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September 14, 2010

**Statement by Mr. Rediker and Ms. Hull on El Salvador  
(Preliminary)  
Executive Board Meeting 10/89  
September 15, 2010**

As the economic recovery gains strength in El Salvador, policy priorities should shift towards the inter-related goals of safeguarding macroeconomic and financial sector stability and enhancing growth. Fiscal policy should be geared to provide space for needed spending on infrastructure and education. Credible economic policies and a stable financial sector will also help attract the foreign capital required to achieve the authorities' investment goals. Structural reforms are an important component of this program and we urge their timely implementation.

**Fiscal Policy**

We commend the authorities for their ongoing fiscal restraint, as discussed in Messrs. Guzmán and Gramajo-Marroquin's statement, recognizing the need to balance fiscal consolidation with political constraints. Given that tax revenues as a share of GDP are lower than regional peers, efforts to boost revenues through the planned fiscal pact should help to meet social spending goals. Revenue measures would usefully be complemented by further subsidy reforms, particularly with respect to liquefied gas. Given the recent large increase in public debt, and its sensitivity to growth and interest rate shocks, contingency measures should be designed to mitigate the impact on debt dynamics should downside risks emerge. We welcome the authorities' intention to undertake a fiscal transparency ROSC.

**Financial Sector**

The FSAP recommendations will provide useful guidance to the authorities as they undertake measures to bolster financial sector supervision and regulation, and we look forward to implementation updates in future staff reports. In a dollarized economy, priority should be given to developing comprehensive lender of last resort and crisis resolution arrangements. Capital market development is also needed and we encourage progress in bolstering the regulatory and supervisory framework. We also hope for prompt passage of the Investment Funds Law. Any decisions to strengthen the role of public banks should be based on a comprehensive analysis of the goals of such measures, including what market failure is to be addressed and how risks will be managed. We would appreciate updates on this issue as the authorities develop their plans.

We congratulate the authorities on the adoption of El Salvador's anti-money laundering and combating the financing of terror (AML/CFT) Mutual Evaluation Report at the May 2010 Caribbean Financial Action Task Force Plenary. The report identified a number of deficiencies in El Salvador's AML/CFT regime and we encourage the expeditious implementation of the recommendations in the report.

**Program Issues**

We are in broad agreement with the main findings of the Ex Post Evaluation of Exceptional Access. Large growth surprises can be difficult to manage but we agree with the staff that cyclically-adjusted conditionality would be very difficult to communicate and implement. There would also be the possibility of a significant disagreement between the staff and the authorities on cyclically-adjusted measures. We urge the authorities to adopt the outstanding recommendations of the safeguards assessment to improve financial reporting.