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November 28, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 89/48

The following correction has been made in the final minutes of EBM/89/48 (4/28/89):

Page 3, para. 2, line 2: for "the Guyanese authorities,"
read "the El Salvadoran authorities,"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

1. EL SALVADOR - 1989 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1989 Article IV consultation with El Salvador (SM/89/49, 3/15/89). They also had before them a background paper on recent economic developments in El Salvador (SM/89/61, 4/5/89).

The staff representative from the Western Hemisphere Department remarked that at the request of the El Salvadoran authorities, the staff had visited El Salvador in the past week to discuss the authorities' plans for an economic adjustment program. While the policy actions contemplated were quite ambitious, considerable work remained to be done on the quantification of the principal components of the program. He noted that the overall economic situation had worsened somewhat since the staff's previous mission in January 1989. The external sector had continued to be under pressure, as reflected by a further loss of international reserves, and there had been a new buildup of external payments arrears.

Mr. Ayales made the following statement:

> I would like to express my authorities' appreciation for the constructive discussions held in connection with the 1988 Article IV consultation with El Salvador. They are in broad agreement with the staff report, as it represents an objective account of recent economic developments in El Salvador. They are also of the view that the staff report provides an impartial analysis of policy implementation, the achievements to date, and the challenges still facing the Salvadoran economy.
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> Despite the severe effects of the 1986 earthquake, the armed conflict, the economic situation in Central America, and the uncertainties surrounding the recent legislative and presidential elections, El Salvador's economic performance was rather satisfactory in 1988. Real GDP expanded by 0.9 percent in 1988, albeit at a slower pace than in 1987, while inflation was brought to slightly less than 20 percent from about 25 percent in 1987 and 30 percent in 1986. The decline in the rate of inflation can be attributed primarily to the pursuit of a prudent monetary policy, and an improved fiscal situation. In the external sector, exports registered a major turnaround, as they rose by 7.1 percent following a contraction of 21.7 percent in 1987. At the same time, imports rose by only 4.3 percent in 1988 compared with 6.3 percent in 1987, mainly as a reflection of tighter demand-management policies. The adoption of several important measures, such as a tax certificate scheme for up to 20 percent of the value of nontraditional exports, the easier access to foreign exchange through the liberalization of foreign exchange deposit accounts, and the establishment of a one-stop agency for the processing of all export documentation, played a large role in improving the trade picture. The decline in the

trade balance as a proportion of GDP, was the main factor behind the reduction in the external current account deficit by 1 percent of GDP, to 4.0 percent in 1988.

My authorities consider these results to be highly satisfactory, particularly given the considerable social and political limitations that had to be overcome in an election year to implement corrective measures.

The gradual reduction of nonmilitary expenses of the public sector continued in 1988, which permitted government consumption to drop to 12.6 percent of GDP; these outlays had risen to 14.2 percent of GDP in 1986. Public investment also declined--a development closely associated with the armed conflict--as the Government found it difficult to execute investment projects. However, private investment and private consumption both showed a moderate recovery during 1988. The service sector provided the main boost to economic activity, which was a particularly welcome development, because the service sector has been severely impaired by the intensification of the armed conflict, as well as the 1986 hurricane.

While minimum wages were adjusted in line with inflation, average real wages continued to decline sharply in 1988. In fact, public and private minimum and average wages have contracted in real terms by more than 40 percent over the last four years.

The main goal of fiscal policy in 1988 was to strengthen the public sector finances through containment of overall spending and improvement of the revenue performance of the Central Government. Total central government expenditures were brought down sharply to 13.8 percent of GDP in 1988 from 15.2 percent in 1987, and 19.4 percent in 1986. The wage bill was the budget item that bore most of the adjustment. Also, government transfers to public enterprises were eliminated and those to the rest of the general government were reduced. These results constitute a clear signal of the authorities' determination to maintain control over the fiscal situation in the face of a very delicate social and economic situation, aggravated by the protracted armed conflict.

The revenue performance was rather disappointing. Most categories of tax revenues declined in relation to GDP, as a result of increased tax evasion and a breakdown in tax administration and collection procedures, which was also associated with the civil situation. The very austere spending policy in 1988 more than compensated for the rather poor revenue performance, and the overall deficit of the Central Government--before grants--was reduced to 3.1 percent of GDP in 1988 from 3.8 percent of GDP in 1987. Tax receipts on coffee exports experienced