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Room 2248-N.S.

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USAID/EL SALVADOR

FY 1992 ESF
POLICY REFORM PROGRAM
CONCEPT PAPER

January 22, 1992

USAID/EL SALVADOR
FY 1992 POLICY REFORM SUPPORT PROGRAM
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I. PROGRAM SUMMARY

This Concept Paper presents the Mission's proposed ESF Policy Reform Support Program for FY 1992. The program will provide continued support to the GOES economic stabilization and structural adjustment program initiated in mid-1989 with USG support. The GOES program has been highly successful in correcting macroeconomic imbalances and reshaping the economy toward more reliance on market forces and the private sector. As a result, economic performance has greatly improved. Output is up, inflation is down, and exports are rebounding. Higher investment and large capital inflows reflect greater confidence in the economy. Moreover, there is convincing evidence that El Salvador's expanding economy is directly benefitting the poor. Urban employment has increased by as much as 100,000 over the last two years, and improved agricultural incentives have increased small farmer income.

Notwithstanding the notable progress to date, however, the Salvadoran economic recovery remains fragile as the policy reforms of the Cristiani Administration have yet to be fully consolidated. Moreover, per capita GDP is still 25 percent below that of 1978, and exports are only 55 percent of levels achieved in the late 1970s. While gains have been made in liberalizing trade and increasing reliance on competitive market forces, many additional measures are needed to solidify the basic economic policy framework now in place to enable El Salvador to achieve self-sustained economic growth. Moreover, this policy reform "follow-through" includes politically difficult measures which must be completed soon as stiff resistance to reform is starting to mount in certain sectors.

The proposed program will cover a critical and politically difficult period as El Salvador initiates its transition from war to peace while consolidating recent gains in strengthening the democratic process, protecting human rights and building a market-oriented economy. Continued USG support will be essential to enable the Cristiani Administration to maximize economic and democratic reform achievements during 1992 and before the politically charged 1993 calendar year leading up to the March 1994 presidential elections.

The Mission's FY 1992 program will encourage the GOES to maintain its policy reform momentum through this difficult period. It will directly support the maintenance of sound macroeconomic policies and the deepening and consolidation of specific structural adjustment measures of particular importance to the achievement of Mission program objectives. It will also promote further progress toward improvement in the administration of justice. In addition, the FY 1992 ESF Program will continue to support the LAC Bureau and Mission strategic objectives of broadly-based, sustainable economic growth and a stable democratic society. Furthermore, it will complement and reinforce the policy reform objectives of El Salvador's Stand-by Arrangement with the IMF, its Structural Adjustment Loan with the World Bank, and its Investment Sector Program with the Inter-American Development Bank.

The Mission proposes a $90 million cash transfer to be disbursed in two equal tranches in the second and third quarters of calendar year 1992. The disbursements will be subject to satisfactory GOES performance in maintaining its overall economic stabilization and structural adjustment program, achieving specific improvements in public sector efficiency, encouraging private investment and strengthening the administration of justice. The dollars provided by the program will finance imported production inputs for the private sector and will facilitate the achievement of GOES 1992 Economic Program objectives of four percent real growth and lower inflation. Local currency generated from the cash transfer will finance GOES counterpart contributions to USAID projects and general budget support. The Mission requests that the LAC Assistant Administrátor approve the use of the general budget option.

The Mission requests delegation of authority to approve the PAAD which is scheduled for completion during March 1992.

II. MACROECONOMIC CONTEXT

A. GOES Economic Reform Performance

1. Overall Performance in 1991

The GOES continues to successfully implement its economic stabilization and structural adjustment program initiated in June 1989 with USG support. Building on the solid progress achieved during its first 18 months in office, the Cristiani Administration maintained fiscal and monetary discipline, further liberalized domestic and external trade, improved public sector efficiency, and initiated the reprivatization of the state-owned commercial banks. In response, during 1991 real output grew 3.5 percent, inflation was cut almost by one-half, the current account deficit of the balance of payments was reduced, and international reserves were further strengthened (see Table I). These gains were especially impressive considering that they were achieved in spite of continued internal conflict, further war-related sabotage, the Persian Gulf Crisis oil price shock, continued recession in the U.S. -- El Salvador's principal trading partner, reduced coffee exports, and El Salvador's mid-year drought.

Money and Credit: The most notable aspect of the GOES economic policy performance in 1991 has been the continuation of its moderately austere monetary program. Through the first nine months of 1991, monetary and credit growth were well within levels consistent with reducing pressure on the balance of payments and the domestic price level while permitting real growth targets to be achieved. Over that period, overall credit expansion was held to a 7.5 percent annual rate. Banking system credit to the consolidated nonfinancial public sector actually declined at an annual rate of 4.2 percent. This permitted an 11.9 percent annual rate increase in credit to support private sector investment and production. However, preliminary data for calendar year 1991 as a whole suggest that greater than expected credit to the public sector during the last calendar quarter pushed overall credit expansion to 11 percent and net credit to the public sector to 15 percent (see Statistical Appendix, Table 4). Broad money supply growth dropped to a 21 percent rate compared to last years's 28 percent rate.

As a result of the recent relaxation in interest rate controls, rates for deposits have moved to levels more closely reflecting market forces. Moreover, in recent months a far greater degree of competition has been noted among banks for deposits. Also, the increased interest rate liberalization, along with lower inflation, has resulted in loan and deposit rates that are substantially positive in real terms.

Fiscal Accounts: Although the mid-year drought and other factors beyond the GOES control caused it to miss some targets, overall fiscal performance during 1991 was generally satisfactory. Central Government tax revenues grew 30 percent compared to last year, and when adjusted for inflation showed 20 percent real growth (see Statistical Appendix, Table 3). As a percentage of GDP, collections reached 9.1 percent, a marked improvement over the 8.1 percent achieved during 1990, but just under the original 1991 program target of 9.3 percent. Contributing most importantly were large increases in import tariffs, income and sales tax revenues. These resulted from tighter enforcement and the reduction of exemptions. They also reflect the higher level of overall economic activity which increased business and personal income, the volume of business transactions and imports. Contributing to the .2 percent of GDP revenue shortfall (from the program target) was a 45-day strike by Ministry of Finance personnel which resulted in substantial unrecoverable revenue losses.

This strong revenue performance, however, was not matched on the expenditure side. Early estimates for 1991 show Central Government nominal expenditures jumping by more than 30 percent. Contributing importantly to this increase was a more than doubling of domestic and external interest payments. This reflected substantially higher interest rates on domestic debt following a public sector debt consolidation exercise at the end of 1990, as well as greater external debt service requirements following the expiration of the period covered by the 1990 Paris Club rescheduling agreement. Another major factor was the greater than programmed transfer to the energy parastatal. This was required to cover additional operating losses resulting from increased higher-cost thermal power generation instead of cheaper hydroelectric power due to the mid-year drought.

These increases pushed total 1991 Central Government expenditures to 13.3 percent of GDP, way above the initial program target near 12 percent. This, together with the slightly lower than expected tax collections, resulted in a deficit, excluding official transfers, equal to 3.8 percent of GDP, well above the original program target of 2.5 percent. While making a moderate but unavoidable deterioration from the 3.2 percent figure achieved in 1990, it was still well below the nearly five percent of GDP deficit recorded in 1989. The larger than programmed deficit required an increase in banking system financing to 1.5 percent of GDP in 1991, up a full percentage point from 1990.

<u>Privatization of Banking System</u>: The GOES is proceeding with its plan to privatize the nation's commercial banks. In late 1990 and early 1991 the GOES obtained Legislative Assembly passage of five key pieces of legislation which established the basis for privatization and financial sector reform. In November 1991, shares of the two largest banks, Banco Cuscatlán and Banco Agrícola, were put on sale. During the initial four-month phase, the shares will be sold only to bank employees and small investors. Subsequently, the remaining shares will be auctioned off to other investors. As of December 31, 1991, 60 percent and 70 percent, respectively, of the shares of Banco Cuscatlán and Banco Agrícola had been sold to private shareholders.

<u>Liberalized Trade Regime Maintained and Strengthened</u>: During 1991, the GOES maintained its flexible, market-determined exchange rate regime. As programmed, in July the GOES reduced the maximum external tariff rate from 35 to 30 percent for all but a few categories (apparel, textiles, footwear, leather products, liquor, artwork, antiques, and certain vehicles, are still subject to the 35 percent rate). The minimum tariff rate remains at 5 percent. As a result, the average effective rate of protection has been reduced, significantly below the 28 percent average rate last year and well below the 44 percent average rate prevailing before the Cristiani administration initiated its trade regime reforms.

<u>Agriculture Sector Reforms</u>: The GOES expanded coverage of its basic grain price band regime to include rice in January 1991 and sorghum in November 1991. These are in addition to the band for yellow corn which went into effect in June 1990. The Beneficiary Rights Law was passed on April 12, 1991. Now members of Agrarian Reform Phase I agricultural cooperatives can chose the form of land ownership they desire. Also, legislation was approved in March 1991 establishing the Land Bank, which facilitates land transfers from willing sellers to small farmers by providing long-term land purchase financing.

Prior to 1991, the GOES eliminated export taxes on sugar and shrimp and reduced the export tax on coffee. The GOES has included in its budget for 1992 a further reduction in the coffee export tax as another step toward its eventual elimination.

The Salvadoran Institute for Coffee Research (ISIC) was closed down and 264 employees separated. Also, the Basic Grains Supply Institute (IRA) remained closed and its 1100 employees were separated from public service.

Table I
Government of El Salvador Economic Program for 1991
Macroeconomic Targets and Actual Performance

Performance Indicators	1989	1990	1991 Program Targets Original 12/90	1991 Program Targets Revised 9/91 1/	1991 Estimated Performance
Real GDP Growth Rate in percent	1.1	3.4	3-4	2.7	3.5
Inflation -- Percent Change in CPI					
Year-end Basis	23.5	19.3	10-14	15.0	9.8
Period Average	17.6	24.0	11-15	15.6	14.4
Fiscal Deficit as percent of GDP 2/:					
Central Government	4.9	3.2	2.5	3.6	3.8
Consolidated Nonfinancial Public Sector	5.8	2.5	2.6	3.4	3.5
Current Account Deficit 2/ in Balance of Payments as Percent of GDP	9.4	6.7	5.5	5.4	5.5
Increase in Net International Reserves of the Central Bank - in Millions of Dollars	37	117	70	70	41 3/
Growth in Broad Money Supply Percent Change Over Previous Year	12	28	14	21	21

Source: Central Reserve Bank
1/ Program revised in September 1991 to reflect impact of mid-year drought.
2/ Excluding official transfers.
3/ Had Mission not withheld second FY 1991 ESF $45 million disbursement, target would have been met.

2. GOES Performance on FY 1991 ESF Supported Measures

The GOES showed similar strong overall performance in policy reform areas supported by the Mission's 1991 ESF program. As indicated above, although overall fiscal performance was less than ideal, the GOES successfully implemented its 1991 economic program which achieved 3.5 percent real GDP growth and substantially lower inflation. With respect to particular measures supported by the FY 1991 ESF program:

- New fiscal measures were developed to reduce tax exemptions, unify the sales tax rate at five percent, tighten up tax collections and improve cash flow management operations. As indicated above, tax revenues increased to 9.1 percent of GDP in 1991, up from 8.3 percent the year before.

- A committee to review and evaluate the GOES strategy for integrated financial management and auditing was established at the beginning of June 1991, and a draft law has been prepared to improve the operations of the Court of Accounts, the GOES audit agency.

- An assessment of public sector employment efficiency was completed in September and the GOES has developed a plan to adjust public sector employment levels and rationalize salary structures. Moreover, the GOES has gone beyond the scope of the ESF-supported measure by initiating implementation of specific elements of the plan. These include the introduction of voluntary separation and accelerated retirement programs for government workers and the termination of employment for public workers illegally on strike.

- A presidential commission for liquidation and privatization of state-owned enterprises was established in May and the Privatization Law was approved by the Legislative Assembly in the same month. However, the privatization commission was later disbanded and the process stalled.

- On April 12, 1991, the Legislative Assembly approved beneficiary rights legislation for agrarian reform beneficiaries, as mentioned above.

- In the area of judicial reform, the GOES has developed and adopted a comprehensive agenda for legal reform to improve criminal justice, launched a public awareness campaign, and established a technical unit within the Ministry of Justice to draft and promote legal reforms. Additionally, the constitutional reforms ratified in October and November 1991 (a result of the peace process), extend the term of office of Supreme Court magistrates, stagger their appointments and require that the Assembly appoint members to the National Council of the Judiciary. The latter reform was enacted as a means for ensuring that a wider range of views are taken into account in developing slates for judicial branch appointments.

One area where GOES performance was lacking related to its failure to maintain intact the basic grains price band mechanism designed to stabilize domestic grain prices from excessive world price fluctuations and domestic supply shocks. The mechanism was supported directly by the Mission's 1990 ESF Program, and its implementation aimed to correct longstanding policy distortions which have reduced the incomes of basic grains producers, most of whom are low-income farmers. The system was established for yellow corn in late 1990 and for rice and sorghum in 1991. In October 1991, considerable pressure from powerful special interest groups, the GOES reduced the external tariff rate supporting the price band for yellow corn from 20 to 10 percent. The Mission protested this change due to its nontransparent nature and the resultant immediate windfall gains for a small number of wealthy poultry producers at the expense of large numbers of low-income farmers. The Mission is withholding disbursement of the second $45 million tranche of FY 1991 ESF until the GOES restores the 20 percent tariff for yellow corn and takes measures to mitigate the adverse impact of the 10 percent rate on basic grains farmers.

3. GOES Performance on IMF and IBRD Programs

International Monetary Fund: The GOES was in full compliance with the quantitative performance targets through June, the last quarterly review scheduled under its IMF Stand-by Arrangement which expired August 26, 1991 (see Table II). The IMF Article IV mission to El Salvador during October applauded El Salvador's overall economic program and reached agreement in principle on the terms and conditions for a follow-on stand-by arrangement which was approved by the IMF Executive Board on January 6, 1992.

World Bank: The GOES also achieved full compliance with the first and second tranche conditionality of the World Bank's Structural Adjustment Loan (SAL), and the World Bank made its first $25 million disbursement in July and the second of equal value in December. Specific reforms supported by the SAL include, inter-alia, relaxation of interest rate controls, further progress toward privatization of the banking system, the elimination of all price controls on basic grains, and further external trade liberalization.

B. The Economy's Response

In 1991, the Salvadoran economy continued to respond well to the economic reforms of the Cristiani Administration. Notwithstanding a major mid-year drought, overall economic performance was impressive in 1991. Preliminary estimates show that the strong economic expansion begun in 1990 and spurred by 7.4 percent real growth in agriculture continued in 1991 and spread convincingly to other sectors. Propelled by the continuation and extension of the economic liberalization measures initiated in 1989 and 1990, real GDP growth in 1991 is estimated to have reached 3.5 percent (see Statistical Appendix, Table 6). This is within the 1991 program target range of 3 to 4 percent and above the 3.4 percent rate achieved last year which was the highest in twelve years. Real per capita GDP is expected to grow 1.1 percent in 1991, and, together with the 1.2 percent growth in 1990, mark the only two years with substantial positive growth since 1978.

Except for agriculture and utilities, the two sectors most adversely affected by the drought, strong performance is expected across the board in 1991. The construction sector, reflecting accelerated implementation of the public sector investment program and increases in private sector housing construction, rebounded convincingly from last year's 13 percent drop and registered a real gain over 10 percent for 1991. Real GDP originating in the transport sector expanded by seven percent, and increases from three to five percent were recorded for manufacturing, commerce and other services.

Regarding agriculture, the drought erased what could have been a second consecutive record year for basic grains production. Reflecting the improved incentive structure for small farmers, the area planted for corn, rice and beans was increased substantially over last year -- for the second year in a row. However, the mid-year drought reduced production 15 percent below beginning-of-the-year projections. This, coupled with a drought-induced six percent drop in projected livestock earnings, resulted in a 0.3 percent decline in real GDP accruing to agriculture in 1991, far below last year's 7.4 percent increase and the 3.6 percent sector growth estimate before the drought.

Investment: Current estimates indicate a major turnaround in investment in 1991 (see Statistical Appendix, Table 7). Fixed capital formation marked an impressive 18 percent increase, reversing last year's 17 percent drop and increasing fixed capital formation to 13.3 percent of GDP, up from 11.8 percent in 1990. The acceleration in the pace of public sector project implementation contributed to a 21 percent jump in public investment. This was in sharp contrast to last year's 38 percent fall. Reflecting improved investor confidence in the Salvadoran economy and in the economic policies of the Cristiani Administration, private sector investment is estimated to have grown by 17 percent in 1991. However, due to the continuation of the huge inventory drawdowns begun the previous year, overall gross investment grew by only 9.3 percent for the year. Nonetheless, it pushed gross domestic investment up nearly a full percentage point of GDP to 12.7 percent from 11.8 percent the year before. It also marked a major improvement over 1990's 33.6 percent decline.

The 1991 investment jump was financed by a major increase in domestic savings. As a percent of GDP, private sector savings rose from 5.4 percent in 1990 to 7.3 percent in 1991. This resulted from higher real interest rates and increased confidence in the financial system. This, combined with a slight improvement in public sector savings, brought the overall domestic savings rate to 7.2 percent of GDP, substantially higher than the 5.1 percent

Table II

El Salvador: GOES Performance on Targets Contained in IMF Stand-by Arrangement

As of 6-30-91	Target	Actual	Margin (+) Excess (-)
Net Banking System Credit to the Consolidated Nonfinancial Public Sector Cumulative Amount from 12-31-90 (Millions of colones)	-95 1/	-95	--
Change in Net Assets of the Central Reserve Bank Outstanding Stock (Millions of Colones)	4555	3200	+1355
Net International Reserves of the Central Reserve Bank Outstanding Stock (Millions of Dollars)	354	362	+8
Stock of External Arrears on Medium and Long Term External Debt (Millions of Dollars)	0	0	0
New External Credits Contracted by the Public Sector and the Central Reserve Bank from January 1 - June 30, 1991 (Millions of Dollars)			
Less than one year	30	0	+30
1-5 years	50	0	+50
1-12 years	60	0	+60

Source: IMF

1/ Adjusted to reflect reprogramming of IBRD SAL second tranche disbursement from the second to the third calendar quarter of 1991 due to strictly technical reasons.

rate recorded in 1990. External savings, measured as the current account balance (in the balance of payments) less official transfers, equalled 5.5 percent of GDP in 1991, down from 6.7 percent in 1990, and 9.4 percent in 1989.

__Consumer prices__: Reflecting continued tight monetary policies, a stable exchange rate and declining inflationary expectations, inflation was cut nearly in half during 1991. The change in the consumer price index (CPI) fell below 10 percent in 1991, far below the 19.3 percent rate recorded in 1990 and even below the bottom of the original 1991 program target range of 10-14 percent (see Statistical Appendix, Table 1). This was achieved in spite of the mid-year drought which caused higher prices for some agricultural products and forced many manufacturers to use higher-cost energy from their own generators.

__Balance of Payments__: Regarding external performance, 1991 showed considerable further improvement. As mentioned, the current account deficit dropped to 5.5 percent of GDP. This drop was achieved notwithstanding a 9 percent increase in the merchandise trade deficit. The widening trade deficit resulted from a $103 million, eight percent surge in imports which more than offset an overall $ 41 million, seven percent increase in exports. The 1991 export increase will be well below last year's $83 million, 17 percent jump. This still respectable but lower growth rate reflects the continuing recession in the United States, El Salvador's principal export customer, and declining world prices for coffee, El Salvador's main export. Non-coffee exports rose $54 million; of this, nontraditional exports to markets outside the region grew $11 million. Some analysts also attribute El Salvador's slower export growth to a loss in international competitiveness due to a moderate but persistent appreciation of the real effective exchange rate from late 1990 through the third quarter of 1991. This reemergence in 1991 of El Salvador's historical "Dutch Disease" symptoms can be attributed to a 27 percent surge in remittances. However, a modest nominal depreciation in the colón/dollar exchange rate combined with El Salvador's negative inflation during the last quarter and the recent weakening of the dollar in world currency markets, have reversed this trend. Preliminary estimates point to a moderate depreciation of El Salvador's real effective exchange rate over recent months. While this suggests that the "Dutch disease" effect should not be considered a major problem at this point, El Salvador's export competitiveness will be closely monitored.

Regarding imports, while overall levels increased, there was a noticeable shift in composition from consumer items to production inputs. Durable and nondurable consumer goods, which had jumped 35 percent in 1990 mostly because of lower external tariffs, fell nearly 8 percent in 1991. Intermediate goods imports excluding petroleum rose 11.8 percent primarily due to greater purchases of manufacturing, agricultural and construction inputs. Reflecting the strong recovery in the manufacturing and transportation sectors, imports of industrial machinery, and other capital goods rose by 34 percent in 1991. This is in sharp contrast to 1990 when capital goods imports dropped 16 percent.

A greater capital account surplus is expected for 1991 due to the combination of greater official loan disbursements and higher private short-term capital inflows. This enabled El Salvador to further strengthen its net international reserve position. A Paris Club rescheduling agreement signed September 17, 1990, provided $45.3 million in bilateral external debt relief for CY 1990 and $89.7 million for CY 1991. The higher than expected remittances and capital inflows enabled the GOES to pay off much of its relatively more expensive short-term commercial credits. Also, El Salvador was able to refinance its USG FMF debt on far more favorable terms, resulting in a reduction of over $11 million in annual debt service payments.

During the entire period of its 1990/91 IMF stand-by arrangement, El Salvador elected not to draw any of the SDR 35 million, 40 percent of quota, available. Should favorable balance of payments trends continue, it is unlikely that El Salvador will utilize any of the SDR 41.5 million (approximately $59.3 million) available under its January 6, 1992 follow-on stand-by arrangement which is programmed to be in effect through February 1993. Nonetheless, those funds, equal to 47 percent of quota, will remain available to El Salvador should external performance deteriorate.

C. Impact of Adjustment on the Poor

The economic adjustment process underway in El Salvador is creating a macroeconomic environment with better incentives and support for lower-income groups to become more productive in the medium to long term. In fact, substantial evidence exists that marginal groups have already benefitted from the effects of the adjustment program. For instance, contributing about 50 percent of the increase in GDP in 1990 was a 7.4 percent surge in output originating in the agricultural sector. The elimination of Government marketing monopolies resulted in substantial increases in prices available to farmers at the farm gate. Many of these farmers are considered to be in the lowest income groups. There is also evidence that many agricultural workers were paid wages considerably above the legal minimum wage in 1990, as farmers had trouble finding available labor. While this can be partially explained due to irregular weather patterns which altered harvest schedules for some crops, a 7.4 percent jump in agricultural output has to be considered a major factor as well. Higher agricultural production has also helped to hold food prices at the consumer level down and this has especially benefitted the urban poor.

In addition, preliminary results from the Ministry of Planning's multipurpose household survey show that employment in urban areas increased by up to 100,000 from early 1989 to early 1991. This lowered the open unemployment rate to 7.5 percent, about one percentage point lower than two years ago. Moreover, approximately 40,000 part-time workers were able to convert to full-time employment, dropping the visible underemployment rate from 12.8 percent to 7.5 percent. Also, a Mission-funded study on the impact of structural adjustment on agriculture showed an increase in agricultural employment since 1989 equivalent to 26,000 full time jobs.

Notwithstanding this progress, there are still significant categories of vulnerable groups which require special attention to prevent undue hardship during the adjustment process. These people include those currently living in extreme poverty and employed in non-agricultural fields. These are largely urban residents who are unable to purchase a nutritionally adequate food basket.

The Cristiani Administration has made a major reduction in poverty one of its top goals. As part of its economic adjustment program, it has developed a strategy to create higher-paying job opportunities for the poor through economic growth which stimulates an efficient use of labor. It is also engaging in activities designed to improve the educational status and health conditions of the poor and hence their capacity to respond to increased opportunities for productive employment. In addition, these activities are being complemented by the establishment of a social safety net for those poor groups which do not benefit immediately from the new opportunities resulting from the economic adjustment program.

In concert with both bilateral and multilateral donors, the Cristiani Administration has instituted a number of programs and activities to assist the most vulnerable groups. The implementation of a number of current donor-funded projects has been accelerated, bolstered with new funds and expanded geographically to create as many new, albeit temporary, jobs during the adjustment period as possible. These include earthquake reconstruction activities to rebuild and rehabilitate schools, hospitals, roads and bridges; expansion of urban water and sanitation facilities; installation of rural water systems; and the construction of small scale infrastructure in rural townships. These jobs will provide badly needed additional sources of income for poor families. Also, society at large will benefit from the economic and social infrastructure that will be put in place through these programs.

In order to promote activities specifically designed to cushion the impact of adjustment on vulnerable groups, the Government has created The Salvadoran Social Investment Fund (FIS). The Fund will channel an estimated $30 million to $60 million in donor resources annually to projects primarily designed to benefit low-income groups. The projects will be implemented by private nonprofit organizations and municipalities. They will be targetted to the poorest areas of the country and will help low-income groups meet their basic education, health and nutritional needs. The FIS will also finance activities designed to promote domestic production, including local investments in infrastructure and occupational training.

In addition to the above, the National Reconstruction Program will provide assistance for those adversely affected by the war through the restoration of local infrastucture, education, and health services.

D. GOES Economic Program for 1992

The GOES economic team fully understands the critical importance of maintaining its economic reform momentum during 1992. They realize that achievement of adjustment measures must be maximized before the politically charged period leading up to the March 1994 presidential elections. Moreover, 1992 will be an especially delicate year politically. As a result of the termination of hostilities and the implementation of the peace plan, additional political forces will be integrated into El Salvador's political system. Many of these groups, including FMLN members and sympathizers, may not fully support many elements of the GOES economic program. The Cristiani Government has already found it increasingly difficult to gain legislative approval of certain reforms after the ARENA Party lost its absolute majority in the Legislative Assembly after the March 1991 elections. With additional opposition political pressure groups on the scene, legislative passage of economic reforms will be even more difficult.

The GOES also realizes that continued adherence to its sound macroeconomic management practices is essential to preserve the confidence generated to date of the private sector in its economic program. In addition, the team prefers that these reforms be implemented quickly to ensure that their positive economic impact will be felt as soon as possible, and, hopefully, by the time of the 1994 elections.

The GOES Economic Program for 1992 consists of two major components: a macroeconomic stabilization component designed to achieve four percent real growth while holding inflation to 8-10 percent, and a structural adjustment component to consolidate, expand and deepen the adjustment measures implemented to date.

1. Macroeconomic Stabilization

While overall economic performance has improved dramatically over the last two years, El Salvador's continuing fiscal problems and high external trade deficit show that serious internal and external imbalances persist. In recognition of this, in 1992 the GOES will continue to pursue monetary, fiscal and exchange rate policies designed to move the economy closer to internal and external balance, i.e., where the fiscal deficit can be fully financed by medium- and long-term external financing and the current account deficit in the balance of payments can be covered by medium- and long-term capital inflows.

The cornerstone of the macroeconomic stabilization program is the Central Reserve Bank's monetary program for 1992. The monetary authorities plan to hold total domestic credit expansion to 9 percent. Growth in net banking system credit to the consolidated nonfinancial public sector is to be held to only one percent. This will permit credit to the private sector to grow by 17 percent, or 7-9 percent in real terms. The programmed growth in the overall money supply (M2) is also 17 percent.

In order to meet the monetary program target of nearly flat growth in net credit to the public sector, the overall public sector deficit will have to be cut to the equivalent of 2.3 percent of GDP. This would represent a marked decrease from the 3.5 percent of GDP deficit for 1991 and be the lowest achieved since 1986. In order to accomplish this goal, Central Government tax collections will have to be increased to 9.5 percent of GDP compared to 9.1 percent in 1991. This will require a major improvement in tax administration and enforcement to offset the negative revenue impact of certain economic efficiency-based reforms. For example, the effective rate of coffee export taxes will be cut to 9 percent compared to 12 percent now, marginal income tax rates will be reduced to 30 percent for individuals and 25 percent for firms, and maximum tariff rates for most categories will be lowered to 20 percent by mid-year. The GOES plans to accelerate the implementation of its tax system modernization program designed to improve taxpayer compliance, expand the tax base and eliminate a number of unnecessary exemptions. The GOES plans to introduce the value-added tax by mid-year with USAID- and IMF-financed technical assistance.

The GOES remains firmly committed to maintaining its flexible, market-determined exchange rate regime. Given the balance of payments projections above, the GOES economic program has targetted an increase in net international reserves of the Central Bank consistent with the GOES's goal of achieving a level of gross official reserves equal to the equivalent of five months worth of imports. This is considered a prudent objective given that El Salvador has a small (by world standards), very open economy highly dependent on one major export product (coffee) and quite vulnerable to external shocks. Maintenance of an adequate reserve cushion is also advisable considering the uncertain political and security climate within which the economic program must operate.

The GOES has indicated that it intends to completely liberalize interest rates no later than June 1992 and, conditions permitting, as early as March 1992. This would be six to nine months ahead of the original timetable contained in the GOES economic program for 1989-94 and included in the IBRD SAL policy reform matrix.

2. Structural Adjustment

Complementing the stabilization component, the 1992 GOES economic program includes a number of structural adjustment measures designed to improve the efficiency of resource allocation and thus contribute to the achievement of sustainable economic growth over the medium term. The reforms programmed for 1992 will further liberalize the trade regime, enhance export competitiveness, improve the investment climate, revitalize the financial sector, increase the level and effectiveness of investment in social sectors, and increase public sector operational efficiency.

Nominal external tariff rates will be limited to a range of 5 to 20 percent by July for all but a few categories (apparel, textiles, footwear, leather products, liquor, artwork, antiques, and certain vehicles), for which the maximum rate will be no greater than 25 percent.

Table III
Government of El Salvador Economic Program for 1992
Macroeconomic Targets

Performance Indicators	Estimated Performance 1991	Program Target 1992
Real GDP Growth Rate in Percent	3.5	3.5-4.5
Inflation -- Percent Change in CPI		
Year-end Basis	9.8	8-10
Period Average	14.4	9-11
Fiscal Deficit as Percent of GDP 1/:		
Central Government	3.8	2.3
Consolidated Nonfinancial Public Sector	3.5	2.4
Current Account Deficit 1/ in Balance of Payments as Percent of GDP	5.5	4.5
Increase in Net International Reserves of the Central Bank - in Millions of Dollars	41	74 2/
Growth in Broad Money (M2) Supply-Percent Change Over Previous Year	21	17

Source: Central Reserve Bank.

1/ Excluding Official Transfers.
2/ This includes the $45 million FY 1991 ESF second disbursement originally programmed for the fourth quarter of 1991.

Price controls will continue to be limited to only those areas where regulation is needed due to monopolistic or oligopolistic market structures. These include wheat flour, sugar, cement and petroleum products. Regulated prices will be periodically adjusted to reflect changes in production costs and market demand conditions. Retail prices for gasoline were liberalized in January 1992.

3. Continued Support from IFIs

The GOES's improved policy stance has enhanced its image with international financial institutions, enabling it to obtain cooperation and financial assistance in support of its economic program. A follow-on IMF Stand-by Arrangement was approved by the IMF Board on January 6, 1992. It will support GOES internal and external stabilization efforts through February 1993 with assistance in the development of a monetary and fiscal program designed to reduce both the fiscal and balance of payments current account deficits.

The World Bank SAL, approved in March 1991, remains in effect through June 1993 and encourages continued progress toward a more open and transparent external trade regime, improved fiscal performance, liberalized interest rates, further financial sector reform, reduced constraints to expanded agricultural output and improved social services. The Inter-American Development Bank plans to encourage the development of a more hospitable environment for domestic and foreign investment through its Investment Sector Loan programmed to begin in late 1992 (see Annex B — El Salvador: Policy Reform Matrix — All Donors).

E. The National Reconstruction Program

The GOES has developed a National Reconstruction Program (NRP) for the post-war period to facilitate and accelerate the process of economic recovery. This will be accomplished primarily through rehabilitation of war-damaged infrastructure and by reintegrating the conflictive zones into the national economy. The NRP seeks to to ensure that economic growth will be broad-based by focusing on the most severely affected parts of the country, emphasizing democratic participation, and allowing local governments to exercise greater decision-making regarding investment programs and other activities in their communities. As currently planned, implementation of the NRP will require just over $1 billion over six years, although 70 percent of that amount will not be needed until the last three years of the Program.

The Mission has proposed its own, $280 million program to support the GOES NRP. Approximately one-half of this total will come from currently programmed funds with the rest representing expected new appropriations. Of the approximately $140 million in existing funds, $65 million will be in the form of host country-owned local currency (HCOLC) which is programmed to be spent over four years.

While the GOES anticipates that nearly all NRP expenditures will be financed by external resources, NRP implementation will still result in additional fiscal pressures on GOES finances. The use of HCOLC for the NRP will limit the amount available for general budget support and require the GOES to make adjustments elsewhere in the budget. Also, while difficult to quantify at this point, recurrent costs of the NRP associated with maintenance of roads and other infrastructure, health posts and schools will be substantial.

F. Principal Problem Areas and Constraints to Growth

As outlined above, the GOES has shown considerable commitment to constructive economic reforms and continues to make notable progress in implementing its ambitious economic reform program. However, as outlined below, the progress is fragile and certain problem areas remain.

1. Fiscal Weakness

The GOES continues to face enormous fiscal pressures. Notwithstanding the notable fiscal performance achieved by the Cristiani administration since coming to power in June 1989, the GOES is still confronted with a situation of inadequate fiscal revenues resulting in persistent fiscal deficits and an insufficient level of public sector savings.

The GOES continues to do what it can to improve fiscal performance. Over the last two years it has exercised a considerable degree of expenditure restraint. Current expenditures of the Central Government, excluding interest payments, have declined from 1989 to 1991 by the equivalent of 1.2 percent of GDP. However, substantial further cuts are not likely and, in fact, are not really desirable. Pressing priorities on the GOES social program agenda will require increased funding in areas related to human resource development, not less.

Therefore, further progress in closing the fiscal deficit will have to come primarily on the revenue side. Reflecting this, the Cristiani Administration has demonstrated its solid commitment toward improving tax performance and in 1989 initiated a series of measures to improve tax policies, administration and enforcement. As a result, tax collections as a percent of GDP climbed from only 7.6 percent in 1989 to over nine percent in 1991. However, this is still far short of the 12 percent of GDP average achieved during the early and mid 1980s and the level necessary to cover current expenditures with enough left over to make a satisfactory contribution to public investment.

In recognition of the need for a much stronger effort, the GOES has just initiated a major overhaul its tax regime with technical support provided by the USAID-funded Modernization of the Salvadoran Tax System (MOST) Program. The Program is providing a team of tax advisors to the Ministry of Finance to further improve tax policies, tax administration, customs administration, and the Ministry's computerized tax information system. The improved tax system should bring tax revenues as a percent of GDP back to the 12 percent range within three to four years. This improvement will allow the Central Government to generate a substantial current account surplus and finance an important segment of the GOES capital budget. However, only limited gains in revenue collections are expected during the initial years of the Program. This is because of the initial impact of tax reform measures designed to improve overall economic performance through further reductions in nominal tariffs, marginal income tax rates and coffee export taxes. The fiscal impact of these reforms will be largely but not completely offset by more aggressive efforts at tax enforcement and improved administration along with new measures to expand the tax base. Therefore, in the near term, and especially during 1992, the GOES will continue to face considerable fiscal pressure.

The GOES 1992 monetary program supported by an IMF Stand-by Arrangement places strict limits on banking system credit to the both the Central Government and the rest of the nonfinancial public sector. Satisfactory fiscal performance is therefore essential to avoid excessive recourse to banking system credit to finance the public sector deficit and thus enable the GOES to keep its monetary program on track, provide adequate credit to an expanding private sector, and achieve its output and inflation objectives.

In order to help the GOES meet its monetary program targets and stay in compliance with its IMF Stand-by, the Mission will program with the GOES Host Country Owned Local Resources (LCOLC) for general budget support in 1992. These resources will finance activities already included in the GOES 1992 budget and thus not result in additional expenditures.

2. Public Sector Inefficiencies

a. Electricity Rates and the Fiscal Deficit

While the energy parastatal CEL raised electricity rates by 30 percent during June 1991, current rates remain among the lowest in the region and only cover about 50 percent of the long-run marginal cost of producing electricity. In addition, due to the mid-year drought which limited the availability of cheaper hydroelectric energy, CEL has had to increase its reliance on higher-cost thermal-power generation. This has resulted in large operational deficits at CEL and required transfers exceeding 300 million colones from the Central Government during 1991. These operational losses increased the 1991 fiscal deficit by the equivalent of .6 percentage points of GDP. Rate adjustments are sorely needed to encourage energy conservation and more efficient electricity use and to reduce the drain on the fiscal accounts.

b. Public Sector Employment Efficiency

A USAID-financed study on public-sector employment efficiency completed in September suggested that the rate of redundancy in the public workforce could reach 40 percent. The GOES is already implementing a plan to reduce public sector employment by several thousand employees by the end of 1992. This will be accomplished through the continuation of an early retirement program, a new program to encourage voluntary separation, the closing down of additional parastatal operations such as IRA and ISIC, and further attrition combined with a continued hiring freeze. Options containing measures for forced retirement and involuntary separation are also being considered. In addition, the GOES is developing a strategy to rationalize public-sector salaries, making them competitive with the private sector and providing sufficient remunerative incentives to retain quality staff.

Progress on some of the measures to reduce the public workforce will run head on into stiff resistance from well organized and highly vocal employee unions and opposition political parties. Therefore, it is essential that the GOES complete most elements of its public-sector employment adjustment program during calendar year 1992 and before the politically charged period leading up to the 1994 presidential elections. Direct Mission support for some of these measures, as well as the use of ESF local currency resources to fund employee mobilization/adjustment costs, may be required to achieve GOES adjustment targets by the end of 1992.

c. Integrated Financial Management and Auditing

Another area of Mission concern relates to the slower-than-expected pace of GOES efforts to modernize its financial management and audit systems.

The Ministry of Finance is responsible for revenue generation (taxation), budgeting, treasury management, and accounting components of the GOES financial management structure. The Laws, regulations and procedures governing these functions are disperse and badly in need of modernization and codification. For example, the accounting system is centralized and does not record information classified according to organizational units of the GOES. This particular aspect is being addressed by the GOES through a consultant from the IMF. The budget system has no single head but is found shared among various public entities. There is lack of coordination between budgeting and treasury which causes problems with liquidity and accumulation of short-term debt. Additionally, in the treasury area, cash flow analyses are not prepared to serve as a management tool.

The Court of Accounts (CA) is El Salvador's supreme audit agency. It was created by constitutional mandate in 1939 as an independent arm of the legislature to review all authorizations for and expenditures of public funds. Article 195 of the Constitution empowers the Court of Accounts to "authorize all disbursements of public funds and intervene preventively in all those transactions which either directly or indirectly affect the Government's balance sheet accounts."

USAID Management and project officers find that the Court of Accounts intervention in the government expenditure process is one of the most serious impediments to project implementation because of their pre-control function on all public sector institutions. The Inspector General has determined that the Salvadoran Court of Accounts does not meet the requirements of supreme audit institutions. Furthermore, the control methodology followed by the Court of Accounts is inconsistent with the LAC Bureau strategy on accountability. The GOES entities implementing USAID/El Salvador-financed projects have been criticized by AID federal and non-federal auditors for the lack of adequate accounting records and orderly supporting documentation.

The Salvadoran public sector has grown so much that the exercise of a centralized accounting and control function is not efficient. For example, the public sector budgets subject to the CA's intervention for 1940 and 1990 were 24.3 million and 4.95 billion colones, respectively. In 1990 a study conducted by KPMG Peat Marwick--Policy Economics Group concluded that a simultaneous improvement in many areas of financial management such as budgeting, accounting, treasury, audit and cash management was required. The same year, in order to address the requirement for modernization in the financial management sector, the Government of El Salvador created a special commission to direct, coordinate and supervise a program of integrated financial management and auditing improvement. This committee is composed of the Minister of Finance, the Minister of Planning and the President of the Court of Accounts.

USAID/El Salvador's rationale for support of integrated financial management and auditing is directly related to the LAC Bureau's Economic Assistance Strategy for Central America -- 1991 to 2000. The Bureau strategy consolidates the gains made throughout the region towards democratization by encouraging democratically elected governments to improve their management and financial practices and to become more effective and efficient. There is no doubt that USAID's intervention in integrated financial management and the modernization of El Salvador's Court of Accounts will have a direct impact on the continuing consolidation of democratization in El Salvador as accomtability for public funds improves. Currently the Mission is in the process of developing its strategic objectives for the upcoming five years. Improved accountability of public institutions is being considered as a major program output contributing to the efficiency of the government and consolidation of democracy.

d. Privatization

An area were the pace of reform has been less than ideal is that of privatization of nonfinancial activities. (As indicated above, privatization of the banking system is moving well.) While outside the financial system El Salvador's public sector is not excessively involved in productive and commercial activities relative to some of its Central American neighbors, privatization of certain primarily agricultural-related assets and services has been included in the GOES economic program. In May 1991 legislation was approved allowing for the formation of a privatization commission. Initially, the commission was to consist of members from both the public and private sectors. Recently, however, the GOES decided to limit participation to the public sector only. The Commission has encountered numerous difficulties in setting itself up and has not been able to make satisfactory progress on the implementation of the GOES action plan for privatization. The Mission continues its discussions with the GOES on the membership of the Commission and has promised technical assistance to the Commission once policy issues are resolved.

3. Export Performance

While El Salvador's overall balance of payments performance has improved dramatically over the last two years, a quick look at the country's trade balance reveals that external stabilization has not been achieved. Notwithstanding two consecutive years of favorable export growth, overall export levels remain well below those needed to support sustained economic growth. El Salvador's 1991 merchandise export earnings totalled $621 million, only about one-half of merchandise imports, resulting in a merchandise trade deficit equal to 12.5 percent of GDP. Moreover, the 1991 export level is only a little over one-half of the $1.1 billion average achieved during 1979-1980. It is doubtful that in the near term El Salvador's coffee exports will reach the high levels achieved prior to the dissolution of the quota system under the International Coffee Agreement. Nontraditional exports to the Central American region have picked up noticeably from about $90 million in 1986 to nearly $200 million in 1991. However, they are still far below the almost $300 million achieved in 1980, especially in real terms. Efforts to break down barriers and revitalize intra-regional trade could contribute toward major increases in this export category over the near term.

Earnings from nontraditional exports to extra-regional markets remain relatively low compared to most of El Salvador's Central American neighbors. Despite the 34 percent surge in 1990 plus near 10 percent growth in 1991, these exports accounted for only $123 million or 20 percent of total export earnings in 1991.

The GOES trade and exchange regime liberalization measures have made a major contribution toward improving El Salvador's export competitiveness and laying the basis for strong export growth over the near term. In the meantime the GOES must continue on its publicly announced schedule of further external tariff rate adjustments designed to reduce the effective rate of protection and proceed with further elimination of bureaucratic impediments to exports. It is also essential that it maintain its flexible and market-determined exchange rate regime.

4. The Investment Climate

The economic policy framework put in place by the Cristiani Government has contributed to a much higher level of business confidence and resulted in substantially increased private investment. However, in order to achieve further increases in domestic and foreign investment to levels required to support sustained economic growth, the GOES must expand its efforts at reducing the remaining impediments to investment. These include various legal and regulatory requirements impeding entry, inadequate protection of intellectual property rights (IPR), excessive bureaucratic procedures and an inefficient and unpredictable judicial system lacking an adequate degree of impartiality. It is expected that many of these issues will be addressed in conjunction with the design and implementation of the IDB's investment sector loan program for El Salvador later this year. However, timely action on a number of specific measures of particular importance to the USG and the Mission's program objectives is required early in 1992. These include improving the intellectual property rights law, permitting foreign investment in the foreign exchange trading houses and revision of the existing labor code.

III. STRENGTHENING DEMOCRATIC INSTITUTIONS AND JUDICIAL REFORM

A. Progress to Date

The inability of the Salvadoran justice system to successfully resolve publicized crimes in the early 1980s led the USG to embark on an assistance program designed to resolve specific technical weaknesses identified in the system, among them: the lack of scientific methods for criminal investigations, the lack of protection for key participants in judicial proceedings, and inadequate funding for the court system. This assistance program, now seven years old, while successful in addressing many of these issues, has unfortunately not resulted in the profound changes sought in the administration of justice. Instead, our experience has shown that the problems of the system are more basic — lack of judicial branch independence from political and economic interests; selective investigation and prosecution, in part, resulting from military control of the police; and a populace basically unaware of their rights in judicial proceedings. None of these were the focus of USG assistance through FY 1990.

Studies commissioned by USAID in 1989 and 1990 concluded that fundamental structural changes were needed in the organization and operation of the judicial process. Changes recommended included: strengthening the independence of the National Council on the Judiciary to reduce political influence in the judicial branch appointment process, extending Supreme Court magistrates' terms of office, strengthening the role of the Attorney General in investigations, and substantive reforms to the criminal and criminal procedural code to afford maximum protection of individual rights in legal proceedings. Armed with this study, the USG decided to increase policy dialogue efforts and link U.S. economic assistance under the 1991 Balance of Payments Program to progress on three specific areas identified: development and adoption of a comprehensive legal reform agenda, increased independence of the judiciary, and heightened public awareness.

In April 1991, following our agreement with the GOES on these measures, the GOES and the FMLN reached agreement on a series of Constitutional reforms that the GOES would present to the Legislative Assembly to alleviate underlying political and institutional obstacles to more just and responsive judicial processes in El Salvador. These reforms, which have with only one exception been ratified, represent first steps toward reducing the politicization and selective prosecution that has characterized the Salvadoran justice system. Specifically, judicial branch independence (and reduced politicization) will be strengthened through reforms which extend Supreme Court magistrates' terms of office from 5 to 9 years, stagger their appointments every three years to avoid any one legislature's domination of the Supreme Court, require a 2/3 majority vote of the Assembly for Supreme Court nominations, and ensure judicial branch financial independence from the executive by earmarking a percentage of the national budget (6%) for the judicial branch. Additionally, the Assembly will now be responsible for appointments to the National Council of the Judiciary, the institution that develops candidate lists for all judicial branch appointments; this reform is intended to reduce the politicization of appointments that has characterized the system by ensuring a more balanced representation of interests on the Council. Selective prosecution should be diminished as well, through Constitutional reforms that (a) place responsibility for oversight of criminal investigations under the functional authority of the Attorney General of the República; (b) establish a new independent Office of the Solicitor (Procurador) for Human Rights, which will be responsive to the Legislative Assembly, as opposed to the Executive Branch, and charged with human rights investigation and prosecution; and (c) place the police under civilian control. (The last of these reforms is still pending ratification by the Legislative Assembly.) Additionally, to comply with the FY 1991 ESF conditionality, the Government of El Salvador also adopted a comprehensive legal reform agenda and launched a public awareness campaign on individual rights and judicial reform.

B. Constraints to an Impartial and Timely Administration of Justice

Actions cited above represent important first steps to improving the administration of justice in El Salvador. As important as these achievements are, however, they mark only the beginning of what must be a long-term effort to ensure just and responsive judicial processes. Major constraints persist: the dependence of the National Council of the Judiciary on the judicial branch; the dependence of investigative agencies on the military and the judicial branch; inadequate funding for the public defender and prosecutor's office, particularly with respect to salary levels, office support, and in-service training programs; and the lack of a broad political consensus and popular support for measures needed to ensure fairness and impartiality in the system. Each of these constraints is described in greater depth below.

Legislative reforms are needed to establish the National Council of the Judiciary as a truly non-partisan, independent body. The Constitutional reforms enacted place responsibility for appointing members to the Council with the National Assembly and require a 2/3 majority vote; this change should improve the representativeness of the National Council. However, the Council remains dependent on the Judicial Branch. Its budget is submitted to the Assembly through the Supreme Court, and it is co-located with the Court.

Supreme Court magistrates also continue to sit on the Council. This not only distracts them from their principal function of rendering judicial decisions, but it also calls into question the objectivity of the Council in developing candidate slates for judicial branch appointments.

Selective prosecution of criminal cases in El Salvador has resulted from the undue influence of economic, political and military forces in judicial proceedings. As noted earlier, Constitutional reforms will reduce military involvement in criminal investigations by establishing a civilian police and increasing the Attorney General's role in the investigative process. To implement this latter change, revisions to several laws will be needed. As an interim step, the Ministry of Justice has presented a modification to the law creating the Special Commission on Criminal Investigations to eliminate Ministry of Defense participation in the Commission and add the Attorney General, who would be designated as president of the Commission. Budget resources must also be provided to the Commission, which is now 100% funded through USG or USG-generated host country local currency.

The judicial sector as a whole, including the Ministry of Justice (and the prison system), the courts, the public defenders office, and the Attorney General's Office, are seriously underfunded. Higher levels of resources are needed to adjust salary levels so as to attract and retain more competent people, conduct in-service training programs to improve substantive and practical legal knowledge, implement improved court administrative practices, and finance the purchase of basic equipment and materials. The Constitutional reforms approved provide for this level of financial independence and stability for the courts, by allocating to them 6% of the national budget. However, there is no similar provision nor commitment by the Legislature and Executive to increase budget allocations provided to the Offices of the Attorney General and Public Defenders. Both offices are highly dependent on USG funding.

Legal reforms to improve access and the transparency of the system are needed both to protect individual rights and to build public confidence in the administration of justice as a means for resolving disputes fairly when they arise. The legal reform agenda adopted by the GOES will, if carried through and accompanied by the reforms described above, provide the guarantees and procedural framework for broadening access and improving the protection of individual rights. This agenda includes:

- changes to the existing criminal procedural code by June 1992 to permit release pending and during trial and to widen the defense's role in pre-trial proceedings,

- modifications to the organic law of the Procurador General's Office to formally incorporate the public defender's program into the Agency's functions and budget;

- a substantive revision to the criminal code; and

- a new criminal procedure code that among other things removes the investigation and sentencing functions from the same judge.

The GOES has already completed drafts on several reforms, and begun the process of vetting them with the legal community and general public. The consensus we thought would be easily obtained on several of the less controversial proposals (e.g., eliminating secondary laws that contradict Constitutional language on the presumption of innocence) has, in fact, required extensive efforts. As the GOES proceeds to develop legal reform proposals in other, more controversial areas, such as reforms to the criminal procedural code, greater resistance will be likely. Thus, it is imperative that public information and awareness efforts continue, particularly those directed at the legal community and lawmakers.

C. Proposed Administration of Justice Strategy

The U.S. Mission in El Salvador has undertaken a stock-taking exercise and is now finalizing a draft of an administration of justice strategy that will guide USG efforts over the next five to seven years. That strategy recommends that the USG continue to emphasize policy dialogue efforts designed to effect the structural reforms needed to improve independence of the judicial branch organs (i.e., the court, the attorney general's office, and the police) and to forge ahead with the legislative reform agenda now adopted. These efforts will require considerable resolve on the part of the GOES, particularly as the country approaches the next Presidential election period, and we therefore recommend the use of ESF conditionality as a support for USG policy dialogue efforts.

Parallel to USG policy dialogue efforts, the strategy calls for targetted U.S. project assistance to enable the GOES to expeditiously implement reforms, professionalize the judiciary, improve judicial efficiency and strengthen public accountability of the actors in judicial processes. USG assistance would be focussed on strengthening judicial training programs, improved case tracking and management systems, and information programs designed to increase public understanding of their basic rights and responsibilities, including support to build private-sector justice monitoring organizations.

IV. PROPOSED FY 1992 ESF PROGRAM

A. Overview

The Mission's proposed FY 1992 ESF cash transfer program will contribute importantly to the achievement of USG foreign policy objectives in El Salvador and Central America. These include consolidating the peace process, facilitating national reconstruction and reconciliation, promoting the evolution of an economy based on increased reliance on competitive market forces and the private sector, and a further strengthening of democratic institutions.

The proposed program is fully consistent with and directly supportive of each of the four goals of the Mission's FY 1990-1994 CDSS: (1) economic and social stabilization; (2) economic growth; (3) broadening the benefits of growth; and (4) strengthening democratic institutions. It will also support LAC Bureau and Mission Action Plan objectives of: (1) the achievement of broadly-based, sustainable economic growth; (2) support for the evolution of stable, democratic societies, and (3) response to needs for international cooperation in addressing specific challenges to the attainment of growth and democracy.

B. Program Rationale

The Mission views the use of the ESF cash transfer mechanism as an essential part of its overall program to address the existing constraints to sustainable, improved economic performance and further progress in the administration of justice. Project funding, while very helpful, is not sufficient to enable the GOES to succeed in the implementation of many of the policy reform measures discussed in this document. Moreover, the external resources made available through the program will facilitate achievement of GOES 1992 economic program targets.

The principal focus of this year's ESF program is on economic and democratic policy reform. In the past, a primary objective of the Mission's ESF cash transfer programs had been to provide essential balance of payments support to enable El Salvador to achieve substantially higher levels of economic growth. Given El Salvador's continued strong balance of payments performance over 1990-1991, the need for huge external transfers to bolster the economy has been reduced. As previously described, improved GOES policies (many supported by previous ESF programs) have increased confidence in the Salvadoran economy and have led to major gains. For example, stable monetary policy, lower inflation, the flexible exchange rate regime, the legalization of the foreign exchange trading houses, positive real interest rates and increased confidence in the restructured financial system, have resulted in inflows of remittances and short-term capital averaging almost $75 million per month in 1991.

Given this improved economic performance and current, relatively strong, external position, balance of payments support is no longer considered a primary objective of the Mission's ESF program. However, the Mission remains concerned regarding prospects for sustaining the recent positive external sector trends. These concerns are explained in more detail below. Unquestionably, the consolidation of the current GOES policy reform process is essential towards improving such prospects. Furthermore, the reform processes in building El Salvador's democracy are still in their infancy.

The following discussion covers four fundamental bases for the Mission's proposed program:

1. **Continued Support for Reform**

The principal rationale for the Mission's ESF program is to encourage GOES policy reforms. Indeed, the Mission's previous ESF cash transfer programs have contributed considerably to a better macroeconomic policy framework, implementation of important structural reforms, and the establishment of a plan for revising the legal framework for the administration of criminal justice and initiating a public debate. This has resulted in stronger overall economic performance, and a more hospitable climate for the consolidation of democracy, major USG, LAC and Mission program objectives. Notwithstanding such progress, however, the economic recovery remains fragile as the policy reforms of the Cristiani Government have yet to be fully consolidated. The proposed ESF cash transfer program will will support GOES efforts to expand and deepen the structural adjustment process.

Continued USG support for economic and democratic reforms in El Salvador will be especially critical during 1992 as the country initiates its transition from war to peace. As new political forces enter the arena, the Cristiani Administration will be under greater pressure to defend and implement its economic reforms aimed at increasing reliance on market forces and the private sector. Most of the new political groups entering the equation do not favor such reforms and would prefer to turn the clock back to the days of greater state control over the economy. Already opposition is mounting to GOES privatization plans. Also, several groups are seriously proposing the resumption of price controls and the reestablishment of the basic grains marketing board. Countering these forces will be difficult but essential to keeping the economic reform program on track. The leverage provided by $90 million in ESF will be needed to provide the additional encouragement required for the GOES to move ahead with reform.

The leverage provided by the Mission's ESF program will also give critical reinforcement to the policy reform agendas of other international financial institutions. El Salvador's improved economic policy stance has greatly enhanced the country's image with other donors and lending agencies. Indeed, the IMF and the World Bank have recently joined the USAID Mission in taking a major role in negotiating the content of the GOES economic stabilization and structural adjustment measures to be supported by external resources. However, there is still an important role for the USG. First, the funds of the other institutions are largely provided on a loan basis, are therefore somewhat less attractive, and thus provide less leverage. Moreover, it is not uncommon for countries with IMF and IBRD programs in process to experience slowdowns and/or backsliding in their policy reform efforts once large disbursements under those programs have been made. The added incentive provided by ESF cash transfers can be decisive in keeping such reform programs on track.

Furthermore, the program will aim to ensure adequate progress on those specific measures of particular interest and importance to the USG and the Mission. Such measures may not be high on the agendas of the other institutions. Many of the individual measures included in the proposed ESF program policy reform matrix represent actions not included in other donor programs, e.g., those related to judicial reform and integrated financial management and auditing for the public sector. Also, strong overall economic performance in El Salvador is vital to USG foreign policy objectives and too important to leave solely to other agencies.

2. Fiscal Support

As described in Section II, above, the GOES continues to face persistent fiscal difficulties, and 1992 is expected to be a most difficult year. The GOES has made a strong commitment to fiscal reform and is now undertaking a major effort with Mission-financed technical assistance to essentially overhaul its tax system.

At this point the Mission sees no reason to doubt the resolve of the GOES to press ahead with its fiscal reform program. Nonetheless, the GOES will be required to take some politically difficult tax reform measures in the coming months. While marginal tax rates for the most part are being reduced, enforcement of those taxes will have to be tightened, and this could result in substantial resistance by groups and individuals not accustomed to paying taxes. In recognition of these potential difficulties, the Mission considers it highly advisable to complement our technical assistance support for tax reform with ESF conditionality. The added leverage of linking ESF disbursements to satisfactory completion of specific fiscal measures should contribute to their adoption, especially regarding the most politically difficult reforms.

However, even with speedy implementation of the GOES tax reform program, increased revenue generations from a more efficient and equitable tax regime will not materialize to any substantial degree in the near term. Furthermore, while little progress is expected soon on the revenue side, the GOES is likely to face steadily increasing pressure on the expenditure side. First, the fiscal accounts are still feeling the impact of the mid-1991 drought which lowered water reservoirs to critically low levels. This required the state-owned electric power company to generate more expensive thermal energy instead of the relatively cheap hydroelectric power. The extra costs have been estimated at near 30 million colones per month, and these will accrue through the advent of the next rainy season expected about May 1992.

Unfortunately, even with the end of El Salvador's 12-year civil war, fiscal pressures will continue. While the termination of hostilities should generate some fiscal savings, it is expected that these will be more than offset by new GOES expenditures related to its National Reconstruction Program. While substantial new external funding for much of this is anticipated, the GOES will have to absorb substantial costs related to expenditures for local goods and services and the continued maintenance of the rebuilt infrastructure. This will especially be the case immediately after a formal cease fire as other donors will not be in a position to provide quick disbursing assistance for some time. Moreover, most of the recovery program activities cannot wait; it will be imperative that they be implemented quickly after a ceasefire to support the peace process and prevent its unraveling.

Given the particularly difficult fiscal situation faced by the GOES during 1992, and given the GOES commitment to comprehensive fiscal reform, the Mission proposes programming a portion of ESF local currency resources for general budget support. This will help relieve GOES fiscal pressures by covering expenditures for specific social programs already included in the GOES budget and which contribute to the achievement of USG and Mission program objectives. In addition, they are proposed to be used to cover the local currency cost of high-priority external and domestic debt service payments coming due during CY 1992.

The use of ESF local currency resources for general budget support will also add to the leverage already provided by the ESF cash transfer dollars.

3. Strengthening Democratic Institutions and Improving the Protection of Human Rights

Through the inclusion of judicial reform in the FY 91 ESF Program conditionality, the U.S. Mission was successful in heightening our policy dialogue efforts and obtaining the GOES's commitment to a comprehensive legal reform agenda that offers great promise in terms of more just and responsive judicial processes. Experience has shown, however, that building the political consensus necessary to finalize and implement such reforms will not be easy. A sustained effort to engage the legal community, political leadership and general public in the debate of legal reform proposals prior to their presentation to the National Assembly will be necessary. Given the numerous other priorities of the Government, including the National Reconstruction Plan, and the political sensitivity of judicial reform, the added support of ESF conditionality will bolster USG policy dialogue efforts and help ensure that reforms are implemented in a timely fashion.

4. Macroeconomic Considerations

Although not a principal program objective, the proposed disbursement of $90 million in FY 1992 ESF resources will enable the GOES to achieve its 1992 economic program objectives of four percent real GDP growth while reducing inflation to between 8-10 percent. As in previous years, the program will also provide critical budget support to the Central Government.

In addition to the proposed ESF cash transfer's contribution toward achievement of GOES 1992 economic program objectives, other macroeconomic considerations relate to the Mission's view that El Salvador still has a ways to go to achieve sustained strong external performance. While recent economic performance has been truly impressive, it has to be emphasized that external stabilization, just as with internal stabilization, has yet been achieved. For example:

- The merchandise trade balance as a percent of GDP has grown from 6.3 percent in 1980 to 12.5 percent in 1991.

- While merchandise exports showed strong growth in 1990, and continued, albeit slower growth was experienced in 1991, total export earnings reached only $621 million in 1991. This is less than one-half of projected imports and only 55 percent of the dollar-value achieved in 1979, El Salvador's peak year for exports. In real terms, of course, exports are an even smaller percentage of their 1979 peak.

- Notwithstanding recent and continuing efforts to diversify exports, El Salvador is still excessively dependent on the export revenue of one product -- coffee, and international price prospects for coffee are not encouraging.

- The period covered by the September 1990 Paris Club debt rescheduling ended September 30, 1991. (Regarding debt to the USG, currently, El Salvador must pay an average of $28 million per year to service A.I.D. and P.L. 480 loans. In this respect, EAI debt reduction provisions would greatly help El Salvador.)

- El Salvador has not yet achieved a stable, sustainable balance of payments condition. Much of the improved balance of payments position is the result of ephemeral trends related to the current stage of the structural adjustment process. For example, a large portion of foreign exchange inflows represents the effects of a stock adjustment, not permanent flows.

- Another part of the explanation for the huge capital inflows relates to interest rate policy. Through most of 1991 the GOES had determined interest rates based on a formula (devised with the World Bank) which relied heavily on past inflation. Thus, as inflation quickly dropped, real interest rates rose and, according to some observers, overshot. This encouraged further capital inflows. With generally lower interest rates now, these foreign exchange inflows are expected to partially abate.

- The current balance of payments situation is potentially highly volatile, and should expectations change, substantial instability could result. This is because the current exchange rate/interest rate regime is being driven largely by expectations that the nominal exchange rate will not depreciate substantially. Should those expectations suddenly change, foreign exchange inflows would be significantly affected and possibly reversed.

The above considerations place El Salvador's recent balance of payments gains in a more sober light. They also provide added emphasis on the importance of further GOES efforts to consolidat its economic reform program.

C. Proposed Conditionality

1. Negotiating Objectives and Strategy:

The GOES is in the final stages of completing its economic program for 1992. This program is supported by an IMF Stand-by Arrangement in effect through February 1993 and the 1991-1993 IBRD SAL. The Mission intends to use its ESF cash transfers to reinforce IMF and IBRD support for macroeconomic stabilization and structural adjustment measures embodied in the GOES 1992 economic program. At the same time, the Mission's policy dialogue process will encourage the GOES to include in its 1992 Economic and Social Program specific measures aimed at improving the tax system, achieving integrated financial management, increasing public sector employment efficiency, creating a better investment climate and strengthening human rights through further movement toward improved administration of justice.

The proposed conditionality package is designed to maximize the leverage of ESF resources while fully supporting important USG and Mission objectives. Therefore, the Mission intends to use ESF conditionality to support a limited number of top priority reforms grouped in four principal areas. From an operational perspective, the conditionality package has been constructed to minimize Mission management requirements and to prevent the need for excessive and complicated monitoring and reporting.

2. Policy Reforms to be Supported

This section lists all proposed measures to be supported by the FY 1991 ESF Policy Reform Support Program. Additional discussion is provided for selected measures. A matrix presenting all measures according to ESF disbursement schedule is attached as Annex A.

a. Consolidating Sustainable Growth

(1) Macroeconomic Program

Measure:
Continued satisfactory progress in achieving macroeconomic targets.

(2) Structural Adjustment

Measure: Maintain structural adjustment measures initiated under GOES economic program.

Discussion: The policy reform matrix supported by the FY 1992 ESF program will include a statement designed to encourage maintenance of sound macroeconomic policies and prevent slippage, especially in areas of key importance to USG and the Mission's program, e.g., price bands, overall fiscal performance. The proposed program will provide an important reinforcement to the IMF and IBRD programs.

Measures: Further liberalize trade regime. Eliminate existing tariff exemptions related to investment goods for autonomous public enterprises and government entities. Remove remaining import permit requirements for basic grains, milk and fibers for sacks. Remove export restrictions on white corn, rice and beans. Reduce import duties to a range of 5 to 20 percent for most categories. Unify tariffs at 20 percent for corn flour, corn gluten, sorghum, and beans; and at 15 percent for powdered milk, wheat and wheat flour.

<u>Measure</u>: Eliminate remaining controls on lending and deposit rates.

b. Public Sector Efficiency

(1) Electricity Pricing

<u>Measures</u>: Develop plan to bring electricity tariffs up to where they cover long-run marginal cost of production. Make initial adjustments in rates. Demonstrate satisfactory progress in implementation of financial restructuring plan for CEL (the energy parastatal).

(2) Improve Tax Policy and Administration

<u>Measures</u>: Continue the implementation of tax reform measures under the Modernization of Salvadoran Tax System (MOST) Program. Submit value-added tax law to the Legislative Assembly. Develop a draft of a new organic customs law to be submitted to the Legislative Assembly.

(3) Strengthen Integrated Financial Management and Auditing

<u>Measures</u>: Conduct review of laws governing treasury and budgeting operations.

Develop action plan to modernize treasury and budgeting operations laws.

<u>Discussion</u>: One of the problems facing the GOES regarding [redacted]

progress made to date, the GOES will contract experts to further review the laws governing these functions and to introduce appropriate reforms for their modernization and consistency with other financial management functions. Specifically, the GOES will further review the laws governing the treasury and budgeting operations of the public sector. This will lead to the promulgation of new organic laws which must be compatible with the existing Accounting Law and the projected interim organic legislation of the Court of Accounts. An action plan will be developed for this purpose and will include improvement on the existing procedures to allow for reduction of time in processing of the GOES's payment obligations.

<u>Measure</u>: The GOES will submit to the Legislative Assembly an interim organic law to reform the Court of Accounts.

<u>Discussion</u>: The most significant financial problem facing the GOES is the existence of the precontrol function in the Court of Accounts. The current practice obstructs timely processing of all government actions and creates a false sense of security and confidence. The First Inter-American Conference on the Problems of Fraud and Corruption in Government-held in Miami, Florida in December 1989, identified precontrol as a mechanism for extortion. According to the participants, "public officials who exercise precontrol are the only public servants not integrated into the hierarchy of the agency over which they are exercising control and are not accountable for the decisions they make or actions they take. In this way external precontrols actually contribute to corruption rather than prevent it."

El Salvador is the only country left in Latin America which is still using the precontrol function. To date, despite direct technical assistance financed by USAID, the government of El Salvador has not been able to overcome the opposition of long-term bureaucrats to the reform and redefine the role of the Court of Accounts. An interim organic law for the Court of Accounts builds on the conditionality in the FY 1991 program and attempts to deepen the GOES concern about this issue by requiring the GOES to develop legislation to redefine the precontrol function and to develop a real post-audit capability.

<u>Measure</u>: Prepare action plan for auditing the GOES financial statements. The audit will be performed in accordance with the professional standards prescribed by the International Organization of Supreme Audit Institutions (INTOSAI).

<u>Discussion</u>: In the classic definition of democracy by Abraham Lincoln, "Democracy is Government of the people, by the people for the people." Public knowledge of the results of government operations is a key element in a lasting democratic process. Accountability is necessary to sustain the democratic process, and accountability means that every act or action is subject to independent, professional, non-partisan audit review and public report of results.

The Constitution of El Salvador recognizes the role of public disclosure of financial operations in the democratic process. Article Number 168 of the Constitution of El Salvador requires the Ministry of Finance to present to the Legislative Assembly an annual financial statement which according to Article 195 of the Constitution must have been audited by the Court of Accounts. Unfortunately, the Court of Accounts has been unable to audit the financial statements prepared by the Ministry of Finance. The last audited financial statement covered the government operations for the year 1987 and was presented to the Legislative Assembly on July 15, 1988. The purpose of this measure is twofold, first to reinforce the concept that audited annual financial statements are essential to the maintenance of a flourishing democratic society and, second to keep the GOES attention focused on strengthening and modernizing the Court of Accounts.

Measure: The GOES will develop regulations to institutionalize the cash flow programming of the Treasury Department and thus establish time limits for public sector processing of payments to its suppliers.

Discussion: With duplicate and redundant budget controls in the Ministry of Finance and the Court of Accounts and the absence of regular cash flow projections to govern treasury operations, it may take from six to eleven months before a payment for goods or services ordered by the GOES can actually be made. Such practice undermines sustained economic development and weakens the democratic process. Entities that deal with the GOES must include in their prices to the government the carrying costs for the inordinate payment processing time. Over time, higher prices result in the acquisition of fewer goods and services or a larger deficit. Both of these slow growth. Slow payment processing is also detrimental to the democratic process because it tends to limit participation in the economic process by small and disadvantaged businesses that are unable to compete for government contracts because they cannot assume or finance the carrying costs associated with a slow and bureaucratic payment process.

This measure is the most far reaching in the package of financial reforms in this year's conditionality package because its passage will set new standards for efficiency in government operations. To implement prompt payment procedures every Ministry within the GOES will have to examine its operations. Additionally, this measure adds increased pressure on the GOES to abandon the precontrol function now exercised by the Court of Accounts.

(4) Rationalize Public Sector Operations

Measure: Implement privatization process; establish a realistic 1992 Action Plan; and initiate implementation of the Action Plan. Initiate two privatizations. Complete privatization of two banks; initiate privatization of two additional banks.

Measure: Continue implementation of public sector employment reduction program.

c. Encourage Private Investment

Measures: Prepare preliminary plan to improve investment climate and initiate actions under investment plan.

Make progress toward resolution of bona fide international investment disputes.

Draft a comprehensive intellectual property (IPR) rights law and submit it to the Legislative Assembly.

Develop plan for reforming labor code and complete draft legislation for revised labor code.

Discussion: While the Mission expects that the IDB will take the lead in this area with its Investment Sector Loan, ESF conditionality will be used to reinforce investment-related reforms of particular interest to the USG. Also, the Mission will encourage the IDB to include on its reform agenda some of the measures important to A.I.D., e.g., the protection of intellectual property rights.

d. Administration of Justice

Conditionality included in the 1992 ESF Policy Reform Program related to strengthening the administration of justice builds upon accomplishments made under the 1991 program, and include two specific areas: (a) continued progress on the GOES's criminal legislative reform agenda, and (b) increased resource allocations to the Public Ministry for criminal investigations, prosecution, and public defense.

Measure: Specifically, by April 1992, the GOES will submit legislation to the Legislative Assembly to: (i) formally ascribe the function of public defense in criminal cases to the Procurador General de la República; and (ii) establish the Commission for the Investigation of Criminal Acts (CIHD, which is composed of the Special Investigative Unit and Forensic Laboratory) as a civilian organization with functional responsibility to the Attorney General. Conditionality for the second tranche of ESF funding will include continued implementation of the GOES's legislative reform agenda relating to criminal and criminal procedure law and strategy for building public and legislative branch support for reforms presented to the Assembly.

<u>Discussion</u>: In August 1991, the Minister of Justice presented its legislative reform agenda to USAID and requested three foreign experts to assist the MOJ in drafting both specific and comprehensive reforms to the criminal and criminal procedure codes. This agenda closely follows recommendations of an AID-financed study on areas of reform needed to improve the administration of justice, and establishes a timeframe for presentation of draft laws to the Assembly. The first major roadmark is June 1992, by which time the MOJ will present reforms to: permit release pending and during trial for the majority of crimes, reduce the 72-hour administrative detention period to 12 to 24 hours, formally ascribe the function of public defense to the Public Ministry, widen the role of the defense attorneys in pre-trial proceedings, and strengthen the habeas corpus law, as well as several other changes to the criminal procedure code. The focus of these reforms is on maximizing the protection of individual liberties and reducing opportunities for human rights abuses. Additionally, the GOES must begin the process of civilianizing the CIHD, as a condition for continued USG funding support (FY 91 FAA). Given the priority of reforms related to public defense and the CIHD, the Ministry of Justice is committed to presenting these reforms during the first quarter of CY 1991. The continuation of the active GOES public awareness campaign will be important not only to facilitating passage of the reforms presented by the MOJ to the Legislative Assembly, but also to building broader support within the country for the judicial reform program.

<u>Measure</u>: Second, by August 1992 the GOES will carry out a study of the composition, independence and operation of the National Council on the Judiciary, with recommendations to improve its independence from political parties and the courts.

<u>Discussion</u>: This policy measure addresses one of the key institutional constraints to the professionalization and depoliticization of the judiciary. As a result of Constitutional reforms ratified in November 1991, efforts are underway to reform the organic law of the Council. In addition to modifying the composition of the Council, this modification should include reforms to ensure the financial independence and integrity of the Council's actions.

<u>Measure</u>: By August 1992 the GOES will complete a study of the financial needs of the Public Ministry to discharge its functions of criminal investigation, prosecution and public defense.

<u>Discussion</u>: As noted in the Constraints section, recent Constitutional reforms provide the courts with greater financial autonomy and security, but do not address the problem of underfunding for the Public Ministry. The Public Defender's Office now receives 100% of its support through the AID program, with the Attorney General receiving nearly 50% of its budget from AID. While additional resources are needed to expand geographic coverage, at a minimum the portion of the budget now financed by the AID

project needs to be incorporated into the GOES ordinary budget so that project accomplishments can be sustained. The study required herein will assist the GOES to identify and quantify resource requirements, both to ensure the continued operation of programs now financed through USG resources, but also to meet the additional costs of expanding the public defense and Attorney General's Office to areas of the country not now adequately covered.

D. **Dollar Resources**

The Mission plans to accelerate its traditional policy dialogue and disbursement schedule in 1992. This will enable the Mission to provide crucial support on a timely basis if needed to ease the fiscal pressures on the GOES as it initiates the implementation of its National Reconstruction Program (as long as GOES makes satisfactory progress on the ESF-supported reforms). The target completion date for the PAAD has been moved up to March from the traditional May/June date. Two disbursements are scheduled -- one as soon as April/May and the other during the third calendar quarter. This would be much earlier than the traditional July/August first and December second disbursements.

The first disbursement will be linked to GOES reform measures which can be completed by early in the second calendar quarter. This will permit, should GOES performance warrant, an immediate disbursement of the first ESF tranche upon obligation. The second disbursement will be linked to GOES reform measures programmed for completion by August/September.

Disbursements made on a semi-annual basis are considered sufficient to encourage policy reforms while sufficiently spreading out the financial impact of the cash transfer. More frequent disbursements would add to the Mission's program management burden without providing significant benefits.

Separate Dollar Account: The Mission will continue to follow the separate dollar account procedures developed for its FY 1991 ESF cash transfer program.

Under the cash transfer mechanism, the dollars made available through the program, plus interests generated by such funds, will be used to liquidate import transactions of the private sector for raw materials, intermediate goods, capital goods, spare parts, agricultural inputs, petroleum and petroleum derivatives from the United States. Additionally, up to thirty percent (30%) of the assistance provided under this Program may be utilized for the importation of petroleum and petroleum derivatives from AID Geographic Code 941 countries other than the United States. Imports to be liquidated against the Program will be for the use of the private sector of the Salvadoran economy in the manufacturing, agricultural, agroindustrial, commercial, construction, transportation, communications, energy and services subsectors.

The Mission has selected the cash transfer mechanism over a commodity import program (CIP) mode as the most appropriate form of ESF non-project assistance. The need for a quick-disbursing, flexible form of assistance to support El Salvador's fiscal deficit and external accounts requires the use of the cash transfer mechanism. Furthermore, the existence of El Salvador's fully liberalized, market-determined exchange rate regime makes the CIP option impractical. Importers would find the CIP costlier than importing through normal commercial channels. Thus, in order to move the CIP, a preferential exchange rate would have to be created resulting in the reestablishment of a multiple rate regime. Under its IMF stand-by arrangement, the GOES has pledged not to reintroduce multiple exchange rate practices.

The Central Reserve Bank's price checking unit, initially established with USAID-financed technical assistance to verify prices of merchandise imports financed under the ESF program, was terminated in FY 1991 with AID/W concurrence (91 STATE LOU 077620). The price checking unit performed an important function under El Salvador's previous overvalued fixed exchange rate regime where it served to limit the overinvoicing of imports. This helped prevent unauthorized access to foreign exchange at preferential rates. Under El Salvador's current flexible, market-determined system, the exchange rate varies with supply and demand, and there are no preferential rates. Therefore, the incentive to engage in overinvoicing of imports to obtain additional foreign exchange at preferential rates has disappeared. As long as El Salvador maintains its flexible exchange rate regime, the Mission sees no need to resume price checking operations.

E. Local Currency Resources — Programming Issues

1. Background

Local currency resources generated from ESF Balance of Payments dollars continue to play a crucial role in Mission efforts to foster broad-based economic growth, support evolution of a stable, democratic society; and facilitate international cooperation in addressing specific challenges. ESF local currencies have financed activities in five areas: (1) counterpart for A.I.D. projects, (2) specific GOES/Mission high priority activities such as the PVO support fund and municipal development projects; (3) general budget support to GOES development Ministries, such as health, education and agriculture and counterpart for other donor projects in those Ministries; (4) A.I.D. OE trust funds; and (5) A.I.D. program trust funds.

Beginning in 1982-1983, the Mission developed complex regulations and procedures to guide management of the program, and to improve accountability. The Mission provided support and encouragement to the GOES entity, the Technical Secretariat for External Financing (SETEFE) in the Ministry of Planning, charged with overall LC fund administration to improve its management, control and accountability of the program. During the 1980s, the local currency program grew until it encompassed hundreds of projects, programs and implementing institutions. The LC Program became a heavy management burden for the Mission and the GOES. Its size and complexity precipitated delays in implementation and micro-management of the portfolio.

Beginning in 1989 and continuing to the present, the Mission and the GOES initiated reforms in the management of the local currency program. The basic decision variables included: (1) the need to focus on principal target areas and project results; (2) the need to streamline the program's and Mission regulations and procedures, while maintaining appropriate levels of accountability; (3) the fact that the GOES, through SETEFE, had significantly improved systems for management, control and accountability, and should assume greater responsibility; and (4) requirements for programmatic and financial consolidation.

As a result of these efforts, the Mission and the GOES agreed then to modify the program to emphasize project impact, delegate more operational authority to GOES agencies and Mission technical offices, reduce review and approval time, and clean up unallocated and/or undisbursed funds. Steps taken included: redesigning the local currency action plan format to stress purpose, objectives and activities instead of inputs; giving Mission technical offices the lead on review and approval of incoming action plans, thereby reducing time and paperwork substantially; placing more audit accountability and responsibility on the GOES Court of Accounts and SETEFE; limiting implementing institutions to submitting only one action plan per program, thereby reducing the total number of local currency action plans to around 50 and significantly reducing the subsequent number of reprogrammings; and establishing a biannual system to facilitate the clean-up of unused funds.

While in effect for less than one year, the reform program has demonstrated positive results, and the Mission expects to report clearer impact data and greater efficiencies achieved as time passes. In particular, the revised format for the action plan is more concise and more clearly identifies performance indicators. The number of new action plans has dropped almost 35 percent, and they more definitively target Mission and GOES objectives. Within USAID, the streamlined procedures have reduced the average review and approval period for new action plans from eight weeks to three. The GOES is increasingly taking the decision-making lead on financial reprogrammings and minor activity changes, thereby easing the burden on Mission staff. SETEFE implemented a strong audit and certification program, with well-defined scheduling benchmarks and a penalty system; this encouraged recipient entities to significantly improve their accounting systems. Via the biannual clean-up exercise, the Mission and SETEFE identified over 100 terminated and uninitiated action plans, some going back to 1983, with cumulatively ¢400 million made available. These action plans were officially retired and virtually all of the collected funds were used for both ordinary budget support and a guarantee fund for agrarian reform farmers.

2. FY 1992 Program

The Mission will apply the new local currency guidance (issued July 1991) to the generations accrued from the FY 92 dollar disbursements. Fortunately, our current program either matches or surpasses the requirements in the policy guidance. Nevertheless, the guidance requires that certain issues be addressed in the PAAD document for AID/W consideration.

a. The General Assessment: In 1990, the Mission completed the General Assessment of Accountability and Vulnerability. It reported that the Mission had an overall medium to high level of confidence in the budgeting and financial management systems of the GOES. Specifically, the report said that "the budgeting and reporting systems of the host country are reasonably adequate to report allocations and expenditures from the general (ordinary budget) fund. A 1988-89 audit performed by RIG/A/T reconfirmed this finding by concluding that the Ministry of Finance has the necessary management and financial capability to manage the Host Country-Owned Local Currency in the general fund." SETEFE, which manages the special account and the extraordinary budget, is generally recognized as a capable organization. As noted earlier, the Mission works closely with SETEFE in all aspects of managing the local currency program: jointly programming local currency; approving action plans; tracking action plan goals, purposes and activities; reviewing program and financial reports; and participating in the audit programs. In the past two years, SETEFE has greatly strengthened its audit/accountability institutional focus and capacity. While SETEFE is not a perfect institution, the Mission has a high level of confidence in its overall capabilities.

To further strengthen overall GOES, and particularly Ministry of Finance, financial management capabilities, the Mission and other donors have begun to implement a series of activities to modernize El Salvador's public finance system. USAID/El Salvador, the IMF, the World Bank, the IDB and UNDP are all working via technical assistance and conditionality to help El Salvador modernize budgeting, accounting, auditing and other financial management systems. USAID/El Salvador specific assistance is explained below. First, a quick response, short-term technical assistance team is assembled to improve financial management systems of host country institutions receiving or under consideration for AID or local currency funding. Second, a major effort to help the GOES develop and implement an integrated financial management system, focussing particularly on the Ministry of Finance and the Court of Accounts, will start in November. Third, a two-year technical assistance team has recently arrived to work with the GOES to modernize the Salvadoran tax system.

b. Programming Options: The Mission and GOES will continue to program funds for the ordinary and extraordinary budgets, and OE and program trust. Within the ordinary budget, the Mission plans to select the general budget (deficit) option. General budget or deficit financing is an attractive approach given that the GOES is implementing an IMF Stand-by Arrangement which places strict limits on net banking system credit to the public sector. Reducing credit to the public sector will permit higher levels of banking system credit to finance private sector investment, production and employment. The new AID local currency guidance indicates the need for a high degree of confidence in GOES accounting and control systems to select this option. In the foregoing discussion, the Mission demonstrated the overall sound capabilities to manage the funds on the part of SETEFE and the Ministry of Finance. While some problems still exist, the Mission and other donors are applying significant levels of expertise to foment improvements. With this in mind, we request, per the new guidance, that the LAC Assistant Administrator approve the use of this option.

The local currency program will continue to support direct counterpart for AID DA projects through the extraordinary budget (extra-budgetary support). However, pursuant to a Mission decision taken last year, we will eliminate approval and funding disbursements for GOES priority projects through the jointly programmed extraordinary budget.

During the past year, the Mission determined that FY91 generations (applied in CY92) would represent the last tranche of support to GOES priority projects through the extraordinary budget, thereby continuing the trends of reducing the number of management units and passing more authority to the GOES. Priority projects are stand-alone activities managed by GOES implementing entities without supporting dollars. The Mission actively participated in managing and monitoring these activities. While in having some success, these projects required significant oversight and time by Mission staff. In terms of making prioritizing decisions within a consolidation framework, the majority of these activities were felt to have a lesser impact on the achievement of Mission objectives. If the GOES wishes to continue these efforts, it will be its responsibility through the normal government ordinary budget allocation process.

Now that the long sought peace is finally arriving in El Salvador, the Mission will be using DA, ESF and ESF local currency generation resources in a major effort to promote the economic reactivation of the conflictive zones by helping to restore their access to basic services and assisting the democratic reintegration of the population. The Mission's proposed five year assistance package will require the equivalent of approximately $65 million U.S. in HCOLC. The Mission estimates that approximately the equivalent of $20 million will be needed to support the National Recovery Program (NRP) from the 1992 HCOLC generations.

Mission plans for the trust fund will correspond to the levels approved by AID/W for operating expenses. The Mission will allocate funds through the program trust for the AIFLD-sponsored Salvadoran Labor Management Foundation, and, in addition, for the University of Central America (UCA) debt payment as legislated by Congress. On the latter case, the GOES has agreed to assume the debt. Both AID and UCA have requested that the U.S. Congress nullify or change the legislative language to recognize the GOES decision. Once both these changes occur, the funds reserved from last year's and this year's generations will likely be reprogrammed for ordinary budget support.

c. Interest Policy: The guidance indicated that AID policy favors local currency being placed into interest bearing accounts in a deposit taking institution, with interest programmed as if it were principal. The local currency program has generated such large levels of funding that the Mission determined that interest generated would undermine stabilization efforts and would represent unsound monetary policy. Therefore, in accordance with the policy, the Mission Director will issue a written determination not to follow AID's preference.

d. Program Performance Indicators: The action plans, through which extraordinary budget resources are allocated, have accompanying indicators, i.e., purpose and output level targets. For general budget support, the Mission will develop budgetary-based indicators, which will be included in the program agreement or subsequent documentation.

e. Illustrative Planning Levels: Although the Mission has not discussed the FY92 program with the GOES, we have estimated the following requirements:

	($ Million)
Extraordinary Budget * (Counterpart to AID Projects)	58.0
Ordinary Budget	19.2
OE Trust	4.1
Program Trust **	8.7
	90.0

* Includes approximately the equivalent of $20 million for National Reconstruction and $38 million for counterpart to AID projects.

** Represents $3.7 million for the AIFLD-sponsored foundation and $5.0 million for the University of Central America.

GOES 1992 ECONOMIC PROGRAM
MEASURES SUPPORTED BY FY 1992 ESF PROGRAM

	APRIL/MAY First Disbursement	AUG/SEP Second Disbursement
1. Consolidating Sustainable Growth		
a. Macroeconomic Program	Continue to implement GOES economic program. Performance targets for 1992: Fiscal deficit: 2.25% of GDP Public Sector Savings: 1.5% of GDP; BOP Current Account deficit: 4.5% of GDP; Monetary targets consistent with 4% real GDP growth and 8-10% inflation.	Continued satisfactory progress in achieving macroeconomic targets.
b. Structural Adjustment	Maintain structural adjustment measures initiated under GOES economic program.	Maintain structural adjustment measures initiated under GOES economic program.
Further Liberalize Trade Regime	Eliminate existing tariff exemptions related to investment goods for public autonomous institutions and government entities.	Import duties reduced to a range of 5 to 20 percent for all categories (except shoes, leather products, apparel and others listed in Tariff Annex III for which the maximum rate will be 25 percent).
	Remove remaining import permit requirements for basic grains, milk and fibers for sacks. Remove export restrictions on white corn, rice and beans.	Unify tariffs at 20% for: corn flour corn gluten sorghum beans and at 15% for: powdered milk wheat wheat flour
Financial Sector	Eliminate remaining controls on lending and deposit rates.	

GOES 1992 ECONOMIC PROGRAM
MEASURES SUPPORTED BY FY 1992 ESF PROGRAM

	APRIL/MAY First Disbursement	AUG/SEP Second Disbursement
2. Public Sector Efficiency:		
a. Electricity Tariffs	The GOES is developing a plan to bring electricity tariffs up to where they cover long-run marginal cost of production. Make first adjustment towards the goal.	Satisfactory progress in implementation of financial restructuring plan for CEL (the energy parastatal).
b. Improve Tax Policy and Administration.	Submit value-added tax legislation to the Legislative Assembly.	Develop a draft of a new organic customs law to be submitted to the Legislative Assembly.
c. Strengthen Integrated Financial Management and Auditing.	Conduct review of laws governing treasury and budgeting operations. Develop action plan to modernize treasury and budgeting operations laws.	The GOES will submit to the Legislative Assembly an interim organic law to reform the Court of Accounts. Prepare an action plan for auditing the GOES financial statements. The audit will be performed in accordance with the professional standards prescribed by the International Organization of Supreme Audit Institutions (INTOSAI). The GOES will develop regulations to institutionalize the cash flow programming of the Treasury Department and thus establish time limits for public sector processing of payments to its suppliers.
d. Rationalize Public Sector Operations.	Implement privatization process; establish a realistic 1992 Action Plan.	Implementation of 1992 Privatization Action Plan including initiation of two privatizations.
	Complete privatization of two banks.	Initiate privatization of two additional banks.
	Continue implementation of public sector employment reduction program.	Continue implementation of public sector employment reduction program.

GOES 1992 ECONOMIC PROGRAM
MEASURES SUPPORTED BY FY 1992 ESF PROGRAM

	APRIL/MAY First Disbursement	AUG/SEP Second Disbursement
3. Private Investment	Prepare preliminary plan to improve investment climate.	Initiate actions under investment plan.
	Make progress toward resolution of bona fide international investment disputes.	
	Draft comprehensive intellectual property rights (IPR) law.	Submit IPR law to Legislative Assembly.
	Develop plan for reforming the labor code.	Complete draft legislation for revised labor code.
4. Judicial Reform	Submit draft law to Legislative Assembly to: (i) formally ascribe the function of public defense in criminal cases to the Procurador General de la República; and (ii) permanently establish the Commission for the Investigation of Criminal Acts (composed of the Special Investigative Unit and Forensic Laboratory) as a civilian organization with functional responsibility to the Attorney General.	The GOES will have initiated an active campaign to promote adoption of reforms presented to the Legislative Assembly. Continue to implement legislative reform agenda relating to elements of the criminal and criminal procedural laws.
		Carry out study on composition, independence, and operation of the National Council on the Judiciary and initiate implementation of recommendations to improve functioning and independence of the Council.
		Complete study of the financial needs of the Public Ministry to discharge its functions of criminal investigation, prosecution and public defense and develop strategy to meet these recurrent costs through ordinary GOES budget resources.

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ANNEX

EL SALVADOR: POLICY REFORM MATRIX — ALL DONORS

INSTITUTION	PROGRAM/DATE OF AGREEMENT AMOUNT	POLICY REFORM AREAS SUPPORTED	KEY MEASURES
A.I.D.	ESF Policy Reform CY 92 $90 million	Macroeconomic Program	Continued implementation of sound macroeconomic stabilization and structural adjustment program.
		Public Sector Efficiency	Improve tax policy and administration. Strengthen integrated financial management. Rationalize public sector employment.
		Investment	Improve private investment climate.
		Judicial Reform	Strengthen administration of justice.
World Bank	SAL 3/91 $75 million	Trade and Exchange Rate Policy	Market-determined exchange rate system. Tariff adjustments/elimination of exemptions.
		Fiscal Policy	Expansion of the tax base. Increased public sector savings. Strengthen tax administration. Improve taxation system equity. Introduction of the value-added tax.
		Interest Rate & Monetary Policy	Gradual elimination of interest rate controls. Reduced administrative credit allocation.
		Financial Sector Reform	Privatization of the Financial System. Strengthening of the Superintendency.
		Agriculture Sector	Elimination of price controls on basic grains.
		Social Sector	Social compensation programs for the poor. Improvements in social services quality, coverage and efficiency. Delivery of nutritional assistance to the poor.

EL SALVADOR: POLICY REFORM MATRIX — ALL DONORS

INSTITUTION	PROGRAM/DATE OF AGREEMENT	POLICY REFORM AREAS SUPPORTED	KEY MEASURES
World Bank (cont.)	Social Sector Rehabilitation Project 6/91 $26 million	Basic Services Development Institutional Development	Improve coverage and delivery of basic social services. Strengthen MOH and MOE planning and management capacity. Strengthen MIPLAN capacity to develop a social sector information system.
	Power Sector Project 9/91 $11 million	Sector Studies	Reforms on electricity pricing policy. Institutional and legal reforms. Privatization of power distribution.
		Engineering and Management Studies	Assessment of the management efficiency and organization of CEL.
		Acquisition of materials	Improve planning, systems reliability and electricity rate design.
		Training Program	Management development program.
	PRISA CY 92 $60 million	Institutional Reform	Strengthen MAG planning and management capacity. Rationalize public sector agricultural expenditures.
		Privatization of Agricultural Enterprises and Services	Privatization of INCAFE and INAZUCAR. Privatization of ENA and ISIC.
		Research and Extension Rehabilitation of Irrigation Districts Vegetable and Animal Health Strengthening of Private Sector Basic Grains Marketing	Improve CENTA administrative and institutional capacity. Privatization vis-a-vis other alternatives. Irrigation pricing policy. Strengthen Project design capabilities. Reforms on pricing system for service charges. Privatization of IRA and BFA's marketing activities.

EL SALVADOR: POLICY REFORM MATRIX — ALL DONORS

INSTITUTION	PROGRAM/DATE OF AGREEMENT	POLICY REFORM AREAS SUPPORTED	KEY MEASURES
International Development Bank	Global Program of Multisectoral Credit 4/91 $60 million	Financial Sector Reform	Strengthening of the Financial System and the Superintendency.
	Investment Sector Loan 9/92 $50 million	Improve Private Investment Climate	Measures to create a more hospitable environment for domestic and foreign private investment.
International Monetary Fund	Stand-by Arrangement 1/92 SDR 41.5 million	Macroeconomic Stabilization	Limits on domestic credit. Fiscal restraint. Net international reserve target.

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STATISTICAL APPENDIX

Table 1
El Salvador
Selected Economic, Social and
Demographic Indicators

	1988	1989	1990	1991 1/
Population (in thousands)	5,031	5,138	5,252	5,375
Population Growth Rate (percent)	2.0	2.1	2.2	2.3
GDP Real Growth Rate (percent)	1.6	1.1	3.4	3.5
Real Per Capita Growth Rate (percent)	-0.4	-1.1	1.2	1.1
GDP per capita ($)	1027	965	1015	1111
Prices				
Consumer Price Index				
End of Period (percent)	18.2	23.5	19.3	9.8
Period Average (percent)	19.8	17.6	24.0	14.4
GDP deflator (1962=100)(percent)	16.4	16.5	23.2	12.5
Real Effective Exchange Rate 2/	16.3	-1.8	-17.2	10.0
Real Wage (percent) 3/	0.2	-15.0	-5.9	-3.3
Labor Market (Urban) 4/				
Employment (000s)		790		890
Unemployment Rate		8.4		7.5
Underemployment Rate (visible)		12.8		7.5

1/ Preliminary.
2/ Increases denote local currency appreciation.
3/ Nominal minimum wages deflated by the consumer price index.
4/ Based on multipurpose household surveys conducted during October 1988 -February 1989 for the 1989 figure, and October 1990-February 1991 for the 1991 figure.

Table 2
Balance of Payments, 1989-1991
with Projections through 1995
(millions of dollars)

	1989	1990	Prelimin. 1991	Projections 1992	1993	1994	1995
Current Account 1/	-466.2	-359.8	-325.7	-299.0	-242.2	-198.5	-154.0
Trade Balance	-663.8	-682.2	-743.9	-743.5	-739.5	-725.0	-713.5
Exports, f.o.b.	497.5	580.2	621.1	706.0	799.5	911.0	1025.5
Coffee	228.6	258.9	246.0	294.4	336.0	387.6	432.0
Other traditional	24.2	35.9	56.8	56.6	62.4	65.2	69.7
Nontraditional	244.7	285.4	318.3	355.0	401.1	458.2	523.8
CACM	160.6	173.0	195.3	220.0	248.6	285.9	328.8
Rest of the world	84.1	112.4	123.0	135.0	152.5	172.3	195.0
Imports, c.i.f.	1161.3	1262.4	1365.0	1469.5	1539.0	1636.0	1739.0
Net factor payments	-121.3	-124.1	-127.0	-112.8	-119.5	-130.6	-139.8
Of which: interest	-78.2	-113.3	-112.9	-107.9	-114.3	-124.9	-133.7
Other services (net)	82.1	101.1	105.9	117.6	129.5	140.6	151.8
Private transfers	236.8	345.4	439.3	459.7	487.3	516.5	547.5
Official transfers	282.4	223.2	178.5	260.2	195.2	146.4	109.8
Of which ESF:	157.0	98.0	45.0	135.0 2/	-.-	-.-	-.-
Capital account	89.5	231.9	21.4	113.0	11.1	34.1	94.2
Nonfinancial public sector	150.2	1.1	64.5	75.9	96.0	75.3	100.2
Disbursements	186.2	71.2	184.5	155.4	179.3	168.0	187.3
Amortization	36.0	70.1	120.0	79.5	83.3	92.7	87.1
Financial sector	7.0	-0.2	-164.3	45.8	-84.9	-41.2	-6.0
Disbursements	115.2	64.0	68.0	90.5	85.6	79.3	80.4
Amortization	108.2	64.2	232.3	44.7	170.5	120.5	86.4
Private capital and net errors and omissions	-67.7	231.0	121.2	-8.7	-.--	-.-	-.-
New Financing	-.-	-.-	-.-	-.-	107.0	61.0	-.-
Overall balance	-94.3	95.3	-125.8	74.2	71.0	43.0	50.0
Net change in arrears (decrease -)	70.5	-104.5	0.0	0.0	0.0	0.0	0.0
Rescheduling	60.4	126.2	167.0	0.0	0.0	0.0	0.0
Change in net official reserves (increase -)	-36.6	-117.1	-41.2	-74.2	-71.0	-43.0	-50.0
Memorandum items:							
Arrears	104.5	-.-	-.-	-.-	-.-	-.-	-.-
Gross Official Reserves	393.1	541.4	515.1	573.0	635.7	680.1	729.3
In months of imports	4.1	5.1	4.5	4.7	5.0	5.0	5.0
Real GDP Growth Target	1.1	3.4	3.5	4.5	4.5	5.0	5.0
(As percent of GDP)							
Trade balance	-13.4	-12.8	-12.5	-11.5	-9.6	-8.1	-6.8
Current account balance	-9.4	-6.7	-5.5	-4.5	-3.2	-2.2	-1.5
Official transfers	5.7	4.2	3.0	3.9	2.5	1.6	1.0
Capital account balance	1.8	4.3	0.4	1.7	0.1	0.4	0.9
New financing	0.0	0.0	0.0	0.0	1.4	0.7	0.0
Overall balance	-1.9	1.8	-2.1	1.1	0.9	0.5	0.5

Source: Central Reserve Bank.
1/ It does not include official transfers.
2/ Includes $45 million in FY 1991 ESF originally programmed for CY 1991.

Table 3
El Salvador:
Fiscal Performance Summary

A. Central Government

	1989	1990	Estimate 1991	Program 1992
(Annual percentage change)				
Revenue	-6.5	34.1	27.6	26.0
Tax Revenue	-3.0	35.5	29.9	22.5
Expenditure and net lending	14.7	15.3	30.4	10.0
Current expenditure	11.7	22.0	22.4	10.0
Interest	18.0	53.9	132.2	4.1
Internal	59.3	204.5		
External	3.6	-99.3		
Capital expenditure	26.9	0.9	17.7	30.2
Net lending	-.-	-.-	-.-	-.-
(In percent of GDP)				
Revenue	8.3	8.7	9.5	10.3
Tax Revenue	7.6	8.1	9.1	9.5
Expenditure and net lending	13.1	11.9	13.3	12.6
Current expenditure	10.5	10.1	10.6	10.0
Interest	0.9	1.0	2.2	1.9
Internal	0.3	0.7		
External	0.6	0.3		
Capital expenditure	2.3	1.8	1.9	2.1
Net lending	0.3	-.-	0.8	0.5
Current account deficit (-)	-2.3	-1.4	-1.1	0.2
Overall deficit (-) before grants	-4.9	-3.2	-3.8	-2.3
Foreign grants	1.6	2.1	1.3	1.1
External financing (net)	0.6	1.2	2.1	1.3
Internal Financing	2.6	-0.1	0.7	-0.2
Banking System	3.1	0.5	1.5	0.2
Other	-0.4	-0.6	-0.8	-0.3

Source: Central Reserve Bank of El Salvador.

(Cont...)

(...Cont. Table 3)

B. Consolidated Non Financial Public Sector

	1989	1990	Estimate 1991	Program 1992
	(Annual percentage change)			
Revenue	-5.6	37.2	25.4	25.6
Current Revenue	-5.9	37.2	25.4	26.7
SOE Operating Surplus	-41.4	80.3	10.2	111.2
Capital revenue	2340.0	38.5	24.3	71.4
Expenditure and net lending	17.1	7.5	31.9	16.2
Current expenditure	11.1	22.6	23.2	10.9
Capital Expenditure	37.1	-25.1	62.2	40.5
Fixed capital formation	32.6	-29.8	72.8	40.7
Net lending	-.-	-.-	-.-	-.-
	(In percent of GDP)			
Revenue	10.3	11.1	12.0	13.0
Current Revenue	9.8	10.4	11.3	11.7
SOE Operating Surplus	0.5	0.7	0.7	1.2
Capital revenue	0.0	0.0	0.0	0.1
Expenditure and net lending	16.1	13.6	15.4	15.4
Current expenditure	11.8	11.4	12.0	11.5
Capital Expenditure	4.0	2.4	3.3	4.0
Fixed capital formation	3.9	2.1	3.2	3.8
Net lending	0.3	-0.1	0.1	-0.1
Current account deficit (-)	-1.6	-0.3	-0.1	1.5
Overall deficit (-) before grants	-5.8	-2.5	-3.5	-2.4
Foreign grants	1.7	2.2	1.3	1.1
External financing (net)	1.6	1.3	2.5	1.5
Internal Financing	2.6	-1.0	-0.4	-0.3

Source: Central Reserve Bank of El Salvador.
Note: Sums of components may not exactly equal totals due to rounding.

Table 4
El Salvador: Monetary Trends 1988-1991

	December 31			Program Targets
	1989	1990	1991	1992
(Annual percentage change)				
Net Domestic Assets	16	7	11	16
Credit to the Public Sector (net)	85	-2	15	1
Central Government	61	5	17	2
Rest of Public Sector	26	-39	-23	-5
Credit to INCAFE/INAZUCAR	-12	0	44	0
Credit to Private Sector	-3	26	17	17
Other	36	-22	-21	46
Liabilities to Private Sector (M3)	12	30	21	16
Basic Money Supply (M1)	15	22	1	17
Currency	30	7	-5	17
Demand deposits	0	41	6	17
Broad Money Supply (M2)	12	28	21	17
Quasi-money	9	32	34	17
Of which: time and savings deposits	9	32	34	17
Other financial claims 1/	16	44	24	6
(As percent of GDP)				
Liabilities to Private Sector (M3)	28	29	30	29
Basic Money Supply (M1)	10	9	8	8
Currency	5	5	4	4
Demand deposits	4	5	4	4
Broad Money Supply (M2)	24	25	25	25
Quasi-money	15	16	17	17
Of which: time and savings deposits	14	14	16	16
Other financial claims 1/	3	3	4	4
(As percent of total liabilities)				
Liabilities to Private Sector (M3)	100	100	100	100
Basic Money Supply (M1)	35	33	27	28
Currency	19	16	12	13
Demand deposits	16	17	15	15
Broad Money Supply (M2)	88	88	86	87
Quasi-money	53	55	59	60
Of which: time and savings deposits	50	50	55	56
Other financial claims 1/	12	12	14	13
Memoranda:				
Central Bank losses 2/				
As a percentage of GDP 3/		1.0	0.9	0.8

1/ Including those of nonmonetary financial institutions on the banking system.
2/ IMF estimate.
3/ On a cash basis

Table 5
El Salvador
International Reserves of the Central Reserve Bank
(Millions of Dollars)

	1988	1989	1990				1991		
	Dec.	Dec.	March	June	Sept.	Dec.	March	June	Sept.
Net Reserves	245.0	281.6	210.9	292.1	377.5	398.7	354.3	397.1	449.1
Assets	290.2	393.1	360.1	433.1	525.4	541.4	492.2	464.2	467.9
Monetary gold 1/	152.4	152.4	152.4	152.4	152.4	152.4	152.4	152.4	152.4
Foreign exchange	137.8	240.7	207.7	280.7	372.8	389.0	339.8	311.8	315.5
Cash	1.5	1.5	3.5	3.2	0.4	0.2	0.3	0.4	0.3
Deposits abroad	100.6	142.7	132.9	202.9	326.8	333.3	288.1	271.6	181.8
Investments 2/	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	95.8
Compensatory agreements	35.6	42.2	39.6	35.9	33.6	34.7	34.7	22.9	22.7
Transitory accounts	0.0	1.6	1.7	37.1	11.9	20.7	13.1	9.1	5.4
Interbank market	0.0	52.6	29.8	1.6	0.0	0.0	0.0	0.0	0.0
SCAP	0.0	0.0	0.0	0.0	0.0	0.0	3.6	7.7	9.6
SDR holdings	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Liabilities 3/	45.2	111.5	149.2	141.4	148.1	142.7	137.9	67.1	18.8
Short-term Loans	13.5	51.3	83.4	79.9	94.4	109.2	103.7	24.6	19.3
Time deposits	0.0	0.2	0.2	0.2	1.2	1.2	1.2	4.3	2.7
Compensatory and payments agreements	20.4	45.2	57.7	58.4	57.6	37.6	38.3	39.0	2.7
Central American Stabilization Fund (net)	-11.2	-14.9	-7.9	-2.7	5.3	5.3	5.3	0.8	5.8
IMF (net)	0.0	0.0	0.0	0.2	0.1	0.0	0.0	0.0	0.0
Memoranda: Gross reserves in months 4/	3.5	4.1	3.8	4.6	5.3	5.1	5.1	4.1	4.1

1/ Gold valued at US$325.00 per troy ounce.
2/ Before September 1991, this amount was classified within deposits abroad.
3/ Liabilities with original maturity of one year or less.
4/ Program target for 1991.

Table 6
El Salvador:
Gross Domestic Product by Sector of Origin
(in constant 1962 prices)

	1987	1988	1989	1990	1991 1/
	(Annual percentage change)				
GDP at market prices	2.7	1.6	1.1	3.4	3.5
Primary production	2.1	-0.9	0.5	7.3	-0.3
Agriculture	2.1	-1.0	0.5	7.4	-0.3
Mining	12.8	6.8	4.3	-8.2	11.1
Secondary production	3.9	3.5	2.4	1.1	5.3
Manufacturing	3.0	3.0	2.5	3.0	4.9
Construction	11.5	7.9	3.6	-12.8	10.1
Utilities	2.0	1.8	0.8	5.6	3.5
Services	2.4	1.9	0.7	2.8	4.3
Commerce	1.4	0.4	3.4	3.1	4.4
Government services	4.0	3.4	-1.1	1.6	4.0
Transport, storage, and communications	1.8	2.0	1.2	6.3	7.0
Finance	2.4	2.0	-9.5	2.0	4.0
Housing	2.6	2.8	2.4	2.5	2.7
Other	1.5	1.4	1.5	1.8	3.8
	(As percent of total GDP)				
GDP at market prices	100.0	100.0	100.0	100.0	100.0
Primary production	23.9	23.3	23.2	24.0	23.2
Agriculture	23.7	23.1	23.0	23.9	23.0
Mining	0.1	0.1	0.2	0.1	0.1
Secondary production	24.8	25.2	25.6	25.0	25.4
Manufacturing	17.6	17.8	18.1	18.0	18.3
Construction	3.4	3.6	3.7	3.1	3.3
Utilities	3.8	3.8	3.8	3.9	3.9
Services	51.3	51.5	51.3	51.0	51.4
Commerce	16.1	15.9	16.3	16.2	16.4
Government services	14.5	14.7	14.4	14.1	14.2
Transport, storage, and communications	5.9	5.9	5.9	6.1	6.3
Finance	3.4	3.5	3.1	3.1	3.1
Housing	4.8	4.9	4.9	4.9	4.8
Other	6.6	6.6	6.6	6.5	6.6

Source: Central Reserve Bank of El Salvador.
1/ Estimated values.

Table 7
El Salvador: Savings and Investment

	1988	1989	1990	1991
(In percent of GDP at current prices)				
Gross Domestic Investment	12.8	16.2	11.8	12.7
Fixed Capital Formation	12.6	13.3	11.8	13.3
Private Sector	9.5	9.8	9.5	10.7
Public Sector	3.1	3.5	2.3	2.6
Gross National Savings	8.2	6.8	5.1	7.2
Private Sector	7.9	8.4	5.4	7.3
Public Sector	0.3	-1.6	-0.3	-0.1
Foreign Savings 1/	4.6	9.4	6.7	5.5
(Real Growth Rates)				
Gross Domestic Investment		34.5	-33.6	9.3
Fixed Capital Formation		9.1	-17.3	17.9
Private Sector		4.4	-7.8	17.0
Public Sector		20.5	-37.5	20.8
Gross National Savings		-12.1	-32.4	45.0
Private Sector		12.1	-41.5	39.0
Public Sector		-.-	81.5	57.6
Foreign Savings 2/		119.0	-34.6	-17.5

Source: Central Reserve Bank

1/ Balance of payments current account excluding official transfers.
2/ Foreign savings deflated by the gross domestic investment deflator.

Table 8
El Salvador:
Outstanding External Public Debt by Lender 1/
(in millions of dollars)

	1988	1989	1990	1991 2/
Total	1714.0	1847.7	2117.3	2115.7
Multilateral	790.8	812.8	877.1	884.5
CABEI	99.4	112.6	140.4	120.8
IDB	520.7	573.0	592.1	589.8
IBRD	126.5	123.1	121.4	146.4
IMF	44.2	4.1	0.1	0.0
FIDA	0.0	0.0	6.6	6.6
OPEC	0.0	0.0	1.0	0.9
CAMSF	0.0	0.0	15.5	20.0
Bilateral	781.0	847.9	1097.8	1128.2
USG	577.6	617.0	763.2	813.3
AID			258.9	267.6
CCC-PL480			364.0	379.3
EXIMBANK			17.5	18.9
CCC-Program			45.4	54.8
FMS			77.4	92.7
Venezuela	89.2	77.0	55.9	57.6
Mexico	25.3	45.7	72.4	87.3
Other	88.9	18.24	206.3	170.0
Private Banks and others	142.2	187.0	142.4	103.0
Annual Growth Rates				
Multilateral		2.8	7.9	0.8
Bilateral		8.6	29.5	2.8
USG		6.8	23.7	6.6
Percent of Total	100.0	100.0	100.0	100.0
Multilateral	46.1	44.0	41.4	41.8
Bilateral	45.6	45.9	51.8	53.3
Of which: USG	33.7	33.4	36.0	38.4
Private banks and Others	8.3	10.1	6.7	4.9
Memorandum:				
Total Debt as percent of GDP	33.2	37.3	39.7	35.4

1/ Includes BCR and Public Sector medium - and long-term debt.
2/ Balance at June 30, 1991.

Source: Central Reserve Bank

Table 9
El Salvador:
External Debt Service 1/ 2/
(In millions of dollars)

	1990	1991 Principal	1991 Interest	1991 Total
Total	206.9	240.5	91.8	332.3
Multilateral	93.9	57.9	44.9	102.8
CABEI	5.9	28.4	12.4	40.8
IDB	51.3	19.8	13.1	32.9
IBRD	24.6	9.5	16.5	26.0
CAMSF	3.7	0.0	0.0	0.0
IMF	8.4	0.2	2.9	3.1
Others	0.0	0.0	0.0	0.0
Bilateral	105.8	73.4	29.8	103.2
USG	71.7	17.9	15.7	33.6
AID	12.5	1.8	2.7	4.5
CC-PL-480	11.7	2.1	4.5	6.6
EXIMBANK	2.3	1.0	0.1	1.1
CCC-Program	22.0	6.6	2.7	9.3
FMS	23.2	6.4	5.7	12.1
Venezuela	0.8	17.1	5.9	23.0
Mexico	0.0	33.9	5.7	39.6
Other	33.3	4.5	2.5	7.0
Private Banks and others	7.2	109.2	17.1	126.3
Annual Growth Rates				
Multilateral	19.9	-.-	-.-	9.5
Bilateral	253.8	-.-	-.-	-2.5
USG	384.5	-.-	-.-	-53.1
Percent of total	100.0	100.0	100.0	100.0
Multilateral	45.4	24.1	48.9	30.9
Bilateral	51.1	30.5	32.5	31.1
Of which: USG	34.7	7.4	17.5	10.1
Other	3.5	45.4	18.6	38.0
Memorandum:				
Debt Service as percent of Exports of Goods and Services	22.9	24.5	9.4	33.9

Source: Central Reserve Bank
1/ Includes BCR and Public Sector medium and long term debt.
2/ Does not include interest and principal payments rescheduled by September 17, 1990, Paris Club.

Table 10
El Salvador
ESF Cash Transfers
(by calendar year)

YEAR	Amount (Millions of dollars)	As percent of: GDP	Exports	Imports	BOP Current Account Deficit	Central Gov't Fiscal Deficit
1980	$ 20	1.1	1.9	2.1	2/	14.6
1981	0	–	–	–	–	–
1982	100	5.6	14.3	11.7	83.5	65.5
1983	120	5.9	15.8	13.4	372.7	67.1
1984	135	5.8	18.6	13.8	202.7	98.7
1985	160	5.6	23.0	16.6	433.6	149.4
1986	130	3.3	17.2	13.9	2/	110.0
1987	204	4.4	34.5	20.5	85.5	122.6
1988	155	3.0	25.5	15.4	65.9	97.1
1989	157	3.2	31.6	13.5	33.7	64.9
1990	98	1.8	16.9	7.8	27.2	57.4
1991	90 1/	1.5	14.5	6.6	27.6	39.7
1992	90	1.4	12.7	6.1	30.1	59.9
TOTAL $	1459	3.0	16.0	10.5	56.9	68.3

Source: USAID

1/ For program comparison purposes, the $45 million originally programmed for CY 1991 but actually disbursed in January 1992 is included in the 1991 total.

2/ Current account surplus recorded.