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March 16, 2023

**Statement by Mr. Alhosani and Mr. Al-Kohlany on El Salvador
(Preliminary)
Executive Board Meeting
March 20, 2023**

We thank staff for the well written set of reports and Mr. Guerra and Mr. Chicas Cienfuegos for their insightful Buff statement. We broadly concur with the thrust of the staff appraisal and offer the following comments for emphasis.

Fiscal consolidation, with a focus on growth-friendly and inclusive measures, is important in the medium term to mitigate vulnerabilities and create space for growth-enhancing expenditures. We welcome the authorities' commendable efforts to curb tax evasion and improve revenue mobilization, however public debt remains unsustainable, and financing constraints continue to grow. To achieve a sustainable debt trajectory and ease financing pressures, a revenue-based consolidation plan is needed over the next three years. This plan should focus on increasing revenue mobilization, enhancing subsidy targeting, rationalizing public spending, and improving social safety net efficiency. A medium-term expenditure framework is important to guide public financial management and ensure control over public spending in the future. Reinstating the suspended Fiscal Responsibility Law would also boost fiscal transparency and credibility.

The banking sector is broadly healthy, but existing vulnerabilities are exacerbated by a deepening bank-sovereign nexus. We encourage the authorities to address underlying vulnerabilities associated with dollarization, growing exposure to public debt, and declining liquidity buffers. Measures to mitigate systemic risks, including by raising reserve requirements at the central bank, strengthening the crisis management and deposit protection framework, and adopting Basel standards, are essential for safeguarding financial stability. Closing regulatory gaps, addressing the recommendations from the 2020 Safeguards

Assessment, and enhancing the central bank's autonomy and governance are also necessary steps to bolster financial stability.

Addressing the risks associated with Bitcoin's legal tender status in El Salvador is crucial for supporting long-term growth and financial stability. The current Bitcoin strategy has not promoted financial inclusion or increased digital remittances, and adoption remains limited. Given the related persistent risks to financial and market integrity, we encourage the authorities to reassess the scope of the Bitcoin law and make its use voluntary, and to strengthen regulatory and supervisory frameworks especially for the Chivo e-wallet. While we appreciate the authorities' commitment to transparency and accountability in Bitcoin transactions, we recommend addressing the Digital Assets Law's shortcomings, particularly related to the limited prudential safeguards. Alternative options for promoting financial education and digital payments should be considered, with a focus on microfinance and credit bureau regulations.

We welcome the authorities' commitment to enhancing security, diversifying exports, improving education quality, and reducing trade and investment barriers. Strong governance and accountability will bolster resource management and contribute to fostering economic growth and resilience. Measures in the area of AML/CFT, including enacting the revised legislation and ensuring risk-based supervision of crypto assets are needed to further strengthen the AML/CFT framework. We applaud the progress in fighting crime, which has contributed positively to the country's economic landscape. Complementing anti-crime action with social programs and initiatives to improve employment opportunities for youth will ensure a lasting decrease in crime rates. Given El Salvador's vulnerability to climate shocks, we urge the authorities to consider a comprehensive policy and investment strategy to tackle climate challenges.