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September 14, 2010

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

1. The global financial crisis took a toll on El Salvador amidst an uncertain electoral environment. As a result, GDP registered a sharp decline, the public sector deficit widened, and debt significantly increased. Against this background, the authorities' efforts in achieving good performance under the Fund-supported program is notable. We note that all end-June performance criteria were met, despite some delays in structural reforms. **We therefore support the completion of First Review under the Stand-By Arrangement for El Salvador.** As we broadly share the staff's assessment and recommendations, we will focus our comments on key issues for emphasis.

Fiscal policies

2. Reducing the public debt-to-GDP ratio to pre-crisis levels is a key priority. Toward this end, further reforms to subsidy programs, particularly in energy and transport sectors, could be helpful. Having said this, we welcome continued political support for these efforts. In this regard, securing external and domestic financing for the 2011 budget plan would also be critical. *Further updates on the prospects for the borrowing program would be appreciated.*

3. Despite tight fiscal position, we see positive aspects in creating space for priority expenditures in social services and infrastructure. We are reassured by Messer. Guzmán and Gramajo-Marroquin that if tax revenues were to exceed those projected under the program in 2010, authorities will use up to 50 percent of the excess revenue to increase spending in social programs.

4. We also see challenges for the authorities to increase government revenue by 1½ -3 percent of GDP in line with their medium-term fiscal strategy, including the possible increase in tax rates. We are encouraged by the improvement of tax administration and recovery in tax collection. As such, we welcome the authorities' commitment to continue the revenue measures and press ahead with strengthened measures in fighting against tax evasion given its huge level (noting staff report that for VAT alone of 3-4% GDP). *Staff's comments of specific measures in dealing with tax evasion are welcome.*

Financial stability

5. In light of the lessons drawn from the global crisis, the authorities' effort to strengthen financial regulation and supervision is commendable. The passage of the financial sector law in which El Salvador's financial supervision agencies will be consolidated and shift regulatory powers to the central bank is a step in the right direction. We are heartening to learn from Messer. Guzmán and Gramajo-Marroquin that the congressional approval of the Financial Sector Supervision and Regulation Law is scheduled for end-December 2010. Nonetheless, we see challenges for the central bank and the Superintendence to take up the new tasks. *Staff's detailed inputs on the central bank's and SSF's preparedness for the new roles, including the emergency resolution framework, are welcome.*

Structural reforms and competitiveness

6. We fully agree with staff that a medium-term reform agenda is vital to improve El Salvador's growth, which is relatively low compared to the rest of the region. We welcome the authorities' initiative to boost private investment, including fostering "public private partnerships" and addressing weaknesses in certain areas such as security, education and innovation. We welcome the authorities' plan to improve the legal framework for domestic capital markets. We thus support the authorities' commitment to obtain congressional approval of the Investment Funds Law.