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USAID/EL SALVADOR
FY 1989 BALANCE OF PAYMENTS SUPPORT PROGRAM
CONCEPT PAPER

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USAID/EL SALVADOR

1989 BALANCE OF PAYMENTS SUPPORT PROGRAM

CONCEPT PAPER

FEBRUARY 1989

I. BACKGROUND

A. Introduction

The Salvadoran economy is at the point where economic adjustment can no longer be ignored. In 1984-86, the GOES achieved measurable success in implementing democratic institutions and extending essential services to the poorer segments of the Salvadoran population. However, the GOES has had less success in stabilizing the country's economy, and since 1984, real GDP growth has averaged about 1% annually, as growth and development of industry and agriculture have been constrained by serious imbalances in the external, fiscal and financial sectors.

The objective of the 1989 ESF Balance of Payments Support Program is to assist the GOES in implementing economic reform and adjustment in El Salvador. However, due to the very complex political situation that will prevail between now (February 1989) and the inauguration of the new government in June 1989, the Mission has adopted a transitional strategy. The Mission and the GOES recently negotiated a package of measures that will ensure continued stability in the economy between now and June. Following the March 1989 presidential election, the Mission will negotiate a broader package of reform measures with the incoming government. These negotiations will focus on specific actions to set the stage for improved economic performance in 1990, as well as the implementation of several reform programs that will span several years and contribute to improved economic performance over the CDSS period (1990-94). An important result will be that the GOES will have more revenue to continue social services to the poor.

USG economic assistance will be key to the reform program. The GOES will not be able to achieve the inflation and growth targets under the 1989 monetary program of the present government without the $138.5 million in balance of payments support and the approximately $40 million in PL480 food aid programmed for this year. These resources will also be essential to cushioning the shock to the economy from the adjustments to be negotiated with the new government to the interest rate and exchange and trade regimes we hope will be taken late in 1989.

This Concept Paper provides the rationale and framework for USAID/El Salvador's $138 million Balance of Payments Support Program for FY 1989. Given the upcoming presidential election in El Salvador in March 1989, the Mission is submitting a detailed Concept Paper at this juncture to be followed by two brief PAADs - one in March 1989, and the second sometime after June 1989 based on negotiations with the new government.

B. The Problem Statement

1. A Brief Review of Recent Economic Events

Although the GOES achieved measurable success during 1984-86 in implementing democratic institutions in El Salvador, it achieved less success in stabilizing the economy and in rekindling the dynamics of economic growth. The economy grew slowly during 1984-86: by 2.3%, 2.0%, and 0.6%, respectively. A lack of fiscal discipline, along with accommodative monetary policies, raised inflation from 11.7% during 1984 to 32% by the end of 1986.

In 1987, with our encouragement and support, the GOES succeeded in arresting the economic deterioration that was evident at the end of 1986. According to revised estimates, GDP grew in 1987 by an estimated 2.7%--slighty higher than the annual target. Utilizing a population growth rate estimated at 1.8%, per capita GDP increased by 0.8%. The balance of payments registered a surplus of $51 million in spite of a large increase in the trade deficit. The overall deficit of the central government (before grants) was equivalent to 3.6 percent of GDP in 1987, higher than in 1986, but much better than the 5.1 percent deficit that was earlier feared. This reflected a determined effort by the GOES to reduce the fiscal imbalance despite lower coffee tax revenues and the limitations imposed by urgent social demands and the war effort. The improvement in the external and fiscal accounts allowed the monetary authorities to implement a monetary program that broke the back of the inflationary spiral. The rate of inflation, as measured by the annual average increase in the consumer price index, was reduced to 25% in 1987 from a 32% increase in 1986.

Unfortunately, these favorable developments did not continue in 1988. The increase in urban and rural guerrilla attacks on the productive infrastructure, the 1987 drought, and adverse weather conditions early in 1988 that lowered 1988/89 coffee output all contributed to no growth in real GDP compared to expectations of 2.6 percent growth. Timely tax payments by INCAFE (the national coffee institute), a containment of current outlays, and an underexecution of capital expenditures, kept the overall central government deficit at slightly below the level in 1987. However, as both current and capital accounts balances worsened, the balance of payments showed a deficit of $64 million.

In spite of the worsening situation in the external sector, the monetary authorities struggled to maintain the integrity of the 1988 monetary program, a task compounded by growing difficulties in controlling money growth. A regime of negative real interest rates and an increasingly overvalued colón contributed to a contraction in the demand for money, i.e., the willingness of the non-bank public to hold colón financial assets. As a result, expansion in banking system net credit resulted not in the anticipated growth in money, but in an unanticipated drawdown in net international reserves. Despite these difficulties, inflation remained at 20%, allowing the GOES to meet the 18-20% target set in their economic program.

Conditions in 1989 will likely not permit improved economic performance over 1988. The imbalances in the economy stemming from the policies put in place in 1986 are becoming increasingly more acute, and economic management will be burdened by continuing problems in financing the public sector deficit and in monetary programming.

The most prominent feature of economic performance in 1989 will be the sharp decline in coffee output during the 1988-89 crop season due primarily to adverse weather conditions that prevailed early in 1988. Production has fallen from a high of approximately 3.2 million quintals in 1987 to an estimated 1.5 million quintals in 1988; both figures are far below the 4.3 million quintals produced in 1979. For the first time in its history, it appears that El Salvador will not be able to meet its international coffee marketing quota, and under the new OIC agreement to be negotiated in September, the country's quota may be cut for the 1989/90 crop year. Even with higher world prices this year, the reduction in coffee production and exports translates into a potential loss of 124 million dollars in foreign exchange and 31 million dollars in coffee export tax revenues. Moreover, a production level of 1.5 million quintals of exportable coffee would result in the loss of 6.6 million person days of harvest labor and 132 million colones ($26.4 million at current exchange rate of C5.00/$1.00) in harvest wages. This can be translated into a loss of an entire harvest employment and income for 73,000 rural poor.

As discussed below in section II.B, GDP growth will probably not exceed that recorded for 1988. A fall in coffee exports and sluggish growth in nontraditional exports will limit the import capacity of the economy. While the reduced level of external resources will force the monetary authorities to limit credit expansion generally, the growing financing requirements of the public sector will further limit the amount of credit available to the private sector.

2. Constraints to Economic Growth

Achieving sustained increases in real per capita GDP in the Salvadoran economy is essential to improving the material well-being of the Salvadoran people and, for this reason, it is an important objective for the Mission's current CDSS planning period, 1990-94. However, an analysis of economic trends since 1984 reveals quite clearly that the Salvadoran economy has only been able to manage average real growth of about 1% annually--in spite of high levels of USG assistance. Allowances must be made for the war, which in intensity has exceeded that mounted by the FSLN against the Somoza regime in Nicaragua, for the depth of the 1981-83 world recession which plunged international commodity prices to lows from which they have yet to recover, and finally, for the collapse of the Central American Common Market (CACM), the driving force behind the industrialization of the 1960s and 1970s.

Rather than economic adjustment, the GOES chose to concentrate on consolidating the democratic process. It was believed that economic adjustment would run counter to their efforts to win the war, improve human rights, and give Salvadorans a greater stake in their society--thereby checking the causes of the insurgency.

Nevertheless, the postponement of key economic adjustments, however necessary in the troubled and torn political landscape of El Salvador, has created structural imbalances in the economy. Import prohibitions and restrictions to support the overvalued exchange rate complicated the trade regime and raised the effective cost of importing for the productive sectors of the economy. The inefficient parastatal monopolies in banking, coffee, and sugar caused substantial losses to the economy. An inefficient financial system is incapable of channeling credit to the productive sectors. The country's fiscal deficit is placing pressures on available credit resources.

a. The External Imbalance

A deficit in the trade balance that has reached the equivalent of 9-10% of GDP (compared to being roughly in balance during the 1970s) must be addressed. Financing this deficit has required a flow of USG grant assistance and foreign remittances that now exceed $400 million annually. It must be kept in mind that the gap has reached this level while overall economic growth has been at a crawl; at any real growth rate higher than 2% annually, the trade deficit would increase at a much more rapid rate. Low commodity prices in world markets have contributed to the problem, but stagnant investment in the coffee sector, a slow pace of agricultural export diversification and nontraditional extra-regional export growth have also been contributing factors to stagnant export growth over the past decade.

At the heart of the problem is an exchange and trade regime that discourages investment in actual and potential export activities and efficient production of import substitutes. A fixed exchange rate regime supported by numerous non-tariff barriers to imports (NTBs such as quotas, import prohibitions and prior deposits for foreign exchange permits), along with ample inflows of foreign remittances and grant assistance, have permitted the maintenance of an overvalued national currency. The overvalued colón has reduced the local currency earnings of producers exporting for the foreign market. In the domestic economy, it has encouraged investment in those goods that are not exported, and the trade balance has worsened.

b. <u>The Fiscal Imbalance</u>

The deficit in the nonfinancial public sector has reached the equivalent of about 4% of GDP. Central government revenues have fallen from the equivalent of 13% of GDP in 1978 to 12% in 1988. Current expenditures, however, needed to sustain the war effort (which today account for 30% of GOES total expenditures) and to extend social services to the poor, have grown from the equivalent of 10% of GDP in 1978 to about 14% in 1988. In spite of adjustments in 1987, fiscal subsidies to support current and capital expenditures in the parastatals providing water, electricity, sewerage and port services have risen. The fiscal deficit has also been increased by an agricultural price and food subsidy program.

The fiscal imbalance poses a constraint to economic growth in several ways. First, financing the deficit places pressures on the financial system by reducing the flexibity of the monetary authorities in programming money and credit expansion, particularly with respect to credit expansion to the private sector. In 1988, approximately 40% of total banking system credit was allocated to financing the deficit. In recent years, the Central Reserve Bank (BCR) has been reluctant to increase banking system finance to the government. As a result, floating debt (unpaid domestic bills and nonpayment of interest on government bonds held by the banking system), has grown sharply. Delaying payment to vendors reduces the cash flow and profitability of part of the private sector. Since the banks are required to hold a certain percentage of their reserves in the form of government bonds, the nonpayment of interest reduces the profitability of the financial sector, and in effect passes a large part of the deficit from the nonfinancial public sector to the financial public sector. Whatever the method of financing, banking system credit or floating debt, the deficit, if it remains at its present levels, will place a constant burden on monetary policy.

The second constraint on growth posed by the deficit stems from reduced government expenditures on the productive infrastructure. As the overall deficit increases, the government is forced to sacrifice investment expenditures in favor of maintaining the level of current expenditures. Capital expenditures have fallen from the equivalent of 4.4% of GDP in 1978 to 2% in 1988. Consequently, even though there has been some other donor participation in these areas, the GOES has not been able to maintain an adequate pace of investment in roads, ports, power and in other such areas important to the growth of the economy.

c. Financial Sector Imbalances

The financial system in El Salvador is not capable of channeling credit efficiently to productive uses, nor is it able to generate sufficient financial savings to finance credit expansion from the system's own resources. The system is characterized by a regime of negative real interest rates, overcentralized control of banking operations, the lack of a strong supervisory and auditing body, and a commercial banking sector burdened with a low level of managerial and technical skill and saddled with portfolios cluttered with perhaps 30% non-performing assets. Consequently, in its current state the financial system cannot provide the necessary degree of financial intermediation for the Salvadoran economy.

Furthermore, and perhaps just as important, the current state of the financial system presents an obstacle to effective monetary programming. Many of the commercial banks have negative net worth, i.e., are technically bankrupt, and require a continuous infusion of credit from the BCR to re-finance weak portfolios. With the global limits on credit expansion required by the annual monetary programs, it becomes progressively more difficult to accomodate this flow of credit. Furthermore, the regime of negative real interest rates has gradually eroded the demand for money, i.e., the desire to hold domestic financial assets. In the past two years, any given expansion of credit has resulted less in the increase in the money supply and more in a reduction in international reserves. This trend may be exacerbated as the nonbank public experiences less and less incentive to save in domestic currency and becomes more and more aware of the overvalued exchange rate. The consequence will be that the monetary authorities will encounter greater difficulties in programming credit to meet growth, inflation and balance of payments targets.

d. Imbalances in the Productive Sectors

Economic performance in El Salvador has also been affected by policies that have resulted in a misallocation of resources in both manufacturing and agriculture. Until 1978, El Salvador's manufacturing sector was one of the strongest in Central America exporting to the CACM and the emerging extra-regional market for nontraditional manufactured goods. However, from 1978 to 1988, the fall in domestic incomes and the 48% contraction in exports to the CACM have led to a 21% decline in manufacturing output. In spite of a 32% rebound in exports of manufactured goods to the CACM in 1987 and some growth in extra-regional exports, the manufacturing sector remains stagnant, operating at an estimated 65% of capacity.

As was discussed above, the war, the world recession of 1981-83, and the loss in investor confidence stemming from the reforms of 1980 depressed performance in the manufacturing sector. In addition to these exogenous factors, the imbalances in the fiscal, financial and external sectors, as well as policies directed specifically at manufacturing, have all had a role in constraining growth in this sector.

The financial sector cannot allocate credit efficiently to manufacturing activities. A banking system whose lending rates are negative in real terms cannot allocate credit through the market to the most productive uses. It must do so administratively. This has resulted in long delays in obtaining loans, periodic shortages of working capital, the absence of long-term lending, and heavy collateral requirements.

The exchange and trade regime has encouraged manufacturing activities that are not consistent with the comparative advantage of the country. An overvalued exchange rate has depressed the profitability of many export activities. The tariff regime, with different rates for capital goods, intermediate goods and consumer goods, as well as the NTBs discussed in section 2.a. above, have had the same effect. Altogether, the overvalued exchange rate, the tariff system and the NTBs, have created protection for manufacturing activities which cannot be exported or substitute inefficiently for imports. This has led to increased investment incentives for activities such as printing, metal manufacture and chemicals, which probably could not be produced competitively in El Salvador, and little incentive for increased investment in food processing and textiles.

In addition to the set of distorted price signals that current policies have given to manufacturing, there are inhibiting non-price signals as well. The GOES has moved to clarify investor rights under the new Foreign Investment Law and the regulations governing free zones. However, other problems remain. Inefficient administration of customs and bureaucratic controls over trade are just two examples of continuing problems between the government and the private sector.

For the economy as a whole, the most significant impact of the imbalances in the economy has been the fall in agricultural production. Until 1978, El Salvador's agricultural sector was the engine of growth for the nation, financing much of the development in the productive and social sectors. However, since 1978, agricultural growth has slowed. From 1960-1978, El Salvador's real agricultural growth averaged 4.0% per year. Since 1978, however, agricultural output has decreased at a rate of -1.7% per year. In 1985-86 constant prices, the per capita value of agricultural production for crops and livestock declined by 29% between 1978 and 1987, returning agricultural output to 1950s levels. Approximately 85% of this decline has been in the traditional export sector (coffee, cotton, sugar) which provides El Salvador with the majority of its foreign exchange earnings and is the principal source of wages and income in rural areas. In terms of foreign exchange and employment, coffee is the major crop. However, as mentioned earlier, production has fallen from a high of approximately 4.3 million quintals in 1979 to an estimated 1.5 million in 1988.

Low world prices for agricultural commodities and the effects of ten years of insurgency have certainly contributed to the fall in agricultural investment, but the exchange rate regime, tariff and tax policy and the management of the agrarian reform cooperatives have played a strong part as well. As a result, El Salvador's agricultural sector is constrained by poor utilization of its scarcest factor of production, good agricultural land, and its most abundant factor, rural labor.

First, as is the case in manufacturing, policies have lowered effective protection for agricultural products. An overvalued exchange rate diminishes the incomes of traditional producers. The overvalued rate also generally makes imports cheaper. However, in spite of cheaper imports the tariff structure and the NTBs discussed above distort the pattern of import prices raising the cost of imported inputs for agriculture, such as fertilizer and other agro-chemicals. Lower incomes and higher costs have led to a rate of effective protection estimated to be -57% for coffee and -43% for corn.

Second, taxes are levied on the final products of agriculture instead of the factors of production. Taxing the final products distorts the allocation of the factors, decreasing the efficiency of their use. Coffee, for example, has been taxed in El Salvador in recent years at an explicit rate of 30-35%, versus 10% in Honduras.

Lastly, within the agrarian reform sector, especially the large Phase I agrarian reform cooperatives, the incentive structure as well as inadequate management, excessive debt loads, and lack technical assistance, have constrained productivity. Cooperatives are generally formed by a group of people who share a common problem or purpose. However, the membership of the Phase I cooperatives is composed of persons having nothing more in common than the fact that they worked on the cooperative the day the state intervened. Consequently, members often share very little in terms of long range goals and lack the managerial skills and/or experience to administer large, complex agricultural operations.

C. A Stagnant Economy: the Human Dimension

A stagnant economy has taken a considerable toll on the people of El Salvador. In 1988, GDP and GDP per capita stood at 84% and 73%, respectively, of their 1978 levels. The Salvadoran labor market has adjusted to a lower level of economic activity mainly through out-migration and a fall in real wages. It has been estimated that since 1978, a million Salvadorans have emigrated to the U.S., Canada, and other locations to escape the political violence and economic conditions in their country. These migrants were, in general, younger and thus active members of the labor force.

Consistent and detailed wage data are not available in El Salvador, but we do know that between 1978 and 1982 nominal wages grew by about 10% annually, inflation was about 15% annually. This downward trend in real wages has probably continued since 1982. The slow growth in nominal wages has been associated with a shift in the composition in output from formal to informal sector goods and services. As incomes, and hence demand for formal sector goods and services fell, there appears to have been an increase in the demand for the goods and services of the informal sector.

Analyses of recent household surveys confirm this interpretation of labor market developments over the past decade. Open unemployment is not a serious problem in El Salvador; the surveys indicate that only 7-8% of the labor force is actively, but unsuccessfully, seeking work. That work, however, is poorly paid. According to the results of the 1986 survey, median earnings among men measured 702 colones a month (US$140); 13% of the men reported earnings of less than 479 colones (US$96). Among women, half earned less than 479 colones (US$96); almost a third earned less than 300 colones (US$60). These statistics indicate that fully 35% of the employed labor force earns less than the minimum wage. These results refer only to the metropolitan area of the capital city of San Salvador. As the analysis of the 1985 survey demonstrated, wages in the rural areas are far more depressed.

D. The Political Context of Economic Adjustment

1. The Duarte Administration: 1984-1988

When President Duarte entered the presidency in 1984, the country was in the midst of an intense guerrilla insurgency and experiencing profound economic and social problems. Most of the economic troubles were related to the war; the pervasive effect of the conflict on the nation cannot be overestimated. For example, as a result of the conflict, over 2,800 schools closed or were abandoned from 1981-1987, and health services declined -- especially in rural areas, where there were fewer primary health care facilities operating in 1985 than in 1979. The urban population also suffered. The entire population, especially the private sector and small producers and entrepreneurs, was severely affected by the protracted power outages and civil disturbances.

The priorities of President Duarte's administration have been focused on winning the war while trying to implement political and social reforms, curb human rights abuses and establish democratic institutions. Given the nascent democracy and precipitious decline in social services, these were legitimate priorities at the time. It is important to remember the context and competing priorities. The GOES examined the trade-off between economic policy reform and its social agenda and decided to accept the risk of a lower level of economic performance.

At the beginning of 1986, El Salvador faced the most favorable external conditions encountered in years. The GOES announcement in January 1986 of its intention to carry out a program to stabilize and reactivate the economy in the midst of high coffee prices, falling oil prices, an improved market for nontraditional exports and a very favorable credit worthiness review, held promise for renewed World Bank operations. Hopes ran high that 1986 would bring substantial economic growth, lower inflation and a stronger balance of payments position.

President Duarte consulted with the private sector on the Government's planned economic program, which included unification of the exchange rate as well as new fiscal, monetary, credit and income policies. A most important consideration was that the plan called for continuing evaluation and further adjustment of the measures as needed. Unfortunately, the necessary adjustments were not made, the money supply increased rapidly, inflation increased, exports both to the CACM and outside of the area failed to make expected gains, and real GDP grew at only 0.6%.

The political cost to the GOES of the failure of the economic program was enormous and the GOES' lack of commitment to economic reforms and their unwillingness to maintain the fiscal and monetary discipline vital to the success of the exchange rate measure in the face of strong opposition caused the program to fail.

In September of 1986, the GOES did attempt to introduce a package of major tax measures for 1986-1987, partially intended to meet increased defense expenditures. The package was met with an overwhelmingly negative reaction by the private sector.

The following month, San Salvador was struck by the devastating earthquake which caused more than $1 billion in physical damage to the capital. As a result, earthquake recovery efforts took precedence over the economic agenda. The earthquake left 1,500 dead, 20,000 injured, 300,000 homeless, and approximately $1 billion in damages to infrastructure -- mainly in the San Salvador area.

It was in this setting that the GOES prepared its economic program for 1987. As initially presented, the proposed 1987 program contained serious flaws, including a monetary program which was insufficient to cover a $100 million fiscal gap, a failure to address balance of payments implications of a sharp fall in coffee prices and a series of actions which, had they been taken, would have led to a further increase in inflation and a further loss of confidence in the GOES' ability to deal with the nation's economic difficulties. A nationwide one-day strike declared by the major private sector business associations only confirmed President Duarte's conviction that further reforms should be rejected. Subsequent negotiations between the USG and the GOES on a revised program were difficult. President Duarte met personally with the AID Administrator and the LAC Assistant Administrator; both urged him to take strong measures in the revised plan. The President, once again, rejected any further devaluation of the colón, restating his commitment to preserving democracy and social stability.

After lengthy and difficult negotiations, a program aimed at arresting the rapidly deteriorating economic situation was agreed upon in June 1987. The revised program represented a major improvement over the one originally proposed. While sufficient to restrain inflation, it was however, insufficient to lay the basis for strong economic growth.

This compromise extended into 1988. Acknowledging political realities surrounding the March 1988 Legislative Assembly and municipal elections, the USG accepted a policy of continued monetary discipline to control inflation, rather than insisting on a strong set of adjustment measures.

2. Current Political Environment

In El Salvador today there is a growing recognition that economic reform has been neglected for too long. Continued emphasis only on stabilization is no longer sufficient; the economic and social costs of postponed adjustment are too steep. This theme has surfaced in speeches and roundtable discussions hosted by the leadership of a number of political parties. Of particular interest in these talks were discussions of needed reform in the financial and exchange regimes. The leadership of both major parties has been very forthcoming in examining and debating the issues surrounding economic reform.

This dialogue has been reinforced by the work of several teams of independent consultants that have come to El Salvador to study the structure of the economy and make recommedations for appropriate adjustment. Although different in their prescriptions, they all agree on the seriousness of the structural imbalances, particularly with respect to the financial sector and the exchange regime.

Some consensus has also been reached between the GOES and the USG on the present and future role of USG assistance. The Salvadoran economy today is very dependent on high levels of concessionary assistance. However, during the 1990-94 timeframe, ESF levels are projected to decline from $185 to $80 million and other donor assistance is uncertain. If this programmed reduction in balance of payments assistance is not accompanied by an orderly and timely adjustment program, the weaning of the Salvadoran economy from ESF will be accompanied by a fall in output and incomes. Consequently, a judicious program of economic reform must be implemented as soon as possible, while the financial resources are still available to support it.

II. THE PLAN OF ACTION

A. A Summary of the Policy Dialogue Agenda

As was demonstrated in the case of the 1987 and 1988 economic plans, USAID efforts in economic reform have proved most successful when supporting GOES commitments in this area. Accordingly, the Mission will negotiate with the GOES the reforms that should be stated as objectives under their annual economic plans. The set of economic reforms to restore the Salvadoran economy to long-term self-sustaining growth is extensive and will be negotiated with the GOES during 1989-92. As the accompanying table shows, these reforms will relate to stabilization and improving the efficiency of the fiscal, financial, external and productive sectors.

B. A Time of Transition: January-June 1989

Due to the complexity of the political situation facing El Salvador in 1989--the presidential elections in March and the accession of the new government in June--the Mission has accepted the arguments of the the present government that it will not be able to pursue comprehensive economic adjustment before the elections. Therefore, the Mission has focused its policy dialogue with the GOES on a minimum set of measures over the next six months. This involves a monetary program that will be sufficient to restrain price inflation in the economy, while USAID continues with its portfolio of projects (e.g., labor-intensive municipal development and rural public services improvements financed through Municipalities in Action, Public Services Improvement and Earthquake Reconstruction Projects; expanded rural health services through the Health Systems Support and Family Health Service Projects) in the basic human needs area to support the incomes of the poor during this period of slower economic growth.

PLAN OF ACTION

	1st Half 1989	2nd Half 1989	1990	1991-1992
OBJECTIVE	Stabilization Program.	Laying the Bases for Accelerated Economic Growth.	Solidifying the Bases for Accelerated Economic Growth.	Solidifying the Bases for Accelerated Economic Growth.
MEASURES BY SECTOR	Implementation of Monetary Program to Achieve 1.5% GDP growth and 17% inflation.	Continuation of 1989 Monetary Program to Achieve stated target.	Implementation of new Monetary Program to Achieve 2% GDP growth and 15% inflation.	Implementation of new Monetary Programs to Achieve continued Growth with Price Stability.
FISCAL.	---	Improve revenue collection and budget control. Extension of Stamp Tax. Adjust utility rates. Budget for 1990 reflecting revenue improvement developed.	Development of Action Plan to examine tax structure.	Continuation of efforts to improve fiscal sector.
FINANCIAL.	Pilot project to strengthen credit analysis capabilities of banks. Action Plan to strengthen Bank Superintendency. Portfolio audit of Banks.	Develop Financial Sector Reform Project. Adjustment of Passive Interest Rates to Positive Real Levels.	- Strengthen credit and approval process. - Implementation of Financial Sector Reform Project.	Continued implementation Fin. Sector Reform Project.
EXTERNAL.	Develop Institutional Blueprint for new Exchange Rate Regime.	Measures to support exchange and trade regime reform. Implementation of flexible exchange rate regime.	Development of Action Plan to Reform Import Tariff Regime. Removal of non-tariff barriers.	---
PRODUCTIVE.	Continuation of agrarian reform activities.	Set parcelization and self-management targets in ag. reform sector. Plan for IRA reform. Reduction in number of Price Control Categories.	Continued progress on parcelization and self-management in ag. reform sector. Implement IRA plan. Reform INCAFE.	Continued progress on self-management and parcelization in ag. reform sector. Streamline industrial liscensing system.

The GOES has agreed to continue monetary austerity and has presented a monetary program that supports a 1 to 1.5% increase in real GDP and a reduction in the rate of inflation to the range of 15-16%. It calls for no increase in the fiscal deficit and no loss in international reserves from the levels achieved in 1988. However, an analysis conducted in the Mission has revealed several inconsistencies in the program. Among the major problems are:

--It will be very difficult to maintain the balance of payments in equilibrium with a projected trade deficit of US$532 million (US$115 million larger than in 1988) unless banking inflows increase by US$60 million, as assumed in the program. Given the obvious political and economic uncertainties in 1989, the increasing overvaluation of the colón, and the lack of supporting economic policies, a balance of payments deficit of about US$60 million may be the best estimate for 1989. Since a deficit of this magnitude could not be supported with present reserve levels, the result would be some combination of a reduction in imports and an accumulation of arrears in the payment of foreign obligations.

--The Central Government may realize an overall deficit that is ₡17 million larger than previous estimates, with the unfinanced portion growing from ₡133 million to C173 million. Financing this amount will require either an increase in banking system financing to the public sector, along with a corresponding crowding out of private sector credit, or a further increase in floating debt (unpaid domestic bills) placing considerable pressure on the cost structure of the private sector and reducing the profitabilty of the financial sector.

The Mission discussed these problems with the GOES. They concurred with the Mission's assessment of the program and agreed to strengthen the monetary program in the following manner:

--explicitly recognize that balance of payments equilibrium, as well as the equivalent ₡300 million in credit expansion to the private sector, depends on the receipt of the $60 million in medium and long-term banking finance and it does not materialize, credit will be reduced accordingly.

--reduce the deficit of the Central Government by ₡173 million through a 5% underexecution of the budget and an increase in utility rates.

We judge this monetary program to be sufficient to achieve the stabilization of the Salvadoran economy over the next six months. If the assumption regarding banking flows is not realized and the actions to reduce the public sector deficit are not undertaken, the monetary authorities would reduce credit to the private sector allowing the GOES to achieve its inflation target, but at a lower rate of growth than targeted. Such an outcome would certainly be a continuation of the slowed growth in incomes, especially among the poorer groups in society, that occured in 1988. Even though it would place more of an adjustment problem on the new government, it would not necessarily place an intolerable strain on the fabric of Salvadoran society.

USG resource flows will be essential to achieving these modest targets. Without US$30 million in balance of payments support as well as disbursements under the USAID project portfolio and PL480 assistance, the monetary authorities would have insufficient reserves to maintain the flow of credit in the economy through June. The consequence would be lower imports and even lower growth.

In addition to the stabilization program, the GOES has agreed to initiate several preliminary steps related to a reform of the exchange regime and the financial system:

--begin a pilot project to strengthen the loan analysis capability in the commercial banks, an effort that will be financed by USAID;

--begin a program to strengthen the Superintendency of Banks, including the external audit capability; and

--together with USAID, employ a technical team to examine alternative institutional blueprints for a reform of the exchange rate regime.

Lastly, the GOES has agreed to continue several ongoing activities related to the agrarian reform sector:

--continue the titling program for existing Phase III beneficiaries and for new beneficiaries who will receive parcels of underutilized land on various Phase I cooperatives;

--continue to monitor the performance of Phase I cooperatives which have recently been granted self-management and identify other cooperatives eligible for self-management;

--continue to support the Land Bank currently in operation and distributing parcels to individual small farmers; and

--continue technical assistance, land management programs currently in place and payments to former landowners.

With this minimum package of stabilization and adjustment measures, the monetary authorities would be able to contain inflation, further the agrarian reform program and lay the groundwork for key reforms to be undertaken later in the year.

The portfolio of projects detailed earlier now being implemented by USAID will help cushion the impact of falling incomes in a slow growing economy. Interventions in the health sector will provide medicines to the poor. Projects in earthquake reconstruction, public services restoration and municipal works could create as many as 36,000 person years of employment during 1989.

C. Setting the Stage: June-December 1989

The structural adjustment program that is presented below, consisting of improved revenue performance in the public sector and reform of the exchange and interest rate regimes, goes far beyond previous policy dialogue agendas and what has been attempted before by the GOES. As has been the case in the past, the policy dialogue between the USG and the GOES includes a blend of social, political, military and economic issues; however, conditions now call for an increased emphasis on specific measures to increase the growth of the economy.

Even though the program could be judged ambitious in terms of scope and magnitude, it is balanced in the sense that it includes the minimum number of adjustments necessary to address the most serious imbalances in the economy, while not so extensive as to threaten El Salvador's fragile democracy.

1. Stabilization. The GOES will be encouraged to continue with the growth and inflation targets set in the monetary program discussed above. The measures that will be presented below, even if taken late in 1989, would probably not result in economic performance superior to that projected in the monetary program negotiated with the current government.

2. Measures to Improve the Fiscal Sector Imbalance. Reducing the fiscal deficit in the short run will rest on revenue improvement. Current expenditures offer little scope for improvement; public sector wages have experienced little or no increase for almost two years, the need to finance the war continues, and investment expenditures are already at a very low level.

Thus, the Mission will encourage the GOES to take several specific actions late in 1989 to improve revenue performance of the Central Government for 1990. The first will be the introduction of a uniform rate for the stamp tax and the elimination of all exemptions to it. The second will be the adjustment of several or all of the rates for water sewerage, electricity and port charges. The GOES 1990 budget will reflect these revenue improvements. By increasing revenues, the GOES will be able to continue the extension of badly needed social services to the poor.

For longer-term adjustments in public finances, the GOES, with a USAID-financed technical assistance, will be requested to begin in 1989 a 2-3 year program of revenue improvement and budget control effort. Some of the proposed measures could have an impact on the financial position of the Central Government as early as 1990, but most probably not until 1991-93. The highlights of this program are:

a) Revenue Improvements to strengthen tax administration and establish a more efficient tax system.

--Establish a training program for tax administrators.

--Expand the computer information system to improve tax audits.

b) Improved Financial Administration to create a uniform system integrated with the needs and requirements of the Court of Accounts and including basic functions such as comprehensive budget formulation, cash flow analysis and accounting.

c) Improvements in Customs Administration

--Review and modernization of the Customs Laws.

--Establishment of a training program in Customs nomenclature and procedures.

--Creation of a computer system linked to the BCR and the Ministry of Finance to maintain updated trade information and speed monitoring of foreign exchange and tax payments.

3. <u>Measures to Address the Financial Sector Imbalance</u>. Even though several actions can be taken in late 1989 to improve financial savings in the short run, a reform of the financial sector, as is the case of the fiscal sector, will involve a long-term program of activities.

To improve financial savings in the short run, the GOES will be encouraged to reform the interest rate regime late in 1989. Based on an implementation plan prepared with USAID-financed technical assistance, the passive rate will be adjusted to equal the rate of inflation and will be further adjusted every three months on this basis. With respect to the active rates, lending categories will be reduced and the rates for the borrower will be set in accordance with the cost of money and risk.

In order to address the structural imbalances in the financial sector, the GOES will be requested to participate with USAID in the development of a five-year Project to develop and strengthen the institutional basis of the financial sector in El Salvador, a Project scheduled for obligation in FY 1990. Following the pilot activity initiated in 1989, this Project will enhance the management and credit analysis capabilities of financial institutions, establish primary and secondary markets for financial instruments, and improve the solvency of the banks.

Improving the efficiency of the financial sector will have several beneficial effects. First, by adjusting interest rates in the short run, the non-bank public will be encouraged to hold more financial assets in colón deposits, giving the banking system the resources to expand lending without recourse to BCR rediscount facilities. This will greatly improve the efficiency of monetary programming as early as 1990. Second, any measures to strengthen the internal management of the banks will only accelerate the flow of needed credit to the private sector. Lastly, the financial system will be able to allocate credit through the market, not through quotas assigned by the BCR.

4. Measures to Address the External Sector Imbalance

A reform of the exchange and trade regime is essential to increasing the profitability of the export sector and removing restrictions to trade that are causing distortions in the economy. The most fruitful course of action would be the adoption of a flexible exchange rate regime that would not only serve to balance the supply and demand for foreign exchange in the short run, but would avoid an appreciation of the colón that undermines the competitiveness of Salvadoran exports and discourages investment in the export sector over the longer run.

The policy dialogue with the GOES will press for the implementation of a new exchange rate regime in 1989. By June 1989, a technical team financed by USAID will have examined the practical alternatives for such a reform. Based on this assessment, the GOES will be requested to adopt a new exchange rate regime late in 1989.

A change of the exchange rate regime cannot be taken in isolation. It must be accompanied by complementary measures so that the beneficial effects of a devaluation will not be dissipated in inflation. Accordingly, the GOES will be asked to begin a series of actions to reinforce the reform of the exchange rate regime. A necessary complement to a reform of the exchange rate regime will be an increase in domestic interest rates, a measure discussed above. Other equally important measures are the elimination of many of the non-tariff import barriers discussed above such as import prohibitions and quotas, prior import deposits and selective consumption taxes. Implementing these measures will involve a process spanning 1989-91.

5. <u>A Program to Address the Imbalance in the Productive Sectors</u>

a) <u>A Reform of IRA</u>, the institute that regulates basic grain prices, is necessary to move the agency into the general function of a food stabilization fund. Accordingly, the GOES will be requested to develop in 1989:

--an action plan to implement a directed food subsidy program directed at the most needy groups in the society to replace the general food subsidy now provided by IRA, and

--an action plan to convert IRA into a price stabilization body.

Both action plans will be completed by the third trimester in 1989 and the GOES will be asked to implement the recommendations during the first trimester in 1990.

b) <u>The Mission's Long-Term Goal in the Agrarian Reform Sector</u> is to improve the efficiency within the reform sector by organizing production in a manner which maximizes the incentives of the agrarian reform beneficiaries, and by distributing abandoned or underutilized land to persons able and willing to work it, either through increasing the number of persons on agrarian reform properties or facilitating land transactions. Accordingly, over the next several years the Mission will focus on:

--Granting a degree of self-management, (<u>autogestión</u>) to all cooperatives which meet specific economic and financial criteria;

--A set of policy actions involving the parcelization of abandoned and underutilized land on Phase I cooperatives. These are properties where the cooperative structure does not exist. In an effort to provide more access to land, the GOES will be encouraged to adopt a set of policy actions regarding parcelizing the underutilized land on the Phase I cooperatives; and

--Upon completion of the Phase III titling, financial support to a Land Bank which will provide credit for agricultural land purchase to persons otherwise not eligible for loans thus reinforcing the impact of the parcelization.

--Reopen negotiations with the GOES and the Legislative Assembly to secure a beneficiary rights law which enables agrarian reform beneficiaries to freely choose alternative forms of land tenure and production systems.

After the new government is in place, the Mission will begin a series of meetings to jointly establish objectives and means of achieving the objectives and targets related to the agrarian reform. Verifiable targets and supporting activites will be agreed upon and negotiated as part of future programs of financial support to the GOES.

D. The Program for 1990

1. Stabilization. A program of economic reform begun in 1989 will permit the economy to begin to achieve its potential in terms of self-sustaining growth with price stability. Accordingly, the GOES will be encouraged to focus on an economic plan and monetary program for 1990 with targets that reflect further reduction in inflation, along with an increase in real incomes and employment in the economy:

--Real GDP growth of approximately 2%;

--An annual rate of inflation of between 14-16%;

--A $50 million (about 15%) improvement in the trade deficit over 1989;

--Equilibrium in the overall balance of payments, i.e., no loss in international reserves over 1988; and

--An improvement in Central Government revenues equivalent to between 2-4% of GDP.

2. Measures to Improve the Efficiency of the Fiscal Sector. The package of technical assistance to improve the efficiency of the tax system and improve the budgetary process will continue in 1990. Specifically, USAID and the GOES will work together to produce an action plan to simplify the tax structure.

3. Measures to Improve the Efficiency of the Financial Sector. The Project to strengthen the financial sector will be obligated in 1990. For 1990, there will be:

--A portfolio audit of banks; and

--A program to strengthen the credit approval process in the banks.

4. Measures to Remove the Imbalances in the External Sector. The complementary actions to support the new exchange rate regime begun in 1989 will continue in 1990.

Specifically:

--Continued removal of non-tariff barriers; and

--Development of an action plan to reform the import tariff regime.

5. <u>Measures to Improve the Efficiency of the Productive Sectors</u>

--Legislation will be introduced to reform INCAFE, the state coffee marketing agency, by permitting private sales of coffee.

--Continued progress on parcelization and self-management in the agrarian reform sector; and

--Implementation of the IRA actions begun in 1989.

III. THE CONSEQUENCES OF DELAYED ADJUSTMENT

The program of economic adjustment discussed in the above sections is essential for an improvement in per capita incomes for the Salvadoran population. Estimating the actual impact of these reforms on the economy must, of course, take into account several unknowns: the direction of the war, the trend in coffee prices, the level of external assistance, and the magnitude of private capital flows. Nevertheless, the Mission has constructed several scenarios to estimate the course of economic developments in El Salvador with and without adjustment.

Three scenarios were examined in depth:

--continued USG balance of payments assistance at the current level with no policy changes;

--continued USG assistance with policy reforms implemente beginning late 1989; and

--elimination of USG BOP assistance in 1991 with no policy change.

The scenarios rest on a simple import-driven model. As export performance improves, there is less of an import constraint to higher growth. For all, it is assumed that the war will continue as at present and that world coffee prices will recover only moderately from current levels. If other donor assistance were to increase, USG assistance would decline by an equal amount.

With no policy change, per capita GDP and the average real wage could fall by 8% and 10% respectively between 1990 and 1994. If USG assistance were to be eliminated in 1991, the two indices could fall by as much as 18% and 19% respectively. However, with foreign aid at present levels and policy change, GDP per capita and the real wage could rise by 9% and 7% respectively.

The difference among the three scenarios is varying levels of export performance, both for coffee and nontraditionals. With foreign aid and better policies, exports and private capital inflows could rise by 60% between 1990 and 1994. For the other two scenarios, the increase is 22%.

Two conclusions flow from this analysis. First, policy reform is essential for improved economic performance. Second, external assistance is crucial during the process of adjustment. Without such assistance, there would be inadequate external resources to buffer the economy from the shock of adjustment and to protect employment and income until higher growth can be achieved.

IV. PAAD DEVELOPMENT

Subsequent to the approval of this Concept Paper, the Mission will present a PAAD requesting only a $30 million disbursement, with the understanding that a PAAD Amendment covering the remainder of the program will be required later in the year, after further negotiations with the new government. The PAAD will present more detail on the transition package of stabilization and selected reforms and request approval and authorization of an initial disbursement of $30 million under the 1989 ESF Balance of Payments Support Program.

Once negotiations with the new government over the comprehensive reform program are complete, the Mission will return with a PAAD amendment requesting approval and authorization for the remainder of the program to be disbursed in two equal tranches of approximately $54 million.

V. INSULATING THE POOR FROM THE SHOCK OF ADJUSTMENT

A. Impact on the Composition of Economic Activity

Individuals of means will be affected by the adjustment process, but will be in a position to weather it. Over the short-term, economic adjustment may be painful to the poor; it is not sufficient to simply state that in the long-run these people will be better off with adjustment than without. However, it is important to stress that the planned structural adjustment is time phased, and will not, therefore, have the same magnitude as economic reform efforts in other countries, such as Bolivia.

Removing the constraints to growth will undoubtably bring increased employment opportunities and incomes to the low income groups in Salvadoran society over time. Nonetheless, the same people will be hit with unemployment and higher prices for their basic consumption basket in the short run. These short-term consequences of adjustment must be addressed, otherwise there will be unacceptable pressures on the already fragile political structure of the country.

Among the package of reforms that the Mission will encourage the GOES to adopt, changes in the exchange and interest rate regimes will have the greatest impact on relative prices in the Salvadoran economy. A change in relative prices will increase the profitability of exports and those industries that are able to produce import substitutes efficiently. However, the change will adversely affect those industries that produce non-tradeables such as services and informal sector goods. As profitability changes, so do investment patterns and, consequently, wages and employment.

There is no data that enables the Mission to accurately predict which industries will benefit and which will suffer declining investment and employment. Based on net export coefficients (industry exports minus imports divided by value added), it is possible that industries such as processed fish products, sugar, coffee and textiles will experience increased profitability. Others, such as milling and bakery, chemical products, and printing may suffer declining activity.

Several of the industries that will benefit from a reform of the exchange rate regime may initially experience adverse effects from a reform of the interest rate regime. A rise in real interest rates resulting from financial sector liberalization will have an adverse short-term impact on credit intensive industries such as cotton, non-residential construction, rice and poultry breeding. Additionally, economic adjustment may be accompanied by very strict monetary and credit programming to control inflation. Consequently, both the quantity and the price of credit will be affected. In such a situation, only the relatively profitable industries would be able to survive in an environment of competition for scarce credit resources.

B. Impact on the Poor

The poor will be directly affected by these adjustments. The impact of the adjustment program on the poor will depend on the nature and timing of the measures. To the extent that overall productivity is increased, the poor majority, urban and rural, will benefit through increased production, employment, foreign exchange earnings and incomes.

However, any measure that increases prices or leads to a decrease in the level of economic activity of their sectors of employment may lower the living standards of the poor in the short run. The change in the composition of economic activity will impact the hardest on the urban low income groups in the formal sector. The bottom 15% of wage earners in the adversely affected industries, perhaps as many as 35,000 to 40,000, may suffer temporary loss of employment opportunities. Those in the urban informal sector, most of whom earn the minimum wage or below, probably will not be much affected. Small farmers and non-farm rural poor (estimated to total 100,000 families) will probably not be adversely affected; within one crop season of a change in agricultural prices, there will be an increase in small farm incomes and in employment opportunities for the non-farm rural poor.

The low income groups will experience increases in the cost of living as the price of their basic consumption basket (gasoline, electricity, bus fares, milk, beans, corn, cooking oil) rises. The increase in interest rates will probably not affect them directly, since they are generally outside the formal credit system. These increases will fall on the lowest wage earners in the formal sector, workers in the informal sector and on rural non-farm labor. Small farmers will immediatley experience a rise in income and will be insulated from price increases in basic necessities.

C. <u>The Impact Response</u>

The economic reform/adjustment process outlined herein will be an evolving effort that will span several years. It is a very ambitious agenda, and one that will take a concerted, sustained effort on the part of both the GOES and AID to implement. Given the fragile, nascent nature of the Salvadoran democracy and the USG commitment to supporting this democracy, the reforms will be measured and sequential. To do otherwise would lead to turmoil and unrest that could threaten the democracy, and possibly have a heavy negative short-term impact with no long-term benefits. The Mission and the GOES will tailor their response in assisting the poor in dealing with the shock of adjustment with its existing portfolio and the flexibility inherent in the local currency programming process.

The GOES can draw on the current inventory of project interventions to help maintain employment and incomes and cushion the impact of adjustment on the targeted poor during the first year of adjustment. There are several public works projects, especially in road restoration and repair, under the US$135 million Public Services Improvement Project to be obligated in FY 1989, for example, that will provide short-term employment to unskilled labor in the urban and rural areas. The Municipalities in Action Program is another vehicle for providing short-term employment to those displaced as a result of the adjustment process through public works projects executed at the municipal level; this program can easily and quickly be expanded to temporarily augment incomes of the most affected in any area of the country. The employment generation impact of USAID and other donor interventions could provide wage relief to as many as 48,000 people during the two critical years of adjustment, 1990-91. Several of the activities, such as road construction and municipal development projects could be quickly expanded adding to the labor absorptive capacity of these programs.

Also contributing to the cushioning of the shock of adjustment will be the Mission's investment in the productive sectors. The private sector--especially those subsectors which will benefit immediately from the economic reforms--will have substantial dollar and local currency resources available for investment in export operations, working capital, refinancing, etc. The FY 1990 Coffee Technology Project will provide credit and technical assistance to approximately 100,000 small farmers. Modifications to the Agrarian Reform Financing Project will expand beneficiaries to other than non-reform small and medium-size farmers. The new Free Zone Development Project will also offer employment in urban areas.

GOES and Mission efforts to assist small and microentrepreneurs will offer further relief to the poor during the adjustment period. In addition to the ongoing Small and Microenterprises Project, complemented by significant local currency credit to these enterprises, a new FY 1990 Project will focus on microentrepreneurs and smaller businessmen in urban and rural areas. Moreover, several PVO's working in this area are being supported by USAID and the GOES.

On the health side, the Mission's efforts in the health sector to improve family health services, reducing malnutrition and providing free medicines will aid the target group over the next several years.

It is also fortuitous that other donors have and are initiating labor-intensive development efforts. The Inter-American Development Bank, for example, is initiating a water and water systems project that generate employment in the San Salvador metropolitan area. In addition, as the longer-term earthquake reconstruction programs financed by other donors and AID move into the construction phase, increased employment opportunities (at least through 1991) will be generated.

Augmenting all the above projects and programs is the Mission's local currency program, which offers flexibility for responding to the situation as it evolves. If adjustments in programming are necessary over the short-term to cushion the shock of adjustment, the local currency program can be modified with greater agility than the dollar portfolio.

Table 1
Selected Macroeconomic Data

	1984	1985	1986	1987	Prel.1988	1989 2/
	(In millions of colones)					
Real GDP (1962 prices)	2935.6	2993.6	3012.5	3093.5	3107.6	3152.6
GDP at current prices	11657.2	14330.8	19762.9	23140.6	27200.0	31145.3
	(In US dollars)					
GDP at current prices 1/	3665.8	3693.5	3946.6	4628.1	5440.0	
	(Annual percentage change)					
Real GDP	2.3	2.0	0.6	2.7	0.5	1.4
GDP at current prices (colones)	14.8	22.9	37.9	17.2	17.5	14.5
GDP at current prices (dollars)	10.1	0.8	6.9	17.2	17.5	
GDP deflator	12.3	20.6	37.0	14.0	17.0	
Consumer Price Index	11.7	22.3	31.9	24.9	19.8	15-16
	(Colones per dollars)					
Official exhange rate	2.5	2.5	5.0	5.0	5.0	
Parallel exchange rate	3.91	4.27	5.64	5.48	5.5	
	(In colones)					
Per capita GDP (nominal)	2381.4	2877.7	3905.7	4493.3	5193.2	

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Exchange rates used: 1984: 3.18 colones per dollar; 1985: 3.88 colones per dollar; 1986-88: 5.0 colones per dollar.

2/ Selected data from the Monetary Program.

Table 2
Summary Operations of the Central Government 1/

	1984	1985	1986	1987	Prel.1988	1989 3/
	(In millions of colones)					
Total Revenue	1922	2070	3160	3299	3337	3371
Tax Revenue	1349	1658	2579	2515	2679	2746
Direct taxes	341	385	526	711	780	
Income tax	267	298	433	561	600	
Other	74	87	93	150	180	
Taxes on foreign trade	373	533	1168	702	721	
Import taxes	126	170	204	259	260	
Export taxes	247	363	964	443	461	
o/w: coffee	240	357	955	432	454	
Taxes on domestic transactions	635	741	885	1102	1178	1210
Stamp tax	370	433	550	703	750	724
Other	265	308	335	399	428	486
Adjustment for Tax Arrears 2/	8	-7	42	-25		
Non Tax Revenue	197	254	309	213	240	225
o/w Transfers from Public Enterprises	70	94	133	29	28	
Grants & Capital Revenue	384	151	314	546	418	400
o/w Capital Revenue	1	—	2	—	—	—

Continued on next table

Table 2
Summary Operations of the Central Govenment 1/

...Cont.

	1984	1985	1986	1987	Prel.1988	1989
Expenditure and Net Lending	2223	2457	3438	3593	3756	3888
Current Expenditure	1770	1909	2567	2762	3105	3174
Wages and salaries	1005	1182	1457	1709	1841	
Goods and services	295	271	385	450	539	
Interest	165	172	260	241	256	
Current Transfers	305	284	465	362	469	
Capital Expenditure	474	542	602	703	520	719
Fixed capital formation	345	367	470	529	426	
Capital transfers	128	172	117	171	93	
Other	1	3	15	3	1	
Net Lending	-22	6	269	128	131	-5
Current Account Balance	-232	10	279	-9	-186	-203
Overall Deficit (before grants)	-684	-538	-590	-840	-837	-917
o/d (after grants)	-301	-387	278	-294	-419	-517
			(In percent of GDP)			
Revenue	16.4	14.4	16.0	14.3	12.3	10.8
Expenditure & net lending	19.1	17.1	17.4	15.5	13.8	12.5
Current account balance	-2.0	0.1	1.4	—	-0.7	-0.7
Overall Deficit (before grants)	-5.9	-3.8	-3.0	-3.6	-3.1	-2.9
Overall Deficit (after grants)	-2.6	-2.7	-1.4	-1.3	-1.5	-1.7

Source: Ministry of Finance and Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Includes extrabudgetary operations.
2/ Unpaid tax revenue in given year.
3/ Selected data from the Monetary Program.

(In millions of colones)

	December 31 (Actual)				Monetary Program Target	Variation for	Relative Change (%)			
	1985	1986	1987	1988	Dec.31, 1989	1989	1986	1987	1988	1989
Banking System										
Net International Reserves 1/	1365.8	1255.4	1509.2	1190.3	1190.3	0.0	-8.1	20.2	-21.1	0.0
Net Domestic Assets	7405.9	9100.6	9532.1	10649.5	12123.4	1473.9	22.9	4.7	11.7	13.8
Domestic Credit	7180.9	7977.4	8673.1	9491.0	10695.2	1204.2	11.1	8.7	9.4	12.7
Credit to public sector 2/	2346.7	2213.3	2433.0	2359.7	2511.0	151.3	-5.7	9.9	-3.0	6.4
Central Government (net)	1820.5	1633.7	1773.6	1613.9	1714.0	100.1	-10.3	8.6	-9.0	6.2
Credit 3/	2238.6	2297.5	2466.7	2586.5	2581.6	-4.9	2.6	7.4	4.9	-0.2
Deposits	-418.1	-663.8	-693.1	-972.6	-867.6	105.0	58.8	4.4	40.3	-10.8
Rest of public sector	526.2	579.6	659.4	745.8	797.0	51.2	10.1	13.8	13.1	6.9
Official credit institutions	640.8	656.5	711.6	912.8	821.3	-91.5	2.5	8.4	28.3	-10.0
Credit to private sector	4193.4	5107.6	5528.5	6218.5	7062.9	844.4	21.8	8.2	12.5	13.6
Other Institutions/not assigned	0.0	0.0	0.0	0.0	300.0	300.0	0.0	0.0	0.0	0.0
Other (residual)	225.0	1123.2	859.0	1158.5	1428.2	269.7	399.2	-23.5	34.9	23.3
AID related deposits (BCR)	396.1	757.7	1389.4	1517.7	1780.8	263.1	91.3	83.4	9.2	17.3
Medium/long-term foreign liabilit.	2857.6	2453.5	1966.4	1735.9	2015.9	-280.0	-14.1	-19.9	-11.7	16.1
Liabilities to private sector	5518.0	7144.8	7685.5	8586.2	9517.0	930.8	29.5	7.6	11.7	10.8
Money	2310.4	2796.4	2812.3	3033.1	3227.6	194.5	21.0	0.6	7.9	6.4
Quasi-money	3207.6	4348.4	4873.2	5553.1	6289.4	736.3	35.6	12.1	14.0	13.3
Central Reserve Bank										
Net International Reserves 1/	828.8	890.4	1180.6	972.0	918.0	-54.0	7.4	32.6	-17.7	-5.6
Net Domestic Assets	4412.3	4313.7	4671.7	5189.8	5783.6	593.8	-2.2	8.3	11.1	11.4
Domestic Credit	3718.9	3350.2	3800.6	4114.3	4834.2	719.9	-9.9	13.4	8.3	17.5
Public sector (net)	1978.2	1687.2	1809.0	1785.4	1941.6	156.2	-14.7	7.2	-1.3	8.7
Central Government	1639.5	1338.1	1422.4	1352.9	1448.0	95.1	-18.4	6.3	-4.9	7.0
Credit 3/	2020.0	1968.1	2077.3	2291.6	2286.7	-4.9	-2.6	5.5	10.3	-0.2
Deposits	-380.5	-630.0	-654.9	-938.7	-838.7	100.0	65.6	4.0	43.3	-10.7
Rest of public sector	338.7	349.1	386.6	432.5	493.6	61.1	3.1	10.7	11.9	14.1
Credit	435.1	475.0	545.2	581.0	632.3	51.3	9.2	1..8	6.6	8.8
Deposits	-96.4	-125.9	-158.6	-148.5	-138.7	9.8	30.6	26.0	-6.4	-6.6
Commercial banks	835.9	817.3	1097.6	1261.1	1656.0	394.9	-7.7	34.3	14.9	31.3
Others nonbank financial inst.	854.8	845.7	894.0	1067.8	1166.6	98.8	-1.1	5.7	19.4	9.3
Private	214.0	189.2	182.4	155.0	178.8	23.8	-11.6	-3.6	-15.0	15.4
Public	640.8	656.5	711.6	912.8	987.8	75.0	2.5	8.4	28.3	8.2
Other institutions/not assigned	0.0	0.0	0.0	0.0	70.0	70.0	0.0	0.0	0.0	0.0
Other (residual)	693.4	963.5	871.1	1075.5	949.4	-126.1	39.0	-9.6	23.5	-11.7
AID related deposits (BCR)	396.1	757.7	1389.4	1517.7	1780.8	263.1	91.3	83.4	9.2	17.3
Medium/long-term foreign liabilit.	2851.8	2442.1	1962.3	1733.9	1664.4	-69.5	-14.4	-19.6	-11.6	-4.0
Liabilities to commercial banks	901.5	832.8	1192.6	1576.7	1766.4	189.7	-7.6	43.2	32.2	12.0
Bank deposits	841.0	716.1	1135.7	1507.9	1691.6	183.7	-14.9	58.6	32.8	12.2
Banks' cash in vault	60.5	116.7	56.9	68.8	74.8	6.0	92.9	-51.2	20.9	8.7
Stabilization Bonds	0.0	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.	n.a.	n.a.
Liabilities to nonbank financial institutions	11.9	15.0	10.0	7.3	8.8	1.5	26.	[illegible].3	-27.0	20.5
Currency in Circulation	1079.8	1156.5	1298.0	1326.2	1481.2	155.0	7.1	12.2	2.2	11.7

Source: Central Reserve Bank.
1/ Data for 1984 and 1985 has been adjusted to make it comparable with the following years.
The colon was devalued and the gold hodings were revalued to reflect the market rate in January 1986.
2/ [illegible]

Table 4
Summary Balance of Payments

	1984	1985	1986	1987	Prel.1988	1989 1/
	(In millions of US dollars)					
Current Account (excluding official grants)	-230	-264	-107	-239	-240	-324
Merchandise Trade	-252	-266	-180	-403	-417	-532
Exports (FOB)	726	695	755	591	633	583
Imports (CIF)	978	961	935	994	1050	1115
Net Services	-116	-110	-87	-30	-45	-29
Private Transfers	138	112	160	194	222	237
Official Grants	177	207	224	379	301	275
US Aid	174	201	204	342	244	233
Other official	3	6	20	37	57	42
Capital Account	61	104	-42	-89	-125	49
Private and net errors and ommissions	-15	32	-32	-51	-119	-62
Government (net)	92	106	64	58	41	55
Financial System (net)	-16	-36	-74	-96	-47	56
Overall Balance	8	47	75	51	-64	—
	(As percent of GDP)					
Current Account Balance (excluding official grants)	-6.3	-7.1	-2.8	-5.2	-4.4	-5.2
Trade Balance	-6.9	7.2	-4.6	-8.7	-7.7	-8.5
Official Grants	4.8	5.6	5.7	8.2	5.5	4.4
Capital Account	1.7	2.8	-1.1	-1.9	-2.3	0.8
Overall Balance	0.2	1.3	1.9	1.1	-1.2	—

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Selected data from the Monetary Program.

Table 5

Exports

(In millions of US dollars and thousands of qq.)

	1984	1985	1986	1987	Prel. 1988	1989 1/
COFFEE						
Value	450	464	457	352	369	301
Volume	3568	3456	2937	3383	2872	2273
$/qq.	126	134	186	104	128	132
COTTON						
Value	9	29	5	2	1	2
Volume	114	514	132	58	20	45
$/qq	80	56	34	39	39	51
SUGAR						
Value	26	23	25	12	18	19
Volume	1636	2422	2144	821	1698	1138
$/qq.	16	10	12	15	11	17
SHRIMP						
Value	20	10	17	21	21	20
Volume	5030	2565	4364	3576	3712	3798
$/qq.	4	4	4	6	6	5
CACM						
Value	157	96	91	120	135	147
REST OF THE WORLD						
Value	64	74	70	85	90	94
TOTAL	726	695	755	591	633	583

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Monetary Program estimates.

Table 6

Imports

(In millions of US dollars)

	1984	1985	1986	1987	Prel. 1988	1989 1/
Consumer Goods	277	259	207	241	275	293
Durables	38	48	25	32	42	45
Nondurables	239	211	182	208	234	248
Raw Materials	569	545	453	501	516	555
Industry	455	418	363	394	403	435
of which: petroleum	130	133	82	104	82	93
Agriculture	57	76	41	39	41	43
of which: fertilizers	25	40	25	27	27	29
Construccion	51	46	44	61	66	70
Other	6	6	5	7	7	7
Capital goods	132	158	225	252	258	267
Industry	43	43	59	72	78	83
Agriculture	13	14	10	13	14	14
Contruction	5	6	6	11	12	12
Transport	53	68	124	124	123	124
Other	18	27	26	32	32	34
Others	—	—	50	—	—	—
Total Imports	978	961	935	994	1050	1115

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Monetary Program estimates.