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March 16, 2023

**Statement by Mr. Potapov and Mr. Biriukov on El Salvador
(Preliminary)
Executive Board Meeting
March 20, 2023**

1. We thank staff for the informative report on El Salvador and the Selected Issues paper on bitcoin and financial inclusion. We also appreciate the additional clarifications provided by Mr. Guerra and Mr. Chicas Cienfuegos in their Buff statement. **We broadly concur with the thrust of the staff appraisal and offer the following remarks for emphasis.**
2. **The authorities deserve praise for the recent improvements in the security situation.** Safe environment is an essential prerequisite for job creation, stronger consumer confidence, and investment growth. Yet other bottlenecks to medium-term growth remain in place and deserve closer attention, including through addressing multiple longstanding macroeconomic imbalances.
3. **Fiscal imbalances have been a structural weakness in the absence of a credible fiscal consolidation plan.** The authorities need to take immediate actions to stabilize the public debt trajectory and restore access to the international capital market. The VAT rate, which is below the average in Latin America, could be increased. On the expenditure side, strict control of the wage bill is required to contain current spending and provide space to address social and infrastructure gaps. We also encourage the authorities to guarantee the sustainability of the pension system. The recent reform added to its vulnerabilities rather than addressed weaknesses.
4. **With the public debt on an unsustainable path, El Salvador remains vulnerable to an adverse shock that could trigger an adverse feedback loop between the sovereign and banks, threatening macro-financial stability.** Erosion of financial system buffers is another concern. In this respect, we see merit in restoring the 15 percent requirement for banks' reserves at the central bank, carefully calibrating this decision with the current needs

of the economy. We also take a positive note that the central bank is progressing in implementing the recommendations of the 2020 Safeguards Assessment.

5. **The Selected Issues paper clearly signals that the adoption of Bitcoin has not led to any visible improvements in financial inclusion.** The volatility of the crypto asset has discouraged its use among households. We would encourage the authorities to reconsider their plans to increase exposure to Bitcoin by issuing tokenized bonds. We also highlight the alternative international digital payments initiatives that could be used to promote financial inclusion.

6. **On the structural front, additional efforts are needed to foster El Salvador's inclusive and durable development.** El Salvador's productivity growth has been relatively low, pointing to the need of tailoring investments in human capital and insufficient physical infrastructure. Generating formal employment remains crucial for providing opportunities to young people. We also support the efforts to reduce the cost of doing business and trade.

7. With these comments, we wish the authorities every success in their future endeavors.