Summary

In recent years, the countries of the Northern Triangle of Central America have experienced a slowdown in their economic growth. This reality raises the question: What restrictions do these countries face that prevent further expansion and a better interaction among economic agents? To respond to this question, the methodological framework designed by Hausermann, Rodrik, and Velasco (2005), titled «Growth Diagnostics», is presented as an ideal alternative, given its adaptability and level of completeness. The outcomes for the 1990-2019 period suggest, without being limitative, the need to strengthen the design of public policies of these countries on key issues, such as: citizen insecurity and crime; the low quality, efficiency and coordination of public sector institutions, as well as, the low levels of productivity and quality of human capital, in order to reduce these restrictions to economic growth. Therefore, the coordination of efforts to implement policy actions that support the reduction of such restrictions can contribute to the success of the national work agendas, and thus enable the countries to reach better stages of development.

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1 The process of preparing and editing this report was coordinated by the Office of the Chief Economist (OEJ) of the Central American Bank for Economic Integration, under the leadership of Dra. Florencia Castro Leal, Chief Economist. Pablo Flores (Senior Economist) was in charge of the general formulation and drafting. The comments and suggestions of Ali Khadr, José Alfredo Marroquín and the entire OEJ-BCIE team are very highly appreciated. Thank you for your valuable support.

The contents of this publication do not necessarily reflect the official position of CABEI.
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Introduction

Economic growth is an indispensable condition to improve people’s standard of living. It is therefore, essential to define a national consensus on a medium-term plan and to direct the countries’ efforts towards the design of a work agenda that clarifies the mechanisms to achieve it. The opportunities for and the limitations faced by countries depend on existing conditions, ranging from physical and human capital endowments and productivity levels to administrative and institutional coordination capabilities, among other factors. That is why political actions should identify the areas of improvement that can yield the greatest returns. Successful development requires a selective, sequential and sometimes «out of the box» approach that must be applied according to each country’s circumstances.

This report focuses on identifying: the circumstances that prevent economic growth from having the desired value and fluidity. Hausmann, Rodrik and Velasco (2005) propose a methodological scheme aimed at identifying the constraints most closely linked to economic activity in order to implement targeted policies correctly which provide the greatest possible impact. The technique relies on a decision tree, based on the question, of why economic growth has remained low? The answer focuses on whether inadequate returns to investment are caused by low appropriability, insufficient factors of production, poor use of imported technologies, high taxes, poor property rights and inappropriate enforcement of contracts and labor capital conflicts or learning and coordination externalities.

Following this rationale, the proposal has been implemented for the Northern Triangle of Central America (Guatemala, El Salvador and Honduras). The objective is to determine the «bottlenecks» that have affected the development of economic activity in this region, thereby restricting higher growth rates. By identifying the critical areas, general guidelines can be established to focus national efforts. This proposal also provides a guide to contribute to the harmonization and promote complementarity actions by multilateral banks in segments where there is a potentially high impact. The results of this analysis will support to the strategies of the Central American Bank for Economic Integration to promote sustainable development in its member countries.

The main constraints identified that hinder economic growth and attracting investment in the Northern Triangle of Central America suggest the need to prioritize:

1. Implementing policy actions intended to strengthen crime prevention and improve citizen security;
2. Improving the quality, efficiency and coordination of public sector institutions; and,
3. A focused drive to increase productivity and the quality of human capital.

At the same time, this prioritization requires, complementary political actions focused on a higher-than observed economic growth, thereby improving the people’s quality of life by:

1. Maintaining economic stability;
2. Improving education quality;
3. Strengthening and consolidating the financial sector;
4. Improving the quality of infrastructure services;
5. Designing and implementing an industrial policy; and,
6. Implementing a strategy that responds to the effects of climate change.

This report has five chapters. The first, focuses on the aggregated analysis of the «bottlenecks» of the Northern Triangle of Central America, followed by the methodological framework implemented, and ends with the analysis for each country.

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2 According to the methodology of Hausmann, Rodrik and Velasco (2005), low appropriability refers to government failures, among which macroeconomic risks such as financial and fiscal instability stand out, as well as market or microeconomic failures, which can be concentrated especially on issues such as citizen security, informality, institutional capacity and governance and governability.

3 Especially about legal security and maintaining the «rules of the game».
CHAPTER I

The Northern Triangle of Central America and the economic growth restrictions
I.1. A general Review

During the last 30 years, the Northern Triangle of Central America had an average economic growth rate of 3.2%. The growth rate observed, is higher than the 2.6% recorded in Latin America and the Caribbean, but far from the South and East Asian countries, which averaged 6.1 and 7.8%, respectively. What is the cause? Are there alternative strategies? These are recurrent and highly relevant questions. In this sense, a necessary task is the proper understanding of what «constrains» progress, as well as the appropriate identification of policy actions to stimulate those essential aspects that can improve the rate observed so far ⁴⁄⁵.

One of the key components that drives economic growth is investment. When analyzing the rate observed by the Central American countries under study, the value fluctuates at an average of 20.1% of GDP, very similar to that recorded by Latin America, but far from the ratio in South or East Asia, which averages values close to 40.0% of the GDP. This low level of investment may be part of the main reasons for the difference in economic growth between the regions; but more importantly, one of the reasons why growth in the Northern Triangle of Central America is low.

In this context, what causes investment to behave this way in the countries of the Northern Triangle of Central America? The first answer can be linked to total factor productivity (TFP). To some extent, the attraction and quality of investment is based on the productivity of physical and human capital in the country. The average TFP growth of the countries of the Northern Triangle of Central America, during the intervals under analysis, is consistently lower than that observed in regions such as South and East Asia. This result suggests that the low attraction of investment, and the consequent effect on economic growth, may also be due to the fact that there is a deficit in the countries’ productivity levels.

### Table I.1. Average economic growth rate (Percentage)

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<thead>
<tr>
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<tbody>
<tr>
<td>Northern Triangle CA</td>
<td>3.4</td>
<td>3.1</td>
<td>3.1</td>
</tr>
<tr>
<td>Guatemala</td>
<td>3.7</td>
<td>3.3</td>
<td>3.3</td>
</tr>
<tr>
<td>El Salvador</td>
<td>3.6</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Honduras</td>
<td>2.8</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Latin America and the</td>
<td>2.7</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Caribbean</td>
<td></td>
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<tr>
<td>East Asia</td>
<td>5.5</td>
<td>6.0</td>
<td>6.0</td>
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<tr>
<td>South Asia</td>
<td>7.9</td>
<td>8.8</td>
<td>8.8</td>
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</tbody>
</table>

Source: Prepared by the authors with information from World Bank development indicators.

### Table I.2. TFP Average economic growth rate (Percentage)

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Northern Triangle CA</td>
<td>-0.43</td>
<td>-0.42</td>
<td>0.39</td>
</tr>
<tr>
<td>Guatemala</td>
<td>0.58</td>
<td>-0.04</td>
<td>-0.28</td>
</tr>
<tr>
<td>El Salvador</td>
<td>-0.08</td>
<td>-1.35</td>
<td>0.62</td>
</tr>
<tr>
<td>Honduras</td>
<td>-1.77</td>
<td>0.14</td>
<td>0.84</td>
</tr>
<tr>
<td>Latin America</td>
<td>-0.23</td>
<td>-0.20</td>
<td>0.43</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.82</td>
<td>0.42</td>
<td>1.50</td>
</tr>
<tr>
<td>East Asia</td>
<td>0.98</td>
<td>0.50</td>
<td>1.30</td>
</tr>
</tbody>
</table>

Source: Calculation with information from PWT 9.0, following the dynamics proposed by Kim & Loayza (2019).

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⁴ South Asia includes the following countries: Australia, Brunei Darussalam, Cambodia, Fiji, Hong Kong, Indonesia, Japan, Kiribati, Republic of Korea, Laos, Malaysia, Mongolia, Myanmar, Nauru, New Zealand, Papua New Guinea, Philippines, Samoa, Singapore, Solomon Islands, Thailand, East Timor, Tuvalu, Vanuatu and Vietnam.

⁵ East Asia includes the following countries: Afghanistan, Bangladesh, India, Maldives, Nepal, Pakistan, Sri Lanka, Macao, China.
Furthermore, since the profitability of capital is linked to the cost of financing and using the «actual» interest rate as a proxy for this rate, it shows that the countries of the Northern Triangle of Central America present important differences. El Salvador, specifically, shows an interest rate close to zero (probably influenced by its dollarized condition), and therefore, a previous assessment indicates that profitability in this country could be lower than that shown by other countries with similar conditions. This suggests that to the extent the value is very different (and decreasing), it could become a restriction to attract new investments.6

Meanwhile, in terms of access to credit for the private sector, the countries of the Northern Triangle of Central America have an average value of 49.0% of the GDP, below those recorded in Latin America at around 56.0% of GDP, or in South and East Asia, which average 52.8% and 93.5% of the GDP. This aspect is not minor and could affect the capacity of countries to provide financial resources, which will affect the levels of access by those who demand resources, and could become a restriction.

As for human capital, a glance at the ratio of growth in output per worker, reveals significant differences between regions. Such is the case that, when compared to East Asian countries, they outperform the countries of the Northern Triangle of Central America by more than double, while South Asia is three times higher. This suggests that investment attraction may be affected by the labor market productive capacity.

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6 The real interest rate is defined as the nominal interest rate minus inflation; in other words, it is the net yield obtained by discounting the effects and corrections induced by price changes.
On the other hand, the relationship between investment, quality and capacity of human capital required should be highlighted. On the educational supply side, the average level of schooling in the Northern Triangle of Central America is 6.7 years, 2.4 years less than in Latin America, and 2.5 years less than in South Asia. When this figure is cross-checked against per capita income (PPP US$), it shows that El Salvador and mainly Guatemala are far from the trend line. This aspect is further magnified when it is established that for a per capita income level as the one of these countries, the value should probably be close to eight years of schooling, which shows a significant lag in the relationship described.

According to the 2017 human capital index, which shows the contribution of health and education to productivity and income levels of the next generation, the Northern Triangle of Central America presents an average value of 0.48. This should be understood as that 48.0% of all children born in period «t» will grow up to be, at best, half the productive level possible compared to the rest of the countries provided, they have full access to education and health. This value is lower than the average recorded for Latin America or South Asia (average of 0.56 and 0.61, respectively).

In terms of the external sector, it should be underscored that the growth of exports of goods and services for the countries of the Northern Triangle of Central America recorded an annual average of 4.5% during the period 1990-2019; while for South and East Asia this value exceeds 10.0% per year. The export concentration index\(^7\) for the Northern Triangle of Central America shows an average value of around 0.212, while the value observed for South and East Asia is 0.183 and 0.095, respectively. Likewise, the diversification index of the Northern Triangle of Central America registers an average of 0.708; while for Southeast and East Asia it is 0.542 and 0.315, respectively\(^8\).

\(^7\) The Hirschman index provides information on the economic concentration of a market. Or, conversely, in the measure of lack of competition in an economic system, high values express a highly concentrated and uncompetitive market.

\(^8\) The index are averaged with information from UNCTAD STAT for the period 1995-2018. It should be noted that the reading suggests that the closer the index is to 0, the more deconcentrated and diversified the economy is.
In addition, since innovation processes are a cornerstone in the development of economies, the total investment in research and development as a percentage of the GDP for 2017 by the countries of the Northern Triangle of Central America was 0.08%; while the average for Latin America is around 0.32%, and South and East Asia are higher than 1.1% of the GDP. These estimates constitute a new benchmark to attract investments in the Northern Triangle of Central America, where exports are poorly diversified and highly concentrated, and investment in innovation and development is low.

The quality and capacity of productive infrastructure is another aspect related to attracting investment and economic growth in the countries. This is especially defined by its impact on the reduction of transaction and transportation costs, employment generation and connectivity of isolated markets, among others. Such is the case that, in 2017, the Northern Triangle region of Central America registered infrastructure investment values between 4 and 5 times lower than those in regions such as South and East Asia. Moreover, according to the 2019 Global Competitive Index, the relative position of the infrastructure quality of the Northern Triangle of Central America averaged 95/141, about 73 steps below the average of East Asian countries, with evident lags in the quality of road infrastructure. The resulting effect is an increase in production and trade costs, which negatively affects growth potential and regional competitiveness.

Investment attraction is also linked to citizen security, as well as to institutional quality in the countries. Generally, the total expenditure to GDP of violence and crime in the Northern Triangle of Central America averaged 13.0% of the GDP, relatively high figures that produce, among others, relevant opportunity costs due to the loss in production and investments. Similarly, in the World Bank’s 2016 Enterprise Survey publication, when questioning entrepreneurs in the countries under analysis about the effect of this condition, more than 60.0% suggested that this situation was a barrier to doing business and was among the three most important aspects of the index.

With respect to the quality of public institutions, according to the 2019 Global Competitive Index, the countries of the Northern Triangle of Central America present an average value of 52.9/100; while for the East and South Asia region it revolves around values of 70/100 (where 100 is the best ranking). According to the 2019 Corruption Perceptions Index for the Northern Triangle of Central America, corruption levels average 28/100; while Asian countries average values around 51/100 (where being close to 100 means being less corrupt and close to 0 means being more corrupt).

This analysis shows some of the conditions in the Northern Triangle of Central America that may affect investment attraction. It is noteworthy to mention that the region’s slow productivity growth and low factor accumulation, access to finance, the quality of human capital, the concentration and lack of innovation in exports, as well as, the perception of security and the quality of public institutions could have influenced the levels of investment observed so far, affecting the economic growth rate observed in the region. In this context, it is important to point out that the strategies or policy actions implemented require adjustments in order to help the economies of the Northern Triangle of Central America close the gap that separates them from the rest of the countries. Along these lines, it is necessary to use a robust methodological framework to better identify and prioritize those areas that are a binding constraint to growth, so that the recommendations derived from the analysis can be implemented and have the highest possible level of completeness.

### Table I.3. Infrastructure as a percentage of the GDP in selected regions (2017)

<table>
<thead>
<tr>
<th>Region</th>
<th>Infrastructure as GDP* percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern Triangle CA</td>
<td>1.3</td>
</tr>
<tr>
<td>Guatemala</td>
<td>0.7</td>
</tr>
<tr>
<td>El Salvador</td>
<td>1.9</td>
</tr>
<tr>
<td>Honduras</td>
<td>2.5</td>
</tr>
<tr>
<td>Latin America</td>
<td>1.0</td>
</tr>
<tr>
<td>East Asia</td>
<td>7.7</td>
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<tr>
<td>South Asia</td>
<td>5.0</td>
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</tbody>
</table>

**Note:** Estimated values include public and private sectors.

**Source:** Prepared by the author with information from ECLAC, World Bank iiglobal and Fay et al. 2017.

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It includes the quantification of costs such as: health costs, costs induced by violence to private agents (extortion expenses, robberies and thefts), institutional costs, preventive security costs, and costs and effects on investment and production. For more details see: Guerra, M., Mendoza, K. y Quintanilla, A. (2014).
I.2. Results of applying a stylized model

The methodology proposed by Hausmann, Rodrik and Velasco (2005), «Growth Diagnostics», which main focus is to identify the main constraints to growth, has been applied to the countries of the Northern Triangle of Central America. The results show a set of restrictions that coincide among the countries, but also some differences due to the particularities of each economy. According to these dynamics, the region presents a relevant bias linked to low returns to investment, over financing costs.

The countries of the Northern Triangle of Central America show a cluster of binding constraints in limited human capital, microeconomic risks, coordination externalities and information externalities. Therefore, the high rating identified in the low profitability and low appropriability suggest a regional work agenda that prioritizes policy actions leading to: A. strengthen the quality of public institutions; B. promote citizen security and crime prevention; and, C. strengthen the quality of human capital and labor productivity levels.

Guatemala

For Guatemala two binding restrictions have been identified, with some complementary political actions that strengthen the capacity for implementation.

Human Capital.
The indicators of schooling, education quality, the generalized low level of productivity and the concentration of a high wage premium for the highest levels of education result in a lack of convergence between labor supply and demand, which leads to a distortion that translates into skilled human capital being a scarce commodity. This situation leads to an important limitation to attract investments with a higher level of return, which converges on a binding constraint that results in a lower than expected level of economic growth. The condition is heightened when the equation is disaggregated and segments of the population are differentiated, such as: women, indigenous peoples and people living in urban or rural areas. This results in a greater divergence in the labor market, with direct implications not only for lower profitability and greater inequality, but also for social cohesion and inclusion problems, which increase poverty, crime and violence.

Therefore, it is essential that a country progresses at an accelerated pace in strengthening quality and inclusive education. Efforts directed to improving the education levels can be highlighted. However, it is important to consider the need to optimize resources and refocus them on promoting policy actions to improve the quality of education at all levels and to expand access to secondary education in order to reduce the education gap; especially in terms of gender, urban vs rural areas, and between the indigenous and non-indigenous populations. It is also relevant to implement strategic actions aimed at strengthening advanced skills education schemes through vocational training programs for adults, both in Spanish and in the main native languages; especially at the level of competency-based training and including training in the use of the English language. All of this is aimed at reducing the existing divergence in the labor market and providing people with the tools to be able to integrate into sectors with greater added value, such as export products.

To complement the actions described above, the prioritization defined in the current government policy in its social development pillar, must be consistent with the implementation of other aspects such as: reducing illiteracy, facilitating access and expanding educational coverage, improving the quality of public education by providing prepared and updated teachers, strengthening the capacity to generate cognitive

<table>
<thead>
<tr>
<th>Table I.4. Growth restrictions in the Northern Triangle of Central America</th>
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<tbody>
<tr>
<td><strong>Restriction</strong></td>
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<td>-----------------</td>
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<tr>
<td><strong>Binding restrictions (low returns)</strong></td>
</tr>
<tr>
<td>Human Capital</td>
</tr>
<tr>
<td>Quality of the institutions</td>
</tr>
<tr>
<td>Citizen security and crime</td>
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<tr>
<td>Productivity of the tradable sector</td>
</tr>
<tr>
<td><strong>Areas of complementary attention</strong></td>
</tr>
<tr>
<td>Macroeconomic stability</td>
</tr>
<tr>
<td>Quality of the education levels</td>
</tr>
<tr>
<td>Infrastructure quality</td>
</tr>
<tr>
<td>Industrial policy</td>
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<tr>
<td>Financial deepening</td>
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<tr>
<td>Resilience to face natural disasters and climate change</td>
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</table>

Source: Prepared by the author with information for the growth constraints analysis for each country.

10 A detailed analysis of each country that attempts to provide a rationale for the findings and policy recommendations is discussed extensively in subsequent chapters.
11 The methodological appendix provides a comprehensive description of the advantages and drawbacks of the application of this model, along with the criteria for the selection.
12 Hausmann, Rodrick & Velasco (2005), op. cit., p. 7.
competencies, reinforcing key training areas for the development of competencies and improving school infrastructure, among others. This requires a prioritized and sustainable financing framework with a medium-term intersectoral commitment to strengthen human capital that guarantees a way out of the current impasse.

**Quality and coordination of public institutions.**

Institutional quality, the regulatory burden for doing business, as well as the quality of oversight bodies and security systems, are areas that directly affect the attraction of investment in Guatemala. Similarly, inter-institutional coordination problems and the existence of harmful aspects, such as corruption, low levels of governance and the effectiveness of public policies, directly affect competitiveness and business creation. This situation is exacerbated by the lack of transparency and continuity of government policies. In this sense, the perception of the productive sector ranks this condition second in importance as an impediment to doing business. Therefore, the low quality and poor coordination of public institutions is a highly restrictive condition and is a binding constraint to economic growth.

According to the findings, promoting institutional strengthening is a task that the country must continue promoting through actions that allow it to improve governance levels, reduce corruption, business environment regulations, government efficiency and the rule of law. To this end, it is essential to implement actions that improve confidence in public institutions through independent, fair and balanced administrative decisions consistent with an explicit commitment to the stability of actions, reducing corruption and promoting reform efforts with emphasis on transparency and accountability; (ii) promoting the improvement of law enforcement, processes, procedures and paperwork, in order (iii) to foster the improvement of the civil service, the optimization of the bureaucratic process and the promotion of administrative simplification on an appropriate technological platform; (iv) to improve the efficiency of the state’s management capacity; (v) to reduce the cost and improve the effectiveness of regulations, thereby increasing compliance and reducing opportunities for corruption; and (vi) to strengthen accountability mechanisms, increasing the capacity to monitor compliance with the law and raising the costs of violations of the law through appropriate and internalized sanctions.

In this regard, it is necessary to: i) promote a comprehensive policy aimed at improving the business climate on a framework of a transparent public administration protected by law, in a scheme where strategic objectives are shaped to ensure institutional interrelation and coordination on the pillars of the country’s development, in a sustainable financial framework and an efficient state structure; ii) improve transparency in the designing and making of decisions that affect the country; iii) strengthen quality and accountability, particularly in the areas that require better performance; and, iv) promote the implementation of actions of broader public interest, together with the insertion of all the stakeholders involved, in a participatory scheme.

The different objectives and actions associated with this comprehensive policy aiming to improve the quality and coordination of public institutions should be based on a cross-cutting and intersectoral complementarity scheme. Thus, some guiding objectives can be identified, such as: (i) professionalizing public administration to maintain continuity in the implementation of actions, reducing corruption and promoting reform efforts with emphasis on transparency and accountability; (ii) promoting the improvement of law enforcement, processes, procedures and paperwork, in order (iii) to foster the improvement of the civil service, the optimization of the bureaucratic process and the promotion of administrative simplification on an appropriate technological platform; (iv) to improve the efficiency of the state’s management capacity; (v) to reduce the cost and improve the effectiveness of regulations, thereby increasing compliance and reducing opportunities for corruption; and (vi) to strengthen accountability mechanisms, increasing the capacity to monitor compliance with the law and raising the costs of violations of the law through appropriate and internalized sanctions.

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13 In other words, a greater gap between the balanced relationship of supply and demand in the labor market, which translates concretely into a marked difference between the value of the worker’s marginal productivity and his or her salary.
El Salvador

In El Salvador’s case, two binding restrictions have been identified that are «bottlenecks» for economic growth:

**Citizen security and crime.**

Security and crime account for an annual cost of around 16.0% of GDP\(^{14}\), with the average expenditure of companies standing out at around 10.0% of their sales revenue. In this context, 50.0% of MSMEs (50.0%) consider it as a constraint to do business. This reality directly affects the level and attraction of investment; it also contributes negatively to achieving higher economic growth rates than those observed.

To address crime and violence in El Salvador, it is essential to evaluate the so-called «opportunity cost of crime»\(^{15}\), as well as, «the drive for prevention».\(^{16}\). Therefore, the implementation of an inclusive strategy geared to prevent and reduce crime and violence must start from the diagnosis of key aspects such as: i) the proper identification of the causes that produce crime, ii) the perception and prevalence of impunity, iii) the causes and effects of youth exclusion, iv) the cost and time associated with rehabilitation and social insertion, and v) the situation of general and extreme poverty. Once the problem and its causality are clear, a proposal should be articulated to ensure strategic alignment at the local, national and regional levels (in line with the primary reasons identified), which should extend over the long term. All this in order for the implicit actions to be cross-cutting, complementary, financially sustainable and with a feasible timeframe for compliance.

An intersectoral coordination work is also required, where, in addition to the security and criminal justice entities of the country, Ministries such as: Health are included through actions on the comprehensive development of adolescent health; Education, Science and Technology, especially through programs to access education and technical and technological education in areas of development; Labor and Social Security; Local Development; Ministry of Economy (MINEC), in particular through its entrepreneurship programs and business opportunities (such as FONDEPRO and DICA, among others); Ministry of Finance, as well as private enterprise and civil society in general. This intersectoral coordination is key for the implementation of a comprehensive and coordinated public policy framework to improve citizen security and reduce crime, with common objectives with a final effect that leads to the improvement of the well-being of the country’s inhabitants, measured through the reduction of the cost of violence, among others.

**Productivity of the tradable sector.**

El Salvador shows a reduction in its levels of productivity and competitiveness in the markets, and although progress is observed in the area of product innovation, the supply of opportunities is limited by the size of the economy and their sustainability over time. In addition, this situation has been exacerbated by the low quality of human capital and the inefficiency of the infrastructure. On the other hand, there are binding constraints in the country in multiple aspects that include: the cost of financing, the structure and incidence of informality levels in the economy, the profitability of human capital, the effect of unilateral transfers in the labor market, and climate change.

In order to increase the productivity of the tradable sector in El Salvador, it is essential to promote an industrial policy through which the government establishes specific actions aimed at supporting a process of structural change that increases productivity. In this regard, the implementation of this policy is foreseen through a strategic framework that includes a productive diversification approach, and that offers companies based in the country the possibility of inserting themselves in dynamic markets (based on the value of national resources and the generation of learning). Therefore, this strategic framework presupposes at the operational level, the support and development of innovation and investment programs, quality approach, technological dissemination and extension (especially in a framework of technology transfer and adoption of international practices and standards), development of suppliers and regional clusters; as well as programs to promote dynamic entrepreneurship, along with a genuine work in the design of actions that promote the development of new productive activities.

Moreover, it is essential to promote industrial reconversion to renew equipment and capital goods, strengthen agri-food production chains, finance programs aimed at promoting industrial and agro-industrial production and the development of skills-based programs, among others, are actions that must be strengthened in the country in order to improve the productivity indices observed to date.

In addition, it is necessary that the country’s vision and its medium and long-term strategy include specific actions to stimulate investment. Certainly, an attractive investment climate must be provided, through which the government’s commitment to a platform that enhances the country’s competitiveness, trade facilitation and guarantees citizen’s and legal security. It is also essential to implement a trade facilitation and bureaucratization policy, in terms of simplifying procedures, reducing costs, improving infrastructure and strengthening institutions.


\(^{15}\) According to Brand and Price (2000), as well as Aboal et al. (2013), suggest that this opportunity cost can take an accounting approach by dividing expenditures into costs of anticipation, costs as a consequence and costs as a response to crime and violence. The approach is deepened in a study by UNDP (2005) and further elaborated by Guerra, M., Mendoza, K. and Quintanilla (2014).

\(^{16}\) Understanding the drive for prevention as the development and implementation of a foresight policy that begins at home and continues in schools trying to change the culture of the citizens, inducing a culture of peace.
Honduras

When applying the methodology to Honduras and assessing compliance with the conditions, the following binding restrictions are evident:

**Citizen security and crime.**

This is a binding constraint since its high cost is in the order of 13.3% of GDP. At the micro level, for example, 70.0% of the companies surveyed mentioned that they have had to pay to address security-related issues or security services. The costs to overcome this condition range from 5 to 7.0% of total sales revenues.17

Reversing the climate of insecurity in Honduras requires, in addition to government initiatives, the participation and empowerment of different sectors of civil society, in order to achieve greater impact of the strategies adopted. In this respect, the role of society is key, to ensure that the proposal is not limited to address the determining factors of violence and crime. Hence, the constant promotion of the comprehensive policy on crime prevention and the improvement of security, articulated across sectors, will allow further progress in improving citizen conditions, and will be key to strengthening the country’s investment climate.

There has been relative progress in the implementation of the Comprehensive Policy for Coexistence and Citizen Security 2011-2022 (PNCS), based on four pillars: i) institutional strengthening; ii) social prevention of violence and crime, promotion of peace and citizen coexistence; iii) rehabilitation and reintegration; and, iv) attention to victims and people displaced by violence. Even though progress has been made in implementing this policy, the current situation of citizen insecurity and crime in Honduras suggests the need for further strengthening of policy actions especially aimed at expanding coverage in the field of violence prevention and prioritization of risk factors (such as family disintegration, loss of family and social values, domestic and gender violence, social inequality, access to education and employability; as well as continuing to promote investments in safe public spaces for healthy recreation; together with actions targeting the retention of human capital to prevent irregular migration and access to illicit economies), a focus on rehabilitation and social reininsertion (especially in areas such as access to improve educational quality, professional training, psychological support and values training, among others), a drop in criminality (through institutional strengthening of government entities and investments in physical and technical capacity) and the improvement of the prison system (improving capacity and developing rehabilitation centers, among others).

**Quality of public institutions.**

The quality of public institutions in Honduras is strongly influenced by issues such as lack of control of corruption and low government effectiveness. According to the analysis, the implicit cost related to this restriction is around 11.0% of the GDP. Consequently, a loss in competitiveness levels and business opportunities is noticeable, especially associated with the lack of transparency and legal certainty in the country, such that companies classify this condition as one of those that mostly affect them in the development of their economic activity.

To make progress in improving the quality of public institutions, it is necessary for the country to focus its efforts on strengthening governance, reducing corruption, business environment regulations, government efficiency and the rule of law. This implies a strategic approach through which, in addition to institutional strengthening, a boost to the rule of law and the judiciary, and a consistent accountability framework are proposed. In particular, the establishment of a comprehensive policy aimed at improving the business climate implies a transparent public management underpinned by the law, focused on strategic objectives such as improving transparency in the design and decisions affecting the country; strengthening the accountability mechanisms of decision makers; especially in cases of poor performance, as well as, supporting the implementation of actions of broader public interest, together with the insertion of all stakeholders, in order for the scheme to be participatory in nature.

The different actions foresee the implementation of a concrete strategy directed at strengthening public institutions based on a cross-cutting framework, with a complementary scheme between sectors. Some guiding lines of action may be oriented towards: i) improving the levels of professionalization of public administration based on guiding pillars such as transparency and accountability; ii) improving paperwork, processes and procedures to increase the efficiency of the administration of justice; iii) promoting administrative streamlining; and iv) enhancing accountability mechanisms, together with the promotion of capacities to monitor compliance with the law and sanctions, ensuring their complete internalization.

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17 Taking as a reference the costs associated with health issues, violence against private and institutional agents, preventive security, and the costs on investment and production.


19 The general estimate of this value crosses modalities in a matrix framework among which different modalities of corruption stand out with certain categories of expenditure. FOSDE op cit. p.p. 9-14.
The Northern Triangle Of Central America

It is also important to mention that the countries of the Northern Triangle of Central America should incorporate and/or continue to promote in their national agendas that, according to the methodology used, can enhance the effects of reducing binding constraints on economic growth in the medium term, such as:

Macroeconomic stability.
An essential condition to achieve sustainable and inclusive economic growth is to have macroeconomic stability and, therefore, countries need to continue implementing macroprudential measures. To this end, it is necessary to continue strengthening efforts to improve revenue collection levels through greater inclusion and less evasion, as well as the good use of public spending to ensure the greatest possible impact on growth and well-being.

Education and skills.
Improving the quality of schooling at all levels is fundamental, as it provides the necessary foundations for learning more advanced skills. However, it is particularly necessary to promote the development of skills-based education, providing citizens with educational alternatives to meet the demands of the labor market. Education policy must be coordinated with economic policy in order to promote skills and knowledge, to work in previously identified strategic sectors.

Quality of infrastructure services.
It is key for countries to establish a framework to prioritize investments and improve management in the areas of energy, productive infrastructure and access to services, with a view to reducing production and trade costs, thus having a positive impact on growth potential and regional competitiveness.

Industrial policy.
The countries of the Northern Triangle of Central America lag behind in their levels of competitiveness and innovation, a situation that discourages the development and growth of potential sectors of the economy. Therefore, it is essential to formulate and implement an industrial policy with the characteristics and special features that each country requires, with the aim of improving the existing levels of competitiveness and innovation. In this context, it is essential to combine strategic efforts to encourage the development and growth of potential sectors of the economy, promoting investment in research and development.

Financial inclusion and access to credit.
It is crucial to promote public policies aimed at inclusion through innovative financial instruments that improve the level of access, especially for the MSME sector. To contribute to financial deepening and inclusion, actions should be promoted to foster access to loans, as well as, other financial services, for companies that lack access to the banking system due to their exclusion, including the facilitation of favorable bank financing on soft terms.

Resilience to face natural disasters and climate change.
Given the region’s fragility to natural disasters, it is necessary to constantly promote policies oriented to the management of these impacts. In this sense, the continuous implementation of actions aimed at strengthening resilience and adaptability to climate change, preserving biodiversity and the protection and sustainable use of ecosystems is still in force and fundamental.

As a conclusion, the countries of the Northern Triangle of Central America require the implementation of reforms and concrete policy actions that will allow them to get out of the «incipient economic growth entrapment». Therefore, the definition of a prioritized agenda to address the identified binding constraints and the sustainability of actions over time are essential to assure attracting investment and maintaining it, thus improving sustainable and inclusive economic growth rates. Clarity in the formulation of such a strategic framework and the definition of the key actors that can implement it will provide the required confidence and provide a clear roadmap.
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