

Case Study 14

Costa Rica, Guatemala, and Honduras: Contrasts and Prospects for Convergence

A comparison of three countries, Costa Rica (CRI), Guatemala (GTM), and Honduras (HND), sheds light on major themes of this chapter—foreign finance, investment, remittances, aid, and conflict—as well as key themes explored throughout this text, including roles of institutions, education, health, poverty, and inequality.

All are former Spanish colonies in Central America, and they share common geographic features such as tropical lowlands with cooler mountain highlands and fertile and populous valleys. The countries are certainly not identical triplets...still, in global, perspective they are reasonably comparable in some other respects; populations range from 5 to 15 million; areas range from 51 to 112 square kilometers; and population densities between 70 to 137 persons per square kilometer.

Yet a wide gulf remains between them in economic development. CRI has enjoyed much better development performance than the other countries in recent decades, despite the fact that CRI was historically poorer. This case study will examine the divergence in context both of their recent development policies and in their long historical roots that explain much about how those diverging policies were shaped. All-around better performance in CRI reflects how differences in earlier institutions can have effects on economic development outcomes. The contrasting experiences again reveal influences of structural inequality and education levels on evolution of institutions over time. We will see that the countries exhibit stark differences in preventing and managing conflict; the comparisons yield insights into causes of conflict and its prevention. We will see that the performance of CRI has been better than either HND or GTM, for similar but

certainly not identical reasons. Conflict has played some role in HND but not a predominant role, as in GTM. In CRI, in recent years, foreign direct investment (FDI) has worked for development because it has been complementary, with sound domestic policies and investments in human capital. The history of FDI has been far more fraught in HND and GTM. Marked reduction of violent conflict in GTM has strongly improved prospects for development there. Recently, remittances have played a large and helpful role, particularly in HND, and to an important extent, in GTM. Foreign aid has helped HND and GTM start to close the gap on education and health. A comparison of indicators for the three neighboring countries is striking, as seen in the table.

Income and Human Development: Basic comparisons

The data reveal sharp differences between Costa Rica, Honduras, and Guatemala in income and human development levels. GNI per capita in CRI is more than triple that of HND and more than two and a half times that of GTM. These differences reflect CRI's much higher economic growth rate over the last 60 years. Life expectancy in CRI is 6 years greater than in HND and 8 years greater than in GTM. Under-5 mortality in CRI is less than half that of HND and less than a third that of GTM. CRI has about two more years of schooling than HND and four more than GTM. Accordingly, while CRI is a high-HDI country (ranked No. 62), HND is medium-HDI (at No. 120); GTM at No. 133 is also medium-HDI, but it is not far above low-HDI status (for details on the HDI, see Chapter 2). The differences in income and human development are mirrored in the

Key Indicators for CRI, HND and GTM

Indicator	CRI	HND	GTM
Population (Millions) (WDI)	5	8	15
Area (Thousand Square Kilometers) (WDI)	51	112	109
Population Density (Per Square Kilometer) (WDI)	93	70	137
2012 GNI Per Capita—2005 PPP U.S. Dollars (203 HDR)	10,863	3,426	4,235
Life Expectancy (2013 HDR)	79.4	73.4	71.4
Under-5 Mortality (WDI, 2012 Data)	10	23	32
Primary Pupil-to-Teacher Ratio, 2009 (Most Recent Comparable WDI)	18	34	28
Mean Years of Schooling (2013 HDR)	8.4	6.5	4.1
New HDI, 2012 Data	0.773 (No. 62)	0.632 (No. 120)	0.581 (No. 133)
Poverty (Percent below \$1.25, WDI)	2.4	21.4	24.4
Inequality (Gini Coefficient, WDI)	51	57	56
Transparency International Corruption Index (2013)	53 (ranked 49th)	26 (ranked 140th)	29 (ranked 123rd)
2012 Economist Democracy Index	8.1	5.84	5.88
2013 Index of Economic Freedom (WSJ)	49	96	85
Language Fractionalization (Alesina)	0.0489	0.0553	0.4586
Ethnic Fractionalization (Alesina)	0.2386	0.1867	0.5122
Stock of FDI, U.S. Dollars (Millions), 2012 (UNCTAD)	18,713	9,024	8,914
Remittances as Percent of GDP, 2012 (World Bank)	1.2	15.7	10

poverty statistics: HND has about 9 *times* the incidence of below-\$1.25 per day poverty, and GTM has 10 *times the poverty incidence* of CRI. There are large differences in births per woman, with particularly high fertility in GTM, where 41% of the population is under age 15—the youngest population in Latin America. Under-5 malnourishment is also particularly severe in Guatemala. Interestingly, CRI has been ranked as the world's happiest country.

Inequality

Inequality is hardly low in CRI, with a Gini of 51 (similar to the US and China), but it is lower than HND's 57 and GTM's 56. Perhaps more importantly, in Guatemala, inequality is sharply along ethnic lines—"horizontal inequalities" that are in many countries associated with strife. Land inequality is also lower in CRI, while in Guatemala and to a significant extent also in Honduras, a *latifundio-minifundio* pattern has persisted, of large estates alongside farms too small to adequately support a family (see Chapter 9). Inequality in human development is also stark. Gender inequality is a smaller problem in CRI than the other countries as measured, for example, with the Gender Inequality Index (GII). Indigenous people in Guatemala have much lower HDI levels, which are close to some low-income countries in Africa; in comparison, the HDI of the Ladino population in GTM is similar to that of Indonesia

(see Chapter 2, Appendix 2.1). The indigenous (Amerindian) population is much smaller in HND (7%) and CRI (about 1%).

Institutions

Comparing the quality of institutions, it is clear that Costa Rica again strongly outperforms Honduras and Guatemala. For example, on the 2013 Transparency International Corruption Perceptions Index, CRI has a level of 53 (ranked 49th); HND's value is only 26 (ranked 140th); and GTM is at 29 (ranked 123rd). On the 2012 Economist Democracy Index, CRI has a value of 8.10, far higher than that of HND (5.84) or GTM (5.88). HND has suffered coups—as recently as 2009, a government was abruptly deposed, widely characterized as a coup—and the political process in GTM remains badly flawed. Finally, on the 2013 Index of Economic Freedom, CRI ranks 49, while HND is much lower at 96; GTM ranks 85.

Economic Growth and Structure

GDP per capita more than quadrupled in CRI between 1950 and 2008; it less than doubled in GTM and is just 1.75 times higher in HND.

The three countries produce similar agricultural products like coffee and bananas, reflecting their similar climates. But partly as a result of active industrial policies, CRI has significantly diversified, including into new high-tech industries. No similar diversification is seen in the other countries. CRI also has much better roads and other infrastructure than the other countries. CRI has attracted more than twice the stock of Foreign Direct Investment (FDI) than the other economies, despite its smaller population. This has followed from CRI's better education, infrastructure, environment, and ongoing economic growth performance. In turn, (FDI) has gone into sectors with good potential for stimulating growth. Probably the key foreign investments were those made by Intel beginning in 1997.

In 2012, HND received almost 16% of its GNI in the form of remittances; for GTM the share was 10%, but for CRI it was little over 1%. Remittances can be very beneficial, particularly to the extent that income is sent back to poorer rural villages. The flip side is that lack of opportunities in HND is leading people to emigrate; people in CRI have much better opportunities at home.

Health and Nutrition Policies

Government policies are more conducive to human development and economic growth in CRI. For example, CRI has a much higher proportion of expenditures on both health and education. In fact, in CRI, an emphasis on ensuring primary education and basic health was already apparent in the early 1930s, far earlier than most developing countries. Today, CRI is one of the few developing countries to approach universal healthcare coverage. Poor early childhood nutrition in the region leads to significantly lower adult productivity, incomes, and other favorable outcomes—and vice-versa (underscored by a randomization-based study in GTM by John Maluccio and others). In contrast, nutrition conditions are good for most, though not all, people in CRI.

Education Policies

In 1886, CRI implemented a law mandating universal primary education for both boys and girls, and grew from there. Particularly coupled with good public health measures, these policies are reinforcing, helping to break the intergenerational transmission of poverty (see Chapter 8). Accordingly, International Labor Organization (ILO) data show that child labor is a far more serious problem in HND than in CRI. Much later, with its strong historical foundations, in the mid-1990s, CRI mandated computer science and English courses for students as a conscious strategy to prepare for successful engagement with the rapidly opening and evolving global economy. The primary student-teacher ratio in CRI in 2009 was an impressive 18; but it was 28 in Guatemala and 34 in Honduras. CRI has proceeded to build a university system that is not only of better quality but also more equitable in its higher admissions of poorer and minority students.

Building on the Foundation of Education

Moreover, human capital policies in CRI facilitated the recent policy push for diversification and higher tech industries, including the capacity to attract particularly development-enhancing forms of foreign direct investment. Education also served as a foundation for CRI's vaunted environmental protection and flourishing ecotourism sector, giving a further boost to economic development. Tourism now generates more income than agriculture in CRI, in sharp contrast to Honduras. Women in

CRI have much more equal access to health, education, and employment opportunities than in GTM and HND—another human development achievement, which should also benefit economic growth. In further contrast with CRI, Honduras and Guatemala spend proportionately less on human capital, while spending substantially on the military.

Conflict

Guatemala has had very high levels of often violent conflict and genocidal campaigns; Honduras has a lower but still serious history of conflict or military domination, and CRI has had comparatively little conflict, particularly over the last 65 years. One factor associated with conflict is fractionalization (section 14.5). The language fractionalization index in CRI is 0.0489, but in GTM it is 0.4586; and the ethnic fractionalization index in CRI is 0.24; but in GTM it is 0.51. But fractionalization is similarly low in HND as in CRI. Conflict has had a major negative effect on Guatemala, and some effect on Honduras. The conflict in Guatemala is predicted by repressive and extractive institutions, and high inequality, particularly of the “horizontal” kind in which the rich and poor come from different ethnicities or other identity groups. In addition, according to the U.N. Office of Drugs and Crime, the homicide rate in HDR is currently the highest in the world at 91.6 per 100,000, and a very high 38.5 in GTM, but 10.0 in CRI (by comparison, it is 4.7 in the United States and 1.5 Canada).

To understand these differences, it is important to go beyond a comparison of recent policies and conditions, to see what constraints and influences have led to the chosen implemented policies. For this, we take a longer historical view, from the time of colonization to the present, as we did for the case studies for Chapters 2, 5, and 10.

Regional History—The Long View

For centuries, the area now including the three countries was part of the Mesoamerican Mayan culture, which was strongest and most urbanized in what is now Guatemala. The Spanish conquistadors took control of the region beginning in the 1520s, establishing a Captaincy General of Guatemala in 1540. Their rule was highly extractive, focusing exploitation on densely populated areas with a large labor force to control. This plausibly led to the worst outcome for

Guatemala, which previously had a high civilization, and secondarily for Honduras. In contrast, Costa Rica was relatively ignored (and thus less exploited), as it had fewer people and a less organized society from which to capture rents from a tribute system. (For details on analysis of long-run causes of comparative development, including the long-lasting influence of the nature of colonial institutions, see Chapter 2, section 2.7). Spanish rule lasted nearly three centuries until the region became independent of Spain in about 1821. The three countries became part of a Federal Republic of Central America until the 1838–1840 civil wars led to their independence.

Costa Rica: Roots of Education and Democracy

Despite its name, meaning “rich coast,” and its contemporary nickname of “the Switzerland of Latin America,” for much of its history, Costa Rica was the poorest of the three countries. It was the most distant from colonial headquarters in Guatemala; and the Spanish did not allow trade with territories to its south (Panama was part of a different Spanish colony). CRI had a relatively small indigenous population, and thus there were no incentives for the Spanish elite to settle there to establish plantations (*haciendas*) operated by forced indigenous labor (*economienda* system). Natural resources appeared limited, and transportation that was needed to reach the interior was lacking. Thus, the region was farmed by small-scale, relatively poor, yeoman farmers. But in the long run, being ignored turned out to have some significant advantages. The country had much less strife than several of its neighbors, although there was a period of political violence in 1948. After the upheaval, the CRI military was abolished outright in 1949; the country was kept safe by the police force. This prevented a major drain of resources that otherwise would go to the military; it also preempted repressive military practices suffered by many countries in the region. Since then, CRI has been the longest continuous democracy in Latin America, with highly competitive elections that have addressed substantive policy matters. A caveat is that two former presidents were sent to prison for corruption in 2004.

Guatemala: Roots of Conflict

The Spanish Captaincy exploited the large indigenous population; after independence, exploitation

continued under plantation owners. In the twentieth century, the country suffered from adventurism of corporations, particularly the United Fruit Company (later renamed Chiquita Brands). United Fruit gained control of the banana market and leveraged this to political power—the origin of the derogatory phrase “banana republics” (also applied to Honduras). United Fruit was backed by the United States, which supported repressive dictatorships—an example of neocolonial policies, modeled by the Dependency School (see Chapter 3, section 3.4). Most notoriously, in 1954 a CIA-sponsored coup overthrew a freely elected government. After several years of repression, civil war broke out around 1960, which was to continue until about 1996. The war often seemed a one-sided attack of the U.S.-supported government against indigenous Mayan people who became affiliated with various left opposition groups. The military campaigns were abetted by death squads operating against indigenous people who were suspected of sympathies with the opposition. Tens of thousands of indigenous people “disappeared.” More than 200,000 people are thought to have been killed in the 34+-year war; and more than 1 million were displaced. The 1994 Oslo Accords created the national Historical Clarification Commission, which confirmed the essential one-sidedness of the war in that the government (and its affiliates) was responsible for 93% of the violence and human rights violations, with 3% attributed to the leftist guerrillas. This included a state-sponsored genocidal campaign against Mayan peoples in the early 1980s. President Clinton responded with a formal statement that U.S. support for Guatemala security forces “was wrong.” Since then, the country has steadily moved toward greater economic and political reform. In 2013, Rios Montt, president during the genocide period, was found guilty and sentenced to 80 years in prison, but his conviction was overturned.

Honduras: Roots of Policy

The Spanish were attracted to Honduras by a key resource: silver mines. They operated the mines with forced (*economienda*) indigenous labor, until many died of disease and overwork; others resisted and fled to areas outside Spanish control. The Spanish responded in part by importing African slaves. (The history was not unlike what occurred

in Hispaniola; see the end-of-chapter case study for Chapter 10.) In the century after independence in 1840, the country had political instability and high inequality, and power continued to be concentrated among the large landowners. Later, there was growing domination by foreign corporations, which began operating the country as a “banana republic.” In the 1980s, the country became embroiled in the Contra war in neighboring Nicaragua; and the military operated a campaign of violent repression against both the nonviolent and the violent left opposition. The country’s institutional weaknesses made it vulnerable to the growth of drug-trafficking gangs, a majority factor in HND’s world’s highest homicide rate. The lack of institutional resilience was also visible in its relatively poor response to natural disasters, including Hurricane Mitch in 1998 and extensive flooding in 2008. In 2009, there was a coup (at least, in all but name). For many years, growth in HDN was bogged down by debt, but it has benefited from debt relief under the HIPC program, and subsequently has grown rapidly, though much of the benefit has accrued to higher-income families.

Writing a New Chapter: Central American Integration and Convergence

As seen throughout the text, great improvements in human capital and reductions in poverty have been found nearly everywhere in the world, and this applies even to GTM and HND. Both have grown somewhat, and health and education standards have improved significantly. The big differences in performance across countries generally reflect the speed of improvements, as great differences in human suffering along the way. Improved policies can make a substantive difference, if they can be implemented. Moreover, by exposing the deep roots of comparative development, new approaches can be forged. A deeper understanding of why it can be so difficult to make progress on basic, critical policies such as promoting education can provide new political impetus for achieving these goals. In turn, once they are educated, people at least have a better chance to participate effectively in the political process, by which institutional reforms are facilitated or thwarted. Outside pressures can greatly worsen conditions, as evidenced by the conclusions concerning the subversive U.S. role in Guatemala

(as well as Honduras); but outside development assistance can be beneficial, as seen recently in these countries.

Currently, efforts are actively under way to strengthen economic and political integration among these and the other Central American countries. To the extent this is successful, it is likely to accelerate convergence and should help to cement human rights and development gains. This process will be watched closely in coming years. ■

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