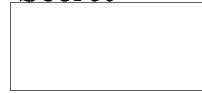




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El Salvador: Duarte and Private Business at Loggerheads



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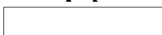

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El Salvador: Duarte and Private Business at Loggerheads



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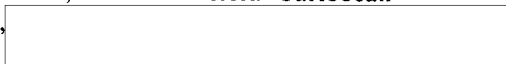
An Intelligence Assessment

This paper was prepared by 
 Office of African and Latin American
Analysis. It was coordinated with the Directorate
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**El Salvador: Duarte
and Private Business
at Loggerheads**

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Key Judgments

*Information available
as of 3 February 1987
was used in this report.*

Relations between El Salvador's private sector and President Duarte are marked by mutual distrust, strong ideological differences, and conflicts over economic policy—all of which have hurt the country's economic performance. Faced with numerous challenges since his election in 1984, Duarte has largely ignored the needs of the business community, focusing instead on combating a tough Marxist insurgency, building better relations with the Salvadoran military, and improving the conditions of the lower classes. For their part, businessmen accuse Duarte of ignoring their concerns and pursuing populist policies that have stalled economic recovery, and they have not supported the government even on issues that favor their interests. Improved government relations with the business community seem unlikely under Duarte, and we believe El Salvador will continue to experience economic stagnation, possibly leading to increased political instability. This could complicate US efforts to support Salvadoran democracy, and increase the country's dependence on US aid.

Despite deteriorating economic conditions and pressure by members of his own party to improve relations with the business community, we believe Duarte is unlikely to make significant concessions to private-sector interests. Many of the measures that would be most effective in stimulating business activity—such as currency devaluations or the removal of price controls—are unlikely to be implemented, in our view, because they would hurt the workers and peasants on whom Duarte relies for support. The President's longstanding friction with the business community was reflected most recently in January 1987 when businessmen called a general strike to protest Duarte's tax reform package.

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Backing from the military—motivated principally by its need for US aid—has enabled Duarte to maintain the upper hand in his relations with the private sector. Despite their concern that continued poor economic performance could benefit the insurgents, military leaders are likely to support the President so long as he does not threaten their institutional interests. Rising popular discontent or support for the rebels could cause the military to press Duarte into adopting the private sector's formulas for improving the economy, but he would be likely to do the minimum—such as soliciting business views but ignoring their proposals—necessary to placate the armed forces leadership.

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The cooperation of private business is, in our judgment, essential for stable, long-term economic growth in El Salvador. We believe, however, that the private sector will remain unwilling to contribute to the revival of the economy—by expanding investment or production—until the government addresses its concerns:

- Businessmen believe government interference, mismanagement, and failure to adopt policies to stimulate the economy have created an unfavorable atmosphere for business.
- They are angered by Duarte's rhetoric, feeling that he has tried to blame the private sector for all the country's economic problems.
- Despite the government's progress on the battlefield, businessmen feel the investment climate remains uncertain because of the insurgency.

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The business community is divided over how to deal with the government, particularly how to gain a greater role in economic decision making. Moderate leaders—who have replaced hardliners at the head of major private-sector groups—have expressed a desire to cooperate with the government—largely, we believe, in hopes of protecting their interests until the end of Duarte's term in office in 1989. A few hardliners, however, continue to reject any dealings with the President and try to foment opposition. These divisions have been exacerbated by the failure of moderate business leaders to change controversial government policies and by the poor electoral performance of conservative political parties representing the views of private business.

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Ironically, Duarte's failure to make reforms that would improve private-sector confidence has slowly undermined his popularity and contributed to the economic difficulties facing El Salvador. This, in turn, has made him even more reluctant to take politically risky adjustment measures for fear of further weakening his political base. A substantial increase in economically motivated public protests—or renewed popular support for the insurgency—might cause the President to take additional measures inimical to business interests in an attempt to revive support for his government. In our opinion, Duarte believes he can rely on US economic aid to see him through hard times without making the reforms necessary to restore the economy or boost private-sector confidence.

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We believe that continued poor economic performance would increase the chances for radical moves by either the left or the right and eventually threaten the political stability of El Salvador. While antigovernment strikes and demonstrations in January by business groups and leftist labor unions have increased political difficulties for President Duarte, he retains control because they lack popular backing and unity. But prolonged periods of protests and heightened popular discontent almost certainly would weaken Duarte and impair the government's war effort. Disenchanted businessmen might choose to support a rightwing extremist group in the 1988 legislative election, further polarizing Salvadoran society. In either case, the US goal of promoting stable, democratic growth in El Salvador would be set back. Similarly, the failure of a democratically elected government to provide a better standard of living for its people—even with massive US support—could have a detrimental effect on nascent democracies in the region. [redacted]

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The goal of improved government-private-sector relations is likely to be a sore point in El Salvador's bilateral relations with the United States. US assistance programs are based on the premise that the private sector will play the major role in strengthening economic performance. Duarte's resistance to policies that might gain business community participation, however, probably will continue to undermine the impact of US aid. [redacted]

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Figure 1



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El Salvador: Duarte and Private Business at Loggerheads

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Introduction

The relationship between President Jose Napoleon Duarte and the private sector in El Salvador has been marked by mutual distrust, strong ideological differences, and conflicts over economic policy, with a negative effect on the country's economic performance. Faced with numerous challenges since his election in 1984, President Duarte has paid only limited attention to the economy and to the needs of the business community, focusing instead on combating a tough Marxist insurgency, improving the conditions of the lower classes, and building good relations with the Salvadoran military. For their part, businessmen have not increased investment or expanded production because they perceive Duarte to be antibusiness and unwilling to address their concerns. Frictions between the two have been aggravated over the past year by the country's worsening economic situation and by the implementation of government policies opposed by private business. Although El Salvador is burdened with a variety of economic and social problems, the stalemate in government-private-sector relations continues to be a major factor stifling recovery and contributing to El Salvador's need for US economic assistance.

military coup in October 1979, when a civilian-military junta—later headed by Duarte—undertook major reforms aimed at redistributing national income and breaking the wealthy elite's control of the economy. Measures such as land reform and the nationalization of banks and export industries undercut the private sector's control over its traditional base of wealth. The business community lost major land holdings, access to credit, and its near-monopoly of foreign exchange earnings from coffee and sugar—the country's most important exports. The private sector's ability to conduct its affairs was further hampered by the inefficient and inexperienced performance of the new government bureaucracy.

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The reforms and the more open political system that evolved also led to a substantial loss of political power for the private sector. Moderate political forces grew stronger under the influence of Duarte's populist Christian Democratic Party (PDC) and the general population supported the development of democracy. Meanwhile, the private sector continued to oppose the reforms and tried to reclaim power. This confrontational approach led to the increasing isolation of the business community. As a result, according to US Embassy reporting, the private sector found itself increasingly unable to influence the formation of national policies that directly affected its interests.

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This paper assesses the prospects for improvement in the government's relations with the private sector over the next two years and describes the attitudes likely to govern the conduct of both sides. It examines the major issues of contention and identifies the most likely course that each side will take. Finally, the paper discusses the implications of government-business interaction for the Salvadoran economy and for US interests.

Duarte's stewardship of the reforms firmly established him as an enemy in the eyes of the private sector, and relations between the two remain colored by Duarte's clear distrust of the private sector and the business community's uneasiness about his intentions. Since becoming President in 1984, Duarte has pressed to consolidate the state's control over key areas of the economy to prevent the upper class from reestablishing its preeminence.

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Socioeconomic Reform and the Private Sector

The current tensions between Duarte and private business are rooted in the political, social, and economic changes in El Salvador that began following a

Duarte believes that Salvadoran business and the upper class should bear the brunt of the sacrifices

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The 1980 Reforms

The fundamental reforms of 1980 followed almost two decades—1960 to 1978—of prosperity as real gross domestic product averaged increases of over 5 percent annually. The vast majority of Salvadorans did not share in the gains, however, because a small group of wealthy business families and the Salvadoran military dominated the political and economic fabric of the country, according to academic studies. By the late 1970s, increasing violence between leftist guerrillas and repressive rightist elements contributed to a growing belief that significant socioeconomic changes would have to be made to prevent a full-scale civil war. Determined to head off a takeover by a rapidly growing Marxist insurgency, a group of junior and middle-grade officers seized power in October 1979. By March of 1980, the civilian-military junta they established had undertaken three sweeping reforms:

- **Land Reform.** The best known and most controversial of the measures—land reform—is divided into three phases affecting over a quarter of the cultivated land in El Salvador. Phase I, involving the expropriation of all farms over 500 hectares and the creation of production cooperatives on this land, has largely been completed. Phase II, yet to be initiated because of a lack of administrative and financial resources, was intended to expropriate farms over 245 hectares. Phase III, carried out concurrently with Phase I, was a “land to the tiller” program designed to give peasants full title to as much as 7 hectares of the land they rented or tilled at the time of the proclamation. For large private landowners, the expropriations were a major blow, subsequently compounded by continuing delays in compensation because of government

mismanagement and inadequate financing. Indeed, World Bank statistics indicate that only half of the former owners of farms affected by Phase I have been compensated for their land, and only 9 percent of the payments have been in cash.

- **Creation of Export Monopolies.** The National Coffee Institute (INCAFE) and the National Sugar Institute (INAZUCAR), state monopolies for the domestic purchase and export of sugar and coffee, were formed to prevent private monopoly abuse and capital flight and to provide financing for crop production. Poor management and inefficiency, however, have resulted in recurring annual losses and excessively low prices paid to private producers. USAID reporting indicates that the lack of private-sector representation in the organizations continues to be a major problem, provoking charges of incompetence and corruption. INCAFE, in particular, has been criticized for an unaggressive marketing approach and a failure to cut costs.
- **Nationalization of Banks.** The junta considered the nationalization of commercial banks and savings and loans organizations the most expeditious way to eliminate the concentration of credit in the hands of a few people and a limited number of organizations. The government took over all domestic banks and placed substantial restrictions on foreign banking operations. Embassy reporting indicates that the private sector has suffered because of a cumbersome and inefficient bureaucracy and the politicization of lending and repayment decisions. In particular, the banking system has failed to provide greater and easier access to foreign exchange and credit.

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necessary to ensure the success of the reforms and economic recovery.

the reforms, while relatively successful in achieving social and political objectives, have had an adverse impact on the Salvadoran economy. Coupled with the growing insurgen-

cy, continuing political violence, and a steep recession in the early 1980s, the reforms have led to massive capital flight and an exodus of entrepreneurial and professional talent, undermining the prospects for economic recovery. Gross fixed private investment in

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Table 1
El Salvador, Gross Fixed Private Domestic Investment

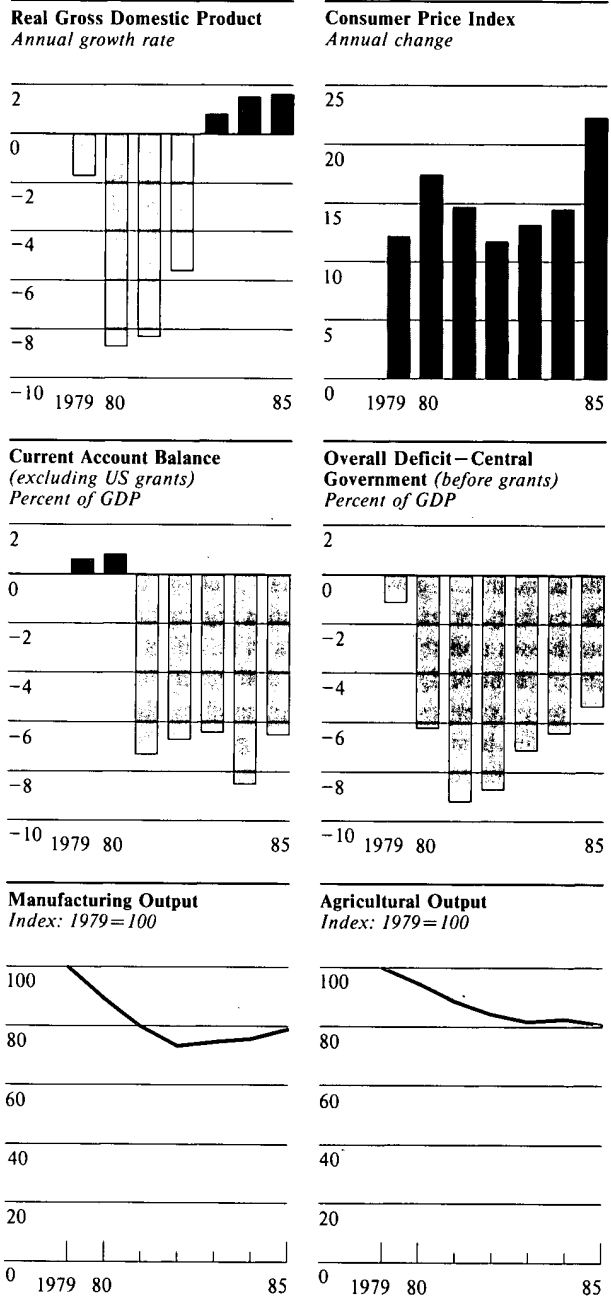
	Gross Fixed Private Domestic Investment (million US \$)	Percent Change	Investment as a Share of GDP
1970	195.6	NA	8.1
1971	209.3	7.0	8.3
1972	272.0	30.0	10.2
1973	245.7	-9.7	8.8
1974	281.0	14.4	9.4
1975	320.3	14.0	10.2
1976	355.1	10.9	10.9
1977	430.8	21.3	12.5
1978	495.3	15.0	13.5
1979	371.2	-25.1	10.3
1980	189.4	-49.0	5.7
1981	161.3	-14.8	5.3
1982	151.0	-6.4	5.3
1983	164.0	8.6	5.7
1984	186.0	13.4	6.3
1985	202.7	9.0	6.8

1986, for example, was roughly the same as in 1971 and less than half the peak levels of 1978, according to World Bank statistics. Industrial and agricultural outputs last year were only 80 percent of 1979 levels. The 1985/86 coffee harvest was the lowest in 10 years and only two thirds the level of the 1979/80 crop, according to US Embassy reporting.

Duarte's Agenda

Since he became President in 1984, Duarte has focused on political, military, and social objectives, often at the expense of the economy. US Embassy reporting indicates that his major priorities have been to build good relations with the Salvadoran armed forces and gain the battlefield initiative against the insurgents because he considers these objectives essential to the survival of his government. As a result, a large portion of the government's financial and managerial resources has been dedicated to conducting the war.

Figure 2
El Salvador: Selected Economic Indicators, 1979-85



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When he has focused on the economy, according to US Embassy reporting, Duarte has taken actions that reflect his concern for the poorer classes of Salvadoran society and his belief that active state participation is capable of solving any economic problem. Duarte's 1976 book, *Communitarianism for a Better World*, emphasizes a collective concern for the good of society and a belief that output should be shared by transferring income from the rich to the poor. As a politician, the President is acutely aware that his popular support depends on his ability to shield his traditional constituents—workers and peasants—from economic misfortune. Consequently, Duarte has not undertaken measures to encourage production or investment, such as currency devaluations or the removal of price controls, out of concern over their potentially negative impact on the lower classes and on his political standing, the US Embassy reports. [redacted]



Jose Napoleon Duarte

predominant control over the economy. For this reason, he remains reluctant to give the business community a role in decisionmaking. His belief that Salvadoran businessmen should be willing to sacrifice their personal interests, coupled with his desire to increase his popular support, has led him to criticize the private sector sharply and to question its motives, according to US Embassy reporting. [redacted]

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As public discontent over deteriorating economic conditions has grown in the past year, Duarte has turned to adjustment measures designed to make the private sector absorb a larger share of the costs of stabilizing the economy. A government tax package enacted last December, for example, includes higher taxes for businesses and the upper class in an effort to address government budget problems and cover increased military expenses for 1986. Angered by the tax increases, businessmen staged a general strike in mid-January that closed about 80 percent of the businesses in San Salvador. Private-sector leaders have assailed the measures as antibusiness and have criticized the government's unwillingness to cut public spending. In response to the attacks by private business, Duarte has tried to portray the business community as selfish and disloyal to the country and has accused it of helping the Marxist guerrillas by refusing to shoulder some of the financial burden of the war. The US Embassy reports that while the new taxes help address El Salvador's budget and inflation problems, they also are contributing to a further loss of private-sector confidence and poor growth prospects. [redacted]

The President has been able to pursue his objectives—and maintain an upper hand over the private sector—largely because of substantial assistance from the United States. Since 1980, the United States has provided \$1.6 billion in economic aid and \$650 million in military assistance to El Salvador. Economic assistance has been essential in insulating the country from high budget and trade deficits and in restoring a small measure of economic growth in 1984 and 1985; Duarte has relied on such US aid to shore up the economy rather than take politically risky adjustment measures. In addition, US military assistance has bolstered President Duarte's position with the armed forces and allowed the government to improve its counterinsurgency effort. [redacted]

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The Private Sector

Concerns

Although the business community's political and economic fortunes have suffered since the early 1980s, the private sector remains the dominant force in the

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Salvadoran economy. We estimate that private enterprise is still responsible for over three quarters of the gross domestic product (GDP). Despite substantial material losses as a result of the reforms, much of the land and production facilities for the country's major export crops are still in private hands. As a result, the business community's investment decisions are closely linked to the country's economic production and growth. [redacted]

A staunchly conservative economic and social philosophy underlies private-sector thought and action in El Salvador. [redacted] Most businessmen share a common desire to protect the viability and integrity of free enterprise. As such, they believe that Duarte's policies are anathema to their interests and many view him as a near Communist. US Embassy reporting indicates that businessmen claim Duarte's populist policies and social agenda have stalled economic recovery and diminished the competitiveness of Salvadoran products in world markets. They feel that the private sector has been singled out to bear a disproportionate share of the country's economic problems. [redacted]

Business leaders fault government economic policies for failing to provide incentives for expanded production or investment needed to stimulate the economy. They also criticize Duarte for his failure to control government spending and for trying to cushion the impact of economic decline on his constituents at the expense of economic health. In addition, businessmen are upset by the poor performance of Duarte appointees and by the government's inability to eliminate bureaucratic inefficiency. For example, Embassy reporting documents continuing business discontent with the lengthy and difficult process of obtaining foreign exchange, which has resulted in reduced production and lost sales. [redacted]

Security also is a serious concern of the private sector because businessmen and their facilities frequently have been the targets of both guerrilla harassment and kidnappings sponsored by rightwing extremists. Guerrilla attacks on transportation links and sabotage of the country's infrastructure have constrained production and export prospects. Businessmen repeatedly have asked the government to provide investment

insurance and improve security, according to US Embassy reporting, and are frustrated by Duarte's seeming lack of concern on this issue. Their worries were partially assuaged by the arrest in early 1986 of several members of a rightwing group responsible for kidnaping businessmen for ransom, but an uncertain security situation continues to be a major stumbling-block to restoring business confidence. [redacted]

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Given the substantial risks involved in operating in a less developed country with an active Marxist insurgency, the private sector has been critical of government policies that they feel have prevented them from making an adequate return on investment. Specifically, businessmen continue to press for the removal of price controls, more efficient access to foreign exchange, and greater control over the marketing of agricultural exports. In the area of stimulative policies, businessmen would like to see trade measures—including a flexible, competitive exchange rate and favorable tax treatment—that would encourage investment and exports of both traditional and nontraditional goods. [redacted]

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Politics

Although the private sector is united in terms of its goals, it is less cohesive when it comes to choosing a tactical approach to relations with the Duarte administration. The business community traditionally has functioned as a strong and well-organized pressure group, but its political influence and ability to regain leverage over national affairs has waned as a result of the reforms and the development of a more open and moderate political system. These changes have been responsible for the divergence within the private sector over how to deal with the government and over the role and use of political power. [redacted]

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The divisions are reflected in the orientations of the country's business organizations. The largest and most prominent private-sector group is the traditionally rightist National Association of Private Enterprise (ANEP). Formed in 1967, ANEP is an umbrella group that includes business organizations run mostly by the 50 or so wealthiest families in El Salvador, according to past Embassy reporting. These families

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Table 2
Leading Private-Sector Organizations

	Leader	Political Orientation	Comments
National Association of Private Enterprise (ANEP)	Carlos Borja	Rightist	Largest and most influential group; formed in 1967 as an umbrella organization to coordinate activities of more than 30 business associations representing key commercial and agricultural sectors and many wealthy families; other rightist private-sector groups linked to ANEP through overlapping memberships and family interconnections; traditionally supported ARENA policies, but since 1984 has become more independent.
Association of Industrial Sectors (ASI)	Eduardo Menendez	Rightist	ANEP member; rightwing moderate leaders have kept group relatively independent on political issues despite pressure from hardliners in ASI and ANEP; leaders have supported dialogue with Duarte.
Chamber of Commerce and Industry of El Salvador (CCIES)	Victor Steiner	Rightist	ANEP member; includes many hardliners antagonistic toward PDC; in the past has publicly attacked Duarte on many issues and been critical of what it sees as "US interference" in Salvadoran affairs; Steiner—called a "responsible conservative" by US Embassy—maintains control over chamber extremists.
National Federation of Salvadoran Small Businesses (FENAPES)	Luis Mendoza	Center-rightist	Represents some 30 associations and about 1,600 small businesses; Embassy says group generally moderate and pro-US, but Mendoza joined with leftist labor to hold an economic forum in April 1986 that turned into an anti-Duarte political rally; opposition to this move from FENAPES members probably will cause Mendoza to distance himself from leftist labor.
Salvadoran Foundation for Economic and Social Development (FUSADES)	Roberto Murray Meza	Centrist	Independent and generally apolitical; created to serve as broad-based, technical advisory group; supported by USAID and US-based Caribbean/Central American Action; Salvadoran contact for Caribbean Basin Initiative matters; membership limited to nonpolitical businessmen; critical of ANEP's rightist positions and pro-PDC stance of CONAES.
American Chamber of Commerce of El Salvador (CCAES)	Unknown	Centrist	Independent; but conservative faction has caused internal problems; tensions with ANEP.
National Council of Salvadoran Businesses (CONAES)	Julio Rivas Gallont	Centrist	Pro-PDC counterweight to ANEP; formed in 1982; includes about 150 members, mostly small merchants; views ANEP as reactionary leftover from the old-line hierarchy; smaller, financially weaker, and less influential domestically and internationally than ANEP.

control key sectors of the business community and include large landowners, coffee producers, bankers, and cattle farmers—most of whom are strongly opposed to Duarte's agenda. Not all affluent businessmen belong to these key families or are politically right wing, however. Some belong to the moderate National Council of Salvadoran Businesses (CONAES), organized in 1982 by the Christian Democrats. CONAES is smaller than ANEP, weaker

financially, and less influential in El Salvador or internationally, according to Embassy reporting. The politically independent Salvadoran Foundation for Economic and Social Development (FUSADES), formed with the help of USAID, serves as a neutral, technical advisory group to the Salvadoran business community. FUSADES probably includes merchants

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and other smaller scale businessmen, and frequently provides advice to the government as well as to business. [redacted]

In response to their loss of political clout, even leaders of rightwing private-sector organizations have come to adopt a more moderate approach to the government because they feel that it is the best way to regain influence. ANEP, for example, underwent an internal power struggle in late 1979 and early 1980 between an older generation of hardliners who actively opposed the reforms and a new generation of younger, more moderate businessmen who recognized the need for change. Embassy reporting indicates that, in the months following the October 1979 coup, the hardliners lost support within the business community because their confrontational approach and intense criticism of the government became counterproductive and increased the private sector's isolation. According to Embassy officials, the advocates of a moderate approach—while also viewing Duarte as an enemy—nonetheless believed that, in order to protect its interests, the business community had little choice but to try to get along with the new government. Their practical approach has won these moderates more support among businessmen and enabled them to win and retain control of ANEP and other rightwing groups in organizational elections over the past few years. Embassy reporting indicates that hardliners—including many wealthy businessmen who emigrated with their money to the United States in the late 1970s and early 1980s—retain some influence over El Salvador's private business affairs, but most appear to be resigned to give way to more moderate leaders. [redacted]

Private-sector organizations, in our judgment, have, to some degree, supplanted rightwing political parties as vehicles for exerting policy influence. In the past, rightist private-sector groups like ANEP strongly aligned with the Nationalist Republican Alliance (ARENA), the leading rightwing party, because both groups shared a conservative economic and social outlook. US Embassy reporting indicates, for example, that many businessmen actively supported ARENA candidate Roberto D'Aubuisson against Duarte in the 1984 presidential election, despite reservations about what even they regarded as his extrem-

ist politics. The electoral success of the Christian Democrats in legislative elections in 1985, however, coupled with ARENA's failure to win broad support because of its confrontational stance, alienated many businessmen from the political process. US Embassy officials report that many members of the private sector have come to believe rightist politicians are pursuing selfish political agendas that fail to represent the interests of private enterprise. As a result, many moderate businessmen now are working through business organizations rather than political parties in an attempt to develop a more practical relationship with the President. [redacted]

Dissatisfaction with ARENA and other rightwing parties, nonetheless, has not translated into a shift in support of business groups for the Christian Democratic Party, even though some individual party officials are viewed more favorably than Duarte. For example, Minister of Planning Fidel Chavez Mena and Second Vice President Abraham Rodriguez both have gained support within the business community because they are more sympathetic to private-sector concerns and seem willing to consider its suggestions to improve the economy. The Embassy reports that many business leaders would be willing to support a Christian Democratic candidate like Rodriguez, but he lacks the broad backing and stature within the party needed to become its next presidential candidate. Although Chavez Mena is a leading contender for the 1989 PDC presidential nomination, Embassy reporting indicates that he trails Minister of Culture and Communications Julio Rey Prendes, who is viewed less favorably by the private sector. [redacted]

Efforts at Accommodation Fall Short

For their part, many government officials appear to recognize that private-sector cooperation is essential for stable, long-term economic growth. [redacted] Duarte is being pressured by members of his own party to be more conciliatory, and he has, on occasion, acknowledged the importance of the business community. In the aftermath of the October 1986 earthquake, the President moved quickly to

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Table 3
Duarte's Relations With Private Business—
Alternative Scenarios

	Policies That Would Improve Relations	Policies That Would Worsen Relations	Most Likely Scenario
Trade and production	Streamline export procedures and improve access to foreign exchange. Allow some private-sector role in marketing export crops. Expand duty-free processing zones.	Fail to implement export promotion law fully. Renew "temporary" coffee export tax. Expand price controls. Postpone additional devaluations.	Duarte resisting pressure to devalue . . . price controls likely to remain in place . . . decision on future of coffee tax will provide good indication of government's intentions toward private sector.
Administration	Simplify bureaucratic procedures and reduce size of government. Be receptive and responsive to private-sector proposals to improve economy. Speed up compensation of former landowners.	Continue to rely on incompetent advisers for political reasons. Duarte continues autocratic style of decisionmaking. Cut off dialogue with the private sector.	Bureaucratic redtape likely to remain . . . private-sector input is likely to continue to be ignored . . . Duarte unwilling to delegate any authority over economic policy.
Security	Crackdown on criminal activity against businessmen, like the arrest of members of a rightwing kidnaping ring last April. Offer government-backed investment insurance.	Make concessions to the guerrillas. Expand resource and financial allocations to the war effort at the expense of the economy.	The kidnaping arrests have assuaged a major private-sector concern, and such efforts are likely to continue . . . Duarte is unlikely to reduce pressure on the insurgency.
Rhetoric	End vitriolic attacks against upper class and private business.	Significantly increase attacks against private-sector interests. Threaten to invoke sweeping new statist reforms.	Although significant new state intervention is unlikely, Duarte's policies continue to reduce private-sector confidence . . . coming elections and the PDC's waning popular support make it likely that the President will continue to attack the business community.

involve businessmen in the relief effort, tasking them with receiving and accounting for all foreign aid. Although the unprecedented level of cooperation between the government and the business community following the disaster seemed to present an opening for improved relations, neither side has changed its fundamental position. Moreover, the clash over the tax package has aggravated the longstanding frictions between the government and business community.

Duarte's continuing distrust of the private sector, as well as his commitment to populist policies, has made the President unwilling to make lasting peace with the business community. The government's 1986 stabilization program also illustrates the obstacles to accommodation. While the package included a number of

positive steps—including unification of the exchange rate and an export promotion law—it fell short of providing incentives necessary to revive private-sector investment. Embassy reporting indicates that in addition to Duarte's concerns about social welfare, the potential for leftist labor unrest and his desire to strengthen his support among democratic unions caused him to soften the impact of the program by including some salary increases and maintaining price controls. Predictably, major business groups considered the package interventionist and condemned the government's lack of consultation, the US Embassy reports.

Business leaders—recognizing that Duarte is in the stronger position—have made several overtures to the

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government in the last two years but are dissatisfied with the President's response. The US Embassy reports, for example, that ANEP has given Duarte proposals for revitalizing the economy in an effort to gain a voice for private enterprise in economic decision making and to persuade the government that some of its policies are hurting the economy. Embassy reporting indicates that business leaders are frustrated, however, because they feel Duarte has ignored their suggestions. [redacted]

In our judgment, the private sector's moderate approach is less indicative of a sincere desire to work with the government than it is a tactical move aimed at biding time until the Duarte presidency ends in 1989. Indeed, the business community has not hesitated to confront the administration when its interests are directly threatened, such as in January when a general strike to protest the tax package closed 80 percent of the businesses in San Salvador. Hardline businessmen have threatened an indefinite shutdown if Duarte does not rescind the increases and take other steps to encourage investment. In addition, businessmen rarely have supported government policies, even when they have benefited from them. Business concerns about security, for example, have not translated into declarations of support for the government's successful prosecution of the war. Rather, the private sector has chosen to focus narrowly on the government's lack of attention to economic problems. [redacted]

Further complicating relations, a small but strong minority of hardliners in the business community, in collusion with political extremists like D'Aubuisson, continues to actively foment popular opposition to the Duarte administration. [redacted]

[redacted] the government's stabilization package announced in early 1986 and tax measures adopted in December both precipitated efforts by extreme rightists to mobilize public protests—some even in cooperation with leftist labor groups—and form a broad-based opposition front to demand revisions in the programs. Such efforts so far have had limited success, however, because the extremists lack broad support from the business community and the military and because of funding shortages and distrust of the rightists' intentions by labor groups. [redacted]

The harsh rhetoric employed by both sides also has hampered the chances for a reconciliation. Conservative Salvadorans—businessmen and politicians alike—use every opportunity to lambaste Duarte's policies and leadership ability. The daily media, owned mostly by wealthy conservatives, provide the business community with a vehicle to defend its interests and voice its opposition to the administration. The extreme positions taken by some conservatives, such as public support for antigovernment protests by leftist labor, have fueled Duarte's suspicions that big business and the political right are trying to unseat him. In return, Duarte's counterattacks against the private sector have caused businessmen to perceive every hardship—even those unavoidable in a weak economy—to be part of a calculated attempt by the President to undermine private business in general. [redacted]

The Military's Position

As the most powerful political institution in the country, the armed forces play a key role in the relationship between the government and the private sector. Until the coup in 1979, the military protected a status quo that enriched the business community and gave wealthy conservatives considerable control over the direction of national affairs. But by the late 1970s, many military officers had become concerned about the intransigence of members of the business community and the political right, and the increasing violence between rightwing extremists and leftist guerrillas. Military leaders feared that, if they did not intervene, the country would erupt into full-scale civil war that might lead to a decisive victory for the rapidly growing Marxist insurgency. After a group of junior and middle-grade officers overthrew the authoritarian dictatorship of President Romero in October 1979, a succession of civilian-military provisional governments began to implement reforms designed to establish more open and equitable political and economic systems. Although the pace of the democratic reforms was uneven and sometimes halted by the

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opposition of some senior rightist officers, the armed forces agreed in the end on the need for changes to restore order and reverse the uneven distribution of wealth in the country. The military also became increasingly nonpartisan and distanced itself from the political right and the business class. The loss of military support for big business, combined with the impact of the reforms, directly contributed to the decline in the private sector's power and influence.

[redacted]

For his part, President Duarte has won high marks and support from the military leadership for his commitment to strengthening the war effort against the guerrillas. The military's continued backing is due in large part to the President's success in gaining support from the United States. US military assistance has helped improve the performance and capabilities of the armed forces and enabled the military to gain the battlefield momentum. In addition, the improvements by the Duarte government in the area of human rights and the image of El Salvador abroad have kept the insurgents generally on the defensive politically and brought about a sharp decrease in their credibility and popular support over the past two years.

Military support for Duarte has been essential in allowing him to follow through on his agenda and maintain control over the business community. The High Command has generally endorsed his economic policies and sided with him in disputes with the private sector. Following the announcement of the economic stabilization package last year, for example, Minister of Defense Vides Casanova warned business leaders not to incite public opposition to the measures. military leaders are becoming increasingly concerned about public dissatisfaction and fear that the worsening economy is benefiting the guerrillas' efforts to expand their public support.

[redacted]

Outlook

Relations between the private sector and the government are unlikely to improve significantly in the next two years, in our view, making the prospects for sustained economic recovery poor. Despite the importance of the private sector, we expect that Duarte will continue to lean towards satisfying popular demands at the expense of measures to restore business confidence. The President's insistence on avoiding tough economic measures that would hurt the lower classes probably will intensify in the aftermath of the earthquake and keep him from correcting underlying weaknesses in the economy. He is likely to argue that new austerity measures would unjustly tax the lower classes, already suffering from the effects of the earthquake. As a result, businessmen probably will remain skeptical of the government's economic policies and unwilling to boost investment or otherwise contribute to the revival of the economy.

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We believe a key objective for Duarte will be protecting his political base of support among workers and peasants. Poor economic performance has caused the President's popularity to wane since the beginning of 1986, as the economy has replaced the war as the issue of highest popular concern. We believe Duarte most likely would respond to growing popular discontent over deteriorating economic conditions by intensifying his populist and antibusiness rhetoric and expanding government programs to protect the poor. He probably would feel justified or even compelled to do so if serious economic difficulties sparked major antigovernment demonstrations by labor or a resurgence of popular support for the leftist insurgency. Ironically, the failure to enact measures to stimulate business activity and regain private-sector confidence will likely exacerbate the fundamental economic difficulties that currently are undermining Duarte's popularity.

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Alternatively—but much less likely, in our judgment—Duarte might overcome or at least repress his hostility to the private sector and adopt a set of policies that would encourage businessmen to expand investment, production, and exports. Initiatives such

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Table 4
Shifting Private-Sector Confidence:
An Economic Scorecard ^a

Variable	Confidence Increases	Neutral	Confidence Decreases
Gross domestic product	Annual real output moves above 3 percent for a sustained period.	Growth remains at levels between 1.0 and 3.0 percent.	Little or no growth . . . possibility of new recession.
Investment	Capital is repatriated . . . sustained annual growth in private-investment of over 20 percent . . . return to levels of late 1970s . . . opening of new firms.	Continued slow expansion of investment . . . annual growth rates between 5 and 15 percent.	Investment stagnant or declining . . . capital flight reappears . . . additional business closings.
Production	Production levels approximate those of the 1970s . . . sustained 5-8 percent growth in manufacturing . . . steadily increasing agricultural output . . . diversification to non-traditional exports.	Little improvement in output . . . 0 to 4 percent growth in manufacturing . . . stagnant agricultural production . . . only minor growth in nontraditional production.	Manufacturing and agricultural output fall . . . continued reliance on traditional export products.
Balance of payments	Significant improvement as expanding exports outpace growth in imports . . . increased earnings from nontraditional exports . . . import and foreign exchange controls eliminated.	Continued trade imbalance with some restrictions on imports and foreign exchange necessary . . . traditional exports continue to provide majority of earnings.	Large deficits with sharp fluctuations due to shifting commodity prices . . . stringent import and foreign exchange restrictions.
Employment	Unemployment drops below 15 percent as production and investment increase . . . underemployment also declines.	Limited job creation but insufficient to absorb all new entrants into the labor market . . . unemployment remains between 20 and 30 percent.	Continued high rates of unemployment and underemployment.

^a This chart plots significant macroeconomic conditions in El Salvador based on shifts in private-sector confidence and participation in the economy. It is highly speculative in that it links economic performance solely to the actions of the private sector, without considering other complex, internal and external factors—such as commodity prices, weather, world economic growth, and external aid flows—that also influence the economy. As such, it is intended to be illustrative rather than predictive.



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as streamlining the bureaucracy or giving businessmen a greater role in marketing export crops would bolster private-sector confidence without forcing the President to sacrifice his objectives. Despite their strong bias against Duarte and overall lack of support for the government, we believe that most businessmen would respond favorably if the steps taken led to increased profits and a healthier economy. We believe, however, that Duarte would not embark on such a politically risky strategy unless popular discontent was reduced. 

We believe the major private-sector groups will continue to try to gain a voice in economic decision making while maintaining their criticism of the government. In our judgment, however, the private sector will not be able to alter Duarte's agenda significantly, given its lack of unity and reduced political clout. For this reason, we expect that the business community

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will again seek out rightist candidates willing to represent its interests as the country prepares for the next legislative election in 1988. [redacted]

Opposition to Duarte from the private sector could increase if it perceives his earthquake reconstruction plans are designed to enhance his popularity or to foster greater public dependence on government programs at the expense of private enterprise. In view of the substantial damage to the private sector's facilities, businessmen are faced with serious choices with regard to replacing fixed assets. Unless Duarte can persuade the private sector that reinvestment will yield profits and remain free of government interference, businessmen probably will remain unwilling to seek new financing or repatriate any of their capital from abroad. [redacted]

In our judgment, the threat of a serious confrontation leading to radical actions by the private sector, such as a prolonged business shutdown, is relatively minor because such tactics would hurt business interests as well as the government. Such a development most likely would occur only if the government attempted to revive popular support or divert attention from serious problems by undertaking a spectacular initiative that attacked a fundamental interest of the business community. Although the possibility of such a confrontation is small, a complete break in relations between Duarte and the private sector could cripple the economy, make the government more vulnerable to agitation by both leftwing and rightwing opponents, and slow or reverse the progress made toward consolidating democracy. [redacted]

The backing of the military will remain important for the President in his relationship with the private sector. In our judgment, as long as Duarte remains judicious in dealing with the armed forces and does not interfere with their institutional prerogatives, they will continue to support him. In the aftermath of the earthquake, the armed forces will remain most concerned that the government maintain its aggressive counterinsurgency effort and not divert resources from vital civic action and rural development programs for reconstruction in the capital. Duarte appears to recognize the sensitivity of these issues, but in

Gloomy Economic Outlook

Prospects for economic recovery in El Salvador remain dim, due to a destructive insurgency and the October 1986 earthquake, as well as more fundamental trade and budget woes. After real GDP growth of approximately 1.5 percent in 1984 and 1985, the economy failed to grow in 1986 and per capita income has continued to fall because of a population growth rate of nearly 3 percent. Inflation, fueled by wage increases and expansionary fiscal and monetary policies, accelerated from 15 percent in 1984 to 22 percent in 1985 and 30 percent by the end of 1986. Slightly over half the work force lacks full-time employment. [redacted]

Despite some improvement, the fiscal and balance-of-payments deficits remain large, and the country continues to face a heavy debt service burden. The government's short-term economic program enacted in January 1986 was poorly implemented and largely unsuccessful in achieving its stabilization goals, according to US Embassy reporting. President Duarte has been slow to consider additional measures, in part because of the damage and uncertainty following the earthquake, making it unlikely that fundamental economic problems will be addressed in the near term. As a result, we believe GDP growth will languish under 1 percent in 1987. In large measure, El Salvador's ability to recover from the earthquake—while maintaining its war effort—will depend on the government's success in generating new sources of development assistance and on continued economic and military aid from the United States. [redacted]

the face of massive reconstruction costs he will be hard pressed to avoid budget cutbacks in the rural programs. [redacted]

Although military leaders so far have backed Duarte's economic policies, widespread popular protests or

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rising support for the insurgents could cause the High Command to pressure the President into adopting private-sector formulas to improve the economy. In such a situation, we believe that Duarte would repeat his past practice of doing the minimum needed on his part—such as initiating dialogue with the private sector but ignoring its proposals—to persuade the armed forces leadership that he was making an effort to improve relations. [redacted]

The continuing stalemate in government–private-sector relations will exacerbate an already clouded economic outlook. In combination with guerrilla sabotage, fluctuating commodity prices, a lack of foreign capital, and widespread earthquake damage, the poor state of government-business relations probably will contribute to low economic growth—under 1 percent for 1986 and 1987, and under 3 percent, the level needed to restore per capita income growth, even by 1988. In addition, we foresee no end to a reliance on traditional export earnings, because the business community will remain unwilling to move toward production of nontraditional exports without incentives from the government. [redacted]

Implications for the United States

Continued tensions in government–private-sector relations, and the economic stagnation that this implies, could have a negative effect on US interests in El Salvador. Poor economic performance—especially further decline in per capita income—will increase the chances for instability and may benefit either the extreme left or the far right. Heightened popular support for the guerrillas or their front groups could seriously impair the government's war effort and allow the insurgents to expand their political and propaganda activities. Increased pressure by the left also could provoke renewed political violence by the extreme right. Similarly, disenchanted businessmen might choose to support a far rightist group in coming elections, further polarizing Salvadoran society. [redacted]

Duarte's recalcitrant attitude toward the business community is likely to make the objective of improved government–private-sector relations a sore point in his dealings with the United States. With the assistance of USAID, several joint government–private-sector policy analysis and advisory groups have been formed in an effort to improve cooperation, and US assistance programs are based on the premise that El Salvador's private sector will play the major role in improving economic performance. Duarte, however, appears unlikely to implement measures that would provide the encouragement necessary to the business community. [redacted]

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Without increased private-sector involvement in the economy, El Salvador's economic dependence on US aid probably will increase. In our judgment, Duarte believes he can rely on US economic aid to see him through hard times without making the politically risky reforms essential to revitalizing the economy and boosting private-sector confidence. In addition, Duarte probably calculates that his support for US policy in Central America provides him with additional leverage in bilateral relations to justify pleas for higher levels of financial assistance. [redacted]

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Finally, the failure of a democratically elected government to deliver a better standard of living to its people—even with massive US support—could have a detrimental demonstration effect on nascent democracies within and beyond the region. Likewise, the government's failure to cooperate with and encourage private enterprise sends a negative signal to important private-sector groups in other countries. [redacted]

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