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

We thank staff for the interesting and detailed set of documents and Mr. Guzmán and Mr. Gramajo Marroquín for their informative Buff statement.

The economy of El Salvador was hard hit by the international crisis and the US downturn. In 2009, real GDP, exports, imports, remittances, and domestic demand, all declined. Private sector investment and FDI were strongly affected, with the latter falling by more than half, to 2.7 percentage points of GDP, from almost 7 percent in 2007, and projected to further decline in 2010 and 2011. The downturn led to deteriorated public finances and public sector debt.

Economic activity has begun to recuperate. It can be expected to follow the US recovery, supported by a rebound in external income from remittances, and exports. Higher incomes and rising imports should result in a higher tax collection. And inflation has remained low. However, medium term structural challenges remain, particularly regarding financial sector reform and improvements in competitiveness to accelerate growth and reduce poverty.

Under the Stand-By Arrangement all end-June performance criteria were met. And, despite delays, the structural reform agenda has the full backing of the authorities. We therefore support the completion of the first review under the SBA. In fact, this chair believes that El Salvador would be an excellent candidate for a PCL. El Salvador does not face an actual balance of payments, has sound economic fundamentals and institutional policy frameworks; has a track record of implementing sound policies and remains committed to maintaining such sound policies in the future. In addition, El Salvador has access to international capital markets, does not need to undertake large macroeconomic or structural policy adjustments, its public debt position is sustainable and there are no widespread bank insolvencies.

We believe that the authorities' fiscal adjustment is adequate, particularly in view of the weak US recovery. Moreover, as the authorities emphasize, it is important to maintain the political consensus in favor of medium term fiscal consolidation. To this end, we welcome the authorities' commitment to reduce subsidies on liquefied gas (LPG) and electricity, to contain government spending, to strengthen tax administration and to reduce tax evasion.

We agree with the main finding of the 2010 FSSA and welcome the authorities plan to seek congressional approval of the Financial Sector Supervision and Regulation Law, which will increase the autonomy, legal protection for supervisors and strengthen cross-border consolidated supervision. We are, however, not fully convinced of the benefit of merging into one all the supervisory entities in the financial system. In fact, the FSSA acknowledges that the merger, and transfer of regulatory authority to the central bank, would be challenging. *The staff's view would be appreciated.*

Finally, we wish to make a final comment on El Salvador's growth performance over the past decade. As noted repeatedly in the Staff Report, growth has been far from stellar in El Salvador, despite its being a country whose authorities have consistently implemented high quality economic policies. The answer probably hinges on the lingering effects of the Civil war that devastated the country during the 1980s, when about a third of the population migrated abroad. In this connection, a better understanding of El Salvador's growth limitations would probably require, as in the case of other countries facing similar circumstances, somewhat different optics, a degree of candor difficult to include in a regular Staff Report. Without it becomes difficult to understand the low savings rates, the low investment rates and, in particular, the stagnant productivity growth and high degrees of insecurity one finds in El Salvador. Transparency in Staff Reports has numerous advantages but, on occasion, it will limit what can be transmitted.