans in El Salvador *vis-à-vis* the rest of the world, without the assistance of Salvadorans abroad. Official transfers (grants) are mostly for investment purposes and are included in the capital account.

13. A stand-by arrangement was approved in August 1990 for SDR 36 million (US$51 million). Shortly after the completion of the mid-term review under the arrangement in February 1991, the World Bank approved the first structural adjustment loan. Thus, the IMF arrangement was negotiated long before the peace agreement was signed (this is quite common; in Bosnia and Herzegovina, for example, negotiations on an economic program started while the Dayton Peace Agreement was still being negotiated). El Salvador has treated this stand-by-arrangement and the subsequent ones as precautionary and has made no purchases under them (e.g., has not borrowed from the Fund).

14. That peace-related programs have been implemented does not necessarily mean that they have fully succeeded or that they will be sustainable. For a discussion of the unfinished business, see the most recent UN reports to the Security Council. See also del Castillo (1997), de Soto and del Castillo (1995).

15. Press conference given by the Secretary-General at the Economic Commission for Asia and the Pacific (ESCAP). See also his report to the Security Council of May 21, 1993.

16. Even after postponing lower priority projects, NRP expenditures in 1993 were 35% higher than in 1992 and represented about 7.3% of central government expenditures. About 40% of these expenditures were financed through grants and about 30% by long-term loans from official creditors.

17. In a mid-1993 meeting between UN, IMF and World Bank officials, the UN expressed concern about the lack of financing for the land transfer program and for the establishment of the new police force. Fear was also expressed that the security situation would deteriorate if the reintegration could not take place in a reasonable amount of time. The Fund had noted that, despite the fiscal targets of the program, limits did not exist on subcategories of expenditure financed by domestic resources. It was up to the government to prioritize its expenditure program.

18. Citing data from the IMF staff and recent economic development reports on El Salvador (IMF, various years), Boyce (1995) notes the lack of progress in decreasing military expenditure. He fails to distinguish, however, between defense (military proper) and police (public security) expenditure, since the IMF data include both as military expenditure. The distinction is particularly important after 1992 since, as per the peace agreements, the repressive and militarized police forces of the past had been dissolved. As a result, police expenditure starting in 1993 only includes expenditure in the national civilian police (an expenditure thus related to the peace accords), which should be clearly distinguished from military expenditure proper (see Table 2).

The drop in military expenditure is in line with what has happened in other countries with IMF-supported programs. Program countries (defined as those with at least one program in 1991–95) reduced their military spending to a low 2% of GDP in 1995 from over 5% in 1990. This represented a larger decrease than for all developing countries and has allowed these countries to increase social spending in the face of cuts in total spending (IMF, open letter of the Managing Director to the Executive Director of UNICEF, December 1996).

19. Some of the critics of Fund *economic conditionality* have proposed that the Fund be empowered further to impose *peace conditionality*, that is, make loans conditional on specific actions by the borrower to secure peace (see Boyce, 1995; Boyce *et al.*, 1995; Boyce & Pastor, 1997). This would, in our view, go against the comparative advantage of the Fund and the UN. Only the UN should impose peace conditionality and the IMF should only impose economic conditionality; the two organizations should work closely together in this endeavor, but only a division of labor would ensure that the targets are realistic and can be monitored.The problems of the UN imposing economic conditionality and the Fund imposing peace conditionality are illustrated by the experience

of Guatemala. The peace agreement contemplated an increase in tax revenue from about 8% to 12% by 2000 (later rescheduled to 2002). This was clearly unrealistic from an economic point of view (given unsuccessful efforts at increasing tax revenues, as recommended by the Fund in the past). The Fund, however, in its efforts to support the peace process in Guatemala from the very beginning, nevertheless insisted on it, fully knowing how unrealistic this was. As a result, Guatemala's tax revenue is still below 12% and the government has not yet been able to reach an agreement with the Fund on an economic program.

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