

## Health

The start of U.S. assistance to Costa Rica for health-related programs is difficult to date, but it began well before 1950. Assistance from some multilateral organizations, such as the Pan American Health Organization, the World Health Organization, and the United Nations Children's Fund also date to at least the 1940s. The involvement of the World Bank and the Inter-American Development Bank in the health sector occurred later. The United States has been a primary provider of assistance in this sector.

The Agency for International Development made 29 loans for health-related projects and 26 smaller loans with P.L. 480 food assistance funds between 1951 and 1987. The government of Costa Rica, despite occasional administrative and political stumbling blocks, invested substantially in the health sector and used foreign assistance to improve the health of its population. Health has improved markedly over the past 40 years along numerous indicators. Infant mortality decreased from 68 deaths per 1,000 live births in 1967 to 14 in 1992. Between 1973 and 1993, coverage of health care programs expanded from 11 percent to 59 percent of the population. The death rate per 100,000 people declined by over half from 1951 to 1981. Deaths from diarrheal diseases have declined from 1,411 in 1953 to 83 in 1993. Nutritional deficiencies have fallen according to a number of different measures. Access to water and sewers has been greatly expanded.

The three largest donors to Costa Rica—the United States, the World Bank, and the Inter-American Development Bank—have devoted approximately 7 percent of their economic assistance to health programs. The overall purpose of those efforts was to improve the quality and access to health care for the population. Between 1950 and 1980, those efforts encompassed a wide range of activities devoted to improving community health, including health infrastructure, education and training of health professionals, improving water supplies and sewage, general sanitation, malaria control, expansion of primary health care, reproductive health, child nutrition, health research, preventive health, and medical services.

In addition, the construction of the Inter-American Highway, which began in the 1940s with U.S. funds, played an important role in helping unify the country and providing the means to get health services to rural areas. It also provided many jobs and, because of the large U.S. presence, introduced a wider and healthier diet to the various local regions during construction.

During the 1980s, however, most AID projects focused on medical issues that were more distant from the public health requirements of the country. Preventive and primary health care were de-emphasized. Projects for improving health services support, new drugs, skills for maintaining medical equipment, and technology

transfer appeared to have yielded limited results. Most of the money seems to have been spent on consultants and travel, with few obvious benefits for Costa Rica. To be fair, however, Costa Rica is no longer confronting the health problems that usually plague developing countries. The health issues it now faces are more similar to those of a developed country.<sup>25</sup>

### Education

Spending on education programs represented less than 4 percent of the assistance provided by the United States, the Inter-American Development Bank, and the World Bank. The Costa Rican government had already placed a high priority on education, and its education levels were higher than in most other developing countries. Nevertheless, those organizations played a mostly positive role in enhancing educational opportunities and quality for Costa Ricans. The record is occasionally marred by the inability of the receiving organizations in Costa Rica to use the funds effectively and by conflicts between the developmental and political priorities of AID and the Costa Rican government.

Through 1961, AID's funding focused on the training of Ministry of Education personnel and University of Costa Rica academicians. Other projects included supporting vocational education, bringing U.S. professors to Costa Rica to teach, and financing graduate degrees for Costa Ricans. In the 1960s, education assistance was limited to supporting mass primary education through a textbook project. That low level of funding continued into the 1970s. In the 1980s, AID placed greater emphasis on education, viewing it as a means of spreading the benefits of future economic growth.

### Population Growth

The fertility rate had begun declining in Costa Rica as a result of the country's relatively good socioeconomic conditions even before any foreign assistance was provided to those programs. AID, in cooperation with such agencies as the United Nations Fund for Population Activities, carried out numerous activities in this area. The first significant project was initiated in 1970. Foreign assistance for population-related issues included such activities as training for medical personnel, introducing a wider variety of contraceptives to a larger proportion of the population, education in family planning, and public information campaigns.

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25. This is drawn from a draft paper for AID's retrospective study on the impact of foreign aid in Costa Rica.

It is impossible to allocate responsibility precisely for Costa Rica's improvement on population-related indicators. Nevertheless, the role of foreign assistance seems to have been a modest one. Foreign assistance was a catalyst at times for supporting projects and programs that the government or other elements of Costa Rican society wanted. But the trend of declining fertility was already in place before AID or multilateral donors entered the picture. Costa Ricans practiced contraception effectively before there were organized family planning activities. Even when some of those programs encountered political disinterest or administrative problems in the late 1970s and ceased being effective, the fertility rate continued to decline.

### Agriculture

An important and valuable contribution of foreign assistance in Costa Rica, according to AID's evaluation, was in the realm of agricultural education and research. In the first decade covered by this study, foreign aid helped establish an agricultural extension service to transfer technology. AID supported research and extension projects for improving pasture lands, irrigation, and soil conservation. Foreign assistance, particularly from multilateral organizations such as the Inter-American Development Bank, supported the development of economic and social infrastructure. Increasingly, agriculture became part of a larger and broader food production and processing industry.

After the 1982-1983 economic crisis, aid played a role in developing and promoting nontraditional agricultural exports, which diversified Costa Rica's export base and improved its export earnings. In 1983, for example, nontraditional export products (those other than coffee, bananas, sugar, and beef) represented 38 percent of total exports. By 1990, that figure had increased to 53 percent. And because nontraditional agricultural exports are more labor intensive, they employed more people at better wages. The United States, the Inter-American Development Bank, and the World Bank devoted approximately 11 percent of their assistance to agriculture.

### Economic Growth

The three big donors to Costa Rica allocated almost 75 percent of their assistance to activities associated with promoting economic growth. Most of the resources in the 1970s and especially the 1980s were devoted to that sector. In the 1980s, foreign assistance helped Costa Rica undertake necessary and costly adjustments to its financial, institutional, and trade policies. But the aid given to Costa Rica in the

1970s was arguably quite harmful in that it enabled the government to pursue the self-destructive policies that brought on the 1982-1983 economic crisis.

Until 1982, aid that was intended to promote economic growth seemed to reinforce the economic policies of the government regardless of how wise those policies were. In the 1950s under President Eisenhower, the United States was a determined advocate for free trade and liberalized economies. But the Cuban revolution of 1959 prompted a different course. During the 1960s, the United States, partly for political reasons, provided Costa Rica with foreign assistance to support its integration with the economies of Central America and thereby resist communist expansion. In addition, "economic planning" was also a requirement of the Alliance for Progress program. Multilateral institutions provided loans and grants to build infrastructure. The short-term result was that Costa Rica's economy continued to grow, and its industrialization process intensified.

During the 1970s, AID focused on basic human needs and reducing poverty. Overall, however, the United States played a very small role in Costa Rica as a whole, and only very small amounts of U.S. direct aid were given in the economic and trade sector. The multilateral institutions, especially the Inter-American Development Bank, contributed substantial sums to Costa Rica for various economic projects. Those financial inflows helped offset Costa Rica's trade deficits at a time when the Costa Rican economy was slowing and its financial situation was worsening. The government's spending and protectionist trade policies were beginning to catch up with it. In that sense, foreign aid enabled the Costa Rican government to postpone the necessary adjustments to its national finances and continue with counterproductive economic and fiscal policies.

In contrast, after the crisis hit, foreign aid helped Costa Rica undertake the reforms it had been postponing. Between 1982 and 1986—the most crucial years—the United States took the lead in supporting and encouraging those reforms, providing 57 percent of all foreign assistance given to Costa Rica. The major initiatives included liberalizing the financial sector, reducing the size and spending of the public sector, promoting exports, reducing trade barriers, and supporting general macroeconomic stabilization and adjustment.

Political and security concerns motivated the U.S. interest in Costa Rica at this time. The Sandinista revolution in Nicaragua and the civil war in El Salvador increased Costa Rica's symbolic value as a stable, market-oriented democracy. Preserving that democracy was a high priority during the economic crisis and, hence, the Reagan Administration provided large amounts of financial assistance to help Costa Rica weather the storm. The National Commission on Central America,

chaired by former Secretary of State Henry Kissinger, provided an endorsement of that strategy for those reasons.<sup>26</sup>

Donors to Costa Rica, including AID, not only provided financing for many of these activities but also made that financing *conditional* on the implementation of reforms. The newly elected government of Luis Monge in 1982 was committed to making those changes. Without a government committed to making reforms, donors' efforts would probably have been fruitless. The relative agreement between the Monge government and the foreign aid donors over what needed to be done—and that the policies were the right ones—is what helped make Costa Rica a success story in the 1980s. In that case, the dual purpose of U.S. assistance did not materially impinge on its usefulness in promoting reforms so that Costa Rica could continue on its development path. Indeed, the flow of foreign aid to Costa Rica in the 1980s far exceeded foreign investment as a percentage of GNP (see Figure 4).

It is impossible, however, to disentangle the separate roles of bilateral and multilateral aid in the economic and trade sector. The United States worked closely with multilateral institutions—the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank—in promoting the reform program in Costa Rica. All of those institutions conditioned their aid on the progress of reforms. AID and the multilaterals reinforced each other. The United States would sometimes make its aid conditional on progress that the World Bank or the Inter-American Development Bank wanted, and vice versa.

Stabilization. The first task was to stabilize Costa Rica's economy. That was accomplished with infusions of cash from AID and the IMF that allowed Costa Rica to pay for needed imports. That adjustment program can be judged a success. Unemployment in 1983 was 9 percent but had declined to 3.8 percent by 1989. After two years of negative growth, the economy began growing again in 1983. The average annual growth rate of GNP between 1983 and 1993 was 5.3 percent; per capita GNP grew by an average of 2.7 percent. Costa Rica's external debt, which had soared to over 160 percent of GNP in 1982, fell to little more than 50 percent by 1993 (see Figure 5).

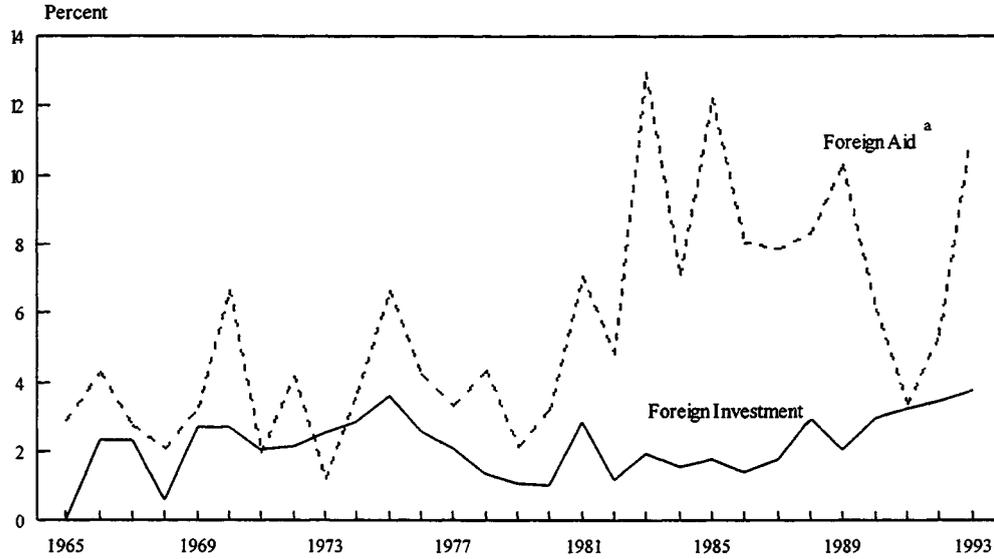
Government Downsizing. The Agency for International Development promoted government downsizing by pushing the privatization of government-owned enterprises, notably the Costa Rican Development Corporation, in three phases. First, the United States pressed to end CODESA's unlimited line of credit with the

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26. *Report of the National Bipartisan Commission on Central America* (January 1984). See also Marc Edelman and Rodolfo Monge Oviedo, "Costa Rica: The Non-Market Roots of Market Success," *NACLA Report on the Americas*, vol. 26 (February 1993), pp. 22-29.

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FIGURE 4. FOREIGN AID AND FOREIGN INVESTMENT AS A PERCENTAGE OF COSTA RICA'S GROSS NATIONAL PRODUCT, 1965-1993



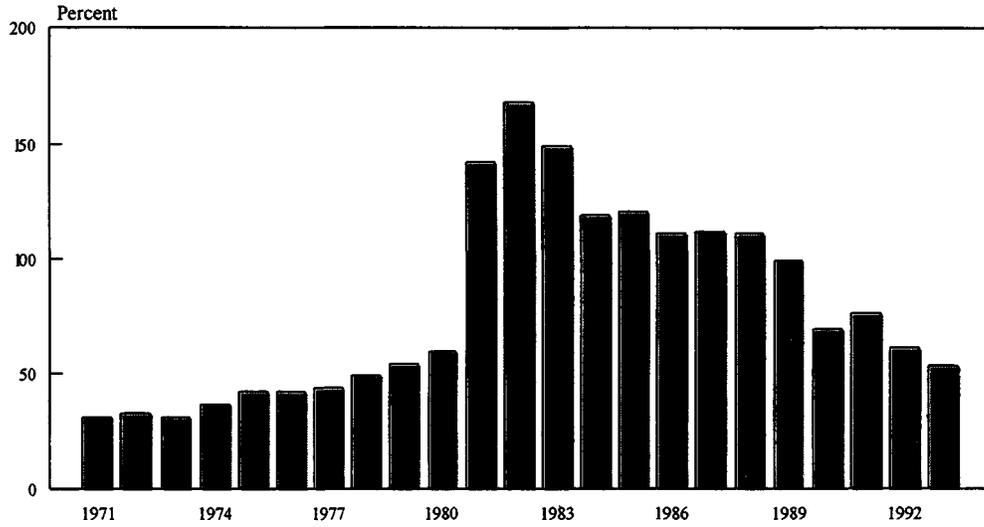
SOURCE: Congressional Budget Office based on data from the Agency for International Development and the World Bank.

a. Excludes the use of credit from the International Monetary Fund.

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FIGURE 5. EXTERNAL DEBT AS A PERCENTAGE OF COSTA RICA'S GROSS NATIONAL PRODUCT, 1971-1993



SOURCE: Congressional Budget Office based on data from the World Bank.

NOTE: No data are available for external debt before 1971.

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Central Bank of Costa Rica. Second, AID pushed for the sale or closure of CODESA enterprises. Third, AID promoted reducing the size of the central government in part by financing “labor mobility” programs that enabled government workers to find employment in the private sector.

Financial Liberalization. Donor money was used conditionally to force various reforms in the financial sector. The reforms included freeing interest rates, eliminating sectoral allocation of credit by the central bank, and strengthening oversight of the banks. AID also directly promoted a private-sector banking industry that could compete with the state-owned banks. State banking has proved to be one of the most difficult sectors to reform in light of the long history of the nationalized bank. Still, without those reforms Costa Rica’s recovery would probably have been much more difficult. The growth of private banking played an important role in fueling the export-oriented trade strategy. Yet the private banking sector is not fully developed. Intermediation margins in the banking system do not meet international standards. The five largest private banks control almost 60 percent of the loan portfolio of the private sector. They tend to behave oligopolistically and neglect rural consumers of credit.

Trade Liberalization and Export Promotion. AID financed the creation of CINDE, a trade organization that established investment promotion offices abroad to lure investors to Costa Rica and supported programs to promote nontraditional exports and industries. AID and other donors sought improvements in the export regime, realistic exchange rates, and reductions in tariffs. By 1990 the highest tariff had fallen to 40 percent and by 1993 to 20 percent. Nontraditional exports to countries outside the Central American Common Market more than tripled between 1983 and 1990. Nontraditional exports accounted for 54 percent of Costa Rica’s exports in 1994.

## INFLUENCE OF GOVERNANCE ON HONDURAS’S DEVELOPMENT

In contrast to Costa Rica, Honduras is one of the poorest countries in Latin America. Although Honduras’s real per capita GNP grew by an average of 1.8 percent a year between 1965 and 1980, it declined by an average of 0.7 percent a year between 1981 and 1994.<sup>27</sup> It suffered from the same type of economic crisis in the early 1980s as Costa Rica, but it was much less successful in overcoming that crisis. Per capita

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27. To compare economic growth in two countries, CBO adjusted GNP to reflect estimates of purchasing power parity provided by the Penn World Tables at the University of Pennsylvania. To calculate the change in GNP per capita within a country, CBO used a constant-dollar series converted by exchange rates. The numbers generated by those two series may appear quite different, even contradictory, but they are appropriate for the two different tasks.

growth has not managed to make any lasting progress since 1978. A great divide between rich and poor remains a particular problem. Most Hondurans live in rural areas and make their living through subsistence farming. A small elite of business executives, military officers, and bureaucrats benefit most from Honduras's economy.<sup>28</sup> The political and economic management of the country deserves much of the credit or blame for Honduras's halting progress. The role of foreign aid in this story is mixed. While it managed to improve the lives of thousands of Hondurans, it has made much less progress in facilitating sustained economic growth. Indeed, some critics believe that Honduras has become dependent on foreign aid.

Honduras has not enjoyed the political stability that Costa Rica experienced. Honduran politics have been highly contentious, and the military has not hesitated to intervene directly in the political process. Unlike Costa Rica, which dissolved its army in 1948, the Honduran military transformed itself into a modern professional organization in the 1950s. That transformation did not mean, however, a disinterest in the political development of the country. On the contrary, of the 12 changes in the executive between 1954 and 1994, five were coups (see Table 5). The military became an independent—and one of the most powerful—interest group within Honduran government and politics.<sup>29</sup>

Although reformist military governments sometimes took positive steps to promote Honduras's development, overall the pervasive influence of the military appears to have contributed to the country's underdevelopment. The military claimed a significant share of the government's resources that otherwise could have been used for development. Of course, that is true for most countries. A second problem was that the coups disrupted the political stability of the country and sometimes brought to an end reformist liberal governments. Finally, according to Kent Norsworthy and Tom Barry, Honduras suffers from a deep fear of its neighbors. The powerful influence of the military in Honduran society appears to have done little to alleviate that fear.<sup>30</sup>

Ostensibly, Honduras is governed by an executive, a legislature, and an independent judiciary. In practice, the chief executive, whether military or civilian, either dominates or ignores the other two branches of government. The president of the republic has been the center of political life and policy in Honduras. Thus, the political management of Honduras, whether good or bad, has been largely the

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28. James A. Morris, *Honduras: Caudillo Politics and Military Rulers* (Boulder, Colo.: Westview Press, 1984), pp. 29-31.

29. *Ibid.*, pp. 35-37.

30. Kent Norsworthy with Tom Barry, *Inside Honduras* (Albuquerque, N.M.: Interhemispheric Education Resource Center, 1993), p. xvii.

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TABLE 5. ADMINISTRATIONS OF HONDURAS, 1948-1994

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Chief Executive	Method of Change	Date of Change <sup>a</sup>
Juan Manuel Gálvez (PNH)	Elections	October 1948
Julio Lozano Díaz (PNH)	Elections	October 1954
Military Triumvirate	Coup	October 1956
Ramón Villeda Morales (PLH)	Elections	September 1957
Col. Oswaldo López Arellano	Coup	October 1963
Gen. Oswaldo López Arellano	Elections	February 1965
Ramón Ernesto Cruz	Elections	March 1971
Gen. Oswaldo López Arellano	Coup	December 1972
Gen. Juan Alberto Melgar	Coup	April 1975
Gen. Policarpo Paz García	Coup	August 1978
Roberto Suazo Cordova (PLH)	Elections	November 1981
José Azcona Hoya (PLH)	Elections	November 1985
Rafael Leonardo Callejas (PNH)	Elections	November 1989

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SOURCE: Congressional Budget Office, based on James A. Morris, *Honduras: Caudillo Politics and Military Rulers* (Boulder, Colo.: Westview Press 1984); and Tim Merrill, ed., *Honduras: A Country Study* (Washington, D.C.: Federal Research Division of the Library of Congress, 1995).

NOTE: PNH = National Party of Honduras; PLH = Liberal Party of Honduras.

a. Date of election or coup.

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president's creation.<sup>31</sup> It is not clear, for example, how well the Honduran judicial system has protected property rights and ideas.

Two major parties have dominated Honduran politics: the National Party of Honduras and the Liberal Party of Honduras. Even when the country was governed by the military, it was often affiliated with the Nationalists. According to one study, political parties in Honduras have generally been narrowly based and unprincipled.<sup>32</sup>

In addition to this weak political structure, flagrant corruption—both government and private—has taken a heavy toll on Honduras's development. The military has readily used public funds and services to accumulate private fortunes, particularly during the massive infusions of U.S. military aid in the 1980s. In addition, private-sector business executives and political elites have often been indistinguishable from each other. Government resources have been diverted for the personal benefit of members of the business community. In 1992, for example, the Honduran congress launched a probe to investigate over 70 cases of alleged corruption within the executive branch, which at the senior levels was drawn largely from the business community.<sup>33</sup>

Finally, the way the Honduran government pursued development was sometimes helpful but at other times caused considerable harm. The administration of Juan Manuel Gálvez in the early 1950s took a number of important steps to begin modernizing the Honduran government and, in particular, establish institutions that would further national development. Notably, Gálvez created the Central Bank of Honduras to control monetary policy and the Agricultural Development Bank. He also created the Ministry of Economy, the National Council on Economics, the Board of Budget Management, and the Income Tax Board—all of which were intended to create the means for modern development.<sup>34</sup>

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31. Morris, *Honduras*, pp. 62-63.

32. Norsworthy and Barry, *Inside Honduras*, p. xvii.

33. Ibid., pp. xviii-xix, 163. For a vivid illustration of this phenomenon, see Juan O. Tamayo and Gerardo Reyes, "Scandals Plague Honduran Ex-President," *Miami Herald*, March 16, 1997, p. 1A.

34. Mark B. Rosenberg and Philip L. Shepherd, eds., *Honduras Confronts Its Future* (Boulder, Colo.: Lynne Rienner, 1986), p. 99.

## INFLUENCE OF DOMESTIC ECONOMIC POLICY ON HONDURAS'S DEVELOPMENT

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Employment in the Honduran economy in the 1950s was based almost entirely on agriculture. Most of the country's exports came from commercial agriculture and natural resources: bananas, coffee, wood, and meat. The manufacturing sector was small; it composed only 5 percent of the workforce in 1950, and by 1960 contributed only 9 percent of GDP.

The Honduran government's main development effort was to invest in infrastructure: roads, electricity, communications, and financial institutions. The government borrowed from abroad to finance the development of that infrastructure and needed expanded export earnings to finance that borrowing. That strategy caused some difficulty in the mid-1950s when floods, hurricanes, and labor strikes at banana plantations sharply cut exports. In 1957, short-term borrowings from the IMF helped Honduras weather a balance-of-payments crisis caused by diseased banana trees. In the late 1950s, the Central Bank of Honduras established a stabilization program that reserved foreign loans exclusively for long-term development.<sup>35</sup>

### The CACM and Slow Progress

By 1960, industry had grown and was employing 11 percent of the workforce. The government's industrialization and development strategy in the 1960s focused on import substitution and diversification of the agricultural export base. Honduras joined the Central American Common Market (CACM), which lowered trade barriers among members but maintained stiff tariffs on outside producers. That strategy worked well for Costa Rica for a decade but was not quite as successful in Honduras.

The Honduran industrial sector and its exports grew during the CACM period but not nearly as much as those of its neighbors. The economy diversified somewhat, but Guatemala, El Salvador, and Costa Rica had better results. Guatemalan and El Salvadoran industries were more competitive and productive; Honduran businesses found it difficult to compete. For example, for the 40 years before 1963, Honduras had enjoyed trade surpluses with its CACM neighbors. Now Honduras began to import more from other Central American countries than it was selling. Limited infrastructure, an underskilled labor force, and an inexperienced entrepreneurial class all helped make Honduran business less competitive.<sup>36</sup> In

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35. Ibid., p. 99.

36. Morris, *Honduras*, p. 88.

addition, the banking system was not strong enough to support business expansion. Despite some government efforts to widen the banking system and improve access to credit, entrepreneurs usually were forced to finance their own expansion and maintain levels of working capital. After a brief war with El Salvador in 1969, Honduras withdrew from the CACM in 1970.

The structure of the agricultural sector remained largely unchanged through the 1960s. In 1961, agriculture employed 70 percent of the labor force but accounted for only 37 percent of GDP. Foreign corporations dominated Honduras's agricultural export sector, which may have limited the benefits of economic modernization—though in some ways Honduras might have modernized more slowly without them. The most important players, the banana corporations, led the diversification into new, nontraditional agricultural products such as citrus and African palm. They also invested in large food-processing and other industries.<sup>37</sup>

With respect to human capital, more than half the population was illiterate and population growth was nearly 3 percent a year in 1961. The liberal government of Ramón Villeda Morales, with domestic and international prodding, pushed through and signed the 1962 Agrarian Reform Law, which sought to address issues of land distribution. But a coup in 1963 put an end to those efforts.

### State-Centered Development

By the 1970s, the Honduran economy was industrializing but at a slow rate. The industrial sector had continued to grow relative to agriculture as a percentage of GDP (see Table 6). The economy suffered a bout of stagnation in the early seventies but returned to robust growth late in the decade as a result of higher commodity prices, especially for coffee, between 1976 and 1979.

The government undertook a number of structural reforms to the economy. Perhaps the most important was a massive expansion of the state's role in the economy and large increases in public-sector investment. In 1972, the reformist military government of General Oswaldo López Arellano inaugurated the National Plan of Development. One of its positive features was an agrarian and land reform plan. Large amounts of resources were invested in the agrarian sector; the government sought to encourage co-ops to produce bananas and African palms. It also managed to take some modest steps toward land reform.

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37. Norsworthy and Barry, *Inside Honduras*, p. 52.

TABLE 6. COMPOSITION OF HONDURAS'S GROSS DOMESTIC PRODUCT BY SECTOR, 1950-1980 (In percent)

Sector	1950	1960	1970	1980
Agriculture <sup>a</sup>	44.8	32.8	34.6	25.1
Manufacturing <sup>b</sup>	9.0	15.3	14.0	15.0
Mining	2.3	1.9	2.3	2.0
General Government <sup>b</sup>	4.1	4.7	3.6	5.2
Other Sectors	39.8	45.3	45.5	52.7

SOURCE: Congressional Budget Office based on data from Victor Bulmer-Thomas, *The Political Economy of Central America Since 1920* (New York: Cambridge University Press, 1987).

- a. Includes forestry and fishing.
- b. The available data do not indicate how the state-owned enterprises are being accounted for—in government or in manufacturing. They are probably recorded in "Manufacturing."

But the government also paralleled Costa Rica's strategy of state-centered development. Honduras, with the support of the major aid donors, started a large number of autonomous, state-owned enterprises. Perhaps the most important was the National Investment Corporation (CONADI), which was charged with promoting public, private, or joint industrial projects, primarily in sugar, hotel, cement, food, and textile industries. It was inefficient and corrupt, however, and accumulated \$300 million in debt by 1982. Other enterprises included the Honduran Corporation for Forest Development (COHDEFOR), which nationalized privately held forest resources, and the Honduran Banana Corporation (COHBANA), which was supposed to support banana growers. The National Bank of Economic Development (BANASUPRO) created stores to supply the people with basic goods, reinforcing measures intended to control the supply and prices of most essential consumer products.<sup>38</sup>

Other reforms and unforeseen external events also undermined economic growth. The government helped the labor movement, which had been relatively strong since the 1954 strike by workers on banana plantations, to set up new organizations and associations. That tended to discourage private investors. Hurricane Fifi in 1974 destroyed a large part of the banana plantations. Large government infrastructure projects, financed by loans from international banks and organizations, turned in mixed results. Some projects came in on budget and served the country well; others finished over-budget, behind schedule, and with their economic viability questionable. But the government was still obligated to repay those international loans.<sup>39</sup>

### Economic Crisis

The worldwide recession in the early 1980s and the decline in commodity prices were severe blows to the Honduran economy. Export earnings dropped, making it difficult to finance the country's growing external debt, much less other development projects. Higher energy prices also hurt the trade balance. Businesses failed; unemployment and underemployment together exceeded 50 percent. Those conditions encouraged the flight of domestic and foreign capital from Honduras. More and more of the country's development projects were being financed by external borrowing. As a result, between 1973 and 1981 the ratio of debt-service payments increased from 3.7 percent to 12.7 percent of export income.

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38. Rosenberg and Shepherd, *Honduras Confronts Its Future*, pp. 101-102.

39. *Ibid.*, p. 102.

To stimulate growth, the civilian government elected in 1981 responded with large foreign borrowing to finance an expansionary fiscal program centered on expensive high-tech infrastructure projects.<sup>40</sup> Between 1981 and 1984, public-sector investment as a percentage of GDP grew from 7.7 percent to 13 percent. Monetary policy supported that program. The public-sector deficit increased from 7.4 percent of GDP in 1980 to 11.4 percent in 1984. Rather than create private-sector employment, those projects increased the public-sector workforce and lined the pockets of a small elite. They apparently never sparked private investment or substantial private employment. Per capita income fell after 1988 even as the external debt grew considerably as a percentage of GNP (see Figure 6).

### The Absence of Recovery

In the early 1990s, the Honduran economy deteriorated rapidly. The new government of President Rafael Leonardo Callejas, elected in 1989, did not manage to make much progress in addressing the economy's problems. The need to cut fiscal and trade deficits conflicted with his party's promise to improve social programs and employment and address the concerns of disgruntled and vocal public-sector employees. Real economic growth between 1989 and 1993 was absorbed by a fast-growing population. Per capita GNP fell from 1989 to 1991 and showed little recovery by 1994.

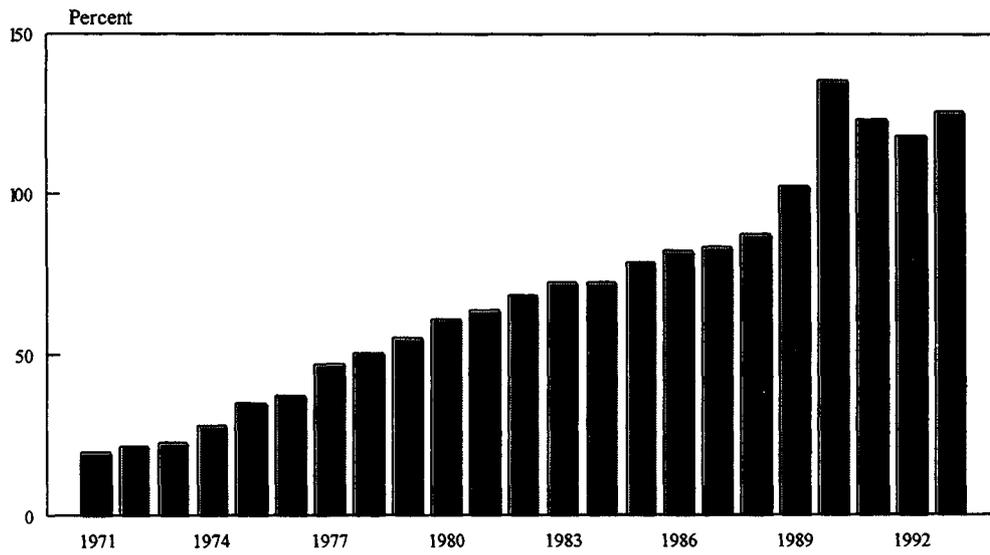
As part of his effort to move Honduras away from a state-centered development strategy, Callejas attempted to reform economic policy and reduce the influence of government. He sought to privatize government-owned enterprises, liberalize trade and tariff regulations, and encourage increased foreign investment. He focused on reducing the size of public-sector spending and employment. He sought to improve Honduras's terms of trade by devaluing the currency. The lempira, the Honduran currency, had been fixed to the U.S. dollar since 1918 and had become dramatically overvalued by 1990. Other reforms included reducing the average tariff rate from 90 percent to 40 percent and removing most surcharges and exemptions. He also aimed to increase government revenue and instituted a continuing program of trade and price liberalization and deregulation.

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40. Tim Merrill, ed., *Honduras, A Country Study*, (Washington, D.C.: Federal Research Division of the Library of Congress, 1995), p. 113.

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FIGURE 6. EXTERNAL DEBT AS A PERCENTAGE OF HONDURAS'S GROSS NATIONAL PRODUCT, 1971-1993



SOURCE: Congressional Budget Office based on data from the World Bank.

NOTE: No data are available for external debt before 1971.

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