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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/41-2

11:45 a.m., May 22, 2019

2. El Salvador—2019 Article IV Consultation

Documents: SM/19/102 and Correction 1; and Supplement 1; and Supplement 1, Correction 1

Staff: Carare, WHD; Gonzalez Miranda, SPR

Length: 18 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	**Alternate Executive Directors**
	J. Essuvi (AE), Temporary
	E. Ondo Bile (AF), Temporary
	J. Corvalan (AG), Temporary
	N. Heo (AP)
	P. Fachada (BR)
	Y. Zhao (CC), Temporary
	A. Del Cid-Bonilla (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
	M. Albert (FF), Temporary
	I. Fragin (GR), Temporary
	M. Siriwardana (IN)
	P. Di Lorenzo (IT), Temporary
	Y. Saito (JA)
	S. Alavi (MD), Temporary
	P. Al-Riffai (MI), Temporary
	D. Cools (NE), Temporary
T. Ostros (NO)	
	A. Tolstikov (RU), Temporary
	W. Al Hafedh (SA), Temporary
A. Mahasandana (ST)	
P. Inderbinen (SZ)	
	O. Haydon (UK), Temporary
	M. Svenstrup (US), Temporary

S. Bhatia, Acting Secretary
K. Hviding, Summing Up Officer
D. Jiang, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Strategy, Policy, and Review Department: R. Giri, M. Gonzalez Miranda. World Bank Group: S. Davies. Western Hemisphere Department: A. Carare, F. Di Vittorio, A. Husain, Y. Yakhshilikov. Alternate Executive Director: P. Moreno (CE). Advisors to Executive Directors: G. Khurelbaatar (AP), I. Skrivere (NO), A. Srisongkram (ST), M. Sylvester (CO).

2. EL SALVADOR—2019 ARTICLE IV CONSULTATION

Mr. Villar and Mrs. Del Cid-Bonilla submitted the following statement:

On behalf of our Salvadoran authorities, we would like to thank staff for its candid and constructive policy dialogue during the 2019 Art. IV consultation. The authorities broadly agree with staff's assessment and policy recommendations. The economy's performance in 2018 was strong with growth above potential at 2.5 percent, reflecting benign global conditions, strong internal demand and high levels of public and private investment, supported by a robust financial system. Inflation remained low and stable and fiscal balances improved. Sustained growth and a consistent and comprehensive agenda in the social area, have allowed real per capita GDP to increase by around 15 percent over the past decade, leading to a considerable decline in inequality and poverty and a significant improvement in human and social indicators, as highlighted in the report.

Recent Developments

The economy is expected to grow at 2.4 percent in 2019. Results from relevant macroeconomic indicators during the first quarter point in this direction: credit to the private sector increased 6.4 percent (year-to-year), mainly driven by a strong growth of credit to enterprises which grew 10.3 percent, reflecting dynamism in many productive sectors, particularly construction. The primary fiscal surplus was 0.4 percent compared to 0.3 percent in the first quarter of 2018, and inflation remain low at 0.7 percent. Remittances increased 5.9 percent, higher than the 5.3 percent observed over the same period in 2018. The total liquidity of the economy grew 4.9 percent providing a good cushion for supporting the economic dynamism. The authorities share staff's view on the main risks to the outlook. Weaker-than-expected global growth could have a negative impact on the economy, and debt could continue to drift upward in the absence of measures or if spending or public sector reforms are approved without identifying suitable funding sources.

Fiscal Discipline and Adjustment

The strong fiscal discipline and measures implemented allowed the primary fiscal balance to improve 1.1 percent of GDP between 2017 and 2018. Over the past year, the authorities continued efforts started in 2017 to reach political agreements aimed at moving forward with the country's economic and social agenda. Consequently, an important number of fiscal laws were approved by the Legislative Assembly in December 2018: The

Fiscal Responsibility Law (FRL) was strengthened by requiring debt to be put firmly on a declining path and by introducing an anchor for public debt of 60 percent of GDP by 2030; the budget and its financing were passed on time for the first time in three years, with a primary surplus of 0.7 percent of GDP. The Assembly also authorized external financing for US$1.3 billion, including to cover the US$800 million Eurobond payment due in December and an IADB loan to finance the program for strengthening tax administration that includes the implementation of the electronic invoicing. Because of the strong political cooperation and agreements that made possible the approval of these important fiscal laws, Standard & Poor's upgraded the rating of El Salvador's sovereign debt to B in December 2018 and the EMBI Global spread declined and is in line with regional peers.

The authorities agreed with the size of the recommended adjustment and considered that a more gradual pace of implementation (three years) would still be consistent with observing the Fiscal Responsibility Law (FRL). They are aware that a further fiscal adjustment of about 1.9 percent of GDP by 2021 is needed to comply with the FRL. To this end, they are preparing several measures, both on the revenue and the expenditure sides, and are also progressing in the technical preparation of tax administration reforms, including electronic invoicing, the "monotributo," as well as the initiative to combat base erosion and profit shifting ("precios de transferencia"). They agreed with staff on the need to adopt additional structural revenue measures, such as excise taxes on luxury goods. The authorities do not see plausible an increase in the VAT in the short term, considering that this type of measure would require consensus among different sectors of the population given its potential negative impact on household's consumption. Going forward, the authorities consider that a comprehensive fiscal reform is needed to eliminate distortions arising from temporary and ad hoc measures accumulated over the years. Harmonizing and simplifying the tax code could improve fairness, equity, competition and growth.

To improve the efficiency of public expenditure, the authorities are planning to centralize the procurement system and extend competitive bidding processes such as reverse auction mechanism to all public entities; to this end, a reform to the procurement law is in process. The authorities are also working on strengthening public debt management and have requested Fund's technical assistance for this purpose.

Policies to Foster Higher Growth

The ease of doing business has improved in recent years and the authorities are committed to further improve the business climate and the country's competitiveness. Policies to reduce poverty, inequality and emigration are bearing fruits and the government is committed to advance even more through strengthening programs in education, health, housing, water and sanitation, and urban and rural development. The agenda to promote growth has also been successful based on cutting red tape, implementing the development, diversification and productive transformation strategy in place since 2014, and on intensifying efforts to increase financial inclusion. In addition, actions are being taken to expedite the process to obtain the tax ID, improve the platform to register new enterprises and obtain construction permits. Completion of the Northern Triangle Customs Union with Honduras and Guatemala would allow to increase intra-regional trade and investment, thereby contributing to boosting growth. Regulatory improvements brought by the customs union, and better infrastructure at border crossing points, will significantly reduce the costs and processing time for exports.

The rehabilitation and prevention efforts through El Salvador Seguro plan launched in 2014 are contributing to substantially lower the homicide rate, as evidenced in Box 2 of the staff report, helping to improve the business climate and the country's competitiveness. The authorities plan to advance the plan further by securing budgetary funds to expand two detention centers, implement public spaces recovery programs and strengthen youth violence prevention programs. They acknowledge that further actions should be taken to combat extortion, including by expanding technological surveillance and police presence in the country, and by continuing to foster community involvement. In this regard, the City Hall of San Salvador launched last April a "Smart City" project with support from Spain.

The authorities continue working on increasing the provision of public infrastructure as a catalyst for private investment growth; they plan to complete this year the expansion of the passenger air terminal and implement other important projects to enhance both country's roads and ports network. They will also develop specific projects oriented at tourism such as the touristic marine coastal strip, and the productive development program, as well as continuing with customs modernization.

The authorities are confident that reducing informality and the gender gap in labor force will contribute to raise potential output. As part of the plan to recover San Salvador's downtown, two large markets will be created in the upcoming years to give street vendors (mostly women) a safe and clean space to operate. The gender gap in the labor force participation rate (30 percent), is lower than in neighboring countries and the authorities expect to reduce it further by leveraging efforts of the recently introduced National Gender Equality Plan and the Gender Seal certification program. Over 60 units have been created in the public sector to institutionalize gender mainstreaming. The second program is implemented with support from UNDP. In addition, the authorities and experts expect that the 2017 amendment to the family code to ban child marriage and the development of a national policy to prevent teenage pregnancy will help reduce the gender gap in education attainment.

Financial Sector Stability

The banking sector remains solid and credit continued to expand during the first quarter of 2019. Banks reduced their external liabilities as global financial conditions tightened, remained well-capitalized and used the remittance-fueled surge in deposits to expand credit. Balance sheet risks remained sound as the deposit-to-loan coverage remained stable at 95 percent, and the cyclical position of credit expansion was within the norm. Non-performing loans declined below 2 percent, provisioning increased, and profitability reached a three-year high.

The authorities concurred with staff's recommendations for enhancing financial sector stability. They agreed with the need to accelerate approval of the bank resolution law and remain committed to further strengthening cross-border cooperation, and appropriately fund the emergency lending assistance framework, which includes the creation of a liquidity fund facility in line with prior Fund's recommendations. Banks' efficiency in liquidity management, including the reactivation of the interbank market, cross-border cooperation and supervision, has increased, and the Superintendence has enhanced supervision and monitoring of financial flows—which are critical in preparation to rejoin the Egmont Group (group of 159 Financial Intelligence Units established to provide a platform for the secure exchange of expertise and information for AML/CT).

Financial Inclusion

The authorities are making progress in promoting financial inclusion. Bank account ownership has doubled from 14 percent in 2011 to 30 percent in 2017, driven by increases in rural accounts and female-owned accounts. A Presidential executive order in July 2018 established the National Council for

Financial Inclusion, the inter-agency support group for financial inclusion and financial education program of El Salvador. Simplified bank accounts, for limited balances and transactions, were introduced in 2015 and 400 of these accounts were opened since the end of 2018. In addition, another electronic money provider, MOMO-Mobile Money, is in process to join the mobile money market.

Governance Framework

The authorities have adopted several measures to improve the governance framework. The Attorney General has significantly strengthened investigation and prosecution activities to curb the illicit use of public funds at the highest level. To support the anti-money laundering (AML/CFT) efforts, the Superintendency of the Financial System has put in place a system for high-frequency monitoring of financial flows. Independence and autonomy of the Financial Investigation Unit has been legally ensured to restore the exchange of information with a worldwide network of financial investigative agencies, and to enhance the governance and anti-corruption framework. In addition, a plan has been developed and implemented by the Presidency to increase citizen participation in the design, implementation, and monitoring of public policies at the national and local levels, and to receive direct corruption complaints. Going forward, the authorities believe it is important to continue strengthening the accountability and supervision of public funds and see space for improvement through further reforms that ensure a comprehensive audit of public accounts, such as (i) harmonizing the existing legal framework; (ii) strengthening the Audit Office by expanding its supervisory role to all public institutions; and (iii) modernizing audit processes through extensive adoption of technology.

Mr. Doornbosch, Mr. Merk, Mr. Psalidopoulos, Mr. Cools, Mr. Di Lorenzo and Mr. Fragin submitted the following statement:

We thank staff for the insightful paper and Mr. Villar and Mrs. Del Cid-Bonilla for the helpful buff statement. Despite a steady economic performance, structural rigidities and security problems act as a burden on El Salvador’s potential growth. Downside external risks are related not only to a deterioration of the global growth outlook, but also to the susceptibility of trade and remittance flows to external developments. On the upside, a more gradual monetary policy normalization in the U.S. could reduce the cost of external financing and improve competitiveness. Overall, we welcome the authorities’ expressed strong commitment to the fiscal and structural reform agenda and encourage the incoming administration to timely implement these reforms. We broadly share staff's assessment and would like to make a few points for emphasis.

Efforts to fight crime and corruption should remain a key priority in the government's agenda. Stronger transparency, controls and accountability of the fiscal operations can go a long way in reducing opportunities for corruption. This will contribute to improving the public perception of public governance. We commend staff for the sound advice about prioritizing prevention and rehabilitation efforts in the fight against crime, given the macro-critical nature of this issue. Improving educational outcomes and training activities, including by allocating adequate resources in the budget, should be placed at the center of this strategy. Education can play a critical role also in the key challenge of reducing the gender gap in the labor market.

Addressing debt vulnerabilities, while preserving progress on social indicators, remains a key priority. The authorities have adopted important fiscal reforms in the recent years, including strengthening fiscal rules and pension reforms which have contributed to a sensible improvement in the primary balance. Nonetheless, in 2018, fiscal outcomes have been below projections at the time of the previous Article IV report, with a sizeable carry over for 2019 and 2020, thus strengthening the case for additional fiscal adjustment, including further pension reforms already advocated last year by staff. We welcome that the authorities' and staff's views seem to be converging in this direction. At the same time, it is critical that the measures are calibrated in a growth-friendly way, as advocated by staff, and without undermining a further improvement of social indicators. We share in particular staff's call for a better targeting of social spending, to make sure that available resources are directed to the benefit of most vulnerable people. Staff's elaboration on to what extent the use of PPPs can help to overcome the country-specific constraints limiting the public investments are welcome.

Deepening financial inclusion is important to support long-term growth. Although in line with the regional average at around 50 percent, the level of credit to the private sector as a share of GDP still appears low. Lack of access to finance is reported as one of the top constraints to the ease of doing business. Policy steps suggested by staff can promote the use of bank accounts, including for channeling remittances, thus favoring credit intermediation. In last year's answers to technical questions, staff identified several regulatory and information constraints impeding credit to SMEs. Could staff kindly provide an update on potential progress in addressing these constraints? We also take positive note of the high potential of mobile money for fostering financial inclusion, as emphasized by staff. Moreover, financial sector reforms such as strengthening the ELA framework and resources, introducing Basel III regulatory standards, and enhancing risk-based supervision, will further bolster financial stability. In this way, the well-capitalized and liquid banking sector could be encouraged to extend credit while preserving the current sound balance sheet and avoiding regulatory forbearance.

Mr. Saito and Mr. Naruse submitted the following statement:

We thank staff for their informative reports and Mr. Villar and Mrs. Del Cid-Bonilla for their insightful statement. We commend that GDP grew by 15 percent over the past decade and this sustained growth allowed for an increase in social spending, leading to a decline in inequality and poverty. We also welcome that the growth momentum is expected to continue in 2019, mostly driven by construction and services. However, the country faces multiple challenges, including reducing homicide rate, addressing high public debt, and fighting against corruption. To this end, we believe that the authorities need policies to address fiscal vulnerabilities, boost long-term growth, and strengthen the governance framework. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

Given the high public debt and sizable financing needs, we support the staff's view that the frontloaded fiscal adjustment is needed in line with the Fiscal Responsibility Law (FRL). It is encouraging that the primary fiscal balance has improved over 2017-2018. However, further fiscal consolidation measures are needed to comply with the FRL. In this regard, we welcome the progress achieved in several tax administration reforms, such as the electric invoicing. In addition, we agree with the need for adopting additional revenue measures, such as excise taxes on luxury goods, improving public procurement by enhancing competitive bidding processes, and curbing the wage bill by facilitating the voluntary retirement of public employees.

We agree with the importance of finding comprehensive solutions in the medium-term to address fiscal challenges. We agree with the staff's view that the authorities need to eliminate distortions arising from the temporary and ad hoc measures accumulated over the years. In this regard, we welcome the authorities' view that harmonizing and simplifying the tax code could improve fairness, equity, competition and growth. In addition, we note the staff's recommendation that any public sector initiative should identify funding sources, such as a property tax, to avoid worsening public debt dynamics and preserve fiscal sustainability. We welcome the staff's comments on the authorities' readiness toward introducing the property tax.

Structure Reforms

We concur with the staff's view that improving the business environment and competitiveness is critical to boost growth. We note that El Salvador lags behind most regional peers in private investment rates and human capital. We agree with the staff's view that continuing to combat crime could have positive effects on investment and further reduce outward migration. Also, increasing the provision of public infrastructure, including through public-private partnerships, could raise potential growth. In addition, we agree with the staff's view that investing in education will contribute to higher human capital accumulation and increase competitiveness. Moreover, to help raise potential output and boost long-term growth, we encourage the authorities to reduce informality and the gender gap in labor force participation as well as to remove barriers to trade and investment and facilitate diversification.

It is welcoming that the authorities are intensifying efforts to strengthen the governance framework. We are pleased to see that the Attorney General has significantly strengthened the investigation and prosecution activities to curb the illicit use of public funds at the highest level. Also, we agree with the need for additional actions to enhance the audit of public accounts, including through strengthening the Audit Office's supervisory power.

Financial Sector Policy

We agree with the staff's view that maintaining financial stability is important to support long-term growth. We agree with the staff's call for the continuing efforts to appropriately fund the emergency lending assistance framework. While we support that central bank is working towards bolstering its emergency liquidity assistance, could staff provide us with information on the current level of ELA resources? Also, we encourage the authorities to continue taking the necessary measures for ensuring financial stability, such as strengthening cross-border cooperation, enhancing the risk-based supervision, and approving the bank resolution legislation in line with best practices.

Mr. Fachada and Mr. Antunes submitted the following statement:

We thank staff for the report and Mr. Villar and Mrs. Del Cid-Bonilla for the informative statement. El Salvador's economy is in an inclusive development trajectory, having delivered substantial social gains over the last ten years. Nevertheless, despite the authorities' efforts, putting the public debt ratio in a clear downward path and guaranteeing external sector sustainability remain pressing challenges. Inasmuch as risks are tilted to the downside, the new administration that takes office on June 1st should use the current window of opportunity wisely to rebalance the economy and increase potential output.

El Salvador has had a consistent economic performance over the last decade, with moderate per capita GDP growth. Forecasts for 2019 are positive, and growth is expected to remain around 2.5 percent. Looking forward, the priority should be increasing potential output and guaranteeing the sustainability of the inclusive growth model, which will allow for further poverty reduction.

We take note that, according to staff, growth has been slightly above potential. A similar assessment could be found in the 2018 Article IV report. At the same time, we notice that inflation remains under control, being forecasted to slow down to 0.6 percent in 2019. Taking into account that, in the case of El Salvador, above potential growth is not resulting in higher inflation, as it would be expected, we encourage staff to take a more cautious approach to potential growth estimates, particularly when the discrepancy between potential and actual growth is minimal. Measuring potential GDP is inherently difficult, and perhaps accepting some degree of uncertainty and defining a potential growth range rather than a point estimate would be more appropriate. Staff's comments are welcome.

The authorities are taking important fiscal consolidation measures, but the debt dynamic is still cause for concern. Since 2017, El Salvador is delivering increasing primary surpluses. Nevertheless, given the public debt stock and the relatively high financing costs, overall balance remains negative. The approval of several fiscal laws in December 2018 and the strengthening of the Fiscal Responsibility Law (FRL) reveal a broad political and social consensus in El Salvador about the importance of putting the debt ratio on a firm declining path. We agree with staff that the good economic moment should be seized to frontload fiscal adjustment, and that additional efforts will be necessary to meet the ambitious targets set by the FRL. Nevertheless, we take note of Mr. Villar's and Mrs. Del Cid-Bonilla's assessment that a more gradual pace of implementation of the fiscal adjustment would still be consistent with the FRL. We believe that El Salvador has given proof of its commitment to macroeconomic stability and that the authorities are better placed to define the adequate pace of fiscal consolidation, taking into account implementation and political economy concerns.

Accelerating economic activity coupled with some real effective exchange rate overvaluation is increasing external imbalances. The current account deficit is on the rise, boosted by increasing imports and stagnating exports. We second staff's multifaced recommendations to improve the competitiveness of Salvadorian exports in a context of full dollarization, but note that all these recommendations take long to yield results. We agree that diversifying productive activities and advancing towards regional integration with Honduras and Guatemala is crucial to improve the long-run perspectives of the economy, reducing dependency on remittances. Creating fiscal space to boost investments in infrastructure and human capital are also key to elevating output potential and rebalancing the economy in the long run. The authorities' efforts at reducing informality and the gender gap in the labor force are steps in the right direction.

Risk are tilted to the downside. Therefore, the authorities must use the current window of opportunity wisely. Uncertainty in US economic and immigration policies over the next years could have negative impacts on El Salvador's economy, particularly if coupled with rising interest rates and further US dollar appreciation. In this challenging scenario, the authorities should strike a delicate balance between preserving the inclusive development trajectory and guaranteeing fiscal and external sustainability.

Mr. Ostros and Ms. Skrivere submitted the following statement:

We thank staff for an interesting report and Mr. Villar and Mrs. Del Cid-Bonilla for their comprehensive buff statement. While El Salvador's economy continues to perform well, more efforts are needed to sustain the growth momentum and boost the economy's potential over the medium- to long-term. We broadly share staff's appraisal and offer the following comments on fiscal policy, governance issues, and structural reforms for emphasis.

We encourage the authorities to consider a more frontloaded fiscal adjustment path. We commend the authorities for their spending restraint. However, while the primary fiscal surplus increased last year, the overall fiscal deficit deteriorated, and public debt continues to trend upward from an already high level of around 70 percent of GDP. The fiscal laws approved at the end of last year are important and welcome steps towards improving fiscal discipline, as illustrated also by credit rating agencies' upgrades. Nevertheless, there is no room for complacency. Given the current relatively favorable growth outlook, we share staff's recommendation to frontload the fiscal adjustment to 2019-20, which would help achieve the public debt target set in the Fiscal Responsibility Law. We found staff's analysis on the timing and composition of fiscal adjustment in Box 1 particularly helpful.

Governance issues should be tackled more forcefully. While the authorities have adopted several helpful measures to address the issue, crime, theft, and corruption continue to be the key reasons behind outward migration, poor business climate, and lower economic activity. Therefore, we urge the authorities to intensify their efforts to address governance, fiscal transparency, and financial integrity issues. We welcome the establishment of the high frequency monitoring system of capital flows, nevertheless further strengthening of the AML/CFT framework is necessary.

A broad range of structural reforms could boost El Salvador's long-term economic growth potential and ensure better living conditions for the population. While the situation has improved notably over the past years, we encourage the authorities to continue their efforts to improve the business environment, strengthen the education system, address informality, and reduce the gender gap. We take note of staff's recommendation that public-private partnerships (PPPs) could be explored to limit the fiscal impact of infrastructure investment. However, we stress the importance of appropriate governance and accountability frameworks and emphasize that potential contingent fiscal risks arising from PPPs should be carefully monitored.

Ms. Levonian, Ms. McKiernan and Mr. Williams submitted the following statement:

We thank staff for their comprehensive report and Mr. Villar and Ms. Del Cid-Bonilla for their informative buff Statement. The economy continued to perform well with growth above potential, inflation contained, and an improved fiscal position. Nevertheless, debt and poverty remain elevated. Security and corruption concerns have dampened the business climate and discouraged investment. To mitigate these vulnerabilities, policy should focus on measures geared at putting debt on a firm downward trajectory, improving public safety and governance, and raising and sustaining inclusive growth. We broadly concur with staff's assessments and recommendations and offer the following remarks for emphasis.

We welcome the authorities' decision to undertake further fiscal consolidation. El Salvador has made steady progress in improving its public finances, which has boosted the country's creditworthiness. The strengthened fiscal responsibility law (FRL) is a key institutional enhancement to entrench fiscal discipline and anchor debt on a downward path. Staff's recommended 1.9 percent of GDP adjustment over the next two years is estimated to lower debt to 50 percent of GDP, below the FRL 60 percent target. At the same time, El Salvador faces vast socio-economic challenges and critical areas, such as crime fighting and audit, need more resources. We invite staff's comments on the merits of a more gradual fiscal adjustment that would still keep debt in line with the FRF requirements. Efforts to mobilize revenue and undertake broader public sector reform, including by upgrading debt management capabilities and enhancing public procurement will be instrumental in preserving fiscal sustainability and durably reducing debt.

The authorities should sustain the momentum on strengthening financial sector resilience. We take positive note of the sound macroprudential indicators and the solid and broad-based credit growth, which are integral to fostering economic expansion. Relatedly, the economy's strong reliance on remittances underscores the criticality of intensifying efforts to advance financial inclusion. Looking ahead, the enactment of a resolution framework, as well as implementation of measures to strengthen supervision and regulation will be key to reinforcing financial sector stability. Further, while efforts to bolster emergency liquidity assistance (ELA) are welcome, it is imperative that the facility functions as a last resort channel to satisfy liquidity needs.

Deeper structural reforms are integral to improve the economy's competitiveness and foster inclusive growth. Curtailing crime, upgrading human capital, and improving the governance and regulatory frameworks should be key components of the authorities' reform package. Measures implemented to fight corruption, enhance the AML/CFT framework, and control crime are steps in the right direction and should be accelerated, including by better leveraging technological solutions. Furthermore, we urge the authorities to prioritize strengthening of the PFM framework. This is crucial for improving spending efficiency, safeguarding state resources, and freeing up fiscal resources into critical areas such as education, in particular for women/girls, and infrastructure.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the detailed report and Mr. Villar and Mrs. Del Cid-Bonilla for their informative buff statement. El Salvador has accomplished noteworthy progress in its macroeconomic performance in the more recent past. Growth has increased to above the potential with the support of the recent surge in remittances. Inflation has been low and stable, and expected to remain low, moving forward. The primary surplus has increased, reflecting improved fiscal performance, which however has offset by the rising interest bill. Poverty and inequality have declined considerably over the last decade. We positively note the political cooperation to secure the agreements on fiscal issues and financing, which led to an upgrade of the country's sovereign rating by Standard & Poor's.

However, going forward, El Salvador faces significant challenges. The average growth rate has been low, dragged by lackluster TFP and low private investment. Weak competitiveness, low human capital, high crime rates and susceptibility to shocks have also negatively impacted the country's economic progress. Public debt remains high, with sizable medium-term financing needs. The current account deficit has widened due to a sharp slowdown in exports and broad-based increase in imports, and projected to widen further in the medium-term. The uncertainty on the temporary protected status (TPS) continues and could affect remittances from the US. Hence, we encourage the authorities to build on the recent progress by using the ongoing smooth political transition to address structural and macroeconomic impediments, facilitate sustained growth, address social challenges, and improve resilience to macroeconomic and natural disaster shocks. We broadly agree with the thrust of staff's appraisal and would like to make following remarks for emphasis.

Continued efforts to ensure fiscal sustainability will help reduce public debt gradually. For this, we agree with staff on the need for a well-designed fiscal consolidation process. In this regard, the recent strengthening of the Fiscal Responsibility Law (FRL) by requiring debt to be put firmly on a declining path and by introducing an anchor for public debt of 60 percent of GDP by 2030, is a commendable step forward. Could staff comment on the feasibility of the envisaged 2 percent fiscal adjustment over 2019-21 in a frontloaded manner? We encourage the authorities to continue with the plans to strengthen tax administration, including the implementation of electronic invoicing, as well as combating base erosion and profit shifting (BEPS). Could staff broadly comment on the plans to modernize the country's international taxation framework in combating BEPS? The rising interest bill is a concern and measures to curb public wage bill, along with civil service reforms, are essential to reduce medium-term fiscal pressures. Further improvements in public financial management, including public procurement, also has a key role to play. In this process, adequate resources to support high growth and meet social spending should be ensured. We commend the authorities for effectively securing financing for the US$ 800 million Euro bond payment.

The banking sector has been resilient and well-capitalized. NPLs remain low with high provisioning. However, reforms are required to improve financial stability and channel credit to productive sectors. Hence, we support the staff's recommendations related to the emergency liquidity assistance (ELA), crisis management and resolution, and supervision and regulation. Cross-border cooperation also needs to be strengthened. Liquidity management should be continued to improve while ensuring the smooth functioning of the re-activated interbank market. Enhancing financial inclusion is also important to have a meaningful impact on growth. While commending the ongoing measures to put in place a system for high frequency monitoring of financial flows, we stress the need for further improving the AML/CFT framework and welcome the international cooperation with the US Treasury to implement related measures.

Far reaching structural reforms are vital to enhance potential growth. This particularly requires reforms to address still prevailing gaps in business environment, enhance export competitiveness and improve private sector participation. We agree that trade and investment reforms, addressing gender gap on labor force participation, and investment in education, vocational training and innovation, are among the other key areas in this respect. Corruption has been identified by the 2018 Global Competitiveness Index as the second most problematic factor for doing business in El Salvador, after crime and theft, underscoring the need for related reform measures. We positively note the progress of El Salvador Seguro Plan and stress the need for its continuation with increased funding to lower homicide rates and combat extortion, while drawing from international experiences. Could staff comment on the extent that the crime and violence has made doing business more expensive while negatively affecting investment decisions and hindering job creation in El Salvador? Authorities are also encouraged to steadfastly continue the reforms to enhance governance and anti-corruption framework, following a strategically prioritized path, as recommended by the staff.

Strengthening resilience to natural disaster risks is also vital in El Salvador. Given the potential to extreme climate variability, ex-ante mitigation measures and adaptation is important to facilitate sustainable long-term growth. Could staff comment?

With these remarks, we wish El Salvadorian authorities all success in their future endeavors.

Mr. Inderbinen and Mr. Imashov submitted the following statement:

We welcome the robust performance over the surveillance cycle. The economy of El Salvador has been growing above potential, and staff expect the momentum to continue. We note the gains in alleviating poverty and addressing inequality. However, the high level of public debt continues to be a matter of concern, as underlined by the increased debt service resulting from higher interest rates. The currently strong economic performance is an opportunity to further improve the fiscal position. We note the broad agreement on many of the policy issues between staff and the authorities, as mentioned in Mr. Villar and Ms. Del Cid-Bonilla's helpful buff statement.

Deeper reforms are needed to preserve the progress made on fiscal consolidation.

Recent legislation to strengthen the fiscal framework is encouraging. This said, we note staff's finding that the introduction of a permanent operational target would be critical to further improve the fiscal rule. How do staff assess the authorities' intentions in this regard? We agree with staff that a comprehensive fiscal reform is needed to expand the tax base and make the system more equitable. The measures initiated by the authorities to this end are welcome, as is agreement on the size of fiscal consolidation that is called for. Could staff elaborate on the reasons why the authorities prefer a more gradual consolidation, despite the clear case for frontloaded adjustment of the fiscal position?

Financial sector stability should be strengthened further. We welcome the efforts to align the regulatory framework to the Basel III standards, including by amending legislation for liquidity, market, and credit risk management, and we agree with staff's call for enhancing risk-based supervision and ensuring that credit bureaus have access to information. We note measures undertaken to fight corruption and encourage the authorities to progress further in the areas highlighted in the staff report. We note the work underway to enable the Financial Investigation Unit to rejoin the Egmont group, which would be a welcome indication of the authorities' commitment to AML/CFT.

Further structural reforms would be beneficial to attract investment and raise potential growth. Reforms should focus on improving the investment and business climate, and on higher job creation, including in the tradable sector. Given the country's susceptibility to natural disasters and climate variability, strengthening climate-related policies would also facilitate long-term growth and sustainability.

Mr. Sylla, Mr. Nguema-Affane and Mr. Ondo Bile submitted the following statement:

We thank staff for the concise reports and Mr. Villar and Mrs. Del Cid-Bonilla for their informative buff statement.

The economy of El Salvador continued to perform well in 2018 and the reinvigorated reform momentum bodes well for future growth. Despite the drought that affected agricultural production, the economy grew further in 2018 supported by strong remittances with low inflation and comfortable international reserves. However, public debt remains elevated and projected gross financial needs are sizable. Looking forward, the medium-term economic prospects are positive propelled by strong remittances, with inflation expected to remain subdued. However, those prospects hinge on continuous implementation of structural reforms to enhance macroeconomic stability and support higher and inclusive growth. In addition, further progress to continue strengthening the governance frameworks will be necessary. We broadly agree with staff policy recommendations going forward and will provide the following comments for emphasis.

Further fiscal adjustment is needed to ensure compliance with the fiscal and debt targets under the Fiscal Responsibility Law (FRL). We welcome the realization of a fiscal surplus and the adoption of recent measures to strengthen public financial management in 2018. In this regard, the recent approval of fiscal laws and the amendments to Fiscal Responsibility Law, and the improvement in the preparation of the budget are positive developments. That said, we welcome the authorities' recognition that further fiscal adjustment is needed to put debt on downward path and comply with the FRL, as the pace of current adjustment is insufficient to reach the fiscal and debt targets under the FRL. Sustaining the ongoing fiscal reforms together with additional structural fiscal measures under a comprehensive fiscal reform will be essential to this end.

The continuous soundness of the banking sector, the ongoing strengthening of the supervision framework and the sustained efforts to increase financial inclusion are encouraging. We note that the banking system is well-capitalized, liquid and profitable with low and well-provisioned non-performing loans. We see merit in the authorities' agreement with staff's recommendations to enhance financial sector stability, notably by accelerating the approval of the bank resolution law, increasing the resources of Emergency Liquidity Assistance and strengthening cross border supervision. Progress made in advancing financial inclusion is commendable. We welcome the authorities' commitment to further advance financial inclusion with the creation of the National council for Financial Inclusion and the consideration of greater use of Fintech services to sustain their efforts in this area.

We support the authorities' efforts aiming to improve the business climate and raise growth potential. We commend the Salvadoran authorities for the implementation of sound structural policies which resulted in significant improvement in social indicators and contributed to sustained growth over the past decade. Going forward, reform momentum should be maintained to further enhance the business climate by lifting barriers to trade and investment. Structural reforms should also focus on increasing physical and human capital stock with a view to strengthening the economy's competitiveness and attracting higher foreign investment. Moreover, further work is needed to tackle corruption and crime, which are identified as main problematic factors for doing business in the 2018 Global Competitiveness Report.

Remarkable progress has been achieved in enhancing the governance and AML/CFT frameworks and should be pursued. The citizen participation in the design, implementation and monitoring of public policies is particularly worth noting. Yet, according to the authorities, public perception of corruption is not improving despite the adoption of the Law on Access to Public Information. Could staff elaborate on this?

With these remarks, we wish the Salvadorian authorities every success in their future endeavors.

Mr. Kaya and Mr. Stradal submitted the following statement:

We thank staff for their informative paper and Mr. Villar and Mrs. Del Cid-Bonilla for their helpful buff statement. The Salvadoran economy has recently grown steadily which contributed to improved social outcomes. However, the recorded growth between two and three percent does not seem to be sufficient to lift large segments of the population out of poverty and put the government debt ratio on a sustainable downward path. We concur with the thrust of staff's appraisal and policy advice.

We welcome the adoption of the Fiscal Responsibility Law recognizing the elevated fiscal risks. We support staff's call to take advantage of the current favorable macroeconomic environment and frontload the fiscal consolidation efforts, which would send a strong signal to the financial markets, boosting the authorities' credibility with a potential positive knock-on effect on the borrowing rates. Given the relatively high government revenue ratio, the brunt of the consolidation should be borne by current expenditures, in particular the public sector wages.

We welcome the well-capitalized banking sector with a stable loan-to-deposit ratio and reduced external liabilities. We take positive note of the broad agreement on the need to enhance financial sector stability by establishing a bank resolution framework, improving the banks' liquidity management, and strengthening the bank supervision and financial flow monitoring. We encourage the authorities to implement the planned levelling of the playing field by aligning the reserve requirements for cooperative banks with those of commercial banks.

Despite the recent decline in the homicide rate, El Salvador still has one of the highest levels of violent crime in the world. The continued determined fight against gang violence is a key condition for unlocking the development potential. We welcome Box 2 which summarizes the recent government initiatives as well as some international experience which could help El Salvador in eradicating gang violence. The recently adopted measures to improve the governance and anti-corruption frameworks are important ingredients of a multi-pronged strategy to reduce crime and informality in the economy. They should also be complemented by well targeted social spending and improved early childhood education coverage.

Finally, we wonder whether the outsized importance of the remittances in the Salvadoran economy should not be explicitly recognized in the risk matrix. The external risks include rising protectionism, a sharp tightening of global financial conditions, as well weaker-than-expected global growth which applies to every other emerging market economy. Staff recognizes the importance of the US labor market for the remittances to El Salvador in the graph on page 5 and the close alignment with the outlook for the US economy on page 7, which may warrant including the slowdown in the US specifically and less open labor market in the US among the key external risks to make the risk matrix less generic. Staff's comments are welcome.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

We thank staff for the report and Mr. Villar and Mrs. Del Cid-Bonilla for the helpful buff Statement.

El Salvador's economy continues to perform well—growth last year was above potential, inflation remained low and stable, and fiscal balances improved. That said, potential growth is still too low to meaningfully enhance social outcomes, slow emigration, and improve debt dynamics. The smooth political transition has provided renewed space for the authorities to advance their economic reform agenda, which should prioritize efforts to improve growth outcomes. In addition, we urge the authorities to address weak public finances and structural competitiveness issues—such as crime, corruption, and limited human capital—and we appreciate that staff have provided actionable recommendations to these ends. We broadly agree with staff's appraisal and would like to emphasize points in three areas:

Fiscal: El Salvador's high public debt is a key risk, and high financing costs crowd out much-needed social and capital expenditures. We commend authorities for the important steps they have already taken to consolidate the fiscal position, including pension reforms, and legislate a strengthened Fiscal Responsibility Law. Compliance with the FRL's debt anchor by 2030 will require sustained efforts. Box 1 helpfully discusses the relative fiscal multipliers of potential measures, and we urge the authorities to focus on growth-friendly measures, as staff recommend. We would have liked to see staff discuss the political feasibility of such measures in Box 1 to help gauge the trade-offs—particularly since the buff Statement expressly conveys that VAT increases are not plausible in the short term. Staff comments on the political feasibility of measures in Box 1 would be welcome.

Efforts to strengthen public debt management, including by developing a medium-term debt strategy framework, would help contain financing costs and lower roll-over risks. We welcome Fund technical assistance in this area. Could staff provide more information about the scope and timing of planned reforms in this area?

Long-term growth potential: The authorities have made commendable progress to reduce poverty and improve social outcomes over the past decade. Higher economic growth, however, is needed to increase domestic employment opportunities. Further, poverty rates are still high, and a strong focus on improving competitiveness, fighting crime and corruption, and boosting human capital are critical to bring El Salvador more in line with regional peers. We appreciated Box 2, which shared successful strategies from other countries to address gang violence. This has been an area of commendable success in recent years for El Salvador, and we support continued progress on this front.

Regarding staff's recommendation to increase public infrastructure, we underscore the importance of having a sound public investment selection and management framework in place prior to scaling up PPPs. A clear and transparent debt management framework will also be critical in this regard.

We support staff's recommendations to remove barriers to trade and investment. The creation of a customs union with Guatemala and Honduras is a welcome first step.

Governance and corruption: We welcome the authorities' efforts to improve governance frameworks and agree with staff that further efforts are needed to improve the business environment and incentivize private investment. We appreciated staff's clear recommendations on this front. Recognizing that overhauling governance frameworks takes time, we also appreciated staff's efforts to help prioritize near-term reforms that can deliver high-impact results.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We welcome the discussion on the recent developments and policy challenges in El Salvador and thank Mr. Villar and Mrs. Del Cid-Bonilla for their informative BUFF statement.

Over the past several years the economy has been growing at a rate of about 2.5 percent, which, however, is not enough to assure the convergence of income levels in El Salvador and the United States. High inequality and still high poverty rate aggravate this economic challenge. Persistent difference in income levels and the presence of already very large diaspora abroad mean that reliance on migration and remittances is likely to remain the key feature of the economy in the foreseeable future. Given the likely moderation in growth of remittances, staff project somewhat slower economic growth in the medium term. At the same time, we note that recent political changes may offer a window of opportunity for implementation of fiscal consolidation and acceleration of structural reforms.

We welcome the authorities' efforts under the El Salvador Seguro plan to address pervasive crime and the lack of security in the country. Staff mentioned in the report that about ninety percent of businesses were subject to extortion by gangs. Are there any estimates of the related financial burden on small and medium size enterprises? Box 2 of the Article IV report mentioned the fight against crime as a key policy priority for the authorities and even referred to successful strategies from international experience. Do staff consider this area as macrocritical for El Salvador? Should it be addressed by the IMF staff, probably, in collaboration with other experts? In addition, in staff's opinion, how does the fight against crime affect governance in the country?

We agree with staff on the need for continuing fiscal consolidation. The list of options suggested by staff in the table on page 12 is appropriately specific on the available options. At the same time, we would invite staff to elaborate on any additional options in this area. For example, in paragraph 18 staff implied that a property tax could be a useful revenue generating measure. Another possible reform would be the increase in the retirement age. We are also concerned about the suggested pace of fiscal consolidation in the amount of almost 2 percent of GDP in 2019-2020. It would be useful to provide additional justification for this strategy and more details on the small growth effects of a frontloaded approach.

Ms. Mahasandana and Ms. Pandit submitted the following statement:

We thank staff for well-written report and Mr. Villar and Mrs. Del Cid-Bonilla for their informative buff statement. El Salvador made significant social and economic progress in the past decade. Nevertheless, the country continues to face challenges of high poverty and unemployment, a large informal sector, and corruption. Despite these significant challenges, the real GDP growth remained above its potential at 2.5 percent in 2018 as noted in the buff. We commend the authorities' efforts to strengthen the economic foundations through the structural reforms, reinforced policy frameworks and manage a smooth political transition. However, maintaining the public debt sustainability remains critical. We broadly agree with the thrust of staff's appraisal and would like to raise the following comments for emphasis.

A front-loaded fiscal adjustment is warranted to ensure debt sustainability and macroeconomic stability. Higher financing costs, and weak revenue mobilization led to rising concerns over debt sustainability. We note from the public debt sustainability analysis that interest rate alone contributed to 3 percent of GDP increase in the debt stock and thus we concur with the staff recommendation to implement fiscal reforms with a goal of bringing down the public debt at reasonable level. We commend the authorities' effort for improving primary fiscal balance along with strengthening the Fiscal Responsibility Law (FRL) and public financial management. We also underscore the importance of rationalization of tax rate and effectiveness of debt management practices to cut down the borrowing cost. We welcome the authorities' commitment to conduct a comprehensive fiscal reform over the medium term to eliminate distortions from the temporary and ad hoc measures, to conduct of tax coding system and employ of digital invoicing system.

Further financial sector reform is needed to maintain financial stability and promote financial inclusion. The financial sector has been resilient, with well-capitalized banks, low NPLs, and high profitability. We take positive note that banks have reduced external liabilities in response to tighter global financial condition. However, further reforms effort is needed to foster resilience over the longer term. Staff's recommendation to modernize the supervision framework and to strengthen the lender of last resorts, crisis management and resolution framework are critical to enhance financial stability. In this regard, reactivating interbank market functions, further strengthening cross-border cooperation on ELA, and ensuring compliance of sector-specific credit measures with the risk-based supervision framework are essential steps going forward. At the same time, there is scope for improving financial access through mobile money as well as fintech services. In this vein, establishment of National Council for Financial Inclusion (CNIF) is a welcome step.

Structural reforms to improve competitiveness and promote more inclusive growth should be prioritized. We positively note that the government has emphasized to establish the foundation for sustainable growth, but physical capital and TFP remain low mostly due to insufficiency of public infrastructure and lackluster private sector investment. In this context, we see merit in staff's recommendation to increase provision of infrastructure through the public private partnership, invest in education for human capital accumulation, formulate a concrete plan to reduce informality, and reduce gender gap to boost long-term growth. The proactive reform is still needed to address the structural and macroeconomic impediments. We appreciate the authorities' efforts intended at improving the security situation and business climate and uplift the country's competitiveness. We encourage the authorities to further strengthen the AML/CFT framework and lay a strong foundation to address crime and corruption. In addition, steadfast implementation of community base program is essential to address early dropout of childhood education for higher human capital accumulation and disincentivize crime and gang involvement.

A Strong governance framework is vital for long term growth prospective. While the country continues to deal with crime-related problems, weak governance frameworks and corruption could further add negative impact and exacerbate inequality and poverty. We therefore concur with staff that prioritizing the governance goals is essential such as integrating the presidency's accounts in the budget laws with transparency and accountability. Similarly, strengthening anti-corruption law to harmonize them with international best practice, and enhancing independence and resources of the audit office are vital for strengthening the governance

With these comments, we wish El Salvador and its people success in their future endeavors.

Mr. Di Tata and Mr. Corvalan Mendoza submitted the following statement:

We thank staff for the report and Mr. Villar and Mrs. Del Cid-Bonilla for their informative buff statement.

Policy reforms have served El Salvador well, with socio-economic indicators showing important improvements in poverty and inequality in the past decade, as well as a reduction in migration to the US, especially after 2015. The institutions responsible for delivering public goods are being strengthened, with positive results. We concur with the staff's assessment and encourage the authorities to continue cementing El Salvador's economic modernization.

Although efforts are paying off, further progress is needed to tackle remaining social challenges, especially the still high level of violence and informality. It is encouraging to learn from Box 2 that important strides have been made in fighting crime under the plan El Salvador Seguro (2014-present). At the same time, important variables such as unemployment and poverty rates have declined. Despite these advances, crime and extortion syndicates are still depressing potential output, with the cost of violence being estimated at 16 percent of GDP in 2014 according to a study conducted by the central bank. Thus, strengthening the capacity of public institutions to tackle security and increase formalization remains a top priority. We understand that these areas are beyond the Fund's expertise. Could staff explain in more detail which institutions and development partners are helping the authorities address these challenges?

El Salvador's economic performance has been solid. Real GDP growth was 2 ½ percent in 2018, above its estimated potential. A further appreciation of the US dollar contributed to a significant decline in inflation and a wider current account deficit, while remittance inflows reached a record high. Gross international reserves have increased but remain below the level implied by the ARA metric. At the same time, public debt remains elevated at 70 percent of GDP. Downside external risks stem from slower-than-expected global growth and trade tensions. On the domestic side, could staff comment on the prospects for the new administration of obtaining legislative support for its reform agenda?

We welcome the important fiscal laws approved by the Legislative Assembly in December 2018. These include the strengthened Fiscal Responsibility law (FRL), the budget approval, the authorization for external financing, and the electronic invoicing law. Going forward, we agree with staff that a frontloaded fiscal adjustment is required to reduce the public debt to about 50 percent of GDP by 2030, a prudent level for El Salvador.

We take positive note of the authorities' agreement with the size of the staff's recommended adjustment of about 2 percent of GDP and welcome that several measures proposed by staff are under consideration. We understand from the buff statement that the authorities intend to proceed with the adoption of tax administration measures, including electronic invoicing, the "monotributo", and the transfer pricing initiative, as well as with the introduction of excise taxes on luxury goods and measures to enhance the procurement process and contain the growth of the wage bill. However, the authorities do not see an increase in the VAT rate as plausible in the short run. Could staff comment on other possible measures that could substitute for the proposed increase in the VAT rate, as well as on the feasibility of reforms to improve the efficiency and quality of subsidies and social spending? Going forward, we notice that the authorities agree that a comprehensive fiscal reform is needed to eliminate distortions. Could staff also elaborate on the authorities' plans regarding the property tax and pension reform? We also encourage the authorities to develop a medium-term debt strategy and strengthen the FRL.

Further efforts are needed to scale up private and public investment. The report notes that the county lags most regional peers in private investment rates and human capital. We concur with staff that increasing investment in public infrastructure could serve as a catalyst for private investment and that public-private partnerships (PPPs) could be an option to limit the fiscal impact. Efforts should also continue to reduce crime and combat extorsion to improve the business climate. In addition, increasing investments in early childhood education would encourage higher female labor participation, while flexible education and training programs would facilitate reinsertion in the education system. We welcome the completion of the Northern Triangle Customs Union, which would allow intraregional trade and investment to increase, as well as the efforts under way to reduce the gender gap through the National Gender Equality Plan and the Gender Seal certification program.

In the financial sector, banks remain well-capitalized, profitability has increased, and non-performing loans have declined to low levels. We encourage the authorities to proceed with their plans to implement the staff's recommendations to enhance financial sector stability, including by approving the bank resolution law; appropriately funding the emergency lending assistance framework; further strengthening supervision and regulation; and promoting financial inclusion by using simplified bank accounts for lower risk customers and widening access to fintech services.

Although we welcome the measures adopted by the current administration to improve the governance framework, additional efforts are also needed in this area. In particular, it is necessary to further strengthen fiscal transparency and the audit of fiscal operations and to fully address remaining weaknesses in the anti-corruption framework. We take positive note of ongoing efforts by the Superintendence of the Financial System to support anti-money laundering through a system for high-frequency monitoring of financial flows.

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

Mr. Heo and Mr. Khurelbaatar submitted the following statement:

We thank staff for the informative report and Mr. Villar and Mrs. Del Cid-Bonilla for their insightful buff statement. El Salvador enjoyed better than anticipated growth in 2018 thanks to the increased remittances and increase in public capital spending. The banking sector is sound with sufficient liquidity and low NPL levels. Although El Salvador accomplished solid results over the last decade, poverty and unemployment is still very high, the public debt is elevated, the financial inclusion is low and crime rate is high. The authorities need to undertake structural reforms to uplift the country's growth potential, reduce macroeconomic imbalances to alleviate poverty and inequality in the country. We broadly concur with the report and have the following comments for emphasis.

Fiscal frontloading of adjustment is important to contain the debt growth. We welcome the fiscal consolidation efforts in the last two years which resulted in the primary balance surplus. But overall fiscal deficit is still large and without corrective measures the public debt will continue to rise. The fiscal cost for interest payments increased rapidly in recent years and public debt sustainability analysis shows that interest rates are the major contributor to the public debt increase. Without changing the upward debt dynamics, it will be difficult for the authorities to free up more fiscal space to invest into important areas of the country's development. Hence, we agree with staff that frontloading the fiscal adjustment will firmly place public debt on a downward path and will allow it to reach the level of public debt outlined in the Fiscal Responsibility Law. Reduction of energy and transport subsidies and rationalizing the current spending could be areas where the authorities could reduce the fiscal expenditures. In this light we align ourselves with staff that the Fiscal Responsibility Law could be improved—the law should aim towards fewer and higher priority targets, mainly on debt anchor to strengthen fiscal discipline and reduce the risk of conflicting fiscal policy objectives.

Continued U.S. dollar appreciation led to widening of the current account deficit and the level of international reserves continues to be significantly below the adequate level implied by ARA benchmark according to External Sector Assessment (Annex II). The real effective exchange rate is appreciated by 3 percent in 2018 and that real exchange rate is estimated to show overvaluation of 4-6 percent. But appreciating currency would hurt the competitiveness of the economy, which probably had to do with the slowdown in exports in 2018. We concur with the staff appraisal that more investment in education and training, increasing access to finance, supporting for R&D investment, and providing entrepreneur-friendly environment are required. We welcome staff's elaboration on what measures the authorities are advised to take in response to external risks in the near term, given that the above-mentioned recommendations are to be pursued for longer-term perspective.

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

Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for the clear report, as well as Mr. Villar and Mrs. Del Cid-Bonilla for their helpful buff statement. We commend the authorities for their fiscal efforts and the progress made to reduce inequality which has reached the lowest level in the region. However, several challenges remain, mainly structural ones, to decrease the still high poverty level, to put public debt on a downward path, to fight criminality and reduce informality. We share the thrust of the staff appraisal and would underscore several points:

Economic outlook

The economic outlook remains relatively favorable, but we concur with staff that risks are titled to the downside. A dollarized and open economy, Salvador is heavily exposed to the United States policies and economic fluctuations. The protectionism risk mentioned in the RAM is identified as the most important one, and a worsening of the tensions at the global or regional levels could have significant negative effects. Against this background, we welcome the completion of the Northern Triangle customs union with Honduras and Guatemala, which will contribute to mitigate these adverse spillovers. As Salvador relies heavily on remittances revenues, which reached a record of 20.7 percent of GDP in 2018, a growth slowdown in the US more pronounced than anticipated, or a cancellation of the Temporary Protected Status (TPS) of the Salvadoran migrants in the US, could have significant adverse impacts on the economy. Moreover, we also note the significant widening of the current account deficit (from -1.9 percent in 2017 to -4.8 percent of GDP in 2018), as remittances helped to boost imports. The external position is assessed as moderately weaker than the level implied by fundamentals. Could staff provide an update on the TPS holders'issue? Could staff indicate in which extent negative shock on remittances could affect the external position?

Fiscal policy

Putting debt on a downward path is a priority, while we encourage the authorities to pursue their efforts to protect the poorest. The debt level remains high at 70 percent of GDP. We welcome the strengthening of the FRL in December 2018 but see the high borrowing costs as the main issue to be addressed as interest rates is the major contributor to the upward debt dynamics, as underlined in the DSA. If additional frontloaded measures, as preconized by staff, were to be implemented (to have a fiscal consolidation of 1.9 percent of GDP in 2019-2020), caution will be needed to avoid the adverse impact on social spending and public investment. However, we note positively the staff proposal regarding additional social spending to offset the regressive effects of a potential VAT increase and strongly encourage the elimination of the 0.7 percent of GDP social assistance and subsidies to the top two quintiles of the income distribution. We also find the idea of a property tax to address long term fiscal challenges as interesting. Could staff provide some assessment about the potential tax revenue that could be generated by a property tax? Do the authorities consider the creation of an independent fiscal council as preconized by staff considering the past poor track-record of compliance with the previous FRL? Could staff provide details on the ongoing analysis done by the Ministry of Finance about additional reforms of the pension system?

Monetary, exchange rate and financial policies

We welcome the progress made to improve the AML/CFT framework through high frequency monitoring system of capital flows and encourage the authorities to enhance their efforts. As staff assessed progress of Basel II/III implementation as mixed and that ELA resources are insufficient, implementing vigorous action will help to enhance the financial sector stability. We applaud the authorities' efforts to improve financial inclusion, which remains low, especially through the access to mobile services.

As reserves are under the adequate level implied by the ARA metrics adjusted for dollarization, but adequate against the traditional metrics, we see some room for increasing reserves to a more comfortable level to ensure the resilience against external shocks.

Structural reforms

We consider boosting potential growth as key to improve the convergence process. The growth rate remains moderate, the negative contribution of TFP to real GDP growth since 2012 remains a concern, and population growth over the next years should remain very low according to the UN. Could staff give an update about the reasons of the low population dynamic both in the recent years and anticipated, and the role of emigration in this movement? As fiscal space should improve in the coming years, we encourage the authorities to boost spending in education, as weaknesses in the system seem widespread, with notably the high school dropouts. Investment dynamics is also limited by the poor business climate, and despite of the welcomed progress with El Salvador Seguro Plan, which represents a good start to reduce the high crime, the country continues to have one of the highest homicides rate in the world, and more globally security issues. Strong action must be pursued for the well-being of the population, and to restore attractiveness. We also encourage more initiatives to reduce the high poverty, one of the main challenges to be addressed with a level of 30 percent of population. However, we applaud the efforts made to reduce inequalities which have reached the lowest level on the region. Finally, as informality plays a main role in the economy with 70 percent of total employment, we urge the authorities to implement a simplified tax code and looking forward to see the results of the National Registry of Procedure effective last February.

Mr. Jin and Ms. Zhao submitted the following statement:

We thank staff for the well-written paper and Mr. Villar and Mrs. Del Cid-Bonilla for the helpful buff statement. The Salvadoran economy has grown steadily which contributed to improved social outcomes. Propelled by positive investments, the growth momentum is expected to continue, with inflation expected to remain subdued. Over the medium term, positive prospects hinge on steadfast implementation of fiscal consolidation and structural reforms that are conducive to raising long-term growth. We broadly share staff's assessment and would like to make the following points for emphasis.

We welcome the authorities' fiscal consolidation so far and encourage the authorities to conduct further fiscal adjustment to addressing debt vulnerabilities. We commend the authorities' adoption of important fiscal reforms in recent years, including approving the Fiscal Responsibility Law (FRL) and implementing pension reforms which have contributed to a sensible improvement in the primary balance. Given the elevated public debt ratio, a comprehensive fiscal reform over the medium term is still needed to avoid worsening public debt dynamics and ensure fiscal sustainability. At the same time, it is critical that the measures are conducted in a growth-friendly way without undermining the benefit of most vulnerable people.

Maintaining financial stability is important to support long-term growth. We note that the banking system is well-capitalized, liquid, and profitable with low and well-provisioned non-performing loans. Financial sector reforms such as strengthening the ELA framework and resources, introducing Basel III regulatory standards, and enhancing risk-based supervision will further bolster financial stability. Going forward, deepening financial inclusion is important to support long-term growth.

A wide range of structural reforms is vital to enhance potential growth. Efforts to fight crime and corruption should remain a key priority in the government's agenda. Stronger transparency and improved legal frameworks play an important role in reducing opportunities for corruption. Potential growth could be further raised by increasing the provision of public infrastructure, investing in education to improve human capital accumulation, and removing barriers to trade and investment.

With these remarks, we wish the authorities every success in their policy endeavors.

The Acting Chair (Mr. Furusawa) noted that Directors had commended the authorities for policies that had contributed to strong economic performance and a decline in poverty and inequality. However, they also noted that El Salvador faced external and domestic challenges, and stressed the importance of a fiscal adjustment to put debt on a firm downward path. Directors also emphasized the need to facilitate structural reforms to boost long-term growth, strengthen governance and anti-corruption frameworks, tackle crime, and to further improve financial stability.

The staff representative from the Western Hemisphere Department (Ms. Carare), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank the Directors for their insightful gray statements, to which we have already provided written answers to all of their questions. I would also like to thank the Salvadorian authorities for the candid and constructive discussions and for their great hospitality. I would like to focus on three themes that spanned many of the issues that were raised: first, to put in context our policy advice; second, the pace of the fiscal adjustment; and third, the alternative structural measures to the suggested VAT rate increase.

First, the staff's overall policy advice is centered on fiscal adjustment, complemented by structural reforms to boost long-term growth, and a clear prioritization of the actions needed to strengthen the governance and anti-corruption frameworks. This policy combination could send a strong signal to financial markets and have positive knock-on effects on borrowing rates, improving the unfavorable debt dynamics.

Second, frontloading the fiscal adjustment over two years, 2019 and 2020, rather than three years, would seize the favorable position at present in the economic cycle. Output is expected to be above potential only during these two years, and therefore, it could limit the drag on growth. Moreover, a frontloaded adjustment would take place at the beginning of the political cycle, locking in the credibility gains mentioned earlier. Such early gains are

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

also needed to reduce policy uncertainty and to overcome the current challenges facing the incoming administration.

There are two challenges. On the domestic front, the parliamentarian elections are scheduled for 2021. The main parties dominating the legislative assembly started to position themselves for the next elections by approving an increase in transfers to local governments without identifying financing sources. They are also dominating the local governments.

On the external front, financing pressures are mounting. In addition to the amortization payment of US$800 million due this December, a similar size of Eurobond amortization payments are needed every two years, starting with 2023.

Third, we had extensive discussions with the authorities, think tanks, the president-elect, businesses, and other international financial institutions to assess the feasibility of various alternative structural measures. For example, the staff initially considered the property tax over the VAT rate increase. Even a fast approval and implementation of such a tax, which is unlikely at this stage, should be used to finance the increase of transfers to local governments recently approved. Such a revenue source only mitigates the risk that we mentioned in the staff report and that has already materialized, and would not contribute to lowering the debt under the baseline. Additional increases in the property tax rates would not offset entirely the 0.7 percent of GDP needed to achieve the adjustment necessary to comply with the fiscal responsibility law. More aggressive measures to curb the wage bill are contemplated by some politicians, yet they are also difficult to implement politically. Other direct tax increases may harm competitiveness. Moreover, to limit the regressive nature of the VAT rate increase and the drag on growth, the staff suggested targeted transfers. When complemented with increased provisioning of public goods, education, security, and infrastructure, it should garner political support. While the authorities do not contemplate this measure at this time, we remain engaged with them to find a viable solution for fiscal sustainability that would also preserve the inclusive development model. These measures need to be identified and implemented to protect the significant social gains made so far before they are jeopardized by financing pressures or the next economic downturn.

Mr. Fachada made the following statement:

> I have two specific comments that I wanted to raise.
>
> First, on the timing of the mission, the Article IV discussion took place in El Salvador between March 11 and 22, after the presidential election that was seen as a rebuke to traditional political parties. The staff just mentioned that they met with President-elect Bukele, but it is not clear if they are also engaged with the economic team of the new president. Could the staff elaborate if the authorities' views only reflect the views of the current authorities or if they tried to capture the views of the incoming administration?
>
> My second point is an issue that the mission chief has just alluded to related to elections. The risk assessment matrix finds the risk of political fragmentation to be a medium-term risk to El Salvador, assessing that the country has a political system that allows for relatively frequent elections, exposing El Salvador to political uncertainty. However, El Salvador is not different from most democratic nations, except for the fact that legislative elections take place every three years. In other countries, in general, it is four years. I believe the presidential election in El Salvador takes place every five years. But the way this was framed in the risk assessment matrix, it sounds like "fear of democratic rule" is affecting El Salvador's economy.

The staff representative from the Western Hemisphere Department (Ms. Carare), in response to further questions and comments from Executive Directors, made the following additional statement:

> We met with President-elect Bukele, and during the campaign, we met with his adviser on economic issues. He had not yet appointed a finance minister or an economic minister. Therefore, the views that are incorporated in the report are the views of the outgoing administration. We promised the President-elect that we would come back in the fall, as usual. At that point, when he will have the entire team and when he will make public all his plans, we will assess them carefully, and we will issue a press release.
>
> On the second question, we commended the authorities for their strong and vibrant democracy. What we meant is that the presidents in El Salvador are not eligible for subsequent terms. They cannot run for re-election. Because of that, the political cycle is a little bit shorter, particularly this time, because he does not belong to any of the two traditional parties. The two traditional parties have dominated the political system for the past 30 years. At the same

time when governing, depending on his future plans, he needs to position for the next elections.

Ms. Del Cid-Bonilla made the following concluding statement:

On behalf of the Salvadorian authorities, I thank Directors for the valuable comments expressed in their gray statements and Mr. Fachada's comments, which I will promptly convey to the authorities.

I also want to express the authorities' special gratitude and recognition to the mission team for the candid and fruitful engagement and policy dialogue before and during the consultation. The authorities broadly agree with the staff's assessment and with most of their policy recommendations.

As a small, open, and fully-fledged dollarized economy, El Salvador still faces important challenges in both the social and economic arenas to boost long-term growth and to further reduce poverty and inequality, crime and informality, and to additionally improve the governance and corruption frameworks. However, the progress achieved during the past years laid the foundation for the work ahead.

Social indicators significantly improved over the past years. Sustained growth, along with the adoption of a comprehensive social agenda, allowed real per capita GDP to increase about 15 percent over the past decade, leading to an important reduction in inequality and poverty and a significant improvement in human and social indicators, while migration to the United States has declined, as the report highlights.

The implementation of El Salvador Seguro plan has contributed to a substantial reduction in crime rates. The authorities' intentions to strengthen the plan further were reflected in the projects and budgets approved.

With no majority in parliament, the authorities manage to achieve important political agreements that pave the way to advancing crucial topics for the country's development and growth. Among these reforms and the laws approved over the past years are the pension reform, the annual budget, the fiscal responsibility law reform, the external financing, the introduction of the electronic invoice, and the important loans for institutional strengthening and for social spending. The authorities were also able to enhance their macroeconomic statistics with the support of Fund's technical assistance, including the revising and updating of the national accounts.

The strong fiscal discipline and measures implemented have allowed the primary fiscal balance to improve 1.1 percent between 2017 and 2018 and to stabilize public debt. The authorities are aware that a further fiscal adjustment is needed to comply with the fiscal responsibility law and to put debt on a sustainable downside path. They have been working with the technical preparations of several measures, both on the revenue and the expenditure sides. While they consider that a gradual implementation could make the adjustment more plausible and contribute to moderate the impact on growth, a further assessment on the specific measures to be adopted will be in the hands of the new administration that will take office next June.

The Acting Chair (Mr. Furusawa) noted that El Salvador is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' policies that contributed to the strong macroeconomic performance and a decline in poverty and inequality. Noting that risks remain tilted to the downside, Directors emphasized the need for prompt fiscal adjustment to reduce the high public debt, and structural reforms to raise potential growth, including measures to combat crime, improve governance, and reduce poverty.

Directors welcomed the authorities' fiscal consolidation efforts and the fiscal laws recently passed by the Legislative Assembly, including the revised Fiscal Responsibility Law. In view of the high public debt and the large financing needs, Directors called for the authorities to adopt frontloaded fiscal measures to put debt on a firmly declining path, while noting, in line with staff recommendations, that the measures should be calibrated in a growth-friendly way without adversely affecting social outcomes. In that context, Directors also stressed the importance of improving revenue collection and tax administration.

Directors commended the authorities' efforts to improve the business environment and competitiveness, including through the implementation of the *El Salvador Seguro* plan, regulatory improvements to complete the Northern Triangle customs union, and policies to help human capital formation. They noted that potential growth could be further raised by increasing investment in public infrastructure, including through public-private partnerships, improving security, removing barriers to trade and investment, and reducing informality and the gender gap in labor force participation.

Directors noted that the banking sector is well capitalized and welcomed the recent progress in risk-based and cross-border banking supervision. To further improve the resilience of the banking sector, they encouraged the authorities to approve the bank resolution law, strengthen the emergency liquidity assistance framework, and ensure full compliance with the risk-based supervision framework. Director also noted the importance of further promoting financial inclusion, including by expanding access to fintech services.

Directors supported the recently adopted measures to improve the governance, anticorruption and Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) frameworks. Nevertheless, these frameworks should be strengthened further by enhancing fiscal transparency of the 2020 budget law, by improving the audit of fiscal operations, and establishing better spending controls. Directors recommended promptly implementing electronic invoicing, and also noted that changes to the anticorruption legal framework should be comprehensive, ensure harmonization of laws and consider the impact on the budget.

It is expected that the next Article IV consultation with El Salvador will be held on the standard 12-month cycle.

APPROVAL: April 22, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***Measuring potential GDP is inherently difficult, and perhaps accepting some degree of uncertainty and defining a potential growth range rather than a point estimate would be more appropriate. Staff's comments are welcome.***

- Staff used several standard measures to estimate potential output. The results point to 2.2 percent on average, which is also broadly consistent with the historical average (2.1 percent over 2001-2018 and 2.3 percent over 1994-2018). This point estimate was used in the macro framework, and we agree that potential growth cannot be assessed with sharp precision.

2. ***Staff recognizes the importance of the US labor market for the remittances to El Salvador in the graph on page 5 and the close alignment with the outlook for the US economy on page 7, which may warrant including the slowdown in the US specifically and less open labor market in the US among the key external risks to make the risk matrix less generic. Staff's comments are welcome.***

- The first two risks in the RAM table acknowledge the importance of remittances for the Salvadoran economy and the high impact that a drop in external demand, remittance flows, and migrant deportations would have. The US is indeed El Salvador's key trading partner and also hosts the bulk of El Salvador's emigrants.

3. ***Could staff provide an update on the TPS holders' issue? Could staff indicate in which extent negative shock on remittances could affect the external position?***

- From the 1.4 million Salvadorans migrants living in the US about 200,000 have temporary protected status (TPS), which has been extended through January 2, 2020.

- According to a central bank survey, many TPS holders could change their status, given their ties to legal residents (500,000) and US citizens (900,000).

- The impact of potential deportations from ending the TPS will be limited. For example, if 25 percent of TPS holders are deported the estimated loss of remittances is US$ 225 million, which represents only 4 percent of 2018 remittance inflows.

4. ***On the domestic side, could staff comment on the prospects for the new administration of obtaining legislative support for its reform agenda?***

- The new administration's plans have not been announced yet. The President-elect's reform agenda during the presidential campaign was a combination of the main two parties' political platforms (business-friendly reforms by ARENA and social development reforms by FMLN). Such an agenda could be supported by a multi-party majority in the Legislative Assembly.

5. ***Continued U.S. dollar appreciation led to widening of the current account deficit and the level of international reserves continues to be significantly below the adequate level implied by ARA benchmark according to External Sector Assessment (Annex II). The real effective exchange rate is appreciated by 3 percent in 2018 and that real exchange rate is estimated to show overvaluation of 4-6 percent. But appreciating currency would hurt the competitiveness of the economy, which probably had to do with the slowdown in exports in 2018. We concur with the staff appraisal that more investment in education and training, increasing access to finance, supporting for R&D investment, and providing entrepreneur-friendly environment are required. We welcome staff's elaboration on what measures the authorities are advised to take in response to external risks in the near term, given that the above-mentioned recommendations are to be pursued for longer-term perspective.***

- There is significant room to help improve the business environment in the short-term, by simplifying the issuance of tax identification numbers, implement electronic invoicing, minimizing the processing time of acquiring construction permits, and prioritizing the simplified tax code for small businesses ("monotributo"). Completion of the Northern Triangle customs union with Honduras and Guatemala is a key step to increase intra-regional trade and investment.

- Staff encourage the Central Bank to bolster its emergency liquidity assistance (ELA) resources, such as reviving expired contingent credit lines.

Fiscal Policy

6. ***We invite staff's comments on the merits of a more gradual fiscal adjustment that would still keep debt in line with the FRL requirements.***

- In the case of a more gradual adjustment, the 60 percent debt to GDP target may not be achievable by 2030 without significant further consolidation. Such adjustment may need to be implemented under weaker cyclical conditions, therefore increasing the drag on growth at that time.

7. ***Could staff comment on the feasibility of the envisaged 2 percent fiscal adjustment over 2019-21 in a frontloaded manner?***

8. ***We would have liked to see staff discuss the political feasibility of such measures in Box 1 to help gauge the trade-offs—particularly since the buff Statement expressly conveys that VAT increases are not plausible in the short term. Staff comments on the political feasibility of measures in Box 1 would be welcome.***

- One third of the proposed adjustment comes from the spending side and should be implemented mostly in 2019. Some of the measures have already been adopted (reducing goods and services spending, and some hiring freezes).

- The President-elect has signaled during the campaign the intention to continue curbing the wage bill by streamlining public entities.

- The remaining adjustment is on the revenue side. The technical preparations of some of the proposed measures (electronic invoicing, *monotributo* and customs tax administration reforms) have already taken place.

- The remaining 0.7 percent of GDP could come from excise taxes on luxury goods and a small increase in the VAT rate with adequate transfers to reduce its regressive impact.

- Although there is strong agreement about the need for fiscal consolidation, it may be hard for political parties to agree between them on certain type of measures. ARENA, the party with most seats in the Legislative Assembly, supports an increase in the VAT. The President-elect proposed a multi-tier VAT rate in his campaign plan.

9. ***Could staff elaborate on the reasons why the authorities prefer a more gradual consolidation, despite the clear case for frontloaded adjustment of the fiscal position?***

- The authorities believe that a more gradual fiscal adjustment (an adjustment over three rather than two years) would still comply with the operational target of the FRL and help reduce the drag on growth. A more gradual adjustment over three years would imply a need for more adjustment later in order to comply with the 2030 public debt target (including pensions).

10. ***We are also concerned about the suggested pace of fiscal consolidation in the amount of almost 2 percent of GDP in 2019-2020. It would be useful to provide***

additional justification for this strategy and more details on the small growth effects of a frontloaded approach.

- Sensitivity analysis shows that the effects of reversing adverse public debt dynamics are robust to plausible multiplier scenarios. The considered multipliers are 0.7 for short term and 0.3 for long-term in line with the economic literature of Central American countries, the 2018 staff report, and the Central Bank's estimates.

- Postponing the needed adjustment may necessitate having to undertake it during less favorable cyclical conditions, when it is more difficult socially and multipliers could also be larger.

11. ***The list of options suggested by staff in the table on page 12 is appropriately specific on the available options. At the same time, we would invite staff to elaborate on any additional options in this area.***

12. ***The authorities do not see an increase in the VAT rate as plausible in the short run. Could staff comment on other possible measures that could substitute for the proposed increase in the VAT rate, as well as on the feasibility of reforms to improve the efficiency and quality of subsidies and social spending?***

13. ***Could staff provide some assessment about the potential tax revenue that could be generated by a property tax?***

14. ***Could staff also elaborate on the authorities' plans regarding the property tax and pension reform?***

- Additional options that could be explored by the new administration are (i) further cuts in the wage bill, (ii) higher income taxes on professional services, (iii) the property tax (0.6 percent of GDP), and (iv) a pension reform that increases the retirement age.

- These measures have not been explicitly listed as part of the 2019-20 adjustment as their implementation is not technically feasible in the short term.

- Moreover, only (i) and (ii) can be considered as substituting partially for the VAT increase, since (iii) and (iv) need to be used to compensate for the approved or planned measures of the Legislative Assembly that do not have identified sources of financing, and for the moment represent considerable downside risks.

- The World Bank has already identified inefficiencies in the provision of public subsidies and encouraged the authorities to reform them in its last spending review. The authorities have requested TA on the matter.

15. ***We note staff's finding that the introduction of a permanent operational target would be critical to further improve the fiscal rule. How do staff assess the authorities' intentions in this regard?***

- The FRL does not have a primary balance operational target after 2021. The authorities did not express an intention to amend the law in this regard.

- The revised FRL establishes minimum revenue and ceilings for current expenditures (excluding transfers). The authorities believe that these are sufficient to anchor fiscal policy and help reach the debt target of 60 percent of GDP by 2030.

- Best practices suggest using only one operational target aligned with the debt target. In the case of El Salvador, it could be an expenditure rule, which applies to current or total spending, including transfers.

16. ***We welcome the staff's comments on the authorities' readiness toward introducing the property tax.***

- The Ministry of Finance is making progress in the technical preparations, including by elaborating a model for the valuation of the taxable properties.

17. ***Could staff broadly comment on the plans to modernize the country's international taxation framework in combating BEPS?***

- In 2018 the Legislative Assembly approved a reform to combat the base erosion and profit shifting ("precios de transferencia"), but the Constitutional Court declared the law unconstitutional because of an irregularity in the voting procedure.

- The current administration favors a fiscal reform, which would include the "precios de transferencia."

18. ***Do the authorities consider the creation of an independent fiscal council as preconized by staff considering the past poor track-record of compliance with the previous FRL?***

- The authorities have not considered yet the creation of an independent fiscal council.

19. ***Could staff provide details on the ongoing analysis done by the Ministry of Finance about additional reforms of the pension system?***

- Several proposals have been sent by the Legislative Assembly to the Ministry of Finance. They are still preliminary. Actuarial studies for each of them have been commissioned by the Ministry.

20. ***Efforts to strengthen public debt management, including by developing a medium-term debt strategy framework, would help contain financing costs and lower roll-over risks. We welcome Fund technical assistance in this area. Could staff provide more information about the scope and timing of planned reforms in this area?***

- The authorities requested technical assistance to improve the medium-term debt strategy framework (MTDS). The authorities' goal is to smooth the profile of the public debt (including pensions) by extending its average maturity, and thereby lower borrowing costs and reduce financing risks.

21. ***Staff's elaboration on to what extent the use of PPPs can help to overcome the country-specific constraints limiting the public investments are welcome.***

- PPPs would be an alternative to finance investment projects, which would reduce pressure on the fiscal accounts in the short-term and ensure compliance with the FRL debt target in the long term.

- Private sector involvement could boost efficiency and improve the public investment execution rate.

- Before pursuing PPPs, their legal framework should be strengthened, including by clearly defining responsibilities of the involved parties.

Financial Sector

22. ***In last year's answers to technical questions, staff identified several regulatory and information constraints impeding credit to SMEs. Could staff kindly provide an update on potential progress in addressing these constraints?***

- The authorities support lending to SMEs and micro-enterprises through the association for small enterprises (CONAMYPE).

- Further progress is needed to lift the existing regulatory and information constraints.

- *Regulatory constraints*: Loan approval requires the need for borrower's tax ID, which could take up to 3 months to receive.

- *Information constraints*: Credit information is still not adequately shared by all credit bureau members.

23. ***While we support that central bank is working towards bolstering its emergency liquidity assistance, could staff provide us with information on the current level of ELA resources?***

- The current ELA resources are US$ 670 million, which comprise the freely available excess net international reserves, government deposits at the BCR, and the contingent credit line with the Central American Bank for Economic Integration.

Structural issues

24. ***Could staff comment on the extent that the crime and violence has made doing business more expensive while negatively affecting investment decisions and hindering job creation in El Salvador?***

25. ***Are there any estimates of the related financial burden on small and medium size enterprises?***

- Several studies show that the impact of crime and violence on the Salvadoran economy ranges between 12 and 18 percent of GDP. The estimates include direct and indirect costs for the government and the private sector (households and businesses).

- All telecom users – including firms – must pay a 5 percent tax on their monthly telecom bill (landlines, cell phone, and internet connection). The proceeds are used to finance *El Salvador Seguro* plan.

- According to anecdotal evidence, collected in meetings with firms and business associations during the mission, the cost of extortion ranges between 5 and 20 percent of firms' operating costs. These either cover the extortion fees, or the costs of prevention, including hiring armed guards and installing high tech surveillance.

- Extortion is a widespread phenomenon, affecting 90 percent of SMEs, according to a CONAMYPE survey.

26. ***Box 2 of the Article IV report mentioned the fight against crime as a key policy priority for the authorities and even referred to successful strategies from international experience. Do staff consider this area as macrocritical for El***

Salvador? Should it be addressed by the IMF staff, probably, in collaboration with other experts? In addition, in staff's opinion, how does the fight against crime affect governance in the country?

- Fighting crime is macro-critical, as crime is one of the main drags to long-term growth through its effect on depressing investment, firm growth, and encouraging informality, and migration. This view is shared by the authorities and the IDB, as reflected in a recently published report on El Salvador's development challenges.[2] The staff report, including Box 2, outlines some of the steps the authorities are taking to combat crime.

- IMF staff, in coordination with IDB, plans to analyze georeferenced crime data, household, and firm surveys to understand the impact of crime on private sector consumption and investment decisions and, ultimately, GDP growth.

- There is no official data linking gang crime to corruption. The few recent high-level cases of corruption are seemingly unrelated to gangs.

27. ***Strengthening the capacity of public institutions to tackle security and increase formalization remains a top priority. We understand that these areas are beyond the Fund's expertise. Could staff explain in more detail which institutions and development partners are helping the authorities address these challenges?***

- The authorities' efforts to fight against crime rely on the technical and financial support from the IDB, the USA, and the Donors Group from the European Union.

- The outgoing administration and the President-elect had, only in the past month, public meetings with U.S. officials, including the Governor of California, the US Attorney General, Vice-president Pence, and Acting Secretary of the Department of Homeland Security.

28. ***Strengthening resilience to natural disaster risks is also vital in El Salvador. Given the potential to extreme climate variability, ex-ante mitigation measures and adaptation is important to facilitate sustainable long-term growth. Could staff comment?***

- As noted in the RAM, El Salvador's economy is exposed to the risk of natural disasters (including extreme climate variability). Staff recommend fiscal buffers and to prepare cost assessments of insurance against natural disasters.

[2] https://publications.iadb.org/es/bideconomics-el-salvador-impulsando-el-crecimiento-inclusivo-y-sostenible

- One of the World Bank projects for which El Salvador could receive support is to increase resilience at the local level, and plan for ex-ante mitigation measures.

29. ***Could staff give an update about the reasons of the low population dynamic both in the recent years and anticipated, and the role of emigration in this movement?***

- El Salvador is in the middle of its demographic transition from high to low fertility and mortality rates.

- Emigration continues, although at a lower rate.

30. ***According to the authorities, public perception of corruption is not improving despite the adoption of the Law on Access to Public Information. Could staff elaborate on this?***

- The Law has been introduced recently. However, the authorities are currently experiencing the *transparency paradox.* As more corruption cases are discovered and prosecuted, public perception of corruption increases.

- However, the big anti-corruption cases are still ongoing, and big changes in the governance and anti-corruption frameworks have not been tackled yet.

- Public opinion about anti-corruption efforts will improve with continuous decisive actions, a comprehensive strategy to strengthen the governance and anti-corruption measures, as well as public information campaigns.