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September 14, 2010

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

We thank staff for the comprehensive reports. We also thank Mr. Guzmán and Mr. Gramajo-Marroquin for their helpful and insightful Buff statement.

We commend the El Salvadorian authorities for the good performance under the precautionary 3-year Stand-By Arrangement (SBA), with total access of 300 percent of quota, in support of the government's economic strategy, aimed at ensuring fiscal and debt sustainability, while safeguarding social spending. We broadly agree with the staff's assessment and recommendations. The authorities' policies appear adequate to meet the targets under the program, support the recovery of the economy, and maintain external stability. We welcome the authorities' intent to continue treating the arrangement as precautionary.

We stress the importance of sustainable public finances over the medium term. We support the authorities' strategy to seek a national consensus on a fiscal pact that is to be implemented no later than 2012 and a tax reform aimed at increasing tax revenue by at least 1½ percent of GDP. We agree with staff that downside risks to the authorities' strategy of gradual fiscal consolidation are not negligible, and urge the authorities to improve fiscal performance by strengthening debt management and by improving the efficiency of public expenditure.

We take good note of the ex-post evaluation of the 2009 SBA. Despite recognizing the importance of the program in preventing a capital account crisis during the political transition, we would have preferred a more cautious approach by staff when stating the success of previous SBA arrangement. After all, Fund resources stopped being available in April 2009 under that arrangement because the only performance criterion (overall balance of the non-financial public sector as of March 2009) was significantly breached shortly after the program had been firmed with the Fund.

As to the Financial Sector Stability Assessment (FSSA), we welcome the soundness of the banking sector, but regret the limited implementation of the 2004 Financial Sector

Assessment Program (FSAP) Update recommendations, and we urge the authorities to implement the necessary legal provisions to strengthen supervision and safety nets as well as a corporate insolvency law.

We note that dollarization continues to be a cornerstone of macroeconomic and financial stability. We welcome that, in the almost ten years since El Salvador adopted the US dollar, interest rates have been lower than under the previous regime as exchange rate risk has disappeared, inflation has remained low, and the real exchange rate has remained broadly in line with fundamentals.

We wish the authorities success in their reform efforts.